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Highlights

Highlights of GAO-06-409T, a testimony before the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

April 5, 2006

DEFENSE ACQUISITIONS

DOD Wastes Billions of Dollars through Poorly Structured Incentives

Why GAO Did This Study

With DOD spending over $200 billion annually to acquire products and services that include everything from spare parts to the development of major weapon systems, our numerous, large, and mounting fiscal challenges demand that DOD maximize its return on investment and provide the warfighter with needed capabilities at the best value for the taxpayer. In an effort to encourage defense contractors to perform in an innovative, efficient, and effective way, DOD gives its contractors the opportunity to collectively earn billions of dollars through monetary incentives known as award and incentive fees. Using these incentives properly—in concert with good acquisition practices—is a key to minimizing waste, maximizing value, and getting our military personnel what they need, when and where they need it.

The subcommittee asked GAO to testify on DOD's use of award and incentive fees and the role they play in the acquisition system. This statement highlights the risks of conducting business as usual and identifies the actions DOD needs to take to use these fees more effectively. DOD concurred or partially concurred with the seven recommendations GAO made in a previously issued report on award and incentive fees. GAO looks forward to seeing DOD turn these promised steps into actual policy and practice.

www.gao.gov/cgi-bin/getrpt?GAO-06-409T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Katherine Schinasi at (202) 512-4841 or schinasik@gao.gov.

What GAO Found

DOD's use of award and incentive fees is an issue at the nexus of two areas that GAO has designated "high risk" for DOD—contract management and weapon system acquisition. Contract management has been a long-standing business management challenge for DOD because it often cannot assure that it is using sound business practices to acquire the goods and services the warfighter needs. For weapon system acquisitions, the persistent and long-standing nature of acquisition problems has perhaps made a range of key decision makers complacent about cost growth, schedule delays, quantity reductions, and performance shortfalls. DOD's strategies for incentivizing its contractors, especially for weapon system development programs, reflect the challenges in these areas.

DOD programs routinely engage in award-fee practices that do not hold contractors accountable for achieving desired outcomes and undermine efforts to motivate contractor performance, such as

- evaluating contractors on award-fee criteria that are not directly related to key acquisition outcomes (e.g., meeting cost and schedule goals and delivering desired capabilities to the warfighter);
- paying contractors a significant portion of the available fee for what award-fee plans describe as "acceptable, average, expected, good, or satisfactory" performance; and
- giving contractors at least a second opportunity to earn initially unearned or deferred fees.

As a result, DOD has paid out an estimated $8 billion in award fees on contracts in GAO's study population, regardless of whether acquisition outcomes fell short of, met, or exceeded DOD's expectations. Despite paying billions of dollars, DOD has not compiled data or developed performance measures to evaluate the validity of its belief that award and incentive fees improve contractor performance and acquisition outcomes.

These issues, along with those GAO has identified in DOD's acquisition and business management processes, present a compelling case for change. By implementing the recommendations GAO has made on award and incentive fees, DOD can improve incentives, increase transparency, and enhance accountability for the fees it pays. At the same time, by working more broadly to improve its acquisition practices, DOD can set the right conditions for getting better acquisition outcomes and making more efficient use of its resources in what is sure to be a more fiscally constrained environment.