HOLD UNTIL RELEASED BY THE SENATE COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

STATEMENT BY

MR. SHAY D. ASSAD

ACTING DEPUTY UNDER SECRETARY OF DEFENSE

(ACQUISITION & TECHNOLOGY)

BEFORE THE

SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENAL AFFAIRS
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DEPARTMENT OF DEFENSE
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ELIMINATING WASTEFUL CONTRACTOR BONUSES

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INTRODUCTION

Chairman Carper, Ranking Member McCain, Members of the Subcommittee: My name is Shay Assad and I am the Director of Defense Procurement and Acquisition Policy. I am also presently serving as the Acting Deputy Under Secretary of Defense for Acquisition and Technology, in the Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics (AT&L).

After serving tours on board two Navy destroyers, I began my career in acquisition thirty-two years ago as a Naval Procurement Officer at the Naval Sea Systems Command. I left the Navy in 1978 and joined the Raytheon Company. Over my twenty-two year career at Raytheon I held a variety of contracting and operational positions ultimately serving as a corporate Vice President, a Senior Vice President, and finally, as Corporate Executive Vice President and Chairman and Chief Executive Officer of one of its major subsidiaries. I retired from Raytheon in July 2000.

In 2004, I entered Government service as the senior civilian contracting official for the U.S. Marine Corps. In April 2006, I was promoted to serve as the Director of Defense Procurement and Acquisition Policy.

DISCUSSION

I want to thank you for the opportunity to appear before you and to participate in today's discussion examining whether federal agencies are effectively using cost-plus-award-fee contracts to successfully incentivize contractor performance. The Department recognizes it is important to both the war fighters and taxpayers that we use the appropriate contracting incentive arrangements to effectively motivate contractors to

deliver systems that work well and provide services that meet or exceed our performance expectations.

Over the past few years, there has been a real sea change in the way award fee contracts are employed. Spurred on by the Government Accountability Office report published in December 2005 as requested by Senator Ensign and Senator Akaka, we have made the necessary improvements to our award fee practices and have realized significant savings as a result. We have implemented the statutory provisions enacted by the Congress which require award fee contracts: to link fees to acquisition outcomes; to define the circumstances and standards for paying out award fees based on contract performance; and to ensure no award fee is paid for contractor performance that is less than satisfactory. We seek to align the contractor's profitability with their performance. As Secretary Gates testified earlier this year before the Senate Armed Services Committee, "we must…write contracts that incentivize proper behavior." To the extent we continue to use cost plus award fee contracts, we are now focused on outcomes and results and not process indicators.

The Department has instituted significant policy changes to provide that award and incentive fees paid are commensurate with contract performance. In March 2006, my office prepared and the Deputy Under Secretary for Acquisition and Technology issued a policy memorandum that made it an imperative that award fee criteria be linked to desired program outcomes. In that memorandum, the practice of rolling over unearned award fees to subsequent evaluation periods was also restricted. In April 2007, I issued policy guidance requiring the use of objective criteria, whenever possible, to measure

contract performance. The April 2007 policy guidance mandated that for new contracts, an "unsatisfactory" contractor performance rating must correspond with a determination that no award fee is earned for a given evaluation period.

These policy changes provide safeguards to ensure that award fees are properly linked to acquisition outcomes. One important safeguard is the requirement we established that all cost-plus-award-fee contracts must be justified by a determination and finding (D&F) signed by the Head of the Contracting Activity (HCA). By elevating the approval to this level, we ensure the senior leadership have thoughtfully considered what should be selective use of cost-plus award fee arrangements. We maintain visibility as to the number of significant cost-plus-award-fee contracts in the Department by requiring Acquisition Category (ACAT) I programs to provide my office with copies of all such determination and findings on a quarterly basis. Senior Procurement Executives of the Military Departments and Other Defense Agencies are responsible for establishing the level of reporting for non ACAT I contracts within their organizations.

In addition to the aforementioned changes, we continue to refine our award and incentive fee policies and procedures. Currently, there are both Federal Acquisition Regulation (FAR) and Department of Defense FAR Supplement (DFARS) cases in process to codify these changes. In addition, we have drafted an Award Fee Guide to provide contracting officers and program officials with a reference for best practices. This guide will reinforce the fact that DoD policy requires objective criteria be used whenever possible to measure contractor performance.

In February 2009, the Department published two papers from the Institute for Defense Analyses (IDA) examining Defense Department Policies on profit, contract incentives and finance and their effects on contract outcomes. The results of these studies found that contractor methods of managing performance, schedule and cost under contracts seem to be indirectly influenced by changes in fee. The Institute did find indirect evidence that incentive contracts appear to limit cost growth. The IDA study concluded that the Department's new polices on award fees, "add significant controls to award fee management while maintaining the present level of program management influence over the contractor. Furthermore, they appear to address the majority of the GAO concerns. The study group found that these policy changes should be given enough time to have an effect on the cost plus award fee process before further changes are made."

In May of this year, I hosted a contract pricing conference which was attended by 300 acquisition professionals representing all the military departments and major Defense agencies, including 80 different DoD organizations and nine civilian agencies. This conference provided an excellent opportunity to share best practices and convey the vision we have regarding the appropriate use of incentive and award fee arrangements. We shared with the attendees the findings of the IDA studies.

The Department has incorporated into the acquisition strategy approval process and in its Peer Reviews, the requirement for a thorough review of incentive arrangements, particularly award fee criteria. In the pre-award time frame, we look to ensure acquisition strategies are structured such that objective criteria will be utilized,

whenever possible, to measure contract performance. In fact, most pre-award Peer Review teams begin by engaging with the program manager to understand the key measures of success to ensure the appropriate incentives are built into the contract. In the post award time frame, our Peer Review teams look to ensure award or incentive fees paid were consistent with DoD award fee policy or, in the case of legacy programs whose contracts preceded the recent award fee guidance, had corrective action plans in place to address past inconsistencies.

For example, in one recent post-award Peer Review, the Peer Review team recommended that the program office establish agreed-to objective measures whenever possible, *before* each evaluation period. The team suggested the agreed-to plan should stipulate what rating the contractor would earn if it were able to exceed requirements, deliver ahead of schedule or reduce costs. Another recent post-award Peer Review observed that the program has essentially discontinued the use of award fee despite the fact it remains an available avenue under an indefinite delivery/indefinite quantity (IDIQ) task order contract. That particular team cited a desire to avoid the burden of administering an award fee process.

In addition, we have established a data collection process that enables us to regularly monitor amounts paid to contractors to ensure the amounts paid are commensurate with performance. In addition to regular reviews conducted by my office, the Senior Procurement Executives of the Military Departments and Other Defense Agencies are developing written policies and procedures for evaluating the effectiveness

of award and incentive fees. The various levels of review will enable us to continuously improve our management of award and incentive fee contracts.

Given the acquisition lead times associated with major programs, it is too early to adequately assess the impact of the March 2006 and April 2007 policy changes, since the first contracts covered by the new policy are just beginning to go through their first award fee review cycle. However, the findings from the Department's analysis of 2007 award and incentive fee data that was submitted to the Congress in November 2008, are instructive in that they serve as a baseline. Our analysis of the 2007 award fee data showed a link between cost and schedule efficiencies and fees. As we continue our award fee data collection going forward, we will monitor the data to ensure there is this correlation.

The Department is trending away from the use of pure award fee contracts and seeking instead, to use incentive fee contracts or contracts that include a mixture of incentive and award fees. In our analysis of the 2007 and 2008 award fee data we have collected (on incentive fee contracts greater than $50 million), there were only 30 new award fee contracts awarded in 2007 and 10 awarded in 2008. In contrast, between 2004 and 2006, 65 award fee contracts were awarded, on average, each year. In those limited cases where cost plus award fee contracts are appropriate, i.e. where only subjective evaluation criteria are possible or where it is not feasible to have pre-determined objective criteria before award, award fees must be linked to desired program outcomes.

Finally, we were pleased that the GAO acknowledged in their May 2009 report the progress the Department has made in this area, but, in our view, there is much more work

to be done. The report concludes, "where the revised policies have been applied, the results have been hundreds of millions of dollars in cost savings and better use of government funds" and estimates that Department will save over $450 million through fiscal year 2010. The Department agreed with the recommendations contained in this report to promote the application of existing guidance and expand upon improvements made in the use of award fees. Also, as noted in this report, the policy changes that have been adopted have required a change in culture on both the government's and the contractor's part. We will hold contractors accountable for performance deficiencies and I am confident that our increased emphasis on the use of objective criteria, where practical, will result in a much closer link between award fees and acquisition outcomes.

SUMMARY

Again, thank you for the opportunity to address the use of cost-plus-award fee contracts. I look forward to working with you and keeping you apprised of the Department's progress in developing meaningful ways to evaluate the effectiveness of incentive arrangements to achieve the desired levels of contract performance. I would be happy to address any questions that you may have. Thank you.