

Eliminating Requirements Imposed on Industry Where Costs Exceed Benefits



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FOREWORD

The work described in this report supports AT&L's Better Buying Power initiatives that maximize capability acquired with taxpayer money. Actions that are unnecessary or of little value for acquisition directly add costs, introduce delays in delivering capability, and bar innovative new entrants. Here, we examined several specific instances of regulatory burdens or their implementation imposed on industry in order to eliminate unnecessary or unproductive actions.

“Unnecessary” and “unproductive” are the key adjectives here. Statute and regulation are not arbitrary but are designed to serve a purpose. The Department of Defense manages a huge taxpayer investment and must provide transparency for oversight to assess efficiency, fairness of the acquisition system, and compliance with broader national, social, and economic objectives. Additionally, many regulations are a response to previous acquisition failures and are intended to prevent recurrence. Attempts to save money by eliminating actions without considering these impacts/benefits are necessarily inappropriate.

So, the central challenge of this work was to identify activities which could be eliminated with no or minimal impact on statutory or regulatory objectives. What we found is that the details in how statute and regulation are implemented do contain unnecessary or even counterproductive activities which are not required by the statute or regulation. There are several mechanisms by which such detail can define unnecessary actions and this work found instances of several of those. Unnecessary work can be introduced by the definition of the agent that performs a regulatory action – requiring an audit where the precision of an audit it is not required for example. Unnecessary work can also be introduced by detail that defines when or how often an activity is done – an example being the repetitive “sweeps” currently performed to assure currency of certified cost or pricing data under the Truth in Negotiations Act. Unnecessary work can also be required by overly stringent thresholds which define when a regulatory function is performed such as the thresholds that trigger required certification of the Earned Value System even without evidence of any shortcomings. Finally, of course, simple lack of consistency in the interpretation of regulation can create costly uncertainty about what is really required to be compliant.

This work has made several specific recommendations that will reduce regulatory burden. But just as such burdens were not created in a single step, decreasing them will also be an incremental, continuous improvement process. There are many areas where the details of implementation are creating unnecessary or unproductive work. Identifying and pruning these areas requires diligence but will be an important part of enduring efforts to ensure that we are effective buyers of military capability for the Nation.



The Honorable Katharina G. McFarland
Assistant Secretary of Defense for Acquisition
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1 Overview

In 2010 the Honorable Ashton Carter, Under Secretary of Defense for Acquisition, Technology, and Logistics (USD(AT&L)), launched Better Buying Power (BBP), a set of initiatives to strengthen the Department of Defense's (DoD) buying power, improve industry productivity, and provide affordable, value-added military capability to the Warfighter. One of the 23 BBP initiatives in what came to be known as BBP 1.0 was to "Reduce non-value-added overhead imposed on industry." In 2013 the Honorable Frank Kendall, USD(AT&L), continued this effort in BBP 2.0 with an initiative entitled "Eliminating Requirements Imposed on Industry Where Costs Outweigh Benefits." Contemporaneously, in response to a Federal Register Public Notice, DoD received scores of recommendations from leaders of industry associations and DoD suppliers for reducing non-value added costs and processes. Among those was a letter written to the USD(AT&L) from the Chairman of the Procurement Round Table (PRT), Dr. Allan Burman, suggesting that DoD initiate a study similar to the December 1994 Coopers and Lybrand (C&L) study "The DoD Regulatory Cost Premium: A Quantitative Assessment."¹ The C&L study found that DoD was paying a cost premium of at least 18 percent over the price of doing business in the private sector. Because statutes and regulations have increased since 1994, the PRT recommended that DoD update the C&L study and provide results to the Office of Management and Budget (OMB) and Congress "to identify opportunities to reduce or amend non-value-added laws, regulations, policies and processes."

In August 2013, Mr. Kendall assigned Assistant Secretary of Defense for Acquisition (ASD(A)), Katharina McFarland, to direct a study to identify unnecessary requirements for which costs exceed benefits. She selected Mark Husband, Senior Advisor for Root Cause Analyses in the Office of Performance Assessments and Root Cause Analyses (PARCA) and David Nicholls, Director of the Cost Analysis Research Division at the Institute for Defense Analyses (IDA) as study co-leads. While this "Eliminating Requirements..." study originated from the same motivation as the C&L study, namely to reduce unnecessary and costly statutes and regulations, there were a few differences in approach. Most notably, rather than attempting to exhaustively collect all costs of DoD unique requirements, the study focused on six broad areas selected based on industry inputs to BBP, a literature review, and the major cost drivers identified in the C&L study. Another difference was that while the C&L study attempted only to collect costs, as the name implies this study was aimed at comparing costs to benefits of the statutes, regulations, policies, and

¹ <http://www.procurementroundtable.org/documents/PRTLetter-4-24-2013.pdf>

Accessed on May 5, 2015

practices examined. Based on this framework, the study objective was defined as:

providing recommendations for improving business processes related to a specific set of DoD-compliance requirements, either through changes to the requirements themselves or changes to the application of such requirements. Specific recommendations might include modifying, replacing or deleting certain regulations or statutes, changing DoD's business processes to improve consistency of application of such requirements, and disseminating DoD or industry best practices in applying or complying with such requirements.

The following areas were selected for study:

- 1) Acquisition of Commercial Items
- 2) Contract Auditing & Management
- 3) Component Specific Supplements to the Department of Defense Federal Acquisition Regulation Supplement (DFARS)
- 4) Application of Earned Value Management (EVM)
- 5) Truth in Negotiation Act (TINA) and Requirements for Cost or Pricing (CoP) Data
- 6) Application of the Buy American Act (BAA)

Twelve of the Department's largest suppliers were invited to participate, including providers of products and services.² In recognition of industry concerns, proprietary data contributed was only accessible to Husband and Nicholls, who ensured that all data and comments released were disassociated from individual companies. The companies participated on a non-remunerative basis and contributed to as many or few areas as they chose. Two areas, "EVM" and "Contract Auditing & Management," generated the most responses, while no responses were received in one of the areas, "Component Specific Supplements to DFARS."

Companies were invited to participate by letter from the USD(AT&L) to Chief Executive Officers on September 17, 2013, and a follow-on letter sent November 1, 2013.³ In December 2013, ASD(A) hosted kick-off meetings with each company, during which she described the purpose and desired outcomes of the study. Key tenants included:

- Desire to collect, insofar as possible, quantitative costs associated with specific inefficiencies or non-value added statutes and regulations. For example, the purpose **is not** to identify the entire cost associated with contract auditing, EVM requirements, providing CoP data, the BAA, etc., but instead to collect costs related to specific requirements or practices within those areas that are considered non-value added.

² The Boeing Company; Booz Allen Hamilton, Inc.; Engility Corporation; General Dynamics Corporation; Honeywell International Inc.; Huntington Ingalls Industries; L-3 Communications Corporation; LEIDOS; Lockheed Martin Corporation; Northrop Grumman Corporation; Raytheon Company; and United Technologies Corporation

³ http://bbp.dau.mil/docs/USD_ATL_Letters_to_Industry_with_Enclosure.pdf
http://bbp.dau.mil/docs/USD_ATL_Follow-up_Letters_to_Company_CEOs_on_Eliminating_Requirements_Study.pdf

- Study is intended to find mutually beneficial opportunities for DoD and industry to reduce overhead costs for the public and private sectors over the long term. The study's purpose **is not** to identify specific cost savings that DoD can extract from on-going or prospective contracts.
- Contractors' proprietary data would not be divulged outside study co-leads without explicit permission. Following initial assessment of contractors' recommendations and supporting data, a wider DoD team of key stakeholders⁴ would assess recommendations while considering benefits DoD derives from the statutes, regulations, or practices in question.
- In addition to identifying opportunities for constructive change, the study should foster mutually beneficial dialogue between DoD and its contractors, providing a forum for reducing misunderstandings about the purpose and rationale for DoD's policies and practices.

Companies were requested to submit information supporting their recommended changes in any of the six areas through March 2014. On February 21, 2014, Husband sent a letter to each of the participating companies with specific questions in each of the six areas.⁵ Companies continued to provide inputs through December 2014, in some cases responding to multiple sets of follow-up questions that served to clarify and amplify information they provided. Several companies invited Husband and Nicholls to visit one or more of their facilities, which afforded opportunities for more in-depth discussions. White paper "Assessments" were then written for each of the five study areas for which contractors provided inputs. These Assessments were provided to the wider DoD team and participating companies for comment and comprise Chapters 2-6 of this report. Study recommendations are compiled in Chapter 7 and Chapter 8 provides conclusions and plans for future work.

⁴ Office of the Secretary of Defense organizations that contributed include: Defense Contract Management Agency (DCMA), Defense Pricing (DP), Defense Procurement and Acquisition Policy (DPAP), Logistics and Materiel Readiness (L&MR), Manufacturing and Industrial Base Policy (MIBP), and Defense Contract Audit Agency (DCAA).

⁵ http://bbp.dau.mil/docs/Questions_for_industry_on_Eliminating_Requirements_Imposed_on.pdf

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2 Acquisition of Commercial Items

Purpose. Assess contractors' recommended changes to policies and practices pertaining to DoD's acquisition of commercial items.

Overview. Recommendations are based on information provided by participating contractors, independent analysis by PARCA and IDA of statutory and regulatory intent and effects, and discussions with subject matter experts in OUSD(AT&L) organizations including Defense Procurement and Acquisition Policy (DPAP), Defense Pricing (DP), Defense Contract Management Agency (DCMA), and Manufacturing and Industrial Base Policy (MIBP). Supporting analysis for our recommendations is provided in Section 2.2.

Contractors asserted the following concerning DoD's commercial item policies and practices:

- (1) Defending commerciality is unnecessarily burdensome;
- (2) DoD demands too much insight into costs of commercial products;
- (3) DoD asserts excessive control of commercial suppliers' processes.

Information provided included three example cases in which DoD challenged commerciality of an item that had previously been classified by a DoD contracting officer as commercial. Estimated incurred costs for these three cases were: approximately \$200,000; approximately \$45,000; and over 700 man-hours (approximately \$140,000), respectively. The time required to resolve the first two cases was 10 months and 5 months, respectively.

For each of the three example cases cited, DoD ultimately agreed that the item qualified as commercial. However, following this determination, in two of the cases DoD requested "other than cost or pricing data" to determine whether the price was fair and reasonable, and in the third case DoD added an addendum to the contract to ensure Government rights to conduct in-process audits of the supplier's facility (including process reviews of commercial practices and product examinations).

A fourth example asserted that a sub-tier COTS supplier threatened to refuse to supply contracted goods because of a Government assessment that resulted in a product specification change. The outcome of this example case was not provided.

Only one contractor responded to this area. Further study targeted specifically at commercially-oriented companies and/or lower-tier suppliers might reveal additional information that could improve DoD's effectiveness in acquiring commercial items.

Recommendations

The examples provided were insufficient to support a quantitative, generalizable cost/benefit assessment of DoD's policies and practices for acquiring commercial items. Conducting such an assessment would require gathering more extensive data to determine the frequency at which commerciality is challenged (and upheld or denied), costs associated with such challenges, and the frequency and merit of DoD requests for cost or pricing data and assessments of commercial item suppliers' processes and costs. However, the examples provided are consistent with and indicative of claims frequently made by industry associations.^{6,7,8} The frequency of such claims indicate there is general dissatisfaction with DoD's policies and practices for acquiring commercial items. Although our conclusions are not based on quantitative cost data, it appears that contractors' dissatisfaction arises primarily from the uncertainty they experience when engaging with DoD on commercial items. We offer three recommendations:

1. Streamline and accelerate commercial item determinations (CID).

- The Director, DP, and Director, DPAP, agree that CIDs take too long and have therefore initiated a variety of actions to streamline and accelerate the process. Their initiatives, which include policy guidance, training, dialogue with industry, and analytical support tools, are described in Section 2.3 and policy guidance released on February 4, 2015, by Director, DP is provided in Section 2.4.

⁶ Aerospace Industries Association (AIA) Report, July, 2014, "Acquisition Rebalancing: Recommendations for Smart, Efficient & Effective Defense Procurement," provided to Members of the House and Senate Armed Services Committee states: "DOD's commitment to the acquisition of, and stated preference for, commercial items is plagued by inconsistencies which creates an uncertain and difficult environment for industry to navigate. Increased use of DOD unique or specific requirements stresses the supply chain and dissuades commercial suppliers from participating. Uneven interpretations of the definition of commercial items, as well as concern whether 'of a type' modifications are outside that definition, convert an otherwise straightforward commercial purchase as envisioned under the statute, into a DOD unique one. The advantages of using commercial items and commercial business practices are essentially sacrificed in order to obtain excessive data rights as well as unneeded certified cost and pricing data from suppliers, and seek to impose compensation limits that do not reflect documented commercial standards." (Cover letter, p. 1).

⁷ Professional Services Council (PSC) Report, July 28, 2014, "The PSC Acquisition and Technology Policy Agenda," states: "Suppliers of goods/services that meet the FAR definition of a commercial item are being required to either certify cost or pricing data & comply with cost accounting standards or are being required to disclose other than certified cost data: • Significantly delaying the acquisition process • Shrinking pool of suppliers • Otherwise reducing private investment in USG goods and services. An item that meets the definition but is "of-a-type" or "offered for sale or lease" is singled out for stricter treatment and is more apt to be subject to greater cost scrutiny." (Attachment, p. 1) Also: "Over the years since FAR Part 12 was initially revised to replace Part 11 for Acquisition of Commercial Items according to the Federal Acquisition Streamlining Act of 1994 (FASA), there have been a steady increase of USG/DoD-unique clauses and requirements that have been levied upon contracts and subcontracts for commercial items and services. As a result, the cost of commercial goods has risen for those companies willing to accept such terms, or has discouraged commercial firms from doing business with the USG/DoD." (Attachment, p. 2)

⁸ National Defense Industries Association (NDIA) Report, November 14, 2014, "NDIA Acquisition Reform Recommendations," states: "NDIA and its members strongly support the commercial item preference enshrined in law and have expressed concerns at its erosion in recent years. To reassert the Government's preference for commercial items, we recommend streamlining the process for commercial item determination by presuming a reliance on a single commerciality determination unless the Government can produce information to demonstrate that such reliance is unfounded." (p. 19).

2. Provide contracting officers with clearer criteria describing the type and extent of information that is necessary for CID.

- Items deemed commercial should be explicitly suited to the Government’s acquisition approach for commercial items as defined in the Federal Acquisition Regulation (FAR) (i.e., Government surveillance and requirements for cost information should be consistent with commercial practices).
- The primary source of lack of clarity in the definition of commercial item are the terms “of a type” and “offered for sale, lease, or license.” In March, 2012, DoD submitted a Legislative Proposal to Congress recommending revising the definition of “commercial item” in the Federal Acquisition Streamlining Act of 1994 to eliminate the term “of a type,” and to exclude items that have been “offered for sale, lease, or license” (but not yet sold, leased or licensed). In the National Defense Authorization Act (NDAA) for Fiscal Year 2013, Congress considered DoD’s recommended changes but explicitly declined to adopt them, providing their rationale in the Senate report accompanying the NDAA.⁹ The full text of the DoD Legislative Proposal on this matter is provided in Section 2.5 and the congressional response in the FY 2013 NDAA Senate Report is provided in Section 2.6.
- Although Congress declined to enact DoD’s recommended changes to the definition of a commercial item, in the Senate Report to the FY 2013 NDAA (Section 2.6), they acknowledged that “the Government Accountability Office and the DOD Inspector General have both criticized the Department for using commercial item procedures to procure items that are misclassified as commercial items and are not subject to competitive price pressure in the commercial marketplace.”
- We recommend that Director, DP provide contracting officers and contractors clearer criteria describing the type and extent of information necessary for CID, and provide use-case examples demonstrating applicability of the term “of a type.”
 - We propose that the following information must be available in order for DoD to determine that an item or service is commercial and therefore appropriate to be acquired using FAR Part 12 contracting procedures:
 1. Evidence of commercial sales and commercial prices paid^{10,11} for non-Government end use are available via market research or information submitted by the offeror,
AND

⁹ “The committee declines to make this change. The Federal Acquisition Streamlining Act of 1994 (FASA) (Public Law 103-355) adopted a broad definition of commercial items to ensure that federal agencies would have ready access to products that are available in the commercial marketplace - including new products and modified products that are just becoming available. Such access remains particularly critical in fast moving commercial markets, including the markets for information technology and other advanced products.”

¹⁰ OUSD(AT&L)/PARCA view is that requiring commercial prices to be divulged when commerciality is determined would significantly reduce cases in which non-commercial items are declared commercial. We believe availability of commercial sales price data is relevant to the contractor officer’s decision on whether to use commercial FAR Part 12 contracting methods. While the price data required for CID need not be as extensive as data required to determine a “fair and reasonable” price, we believe requiring commercial sales price data for CID would reduce and possibly

2. For “of a type” and “offered for sale” items, technical data and other information voluntarily submitted by the offeror provides sufficient evidence to determine that the item is like an existing commercial item (for which evidence of commercial sales and commercial prices paid are available).

The first recommendation is currently being implemented through OUSD(AT&L)/DP policy memos and changes to the DoD Commercial Item Handbook. According to the Director, DP, because of congressional interest, the second recommendation would likely require a DoD legislative proposal.¹²

eliminate contentious and time-consuming discussions that often occur between the Government and suppliers on the type and quantity of cost or pricing data necessary for the contracting officer to determine a “fair and reasonable” price.

¹¹ OUSD(AT&L)/MIBP disagrees that evidence of prices paid should be a necessary criterion for determining commerciality. For example, a vendor may offer a commercial item that may not have sales history, but which could be determined to be a commercial item and, subsequently, the vendor may justify price based on prices paid for an analogous commercial item. The authors propose combining the CID and the price justification decisions. The ease of justification of a reasonable price does not define the item’s commerciality. The authors contend that if commercial prices are divulged for a CID, it would eliminate contentious price justification discussions. MIBP asserts that if commercial prices are available, neither the CID nor the price justification would be contentious. In-depth price justification discussions for commercial or commercial-of-a-type items are used in cases where there is a lack of market sales and a price needs to be justified through more extensive means. Using the proposed criteria would result in a determination of non-commerciality for items that require more extensive justification – leading to the need for the use of FAR Part 15 certified cost and pricing data.

¹² Contemporaneously with this study, as a result of Section 831 of the FY 2013 NDAA “Guidance and Training Related to Evaluating Reasonableness of Price,” Director, DP, and Director, MIBP, conducted discussions with 17 companies and industry associations to provide them an opportunity to share their concerns regarding CID and Commercial of a Type contracting. The Director, DP policy memo provided in Section 2.3 was informed by these discussions. In addition, Director, DP proposes DCMA establish five commercial pricing cells aligned to support the Department’s buying commands by geographic region and reporting to the DCMA Cost & Pricing Center. These cells will provide expert advice to contracting officers in CID and in pricing commercial items. This proposal is currently being evaluated by the Director, DCMA.

2.1 Actions Directed by USD(AT&L)

As a result of this study's recommendations on DoD acquisition of commercial items, USD(AT&L) directed the following action in the BBP 3.0 Implementation Directive dated April 9, 2015:

DCMA, in coordination with DPAP, will provide an actionable plan to establish Cost and Pricing Centers of Expertise to facilitate Commercial Item Determinations, and DPAP will prepare updated guidance on Commercial Item Determinations by September 2015.

2.2 Analysis Supporting Acquisition of Commercial Items Recommendations

Contractors were asked to comment on policies, practices, and procedures that inhibit commercial item acquisitions by DoD. Three comments were received:

1. Insufficient guidance is being published by contracting activities to define what constitutes a commercial item;
2. DoD demands too much insight into the costs of commercial items; and,
3. DoD attempts to assert excessive control of the processes of commercial suppliers.

Insufficient guidance on what constitutes a “commercial item:” A central issue is what constitutes, by definition, a “commercial item.”¹³ The definition of a commercial item is broad, as the item can be: any item of a type customarily used by the general public, or by non-Governmental entities, for purposes other than Government purposes that has been sold, leased, or licensed, or offered for sale, lease, or license to the general public or any item that has evolved

¹³ FAR 2.101 Definitions. “Commercial item” means -- (1) Any item, other than real property, that is of a type customarily used by the general public or by non-governmental entities for purposes other than governmental purposes, and-- (i) Has been sold, leased, or licensed to the general public; or, (ii) Has been offered for sale, lease, or license to the general public; (2) Any item that evolved from an item described in paragraph (1) of this definition through advances in technology or performance and that is not yet available in the commercial marketplace, but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Government solicitation; (3) Any item that would satisfy a criterion expressed in paragraphs (1) or (2) of this definition, but for -- (i) Modifications of a type customarily available in the commercial marketplace; or (ii) Minor modifications of a type not customarily available in the commercial marketplace made to meet Federal Government requirements. Minor modifications means modifications that do not significantly alter the nongovernmental function or essential physical characteristics of an item or component, or change the purpose of a process. Factors to be considered in determining whether a modification is minor include the value and size of the modification and the comparative value and size of the final product. Dollar values and percentages may be used as guideposts, but are not conclusive evidence that a modification is minor; (4) Any combination of items meeting the requirements of paragraphs (1), (2), (3), or (5) of this definition that are of a type customarily combined and sold in combination to the general public; (5) Installation services, maintenance services, repair services, training services, and other services if-- (i) Such services are procured for support of an item referred to in paragraph (1), (2), (3), or (4) of this definition, regardless of whether such services are provided by the same source or at the same time as the item; and (ii) The source of such services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government; (6) Services of a type offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific outcomes to be achieved and under standard commercial terms and conditions. For purposes of these services— (i) “Catalog price” means a price included in a catalog, price list, schedule, or other form that is regularly maintained by the manufacturer or vendor, is either published or otherwise available for inspection by customers, and states prices at which sales are currently, or were last, made to a significant number of buyers constituting the general public; and (ii) “Market prices” means current prices that are established in the course of ordinary trade between buyers and sellers free to bargain and that can be substantiated through competition or from sources independent of the offerors. (7) Any item, combination of items, or service referred to in paragraphs (1) through (6) of this definition, notwithstanding the fact that the item, combination of items, or service is transferred between or among separate divisions, subsidiaries, or affiliates of a contractor; or (8) A nondevelopmental item, if the procuring agency determines the item was developed exclusively at private expense and sold in substantial quantities, on a competitive basis, to multiple State and local governments.

from a commercial item, even if it is not yet available in the commercial marketplace or items that require modifications of a type customarily available in the commercial marketplace, or require minor Government-unique modifications.

The Commercial Item Handbook addresses the phrase "**of a type**" as "allows the best offer to qualify for a FAR Part 12 contract as long as the items offered are sufficiently like similar items that meet the Government's requirement... The best offer in a competitive FAR Part 12 solicitation can be for an item that previously satisfied the Government's need but has not yet been sold, leased, licensed or offered for sale, lease, or license to the general public (e.g., a non-developmental item)..."

The definition of a "commercial item" is ambiguous as the respondent contractor has reported. The FAR is mandatory guidance to contracting officers while the Handbook is not. It is not that the Handbook and the FAR are contradictory, but rather that the Handbook does not provide contracting officers with tools to help classify items proposed to be "of a type" as commercial items for contracting purposes.

DoD demands too much insight into the costs of commercial products:¹⁴ All procuring contracting officers are required to determine whether a price being offered meets the "fair and reasonable" standard. This issue has several facets. First, FASA mandated that commercial item acquisitions be conducted using commercial practices. For commercial items a contracting officer should first do a price analysis for which the DoD Commercial Item Handbook provides "...the price analysis process used to determine its price is fair and reasonable should be fairly simple and not overly burdensome..." If a price analysis is insufficient to convince the procuring contracting officer that the price being offered is "fair and reasonable," the analysis moves to a cost analysis that can get into the detailed costs of a contractor and its subcontractors.

Commercial item acquisitions are exempted from certified cost or pricing requirements under the Truth in Negotiations Act. However, FAR 15.403-3(c) provides in part: "...If the contracting officer cannot determine whether an offered price is fair and reasonable, even after obtaining additional data from sources other than the offeror, then the contracting officer shall require the offeror to submit data other than certified cost or pricing data to support further analysis..."

"Data other than cost or pricing data" are defined in FAR 2.101 as: "...pricing data, cost data, and judgmental information necessary for the contracting officer to determine a fair and reasonable price or to determine cost realism. Such data may include the identical types of data as certified cost or pricing data, consistent with Table 15-2 of 15.408, but without the certification..."

¹⁴ DCMA noted that this tends to be the case with "of a type" items, for which commercial sales data is often lacking and the contractor cannot substantiate a price for a similar product. DCMA also noted that true commercial contractors sometimes refuse to provide their "proprietary" pricing information regarding other customer sales. In many cases, this refusal drives the requests for cost information.

The bottom line is that FAR Part 15 not only allows, but also requires the contracting officer to solicit the data required to determine a fair and reasonable price, and such data may include other than certified cost or pricing data.

The Government attempts to exert excessive control of the processes of commercial suppliers:

This issue is covered in regulatory mandates as FAR 12.208 provides:

“Contracts for commercial items shall rely on contractors’ existing quality assurance systems as a substitute for Government inspection and testing before tender for acceptance unless customary market practices for the commercial item being acquired include in-process inspection. Any in-process inspection by the Government shall be conducted in a manner consistent with commercial practice...”

Though FAR 46.102 is generally in conformance with 12.208, it also provides that

“Agencies shall ensure that—(a) Contracts include inspection and other quality requirements, including warranty clauses when appropriate, that are determined necessary to protect the Government’s interest; (c) Government contract quality assurance is conducted before acceptance (except as otherwise provided in this part), by or under the direction of Government personnel; (d) No contract precludes the Government from performing inspection...”

FAR 46.104 details the responsibilities of the Defense Contract Management Agency’s (DCMA) contract administration office at which QA inspectors are stationed. It makes no special provision for commercial item inspections.

The Commercial Items Handbook provides: “Contract administration practices vary considerably between commercial and Government acquisitions, so the contract administration duties as identified in FAR Part 42 generally do not apply to contracts for commercial items.... Agreements documenting the delegation of authority to the Defense Contract Management Agency should clearly state the ways in which commercial practices will affect the administration mechanisms and procedures that historically have been used.”

The contractor’s claim that the Government attempts to exert excessive control of the processes of commercial suppliers is likely valid in certain instances, although only a single example was provided. Clearly, the FAR provides the Government the right to conduct inspections and other quality requirements, while at the same time stipulating that for commercial items such inspections should be conducted in a manner consistent with commercial practice. Excessive Government control of commercial suppliers processes is likely intertwined with the fundamental problem identified earlier, i.e., insufficient guidance exists on what constitutes a commercial item.

2.3 Initiatives to Improve Commercial Item Determinations and Pricing¹⁵

The Director, Defense Pricing (DP) agrees that commercial item determinations take far too long and provide value that is not commensurate with the time they require. Director, DP, in concert with the Director, Defense Procurement and Acquisition Policy (DPAP), has sought to provide policy, references, tools, and training to decrease the time for commercial item determinations and to re-focus the contracting officer on commercial item pricing for an item.

Listening Sessions with Defense Contractors and Report to USD(AT&L). At the direction of USD(AT&L), the Director, DP and Director, Manufacturing and Industrial Based Policy (MIBP) conducted a series of listening sessions to learn more about the industry perspective regarding commercial item determination and commercial item pricing. The team held a series of 15 one-hour meetings with a cross section of interested defense contractors. The Directors, DP and MIBP team was particularly interested in the frustrations of defense contractors and in any suggestions for improvements. This intensive research project confirmed many of the Director, DP's thoughts and resulted in an internal report to USD(AT&L) recommending future actions.

Many of these initiatives were addressed in Section 831 of the FY 2013 NDAA. Section 831 included several documentation requirements, including:

- A justification of the need for additional cost information.
- A copy of any request from DoD to a contractor for additional cost information.
- Any response received from the contractor to the request, including any rationale or justification provided by the contractor for a failure to provide the requested information.

Director, DP policy memorandum, "Commercial Items and the Determination of Reasonableness of Price for Commercial Items," released February, 4, 2015, responds to several requirements set forth in Section 831 of the FY 2013 NDAA until a DFARS rule can be considered. The memorandum:

- Sets forth standards of timeliness for making commercial item determinations once supporting data is provided.
- Provides guidance for Contracting Officers as to how they should approach the pricing of items purported to be commercial.
- Highlights hierarchy of pricing techniques to use if market based pricing is not available. FAR Part 12 provides the flexibility to use in commercial item pricing, including, but not limited to, cost analysis, parametric estimating, and/or analogous pricing in determining whether the Government is paying a fair and reasonable price.

¹⁵ Section 2.3 was provided by Ms. Patricia G. Foley of OUSD(AT&L)/DPAP

- Notes that in some instances where items have minimal or no sales history to non-Governmental entities, it is likely that information from the potential offeror will be required to support the justification that the Government is paying a fair and reasonable price for the item being procured.
- Requires that requests for uncertified cost information for the purposes of evaluating reasonableness of price are sufficiently documented. The memorandum states that the contract file must contain: (1) a justification of the need for the additional cost information; (2) a copy of any request from the Department to the contractor for such additional cost information; and (3) any response that the Contracting Officer receives from the contractor to the request, including any rationale or justification provided by the contractor for a failure to provide the cost information requested.

DFARS Case 2013-D034, “Evaluating Reasonableness of Price for Commercial Items,” is a draft proposed rule to implement Section 831. The DFARS is a deliberative rulemaking process that includes the opportunity for public comment and consideration of those comments prior to implementation of a final rule. The pricing committee will review the draft proposal before it is submitted to the DAR Staff for DAR Council review and consideration. The next meeting is scheduled for February 2015 for review and discussion prior to submission to the DAR Staff for review.

Section 831 also mandated that the Department “develop a cadre of experts within the DoD to provide expert advice to the acquisition workforce in the use of the authority provided by such sections in accordance with the guidance issued pursuant to subsection (a).”

DoD has created a cadre of experts in Defense Contract Management Agency’s (DCMA) Commercial Pricing Center of Excellence. The Navy Price Fighters and the Air Force Materiel Command Pricing Division are additional centers of expertise.

Pricing Training: Section 831 required the Department to train the acquisition workforce on the use of the authority provided by sections 2306a(d) and 2379 of title 10, U.S.C., in evaluating reasonableness of price in procurements of commercial items;

- June 2014 – Five-Day Commercial Item Pricing Workshop in Southbridge, Massachusetts.
- November 7, 2014 – The Director, DP, in conjunction with DAU and the Components, held an industry day on contracting with DoD. Mr. Shay Assad, Director, DP; senior DoD pricing personnel; and industry representatives engaged in an information exchange to better understand the concerns of parties when negotiating the acquisition of goods and services for DoD. The Director, DP articulated policy and regulations on commercial item pricing and selecting appropriate contract type as well as listened and responded to all concerns and suggestions from industry. Four panels addressed various aspect of this issue:
 - Government panel of senior DoD procurement executives, OFPP staff, SPEs, DPAP, and Director, DP;

- Acquisition of Services panel consisting of DoD Senior Service Managers and Industry personnel; ,
- Cost estimating, pricing, and contracting issues panel consisting of senior DoD and Industry personnel;
- Commercial acquisition panel consisting of senior DoD and Industry personnel.
- Pricing Webinars – Webinars of relevant training have also been produced for the benefit of those who could not attend. In addition, Director, DP has sponsored a variety of webinars by other experts on issues of pricing negotiation and analysis.
- Procurement Contracting Officer (PCO) Training is a week-long training workshop that covers pricing of major weapons systems and addresses both sections 2306a(d) and 2379 of title 10, U.S.C.

2015 Training Planned to Date:

- August 16-21 and August 23-28, 2015, are reserved for two sessions of week-long training for all DCMA pricers.
- December 6-11, 2015, is reserved for additional pricing training workshops for other pricers.

Defense Acquisition University Training – DAU, under the guidance of the Contracting Functional Integrated Product Team (CON FIPT), has restructured and rewritten the entire certification curriculum since 2008 to provide more pricing training and more rigorous pricing training at all levels of certification. In addition, the DAU Pricing Community of Practice Pricing Site provides support for pricers by providing a central archive of relevant information as well as ad hoc training in response to requests.

Analytical Tools to Support Commercial Item Determination and Commercial Item Pricing:

Contract Business Analysis Repository (CBAR) database and CBAR commercial Item Module. In addition to the actions required by Section 831, Better Buying Power recognized the need to provide the acquisition workforce with additional tools to support analysis. These include data bases to archive information regarding prices actually paid by Government organizations to support improved pricing data. The CBAR database, released in early 2012, has enabled the Department to share critical cost and pricing information among our acquisition professionals. Now DCMA is preparing to introduce the CBAR Commercial Item Module to assist with the acquisition of commercial items. The module will be a repository of data on commercial items that have been purchased within DoD. It will contain commercial item determinations, supporting evidence, and pricing data on commercial, or possibly commercial, items. DCMA will develop the initial requirements for this module and then develop, test, and deploy the module to the acquisition community.

Commercial Item Handbook. Director, DP is continuing to revise the Commercial Item Handbook to reflect work pursuant to Section 831. The purpose of the Commercial Item Handbook is to assist acquisition personnel develop sound acquisition strategies for procuring commercial items

CONUS and OCONUS. The Handbook is a practical reference tool describing how market research and cross-competency teaming can increase the Government's cost-effective use of commercial items to meet Warfighter needs. The Handbook offers suggestions on questions to ask, and it points to additional sources of information, sources of training, and available tools. The Handbook is designed to be a practical reference tool for use in commercial item acquisitions.

Pricing Oversight. One means to provide lasting change is to include oversight mechanisms. A fundamental principle of the Department is "centralized policy, decentralized execution" to empower the Components to conduct contracting in support of their missions. Many of the methods of oversight are conducted by the Components in addition to the many audits performed by DoD IG and GAO. These include: the Services' Procurement Management Reviews (PMRs) conducted by the components in which DPAP individuals are on occasion asked to participate; DCMA's Procurement Systems Reviews (PSRs); and the Joint Staff's Combat Support Agency Review Teams (CSARTs) to assess the capability of Combat Support Agencies such as DCMA and DLA. One CSART review is ongoing now to assess the effectiveness of DCMA in providing pricing support.

Peer Reviews. Not all means of oversight are inspections. Directors, DP and DPAP's very effective Peer Reviews are advisory in nature and effective partly because they are not inspections, rather a collegial dialogue providing support and advice regarding contracts for high dollar value programs.

Research and Analysis for Reports to Congress. Similarly, Directors, DP and DPAP and have exercised oversight in analyzing and preparing reports to the Congress such as the Price Trend Analysis Report and the Report to Congress on the Truth in Negotiations Act (TINA) exceptions/waiver.

2.4 Director, Defense Pricing Policy Memorandum on Commercial Items



ACQUISITION,
TECHNOLOGY,
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

FEB 04 2015

MEMORANDUM FOR: COMMANDER, UNITED STATES SPECIAL OPERATIONS
COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION
COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY
(PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY
(ACQUISITION AND PROCUREMENT)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING)
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Commercial Items and the Determination of Reasonableness of Price for
Commercial Items

The Department acquired well in excess of \$60B in commercial items in the last fiscal year (FY). Section 831 of the FY 2013 National Defense Authorization Act (NDAA), "Guidance and Training Related to Evaluation Reasonableness of Price", requires the Department to issue guidance on the use of the authorities provided by 10 U.S.C. §2306(a) and §2379, and to include in that guidance standards for determining when additional cost information is required in determining reasonableness of price for commercial items.

We are currently processing a proposed rule for the Defense Federal Acquisition Regulation Supplement (DFARS) that will address the standards required by section 831. In conjunction, we will issue a revision to the DFARS Procedures, Guidance, and Information (PGI) and an update of the DoD Commercial Item Handbook, to include more detail and a variety of illustrative scenarios and examples. In the meantime, this memorandum is intended to provide guidance for Contracting Officers as to how they should approach the pricing of items purported to be commercial.

The concept behind the commercial items pricing exception to the Truth in Negotiation Act is that the item, its value, and its price, are results of supply and demand in a commercial marketplace where buyers and sellers have other commercial alternatives which compete with the commercial item(s) being procured. The determination of an item described as "commercial of-a-type" has been difficult for Contracting Officers. Assuming that one has adequate supporting data from the contractor involved and appropriate technical support, it should take a Contracting Officer a reasonable period of time to determine whether an item is commercial. *As a matter of policy, Contracting Officers should establish a goal of making a commercial item determination within ten business days after assembling all the support data, either from available sources or from the contractor, if necessary.* In any case, the commercial item determination should be accomplished promptly. Whether we deem an item to be commercial or not, *the key consideration should be: "Am I paying a fair and reasonable price?"*

A commerciality determination enables a Contracting Officer to acquire the item utilizing procedures in FAR Part 12 instead of FAR Part 15. When acquiring commercial items, the preference is to use market-based pricing when determining a fair and reasonable price. If market based pricing is not available, FAR Part 12 provides the flexibility to use a variety of pricing techniques to include, but not limited to, cost/price analyses, parametric estimating, should-cost techniques and/or analogous pricing of similar items in determining whether the Government is paying a fair and reasonable price. ***If market based pricing is not available, a Contracting Officer may use cost-based analysis, but he/she is not required to use cost-based analysis as the means of determining price reasonableness.***

Contracting Officers are reminded that the FAR, Subparts 15.403-1(c)(3) and 15.403-3, and the DFARS PGI Subpart 215.403-3, already recognize that there are times when other than certified cost and/or pricing information is needed to determine a fair and reasonable price. ***“Other than certified cost or pricing data” takes many forms.*** In certain instances, the only difference between “certified cost and pricing data” and “other than certified cost and pricing data” can be the fact that the data is certified.

Contracting Officers are reminded that the primary purpose of obtaining “other than certified cost or pricing data” is to support the justification that the Government is paying a fair and reasonable price for the item being procured. (Note, however, with regard to major weapons systems along with their components and spare parts, DFARS 234.7002 implements 10 U.S.C. §2379 which provides those items *may be treated as commercial items only if* the offeror has submitted sufficient information to evaluate, through price analysis, the reasonableness of the price.) The preference in the FAR is for Contracting Officers to seek information through market research and other Governmental sources. In cases where items have minimal or no sales history to non-governmental entities, market research by the Contracting Officer is difficult and often fruitless. In these instances, the contractor should be asked to provide information on why the price it wishes the Government to pay is fair and reasonable. The statute and the regulation provide that the Contracting Officer shall require “appropriate information on the prices at which the *same or similar* items have been previously sold that is adequate for evaluating the reasonableness of the price for the procurement.” ***Contracting Officers should not interpret this guidance as discouraging effective deliberative market research, but the Contracting Officer should require contractor submitted information when needed to make an appropriate determination of price reasonableness. The contractor should be in the best position to substantiate why the price it wishes the Government to pay is fair and reasonable.***

If a Contracting Officer determines that the “other than certified cost or pricing data” submitted justifies a fair and reasonable price, he or she should document the file and move forward. ***The standard to be used by Contracting Officers is whether a reasonable businessman or business woman reviewing the data would conclude that it is sufficient to demonstrate that the taxpayers are paying a fair and reasonable price for the item.***

In response to requests for “other than certified cost or pricing data,” the contractor shall provide that information in the form in which it is regularly maintained by an offeror in its business operations. Section 831 requires that requests for uncertified cost information for the purposes of evaluating reasonableness of price are sufficiently documented. In furtherance of this requirement, the contract file must contain: (1) a justification of the need for the additional cost information; (2) a copy of any request from the Department to the contractor for such additional cost information; and (3) any response that the Contracting Officer receives from the


contractor to the request, including any rationale or justification provided by the contractor for a failure to provide the cost information requested. In the event that a contractor is not willing to provide this information to justify its proposed price, Contracting Officers should solicit the assistance of their management

Please ensure that your contracting community is aware of this policy pertaining to documentation requirements and adheres to these requirements. The DFARS PGI will be updated to incorporate the documentation guidance. The Government Accountability Office has been directed to conduct a review of the Department's implementation of the requirements of Section 831.

Section 831 also requires the Department to develop training for the acquisition workforce on the use of the authority provided by sections 2306a(d) and 2379 of title 10, U.S.C., in evaluating price reasonableness for commercial items, and to develop a cadre of experts within the Department to provide expert advice to the acquisition workforce on the use of these authorities. We are working with the Defense Acquisition University to develop a Continuous Learning Course that will provide training to the acquisition community on the requirements and their implementation.

The Defense Contract Management Agency (DCMA) Cost & Pricing Center has been designated to establish the cadre of acquisition professionals that will provide expert advice to the acquisition workforce on the use of those authorities. DCMA will be assisted by the Defense Contract Audit Agency and the Navy Price Fighters in performing this mission. This team will function as advisors in determining the commerciality of items that are being procured and provide pricing support. A separate memorandum will be issued regarding the commercial pricing cell within the DCMA Cost & Pricing Center.

Contracting Officers have great latitude and discretion with regard to commerciality determinations. In the past, significant periods of time have been spent contemplating the commercial nature of a particular item. We need to be more timely in making commercial item determinations, as the more germane issue is to ensure that we are paying a fair and reasonable price for the commercial items we acquire. My point of contact for these matters is Patricia Foley, patricia.g.foley.civ@mail.mil or 703-693-1145.



Shay D. Assad
Director, Defense Pricing

2.5 DoD Proposal Recommending Revising Definition of Commercial Item

(transmitted to Congress March 28, 2012)

SEC. ____ . REVISION TO DEFINITION OF TERM “COMMERCIAL ITEM” FOR PURPOSES OF FEDERAL PROCUREMENT STATUTES PROVIDING PROCEDURES FOR PROCUREMENT OF COMMERCIAL ITEMS.

(a) ELIMINATION OF “OF A TYPE” CRITERION.—Section 103 of title 41, United States Code, is amended by striking “of a type” in paragraphs (1)(A), (3)(A), and (4).

(b) ELIMINATION OF ITEMS AND SERVICES MERELY OFFERED FOR SALE, LEASE, OR LICENSE.—

(1) ITEMS.—Paragraph (1)(B) of such section is amended by striking “, or offered for sale, lease, or license,”.

(2) SERVICES.—Paragraph (6) of such section is amended by striking “offered and”.

(c) ADJUSTMENT OF THRESHOLD RELATING TO PRIOR SALES.—Paragraphs (6) and (8) of such section are amended by striking “substantial quantities” and inserting “like quantities”.

Section-by-Section Analysis

This proposal would permit the Government to acquire commercial items at better prices by ensuring that such items are only those goods or services that actually have been sold, leased, or licensed in comparable quantities in the commercial marketplace and therefore have prices that clearly are based on competitive market pricing or established catalog prices.

After enactment of the Federal Acquisition Reform Act of 1996 (later renamed the Clinger-Cohen Act of 1996 (divisions D and E of P.L. 104-106), and the Federal Acquisition Streamlining Act of 1994 (P.L. 103-335), reports by the Government Accountability Office (GAO), the DoD Inspector General (DoD-IG), and senior level advisory panels repeatedly have criticized the ability of the Federal Government, including the Department of Defense (DoD), to effectively acquire commercial goods and services at fair and reasonable prices. For example, GAO Report 06-838R dated July 7, 2006, cites “adequate pricing” as one of five key area vulnerabilities of the DoD. In part, the report states that “Also, DoD sometimes uses commercial item procedures to procure items that are misclassified as commercial items and therefore not subject to the forces of a competitive marketplace. While the use of commercial item procedures is an acceptable practice, misclassification of items as commercial can leave DoD vulnerable to accepting prices that are not

the best value for the department.” In addition, the DoDIG Report D-2006-115, Commercial Contracting for the Acquisition of Defense Systems, dated September 26, 2006, found that the commercial item definition is broad and has allowed contracting officials to award contracts for defense systems and subsystems that had no commercial market.

Although updated policy guidance was issued on June 8, 2007 by the Director, Defense Procurement and Acquisition Policy (DPAP), subject: “Determining Fair and Reasonable Contract Prices – Revised Procedures, Guidance and Instruction (PGI)”, the existing statutory language of 41 U.S.C. 103 (previously section 4(12) of the Office of Federal Procurement Policy Act (41 U.S.C. 403(12))) continues to complicate the ability of the DoD to ensure that commercial goods and services are acquired based on competitive market pricing that represents the best value or the best price. While changes in the National Defense Authorization Act for Fiscal Year 2008 were a step in the right direction, the changes did not address that the current statutory definition of commercial items is too broad to allow only truly commercial items to be treated as such.

This legislative proposal is consistent with section 813 of the John Warner National Defense Authorization Act for Fiscal Year 2007 (Public Law 109-364), which directed the Department to recommend changes in the law to eliminate areas of vulnerability that allow fraud, waste, and abuse to occur. Section 813 also established the Panel on Contracting Integrity consisting of senior leaders representing a cross-section of the Department.

The Panel’s 2009 Report to Congress recommended this change based on the Working Group for Adequate Pricing analysis. The Panel found commercial item acquisitions Government-wide continues to be vulnerable to pricing deficiencies. The situation cannot be rectified unless the statutory definition of “commercial item” is amended and clarified appropriately. Their analysis reaffirmed the findings of GAO and DoD IG that the commercial item definition is too broad and continues to be a contracting vulnerability.

This proposal would (1) eliminate items “of a type” from the existing statutory prescription; (2) eliminate items or services merely offered for sale, lease, or license (but not yet sold, leased, or licensed) to the general public from the existing statutory definition; and (3) adjust the threshold that requires prior sale of “substantial” quantities to one that allows prior sale of “like” quantities. The first two changes would preclude any further abuse in the overly broad application of the statutory definition. The third change would recognize that a sale in the commercial market is sufficient for purposes of determining fair and reasonable prices if the magnitude of such sale is comparable, or “like”, the quantity to be purchased by the DoD or other Federal agency.

The current statute is focused on the "nature" of the goods and services currently being sold in the competitive commercial marketplace, not the individual vendors selling (or the end users acquiring) those goods and services. It is the "nature" of the items or services, not the end user of such items or services, which should be considered in the determination of whether or not an item or service is considered to be "commercial." The removal of "of a type" and "offered for sale" would not restrict new vendors from qualifying their goods and services as commercial

items. Additionally, it is important to note that "next generation" items may meet this criteria where new or additional functionality or value is available in the commercial market place.

These amendments of the law would prompt commensurate adjustments of the Federal Acquisition Regulation and ensure that commercial goods and services are acquired by the DoD and other Federal agencies only at fair and reasonable prices consistent with comparable sales actually observed in the competitive market.

Budget Implications: None. This proposal simply amends the definition in law of the term "commercial item." It has no other impact on the use of commercial item procedures in federal Government procurement.

Unified Legislation Budget (ULB) Proposal Number: None

Department of Defense Priority: Fostering a "Culture of Saving" Throughout the Department: If enacted, this proposal would permit the Government to acquire commercial items at better prices by ensuring that such items are only those goods or services that actually have been sold, leased, or licensed in comparable quantities in the commercial marketplace and therefore have prices that clearly are based on competitive market pricing or established catalog prices. This will allow for better value to the taxpayer and improving the way the Department does business.

This proposal will eliminate the root cause of often-cited abuse of the term "commercial item" as a premise for the use of streamlined commercial item procedures. That is, it will ensure that future use of commercial item procedures based on the application of this definition will enable the contracting officer to have the benefit of commercial sales history for comparable quantities of goods and services being purchased and enable the contracting officer to determine with confidence that the pricing for the items being purchased is fair and reasonable since he/she cannot rely upon certified cost or pricing data. In addition, this proposal reflects recognition of, and a desire to responsively address, continuing concerns expressed by independent audit reports as well as the 2009 Report by the Panel on Contracting Integrity regarding the use of commercial item procedures, particularly as the matter relates to what has too often been problematical implementation of the statutory definition of the term "commercial item."

AT&L Priority: This proposal would be helpful if enacted in this cycle; it is AT&L priority #25 of 38.

Resubmission Justification: This proposal is an AT&L resubmission from the Call for Legislative Proposal for FY 2009 of June 1, 2007 as well as the Call for Legislative Proposal for FY2012. The proposal was submitted by USD(AT&L) and posted as OLC 217 entitled "Change to the Definition of the Term "Commercial Item." Although DCAA requested it be supported as a late proposal and expedited accordingly, AT&L subsequently asked that it be held. No further action occurred in 2007. DoD's Panel on Contracting Integrity (mandated by Section 813 of the NDAA for FY 2007) identified this area for action in 2009. The panel subcommittee recommended a legislative proposal be submitted for FY 2012 "to eliminate "of a type" and "offered for sale" from the definition of commercial item.' The resulting proposal was OLC 107 Revision to Definition of Term

“Commercial Item” for Purposes of Federal Procurement Statutes Providing Procedures for Procurement of Commercial Items. The proposal cleared OSD and went forward to OMB. As part of the interagency review process, DPAP resolved outstanding issues raised by General Services Administration. However the proposal did not receive OMB clearance. Panel leaders continue to advocate this change and support its resubmission.

AT&L Subject Matter Expert: Lyndi Balven and Cassandra Freeman, DPAP/CPIC, 703- 693-0701

Reviewing Legal Counsel: Bo McBride, ODGC(A&L), 703-571-9462

Budget POC: N/A

Changes to Existing Law: This proposal would make the following changes to section 103 of title 41, United States Code:

§ 103. Commercial item

In this subtitle, the term “commercial item” means—

- (1) an item, other than real property, that—
 - (A) is ~~of a type~~ customarily used by the general public or by nonGovernmental entities for purposes other than Governmental purposes; and
 - (B) has been sold, leased, or licensed, ~~or offered for sale, lease, or license,~~ to the general public;
- (2) an item that—
 - (A) evolved from an item described in paragraph (1) through advances in technology or performance; and
 - (B) is not yet available in the commercial marketplace but will be available in the commercial marketplace in time to satisfy the delivery requirements under a Federal Government solicitation;
- (3) an item that would satisfy the criteria in paragraph (1) or (2) were it not for—
 - (A) modifications ~~of a type~~ customarily available in the commercial marketplace; or
 - (B) minor modifications made to meet Federal Government requirements;
- (4) an combination of items meeting the requirements of paragraph (1), (2), (3), or
- (5) that are ~~of a type~~ customarily combined and sold in combination to the general public;
 - (5) installation services, maintenance services, repair services, training services, and other services if—
 - (A) those services are procured for support of an item referred to in paragraph (1), (2), (3), or (4), regardless of whether the services are provided by the same source or at the same time as the item; and
 - (B) the source of the services provides similar services contemporaneously to the general public under terms and conditions similar to those offered to the Federal Government;

(6) services ~~offered and~~ sold competitively, in ~~substantial~~like quantities, in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific outcomes to be achieved and under standard commercial terms and conditions;

(7) any item, combination of items, or service referred to in paragraphs (1) to (6) even though the item, combination of items, or service is transferred between or among separate divisions, subsidiaries, or affiliates of a contractor; or

(8) a non-developmental item if the procuring agency determines, in accordance with conditions in the Federal Acquisition Regulation, that the item was developed exclusively at private expense and has been sold in ~~substantial~~like quantities, on a competitive basis, to multiple State and local Governments.

2.6 Excerpt from Senate Report to the FY 2013 National Defense Authorization Act

Subtitle C-Amendments Relating to General Contracting Authorities, Procedures, and Limitations

Applicability of Truth in Negotiations Act to major systems and related subsystems, components, and support services (sec. 841)

The committee recommends a provision that would authorize the Department of Defense (DOD) to request additional contractor data, where necessary to evaluate the price reasonableness of commercial items (other than commercially available off-the-shelf items and other items that are developed exclusively at private expense) that are procured for the support of a major weapon system.

The Administration requested legislation that would amend the definition of commercial items in section 103 of title 41, United States Code, to exclude items that are merely "offered for sale" or "of a type" offered for sale in the commercial marketplace. The committee declines to make this change. The Federal Acquisition Streamlining Act of 1994 (FASA) (Public Law 103-355) adopted a broad definition of commercial items to ensure that federal agencies would have ready access to products that are available in the commercial marketplace - including new products and modified products that are just becoming available. Such access remains particularly critical in fast moving commercial markets, including the markets for information technology and other advanced products.

At the same time, the committee shares the Administration's concern that some contractors have abused the commercial item definition to obscure cost and price information with regard to spare parts and components for DOD weapon systems. As DOD has pointed out, the Government Accountability Office and the DOD Inspector General have both criticized the Department for using commercial item procedures to procure items that are misclassified as commercial items and are not subject to competitive price pressure in the commercial marketplace. In 2011, the DOD Inspector General found that non-competitive spare parts provided by two different contractors were significantly overpriced because of inadequate and inaccurate data supplied by the contractors .

The provision recommended by the committee would provide the Department with additional tools to collect needed data for products and services that may arguably qualify as commercial items, without undermining the widely accepted definition of commercial items.

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3 Contract Auditing and Management

Purpose. Assess contractors' recommendations pertaining to contract auditing conducted by the Defense Contract Audit Agency (DCAA) and related Defense Contract Management Agency (DCMA) contract management requirements.

Overview. Section 3.2 provides specific comments and recommendations submitted by seven participating contractors. This assessment was prepared by PARCA and IDA study leads in consultation with subject matter experts in the OUSD(C)/DCAA and OUSD(AT&L) organizations including DCMA, Defense Procurement and Acquisition Policy (DPAP), and Defense Pricing (DP).

In general, responses received from participating contractors did not include quantitative costs associated with specific inefficiencies associated with DCAA auditing or DCMA contract management. A cost-benefit analysis of recommended changes therefore was not possible. Instead, we simply identify the most promising recommendations based on a subjective assessment of their merit.

"Most promising" contractor recommendations

The following ideas were provided to DCAA and DCMA for an assessment of their viability and potential for implementation. DCAA's and DCMA's comments are provided in the footnotes.

- 1. Streamline DFARS contractor business system compliance reviews for large public companies by considering results of Sarbanes-Oxley (SOX) required audits and company internal controls.**
 - Multiple contractors asserted that many sub-processes examined in SOX audits duplicate or overlap with DFARS Business System processes. In particular, one contractor identified multiple SOX-DFARS overlaps for the Accounting System and some overlaps for the Purchasing System and Material Management and Accounting System¹⁶ (see Attachment 3).

¹⁶ DCAA noted: "We believe the business system compliance reviews where we have responsibility (i.e., accounting, estimating, and material management accounting system (MMAS)) can be significantly enhanced by leveraging existing compliance work performed by the contractor (such as SOX). However, DCAA has not been successful in the past in obtaining access to the contractor's supporting information used in the SOX evaluations. DCAA has submitted legislative proposals to specifically state that DCAA should have access to this type of information, but to date, the only legislation that has passed requires DCAA to maintain documentation regarding our access to these types of records. We continue to try to obtain information that will allow us to leverage work performed on SOX, however to date, we have not been very successful. In addition, although SOX compelled contractors to document and assess their internal controls over financial reporting, contractors have generally not given the same attention to their cost accounting systems which document and assess internal controls on compliance with Government laws and regulations. Therefore, the controls identified in Atch 3 are a good start, but would not cover all the documented

- Recommendation: DCAA's comment indicates there is potential to leverage contractor compliance work (such as SOX) to fulfill DCAA auditing requirements. Recommend a jointly-led OUSD(AT&L)/OUSD(C) team be established to engage with willing contractors on proposed approaches and provide an assessment to OSD leadership. Several contractors that participated in this study have indicated a willingness to partner with DoD on this issue.¹⁷

2. Continue to aggressively address contract closeout backlogs through a risk-based approach.

- Multiple contractors asserted that despite renewed attention to the problem by DCAA and DCMA, contract closeout backlogs have not improved.
- In its report accompanying the FY 2012 NDAA, the Senate Armed Services Committee (SASC) directed GAO to consider the following options for facilitating contract closeouts:¹⁸ (1) restoring the authority of the head of an agency to close out a contract that is administratively complete, was entered into 10 or more years ago, and has an unreconciled balance of less than \$100,000; (2) authorizing the contracting officer, in consultation with DCAA, to waive the requirement for an incurred cost audit in the case of a low risk, low-cost contract; (3) authorizing the contracting officer to waive final payment in a case where the contractor has gone out of business and cannot be reached; and (4) addressing efficacy of May, 2011 change to the FAR that was intended to increase the use of quick closeout procedures. GAO recommended: DCAA develop a plan to assess its incurred cost audit initiative; DCMA improve data on over-age contracts; military departments develop contract closeout data and establish performance measures; and DCMA and the Services consider the use of quick closeout procedures authorized by FAR § 42.708.
- One contractor recommended a novel approach to conduct an en masse closeout of 87 contracts executed from 1974–1998. They recommended these contracts, totaling approximately \$10 billion in sales, be closed out in a combined action that would result in the contractor paying the net difference between unbilled costs and accounts receivable, whereby the difference is on the order of 0.005 percent of sales for these contracts.
 - OUSD(C) would need to approve pursuing such a novel mechanism, in consultation with the Office of General Counsel and DoD Inspector General.^{19,20,21}

information necessary to demonstrate compliance with the processes over DoD contracts as required by the DFARS business system criteria.”

¹⁷ DCMA and DCAA concur with recommendation and agree to participate on a jointly-led OUSD(AT&L)/OUSD(C) team that provides an assessment to OSD leadership on opportunities to leverage contractor compliance work. DCAA also noted: “The SOX data may assist in determining the extent of reliance we may place on contractor business systems for use in our other audits. Getting the correct data is important to ensure the information will be sufficient to inform our audits and achieve the efficiency desired.”

¹⁸ GAO-13-131, December 12, 2012, DOD Initiative to Address Audit Backlog Shows Promise, but Additional Management Attention Needed to Close Aging Contracts; available at: <http://www.gao.gov/assets/660/650970.pdf>

¹⁹ The contractor that recommended en masse batch contract closeouts stated they are willing to work with OUSD(AT&L), OUSD(C), OGC, and Service officials in implementing their suggested approach.

²⁰ DCMA noted: “We have and continue to aggressively address contract closeout backlogs through a risk based approach. We have implemented SASC options (2) and (4), both of which were implemented by using a DCMA deviation to FAR 42.708. We support department efforts to explore the feasibility and desirability of implementing options (1) and (3) and the en masse batch closeout approach. In addition, we will identify leading impediments to

- Recommendation: Collectively, DCAA and DCMA comments assert that while contract closeout backlogs continue to be an issue, progress has been made in adopting new procedures that are designed to improve the situation. Both agencies are open to considering additional initiatives. Recommend a jointly-led OUSD(AT&L)/OUSD(C) team be established to assess contract closeout initiatives proposed by contractors. Several contractors that participated in this study have indicated a willingness to partner with DoD on this issue. Also recommend that Directors of DCMA and DCAA provide an update to USD(AT&L) and USD(C) on recent contract closeout progress and promising approaches. Directors of DCMA and DCAA should also assess status of DoD's implementation of GAO recommendations and feasibility of SASC-proposed options in GAO Report 13-131 and provide recommendations to USD(AT&L) and USD(C) for statutory or policy changes that may be required to facilitate their implementation.²²

3. Streamline forward pricing rate (FPR) reviews/audits.^{23,24}

- Multiple contractors asserted that having both DCMA and DCAA review forward pricing rates is generally unnecessary. Since DCMA's forward price rate recommendation (FPRR) is an estimate and payments made on Forward Pricing Rate Agreements (FPRA) are corrected when actuals become available, contractors asserted that settling on an FPRA may not require the rigor of an audit.
- Recommendation: Collectively, DCAA and DCMA comments assert that DoD process improvements since January 2011 have reduced DoD duplicative effort on FPRR/FPRA reviews and audits. However, additional streamlining opportunities appear possible.

closeout by contract types/dollar values for consideration as possibilities for other risk based approaches to alleviate the backlog.

²¹ DCAA commented that they have made significant progress over the past several years in reducing the backlog of audits, closing out over 23,000 years of incurred cost audits since 2012. DCAA also stated they will continue to use a risk based approach to doing audits and will consider other initiatives that will help to reduce the backlog while still protecting the DoD and taxpayer interests.

²² DCMA and DCAA concur with recommendation and agree to participate on a jointly-led OUSD(AT&L)/OUSD(C) team that provides an update to USD(AT&L) and USD(C) on recent contract closeout progress and promising approaches.

²³ DCAA noted: "In Jan 2011, the Director, DPAP (now Director, Defense Pricing) and the Directors of DCMA and DCAA implemented a work realignment and reduction in DCAA/DCMA overlap in FPR. The memorandum stated: 'DCMA will be the single Agency responsible for issuing all FPRR for contractors where DCMA is the cognizant contract administration office. In those cases, where DCAA has completed an audit of a particular contractor's rates, DCMA shall adopt the DCAA recommended rates as the Department's FPRR position.' DCAA audits evaluate whether proposed FPR comply with applicable requirements (FAR, CAS, DFARS, or other Agency supplements). DCMA relies on DCAA to perform this service and both agencies have essential complementary roles in the process." DCAA also provided examples of their efforts to improve training and collaboration with DCMA to reduce duplication of effort.

²⁴ DCMA agreed there is opportunity for streamlining FPR reviews/audits, but does not agree that rate audits are unnecessary. DCMA noted: "Fair and reasonable costs determinations on fixed priced contracts and profit/fee considerations on all contracts are dependent on careful analysis of the considerable amount of contract costs allocated using rates and factors. These analyses may require audit services. In accordance with FAR 15.404-2(a)(1), "the contracting officer should request field pricing assistance when the information available at the buying activity is inadequate to determine a fair and reasonable price. The contracting officer shall tailor requests to reflect the minimum essential supplementary information needed to conduct a technical or cost or pricing analysis." If DCMA has the capability necessary to perform the required analysis, we do not seek assistance from DCAA."

Recommend opportunities be assessed by the Directors of DCMA and DCAA and proposals be provided to USD(AT&L) and USD(C).²⁵

4. DCAA report progress on Agency initiatives to reduce incurred cost audit backlogs and starts and stops in audits.

- It was asserted that “given DCAA’s limited resources that are being deployed to cover a wide breadth of areas, there have been many starts and stops in audits. The result has been for audits to be cancelled at various stages after the company and DCAA have invested resources to start the reviews... To resolve this issue, we recommend that the scope of DCAA audits with respect to the areas they review be focused to examine incurred costs and business systems.”²⁶
- DCAA provided data shown in Figure 3.1 demonstrating they have made considerable progress since 2012 in reducing audit backlogs of contractors’ incurred cost proposals.
- Recommendation: Director, DCAA continue to analyze and assess progress of on-going Agency efforts to decrease backlogs of incurred cost²⁷ and business system review audits and minimize disruption of audits that have been started.²⁸ DCAA should provide results of their analysis to Government and industry customers.

²⁵ DCMA and DCAA concur with recommendation.

²⁶ DCAA noted: “DCAA does not agree that our resources should be focused solely on incurred cost and business systems. We believe our resources should be focused on risks to the Department and the taxpayer. Over the past several years, DCAA has used its entire portfolio of audits (Incurred cost, Forward Pricing, business systems, Truth in Negotiation, Cost Accounting Standards, etc.) to focus resources on the highest risk audits. DCAA has dedicated resources and set up teams to specifically address incurred cost, business system audits, and Truth in Negotiations audits. This process has resulted in over \$4.5 billion in cost savings, from reduced prices of contracts negotiated as well as monies refunded to the Department. We believe the internal assessments we are continually performing ensure our limited resources are used in the most efficient manner.”

²⁷ DCMA noted that as “DCAA’s largest department customer, we believe DCAA should consider prioritizing the incurred cost backlog. Besides being a check for unallowable cost controls, incurred cost audits allow us to settle rates (establish entitlements), close contracts and provide significant information about contractors. These audits help us to test the ability of contractors to accurately estimate pricing rates, forecast current and future costs and understand their accounting behavior.”

²⁸ DCAA concurs with this recommendation noting they have already taken specific actions to address “starts and stops” and results show continuous progress in eliminating interruptions during audits. Actions taken to date include: pin point focus from executive leadership on changing Agency culture to emphasize “if you start an audit, complete the audit,” monthly executive performance meetings with focus on audit completion, field audit offices and audit teams dedicated to incurred cost audits, and Agency-wide teams focused on business systems and Truth in Negotiation compliance. DCAA continuously prioritizes its workload and the types of audits that should be performed. As indicated by the significant reduction in backlogs of incurred cost years shown in Figure 3.1, specific attention has been and will continue to be placed on incurred cost audits. In FY 2014, DCAA completed over 11,000 incurred cost fiscal years – over twice the number received per year. Due to initiatives we have put in place we are making steady progress in significantly reducing the backlog of incurred cost audits. Furthermore, the Agency established an Agency-wide business system team that has been performing business systems audits for over the past year. Through a risk-based approach, the team has identified contractor locations where business systems audits are most critical and has dedicated teams to complete these audits. DCAA will continue with our successful approach to business system audits.”

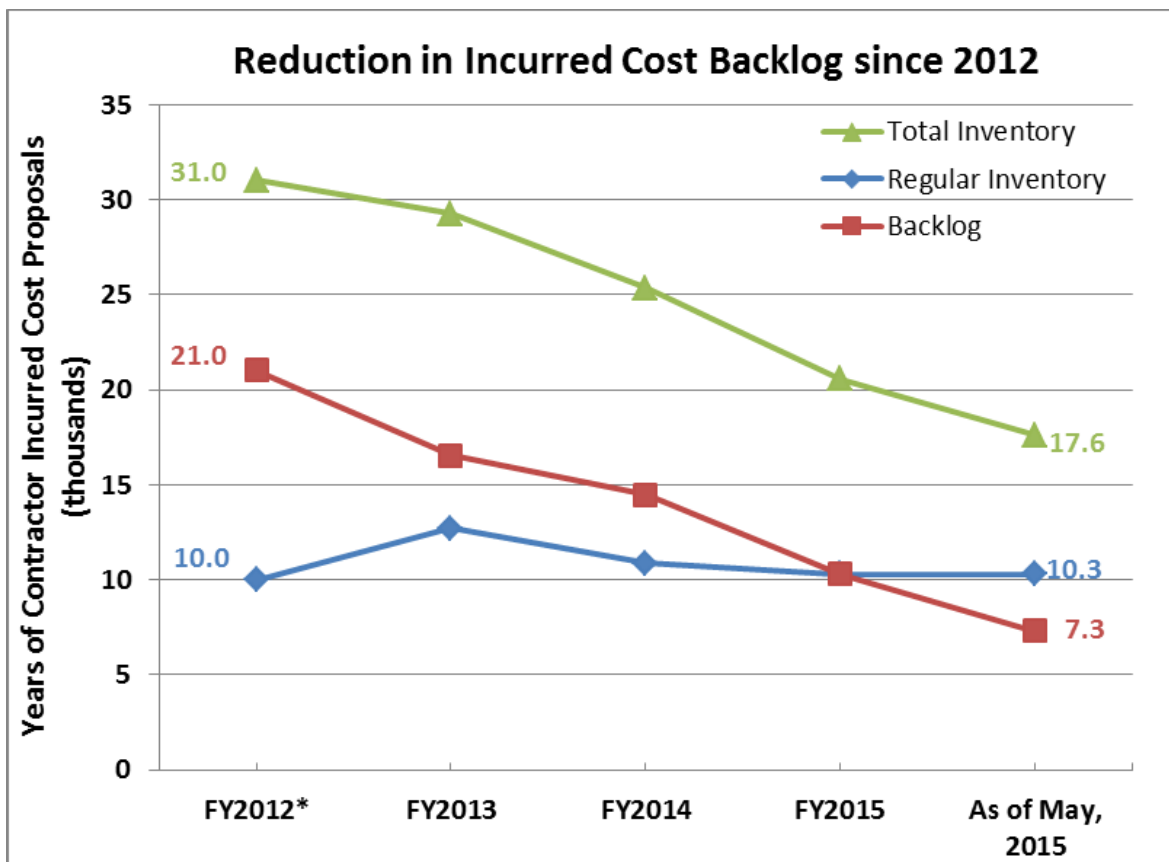


Figure 3.1 Reduction in DCAA's Backlog of Contractor Incurred Cost Proposals Since 2012

- **Total Inventory** – DCAA's entire inventory of contractor proposals (Regular Inventory plus Backlog).
- **Regular Inventory** – Includes 2 years of contractor incurred cost proposals prior to the current fiscal year (in inventory or currently subject to audit) and the most recent contractor completed fiscal year submissions accumulated before year-end.
- **Backlog** – Represents incurred cost proposals older than the regular DCAA inventory.

*2012 Total Inventory and Regular Inventory were estimated based on historical average of DCAA's Regular Inventory (DCAA receives approximately 5,000 incurred cost proposals per year). Backlog determined in 2012 was 19,352 contractor proposals. After determining this backlog, DCAA received additional overdue contractor proposals, resulting in a 2012 backlog of approximately 21,000.

5. Streamline records retention policies related to originals of scanned images.

- Two contractors recommended changes related to retention of original paper records. In particular, one contractor asserted that while SOX requires that hardcopies of scanned images be retained for one year in order to ensure that electronic records match the originals, SOX auditors generally do not verify and validate that scanned copies are accurate unless their audit steps bring the reliability into question, whereas DCAA policy requires that auditors examine the original records in annual audits. This contractor suggested that DCAA revise its policy so that scanned copies are verified only if other audit steps bring the reliability of such records into question.²⁹ Another contractor asserted that requiring originals of scanned images to be retained for one year is unnecessarily burdensome.
- Recommendation: The FAR 4.703 requirement to retain original hardcopies of scanned images to allow verification that scanned copies are accurate seems reasonable. While Director, DCAA may wish to revisit Agency practice on the frequency of testing scanned images to original documents, the current policy seems reasonable. There does not appear to be compelling evidence to make changes to policies.³⁰

²⁹ “DCAA does not have a policy that requires the contractor to retain paper records. FAR 4.703 includes language that states original records need not be maintained or produced in an audit if the contractor provides photographic or electronic images of the original records and meets certain requirements. One of those requirements is for Government contractors (that include FAR 52.214-26 or 52.215-2 clauses) to maintain their original records for a minimum of one year after imaging to permit periodic validation of the imaging system. We are unaware that SOX contains any such requirement, but rather, the SOX record retention requirements are very broad in that they give specific retention periods for various types of documents/records. In order for DCAA to ensure contractors meet the requirements of FAR, DCAA has developed a policy to annually review the contractor’s records on a real time basis. Unlike SOX auditors that perform financial statement audits on a real time basis, DCAA auditors perform audits of Government contracts, and in many cases, the audit documentation we request is from a period of more than one year ago. Given the lapse of time between creation of the documents and our audit that requires those documents, DCAA does not have the opportunity to verify and validate that scanned copies are accurate if the reliability of the records is brought into question. Therefore, DCAA established our current process of testing scanned images to original documents as part of an ongoing audit during the year, so that we can then rely on the scanned images during all of our audits performed during that year, and for future audits performed that cover that year (incurred cost).”

³⁰ DCAA concurs with the recommendation.

3.1 Actions Directed by USD(AT&L) and USD(C)

As a result of this study's recommendations, USD(AT&L) and USD(C) jointly directed the following actions:

1. Streamline DFARS contractor business system compliance reviews for large public companies by considering results of Sarbanes-Oxley (SOX) required audits and company internal controls.
 - OUSD(AT&L)/PARCA is directed to establish a jointly-led OUSD(AT&L)/OUSD(C) team to engage with willing contractors on proposed approaches and provide an assessment to OSD leadership.
2. Continue to aggressively address contract closeout backlogs through a risk based approach.
 - OUSD(AT&L)/PARCA is directed to establish a jointly-led OUSD(AT&L)/OUSD(C) team to assess contract closeout initiatives proposed by contractors.
 - Directors of DCMA and DCAA are directed to provide an update to USD(AT&L) and USD(C) on recent contract closeout progress and promising approaches. Directors of DCMA and DCAA are also directed to assess status of DoD's implementation of recommendations and SASC-proposed options outlined in GAO Report 13-131 and propose statutory or policy changes that may be required to facilitate implementation of those recommendations and options.
3. Streamline forward pricing rate (FPR) reviews/audits.
 - Process improvements since January 2011 have reduced DoD duplicative effort on FPRR/FPRA reviews and audits. However, additional streamlining opportunities appear possible. Directors of DCMA and DCAA are directed to provide streamlining proposals to USD(AT&L) and USD(C).
4. Report progress on DCAA initiatives to reduce incurred cost audit backlogs and starts and stops in audits.
 - Director, DCAA is directed to continue to analyze and assess progress of on-going Agency efforts to decrease backlogs of incurred cost and business system review audits and minimize disruption of audits that have been started. DCAA should provide results of their analysis to Government and industry customers.

3.2 Contractors' Comments and Recommendations on Auditing and Contract Management

Forward pricing rate (FPR) reviews/audits	
1	Having both DCMA and DCAA review FPRs is duplicative and unnecessary because it is judgmentally based and not well suited for the GAGAS audits conducted by DCAA... DCAA audit services have not been timely with respect to forward pricing and incurred cost reviews... Most of DCAA's questioned costs in their FY 2013 completed audit reports are related to forward pricing estimates, which tend to be speculative... DCMA is responsible for negotiating forward pricing rate agreements; due to the backlog at DCAA, Contracting Officers have had to rely on other means to obtain advice. We recommend that FAR Part 42.1701(b) be amended to replace the word "shall" with "may" to eliminate duplicative reviews by the DCMA cost monitors and DCAA auditors of FPRs. ³¹ (multiple contractors)
2	Forward pricing rates are a set of assumptions that are aggregated into a mathematical model and which are ultimately adjusted subjectively on the basis of the amount of risk a contractor is willing to accept and not subject to the checklist approach that DCAA has proposed as a pending rule.
3	Timing of rate determinations should be synchronized with billing/invoicing cycles to prevent retroactive calculations, interim vs. final proposals, multiple reviews, increased coordination between functional areas, and "amounts on hold." ³²
Contract Closeout Backlogs	
4	DCAA backlogs of indirect cost audits should be governed by the "statute of limitations (SOL)" and be closed once the limitations period has passed. Auditors should be directed to stop audits where the SOL has passed. Provide the DCMA with alternatives for dispositioning the backlog of open overhead years. DCMA should be afforded more discretion to close years where no audit has been completed or the SOL is approaching or may have passed. Alternatives to consider include the use of sustained rates from past years as a basis for negotiations. ^{33,34,35,36} (multiple contractors)

³¹ DCMA: We agree audit/review efforts should be tailored not to duplicate procedures.

³² DCMA: This might be worth exploring if the contractor could provide examples of the "rework" caused by poor timing.

³³ PARCA: Further discussion with DCAA and contractors revealed that there is generally no misunderstanding or dispute about the statutory and regulatory SOLs that apply, but instead the dispute often centers on when the SOL clock begins. For example, in the case of incurred cost (IC) proposals, contractors tend to view the SOL as commencing from the date they submit their proposal to DCAA, whereas DCAA's position is that receipt of the IC proposal is really the earliest possible accrual date, not the actual accrual date. According to contractors, DCAA policies stipulate they should render judgment on the adequacy of a contractor's proposal within 90 days, but contractors assert that in some cases it can take as long as two years to render judgment. Another point of dispute is when final contract closeout officially occurs, especially in contracts that include product warranties.

³⁴ DCAA and DCMA both agree with the principle that audits should not be performed after the SOL has passed. However, they both stressed that there are caveats to this principle.

³⁵ DCMA stated: "We do not support a single strict interpretation of the SOL as it relates to costs questioned in indirect cost audits. There are often legitimate differing views on when the SOL has passed. This issue has been the subject of disputes between contractors and the Government, and case law is continuing to evolve."

5	The process for closing out contracts is very inefficient – the definition of an overage contract is that it is overage if not closed within the standard closeout timeframes per FAR 4.804-1.
<i>DCAA procedures for Conduct of Audits</i>	
6	DCAA has not aligned its organization into a single reporting structure similar to that of the DCMA and uses, as a result, a complex reporting structure that is inefficient. FAR provisions for Contract Audit services (42.1) could be more efficiently achieved through single DCAA reporting structure and improved Project management on behalf of the responsible audit agencies. This approach would allow the responsible audit agencies to rely more on the work of other offices within their agency while still maintaining the proper level of autonomy and independence.
7	Multi-year audits are being conducted by DCAA as simultaneous single year audits causing the contractor to double or triple the number of employees to support each single year audit. DCAA should adopt an efficient multi-year audit approach. We recommend DCAA determine how to conduct multi-year audits as a single audit by combining audit universes.
8	Audit centralized services at the source to reduce rework. By auditing on a contract basis, auditors duplicate common inquiries such as payroll disbursements and accounts payable transactions, which could be more efficiently answered if that inquiry were made on a corporate rather than a contract basis. Often times, identical audit steps are completed dozens of times for the same type of centralized transaction. For example, each Cost Accounting Standards (CAS) segment must pull an extensive sample of paycheck data to prove that we have actually paid our employees for time worked on Government contracts. This step is duplicated dozens of times for a process that is common across the entire business. If the cognizant audit agency were to conduct audit procedures on the payroll payment process one time and provide the other audit

³⁶ DCAA stated: “We do not have the authority to define when the SOL commences. That is governed by the statute and FAR. The Director of DCAA does not have authority to determine when contract closeout officially occurs. FAR 4.804-5 places all responsibility for contract closeout in the contract administration office. Coherent Logix, ASBCA No. 59725 (April 2, 2015) is a case where the Government has obtained a final ruling allowing it to recover money based on a finding that the SOL accrued more than 6 years after the initial IC proposal submission. However, the recent Federal Circuit ruling in *Sikorsky v. US*, 773 F. 3rd 1315 (Fed. Cir. 2014) that the CDA SOL is not jurisdictional has the effect of changing the burden of proof in an ASBCA case. Now, if the SOL is raised against a Government claim, the contractor will have the burden of proof to show that the Government had adequate information to put it on notice that it had a claim against the contractor. Previously, the ASBCA had ruled that the Government had the burden of proof to show when it knew or could have known of a claim against the contractor. This change means it will be more difficult for contractors to prevail on SOL grounds with respect to Government claims and the Government will have a better chance of prevailing on this issue. Furthermore, we believe the SOL issue is no longer significant enough to warrant further efforts. In FY 2014, DCAA completed over 11,000 incurred cost fiscal years significantly reducing the number of contractor submissions now subject to the potential for SOL (using the most conservative date as the receipt of the contractor submission). Entering FY 2016, we will have a 76% reduction since FY 2012 in submissions that could potentially be subject to the SOL (using the most conservative date as the receipt of the contractor submission). For example, we will largely be working on FY 2010 and later submissions that would not be subject to any statute issues in FY 2016. Additionally, to address industry’s concerns in regards to timely feedback on its incurred cost submissions, DCAA already has existing policy to assess submitted IC proposals within 90 days for adequacy. DCAA will be re-emphasizing this existing policy.”

	offices with assurance that the process is sound, hundreds of hours could be saved by both sides. ^{37,38} (multiple contractors)
9	For subcontractors to Government prime contractors, reconciliation of invoicing, time charging (especially without disclosing proprietary information), and cash collection is difficult and time consuming, if time charging systems between the prime and the subcontractor are not the same.
10	DCAA imposes requirements on contractors to manufacture bases of estimates to include historical data, which is not always used by contractors in developing current estimates. Clarify documentation requirements that relate to contractor support for purchasing decisions to enable cost effective practices, through technology and elimination of manual effort.
11	DoD can avoid significant costs of contract auditing and contractor surveillance by eliminating the Accounting System requirements from the Contractor Business Systems Rules implemented in DFARS. These rules duplicate the internal control requirements of Sarbanes Oxley (SOX), and many of the objectives of these requirements are already achieved through existing FAR regulations, as well as competitive market forces that ensure sound pricing and buying practices for contractors as a matter of survival. (multiple contractors)
12	Recent changes to the pass/fail grading system have made DCAA audits of business systems unnecessarily stringent. Affected business systems (and associated regulations) are Accounting System (252.242-7006), Estimating System (252.215-7002), and Material Management and Accounting System (252.242-7004). Before 2012, DCAA rated these as “adequate,” “inadequate,” or “inadequate, in part” based upon its auditors reviews. If one or two elements of the system were considered weak or needing enhancement, the contractor would likely have received an “inadequate, in part” rating. In 2012, the Director, DCAA changed the classification grading system to either “adequate” or “inadequate.” As a consequence, DCAA now rates the old “inadequate, in part” rating as “inadequate” and recommends to DCMA that billing withholds be taken against current and future billings until the system is corrected. That there is no longer a middle ground option drives increased compliance risk and costs to maintain compliance. There is an emerging ‘zero defect’ standard for passing a Business System audit, particularly for major contractors. DCAA does not assess the magnitude or materiality of transaction sample infractions in assessing whether their

³⁷ DCAA noted: “We understand industry’s concern with duplicative procedures and have tried to address these issues as we become aware of them. As a result, DCAA has already begun to use a streamline approach to gain efficiencies by retaining the information requested during an audit in the field audit office’s permanent files for use during the performance of future audits. To the extent possible, auditors use that information and confirm with the contractor whether changes have taken place depending on the length of time passed. In some cases, the subject matter under audit required additional information to satisfy its objective. If a contractor is having an issue with multiple requests for the same information, they should address it with the local field office.”

³⁸ PARCA: DCAA’s comment indicates they have been responsive to industry concerns on this issue and are open to addressing contractor concerns about multiple requests for information as they are made aware of such instances. If systemic issues remain, recommend that contractors provide specific details and recommended actions to the Director, DCAA and the USD(C).

	findings rise to ‘significant deficiencies’ that can result in system disapproval. This results in the Government being unable to purchase desired products and services due to system findings that might be quite minor in scope and materiality ... In an effort to avoid or reverse a system disapproval determination, contractors feel compelled to expend significant resources (both in terms of staff and dollars) to develop and implement corrective actions to ensure a zero infraction standard to prevent minor and immaterial matters from being reported as significant deficiencies. System disapprovals and withholdings should be reserved for infractions that are truly ‘significant’ and legitimately put the Government at risk. ³⁹ (multiple contractors)
13	Contractors have no guarantees that remediation actions they complete to remediate ‘significant deficiencies’ and system disapprovals will be reviewed in a timely manner by DCMA/DCAA. This amplifies and extends the punitive impact of withholdings, as well as the competitive disadvantage to win new procurements, and further elongates the period of time in which the Government may be prevented from purchasing the products and services it desires from the suppliers it would prefer to engage. ⁴⁰ (multiple contractors)
14	Premiums paid by it to the Pension Benefit Guaranty Corporation are a cost to the Government to cover a risk that does not exist because if a Government contractor were to terminate the defined benefit plan, the CAS rules provide for reimbursement by the contracting Government agency so that the PBGC would not provide funds to make the defined benefit plan complete. ⁴¹
15	DCAA had the FAR Part 52.216-7 on final indirect cost rates changed to suit their needs at the expense of other stakeholders within the Acquisition Community. DCAA convinced FAR council to issue revisions to the allowable cost and payment clause by inserting onerous requirements on contractors by incorporating their “ICE” (Incurred

³⁹ DCMA: DCAA has responsibility for issuing accounting, estimating, and MMAS audits and providing the data to contracting officers. These audits may find material weaknesses existing in a system or other system issues (i.e., non-significant findings). Contracting officers review the information in these audits, in consultation with the DCAA auditor, to determine the acceptability of a contractor’s accounting, estimating, or MMAS and have the authority to approve or disapprove the system (Reference DFARS 242.7502(b)(1), Contractor Accounting Systems and Related Controls; 215.407-5-70(c)(2)(i), Estimating Systems; and 242.7202(b)(1), Contractor MMAS). Approval or disapproval of a system is based on the existence of a significant deficiency, which the DFARS defines as a shortcoming in the system that materially affects the ability of officials of DoD to rely upon information produced by the system needed for management purposes. Therefore, a contractor’s system could have deficiencies determined not material weaknesses and still be considered adequate, thus warranting a system approval.

⁴⁰ DCMA: DFARS 242.7000, Contractor Business Systems, provides guidance to contracting officers for monitoring contractor’s corrective actions; procedures to follow when contractor’s state corrective actions were taken, and procedures to reduce or release applicable withholding of payments. Within 90 days of receipt of contractor notification all significant deficiencies are corrected, the contracting officer must make a determination in accordance with DFARS 242.7000(d)(3) and continue, reduce, or discontinue/release payment withholding. Furthermore, the withholding of payments is not a punitive action but is meant to mitigate the risk to the Government as a result of the contractor’s system having significant deficiencies. DFARS 252.242-7005, Contractor Business Systems, authorizes payment withholding as a mechanism to incentivize contractors to comply with the contractual requirements of maintaining an acceptable business system. Additionally, any payments previously withheld are released back to the contractor upon system approval.

⁴¹ PARCA: This issue is considered outside the scope of this study.

	Cost Electronically) Model for incurred cost proposals ... DCAA's contention was that if contractors submitted all of the data in their ICE model, it would enable rapid audits and close-out of contracts. Since the rule has been issued, the DCAA audit backlog of incurred cost audits at major contractors has increased and the contract close out process has slowed down. The "rule" has had the exact opposite impact as intended. The rule lists 15 "required" items and 15 items that "may be required" in order to have an "adequate" annual incurred cost submission ... the adequacy of incurred cost proposals should be strictly limited to information necessary to audit the specific incurred cost rate. Ancillary schedules and information that fulfill some other audit matter should be divorced from the incurred cost process. See Attachment 4 for additional comments provided by the contractor and DCAA's response to those comments.
16	Focus DCAA resources to only work on incurred cost audits and business system reviews.
17	We have experienced duplication of efforts between our in-house DCAA auditors and the in-house DCMA Cost Monitor. We have observed that the DCMA and DCAA personnel tend not to coordinate when sharing of information between the groups would be welcome by the contractor.
18	If DoD were to hire a public CPA firm to give DCAA advice about how to streamline and adopt more of a risk-based approach, I think they would have lots of suggestions.
19	We have had several incurred cost proposals that had been previously accepted as "adequate" (in writing) by the DCAA, only to languish and not be audited for several years. When the DCAA did begin auditing, they rescinded the previous acceptance and applied the new FAR requirements that did not exist at the time of the original submission. We have had to retrospectively recreate submissions and provide information that has no impact on the final rate determination, but does satisfy DCAA audit needs outside of the rate calculation/audit area. This activity further delays audits and increases administrative burdens on our side.
<i>Records Retention and Information Submission Requirements.</i>	
20	Keep Scanned Records for one year. When scanning technology was new, this rule was established to allow for scanned records to be used instead of original paper copies. The statute that enabled this practice allowed for keeping original records for up to one year to validate that the scanning systems are working properly. The regulators could have established a required period to hold original from not keeping the documents (current commercial practice) to requiring the records to be kept up to a year. At that time, they chose to establish keeping the originals for the longest period of time required under the statute. Perhaps that was done with an abundance of caution since scanning technology was new at that time. Today scanning technology is pervasive in our society as well as a proven technology. The need to validate the quality of those scans is an outdated concept. In 2007, the DCAA and DCMA cited our company for discarding invoices after they were scanned and not keeping them for 12 months. The company now pays for storing those documents, and then destroys them after 12 months. Typically DCAA does not request those originals during that 12-month

	period. We recommend that this requirement to keep the original for one year be removed from the FAR. (FAR 4.703(c)(3))
21	Scanned Images - DCAA is wasting taxpayer resources by requiring that the auditors conduct annual testing when DCAA themselves state that scanned images are similar to paper invoices. Unless there is a suspicion of fraud, it should be beyond the scope of a DCAA audit to validate, on a yearly basis, that the contractor has scanned the invoices, or other records, properly. Contractors do not make scanned copies of documents for the benefit of DCAA, nor for the Government. Rather, contractors need to better control the storage and archiving of documents to remain competitive in the marketplace. The storage and retrieval of original records in off-site locations is very expensive. Contractor scanning of documents requires a number of attributes that are contained within FAR 4.703(c). Key to the requirements is a system of quality controls to ensure fast, efficient, and accurate recording of the data and to facilitate its retrieval. There are no comparable periodic audit steps that auditors are required to perform to validate that vendor paper invoices are in fact “proper invoices.” When audits are done (under Sarbanes-Oxley for example), the outside CPA firm does not verify and validate that scanned copies are in fact accurate unless their audit steps bring reliability into question.
22	Contractors are not permitted to present compiled expense reports such as credit card receipts because they might contain an unallowable charge (e.g., alcohol). (FAR 31.201-2(d).)
<i>DCMA Material Management and Purchasing System Reviews</i>	
23	The FAR requires the contractor to perform property self-assessments. This is duplicative to the PMSA conducted by the DCMA Property Center Team. DCMA property reps in the field have not embraced the concept of relying on contractor self-assessments (CSAs), which results in duplicative effort. We recommend a change to the FAR...to have contractors submit a self-assessment plan for approval and submit all contractor self-assessment reports conducted per the approved plan at the end of the fiscal year.
24	Item Unique Identification is being applied to all sub-assemblies, components, and parts embedded in delivered items. IUID marking should be limited to line replaceable units with a value over \$5,000, and contracting officers should be precluded from listing subassemblies, components, and parts embedded in line replaceable units in excess of \$5,000 (DFARS 252.211-703(c)(iii)). We recommend eliminating the UID registry reporting requirements (DFARS 252.211.7007) to Government Furnished Property over \$5,000 unit cost to an annual reporting requirement of property in the contractor’s possession. ⁴²

⁴² DCMA: This requirement is a part of DFARS clause 252.211-7003, Item Unique Identification and Valuation. This is not a Government “contract” property requirement (clause). That aside, no analysis is offered; DPAP/PDI would need to address.

25	Creation of an audit function at DCMA for cost-reimbursable price proposals of less than \$100 million and fixed price proposals under \$10 million is duplicative with the audit functions of DCAA. ⁴³
26	DCMA is requiring significant documentation for procurement actions ranging from \$3,000 to the Simplified Acquisition Threshold (\$150,000) when performing Contractors' Purchasing System Reviews. ^{44,45}
27	All of our locations are currently out of cycle for Material Management and Accounting System (MMAS) audits. This has resulted in additional related audits by DCAA and DCMA and ongoing surveillance by DCMA... Mandatory Annual Audit Requirement (MAAR13) audits are being conducted at our two of our businesses in lieu of an MMAS audit... At one of those businesses, DCAA has conducted quarterly MAAR13 audits from USG FY 2010 through USG FY 2012 Qtr 3 (11 audits in total). Beginning in USG FY 2014 MAAR13 audits are being conducted monthly... In the period from USG FY 2010 to USG FY 2012, the final report for one MAAR 13 has been written. The lack of final reports for 10 of the 11 quarterly audits has resulted in the same processes and outcomes being repeatedly audited. Auditors are also unable to apply CAM 4-1000 "Relying Upon the Work of Others" to ensure that past MAAR13 audits provide adequate evidence of compliance and avoid duplication of effort. Our business unit has determined that each MAAR13 audit response requires 160 hours of manpower, resulting in 1,760 man hours for the 11 quarterly audits. Monthly audits being conducted in USG FY 2014 have incurred 360 man hours through ME February 2014. ^{46,47}

⁴³ DCMA: Upon request, DCMA performs field pricing reviews of cases above or below the stated thresholds. For the most part, DCAA declines to perform audits under the stated thresholds. We are not duplicative.

⁴⁴ PARCA: Contractor was asked "What is the particular FAR language at issue?" And "can you give some examples of the "significant documentation" DCMA is requiring?" Contractors response was: "We believe it is just a matter of changing DCMA practice in their interpretation of existing FAR language as it relates to the adequacy of documentation for procurement actions under the Simplified Acquisition Threshold. (Refer to FAR 13.003, FAR § 13.106-3(b), FAR § 13.106-2(b)(1), FAR § 13.003(g) and FAR § 13.003(h)(4))"

⁴⁵ DCMA: There appear to be no examples provided to support an allegation DCMA is requiring significant documentation. In keeping with FAR policy, the CPSR team reviews only for documentation necessary, given the dollars and complexity of the procurement, to justify the procurement actions resulted in a fair and reasonable price.

⁴⁶ PARCA recommends that Directors, DCMA and DCAA provide recommendation whether establishing a schedule for MMAS reviews is feasible and would be in the best interests of DoD and industry.

⁴⁷ DCMA and DCAA concur that Directors, DCMA and DCAA should provide a recommendation whether establishing a schedule for MMAS reviews is feasible and would be in the best interests of DoD and industry. DCAA noted: "we already have procedures in place to perform the MMAS reviews on a cyclical basis determined based on the risk. To ensure the risk to Government is addressed, DCAA has taken a risk-based approach in auditing the three business systems for which we have review responsibility, which includes the MMAS. We are utilizing our experience and knowledge of contractors and working with DCMA and other buying commands to determine the contractors that have the greatest risks to the Government. We have established teams of auditors with technical knowledge in the particular business systems, to ensure our resources are used to the best extent possible. The teams coordinate their efforts with DCMA to ensure all risks areas are identified and addressed during the audits. Currently, we have completed several Material Management Accounting Systems (MMAS) audits using this approach and have several more in process. Several contractors have expressed their appreciation of the new process. One contractor recently made some very positive statements on how well the audit was run by the business system team responsible for MMAS. DCAA disagrees that extraordinary reviews are being performed in the absence of a current review of the MMAS. DCAA performs a real time purchase, existence and consumption audit (MAAR 13). This is not an additional

Cost Accounting Standards

28	<p>Industry has often felt that CAS 404 and CAS 409 were both unnecessary and that Generally Accepted Accounting Principles (GAAP) or IRS rules should be used with respect to capitalization and depreciation. In fact, when these standards were adopted by the CAS board there was a split board and Congressional Hearings ensued... CAS 409 implemented a requirement for contractors to maintain records to establish both the service lives of assets as well as the residual values. This is an onerous requirement that the DCAA has continually cited companies for non-compliance. This really only affects the timing of when you recognize the cost and is completely unnecessary. As noted above, both GAAP and IRS rules exist for this area, as such CAS standards are therefore redundant... In CAS 404-50(b), the rule requires contractors to capitalize G&A on self-constructed assets. This is not allowed under GAAP rules and created a dichotomy between the two sets of rules. The amount is almost always immaterial, but nonetheless this inconsistency between the two sets of financial rules makes for complications, which adds costs. It is these types of insignificant items which end up in audit reports and drains our collective resources to address to resolve... We recommend that GAAP or IRS rules should be used with respect to capitalization and depreciation.^{48,49}</p>
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audit in absence of a current MMAS audit and does not include the same audit procedures (e.g., does not test for the 98 percent bill of material accuracy or 95 percent master production schedule accuracy). The purpose of the audit is to validate on a real time basis that purchased direct materials/services were, in fact received and ascertain that they were needed for the contract, purchased in reasonable quantities, purchased at a prudent price, used on the contract and properly accounted for to ensure the Government interest is protected real time. DCAA believes its current approach will provide the most advantageous way to protect the Government and taxpayer interest and create a win-win situation for contractors that have good MMAS systems.

⁴⁸ DCAA does not concur. The Cost Accounting Standards provide for uniformity in the accounting for costs amongst Government contractors. Specifically, CAS 404 and CAS 409 intend to alleviate the inconsistency that is created if the contractor was held only to GAAP or the IRS by providing rules for areas of interest, that are not covered by those rules. Therefore, relying solely on the accounting set out by GAAP or the IRS could result in inconsistencies in accounting for costs amongst contractors, thus hindering the procurement process in being able to adequately compare prices. Further, it would not be in the best interest of the Government to eliminate the two standards, as it would do away with the Government's ability to recover increased costs on closed contracts due to a noncompliance. Furthermore, DCAA does not have the sole authority to rescind Cost Accounting Standards. The Cost Accounting Standards Board has the exclusive authority to make, promulgate, and amend cost accounting standards designed to achieve uniformity and consistency in cost accounting practices. The Board consists of five members including the OFPP Administrator, who serves as the chairman, and four members with experience in Government contract cost accounting including two from the Federal Government (DoD and GSA), one from industry, and one from the accounting profession.

⁴⁹ PARCA: See Attachment 5 for a detailed assessment of this issue, including explanations of differences in the CAS, GAAP and IRS rules and their implications for the DoD.

Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)

29	Although ATF regulations exempt Explosives and Destructive Devices managed through DoD regulations from ATF requirements, ATF inspectors have informed RMS that all Destructive Devices...are subject to ATF regulatory requirements... Compliance to ATF Requirements is a duplication of effort... We recommend that DoD contractors that produce weapons for DoD be exempt from ATF oversight which is duplicative and in many cases not applicable. ⁵⁰
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⁵⁰ PARCA: This issue is considered outside the scope of this study.

3.3 DFARS System Controls that are Potentially Duplicative of SOX Controls⁵¹

SOX Process	SOX Sub-processes	Potential Overlap with DFARS Business System?	Related DFARS Business System
Contract to Cash	Project Set-up	Yes	Accounting
	Defer and Recognize Revenue	Yes	Accounting
	Estimates at Completion (EAC's)	Yes	Accounting
	Billing / Accounts Receivable	Yes	Accounting
	Cash Applications / Receipts	Yes	Accounting
Payroll & Benefits	Time & Expense	Yes	Accounting
	Payroll	Yes	Accounting
	Bonus	Yes	Accounting
	Defined Contribution Plans	Yes	Accounting
	Deferred Compensation	Yes	Accounting
Procure to Pay	Vendor Master Data Purchasing	Yes	Purchasing
	Purchasing	Yes	Purchasing
	Accounts Payable	Yes	Purchasing
Entity-Level Controls	Accruals	Yes	Purchasing
	Control Environment	Yes	Accounting
	Risk Assessment	Yes	Accounting
	Information & Communication	Yes	Accounting
	Monitoring	Yes	Accounting
Equity / Stock	Control Activities	No	Accounting
	Equity	No	N/A
General IT Controls	Stock-Based Compensation	Yes	N/A
	Logical Security	Yes	Accounting, Purchasing
	Change Control	Yes	Accounting, Purchasing
	Operations	Yes	Accounting, Purchasing
Record to Report	Physical Security	Yes	Accounting, Purchasing
	GL / Account Master Data	Yes	Accounting
	Journal Entries	Yes	Accounting
	Account Reconciliations	Yes	Accounting
	Reserves & Disclosures	Yes	Accounting
Property, Plant, and Equipment	Consolidations	Yes	Accounting
	External Financial Reporting	Yes	Accounting
	Fixed Assets	Yes	Accounting
Leases	Depreciation / Amortization	Yes	Accounting
Goodwill & Intangibles	Leases	No	Accounting
	Goodwill	No	N/A
Income Taxes	Intangible Assets	No	N/A
Cost Accumulation	Business Combinations / Divestitures	No	N/A
	Tax Provision	Yes	N/A
Inventory	Cost Set-up (e.g. service centers, burdening)	Yes	Accounting
Treasury - Debt & Cash Disbursements	Rate Approval & Set-up	Yes	Accounting
	Inventory	No	MMAS
	Debt	No	N/A
	Share repurchases / special dividends	No	N/A
	Manual cash disbursements	No	N/A

⁵¹ Section 3.3 was provided by one of the contractors that participated in this study.

3.4 Contractor Recommended Revision to FAR 52.216-7(d) and DCAA response

(d) Final indirect cost rates.

~~(1) Final annual indirect cost rates and the appropriate bases shall be established in accordance with Subpart 42.7 of the Federal Acquisition Regulation (FAR) in effect for the period covered by the indirect cost rate proposal.~~

Comment [JGP Sr.1]: The suggested changes below essentially restores this FAR clause to the terminology that existed before DCAA had it changed to suit their needs at the expense of the other constituencies within the Acquisition community.

(2)

(i) The Contractor shall submit an adequate final indirect cost rate proposal to the Contracting Officer (or cognizant Federal agency official) and auditor within the 6-month period following the expiration of each of its fiscal years. Reasonable extensions, for exceptional circumstances only, may be requested in writing by the Contractor and granted in writing by the Contracting Officer. The Contractor shall support its proposal with adequate supporting data.

(ii) The proposed rates shall be based on the Contractor's actual cost experience for that period. The appropriate Government representative and the Contractor shall establish the final indirect cost rates as promptly as practical after receipt of the Contractor's proposal.

(iii) An adequate indirect cost rate proposal shall include the following data unless otherwise specified by the cognizant Federal agency official:

(A) Summary of all claimed indirect expense rates, including pool, base, and calculated indirect rate.

~~(B) General and Administrative expenses (final indirect cost pool). Schedule of claimed expenses by element of cost as identified in accounting records (Chart of Accounts).~~

~~(C) Overhead expenses (final indirect cost pool). Schedule of claimed expenses by element of cost as identified in accounting records (Chart of Accounts) for each final indirect cost pool.~~

~~(D) Occupancy expenses (intermediate indirect cost pool). Schedule of claimed expenses by element of cost as identified in accounting records (Chart of Accounts) and expense reallocation to final indirect cost pools.~~

~~(E) Claimed allocation bases, by element of cost, used to distribute indirect costs.~~

Comment [JGP Sr.2]: Delete this is redundant with item A

~~(F) Facilities capital cost of money factors computation, if applicable.~~

~~(G) Reconciliation of books of account (i.e., General Ledger) and claimed direct costs by major cost element.~~

Comment [JGP Sr.3]: Direct costs are not part of the rate calculation. If you are trying to determine the rate a total reconciliation in our submission is unnecessary to the determination of a rate.

~~(H) Schedule of direct costs by contract and subcontract and indirect expense applied at claimed rates, as well as a subsidiary schedule of Government participation percentages in each of the allocation base amounts.~~

Comment [JGP Sr.4]: Completely unnecessary for the determination of an incurred cost rate. DCAA introduced this on the theory that you could close out a contract by just looking at this schedule after DCAA has audited it. That has never happened and is unlikely ever to happen. This schedule is created to merely paper an auditors file.

~~(I) Schedule of cumulative direct and indirect costs claimed and billed by contract and subcontract.~~

~~(J) Subcontract information. Listing of subcontracts awarded to companies for which the contractor is the prime or upper tier contractor (include prime and subcontract numbers; subcontract value and award type; amount claimed during the fiscal year; and the subcontractor name, address, and point of contact information).~~

Comment [JGP Sr.5]: Has nothing to do with final indirect rates.

~~(K) Summary of each time and materials and labor hour contract information, including labor categories, labor rates, hours, and amounts; direct materials; other direct costs; and, indirect expense applied at claimed rates.~~

Comment [JGP Sr.6]: Has nothing to do with final indirect rates

~~(L) Reconciliation of total payroll per IRS form 941 to total labor costs distribution.~~

Comment [JGP Sr.7]: Has nothing to do with final indirect rates. Is a significant burden for companies with submit one 941 yet have multiple segments.

~~(M) Listing of decisions/agreements/approvals and description of accounting/organizational changes.~~

~~(NC) Certificate of final indirect costs (see 52.242-4, Certification of Final Indirect Costs).~~

~~(O) Contract closing information for contracts physically completed in this fiscal year (include contract number, period of performance, contract ceiling amounts, contract fee computations, level of effort, and indicate if the contract is ready to close).~~

Comment [JGP Sr.8]: Has nothing to do with final indirect rates.

~~(iv) The following supplemental information is not required to determine if a proposal is adequate, but may be required during the audit process:~~

Comment [JGP Sr.9]: For listed companies much of this information is publicly available on the internet (SEC filings). Furthermore much of it has nothing to do with actual incurred cost proposals or the calculation of incurred cost rates. This is an example of DCAA overreaching into proprietary contractor information without a discrete nexus to the task at hand. By making this a "may" be required item, DCAA is in effect acknowledging this information lacks nexus (extraneous reviews, which waste resources for contractors and the Government).

~~(A) Comparative analysis of indirect expense pools detailed by account to prior fiscal year and budgetary data.~~

~~(B) General organizational information and limitation on allowability of compensation for certain contractor personnel. See 31.205-6(p). Additional salary reference information is available at http://www.whitehouse.gov/omb/procurement_index_exec_comp/.~~

~~(C) Identification of prime contracts under which the contractor performs as a subcontractor.~~

~~(D) Description of accounting system (excludes contractors required to submit a CAS Disclosure Statement or contractors where the description of the accounting system has not changed from the previous year's submission).~~

~~(E) Procedures for identifying and excluding unallowable costs from the costs claimed and billed (excludes contractors where the procedures have not changes from the previous year's submission).~~

~~(F) Certified financial statements and other financial data (e.g., trial balance, compilation, review, etc).~~

~~(G) Management letter from outside CPAs concerning any internal control weaknesses.~~

~~(H) Actions that have been and/or will be implemented to correct the weaknesses described in the management letter from subparagraph (G) of this section.~~

~~(I) List of all internal audit reports issued since the last disclosure of internal audit reports to the Government.~~

(I) Annual internal audit plan of scheduled audits to be performed in the fiscal year when the final indirect cost rate submission is made.

(K) Federal and State income tax returns.

(L) Securities and Exchange Commission 10-K annual report.

(M) Minutes from board of directors meetings.

(N) Listing of delay claims and termination claims submitted which contain costs relating to the subject fiscal year.

~~(O) Contract briefings, which generally include a synopsis of all pertinent contract provisions, such as: Contract type, contract amount, product or service(s) to be provided, contract performance period, rate ceilings, advance approval requirements, pre-contract cost allowability limitations, and billing limitations.~~

Comment [JGP Sr.10]: DCAA use to do their own contract briefings years ago, and have move this to contractors increasing our costs (these are after all Government contracts). We do not understand why they do not have their own list of Government Contracts at contractors from a Government source?

(iv) The Contractor shall update the billings on all contracts to reflect the final settled rates and update the schedule of cumulative direct and indirect costs claimed and billed, as required in paragraph

(d)(2)(iii)(I) of this sections, within ~~60~~ 120 days after settlement of final indirect cost rates.

(3) The Contractor and the appropriate Government representative shall execute a written understanding setting forth the final indirect cost rates. The understanding shall specify

(i) the agreed-upon final annual indirect cost rates,

(ii) the bases to which the rates apply,

(iii) the periods for which the rates apply,

(iv) any specific indirect cost items treated as direct costs in the settlement, and

(3) The Contractor and the appropriate Government representative shall execute a written understanding setting forth the final indirect cost rates. The understanding shall specify

(i) the agreed-upon final annual

indirect cost rates, (ii) the bases to

which the rates apply,

(iii) the periods for which the rates apply,

(iv) any specific indirect cost items treated as direct costs in the settlement, and

(v) the affected contract and/or subcontract, identifying any with advance agreements or special terms and the applicable rates.

The understanding shall not change any monetary ceiling, contract obligation, or specific cost allowance or disallowance provided for in this contract. The understanding is incorporated into this contract upon execution.

(4) Failure by the parties to agree on a final annual indirect cost rate shall be a dispute within the meaning of the Disputes clause.

(5) Within 120 days (or longer period if approved in writing by the Contracting Officer) after settlement of the final annual indirect cost rates for all years of a physically complete contract, Contractor shall submit a completion invoice or voucher to reflect the settled amounts and rates. The completion invoice or voucher shall include settled subcontract amounts and rates. The prime contractor is responsible for settling subcontractor amounts and rates included in the completion invoice or voucher and providing status of subcontractor audits to the contracting officer upon request.

(6)

(i) If the Contractor fails to submit a completion invoice or voucher within the time specified in paragraph (d)(5) of this clause, the Contracting Officer may--

(A) Determine the amounts due to the Contractor under the contract; and

(B) Record this determination in a unilateral modification to the contract.

(ii) This determination constitutes the final decision of the Contracting Officer in accordance with the Disputes clause.

DCAA Response:

DCAA does not agree with the contractor's recommended changes to FAR Part 52.216-7(d). The information to be included in the final indirect rate proposal in accordance with FAR is the information necessary for DCAA to effectively perform its audit activities. The contractor's assertion that we are only auditing indirect rates is not true. DCAA's annual incurred cost audit includes the audit of direct costs in addition to the indirect rates. Although DCAA does not audit every indirect rate proposal that we receive due to our low risk process, we still require each contractor to submit their proposal in accordance with the FAR requirements. In order to determine a contractor's risk profile, we must review the indirect rate proposal for adequacy and assess the risk. Without an adequate indirect rate proposal, DCAA would be unable to determine whether the proposal is low risk and thus subject to low risk sampling. As a result, every incurred cost submission would require an audit.

In the past, DCAA only required information on indirect rates; however, that led to several problems:

- Auditor's ability to understand and verify the base of the indirect rates because the base is predominantly direct costs in nature
- Lack of insight into subcontract costs, which is also part of the base for indirect rates
- Required separate audits for the direct costs (contractors would still have to provide the same information but at a different audit)

As a result, the FAR was enhanced and expanded to address contractors' complaints on the differing expectations on what constituted an adequate incurred cost proposal. Also, contracting officers need the required information to facilitate contract closeout.

Removing these requirements from the FAR would likely have the following unintended consequences:

- **Allowability unknown:** Lack of understanding the allowable nature of direct costs.
- **Increased fieldwork:** Auditors would have to increase fieldwork to understand the costs going into the base of each indirect rate.
- **Increased number of audits:** Per FAR 52.216.7(g), contracting officers have the right to request audit up until final payment. Without direct costs in the annual audit, the number of DCAA audits may significantly increase (additional resource requirement) because the number of voucher audits and final close out audits will significantly increase to ensure contracting officers have adequate assurance on the allowability of direct costs.
- **Lack of centralized information:** Currently, the direct costs and indirect rates go to the ACO—with separate direct cost audits, each PCO would be requesting direct cost audit coverage, resulting in DCMA having a lack of centralized information and many additional audit reports being issued.
- **Difficulty assessing risk:** Without these schedules, it will be more difficult for DCAA to determine whether a contractor is classified as a low risk contractor going forward. The low risk determination allows DCAA to forgo audits in many cases.

DCAA also does not agree that the list of supplemental information in FAR paragraph 52.216-7(d)(iv) and all subparts should be removed from FAR. The list of supplemental information is not required to determine if a proposal is adequate; however, the information contained will be required during the incurred cost audit process. We believe including this information in the FAR gives industry insight into what additional information they may need to make available to the auditor when they are performing the incurred cost audit. It is not information that will fulfill some other matter, it is relevant to the incurred cost audit, and therefore, appropriate. Furthermore, the incurred cost audit is an audit of all incurred costs (Direct and Indirect) and the information contained on these schedules are required for our audit purposes and so that we can fully report the necessary information to the contracting officer for contract closeout purposes.

In summary, removing the schedules cited in the contractor's recommendation would significantly impact the efficiency and effectiveness of DCAA audits and DCMA contract closeout.

3.5 White Paper on Generally Accepted Accounting Principles (GAAP), Cost Accounting Standards (CAS), and Internal Revenue Service (IRS) Capitalization and Depreciation Rules⁵²

Industry Comments: A contractor asserted that CAS 404 and CAS 409 are unnecessary and that Generally Accepted Accounting Principles (GAAP) or IRS rules should be used for capitalization and depreciation. The contractor stated that CAS 409 implemented a requirement for contractors to maintain records to establish both service lives and residual values of assets and that this is an onerous requirement, and that the DCAA has continually cited companies for non-compliance. The effect, the contractor argues, is in the timing of when the cost is recognized and is completely unnecessary. Both GAAP and IRS rules, it is argued, exist for this area, and, as such, CAS standards are redundant. In CAS 404-50(b), the rule requires contractors to capitalize G&A on self-constructed assets. This is not allowed under GAAP rules and created a dichotomy between the two sets of rules. The amount is almost always immaterial, but nonetheless this inconsistency between the two sets of financial rules makes for complications, which adds costs. It is these types of insignificant items, it is argued, which end up in audit reports and drains collective resources to address resolution.

Summary of Findings: GAAP and CAS rules differ for they are used for different purposes. GAAP is used for the benefit of financial statement users and do not apply to the Federal Government. CAS rules determine how costs are measured, accumulated, and allocated to government contracts and demand consistency in the accounting practices used by contractors awarded CAS-covered contracts. Comments were confined to CAS 404 and 409 though there are 19 CAS Standards. In terms of CAS 404 and 409, CAS rules favor capitalization and allocation of depreciation expenses to contracts over the useful life of the asset rather than by charging, as a current expense, the cost of a tangible capital asset, improvements to it, or costs of putting the asset into service. The CAS rules also govern how to calculate the useful life of a tangible capital asset and how to account for residual value in determining depreciation expenses for any applicable period. GAAP allows assets to be fully depreciated without concern for residual value, even though the asset may retain value at the end of its calculated useful life. In cases in which there is no factual basis for determining the useful life of an asset, CAS refers to IRS rules to do so. Further, recent IRS “safe harbor” rules for capitalization of tangible capital assets resemble the CAS rules. Contractors would be expected to favor CAS because those Standards reduce the amount that can be charged in the contractor’s immediate fiscal year to CAS-covered Government contracts. Differences between GAAP and CAS rules may have a cost impact on contractors that are awarded CAS-covered contracts, but ultimately that cost is passed on to the Government, which benefits by having reduced expenses allocated to applicable CAS-covered Federal contracts.

GAAP vs. CAS Distinctions: There are 19 published cost accounting standards that require companies that are awarded negotiated contracts that are not exempted from CAS coverage to follow the precise and unique accounting rules designed to control how costs are measured,

⁵² Section 3.5 was provided by Mr. Richard P. Diehl, Institute for Defense Analyses

accumulated, and allocated to a final cost objective.⁵³ GAAP and CAS⁵⁴ are complementary but designed for different purposes. GAAP does not apply to Government entities. GAAP is structured for the benefit of financial statement users while CAS has a broader set of public policy implications. CAS 404 and 409 address the step-up or step-down of asset values and provide capitalization rules that favor charges to Government CAS-covered contracts over an extended period as depreciation expenses measured against the book value of the asset rather than as current period chargeable expenses. GAAP recognizes the economic impact of asset purchases and allows for an asset's value to be depreciated, but the expenses of placing an asset into service may be immediately charged as an expense, while under CAS they would be capitalized; GAAP also allows assets to be fully depreciated without a residual value. CAS provides that an asset should retain its book value for the purpose of allocating costs to a contract. CAS does not allow for a step-up or step-down of assets when a company re-evaluates assets post-merger or acquisition. GAAP not only requires such adjustments but for accounting by the purchase method the business combination assets are recorded at the fair market value with any amount in excess of fair market value being recorded as goodwill.⁵⁵ GAAP contains a series of guidelines that define how American companies are supposed to record their accounting data and present their financial statements. Generally Accepted Government Auditing Standards (GAGAS) are published by the Government Accountability Office (GAO) and define the standards for Government audits of contracts and business entities.

CAS Board and CAS Applicability:

CAS Board (CASB) History: The CASB was established in 1970 as an agency of Congress under Public Law 91-379 to promulgate cost accounting standards to achieve uniformity and consistency in cost accounting principles for contractors or subcontractors awarded Federal contracts in excess then of \$100,000 and to establish regulations requiring contractors and subcontractors as a condition of contracting with the Federal Government to disclose in writing their cost accounting practices, to follow those practices consistently, and to comply with CAS requirements. The CASB established the original 19 CAS standards and rules and regulations and thereafter was disbanded on September 30, 1980. It was brought back into existence on November 17, 1988, through Public Law 100-679.⁵⁶ The current CASB is subordinate to the Office of Management and Budget. It consists of five members-the Administrator of the Office of Federal Procurement Policy as its Chairman, and one member each from DoD, GSA, Industry, and the private sector.⁵⁷

CAS Coverage: FAR Part 30 and DFARS Subpart 230.2 provide policies and procedures for implementing CAS Board rules and regulations codified at 48 C.F.R. Chapter 99, including CAS 404 and 409. As FAR 30.101 provides, Public Law 100-679, codified at 41 U.S.C. §§1501-1506 (formerly

⁵³ Kohn, Phillip, CPA, *The Intersection of GAAP and CAS, Understanding the Differences*, CPA Insider, March 28, 2011.

⁵⁴ Found at 48 C.F.R. Chapter 99.

⁵⁵ FAS 146 (Accounting for Costs Associated with Exit or Disposal Activities), FAS 141 (Business Combinations) and FAS 143 (Accounting for Asset Retirement Obligations).

⁵⁶ It should be noted that the current version of both CAS 404 and 409 (both published at 61 F.R. 5523), about which contractors complain, became effect on April 15, 1996, after public comment was received.

⁵⁷ See Paragraph 8-102.1, DCAA Contract Audit Manual, October 24, 2013.

41 U.S.C. §422) requires that certain contractors and subcontractors comply with Cost Accounting Standards and disclose in writing their cost accounting practices and thereafter to follow those practices consistently. CASB 9903.201-1 provides rules for determining whether a proposed contract or subcontract is exempt from CAS coverage.⁵⁸ All other negotiated contracts not exempt will be subject to CAS.

Full or Modified CAS Coverage: CAS coverage can be “full” or “modified.” As provided in CASB 9903.201-2, full coverage (FAR 52.230-2) requires that a business unit comply with all of the CAS specified in CASB Part 9904 (including CAS 404 and 409) that are in effect on the date of the contract award and with any CAS which become applicable because of later award of a CAS-covered contract. Full coverage applies to contractor business units that receive a single CAS-covered contract award of \$50 million or more or received \$50 million or more in net CAS-covered awards during its preceding cost accounting period. Modified CAS coverage (FAR 52.230-3) requires only that the contractor comply with Standard 9904.401, Consistency in Estimating, Accumulating, and Reporting Costs; Standard 9904.402, Consistency in Allocating Costs Incurred for the Same Purpose; Standard 9904.405, Accounting for Unallowable Costs; and Standard 9904.406, Cost Accounting Standard—Cost Accounting Period. CAS coverage might be applied to a covered contract of less than \$50 million awarded to a business unit that received less than \$50 million in net CAS-covered awards in the immediately preceding cost accounting period. The rules in this regard are, if any one contract is awarded with modified CAS coverage, all CAS-covered contracts awarded to that business unit during that cost accounting period must also have modified coverage with the following exception: if the business unit receives a single CAS-covered contract award of \$50 million or more, that contract must be subject to full CAS coverage. Thereafter, any covered contract awarded in the same cost accounting period must also be subject to full CAS coverage. A contract awarded with modified CAS coverage shall remain subject to such coverage throughout its life regardless of changes in the business unit's CAS status during subsequent cost accounting periods.

Waivers of CAS Coverage: CASB 9903.201-5 provides that the head of an executive agency may waive the applicability of the CAS for a contract or subcontract with a value of less than \$15 million, if that official determines, in writing, that the business unit of the contractor or subcontractor that will perform the work is primarily engaged in the sale of commercial items; and would not otherwise be subject to the Cost Accounting Standards. The head of an executive agency may also waive the applicability of the Cost Accounting Standards for a contract or subcontract under exceptional circumstances when necessary to meet the needs of the agency.

⁵⁸ Sealed bid contracts, Negotiated contracts and subcontracts not in excess of the Truth in Negotiations threshold (\$700,000), contracts and subcontracts with small businesses, contracts and subcontracts with foreign Governments or their agents or instrumentalities, contracts or subcontracts in which the price is set by law or regulation, firm-fixed price or fixed price with economic price adjustment (provided the price adjustment is not based upon actual costs incurred), contracts or subcontracts of less than \$7.5 million, provided at time of award the business unit of the contractor or subcontractor is not performing any CAS-covered contracts or subcontracts valued at \$7.5 million or greater, subcontractors under the NATO PHM Ship program to be performed outside the U.S. by a foreign concern, and firm-fixed price contracts or subcontracts awarded on the basis of adequate price competition without submission of cost or pricing data.

A determination to waive the applicability of the Cost Accounting Standards by the agency head shall be set forth in writing, and shall include a statement of the circumstances justifying the waiver. The head of an executive agency may not delegate the waiver authority to any official below the senior policymaking level in the agency. The head of each executive agency shall report the waivers granted for that agency, to the Cost Accounting Standards Board, on an annual basis, not later than 90 days after the close of the Government's fiscal year. Under CASB 9903.201-5(e) the CASB may waive upon request of the head of an executive agency or his/her designee, CAS or Disclosure and Consistency of Cost Accounting Practices for a contract that is otherwise subject to the CAS. FAR 30.201-5 and DFARS 230.201-5 modify somewhat the CASB rules in that not only may the Military Departments grant a CAS waiver but also the Director, Defense Procurement and Acquisition Policy (DPAP) may do so.

CAS 404 (Capitalization of Tangible Assets): CAS 404⁵⁹ provides the Standard for Capitalization of Tangible Assets and requires that contractors' follow a capitalization policy that will facilitate measurement of costs consistently over time. What it requires is that contractors establish and adhere to policies with respect to capitalization of tangible assets that satisfy the criteria established within the Standard.⁶⁰ The import of this capitalization policy is that instead of treating capital asset purchases as an expense and deducting that total expense from revenues (thus reducing net revenue for tax purposes) or charging the expense to a Government cost-type contract(s) within the current period, capitalized assets must be depreciated over the life of the asset meaning depreciation expense is spread over the future years that define the service life of the asset. For Government cost-type contracts to which CAS applies, this will reduce the chargeable expenses allowable in any year of the contract.

CAS 404-30 contains the definitions of terms of import to both GAAP and CAS, namely asset accountability unit,⁶¹ original complement of low cost equipment,⁶² repairs and maintenance,⁶³ and tangible capital asset.⁶⁴ CAS 404-40 provides⁶⁵ that the "acquisition cost of tangible capital assets shall be capitalized" and that the capitalization shall be based upon a written policy that is reasonable and consistently applied. A requirement related to *tangible capital assets* that may cause concern in the contractor community is that a contractor's policy shall designate a minimum service life criterion that shall not exceed two years, but may be a shorter period, and that the minimum acquisition cost criterion shall not exceed \$5,000, but can be a lesser amount,⁶⁶ (see also IRS Safe Harbor rules discussed below) but the "contractor's policy may designate higher minimum

⁵⁹ CASB 9904.404.

⁶⁰ CASB 9904.404.20.

⁶¹ "...a tangible capital asset which is a component of plant and equipment that is capitalized when acquired or whose replacement is capitalized when the unit is removed, transferred, sold, abandoned, demolished, or otherwise disposed of."

⁶² "...a group of items acquired for the initial outfitting of a tangible capital asset or an operational unit, or a new addition to either."

⁶³ "...the total endeavor to obtain the expected service during the life of tangible capital assets."

⁶⁴ "...an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the service it yields."

⁶⁵ CASB 9904.404-40.

⁶⁶ CASB 9904.404-40(b)(1).

dollar limitations for *original complement of low cost equipment* and for *betterments and improvements* than the limitation established in accordance with paragraph (b)(1) of this subsection, provided such higher limitations are reasonable in the contractor's circumstances."⁶⁷ This means a contractor must fashion its policies around minimums that confine immediate charging of capital acquisition and related costs above those minimums to a Government CAS-covered contract at the time of the acquisition as opposed to capitalization of that asset's acquisition costs (including costs of putting the asset into service) and spreading those costs out over the useful life of the asset as a depreciation expense. Any costs incurred subsequent to the acquisition of a tangible capital asset that extends the life of or increases the productivity of the assets, provided it meets the contractor's policy thresholds, will be capitalized but costs incurred for repairs and maintenance will be treated as costs for the current period (meaning they are immediately expensed). The import of this Standard is that it determines what can be expensed immediately and charged to a Government contract(s) in the current period vs. what must be capitalized with acquisition costs/expenses spread out over subsequent periods.

CAS 404-50 provides that the cost of a tangible capital asset includes the purchase price as adjusted by premiums and extra charges paid or discounts or credits received. Plus, costs necessary to prepare the asset for use include the cost of placing the asset in a location and bringing the asset to a condition necessary for normal or expected use – they are to be capitalized, not expensed as GAAP would allow. Thus, the amount chargeable to a Government contract(s) will be spread out over the years of the useful life of the asset as a depreciation expense in a particular future year rather than all charged as an expense in the year the expense was incurred. Costs may include general and administrative expenses, as the contractors complain, when those expenses are identified with an asset constructed or fabricated by a contractor for its own use and they are material in amount—this occurs when supervisory personnel expenses or other expenses normally chargeable as G&A are incurred in the fabrication or in putting the asset into service. CAS 404-50 also contains rules for valuation of tangible capital assets for business combinations accounted for under the “purchase method” of accounting or the “pooling of interest” method. CAS 404-60 provides illustrations of the rules published within CAS 404.

New IRS Safe Harbor rules relate to tangible property and to tax deductions and capitalization of fixed assets. The Safe Harbor rules that went to effect on January 1, 2014, are not absolute requirements in that businesses can have capitalization policies that differ from the Safe Harbor rules. Businesses simply risk having the IRS reject a non-complaint set of policies making the business subject not only to tax liability but also penalties, interest, and other negative consequences. There are two different Safe Harbors—one for businesses that have financial statements that are audited for other than tax purposes (“applicable financial statements”) such as SEC filings and those that do not. For those businesses with “applicable financial statements,” the business must, to fit under the Safe Harbor rule, have a capitalization policy that allows acquisitions to be expensed for assets that cost less than \$5,000 and/or have a useful life of less than 12 months. For the business without an applicable financial statement, under the new Safe Harbor rule, the capitalization policy allows acquisitions to be expensed if the assets cost less than

⁶⁷ CASB 9904.404-40(b)(4)—paragraph (b)(1) in the quote relates to Tangible Capital Assets..

\$500 and or if the assets have a useful life of less than 12 months.⁶⁸ These rules address the same issues as those found in CAS 404-40 and if businesses follow the IRS Safe Harbor thresholds they will be in compliance with CAS 404-40.

CAS 409 (Cost Accounting Standard—Depreciation of Tangible Capital Assets): CAS 409-20 is based on the premise that depreciation costs identified with specific cost accounting periods should be a reasonable measure of the amount of service life of tangible assets subject to depreciation.⁶⁹ CAS 409-30 contains definitions, similar to CAS 404-30, that are important to both GAAP and CAS, namely, residual value,⁷⁰ service life,⁷¹ and tangible capital asset.⁷² CAS 409-40 prescribes how the depreciable cost of a tangible capital asset is to be assigned to cost accounting periods.

The contractor opinion that the GAAP or IRS capitalization and depreciation rules should be followed instead of CAS, in addition to not mentioning the Safe Harbor rules summarized above, does not acknowledge that for computing estimated service lives of tangible capital assets for which the contractor has no available data or prior experience with similar assets, the CAS rule does in fact follow IRS rules and procedures.⁷³ The contractors commented that CAS 409 “implemented a requirement for contractors to maintain records to establish both the service lives of assets as well as the residual values and that this is an onerous requirement...” What is not referenced by the contractor that provided the quoted comment were the IRS rules that deal with depreciation of tangible capital assets.⁷⁴ To be allowed a depreciation deduction the taxpayer must (1) own the property (capital improvements are depreciable on property the taxpayer leases); (2) the asset must be used in a business or an income producing activity; and (3) the asset must have a determinable useful life of more than one year. Even if those conditions are met depreciation is not allowable for (1) assets placed in service and disposed of in the same year; (2) equipment used to build capital improvements (otherwise allowable depreciation must be added to the basis of the asset); and (3) certain term interests. Importantly, to claim depreciation

⁶⁸ See Dickinson, Mary E., *Are Your Tangible Property Capitalization Policies Subject to Challenge? IRS Publishes New Safe Harbor Rules*, Bader Martin CPA eNewsletter, January 19, 2014.

⁶⁹ “The purpose of this Standard is to provide criteria and guidance for assigning costs of tangible capital assets to cost accounting periods and for allocating such costs in cost objectives within such periods in an objective and consistent manner. The Standard is based on the concept that depreciation costs identified with cost accounting periods and benefiting cost objectives within periods should be a reasonable measure of the expiration of service potential of the tangible assets subject to depreciation. Adherence to this Standard should provide a systematic and rational flow of the costs of tangible capital assets to benefitted cost objectives over the expected service lives of the assets...”

⁷⁰ “...the proceeds (less removal and disposal costs, if any) realized upon disposition of a tangible capital asset. It usually is measured by the net proceeds from the sale or other disposition of the asset, or its fair value if the asset is traded in on another asset. The estimated residual value is a current forecast of the residual value.”

⁷¹ “...the period of usefulness of a tangible asset (or group of assets) to its current owner. The period may be expressed in units of time or output. The estimated service life of a tangible capital asset (or group of assets) is a current forecast of its service life and is the period over which depreciation cost is to be assigned.”

⁷² “...an asset that has physical substance, more than minimal value, and is expected to be held by an enterprise for continued use or possession beyond the current accounting period for the services it yields.”

⁷³ See CASB 9904.409-50(e)(4).

⁷⁴ See Internal Revenue Code Sections 162 and 263 along with IRS Internal Revenue Bulletin, *Guidance Regarding Deduction and Capitalization of Expenditures Related to Tangible Property*, dated April 2, 2012.

the taxpayer must identify (1) the depreciation method used; (2) the class life of the asset; (3) whether the property is “listed property;” (4) whether any part of the asset has been expensed; (5) whether the taxpayer qualifies for any “bonus” first year depreciation; and, (6) the depreciable basis of the asset. In short, there are significant record keeping requirements to comply with IRS rules and procedures, and they are not much different than the requirements of the CAS rules.

Adding to taxpayer confusion is the fact that the IRS has been changing rules and procedures for expensing vs. capitalizing amounts paid to acquire or produce tangible capital assets (see Safe Harbor rule above). On September 16, 2013, the IRS issued final regulations as well as proposed regulations regarding disposition rules and treatment of assets in a general asset account. The issue is much the same as the contractor comments address (i.e., expensing immediately material and supplies vs. capitalization of property and improvements and claiming depreciation expenses over a longer time horizon). The new regulations provide an election to substitute a taxpayer’s capitalization threshold (items expensed if they are under a certain dollar amount) in certain circumstances for the \$200 limit under the *de minimis* rules. The *de minimis* election is made annually, and the threshold maximum amount depends upon whether the taxpayer has a capitalization policy in place at the beginning of the year and whether the taxpayer has an applicable financial statement (see safe harbor discussion above). As stated above, if a taxpayer has an applicable financial statement, the maximum threshold is \$5,000; if the taxpayer does not, the threshold cannot exceed \$500.⁷⁵ But, the important difference is that IRS rules govern deductions allowable for Federal Income Tax purposes, GAAP governs preparation of contractor financial statements, and CAS governs what expenses are chargeable to Government CAS-covered contracts. The purposes are mutually exclusive though the financial and cost accounting rules and procedures may look very similar in common areas.

It is true that CAS 409-40 prescribes that “the depreciable cost of a tangible capital asset shall be the capitalized cost less its estimated residual value.” It further prescribes that “the estimated service life of a tangible capital asset (or group of assets) shall be used to determine the cost accounting periods to which the depreciable cost will be assigned,” and the gain or loss on the sale or other disposition of the asset will be assigned to the period that the sale or other disposition occurs. CAS 409 prescribes that the method of depreciation that a contractor uses for financial accounting purposes shall be used for contract costing unless the method does not reasonably reflect the expected consumption of services for a tangible capital asset (or group of assets) or the method is unacceptable for Federal Income Tax purposes. An accelerated method of depreciation is acceptable if the consumption of services are skewed toward the early years of service and a straight line method of depreciation is appropriate if the level of consumption is reasonably level over the service life of the asset or group of assets.

DCAA Auditing and Capitalization and Depreciation:

General: Chapter 8 of the DCAA Contract Audit Manual⁷⁶ is entitled Cost Accounting Standards. It begins with an explanation of the facts summarized in Section 3 above and thereafter describes

⁷⁵ Wood, Christian, J.D., *Implementing the New tangible Property Regulations*, Journal of Accountancy, February 2014.

⁷⁶ Dated October 24, 2013.

auditor functions beginning prior to contract award with an audit of a contractor's Disclosure Statement in concert with the Cognizant Federal Agency Official (CFAO).⁷⁷ FAR 30.202-6 provides that the procuring contracting officer (PCO) "shall" not award a contract until the CFAO has made a written determination that a contractor's or subcontractor's Disclosure Statement is adequate or if the agency head has authorized the award prior to the submission of the Disclosure Statement.⁷⁸

CAS 404 Auditing: Section 8-404 of the DCAA Contract Audit Manual provides guidance to auditors concerning CAS 404 auditing. It begins with a history of the CAS standard including the changes effected in 1996 to the capitalized value of tangible capital assets section⁷⁹ and the contractor's policy on minimum service life and minimum cost criteria section.⁸⁰ What the latter change did was change the dollar threshold from \$1,500 to \$5,000. Paragraph 8-404.1(c) addresses the concern in the contractors' comments about the capitalization of indirect costs, including G&A and cost of money when those expenses are identifiable with the constructed asset and are material in amount. This applies only to tangible capital assets constructed or fabricated for the contractor's own use. Contractors will not favor this provision, as the comments indicate, because under it, as detailed above, they will not be able to recover indirect costs, including G&A and cost of money, in the current fiscal year because the capitalized expenses will be recovered in subsequent years as a depreciation expense. Section 8-404 follows the format of CAS 404 and provides for auditors explanations of the Standard and illustrative examples of situations that comply with the Standard and those that do not.

⁷⁷ Defined at FAR 30.001 as the contracting officer assigned by the cognizant Federal agency to administer the CAS—the DCAA Contract Audit Manual at paragraph 8-104.1 identifies that CFAO as the cognizant Administrative Contracting Officer.

⁷⁸ FAR 30.202-6(b): "The contracting officer shall not award a CAS-covered contract until the cognizant Federal Agency official (CFAO) has made a written determination that a required Disclosure Statement is adequate unless, in order to protect the Government's interest, the agency head, on a non-delegable basis, authorizes award without obtaining submission of the required Disclosure Statement (see 48 CFR 9903.202-2). In this event, the contractor shall submit the required Disclosure Statement and the CFAO shall make a determination of adequacy as soon as possible after the award."

⁷⁹ Of note, the Manual outlines the history of CAS 404 as being effective initially on July 1, 1973, with amendments on February 13, 1996, to amend the capitalized values of tangible capital asset section ("The capitalized values of tangible capital assets acquired in a business combination, accounted for under the "purchase method" of accounting, shall be assigned to these assets as follows: (1) All the tangible capital assets of the acquired company that during the most recent cost accounting period prior to a business combination generated either depreciation expense or cost of money charges that were allocated to Federal Government contracts or subcontracts negotiated on the basis of cost, shall be capitalized by the buyer at the net book value(s) of the asset(s) as reported by the seller at the time of the transaction. (2) All the tangible capital asset(s) of the acquired company that during the most recent cost accounting period prior to a business combination did not generate either depreciation expense or cost of money charges that were allocated to Federal Government contracts or subcontracts negotiated on the basis of cost, shall be assigned a portion of the cost of the acquired company not to exceed their fair value(s) at the date of acquisition. When the fair value of identifiable acquired assets less liabilities assumed exceeds the purchase price of the acquired company in an acquisition under the "purchase method," the value otherwise assignable to tangible capital assets shall be reduced by a proportionate part of the excess.")

⁸⁰ "The contractor's policy shall designate economic and physical characteristics for capitalization of tangible assets. The contractor's policy shall designate a minimum service life criterion, which shall not exceed 2 years, but which may be a shorter period. The policy shall also designate a minimum acquisition cost criterion which shall not exceed \$5,000, but which may be a smaller amount."

CAS 409 Auditing: Section 8-409 is similar to Section 8-404 in that it follows generally the format of CAS 409. The changes to CAS 409 that were approved in 1996 were in the area of tangible capital assets transferred in a business combination—they relate to recapture of gains and losses on the disposition of the tangible capital assets that are transferred.⁸¹ Similar to 8-404, 8-409 follows CAS 409 and ends with illustrative examples of situations to which CAS 409 applies and what the auditor should look for, e.g., “Auditors at the seller location should be alert for contractors claiming a loss on disposition of assets as a result of a business combination meeting the provisions of CAS 404.50(d)(1) and question it, if claimed.”⁸²

⁸¹ “Gains and losses on disposition of tangible capital assets shall be considered as adjustments of depreciation costs previously recognized and shall be assigned to the cost accounting period in which disposition occurs except as provided in subparagraphs (j)(2) and (3) of this subsection. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds in the event of involuntary conversion, and its undepreciated balance. However, the gain to be recognized for contract costing purposes shall be limited to the difference between the original acquisition cost of the asset and its undepreciated balance. (2) Gains and losses on the disposition of tangible capital assets shall not be recognized where: (i) Assets are grouped and such gains and losses are processed through the accumulated depreciation account, or (ii) The asset is given in exchange as part of the purchase price of a similar asset and the gain or loss is included in computing the depreciable cost of the new asset. Where the disposition results from an involuntary conversion and the asset is replaced by a similar asset, gains and losses may either be recognized in the period of disposition or used to adjust the depreciable cost base of the new asset. (3) The contracting parties may account for gains and losses arising from mass or extraordinary dispositions in a manner which will result in treatment equitable to all parties. (4) Gains and losses on disposition of tangible capital assets transferred in other than an arms-length transaction and subsequently disposed of within 12 months from the date of transfer shall be assigned to the transferor. (5) The provisions of this subsection 9904.409–50(j) do not apply to business combinations. The carrying values of tangible capital assets acquired subsequent to a business combination shall be established in accordance with the provisions of subsection 9904.404–50(d).”

⁸² Extracted from 8-409.1(g).

4 Application of Earned Value Management

Purpose. Assess contractors' recommendations to improve DoD's application of EVM requirements and compliance reviews and surveillance of contractors' EVM Systems (EVMS).

Overview. This assessment of recommended changes to EVM is based on information provided by eight participating contractors, independent analysis by PARCA and IDA of statutory and regulatory intent and effects, and discussions with subject matter experts in the OUSD(AT&L)/Defense Contract Management Agency (DCMA), OUSD(AT&L)/Defense Procurement and Acquisition Policy (DPAP), OUSD(C)/Defense Contract Audit Agency (DCAA), and the National Reconnaissance Office (NRO).

As described in the Overview, this study's objective included soliciting contractors' perspectives on burdensome compliance requirements imposed by DoD and costs associated with those requirements. The Government team would then examine and conduct a cost-benefit analysis by attempting to quantify the Government benefit of such requirements. The concept was not that DoD would eliminate the requirement for EVMS compliance or EVM reporting on large programs, but would improve and streamline its application of EVM policies, procedures, and practices, based on quantitative cost data provided by contractors. In general, it proved difficult to obtain quantitative data associated with specific inefficiencies of DoD's application of EVM. Several firms told us that they do not collect EVM associated costs at such a fine level of fidelity. However, eight contractors presented over thirty recommendations for changes to DoD regulations and practices related to EVM application and EVMS compliance and review procedures. While a quantitative cost-benefit analysis of the contractors' recommendations proved infeasible, this assessment provides our considered recommendations on constructive changes DoD could implement to improve the efficiency of EVM implementation.

Changes proposed by the contractors were grouped into the following categories:

1. EVM reporting is often required on inappropriate contract types
2. Thresholds for EVM reporting and EVMS validation should be increased
3. DoD's EVMS surveillance is more rigorous than ANSI/EIA-748 guidelines require
4. DoD's implementation of EVM on individual programs is often overly burdensome

Section 4.2 provides the specific comments and recommendations submitted by the participating contractors (redundant comments have been consolidated).

Recommendations

EVM reporting is often required on inappropriate contract types:

We concur with contractors' assertions that EVM reporting is often required on inappropriate contract types. In particular, contractors mentioned level of effort (LOE), time and material (T&M), Performance Based Logistics (PBL), and labor hour contracts as types that are not appropriate for EVM reporting.⁸³

DoD should amend its EVM policies to clarify that EVM reporting is required on non-firm-fixed price contracts above the regulatory dollar threshold ***that have discrete, schedulable, and measurable work scope***.⁸⁴ Current DFARS policy prescribes that EVM reporting is required on cost or incentive contracts above the dollar threshold (currently \$20 million), but ***does not*** indicate that contracts that cannot be decomposed into discrete, schedulable, and measurable work scope should be excluded.

The PARCA EVM Division drafted a modification to DFARS stipulating that a contract must have discrete, schedulable, and measurable work scope to be subject to EVM reporting. This proposed revision is currently being vetted within DoD. Any resultant DFARS revision will follow the regulatory rulemaking process, including publishing the rule for public comment. Currently, DoD program managers can (and are encouraged to) request a policy deviation permitting them to waive EVM reporting when it is not beneficial.⁸⁵ However, DoD recognizes there are cases when deviations are appropriate but have not been requested. The proposed DFARS change should result in fewer instances in which DoD requires EVM reporting on inappropriate contract types.

Thresholds for EVM reporting and EVMS validation should be increased:

We concur with contractors' recommendations to increase the contract dollar thresholds that apply to EVMS validation and surveillance reviews and to provide more flexibility in application of EVM reporting to contracts above the current dollar threshold.

Currently, DFARS stipulates that for cost or incentive contracts and subcontracts valued at \$50 million or more, the contractor shall have an EVMS determined by the cognizant federal agency to be in compliance with ANSI/EIA-748 guidelines. DCMA implements this requirement for

⁸³ Program Management Offices and Procurement Contracting Officers are responsible for ensuring appropriate alignment of contract type with work scope and appropriateness of EVM reporting requirements. DCMA noted that mismatch between contract type and work scope is often a cause of EVMS compliance and reporting issues.

⁸⁴ Properly applying this criteria will require professionalism and astute judgment by Government and contractor acquisition personnel.

⁸⁵ The process to obtain a deviation and decision approval authorities are described in each Service Supplement (i.e. AFARS, AFFARS, NMCARS). For ACAT I programs, program offices should seek guidance from PARCA on deviation requests, while for ACAT II and below programs, the responsible Service or Agency EVM Focal Point should be contacted for guidance. As part of the advisory process PARCA or the Service EVM Focal works with PMO to determine appropriate deviation or tailoring through review of specific program data including work scope, contract value, reporting, program management practices, period of performances. The result of the advisory process is a memo documenting an opinion of concurrence or non-concurrence with the recommended approach that can be used to support the request to the Service decision approval authority.

DoD by conducting Compliance Reviews of contractors’ EVMS and annual System Surveillance⁸⁶ of approved systems. For cost or incentive contracts and subcontracts valued at \$20 million or more, DFARS stipulates that contractors’ EVMS shall comply with the ANSI/EIA-748 guidelines. DCMA implements this DFARS requirement by conducting annual System Surveillance of contractors’ EVMS.

The DFARS revision drafted by the PARCA EVM Division would establish a single threshold for Compliance Reviews and System Surveillance of \$100 million. Contracts between \$20 million and \$100 million would still be subject to EVM reporting, but surveillance reviews to determine EVMS compliance with ANSI/EIA-748 guidelines would be conducted **only** on an exception basis, e.g., when a contracting officer, program office, buying command or higher headquarters asks for DCMA assistance due to a concern about the quality of EVM data reported on a given contract. The proposed DFARS update would also stipulate that EVM reporting would apply to contracts with a period of performance of 18 months or more (the current standard is 12 months). Figure 4.1 shows that increasing the threshold for Compliance Reviews from \$50 million to \$100 million would decrease the number of contractor sites reviewed by nearly 20 percent (from 142 to 114), but only reduce the value of the contract dollars covered by 2.3 percent, compared to what is currently covered (from \$260 billion to \$254 billion).

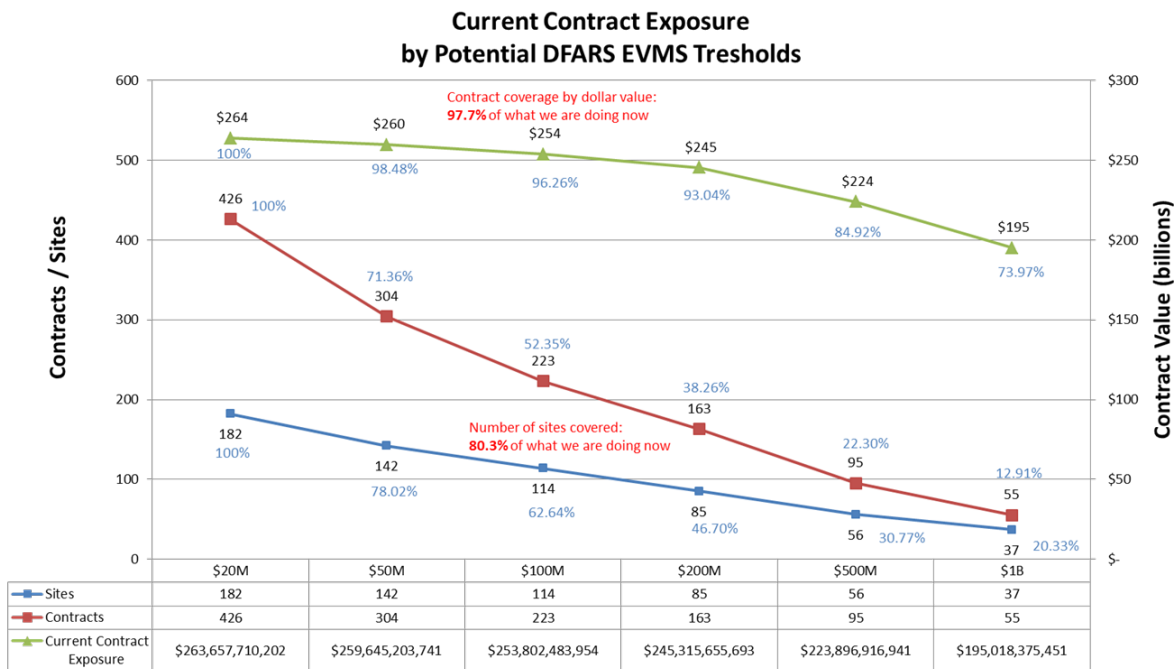


Figure 4.1 Contract Exposure, Number of Contracts and Sites based on contracts subject to EVM reporting

⁸⁶ System Surveillance provides a continuing assessment of the application of contractor processes and procedures to ensure the 32 ANSI/EIA-748 Guidelines are being followed and is applied to all contracts over \$20 million. The outcome of surveillance ensures reported contract performance data accurately reflects the status of programs and can result in a CAR for system disapproval if there are significant deficiencies on a contract over \$50 million. No system determination is made for contracts below \$50 million.

DoD's EVMS validation and surveillance is more rigorous than ANSI/EIA-748 guidelines require:

We concur with the contractors' comments that EVMS validation and surveillance as implemented is more rigorous than the ANSI/EIA-748 guidelines require.⁸⁷

DCMA has recently conducted an EVMS pilot project (Data Driven EVMS Compliance) whose goals include eliminating disconnects between surveillance reviews and compliance reviews and providing guidance to DCMA regions and contractors on expectations for such reviews. This effort, described in further detail in Section 4.3, is expected to reduce uncertainty that currently exists concerning the requisite standards required for a contractor's EVMS system to be validated. The Data Driven approach will provide DCMA a new capability to remotely test a contractor's EVMS data, thus eliminating the need for multiple DCMA interviews and assessments (and the labor and costs associated with numerous Government personnel in a contractor's plant), which should result in significant cost savings for DCMA and industry. DCMA is currently drafting a standard list of attributes, test steps, test metrics, and artifacts required to formally validate a contractor's EVMS.⁸⁸ DCMA is also revising policies and CONOPs to streamline its EVMS mission (Compliance, Surveillance, and Analysis) in concert with its other two DFARS Business Systems missions (Property Systems and Purchasing System Reviews) to present a single face to its customers.

Several comments addressed overly burdensome aspects of EVMS implementation that might be mitigated by reducing EVMS-related audit activities now performed by DCAA.⁸⁹ This is not because DCAA auditors are doing a poor job—but instead because determining compliance of a contractor's EVMS to ANSI/EIA-748 guidelines could be accomplished through alternative validation methods. For example, if a contractor's accounting system has already been validated, that might suffice to satisfy several ANSI/EIA-748 guidelines (such as 16-21 and 30).^{90,91} We therefore recommend that DCMA revise their policies to assume sole responsibility for conducting Compliance Reviews of contractor's EVMS based on all 32 ANSI/EIA-748 guidelines in accordance

⁸⁷ See Section 4.1 for specific examples provided by contractors.

⁸⁸ The DCMA Instruction document will be based on the DoD EVMS Interpretation Guide (EVMSIG), which was issued on March 9, 2015. The EVMSIG provides basis for DoD to assess EVMS compliance in accordance with ANSI/EIA-748 Guidelines. It was developed in collaboration with EVMS experts from the Office of the Secretary of Defense and DoD organizations responsible for conducting EVMS compliance reviews (i.e., Defense Contract Management Agency, Intelligence Community, Navy Shipbuilding, and Defense Contract Audit Agency).

⁸⁹ DCAA noted that their current process is based on collaboration between DCMA and DCAA. The collaboration considered the skill sets of both agencies. Out of the 32 guidelines, DCAA EVMS audits are limited to the 8 guidelines that are mainly classified as accounting and as such should be performed by DCAA. DCMA establishes the surveillance schedule. DCAA participates only when the DCMA scheduled review covers one of the 8 guidelines. DCAA performs audits of the 8 guidelines using a risk-based approach that results in a well-supported position for the Department.

⁹⁰ DCMA noted that financial attributes of the accounting system can be obtained through DCAA audits of the accounting business system. They further noted that functionality for management purposes of the accounting guidelines can be readily assessed by DCMA as part of its testing protocols.

⁹¹ DCAA disagrees that a compliant Accounting System would satisfy ANSI-748 guidelines. Although the Accounting System and EVM system are integrated, they have separate management systems, processes, operating procedures and the DFARS criteria for each system are different (i.e., accounting system has 18 criteria and ANSI-748 has 6 accounting guidelines specific to the EVM system). Therefore, DCAA's audit of an accounting system would not provide evidence that the contractor is complying with the EVMS DFARS criteria or the incorporated ANSI-748 guidelines.

with DCMA validation procedures, leveraging streamlining efforts that have been achieved through the Data Driven EVMS Compliance pilot project.

DoD's implementation of EVM on individual programs is often overly burdensome:

Contractors provided various recommendations to reduce the burdensome manner in which DoD implements EVM reporting on individual contracts. We assess that the most significant change DoD could make to reduce costs of EVM reporting, would be to accept, insofar as possible, the contractors proposed control account structure, rather than demanding higher fidelity (i.e., lower levels of control accounts). Similarly, it is inappropriate for DoD to require cost details, Variance Analysis, and computation of Estimates At Completion at levels below the control account (e.g., work packages).

Traditionally, the Work Breakdown Structure (WBS) DoD requires has driven the number of control accounts established for the contract.⁹² The WBS governs not only the EVM reporting structure, but also the structure for Cost and Software Data Reports (CSDRs) required on contracts valued at more than \$50 million. Demand for lower-level WBS detail has traditionally led to increased and potentially excessive numbers of control accounts. EVM Reporting and CSDR Reporting are for different purposes and cost reporting requirements should not drive the level of the WBS used for program management purposes.⁹³

As a result of this study, on June 18, 2015, the Director of PARCA released EVM policy guidance on the “Level of Detail Required on Contract for EVM Reporting.” This memo, shown in Section 4.4, states that “Program Offices should only require EVM data to a level that maintains the cost effectiveness of the reporting, targets strategic areas, and aligns with how the program is managed. Too much detail in reporting will slow down the review, response, and strategic utility of the data, and potentially detracts from the agile nature needed for proactive Government decision making.” It further states that “collection of cost data for cost analysis purposes should not drive the level of detail for EVM reporting.”

PARCA EVM Division is currently coordinating with OSD/CAPE to define a joint EVM/CSDR data requirements review policy, which is intended to ensure the appropriate EVM and cost reporting

⁹² PARCA/EVM Division noted that suppressing the demand for increased number of control accounts will require education of Government program managers to ensure they understand DoD EVM policy and requirements and the negative effects of requiring detail more excessive than that required to effectively manage the program.

⁹³ Contractor stated: “Utilization of MIL-STD-881 for use as one of the two major structural attributes for performance reporting is not effective for all EV implementations. Both the Government and suppliers are interested in the most relevant method of organizing the scope of work and its sub-division into manageable blocks, mods that can be logically related, budgeted and scheduled and is critical for the effective management of programs...Requiring the use of MIL-STD-881 by a supplier in addition to the attributes for control accounts necessary to enable the system adds a multiplicative impact to the number of control accounts, complexity in the management system and costs in its effective execution...System attributes of MIL-STD-881 will be of marginal relevance to management discussions, will add little management value, and what benefit they do provide could easily be provided in the form of historic cost reports through cost and software data reporting (CSDRs that are generally acknowledged to appropriately apply MIL-STD-881) rather than by constructing a burdensome performance management view around an attribute structure for population of performance management data in monthly contract data requirements list (CDRL) submittals.”

level of detail is included in Request for Proposals. Currently, the CSDR plans required by the cost estimating community specifies a WBS that identifies data elements for cost reporting that are typically at a greater level of fidelity than required for EVM. As a result, contractors structure their EVMS with additional detail to support cost reporting requirements by creating control accounts (which is the level at which resources are mapped to work scope and managed). Creating additional control accounts results in non-value added effort to manage to the EVMS. PARCA EVM Division and OSD/CAPE have initiated efforts to address this problem, with a goal to recommend policy that can be signed out jointly by USD(AT&L) and Director, CAPE.

Recently, the NRO worked with contractors to establish WBS and cost reporting structures that provide the information required by DoD without the need to establish control accounts at the lowest WBS level. Contractors may be able to provide the cost information required by DoD from their internal systems without establishing excessive control accounts.⁹⁴ We recommend that NRO's approach be considered for implementation by other DoD buying commands.

- We concur with contractor's recommendations that EVM performance metrics should not be used as either award fee criteria or performance incentives.⁹⁵
 - Paragraph 2.5.3.2 of the October 2006 DCMA EVM Implementation Guide currently states: "While it seems obvious that earned value metrics, such as variances or indices, seem tailor made to provide incentives to the contractor in an award fee environment, experience shows otherwise. Using metrics such as cost or schedule variances, cost or schedule performance indices or VACs to measure performance for award fee purposes should be avoided."
 - **We recommend that OUSD(AT&L)/DPAP consider providing policy guidance to contracting officers that using metrics such as cost or schedule variances, cost or schedule performance indices, or VACs to measure performance for award fee purposes is inappropriate and therefore prohibited.**
- We concur with contractor's assertion that it is inappropriate for DoD contracting officers to ask contractors to move budget from control accounts that have under-runs and apply this budget to new work. We agree that this practice threatens the integrity of the contractor's EVMS and that it is inappropriate for DCMA to sanction the contractor for a non-compliant

⁹⁴ NRO has successfully collaborated with industry partners to establish an extended Contract WBS that is consistent and traceable with the Space WBS down to level 5, while still allowing the contractor and DoD to establish control accounts at the level they jointly determine to be most effective (often at levels 3 or 4 of the Space WBS). Traceability to Space WBS level 5 products for cost reporting purposes is supported by using charge numbers or other means rather than forcing control accounts to be established at too low a level. If, for instance, a contractor and DoD program officers agree to a control account at the subsystem level (e.g., WBS level 4 to be consistent with how the contractor plans and manages work commercially), NRO still obtains insight into contractor costs using charge numbers which remain consistent and traceable with the Space WBS in MIL_STD 881c, i.e., WBS level 5.

⁹⁵ Contractor stated: "inclusion of EVM-related metrics and criteria for contract Award Fee and incentive provisions should be eliminated once and for all. It is currently discouraged but still exists on a limited basis. The Government is already aware of the potential for abuse and should take steps to prevent further instances. [Our company] recommends that a revision be made to the DFARS that forbids the use of EVM performance metrics as either award fee criteria or as performance incentives."

EVMS as a result of such Government-directed changes.⁹⁶ We agree with contractor's assertion that "the contractor cannot be expected to resist its customer and undermine its programs in order to enforce compliance interpretations" (for EVMS). Proper contract change procedures to obligate and de-obligate work scope on contracts should be followed by Government contracting officers. DoD Program Offices should be familiar with the contractor's EVMS System Description and not ask for things that require the contractor to fail to comply with their documented EVMS processes and procedures.⁹⁷

- The EVMS Interpretation Guide (EVMSIG) emphasizes that work scope tied to budget and control of retroactive changes for completed work is imperative to maintain validity of EVMS data. Per Section 6.3, Guideline 30, "controlling retroactive changes to budgets or costs for completed work maintains the validity of historic Earned Value Management System (EVMS) cost and schedule variance trends and reflects true program performance."
- **We recommend this issue be addressed in the curricula of DAU PM and EVM courses so that Program Managers, Contracting Officers, and Financial Managers are aware of DoD policies on transferring of budget between control accounts.**
- We confirmed contractor's assertion that contractor's requests to formally reprogram a contract using the over target baseline/over target schedule (OTB/OTS) process have sometimes been denied by DoD buying commands when such a reprogramming is warranted. In particular, we learned from EVM practitioners that some commands avoid formally reprogramming contracts to avoid providing explicit evidence of contract cost overruns. DoD's OTB and OTS Guide⁹⁸ provides guidance on when formal reprogramming should occur, but the decision whether to reprogram rests with the buying command, and requires good judgment. The Guide states:

The contractor should continually analyze performance data and compare the estimate of cost for the remaining work to the remaining baseline value. Recognition of a significant projected cost overrun or inability to achieve schedule

⁹⁶ DCMA concurred that it is inappropriate for DoD contracting officers to ask contractors to move budget in this way. They noted that the integrity of EVMS compliance and EVM reporting rests on the ability of the EVMS to record actual performance of a control account. They further noted that it is concerning when program offices and PCOs direct contractors to do things that materially violate the basic terms and tenants of the EVMS Description. Oftentimes, contractors are unwilling to confront these situations for fear of alienating themselves from their customer and risking consequences of an EVMS violation. Contractors should have the ability to freely communicate concerns without retribution. Program Offices and PCOs should be concerned when a contractor is asked to do things that have the potential to place them at odds with DFARS regulations.

⁹⁷ David Kester, Director for Earned Value Management Policy and Strategy at DCMA, succinctly addresses this issue in an article on Data Driven EVMS Compliance accepted for publication in *The Measurable News*, The Magazine of the Performance Management Institute's College of Performance Management: "an example of an unacceptable change is when a contractor retroactively reduces a performance value previously reported to equal the actual costs incurred, and then transfers the resulting budget for the effort to other activities that are overrunning. Even though this may be undertaken at the prompting of the program office, this translates to mean a funding underrun (placed against the next emerging issue) rather than a measure of performance. As a result, these changes often have a material impact on reported values and go uncontrolled as negative BCWS, BCWP and ACWP."

⁹⁸ Over Target Baseline and Over Target Schedule Guide, published by OUSD(AT&L) PARCA, December 5, 2012, located at: <http://www.acq.osd.mil/evm/docs/OTB-OTS%20Guide%20121205.pdf>

may indicate the need to consider formal reprogramming. The overarching factor is an assessment that the current Performance Measurement Baseline is not achievable. Other considerations are the projected use of Management Reserve.

- **We recommend this issue be addressed in the curricula of DAU PM and EVM courses so that Program Managers, Contracting Officers, and Financial Managers are aware of DoD policies and best practices on formal reprogramming via OTB and OTS.**
- We concur with contractor’s assertion that it is inappropriate to conduct Integrated Baseline Reviews (IBR) with less than 3 months or 25 percent of work remaining. However, DoD policy states that the IBR should be conducted within 180 calendar days of contract award.⁹⁹ Discussions with contractors and EVM practitioners revealed that the problem contracts in which IBRs are conducted late are most likely Undefined Contract Actions (UCAs), for which the buying command is reluctant to conduct an IBR until the contract is definitized. However, since DoD resources are being expended and work is being performed on UCAs, buying commands should ensure that IBRs are conducted well before the majority of work on the contract has been completed.
- We concur with multiple contractors’ objections that different DCMA examiners have different standards with respect to the permissible amount of level of effort (LOE) associated with a contract subject to EVM reporting.¹⁰⁰ Contractors claimed not only that examiners have different standards, but that the assertion adopted by some examiners that a contract have no more than 20 percent of LOE is arbitrary and inappropriate for some contracts.¹⁰¹
- We concur with multiple contractors’ recommendations that DCMA establish clear, consistent definitions and application of Corrective Action Requests (CARs) and significant deficiency assessments. We recommend that DCMA establish descriptions and examples for the meaning of “Significant Deficiency” specific to EVMS validation and surveillance.^{102,103}

⁹⁹ DoD Instruction 5000.02, January 7, 2015, Enclosure 1, Table 8. EVM Requirements.

¹⁰⁰ DCMA also concurred that significant inconsistencies exist both with the DCMA EVMS validation process and ongoing surveillance. They noted that these inconsistencies are expected to be corrected with release of specified guideline testing protocols, as described in Section 4.3. However, they also noted that an excessive use of LOE provides no value in the context of an EVM methodology. If high levels of LOE exist than perhaps the wrong contract type is being administered by the PMO for the level of risk being incurred.

¹⁰¹ One contractor stated “when being cited for “too much” LOE, [our company] has attempted to work with DCMA to develop valid measures for any of the LOE efforts. This is necessary since [our company] would have measured the work in the first place if we thought it to be legitimate. Without a mutual understanding of how various tasks will be validly measured, [our company] incurs the risks of questionable measurement and distortion of schedule relationships. It is frustrating when a request for specific dialogue on which/how current LOE work should be measured is rebuffed with direction to simply meet the pre-determined percentage. It is beyond frustrating when [our company] changes LOE to measured effort to satisfy one audit only to be sanctioned for performing invalid measurement by a later audit team.”

¹⁰² One contractor stated “Site EVM surveillance yields numerous Level I CARs for what amount to minor data conditions that do not bear on the ability of the program to use the EVM data to make management decisions... DCMA effectively ended the joint surveillance process with the advent of the Standard Surveillance Operating Manual (now Standard Surveillance Instruction and Plan) which mandates all findings to be written up as at least a Level I CAR. It states ‘If deficiencies are found during the course of the surveillance process it is the surveillance team’s responsibility, working through the EVM Center, to issue a written Corrective Action Request (CAR). All EVM, EVMS, or other Earned

- Some contractors recommended that DoD should more extensively utilize its authority to apply EVM preferentially to individual Contract Line Item Numbers that are discrete, schedulable, and measurable in cases in which the contract on the whole is not appropriate for EVM reporting. However, this is already currently DoD policy as expressed in the October 2006 DCMA EVM Implementation Guide.¹⁰⁴ Furthermore, one contractor, and some DoD EVM SMEs asserted that handling CLINs separately can make EVM reporting more burdensome, not less. **We conclude that DoD policy already addresses this issue, but program officials must use good judgment when deciding whether to treat CLINs differently for EVM reporting within a given contract.**
- Multiple contractors asserted that requiring EVM to be based on MIL-STD-881 WBS is inappropriate for shipyards (because of their different management structure). PARCA, DCMA, and Navy officials conducted discussions on-site at one shipbuilder's facility and determined that this issue has been resolved – the EVMSIG issued on March 9, 2015, allows for alternative product oriented structures like the Extended Ship Work Breakdown Structure.
- Multiple contractors asserted that shipbuilding contractors should be allowed to report control account earned value in labor hours rather than costs since their control account budgets are so organized. PARCA, DCMA, and Navy officials conducted discussions on-site at one shipbuilder's facility and concluded that EVMS criteria and attributes described in the recently published EVMSIG may provide such flexibility, but needs to be tested on a contractor's EVMS. **PARCA and DCMA recommend that DCMA conduct a pilot EVMS validation review at contractor's site to determine if contractor's current management system and reporting approach satisfies DoD's needs.**¹⁰⁵

Value related discrepancies, no matter how minor must be documented on a written CAR and address at a minimum the severity level of consequence if not corrected, and appropriateness of supplier corrective actions.' This overly-restrictive directive removes any discretion from the reviewer and compels initiating a stream of paperwork to address matters that were previously corrected real time through joint directive and follow up... Current CAR policy is overly rigid and results in unnecessary paper churn for the contractor and Government alike for Level I CARs. There is also insufficient consistency of definition between Levels II and III arising from a failure to consider the consequences of findings based on their significance and likelihood to impact management decision making...[Our company] believes the blurred line between Level II and Level III CARs has resulted in Level III CARs being issued prematurely."

¹⁰³ DCMA noted that better descriptions and examples of "Significant Deficiency" will be provided in their "Data Driven EVMS Compliance Protocols" described in Section 4.3.

¹⁰⁴ "...The following general guidance applies in this circumstance (mix of contract types): limit reporting to what can and should be effectively used. In some cases, it may be advisable to exempt portions of the contract from CPR or IMS reporting, if they do not meet the overall threshold or contract type criteria. Normally, different contracting types are applied to different contract line item number (CLIN) items, and these can then be segregated within the WBS. Each portion of the contract that falls under a different contract type should be evaluated separately for EVM implementation, including CPR or IMS reporting..."

¹⁰⁵ DCMA stated that allowing shipyard contracts to report labor hours rather than costs (when their control account budgets are so organized) is problematic. The fact that shipbuilding CAMs would not have knowledge, authority, or even understanding of costs (dollars) of their control account budgeted hours is contrary to EIA Standards and sets a bad precedent for other sectors. DCMA addressed this issue several years ago with the Navy and met them halfway by requiring CAMs to at least have awareness and understanding of costs (namely for EAC projections) for the hours budgeted and expended within a control account. DCMA articulated this concern in the DCMA-NAVY EVMS Amplifying Guidance signed by the DCMA Director and Navy Acquisition Executive. Senior DCMA and Navy leaders

- Multiple contractors asserted that during surveillance of contractors EVMS, DCMA requires contractors' ERP/MRP systems to achieve uniform and complete equivalence with the EVMS data, which they assert is technically unrealistic and unnecessary for a properly functioning EVMS.^{106,107} PARCA, DCMA, and Navy officials conducted discussions on-site at one shipbuilder's facility and determined that this issue has been resolved – the EVMSIG issued on March 9, 2015, provides clearer criteria and attributes that should prevent expectation that ERP/MRP systems are entirely replicated in the EVMS scheduling system.
- **DoD should enforce policy on capturing contractor actual costs associated with EVMS reporting in the "Data" section of the WBS. This would enable DoD customers to better weigh the costs vs. benefits of EVM associated activity and better tailor EVM reporting in the future.**

In parallel with this study, the Joint Space Cost Council (JSCC)¹⁰⁸ recently completed a study on "Better EVM Implementation," based on contractor surveys. A summary of themes and recommendations from their study are provided in Section 4.5. The full report, *Better EVMS Implementation: Themes and Recommendations*, is available at:

<http://www.acq.osd.mil/evm/docs/JSCC%20Better%20EVM%20Implementation%20%20Recommendations%2015%20April%202015.pdf>

DCMA noted that industry deficiencies are in part responsible for unnecessary EVMS costs. DCMA noted that industry's record on effectively implementing EVMS has not changed much from the assessment in DoD's 2009 Report to Congress on EVM. Section 4.6 provides an excerpt from this report, the full text of which is available at:

https://acc.dau.mil/adl/en-US/329976/file/47235/EVM_Report_to_Congress.pdf

agreed that a CAM should have an awareness of cost. Some (but not all) shipbuilders and some influential Navy EVM practitioners still argue that an understanding of cost is unnecessary. DCMA disagrees, reasoning that a CAM's responsibilities are for scope, cost, schedule, and technical performance.

¹⁰⁶ One contractor stated: "Government requirements imposed, from interpretation of EV principles, do not reflect balanced cost-benefit expectations for the integration of effective EVM system implementations. Large scale heavy manufacturing of complex ship systems require the use of enterprise resource planning and manufacturing resource planning (ERP/MRP) systems for detailed process enablement, management of critical resources, material procurements and the shop floor and deck plate execution level. The utilization of EVMS provides a valid and rigorous top level summary representation effective in the establishment and sustainment of Performance Measurement Baselines, logic sequences for scopes of work, accurate performance achievement metrics, and viable future forecasts upon which controls, analysis, and aggressive management action can be effectively applied. The expectation that these principles can be uniformly and universally applied down into the ERP/MRP systems to achieve absolute equivalence, compliance and alignment in every respect with the higher level system continuously over time exaggerates the possibilities of technology, discounts the necessity of human analysis of the complex factors in the planning and execution process, and disregards the cost in terms of time, money and effort."

¹⁰⁷ DCMA stated they concur with the contractor's assertion and noted that the subject is to be addressed during the development of Ship EVMS testing protocols. They further noted that ERP/MRP is a system within the larger EVMS context and data from this system is not expected to be entirely replicated in the scheduling system.

¹⁰⁸ The JSCC is a body consisting of industry and Government cost estimating leaders that was established by the Aerospace Industries Association Executive Space Board of Governors in 2007 to address mutual issues in space cost estimation and Earned Value Management.

4.1 Actions Directed by USD(AT&L)

As a result of this study's recommendations on DoD application of EVM, USD(AT&L) directed the following actions in the BBP 3.0 Implementation Directive dated April 9, 2015:

OUSD(AT&L)/PARCA will submit revisions to the DoD FAR Supplement that (1) adds work scope as a criteria to whether a contract should have EVM reporting, and (2) establishes a single threshold of \$100 million for DCMA compliance and surveillance reviews of EVM systems by May 2015.

DCMA will expand "Data-Driven EVM Systems Streamlining Pilot" to conduct streamlined compliance reviews and system surveillance at three additional contractor facilities by October 2015.

DCMA will provide an actionable plan to assess the benefits of streamlining its EVMS operations and centralizing its EVMS competency to improve consistency of EVMS implementation by September 2015.

In addition, USD(AT&L) directed the following EVM-related actions:

- DCMA initiate an EVMS pilot of a shipbuilding contractor's EVMS to determine whether existing contractor management systems and organizational structures adhere to tenants of the EVMSIG.
- OUSD(AT&L)/PARCA provide policy guidance concerning optimal level of EVM control account reporting required for program execution situational awareness and decision making. This was completed with release on June 18, 2015 by Director, PARCA of a memorandum entitled: "Level of Detail Required on Contract for Earned Value Reporting."
- OUSD(AT&L)/PARCA provide policy guidance on conducting Integrated Baseline Reviews. This was completed with release on July 20, 2015 by Director, PARCA of a memorandum entitled: "Guidance for Integrated Baseline Review."
- OUSD(AT&L)/PARCA provide policy guidance stipulating that in order to maintain a proper EVM contract budget baseline, excess funds as a result of under-runs in control accounts may not be applied to changes in work scope. This was completed with release on August 24, 2015 of a memorandum entitled: "Application of Excess Funds on an Earned Value Management Contract."
- OUSD(AT&L)/PARCA provide policy guidance that using metrics such as cost or schedule variances, cost or schedule performance indices, or Variances at Completion to measure performance for award fee purposes is inappropriate.
- OUSD(AT&L)/PARCA provide policy guidance on formal reprogramming to address cases in which the performance measurement baseline no longer realistically reflects work scope and schedule.

4.2 Contractors' Comments and Recommendations on Earned Value Management

<i>EVM reporting is often required on inappropriate contract types</i>	
1	EVM is being applied mandatorily in contracts to establish a performance management baseline over performance based logistics, level of effort, fixed price level of effort, time and materials, and labor hour contracts that are not susceptible to measurement based upon exit criteria. (multiple contractors)
2	Automatic flow-downs of EVMS requirements to subcontractors without consideration of the effort of the subcontractor (T&M, LOE, etc.) based solely upon contract type, and not risks, is a misapplication of EVMS.
3	EVM reporting should not be required on contracts less than \$20 million without a documented risk analysis to support the burden of cost on that contract of EVMS.
4	For Engineering Services contracts... the buying command requires the flexibility to add scope to the delivery order without increasing the price. This type of event results in a deviation of EV guidelines in that variances are being reset in order to "harvest" budget to support these additional requirements, which are being added with no change to the contract price. In order to support this type of re-planning, the result is significant manual rework and the establishment of a new Performance Plan baseline which is often delayed while the IPTs agree upon the newly revised statement of work per the approved contract language... the cumbersome process which is required in order to provide the flexibility which the customer desires, results in spending about 25 percent of the BAC on reporting and re-planning of these efforts.
5	The Low Rate Initial Production contract, although it is a production representative project, based upon its requirement to meet the DFARs flow-down is treated as if it were a full development project... When the scope content of the overall LRIP effort that is being evaluated is taken into account; it does not seem to make a valid business case other than meeting a contract flow-down requirement to use full criteria EVMS reporting for this type of effort.
6	Advance Acquisition Contracts (AAC) often referred to as long lead contracts are not seen as receiving benefits from the use of an Earned Value Management System... the recommendation is to exclude EVMS from AAC contracts and to provide CPR Format 1style report with ACWP only until receipt of UCA or Definitized contract.
<i>Thresholds for EVM reporting and EVMS validation should be increased</i>	
7	The current EVM \$50 million and \$20 million thresholds have not changed and should be raised to \$200 million (requiring DCMA Implementation Reviews) and \$50 million (not requiring DCMA Implementation Reviews). (multiple contractors)
<i>DoD's EVMS surveillance is more rigorous than ANSI/EIA-748 guidelines require</i>	
8	EVM compliance audits have become fixated on accuracy of financial data reporting and minor errors and not the underlying usability of the data to serve the management needs of Program Managers. (multiple contractors)

9	The increase in cost and burden to programs is driven primarily by the external reporting requirements, the increased rigor necessary to demonstrate compliance to the ANSI/EIA-748 EVMS Guidelines, and the increased resources required to support regular Joint Surveillance Audits (JSA).
10	Corrective Action Reports are being issued by DCMA while the definition of a “significant deficiency” and its consistency with defined Corrective Action Report levels (I, II, & III) is unclear, and results in acceleration of CAR level actions that affect the contractor adversely through, for instance, revocation or denial of site certifications and/or imposition of business system withholds which affect cash flow, namely each Hub follows a different definition of a “serious deficiency,” CARs are being issued without explanation, and Level III CARs are being issued prematurely. (multiple contractors)
11	Joint Surveillance Audits are too frequent and JSAs and CARS are often not focused on material issues. The frequency of JSAs is driven by a system that annually reviews all 32 ANSI/EIA-748 EVMS Guidelines across all Contractor sites, regardless of the number of programs at the specific site or the risk profile of those programs. This results in instances where a single, small program with minimal risk may be subject to JSAs on a monthly basis every year. (multiple contractors)
12	Site EVM surveillance makes no distinction between minor shortcomings and major deficiencies. (multiple contractors)
13	During EVM reviews, contractors are being required by DCMA to create and retain documentation unrelated to the contractual statement of work and to satisfy downstream reviews of process, including work authorization, budget authorization, determination of earned value, variance analysis, and maintenance of estimates at completion, thereby requiring the contractor to pay to increase the EVM business system’s functionality to retain historical artifacts that have no business purpose beyond the current period and/or to create or modify documents to support valueless traces, as well as to train control account managers to conduct the traces or to explain and justify activities from past time periods. (multiple contractors)
14	Large scale heavy manufacturing of complex systems require the use of enterprise resource planning and manufacturing resource planning (ERP/MRP) systems for detailed process enablement, management of critical resources, material procurements and the shop floor execution level. The utilization of EVMS provides a valid and rigorous top level summary representation effective in the establishment and sustainment of Performance Measurement Baselines, logic sequences for scopes of work, accurate performance achievement metrics, and viable future forecasts upon which controls, analysis, and aggressive management action can be effectively applied. The expectation that these principles can be uniformly and universally applied down into the ERP/MRP systems to achieve absolute equivalence, compliance and alignment in every respect with the higher level system continuously over time exaggerates the possibilities of technology, discounts the necessity of human analysis of the complex factors in the planning and execution process, and disregards the cost in terms of time, money, and effort. (multiple contractors – but one contractor asserted this has been resolved)

15	During the execution phase of an LRIP contract, there is a significant amount of effort spent monthly in re-pegging MRP requirements to the development reporting WBS from the production WBS in order to meet contractual reporting requirements. The re-pegging process, along with the monthly reconciliation of MRP “soft peg” movement of parts to determine if de-performing is required on the activity status, results in an inordinate amount of time to provide quantifiable backup which support the monthly MRP movement. This type of parts movement is complex and difficult to explain without going into significant detail as to where the requirements changed as of a particular point in time and provide an accurate trace of the process when requested at month-end. This also has to be explained monthly as part of variance analysis flow-down at the control account level and CPR reporting level. At times during the monthly System Surveillance Plan with the DCMA/DCAA, additional effort is required to address RFIs that are received requesting information on the de-performance of parts based upon MRP pegging changes that are within the contract but reflect movement between IPTs (ex- Dynamic components to Spares). The contractor has had to spend during the past SSP and compliance review more than \$500,000 to walk through and trace the movement of parts from the Production Bill of Material to the Development Bill of Material in order to demonstrate compliance to EVMS guidelines. It is estimated that during the life of an LRIP contract, several million dollars will be spent in order to meet EVMS reporting requirements with limited return for the investment since visibility into MRP execution can be derived by using alternate reporting tools.
16	The American National Standards Institute (ANSI) EVM guidelines, as currently interpreted and applied by the oversight agencies, are essentially “one size fits all” more suitable to conventional acquisitions. By not giving full recognition to these unique aspects and structuring EVM requirement accordingly, the requirements and benchmarking standards as currently applied tend to require extensive analysis, rationale, and justification whenever elements fail to demonstrate consistent, strict adherence to such benchmarks. This invariably leads to additional costs to generate explanations, without commensurate benefit.
17	There is no accountability for or visibility into costs that either the respondent contractor or the Government must incur for EVMS validation and surveillance reviews. (multiple contractors)
<i>DoD’s implementation of EVM on individual programs is often overly burdensome</i>	
18	Excessive quantity of Control Accounts (multiple contractors)
19	EVM should be applied on a CLIN-by-CLIN basis rather than to a contract as a whole. (contractors had differing views – some believed this would increase burden)
20	If a contractor transfers sites for contract execution, the gaining site should be able to transfer the losing site’s EVM approval with the contract subject to on-going surveillance.
21	Inclusion of EVM-related metrics and criteria for contract Award Fee and incentive provisions should be eliminated once and for all. It is currently discouraged but still exists on a limited basis. The government is already aware of the potential for abuse and should take steps to prevent further instances. We recommend that a revision be made to the DFARS that forbids the use of EVM performance metrics as either award fee criteria or as performance incentives.

22	The DCMA expectations on the permissible amount of level of effort on a contract vary widely with each examiner who applies his/her personal standard and challenge the assertion that all contracts must be at least 20 percent (or some other amount) measured without regard to the type of work performed.
23	System Program Management Offices are under pressure to refine or add technical requirements to weapon systems but not having monies for new contract scope often ask contractors to move budget from control accounts which have under-runs and apply the past budget to the new work without contracting officer authority to violate EVM compliance requirements. (multiple contractors)
24	The PMO should be able to structure its data requirements (CPR or IPMR) without imposition of IBRs, DCMA surveillance, or removal of flexibility within a program.
25	Employment of contract types appropriate for low-risk acquisitions to above and below threshold acquisitions and then requiring EVM because of high risk is contradictory.
26	Contracting officers should have the discretion to tailor EVM reporting to fit particular conditions to streamline EVM to levels commensurate to corresponding management value. (multiple contractors)
27	Significant differences in level of reporting required between CPRs, CCDRs, and CLINs (multiple contractors)
28	CAMs should not be required to report in dollars if they manage their control accounts based on labor hours. Control Accounts and their assigned managers are fundamental to the operation of EV, but control account managers (CAMs) should be focused upon the effective management of their scope of work to the available budgets in unburdened labor hours and material dollars. ANSI and National Defense Industrial Association (NDIA) both recognize hours as an acceptable measurement for the performance of the CAM function, but oversight agencies invariably invoke requirements for CAMs to manage the burdened dollars of their control accounts. In this industry, CAMs are not commonly associated with human resource wage decisions, the assignments of working level craftsman (other than skill proficiency requirements), or financial functions. Expectations for the validation of EVM systems become difficult to satisfy because this distribution of functions changes the CAM role to management of the functions with understanding of the function and familiarity with the resultant plans rather than actual performance of the function.

29	Utilization of MIL-STD-881 for use as one of the two major structural attributes for performance reporting is not effective for all EV implementations. Both the Government and suppliers are interested in the most relevant method of organizing the scope of work and its sub-division into manageable blocks, mods that can be logically related, budgeted, and scheduled and is critical for the effective management of programs. They state that requiring the use of MIL-STD-881 by a supplier in addition to the attributes for control accounts necessary to enable the system adds a multiplicative impact to the number of control accounts, complexity in the management system and costs in its effective execution. They claim that the system attributes of MIL-STD-881 will be of marginal relevance to management discussions, will add little management value, and what benefit they do provide could easily be provided in the form of historic cost reports through cost and software data reporting (CSDRs -that are generally acknowledge to appropriately apply MIL-STD-881) rather than constructing a burdensome performance management view around an attribute structure for population of performance management data in monthly contract data requirements list (CDRL) submittals.
30	Waste in conducting Integrated Baseline Reviews at very end of contract period of performance... the recommendation is to exclude IBRs that have remaining performance periods of less than 3 months or 25 percent of remaining work.
31	On two recent situations where an Over-Target Baseline (OTB) was warranted due to significant poor program performance, each program submitted multiple requests for an OTB and the requests were denied. The inability to obtain an OTB resulted in the establishment of a baseline built on “factored” budgets that were grossly inadequate for performance measurement.

4.3 Description of DCMA Pilot Project: Data Driven EVMS Compliance¹⁰⁹

Introduction and Background

The digital revolution will fundamentally change the way DCMA will collect, correlate, and deliver data and information. The Department's information broker will be challenged to rethink its approach to oversight and redefine its value to the acquisition process. Removing layers of bureaucracy and introducing analytical strategies backed by innovative technologies to personalize and deliver coordinated services will become a necessity.

DCMA DFARS Earned Value Management System (EVMS) Mission

1. Influence industry partners to field effective and efficient EVMS that are compliant with the 32 EIA-748 Guidelines
2. Strengthen program management (decision-making) by the way we think about (and use) EVMS data

Since 1999, DoD has recognized the EIA-748 32 Earned Value Management System (EVMS) Guidelines as the basis for determining the compliance (or worthiness) of managerial tools used to control billions of dollars each year. A compliant EVMS by definition provides for the generation of timely, reliable, and verifiable contract performance data, permitting Government program managers to evaluate a contractor's progress and likelihood of meeting programmatic and contractual requirements for cost, schedule, and technical viability. EVM is founded on the idea that program managers and their teams make the best decisions when they have the best information. EVMS is defined by guidelines, where management practices, business processes, systems, and organizational culture meet and mix.

However, for years DoD and industry have debated the finer points of EVMS compliance. DoD is working to ensure that industry is aware of and taking steps to comply with the EIA-748 32 EVMS Guidelines, and industry is working for greater clarity in what the Government is looking for and how it goes about its business. In practice, loosely defined EVMS Guidelines have led to differences in interpretation of requirements. With the impending release of the EVMS Interpretive Guide, DoD looks to rectify the situation by turning to more precise definitions and translations to prevent future differences.

A Call for Change that Addresses the Department's Cost Issue

Since the establishment of the DCMA Earned Value Management (EVM) Division in May 2013, a number of EVMS policies have been reconsidered to address inherent redundancies and inefficiencies in the conduct of assessing contractor EVMS. To improve productivity and better execute our mission and objectives, a first-of-a-kind initiative was launched to rethink the way in which contractor EVMS validations and follow-on surveillance can be performed simultaneously to

¹⁰⁹ Section 4.3 was provided by Mr. David R. Kester, OUSD(AT&L)/DCMA

test the reliability of core management processes using data sets and algorithms to summarize, detect patterns, and draw conclusions.

Deficiencies raise concerns regarding the validity of data and information produced by an EVMS and the ability to assess emerging issues of cost and schedule in a timely manner - Early detection of trends and issues is central to success of an EVMS.

DCMA's "Data Driven EVMS Compliance" approach eliminates the need for multiple DCMA assessments (and the labor and travel costs associated with upwards of 30 people visiting a contractor's plant) because it enables any combination of tests to be run from a remote location using a contractor's EVMS data. Markers (as indicated by the red blocks in Figure 4.2) indicate when an EVMS Guideline Attribute has exceeded pre-determined thresholds. Markers are set at a level that allows emerging issues to be identified early, enabling the contractor to take pre-emptive action to remedy data quality issues. Persistent EVMS concerns can then be addressed by a much smaller and more nimble Government team with specific expertise. A standardized set of data now provides both the Government and contractor with an instant diagnosis. This approach, while still in its infancy, has already proven invaluable in communicating the requirements of the 32 ANSI-748 EVMS guidelines to industry while lowering implementation costs for industry and DoD. DCMA currently leads a pilot effort to deploy this innovative approach on the F-35 Joint Strike Fighter Program, working with Lockheed Martin Aeronautics (LMA) at its facility in Fort Worth, Texas.

How is an EVMS data-driven test carried out?

Figure 4.2 shows a listing of the diagnostic test results performed on a sample of a contractor's EVMS data. The data is collected and sent to a processing tool called the "Earned Value Analytics System" that allows Government technicians to look for potential issues. The technician reports the test results in writing to a supervisor, who in turn provides near real time feedback to the contractor. EIA-748 guideline tests are done on a relatively small sample, which is taken directly from the contractor's EVMS. Unlike other types of testing, a contractor will usually only receive the results if they are positive (i.e., indicate a problem). If so, additional testing is needed to determine whether the EVMS has a deficiency. EIA-748 guideline data-driven testing can reveal valuable information about the cause of a deficiency, its symptoms and potential solutions (diagnosis) and are also valuable in monitoring the effects of corrective actions. The test results from the LMA Pilot show the specific EIA-748 guidelines and attributes that need immediate attention using a red color scheme. The hope is that by documenting, classifying, and sequencing the 73 attributes of a compliant EVMS, the Government technician will be able to find the underlying causes of core management process issues. Over time, analysis of these results is expected to uncover newer and better diagnostic tests and remedies.

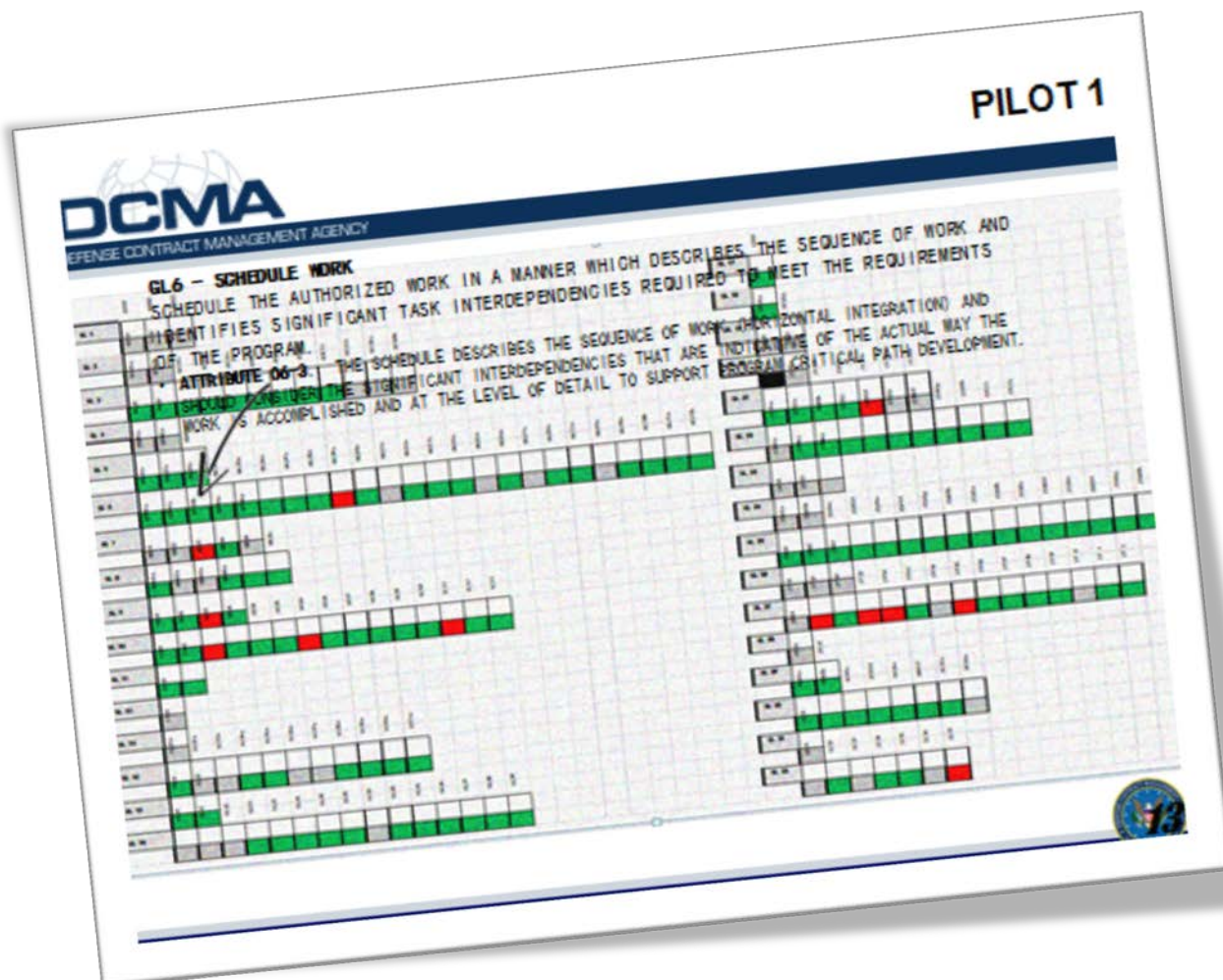


Figure 4.2 Results for the 32 EVMS guidelines following data driven compliance process

In the past year, LMA's response in correcting EVMS deficiencies following the DCMA data-driven approach has resulted not only in the company regaining its DFARS 252.234-7002 EVMS compliance credentials as a condition for doing business with DoD, but has fundamentally changed the way it uses its EVMS to manage work in the future. The JSF Program Office's (JPO) and LMA's commitment to using reliable EVMS data for day-to-day decision making on the largest single global defense program has solidified the long-term stability of the program and increased the purchasing power of the Department. LMA estimates that the Earned Value Analytics System can save the Government and company upwards of 3,000 hours (an estimated \$1 million) in avoidable surveillance costs per year. For this reason, the implementation of the DCMA data-driven approach advances the Department's Better Buying Program (BBP 2.0) initiatives for incentivizing productivity and innovation while eliminating unproductive processes and bureaucracy. For example, following up on the Department's recommendations made to Congress on EVM in September 2009 resulting from the Weapon Systems Acquisition Reform Act of 2009, DCMA has participated with other DoD organizations in a PARCA-led initiative to develop a Government EVMS intent guide that defines the purpose of each ANSI-748 Guideline, the attributes (e.g., characteristics) of each guideline that make it distinct from other guidelines, and the testing

protocols that define compliance. Working with the PARCA EVM Division and other Government experts, DCMA has reduced the existing number of the 32 ANSI-748 EVMS Guideline attributes by 52 percent, from 155 to 73 (see Figure 4.3). This accomplishment reduced the number of attributes the Government tests from over 5 per guideline to 2 while retaining the full coverage of contractor EVMS compliance requirements, a considerable increase in efficiency. DCMA's data-driven approach strikes the right balance between the needs of protecting the interests of the U.S. taxpayer and the objectives of the DoD and contractors.

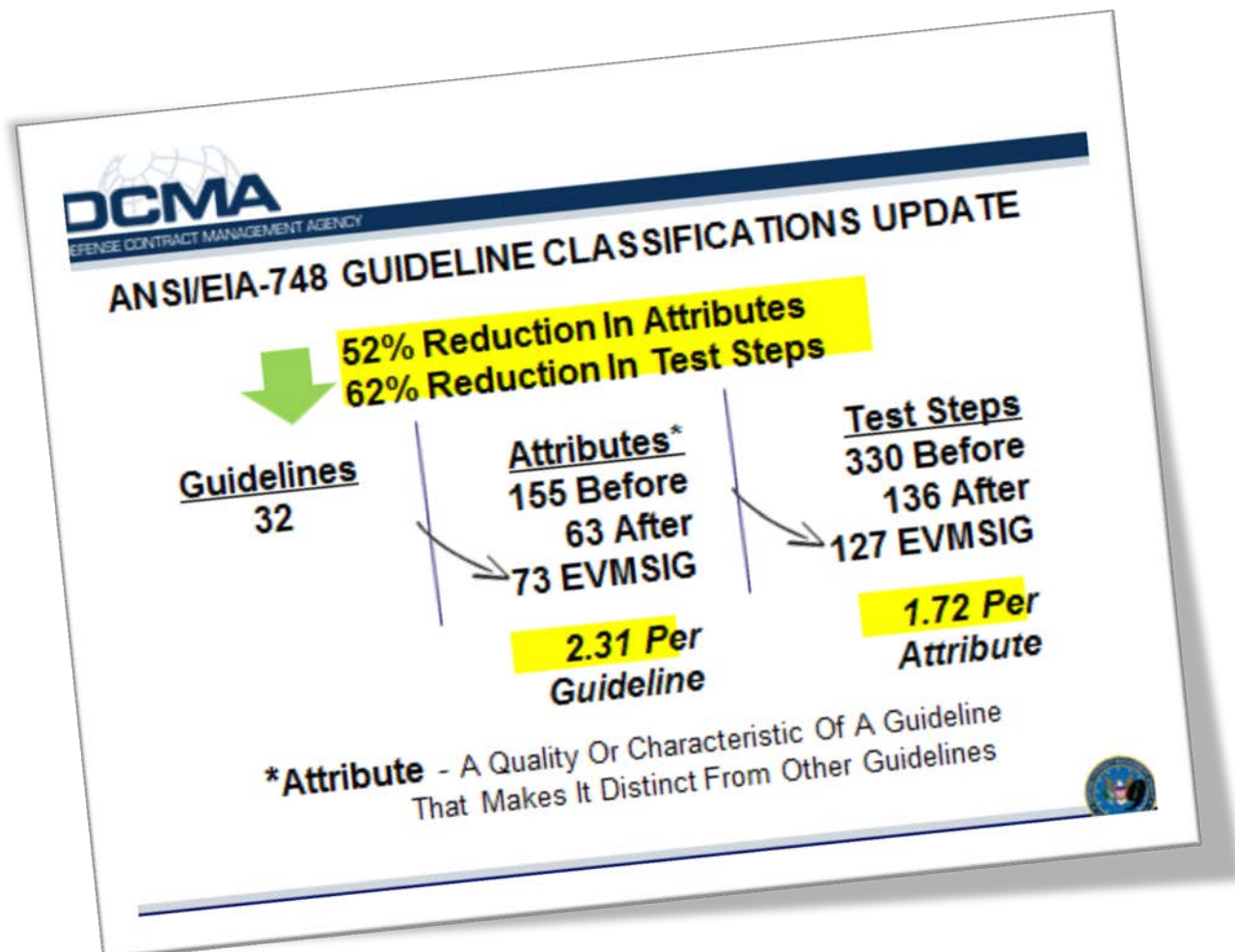


Figure 4.3 Reduction in the number of EVMS guideline attributes and test steps

DCMA's efforts to provide for a simplified and consistent definition of the 32 ANSI/EIA-748 EVMS guidelines at the level at which they can best be understood, and its data-driven approach to modernize DCMA's EVMS mission advances the Joint Space Cost Council (JSCC) themes for 'Better EVM Implementation,' including reducing the volume of EVMS reviews and addressing inconsistencies when interpreting the 32 ANSI-748 EVMS Guidelines. DCMA's work was recently recognized by the National Defense Industrial Association (NDIA) Integrated Program Management Division (IPMD) Chair who wrote on May 29, 2014: "Your efforts have gone a long way in building a strong relationship between DCMA and industry and promoting open dialog and discussion. The feedback from the meeting attendees on your presentations was overwhelmingly

positive. Your open and sincere remarks surrounding your new approach to surveillance and compliance reviews enlightened our division members and your presence openly displays the vital need for Government/Industry collaboration.”

The Importance of Context In EIA-748 Guideline Interpretation

Although the 32 EIA-748 EVMS Guidelines are unambiguous statements of basic program management principles, legitimate questions do arise concerning the application of these principles to specific practices. Of the reasons people disagree, an inadequate knowledge of what the EIA-748 EVMS Guidelines require tops the list. If more people learned to interpret the EIA-748 EVMS Guidelines in context, quite a few differences would disappear. When interpreters from both Government and industry groups have worked together to unfold the meaning of an EIA-748 EVMS Guideline, agreement on many significant conclusions have been reached. A much better unity will result by documenting the meaning of each EIA-748 EVMS Guideline and studying their general purpose and context towards the requirements of DFARS 234-201. Having a general purpose and well-defined attributes (i.e., qualities and characteristics) that make each guideline distinct from others safeguards the fairness of EVMS compliance proceedings throughout DoD. The genuine adoption of these common management practices across industry sectors reinforces EVMS as a widely accepted best practice for program management. Correctly interpreting EIA-748 Guidelines is essential. It can make the difference between creating an authentic connection to a necessary management principle or implementation of an unwarranted, burdensome, and costly non-value added oversight.

Through use of DCMA’s Data Driven EVMS Compliance approach, LMA achieved reductions in number of schedule lines of as much as 85 percent compared to their previously manually-intensive aircraft assembly scheduling process. Simultaneously, they were able to achieve *increased* visibility of their assembly progress and separate their work by tail number (which was previously not achievable). This has significantly decreased their costs to build, maintain, and report their integrated master schedule (see Figure 4.4). The JPO customer has benefitted through a reduction of LMA overtime charges of approximately 56 percent despite a steady state headcount and increased reporting requirements. Due to its success at LMA, efforts are currently underway to replicate the Data Driven EVMS Compliance approach at other contractor locations including LMA F-35 Joint Strike Fighter top tier subcontractors and Navy Shipyards to resolve longstanding EVMS issues. Through ongoing collaborative efforts with the Navy (ASN(RDA)) and the various Agencies that form the DoD Intelligence Community, DCMA is readily nearing its ultimate goal to take the current complexities of EVMS compliance from Tax Law to Turbo Tax© for a smarter and more sustainable future.

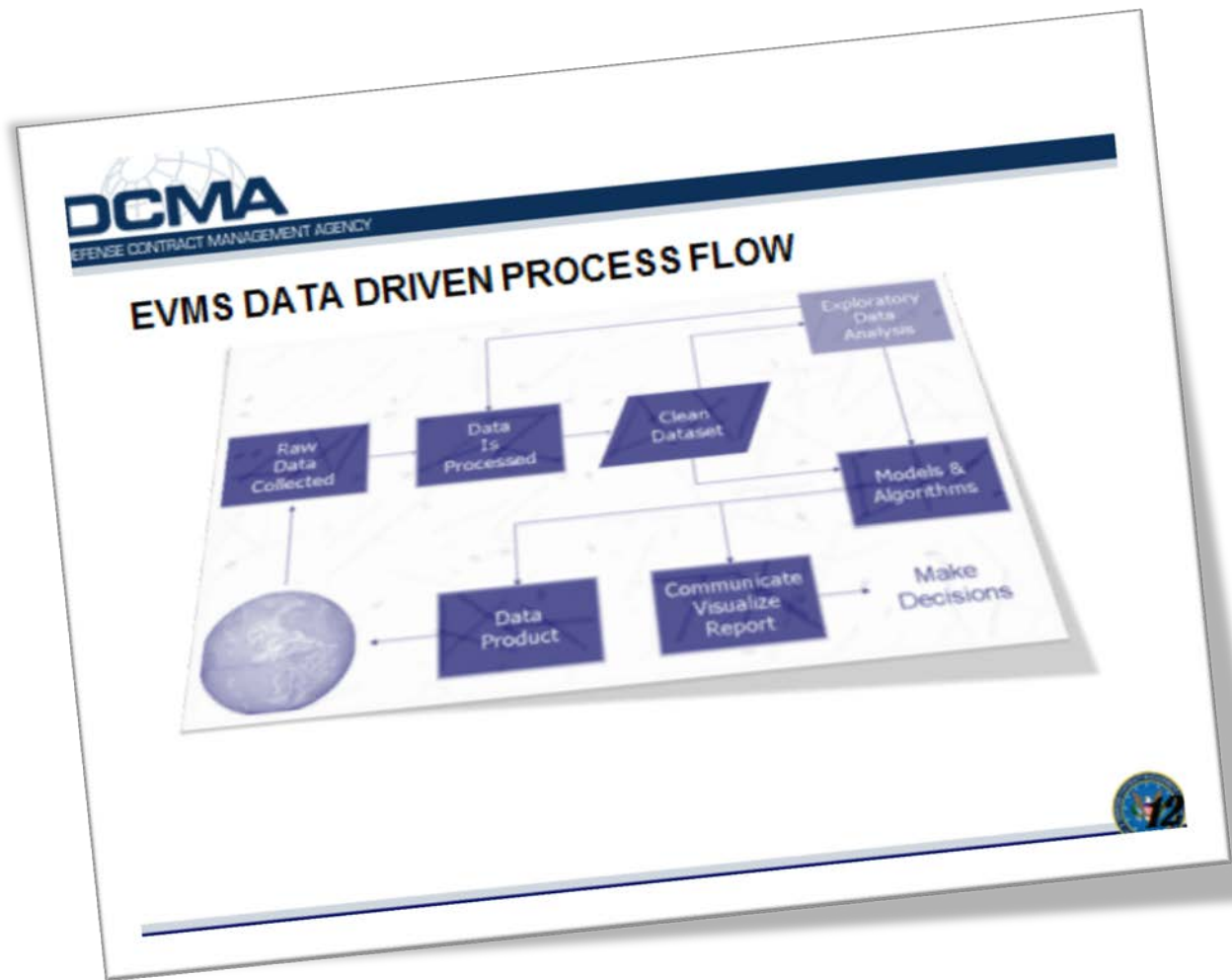


Figure 4.4 Diagram of the DCMA data driven EVMS compliance process

4.4 Director, PARCA memorandum: Level of Detail Required on Contract for EVM



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

JUN 18 2015

MEMORANDUM FOR SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARIES OF DEFENSE
DEPUTY CHIEF MANAGEMENT OFFICER
COMMANDERS OF THE COMBATANT COMMANDS
DIRECTOR, COST ASSESSMENT AND PROGRAM EVALUATION
DIRECTOR, OPERATIONAL TEST AND EVALUATION
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARIES OF DEFENSE
ASSISTANTS TO THE SECRETARY OF DEFENSE
DIRECTOR, ADMINISTRATION AND MANAGEMENT
DIRECTOR, NET ASSESSMENT
DIRECTORS OF THE DEFENSE AGENCIES
DIRECTORS OF THE DOD FIELD ACTIVITIES

SUBJECT: Level of Detail Required on Contract for Earned Value Reporting

Earned Value Management (EVM) is one of DoD's and industry's most powerful proven program management tools. Government and Industry program managers use EVM to provide joint situational awareness of program status, to assess cost, schedule, and technical performance on programs, and to support proactive decision-making as program teams navigate constraints and risks in the performance of DoD programs. As a program management tool, EVM practices and competencies must be integrated into the program manager's acquisition decision-making processes, the data provided by the EVM System (EVMS) must be timely, accurate, reliable, auditable and implemented in a disciplined manner consistent with the 32 Guidelines prescribed in Section 2 of the Electronic Industries Alliance Standard-748 EVMS (EIA-748). The Office of Performance Assessments and Root Cause Analyses (PARCA) in OSD serves as the policy and competency owner of EVM for the Department and ensures that EVM guidance is current and correct for constituents.

In the DoD, EVM should be a cost effective system that shares program situational awareness between Government and Contractor. In an oversight role, a critical function of the Government Program Office is to utilize all data, including cost, schedule, and technical performance metrics, to identify early indicators of problems so that adjustments can be made to influence future program performance. The decision to apply EVM and the related EVM reporting requirements should be based on work scope, complexity, and risk along with the threshold requirements in the DFARS.

The level of detail in the EVM reporting, which is placed on contract through a CDRL referencing the Integrated Program Management Report (IPMR), should also be based on scope, complexity, and risk. The IPMR's primary value to the Government is its utility in reflecting current contract status and projecting future contract performance. It is used by the DoD component staff, including program managers, engineers, cost estimators, and financial

management personnel as a basis for communicating performance status with the contractor. The IPMR DID states that the reporting level is defined through tailoring the WBS from the applicable MIL-STD-881 appendix and does not prescribe a required level of detail. In their oversight role, Program Offices should only require EVM data to a level that maintains the cost effectiveness of the reporting, targets strategic areas, and aligns with how the program is managed. Too much detail in reporting will slow down the review, response, and strategic utility of the data, and potentially detracts from the agile nature needed for proactive Government decision making.

In particular, collection of data for cost analysis purposes should not drive the level of detail for EVM reporting. EVM data is for management of project execution, not cost estimating for which the Government has other dedicated means to obtain data.

PARCA promotes the tailored, risk-based approach in developing the requirements for level of detail in EVM reporting that makes sense for program management and does not add administrative burden to the Contractor or Government. Thank you in advance for your support of this important initiative. My point of contact is Mr. Gordon M. Kranz, Deputy Director, EVM, Office of Performance Assessment and Root Cause Analyses at 703-697-3703 or Gordon.m.kranz.civ@mail.mil.



Gary R. Bliss
Director, Performance Assessments and
Root Cause Analyses

cc:
USD(AT&L) Direct Reports

4.5 Overview of the Joint Space Cost Council Better EVM Implementation Study Themes and Recommendations¹¹⁰

Relying on the premise that *EVM is a best management practice for Government programs* and that *contractors already have a management system in place that can support a major Government acquisition*, the Joint Space Cost Council (JSCC) sponsored a study in April 2013 to assess Industry's concerns of excessive costs related to EVM typically incurred on federal Government cost type contracts in the Space community. The primary purpose of the study was to:

1. Understand any real or perceived impact on program cost specifically associated with Government EVM requirements on major development programs;
2. Review and analyze any significant delta implementation impacts identified in the survey; and,
3. Provide feedback and recommendations to Government and industry stakeholders in the spirit of the Better Buying Power initiative.

In order to perform the study, the JSCC hosted an Industry day, which provided contractors with the opportunity to identify all issues and concerns associated with EVM requirements on Government cost type contracts. A study team used this input to develop a survey instrument containing 78 Cost Areas grouped into 15 Cost Drivers.

1. Variance Analysis	6. WBS	10. Customer Directed Changes
01.01 Reporting Variance at Too Low a Level of the WBS	06.01 Level	10.01 Delta IBRs
01.02 Volume - Lack of Meaningful Thresholds	06.02 Recurring/Non-Recurring	10.02 Baseline Change/ Maintenance
01.03 Frequency of Variance Analysis Reporting	06.03 Clin Structure Embedded	10.03 Baseline Freeze Period
01.04 Number of Approvals Before Submitting Variance Analysis	06.04 Non-Conforming	10.04 Changes to Phasing of Contract Funding
01.05 Developing Corrective Actions	06.05 Conforming	10.05 Baseline by Funding, not Budget
01.06 Tracking Corrective Actions	06.07 Unique Customer Driven Requirements	10.06 Poorly Defined Scope
2. Level of Control Account	7. Documentation Requirements	10.07 Level of Control Account
02.01 Plan	07.01 Interim WADs	10.08 Delay in Negotiations
02.02 Analyze	07.02 IPMR/CPR/IMS	10.09 Volume of Change
02.03 Report	07.03 Logs	11. Subcontractor EVMS Surveillance
02.04 Volume of Corrective Actions	07.04 EAC/CEAC	11.01 Customer Involvement
3. Integrated Baseline Reviews	07.05 Frequency of Reporting	11.02 Duplication of Prime/Customer Review
03.01 Attendance	07.06 Level of Detail	11.03 Supplier Cars Flow to Prime
03.02 Frequency	07.07 Accounting Reconciliation	12. CLINs Reporting
03.03 Depth	07.08 Expectation that Every Doc Stands Alone Drives Redundancy	12.01 Multiple CLINs
03.04 Data Requests	07.09 Overly Prescriptive	12.02 Tracking MR
03.05 Overlap with Surveillance	8. Interpretation Issues	12.03 Embedding Clins in WBS
4. Surveillance Reviews	08.01 Differing Guidance	12.04 Separate Planning, Tracking & Reporting Reqmts
04.01 Attendance	08.02 Sub Invoice Trace	12.05 CLIN Volume
04.02 Frequency	08.03 Lack of Understanding/Inexperienced Auditors	13. IMS
04.03 Breadth/Depth	08.04 Schedule Margin	13.01 Integration of Subs
04.04 Data Requests	08.05 Inconsistent Interpretation Among Reviewers	13.02 Volume of Tasks/Level of Detail
04.05 Dcma Internal Reviews by Cage Code	08.06 Limited Recognition of Materiality / Significance of Issues	13.03 45 Day NTE Task Durations
04.06 Layers of Oversight	9. Tools	13.04 Float NTE 45 Days or Some Number
04.07 Derived Requirements	09.01 Inadequate EVM Tools	14. Reporting Requirements
04.08 Zero Tolerance for Minor Data Errors	09.02 Cost Schedule Integration	14.01 Tailoring
04.09 Prime/Subcontractor Surveillance	09.03 Prime Sub Integration	14.02 Add'T Reqmts Beyond CDRLs
5. Maintaining EVM System	09.04 Materials Mgmt Integration	14.03 Volume of Ad Hoc / Custom Reports
05.01 Forms		15. Funding/Contracts
05.02 Processes		15.01 Changes to Phasing of Contract Funding
		15.02 Incremental

Survey Framework

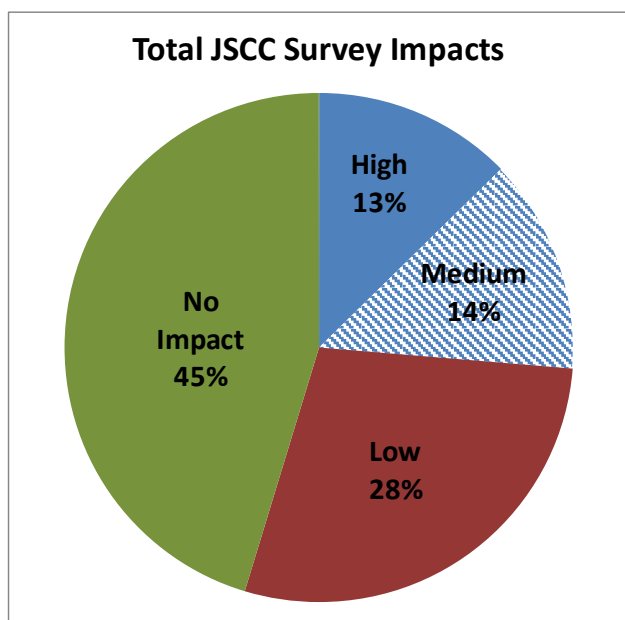
The survey asked each respondent to provide comments to support any Cost Area identified as a *Medium* or *High* impact and to identify the responsible stakeholder. The survey was distributed to five major contractors (Ball, Boeing, Lockheed Martin, Northrup Grumman, and Raytheon) who

¹¹⁰ The JSCC EVM Implementation Study was authored by Mr. Ivan Bembers, Ms. Michelle Jones, Mr. Ed Knox, and Mr. Jeff Traczyk, National Reconnaissance Office

then passed it on to 50 programs with dollar values ranging from tens of millions to multiple billions.

Once the survey was completed, the JSCC Study Team engaged with stakeholders identified in the survey to share preliminary results, gathered with EVM experts to analyze those results, and developed recommendations. In its raw state, the survey results contain 1,223 comments and over 3,500 impact ratings. This data was originally organized to capture the potential problematic areas identified by the JSCC. Further analysis identified fact-driven data that supports or refutes decades of biases and anecdotal assertions of EVM Cost Drivers (e.g., the cost of IBRs, EVM reporting requirements, tracking MR by CLIN, IMS delivery, etc.).

The significant amount of data collected, coupled with the number of comments, created an opportunity to perform crosscutting analysis of closely interrelated Cost Areas that could be used to identify trends along with a better understanding of the data. To perform this analysis, an EVM Expert Working Group of subject matter experts representing both Industry and Government performed a Cost Area re-grouping exercise that resulted in a series of candidate themes. The purpose of a theme was to develop consensus of expert opinion representing crosscutting analysis



of survey comments, which were not limited and restricted to the initial categories of the survey Cost Drivers. As a result of the JSCC's analysis and recommendations, both Government and Industry stakeholders have suggested actions for better EVM implementation.

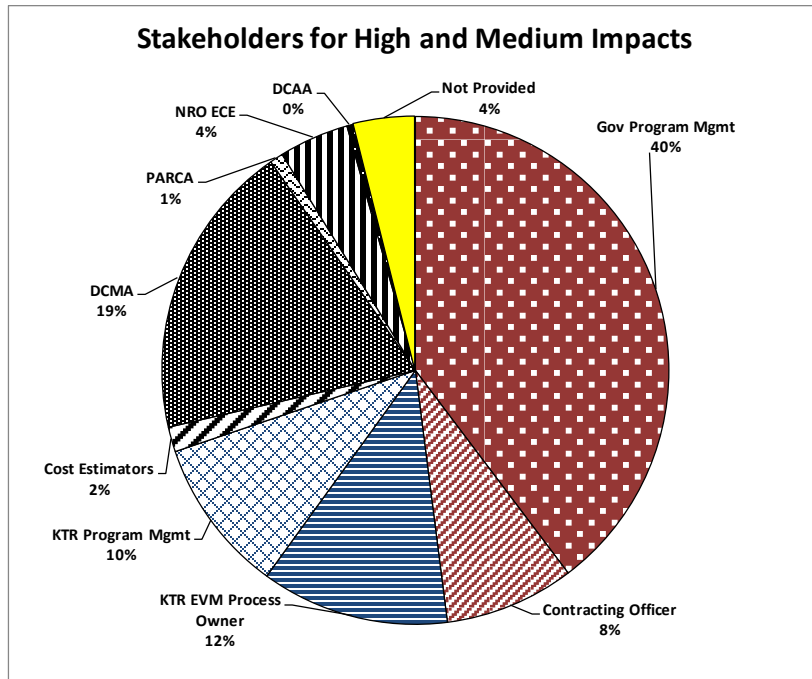
In February 2015, the JSCC published its results in *Better EVMS Implementation Themes and Recommendations*. The study revealed that the delta implementation cost of EVM on Government Contracts is minimal. Seventy-three percent of all survey data points (2,644 of the 3,588 answers) were categorized as *Low Impact* or *No Impact* for cost premium identified to comply with Government EVM requirements (45 percent were *No Impact* and 28 percent were

Low Impact). The remaining 27 percent of survey data points were recognized as *High Impact* or *Medium Impact* (13 percent were *High Impact* and 14 percent were *Medium Impact*). It is interesting to note that there was not a single Cost Area identified with *High* and/or *Medium impacts* in 50 percent of the programs surveyed.

Overall, the JSCC Survey results appear to be in-line with previous studies showing a marginal Government cost premium associated with EVM. Coopers Lybrand¹¹¹ identified this cost at less than one percent. Even so, the survey results did identify several areas that can be addressed to create a more efficient implementation of EVM.

¹¹¹ Coopers Lybrand performed an activity based costing approach of C/SCSC (EVM) in 1994. It is the most commonly referenced study regarding the Government Cost Premium of EVM.

It is important to note that Government Program Management was identified in the survey as the Primary Stakeholder for 40 percent of all *High* and *Medium Impacts* and the most significant stakeholder by a 2:1 ratio over the next closest (DCMA with 19 percent). Contractor (KTR) EVM Process Owner (12 percent), KTR Program Management (10 percent), and Contracting Officer (8 percent) were the only other stakeholders identified with any real significance.



Using the data from the JSCC study along with analysis provided by EVM experts, *Better EVMS Implementation Themes and Recommendations* provides recommendations and actions for stakeholders for three separate themes. These recommendations should provide assistance in

generating a more efficient approach regarding EVM when applied to Government contracts.

The following are the final JSCC Themes and Recommendations (R) for Better EVM Implementation:

- **Theme 1:** *The Control Account level (size and number) significantly impacts the cost of EVM*
 - R1: Ensure WBS, Control Accounts, and Reporting Levels are appropriate for the contract type, scope, risk, and value
 - R2: Define a product oriented WBS and do not allow it to be replicated by CLIN or other reporting needs
 - R3: Include EVM expertise in RFP and Proposal Review panels and processes
 - R4: Re-evaluate management structure and reporting levels periodically to optimize EVM reporting requirements and levels commensurate with program execution risk

- **Theme 2:** *Program volatility and lack of clarity in program scope as well as uncertainty in funding may impact the cost of EVMS, just as any other program management discipline*
 - R1: Scale the EVM/EVMS Implementation (depth) to the Program based on program size, complexity and risk. EVMS includes people, processes and tools.
 - R2: Plan the authorized work to an appropriate level of detail and time horizon, not just the funded work

- R3: Align the IBR objectives to focus on the risk, pre- and post- award to assess the contractor's ability to deliver mission capabilities within cost, schedule and performance targets.
- **Theme 3:** *Volume of IBRs and compliance/surveillance reviews and inconsistent interpretation of the 32 EIA 748 Guidelines impacts the cost of EVM*
 - R1: Data requests for Surveillance reviews should focus on the standard artifacts/outputs of the compliant EVMS
 - R2: Data requests for IBRs should focus on standard artifacts/output that support mutual understanding of the executibility of the PMB
 - R3: The IBR should not replicate the surveillance review
 - R4: Establish a consistent definition within each organization of severity and the remediation required to address a compliance or surveillance finding
 - R5: Adopt a risk-based approach to scheduling surveillance reviews, minimizing reviews by timeframe and site
 - R6: Reduce inconsistent interpretation of EVMS implementation

4.6 Excerpt from DoD's 2009 Report to Congress on Earned Value Management

2. Findings

DCMA has documented EVMS deficiencies (discussed further in Requirement 6) relating to data reliability. The production of inaccurate data from an EVMS points to a contractor's inability to consistently implement program management systems and processes for assessing and reporting emerging cost and schedule performance issues. Therefore, even if the data provided to leaders are timely, consistent, and complete, they are still of little use if they do not accurately portray the true status of the project. DoD has some processes in place to address the reliability of the data received from contractors, but it is still a concern.

As required by the DFARS, contracts that exceed certain thresholds contain a requirement that the contractors use an EVMS that complies with ANSI/EIA-748, the industry EVMS standard that defines basic EVMS requirements as 32 guidelines to ensure that management systems produce reliable performance data. DCMA has the responsibility for assessing contractor compliance to the EVMS standard on DoD contracts.¹¹² Once it has validated the EVMS, DCMA conducts ongoing surveillance of the contractor system to ensure that it remains compliant. One exception is the Navy's Supervisor of Shipbuilding (SUPSHIP), which performs the surveillance at the shipyards.

Of the last 13 comprehensive reviews conducted by DCMA, only two contractors were found to be compliant with ANSI/EIA-748. Another four were found to be compliant after multiple reviews and support from the Government. The remaining seven contractors were found to be noncompliant with at least half of the ANSI/EIA-748 guidelines.

In its analysis of the issues, the DST uncovered several common themes:

- The various subsystems that make up many contractors' EVMS are not integrated, resulting in inconsistent portrayals of status.
- The schedules often cannot show downstream impacts of problems or cannot determine the critical path driving contract completion.
- Contractors frequently do not have adequate work authorization processes for developing a detailed, time-phased baseline plan.
- When assessing cost and schedule variances, contractors cannot effectively identify the root cause, impact, and appropriate corrective actions.
- Contractors do not have a process for developing reliable estimates at completion.
- Contractor change control processes do not maintain the integrity of the PMB.
- Contractors treat EVM as a reporting requirement rather than the management process it is intended to be. The end result is that many Defense contractors cannot accurately predict outcomes that affect program costs or deliveries.

¹¹² The IC is responsible for validating EVMS, coordinating EVMS reviews, serving as subject matter experts, and establishing standard processes across the IC Agencies.

These types of data quality problems hinder the Government's ability to meet program objectives by delaying or masking insight into developing problems. For instance, there is a method for measuring performance called Level of Effort (LOE). LOE tasks measure performance by the passage of time rather than by accomplishment of a discrete task. LOE is acceptable in some instances, but it can be abused. LOE does not show any schedule variances, nor does it provide meaningful cost variances. When used heavily during program startup (when contracts may not yet be fully staffed), LOE gives the impression that work is on schedule and under budget. In reality, understaffing causes schedule delays and usually results in downstream overruns due to the work-around plans required.

Without well-developed schedules, the Government and the contractor team cannot effectively reassign resources to the tasks that will drive contract completion. The schedule should be based on a precedence logic network that shows the order in which tasks need to be completed. This network logic facilitates a critical path, the longest sequence of tasks to completing the effort. Identification of the critical path and near-critical paths helps managers prioritize those activities to keep on schedule. DoD often finds that contractor schedules cannot effectively identify these critical paths, because the task relationships are not properly defined or artificial constraints are added to the schedule that override the task relationships. These problems prevent managers from making informed tradeoffs about task prioritization, the need to work overtime, and other tradeoffs that could be made to keep on schedule.

Contractors often do not have robust procedures or processes for updating their estimated cost at completion. Contractor managers cannot explain how or if risks and opportunities were incorporated into their estimates. During many assessments, managers cannot explain disparities between their cost efficiency to date and their projected cost efficiency for remaining work. DoD has also found instances in which contractors' estimates for cost at completion were lower than the actual costs already incurred. Although the Government is responsible for developing its own cost estimates, contractor estimates provide additional information and different assumptions.

The ability to assess these different estimates and assumptions help Government PMs better assess the state of the contract and take appropriate action. Unrealistic estimates from the contractor limit the amount of insight and outside information provided to DoD managers. Improper changes to the baseline plan also affect Government programs. Because change is inevitable, EVM allows for controlled changes to the PMB. When done properly, baseline changes will not impair program management. However, DoD has found many instances of inappropriate changes, such as arbitrarily changing past variances, moving budgets to mask overruns, and making changes that were not properly authorized. Inappropriate changes will not allow early insight into developing issues and will prevent managers from making effective decisions to mitigate problems. Part of the reason that EVM data quality is a problem is that PMs and DoD decision makers have not historically emphasized this aspect of EVM. Specifically, DoD did not actively assess data quality, and when problems were uncovered, there were no consequences.

Beginning in 2006, USD(AT&L) began looking at a set of tripwires during the monthly DAES reviews. One of the primary tripwires is the status of the contractor's EVMS. Since 2006, DCMA has suspended one contractor's previously approved EVMS due to ongoing issues. In two cases, DoD has withheld funds when the contractors did not show adequate progress toward taking corrective actions to resolve EVMS issues. Some actions have been taken to provide disincentives for noncompliance with the EVMS standard, but DoD has no standard guidance on which actions programs should take and when those actions should be taken.

The NDIA Program Management Systems Committee (PMSC) is the industry organization responsible for EVM, including ANSIfEIA-748. The PMSC is comprised of EVM functional specialists representing the largest defense contractors and vendors of EVM products and services. When first established, these company EVM focal points were not empowered organizationally to commit their companies for improving the "state of EVM" or to do more than write guidance and point out why the Government is party to their inability to implement EVM in compliance with contractual requirements. However, industry attention has improved and the support is being provided to the members of the PMSC. OSD and the DoD Component EVM focal points also participate in the NDIA PMSC. With executive-level participation and a commitment to communication by both DoD and industry members, the PMSC is becoming more effective as a forum to address EVM data quality issues across the defense industry.

Whether DoD works with NDIA as a group or with individual contractors, it needs to do a better job of guiding industry toward resolution of data quality issues. Since the 1990s, DoD has had a hands-off approach to EVM issue resolution because contractors were responsible for managing their own management processes. Industry has lost many of its EVM experts, just as DoD has, and needs additional guidance. The Department is committed to working with industry to implement solutions that facilitate delivery of timely, complete, and accurate EVM data. Both DoD and its contractors need to determine how best to utilize scarce EVM experts, while training the next generation of EVM analysts. In the end, it is DoD and the taxpayer that bear the consequences of unreliable contract performance information.

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5 Truth in Negotiation Act (TINA) and Requirements for Cost or Pricing (CoP) Data

Purpose. Assess contractors' recommended changes to the Truth in Negotiations Act (TINA) and Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulations Supplement (DFARS) guidance pertaining to TINA.

Overview. The assessment of recommended changes to TINA is based on information provided by three participating contractors, independent analysis by PARCA and IDA of statutory and regulatory intent and effects, and discussions with contracting officers and subject matter experts in the OUSD(AT&L)/DP and DPAP. Sections 5.1 and 5.2 provide summary and detailed assessments of the contractors' recommendations, respectively, and Section 5.4 provides key supporting data provided by contractors.

TINA-related changes proposed by contractors can be grouped into the following categories:

- (1) Clarify policy guidance to reduce repeated submissions of certifiable Cost or Pricing (CoP) data (regulatory);
- (2) Increase/modify thresholds for providing certifiable CoP data (statutory); and
- (3) Relax requirements for obtaining an Exceptional Circumstances waiver to the TINA requirement (statutory).

Recommendations

We concur with contractors' recommendation in the first category: DoD should clarify policy guidance to reduce repeated submissions of CoP data. Multiple submissions are an unintended, and generally unsought, consequence of the FAR requirement that certified CoP data be "current." Frequent resubmissions appear to be the result of contractors' fears that out of date CoP data that becomes inaccurate will lead to defective pricing claims by DoD post-award. However, lack of clarity on what is considered "current" motivates some contractors to provide excessively frequent CoP data updates during negotiations (weekly or monthly), which creates unnecessary work not only for contractors, but also for the Procuring Contracting Officer (PCO). We recommend amending DFARS (and/or the FAR) to remove uncertainty about the appropriate frequency of providing certifiable CoP data to ensure it remains "current" and/or to clarify pricing changes that warrant resubmission of CoP data. Policy clarification might be accomplished in one of several ways:

1. Require CoP data be certified as of proposal submission date or other cut-off date, rather than as of the date price negotiations are concluded (the current FAR requirement). Making certified CoP data available at the beginning of negotiations is consistent with

TINA's purpose, which is to put the PCO on level footing with contractors for negotiations in a sole source environment.

2. Consider certifiable CoP data to remain effectively "current" through a specified post-CoP data submission date (e.g., it remains current for 45 or 90 days).
 - OUSD(AT&L)/DP suggests that data submitted within 30 days of negotiated price settlement could be considered "current" and thereby not subject to resubmission.
3. Limit the resubmission of more current, accurate and complete CoP data to items that change by a given threshold (e.g., 10 percent).
4. Reinstigate practice from 1980s that provided contractors the option to voluntarily disclose defective pricing data post-award and provide DoD with refunds (including interest), without risk of initiating defective pricing claims and associated audits.

Reducing unnecessary resubmissions of certifiable CoP data would lower contractor proposal costs and reduce procurement administrative lead time. Making this change also weakens the argument for making additional changes to the TINA statute, such as increasing thresholds or relaxing waiver criteria. A potential disadvantage of reducing multiple submissions of CoP data is that the auditable baseline could become obscured during extended negotiations.

Contractors' recommendations in the second category, increasing thresholds for providing certified CoP data, would potentially yield modest savings from reduced contractor proposal costs, but could also result in less or lower quality CoP data available to the PCO, resulting in potentially higher prices for items priced on the basis of price analysis alone. Although it would be problematic to quantify the cost benefits to DoD of certified CoP data, we assess it highly likely that DoD's benefits in the form of lower negotiated contract prices exceed the costs of CoP data. A potential exception for which DoD's costs may exceed benefits is the current TINA threshold that applies to subcontractors, although we were unable to obtain conclusive quantitative data supporting a change.

Contractors' recommendations in the third category, relaxing requirements for obtaining a TINA waiver could yield modest savings from reduced contractor proposal costs, but also could result in less or lower quality CoP data available to the PCO for contracts granted a waiver, making it more difficult to determine a "fair and reasonable price." There would be less risk to DoD if waiver criteria were relaxed than if TINA thresholds were increased, since DoD decides on a case-by-case basis whether to approve a waiver. While relaxing TINA waiver requirements might not have deleterious effects on DoD costs, it is clear that intent of current statute and DoD policy is that TINA waivers should only be approved under narrowly prescribed exceptional circumstances. As in the case of TINA thresholds applicable to subcontractors, we were unable to obtain conclusive quantitative data supporting changes to waiver criteria.

On January 23, 2015, Director, DP, requested comments on proposed recommendations from Service and Agency Contracting Officer Senior Leaders. Ten organizations responded, with six of those providing detailed comments, which are provided in Section 5.5. All respondents concurred

with the recommendation that there is insufficient evidence to justify relaxing waiver criteria and all but one respondent concurred that there is insufficient evidence to justify increasing the TINA threshold for prime contractors. Several respondents agreed with the premise that measures should be adopted to reduce resubmissions of CoP data, but most did not support three of the four proposals described above (require data be certified as of proposal submission date; consider certifiable data to remain effectively “current” through a specified date; and limit resubmission of data to items that change by a given threshold). Respondents who commented agreed with the fourth proposal, that DoD should not *automatically* subject contractors that voluntarily disclose defective pricing post-award to defective pricing claims and associated audits. This change could be made by revising FAR 407-1(c) to eliminate the requirement that “...the contracting officer shall request an audit...” if the contracting officer “...learns or suspects that data furnished “were not accurate, complete, and current, or were not adequately verified by the contractor as of the time of negotiation...”

Respondents provided two alternative approaches to reduce resubmission of CoP data:

- Although the FAR requires contractors to provide certified CoP data “as of the date price negotiations were concluded or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price,” it also encourages PCOs to reach a prior agreement on criteria for establishing cut-off dates when appropriate. Therefore, if determined to be in DoD's interest, cut-off dates might be used to limit resubmission of CoP data and reduce acquisition lead time. For selected large dollar acquisitions, DoD could test whether *providing cut-off dates to subcontractors that exceed TINA but are below a PCO-established threshold* reduces lead time and unnecessary CoP data resubmissions without adding significant risk. Test parameters would need to be established and consider circumstances that might require resetting the cut-off dates.
- Rather than submitting a complete FAR 15.2-compliant proposal, subcontractors could submit and certify to actual cost and prices based on recent sales. This would likely minimize proposal development efforts required by subcontractors as well as proposal analysis efforts by prime contractors and DoD.

Based on comments provided by Contracting Officer Senior Leaders, we recommend Director, DP:

- Consider revising the FAR to eliminate the requirement that a defective pricing claim and associated audit *must* be initiated if a contractor voluntarily discloses defective pricing post-award; and
- Consider implementing a pilot effort to reduce resubmissions of CoP data based on one or both of the approaches described above.

5.1 Actions Directed by USD(AT&L)

As a result of this study's recommendations on DoD requirements for CoP data, USD(AT&L) directed the following actions in the BBP 3.0 Implementation Directive dated April 9, 2015:

DPAP will initiate pilot programs to demonstrate and quantify impacts of reducing repeated submissions of cost or pricing data by October 2015.

DPAP will submit a revision to FAR 15.407-1(c) that eliminates the requirement that a contracting officer shall request an audit if a contractor voluntarily discloses defective pricing post-award by May 2015. (Status: as of May 31, 2015, a DFARS case was opened and language drafted for the proposed rule approved by the Director, Defense Pricing. The case number is DFARS 2015-D030, Promoting Voluntary Post-Award Disclosure of Defective Pricing.)

5.2 Summary Assessment of Contractors' Recommendations

- Clarify policy guidance to reduce/eliminate contractor resubmissions of certifiable CoP data.
 - Change appears justified and is recommended for consideration by DPAP.
- Increase statutory TINA threshold for prime contractors from current \$700,000 to \$5 million.
 - Change is not supported.
- Increase statutory TINA threshold from current \$700,000 to \$50 million for cost-type contracts.
 - Change is not supported.
- Increase statutory TINA threshold for subcontractors to \$2 million or \$5 million.
 - Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study.
 - Modest cost savings from reduced contractor proposal costs likely offset or negated by reduced negotiating advantage and fewer cost analyses of subcontractor proposals.
- Revise statutory requirement that all subcontractors above TINA threshold of \$700,000 must provide certified CoP data, exempting smaller suppliers as long as certified CoP data is provided for suppliers comprising 90 percent of the estimated contract value.
 - Change is not supported.
- Revise/relax FY 2003 NDAA statutory language that defines conditions for obtaining an Exceptional Case Exception or Waiver to TINA.
 - Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study.
 - Modest cost savings from reduced contractor proposal costs likely offset or negated by reduced negotiating advantage.
- Revise statutory TINA language that prevents delegation of TINA waiver approval authority below the head of the contracting activity.
 - Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study.
 - Would likely have little impact on frequency of TINA waiver approvals but may reduce procurement administrative lead times for contracts that qualify for a TINA waiver.

5.3 Detailed Assessment of Contractors' Recommendations

5.3.1 Clarify policy guidance to reduce/eliminate contractor resubmissions of certified CoP data.

Contractors asserted that FAR 15.406-2 (Certificate of Current Cost or Pricing Data):

“requires contractors to expend substantial time and effort in sweeping & re-sweeping cost data to ensure ‘current, accurate and complete’ up to the date of price agreement. During prolonged negotiations, multiple sweeps of proposal data are required to ensure compliance in providing ‘current, accurate and complete’ data. Additionally, the results of follow on sweeps generally do not reveal material change in cost or pricing information.”

In response to our follow-on question requesting data supporting the assertion that sweeps generally do not reveal material changes in CoP data, one contractor provided evidence from two Firm Fixed Price proposals in which price agreement was reached three and four months after proposal submissions, respectively. In both cases, the contractor asserted that no significant changes in price were identified as a result of the sweeps.

Procuring Contracting Officers (PCOs) interviewed opined that the TINA and FAR requirements that certified CoP data be “current” was beneficial in determining a “fair and reasonable price” because it places the onus for updates on the prime contractor to prevent potential claims by DoD of defective pricing. However, the purpose of TINA is not to support defective pricing audits—it is to level the playing field during negotiations by providing the PCO with the same cost or pricing knowledge base as the contractor’s negotiating team. PCOs interviewed asserted that some prime contractors are overly zealous in providing updated certified CoP data that reflect only minor changes in pricing. All resubmissions must be considered by the PCO, generating added work and procurement administrative lead time delays. While some PCOs agreed with contractors’ assertions that resubmissions are “usually not significant” in changing negotiated contract prices, they were reluctant to recommend that certified CoP data submitted as of a certain date be considered current for a specified period because of the potential for big shifts in prices (up or down) of certain commodity types.

Assessment: Change appears justified and is recommended for consideration by DPAP. We concur with contractors’ recommendation that DoD should clarify policy guidance to reduce repeated submissions of CoP data.¹¹³ Multiple CoP submissions are an unintended, and generally unsought, consequence of the FAR requirement that certified CoP data be “current.” Frequent resubmissions appear to be the result of contractors’ fears that out of date CoP data that becomes inaccurate will lead to defective pricing claims by the DoD post-award. However, lack of clarity on what is considered “current” motivates some contractors to provide excessively frequent CoP data

¹¹³ FAR guidance already explicitly addresses excess data requests. Per FAR 15.402(a)(3), contracting officers are directed to “[O]btain the type and quantity of data necessary to establish a fair and reasonable price, but not more data than is necessary. Requesting unnecessary data can lead to increased proposal preparation costs, generally extend acquisition lead time, and consume additional contractor and Government resources.” However, additional guidance specifically intended to reduce repeated submissions of CoP data may still be warranted.

updates during negotiations (weekly or monthly), which creates unnecessary work not only for contractors, but also for the PCO. We recommend amending DFARS (and/or the FAR) to remove uncertainty about the appropriate frequency of providing certifiable CoP data to ensure it remains “current” and/or to clarify pricing changes that warrant resubmission of CoP data. Policy clarification might be accomplished in one of several ways:

1. Require CoP data be certified as of proposal submission date or other cut-off date, rather than as of the date price negotiations are concluded (the current FAR requirement). Making certified CoP data available at the beginning of negotiations is consistent with TINA’s purpose, which is to put the PCO on level footing with contractors for negotiations in a sole source environment.
2. Consider certifiable CoP data to remain effectively “current” through a specified post-CoP data submission date (e.g., it remains current for 45 or 90 days).
 - OUSD(AT&L)/DP suggests that data submitted within 30 days of negotiated price settlement could be considered “current” and thereby not subject to resubmission.
3. Limit the resubmission of more current, accurate, and complete CoP data to items that change by a given threshold (e.g., 10 percent).
4. Reinstigate practice from 1980s that provided contractors the option to voluntarily disclose defective pricing data post-award and provide DoD with refunds (including interest), without risk of initiating defective pricing claims and associated audits.

Reducing unnecessary resubmissions of certifiable CoP data would lower contractor proposal costs and reduce procurement administrative lead time. Making this change also weakens the argument for making additional changes to the TINA statute, such as increasing thresholds or relaxing waiver criteria. A potential disadvantage of reducing multiple submissions of CoP data is that the auditable baseline could become obscured during extended negotiations.

5.3.2 Increase TINA threshold for prime contractors to \$5 million

Contractor-provided data for contracts negotiated in a sole source environment ranging from \$700,000 to \$5 million estimate that TINA-compliance related proposal costs account for 50-60 percent of total Bid and Proposal (B&P) costs and B&P costs are roughly 2-3 percent of the contract value.¹¹⁴ See Section 5.4 for key supporting data provided by contractors. Thus, increasing the TINA threshold could reduce contractor proposal costs for contracts in this dollar range subject to TINA by as much as 1.0 to 1.8 percent. DoD may also realize financial or other savings due to reduction in procurement administrative lead time and reduced efforts in evaluating proposals priced between \$700,000 and \$5 million.¹¹⁵ However, actual cost savings DoD might realize by increasing the TINA threshold would be reduced (or possibly negated entirely), for two reasons:

1. Savings would likely be offset by an increase in contract prices resulting from decreased information available to the Government during negotiations. The intent of TINA is to “level the playing field” when the Government negotiates with a sole source contractor. If the “negotiating advantage” resulting from TINA is less than approximately 1 percent of the contract value, raising the threshold could provide savings. However, if the negotiating advantage exceeds approximately 1.8 percent, then increasing the threshold would lead to price increases that exceed TINA-related savings. Contracting officers we interviewed asserted that TINA likely provides a negotiating advantage well above 1 percent of the contract value. However, we found no studies estimating the negotiating advantage from TINA. Quantifying the negotiating advantage analytically (i.e., using methods other than expert opinion) would be problematic.
2. The FAR requires contracting officers to obtain “data other than certified cost or pricing data as necessary to establish a fair and reasonable price.”¹¹⁶ In the absence of TINA, “other than certified CoP data” would likely be requested which would reduce the savings resulting from the increased TINA threshold. While the contractor-provided data clearly indicates that the certification process is a significant contributor to B&P costs (50-60 percent), we were unable to obtain data that quantified the cost differential between “certified” and “other than certified” CoP data.

Assessment: Change is not supported. Increasing the TINA threshold for prime contractors to \$5 million is unlikely to provide cost savings to DoD. Although DoD’s negotiating advantage due to TINA has not been quantified analytically, it likely exceeds TINA-related contractor proposal costs for contracts from \$700,000 to \$5 million negotiated in a sole source environment.

¹¹⁴ One contractor provided data that indicate B&P costs average approximately 2.2 percent of contract value for sole source contracts from \$700,000 to \$5 million.

¹¹⁵ DoD IG Audit Report 94-171, August 1, 1994, “Truth in Negotiations Act Revised Dollar Thresholds,” reviewed effects of the 1991 change in the TINA threshold from \$100,000 to \$500,000, which is the only previous change apart from inflation adjustments. Six of eight DoD contracting organizations surveyed believed that the increased threshold only marginally decreased paperwork required, principally “because some contracting officers apparently still insisted on negotiating a contract price based on detailed cost analyses.” However, six of eight DoD organizations reported that financial or other savings were realized, “primarily from reductions in procurement administrative lead time” and “less effort in evaluating proposals priced between \$100K and \$500K.” Of 55 contractors surveyed, roughly half believed that a reduction in paperwork had occurred and that noticeable financial or other savings were realized.

¹¹⁶ FAR 15.402(a)(2)

5.3.3 Increase TINA threshold for cost contracts to \$50 million.

Contractor's recommendation to increase the TINA threshold for cost type contracts to \$50 million is based on the rationale that such contracts represent low-cost risk to DoD, with the risk being essentially equivalent to the negotiated fee, estimated as typically 10 percent. The risk to DoD was also asserted to be low because contract reporting and Government controls and oversight during execution mitigate risk. Finally, increasing the threshold for cost type contracts was said to be consistent with how DoD currently balances proposal cost/risk, e.g., audit thresholds are \$10 million for FFP proposals whereas they are \$100 million for cost type. One contractor estimated that TINA-compliance related costs comprise approximately 50 percent of B&P costs for cost type contracts ranging from \$5 million to \$50 million in value.

Contracting officers interviewed asserted that the Government risk for cost type contracts is not confined solely to the fee. CoP data (both certified and other than certified) is used in cost realism analysis, i.e., determining the contractor's capability and understanding of the required effort (e.g., are estimated cost elements realistic for the work to be performed, do they reflect clear understanding of requirements, and are they consistent with the methods of performance and materials described in the offeror's technical proposal). DoD bears the risk for cost overruns, reasonable fees, and ensuring that the resulting contract meets DoD's affordability requirements.

Assessment: Change is not supported. Like the negotiating advantage described above, the benefit of certified CoP data to DoD for determining cost realism of cost type contracts would be problematic to quantify analytically. However, even if one were to stipulate that DoD's risk is confined solely to fee, if the absence of certified CoP data led to fee increases on the order of 1-2 percentage points, that would negate most, if not all, of the savings resulting from raising the TINA threshold on cost type contracts.

5.3.4 Increase TINA threshold for subcontractors to \$2 million or \$5 million.

A cost/benefit assessment of increasing the TINA threshold for subcontractors differs from the analogous assessment for prime contractors in several respects. Firstly, potential savings would be less (as a percent of contract value) in the former case because the increased threshold would affect only a portion of subcontractors rather than the entire contract. Secondly, quantifying the DoD's benefit associated with the subcontractor threshold is even more difficult than is the case for prime contractors because in some cases subcontractors' certified CoP data is not required to be submitted to DoD.¹¹⁷ A cost/benefit assessment must therefore consider benefits of requiring subcontractors to submit certified CoP data to the prime contractor that may not be submitted to DoD.

Potential savings from increasing the subcontractor threshold vary depending on contract value and the number of suppliers involved in the proposal. Contractor-submitted data for contracts negotiated in a sole source environment indicate that the ratio of total B&P costs to contract value decreases as contract value increases. Data submitted on several large sole source contracts indicate that TINA-associated costs are less than 0.1 percent of contract value (rather than the 1.0 to 1.8 percent range for contracts in the \$700,000 to \$5 million range). For an example contract in which the total subcontractor Bill of Material (BOM) was valued at approximately \$3 billion (and the final proposed price was approximately \$6.1 billion), increasing the subcontractor threshold to \$2 million or \$5 million would reduce the number of subcontractors that exceed the TINA threshold by 35 percent or 62 percent, respectively. For this roughly \$3 billion BOM, the contractor estimated that a \$2 million subcontractor threshold would reduce TINA-associated costs by approximately \$0.9 million (roughly 0.015 percent of contract price), while a \$5 million threshold would reduce costs by approximately \$1.7 million (roughly 0.03 percent of contract price).¹¹⁸ This contractor estimated that such savings might apply to approximately 20 of their proposals per year. DoD might also benefit from procurement administrative lead time reductions and from reduced effort required for proposal evaluations.¹¹⁹

It is problematic to quantitatively assess the DoD's benefit from the current TINA subcontractor threshold, and even more challenging to quantitatively assess the diminishment of that benefit as a function of increasing the threshold. The intent of this provision of TINA is to provide the prime contractor information to assist in its negotiations with its suppliers (i.e., a "negotiating advantage" as described above) and thereby ensure the lowest overall cost and technical risk to

¹¹⁷ FAR 15.404-3(c) requires subcontractors to provide certified CoP data to DoD when their proposed subcontract is the lower of either—(i) \$12.5 million or more; or (ii) above the TINA threshold and more than 10 percent of the prime contractor's proposed price. However, the contracting officer may require subcontractors to submit certified CoP data below these thresholds if they consider it necessary for adequately pricing the prime contract.

¹¹⁸ Savings were estimated based on reduced number of subcontractors subject to TINA. However, we estimate proposal cost savings are approximately one-third of that estimated by the contractor because of the number of subcontractors with FAR-permissible exceptions to TINA. See Section 5.4 for key supporting data provided by contractors.

¹¹⁹ DoD IG Audit Report 94-171, August 1, 1994, states that "organization reduced costs by not having to request field pricing support reviews from the administrative contracting officers or audit assistance from DCAA for those contract proposals priced under \$500K." While contracting organizations reported reduction in procurement administrative lead time, the magnitude of the reduction was not quantified.

DoD. Prime contractors are obligated to ensure that the data submitted by subcontractors are current, accurate, and complete. Although the subcontractor certified CoP data may not be required to be submitted to DoD for proposals below the aforementioned FAR thresholds, the prime contractor is required to perform cost analyses of subcontractor proposals above the TINA threshold (and price analyses below the TINA threshold) and to include the results of these analyses in the price proposal to DoD.¹²⁰ Thus, tangible benefits to DoD of requiring certified CoP data to be submitted to the prime contractor (for cases when it is not required to be submitted to DoD) include: the negotiating advantage such data provides to the prime contractor; and the prime contractor's cost analyses of subcontractor proposals provided to DoD in the prime contractor's price proposal. Both of these benefits are problematic to quantify.

On one hand, contractors assert that "values below the new \$2M threshold could be estimated by any number of valid cost estimating techniques apart from requesting detailed cost proposals from suppliers." They further assert that "[G]eneration of supplier proposals, related analyses and related audits are the primary contributor to lengthened acquisition process cycle times. Expanded usage of cost estimating techniques other than detailed cost proposals will shorten cycle time and reduce costs for all parties." Finally, because "supplier proposals are being generated to support the prime contract proposal and not the actual anticipated date of supplier subcontract award... suppliers are being asked to submit firm proposals so far in advance of subcontract award that they actually increase their proposed costs to cover unknowns and address other perceived risk concerns."

On the other hand, contracting officers we interviewed contend that cost analyses provided by prime contractors can be useful in determining a fair and reasonable price and in some cases may provide indications of potential problems with smaller suppliers if they significantly overbid or underbid the required effort. Another consideration arguing against raising the subcontractor threshold is that in a non-competitive fixed-price environment, financial incentives of the prime contractor during negotiations are aligned with higher subcontractor costs, in order to obtain a higher negotiated price. Requiring subcontractors to submit certified CoP data to the prime may serve as a restraint on prices of subcontractors' proposals. Finally, a 1992 GAO study¹²¹ found that 63 percent of the defective pricing identified by DCAA in FYs 1987-1990 was attributable to subcontractors; increasing the subcontractor threshold would reduce the number of suppliers subject to defective pricing remediation.

Assessment: Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study. The TINA-related cost data provided by contractors is insufficient to determine whether increasing the TINA threshold for subcontractors would provide net cost savings to DoD. Potential cost savings directly attributable to reduced contractor proposal costs associated with TINA would be relatively modest, with best case savings on the order of 0.03 percent of contract price for large contracts. DoD cost savings associated with reduced effort to evaluate proposals would be problematic to quantify, but six of eight DoD contracting organizations surveyed qualitatively assessed that at least marginal financial savings

¹²⁰ FAR 15.404-3(b) and 15.404-3(c)

¹²¹ GAO/NSIAD-92-131, May 1992, "Subcontracts are Significant in Prime Contract Defective Pricing"

were achieved when the TINA threshold was increased from \$100,000 to \$500,000.¹²² The procurement administrative lead time reduction resulting from increasing the threshold would be problematic to quantify.¹²³ Further study might include surveys of contracting officers to estimate the value of the negotiating advantage that subcontractor CoP data provides to the prime (and DoD), the negotiating advantage that the prime's cost analyses of subcontractor proposals provides DoD, and the reduction in procurement administrative lead time that might result from increasing the TINA threshold on subcontractors.

¹²² DoD IG Audit Report 94-171, August 1, 1994, Appendix A.

¹²³ The reduced requirement for the prime to obtain subcontractor CoP data might tend to reduce procurement administrative lead time, but this reduction could be offset by increased time required for the contracting officer to determine a fair and reasonable price without the prime contractor's cost analyses of subcontractor proposals.

5.3.5 Revise requirement that all subcontractors above TINA threshold of \$700,000 must provide certified CoP data, exempting smaller suppliers as long as certified CoP data is provided for suppliers comprising 90 percent of the estimated contract value.

The cost/benefit assessment of this recommendation is analogous to the recommendation that the TINA threshold for subcontractors be increased to \$2 million or \$5 million. For large dollar contracts, both recommendations would require fewer subcontractors to provide certified CoP data than under the current TINA threshold. Savings from reduced proposal costs would be comparable (depending on the contract value and subcontractor composition), and it is equally problematic to quantify the loss of negotiating advantage (for the prime contractor and DoD) and the potential procurement administrative lead time reduction that might result from this recommendation.

While potential cost savings and change in benefits are comparable, this recommendation has several disadvantages compared with the recommendation to increase the TINA threshold for subcontractors. Firstly, implementing such a recommendation would introduce complexities that may lead to confusion or uncertainty by contractors. The recommendation would reduce the number of subcontractors subject to TINA only for relatively large contracts; for smaller contracts, the existing TINA threshold would apply (otherwise *more* subcontractors would be subject to TINA, not less). This would create a situation in which a subcontractor providing a given value of materials above the current TINA threshold (say \$1 million) would be required to provide certified CoP data for lower value contracts, but not for higher value contracts. Secondly, potential exists that prime contractors could alter their subcontractor sourcing strategy to reduce the numbers of subcontractors subject to TINA (by further splitting orders among suppliers).

Assessment: Change is not supported. This recommendation has similar potential cost savings and benefits changes as the recommendation to reduce the TINA threshold for subcontractors but has disadvantages that make it less attractive.

5.3.6 Revise/relax FY 2003 NDAA statutory language that defines conditions for obtaining an Exceptional Case Exception or Waiver to TINA.

Contractors correctly asserted that DoD-approved waivers to TINA requirements based on FAR 15.403-1(c)(4) have decreased considerably since passage of the FY 2003 NDAA, which defined three criterion for granting a TINA waiver.¹²⁴ This legislation also requires DoD to submit annual reports to Congress with explanations of the basis for waivers granted on contracts with values exceeding \$15 million. Data provided by OUSD(AT&L)/DPAP indicate that since 2003, TINA waivers have decreased in numbers and total dollar value as shown in Figure 5.1 and Figure 5.2, respectively. Data on TINA waivers prior to 2003 was not available from DPAP.

The most stringent of the three criteria in the FY 2003 NDAA is: “the property or services cannot reasonably be obtained under the contract, subcontract, or modification, as the case may be, without the grant of the exception or waiver.” The DFARS Procedures Guidance and Information (PGI) published by DPAP is equally explicit in describing conditions that warrant a TINA waiver: “waivers must be used judiciously, in situations where the Government could not otherwise obtain a needed item without a waiver.”¹²⁵ The PGI references a March 23, 2007, DPAP policy

¹²⁴ Note: Pub. L. 107–314, div. A, title VIII, § 817, December 2, 2002, 116 Stat. 2610, (Bob Stump National Defense Authorization Act for Fiscal Year 2003) as amended by Pub. L. 112–81, div. A, title VIII, § 809(a), December 31, 2011, 125 Stat. 1490, provides that: “(a) Guidance for Exceptions in Exceptional Circumstances.—Not later than 60 days after the date of the enactment of this Act [Dec. 2, 2002], the Secretary of Defense shall issue guidance on the circumstances under which it is appropriate to grant an exceptional case exception or waiver with respect to certified cost and pricing data and cost accounting standards. “(b) Determination Required for Exceptional Case Exception or Waiver.—The guidance shall, at a minimum, include a limitation that a grant of an exceptional case exception or waiver is appropriate with respect to a contract, subcontract, or (in the case of submission of certified cost and pricing data) modification only upon a determination that— “(1) the property or services cannot reasonably be obtained under the contract, subcontract, or modification, as the case may be, without the grant of the exception or waiver; “(2) the price can be determined to be fair and reasonable without the submission of certified cost and pricing data or the application of cost accounting standards, as the case may be; and “(3) there are demonstrated benefits to granting the exception or waiver. “(c) Applicability of New Guidance.—The guidance issued under subsection (a) shall apply to each exceptional case exception or waiver that is granted on or after the date on which the guidance is issued. “(d) Annual Report on Both Commercial Item and Exceptional Case Exceptions and Waivers.—(1) The Secretary of Defense shall transmit to the congressional defense committees [Committees on Armed Services and Appropriations of the Senate and the House of Representatives] promptly after the end of each fiscal year a report on commercial item exceptions, and exceptional case exceptions and waivers, described in paragraph (2) that were granted during that fiscal year. “(2) The report for a fiscal year shall include—“(A) with respect to any commercial item exception granted in the case of a contract, subcontract, or contract or subcontract modification that is expected to have a price of \$15,000,000 or more, an explanation of the basis for the determination that the products or services to be purchased are commercial items, including an identification of the specific steps taken to ensure price reasonableness; “(B) with respect to any exceptional case exception or waiver granted in the case of a contract or subcontract that is expected to have a value of \$15,000,000 or more, an explanation of the basis for the determination described in subsection (b), including an identification of the specific steps taken to ensure that the price was fair and reasonable; and “(C) with respect to any determination pursuant to section 2304a (d)(3)(D) of title 10, United States Code, that because of exceptional circumstances it is necessary in the public interest to award a task or delivery order contract with an estimated value in excess of \$100,000,000 to a single source, an explanation of the basis for the determination. “(e) Definitions.—In this section: “(1) The term ‘exceptional case exception or waiver’ means either of the following: “(A) An exception pursuant to section 2306a (b)(1)(C) of title 10, United States Code, relating to submission of certified cost and pricing data.

¹²⁵ PGI 215.403-1(c)(4)(A)(1); available at: http://www.acq.osd.mil/dpap/dars/pgi/pgi_pdf/PGI215_4.pdf

memorandum which states: “The purpose of this policy memorandum is to (a) make it clear that the standard to be met for granting a TINA waiver is extremely high...”¹²⁶

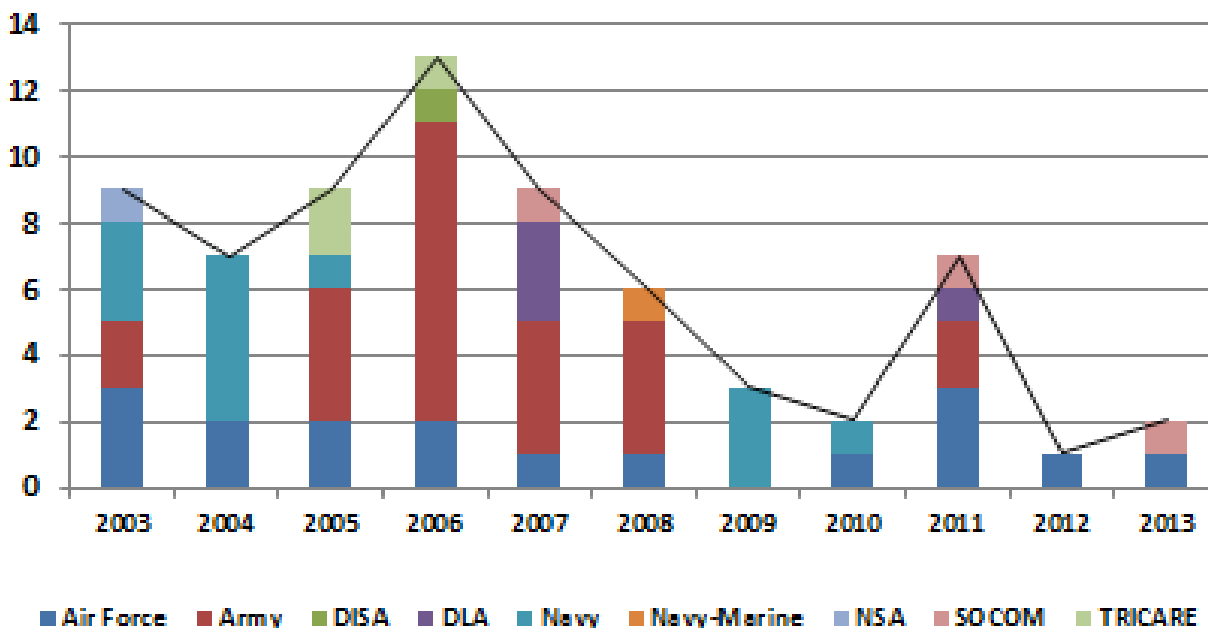


Figure 5.1 TINA Trends: Number of Waivers

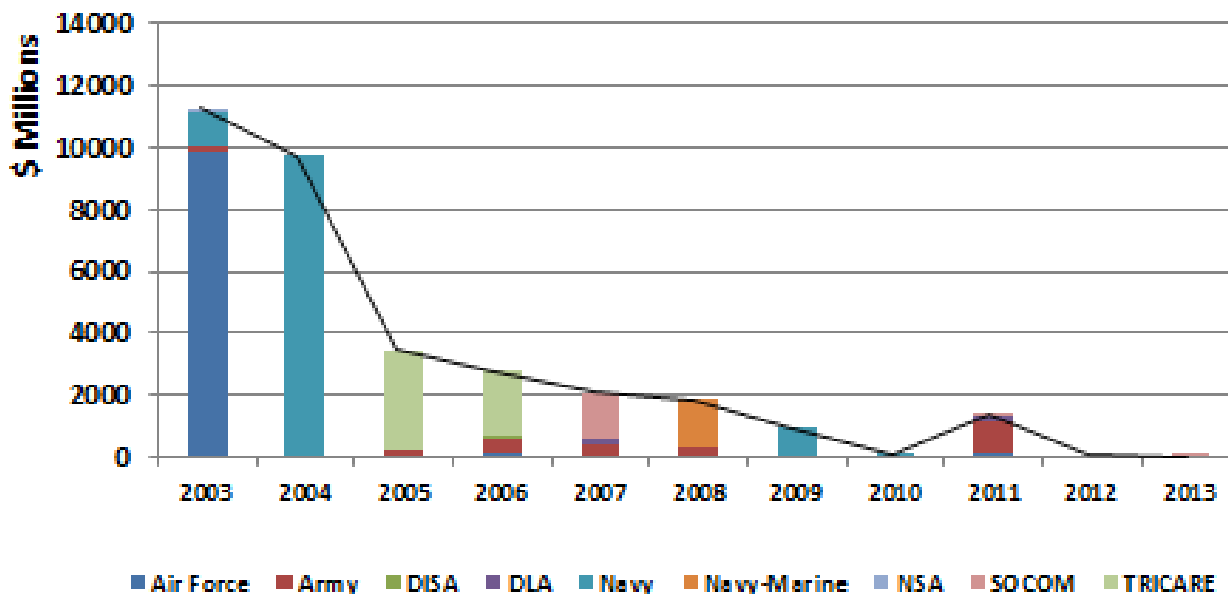


Figure 5.2 TINA Trends: Dollar Value of Waivers

¹²⁶ DPAP Memo, March 23, 2007; available at: <http://www.acq.osd.mil/dpap/policy/policyvault/2007-0195-DPAP.pdf>

Based on current statute and DPAP implementing instructions, it is clear that waivers of TINA requirements are permissible only under narrowly prescribed circumstances. Whether such stringent criteria are beneficial based on a cost/benefit assessment is a separate question. Unfortunately, extant data is insufficient to determine whether relaxing the requirements for a TINA waiver would provide net benefits. While contractor-provided data can be extrapolated to estimate TINA-associated costs for several representative contracts for which adequate historical cost data could be presumed to exist, determining the benefits of the certified CoP data in providing a negotiating advantage to DoD would be problematic.

Assessment: Change is not amenable to a quantitative cost/benefit assessment but may be worthy of consideration by DPAP and/or further study. Based solely on the quantitative cost data provided by contractors, we assess it unlikely that revising/relaxing TINA waiver requirements would provide net cost savings to DoD. Potential cost savings directly attributable to reduced contractor proposal costs associated with expanded TINA waivers would be relatively modest, with best case savings on the order of 0.3 percent of contract price or lower for contracts greater than \$300 million. However, proposal cost savings would likely be offset or negated by increased contract costs as a result of DoD's reduced negotiating advantage in the absence of certified CoP data. As described previously, quantifying this negotiating advantage analytically (i.e., using methods other than expert opinion) would be problematic. Further study might include surveys of contracting officers to estimate the value of the negotiating advantage that certified CoP data provides DoD on contracts for which significant historical cost data exist. In addition, analysis of similar contracts awarded with waivers prior to 2003 and without waivers subsequent to 2003 might provide insights into the negotiating advantage that certified CoP data provides DoD.

5.3.7 Revise statutory TINA language that prevents delegation of TINA waiver approval authority below the head of the contracting activity (HCA).

Several contractors recommended revising TINA to invest the procuring contracting officer (PCO) with TINA waiver approval authority. Contracting officers and DPAP subject matter experts we interviewed opined that delegation below the HCA may have merit but were united in the view that delegating such authority to the PCO would be detrimental to DoD's interests. According to these experts, pressure on PCOs to award contracts quickly could lead to inappropriate application of TINA waiver approval authority. Delegation of waiver approval authority one level below the HCA or to a GO/SES official in the contracting chain were considered viable options by the experts interviewed. However, experts did not believe that such delegation authority would have a significant impact on the frequency or timeline associated with TINA waivers, because of the stringent waiver criteria described previously.

Assessment: Change is not amenable to a quantitative cost/benefit assessment but may be worthy of consideration by DPAP and/or further study. Delegating TINA waiver approval authority to the PCO is likely detrimental to DoD's interests. Allowing delegation of TINA waiver approval authority one level below the HCA, or to a GO/SES in the contracting chain, is not likely to be detrimental to DoD's interests. If the criteria for granting a TINA waiver are not relaxed, then it is unlikely that delegating approval authority would increase the number of TINA waivers DoD approves. DoD would still be required to provide an explanation of the basis for the TINA waiver for contracts exceeding \$15 million to congressional defense committees. Providing delegation of TINA waiver approval authority would likely reduce procurement administrative lead times for contracts that qualify for a TINA waiver, but the magnitude of potential reduction in lead time has not been quantified. In any case, this potential procurement administrative lead time reduction would apply only to a small number of relatively low value contracts, as shown in Figure 5.1 and Figure 5.2.

5.4 Key Supporting Data Provided by Contractors Related to TINA and CoP data

Contract Value (\$M)	B&P costs (\$K) [*]
< 20.0	58 ^{&}
> 20.0	700 [∨]
Single Example ~\$340M program	2000
Single Example ~\$800M program	2700

Contract Value (\$M)	Estimated TINA cost to total B&P costs (%) [*]
0.7 – 5.0	60
In general	50 – 60

* For certified proposals negotiated in sole source environment

& Estimate of average B&P costs based on actual costs of 9 example proposals

∨ Estimate of average B&P costs

Sole Source Proposal Supplier Bill of Material (BOM)	Subcontractors above current TINA threshold	Subcontractors above if threshold changed to \$2M	Subcontractors above if threshold changed to \$5M
Multi-year, ~\$3B	196 [*]	132 [^]	72 [#]
Three combined proposals, ~\$1.8B	115	79	

* However, only 75 of these subcontractors were subject to TINA, due to FAR-permissible exceptions

[^] Contractor's estimate of potential proposal cost savings = \$0.9M

[#] Contractor's estimate of potential proposal cost savings = \$1.7M

5.5 Comments from Contracting Officer Senior Leaders

1. ***Require CoP data be certified as of proposal submission date or other cut-off date, rather than as of the date price negotiations are concluded (the current FAR requirement). Making certified CoP data available at the beginning of negotiations is consistent with TINA's purpose, which is to put the PCO on level footing with contractors for negotiations in a sole source environment.***

Service 1 Comment: There is no benefit to certifying a proposal at time of proposal submission. A very large delay in awarding contracts in a sole source environment is contractors not providing cost or pricing data in a timely manner. Often contractors delay providing all of the information as a negotiation ploy. If a contractor would utilize the adequate proposal checklist, they would provide the required data to the PCO to be used for the Government to prepare its objective and negotiate a fair and reasonable price. This information is readily available at time of proposal submission since the contractor utilized this information for preparing the proposal and for internal reviews with contractor management prior to submission of the proposal to the Government. This would reduce the time needed for negotiations.

Contractors are required to sign a TINA certification at the completion of negotiations because it ensures that the Cost or Pricing data is the latest and most current data. There is no benefit to a certified proposal. Some negotiations are very lengthy and take several months to complete, which makes certification at proposal submission or an arbitrary cut-off date unwise. Many contractors do not provide updated CoP data prior to or during negotiations. Having the contractor certify data at the conclusion of negotiations ensures the PCO at that time is on level footing with the contractor. This alternative may lead to situations where contractors only revise their initial proposal data when it is in their favor.

Service 2 Comment: Do not pursue certification as of proposal submission. Due to the passage of time between proposal submission and conclusion of negotiations, the Government would not be on equal footing with the contractor. Recommend looking at the use of cut-off dates consistent with FAR 15.403-4, "as close as practicable to the date of agreement on price." However, while cut-off dates may allow for an earlier sweep, cut-off dates add additional risk only to the Government.

Agency 1 Comment: Applying TINA only at the proposal submission date will remove an important quality check in the acquisition system. Making the cutoff date the proposal submission date will effectively put DoD in a situation where there is no recourse for the contractor not disclosing current known information on its costs during contract negotiations. DoD would not be protected by post-award audits of contracts. DoD continues to find instances of defective pricing in performing post-award audits of recent contracts. We do not see where the PARCA assessment considered the potential impact between the initial proposal and the final price agreement to determine the risk to the Government and how many dollars are at stake. Finally, if implemented at the proposal submission date, only the DoD Office of Inspector General would be able to audit the difference between initially proposed costs and current contractor costs at handshake

agreement, and there would not be a contractual/statutory requirement for the contractor to repay its additional profits gained from the difference in these amounts. As a result, the Department will pay higher costs and be in a clear disadvantage in recouping price adjustments that occur during the normal course of negotiations as the contractor completes negotiations with its subcontracts.

We believe that the intent of the recommendation to reduce repeated submissions of certified cost or pricing data has merit. However, the implementation of an effective cutoff date needs to be at the time of final price/handshake agreement to protect the Department and the taxpayers. PARCA's consideration of making the cutoff date the proposal submission date is troublesome and will not adequately protect the Government as we detail below.

Normally, the acquisition process takes longer than a year (and in some cases, multiple years) to complete and get to final price agreement. In this circumstance, applying TINA at only the proposal submission for fixed-price contracts will result in the contractor having the advantage of knowing more current pricing information than the Government negotiator with no requirement to disclose it. This will place the Government negotiator in a clear unfair advantage and the Department will not have a mechanism to ensure contractors share relevant pricing information necessary to negotiate effectively. Furthermore, we do not see how this consideration is consistent with the purpose of TINA - to put the Government on equal footing - as the assessment states. In fact, it will have the opposite effect and place higher importance on ensuring that we have adequate supportable proposals from contractors, which remains a frequent problem for contractors and their subcontractors. This change will also likely have the unintended consequence of incentivizing contractors to provide support (i.e., quotes) for prices at the highest possible price when submitting its proposal and then will allow them to negotiate lower contractual prices from its subcontractors that are not required to be disclosed, thereby maximizing profits. The result of using the proposal submission date as the cutoff date is that DoD will pay higher and excessive prices for goods and services because we would be less informed of contractors' costs than we are today.

2. Consider certifiable CoP data to remain effectively "current" through a specified post-CoP data submission date (e.g., it remains current for 45 or 90 days).

Service 1 Comment: Any time line on how "current" cost or pricing data is arbitrary. Market prices on commodities can vary greatly in short time periods, due to market conditions or technological advances. How do we deal with the contractor negotiating lower prices with their vendors within this period (30/45/90 days)? The inability to require the contractor to share updated information could cost the Government money. If a timeframe is identified, we would prefer to see a shorter timeframe (maybe 15 days).

Service 2 Comment: Do not pursue. By law, current is through the conclusion of negotiations, unless the parties agreed to an alternative date as close as practicable to negotiations. This would be accomplished through the use of cutoff dates.

3. OUSD(AT&L)/DP suggests that data submitted within 30 days of negotiated price settlement could be considered “current” and thereby not subject to resubmission.

Service 1 Comment: This is confusing as to what is meant. If you have negotiated a price settlement within 30 days, why are you submitting the same cost or pricing data for the same effort? If there is a new requirement for the same or similar item, the new requirement requires the price be supported. Disagree with recommendation to change policy.

Agency 2 Comment: In order to allow contractors the freedom to choose a point of certification perhaps sometime prior to negotiation, the word "current" needs to be eliminated from the statute and the FAR. The words accurate and complete are sufficient. The word "current" drives the need for updates before and finally after negotiation and prior to certification. Rather than making certification a function of mutual agreement, it should be the contractors' call alone when they have submitted accurate and complete data in order to negotiate fairly.

4. Limit the resubmission of more current, accurate and complete CoP data to items that change by a given threshold (e.g., 10 percent).

Service 1 Comment: This again is arbitrary. The PCO can determine significance once the cost or pricing data is provided to the PCO. If you have a high dollar value BOM, then even something as small as a 5 percent change can make a material difference, which could end up costing the Government money if it is not disclosed. Who is going to verify that the contractor did not miss items or costs that were at the threshold?

Service 2 Comment: Do not pursue. This approach makes the responsibility for disclosure rather ambiguous and could have serious unintended consequences, including limiting the Government's rights from a post-award standpoint. A 10 percent threshold could mean that any time a single data change exceeds 10 percent that a disclosure would be required, or once an aggregate value exceeds 10 percent a disclosure would be required. It could be 10 percent at an elemental level or at a level lower than that. Either way, the contractor must obtain data and assess its impact to the proposal as he normally would. There would be no savings from a time or resource standpoint. Again, this type of limitation would put the Government and the contractor on unequal footing in negotiations. Finally, it is important to consider gross dollars and not just percentages. A 9 percent change could still be millions of dollars and very important to our taxpayers and our ability to procure additional capabilities. This approach would add significant risk to the Government and would add significant complexities to defective pricing audits and our ability to support defective pricing claims.

5. Reinststitute practice from 1980s that provided contractors the option to voluntarily disclose defective pricing data post-award and provide DoD with refunds (including interest), without risk of initiating defective pricing claims and associated audits.

Service 1 Comment: FAR 15.408 Instructions to Table 15-2 provide:

As later data come into your possession, it should be submitted promptly to the Contracting Officer in a manner that clearly shows how the information relates to the offeror's price proposal. The requirement for submission of certified cost or pricing data continues up to the time of agreement on price, or an earlier date agreed upon between the parties if applicable.

The general rule has been that the contractor can update any part of the proposal at any time as long as the audit trail to the proposal and the impact on the proposal are clear. There is no requirement for a sweep. One of our managers recalls the practice of conducting sweeps started in the early 1990s. After contractors had been doing this for a couple of years, we found out Dykema Gossett (Detroit law firm that specializes in Government contract law) was conducting seminars where they were teaching companies to do sweeps because the sweep after agreement on price, if accepted by the Government, is a DEFENSE to defective pricing. We looked at it, realized that we could either accept the price reductions now and have 100 percent of the amount in our pockets (and be able to reobligate the amounts), or we could wait until DCAA uncovers something under a defective pricing audit, potentially get 30 cents on the dollar (or less) and lose the money to the Treasury. So we adopted the practice of accepting downward adjustments that result from sweeps after agreement on price or the cutoff date. But to be clear, sweeps are a defense against potential defective pricing, not a requirement of the statute.

While we agree in principle that the Department should not impose duplicative requirements, we believe the 15.408 instructions are clear and do not require modification.

This change makes some sense. The contractor can avoid interest penalties and the Government collects the refund in an expedited manner. Additionally, the Government may collect money on defective pricing which may not have been discovered during the normal Government post award review process. Conversely, if the Government learns about defective pricing in this manner, a PCO can still request a DCAA audit. We would have to verify the amount of the refund offered by the contractor is accurate and all included defective pricing.

Another option to consider is changing FAR 14.407-1 (c) from "PCO Shall" to "PCO May," allowing the contractor to voluntarily disclose changes in prices without definite repercussions. This leaves the decision of whether a DCAA defective price audit is necessary to the PCO on an individual contract basis.

Service 2 Comment: Pursue a potential change to FAR 15.404-1(c) which (currently) makes it mandatory for the CO to request an audit. In addition, DoD-level discussions with Legal would be needed regarding the regulations associated with voluntary refunds. Specifically, DoD PGI 242.7100 prohibits the Government from accepting a voluntary refund if other contractual remedies are available (i.e. defective pricing). Finally, a change to these regulations to allow for the submission of post award sweep data should not be unbounded. Recommend the regulations

enable contractors to submit data as a voluntary refund only within a certain period of time from the negotiation settlement date. Data submitted beyond the allowance period would be subject to defective pricing.

Agency 2 Comment: It is good idea to reinstitute the practice from 1980s providing contractors the option to voluntarily disclose defective pricing data post-award and provide DoD with refunds (including interest), without risk of initiating defective pricing claims and associated audits. Many contractors do not voluntarily disclose the defective pricing because the disclosure can be used by the Government who can claim the disclosure is "de facto," the second of three elements the Government must show to allege defective pricing (which are (1) it must show that the information at issue fits the definition of "cost or pricing data"; (2) it must further show that this information was not meaningfully disclosed to the Government; and (3) it must show that its negotiators relied upon the contractor's defective data, leading to an overstatement in the final price agreed to by the Government). It is always more effective and efficient to give the contractor incentive to do work voluntarily than audit the contractor to find the contractor's defective pricing.

Comments on: Analysis of Contractor Recommended Changes to TINA:

1. Clarify policy guidance to reduce/eliminate contractor resubmissions of certifiable CoP data.
Change appears justified and is recommended for consideration by DPAP

Service 1 Concur: Suggest that the DFARS or DFARS PGI be amended to simply provide guidance that there is no requirement for frequent contractor submissions of updated CCoP data after submission of the initial proposal, during the phase of Government proposal evaluation and negotiations with the contractor. The contractor should only provide updated information that has a significant impact on the Government's proposal evaluation such that if it were not submitted, it would significantly delay the proposal evaluation and negotiation process. Depending on the circumstances, this new information does not necessarily have to be a complete update of the proposed cost for the contract action. However, it often makes sense for the PCO to obtain a proposal update a short time before negotiations are to commence, if a considerable period of time has elapsed since initial proposal submission or the contractor agrees their proposed costs are not substantially current, accurate, and complete. Of course, before final price agreement the contractor must have submitted all data that will enable them to sign a certificate of current cost or pricing data.

Agency 3 Concur: We believe DoD should clarify policy guidance to reduce repeated submissions of CoP data. CoP data should be certified as of proposal submission date or, if applicable, a later date agreed upon between the parties, rather than as of the date price negotiations are concluded (the current FAR requirement).

2. Increase statutory TINA threshold for prime contractors from current \$700,000 to \$5 million.
Change is not supported

Service 1 Does Not Support Change.

Agency 3 Supports Change: We believe the threshold for CoP data is too low. The CoP data threshold has not been changed (except for inflation adjustments) since 1991. We do not agree that increasing the threshold would only yield modest saving. We believe that increased savings could be achieved by reduction in the amount of time necessary to provide CoP data for these low dollar proposals both on the contractors' side as well as the Government's side.

3. Increase statutory TINA threshold from current \$700,000 to \$50 million for cost-type contracts.

Change is not supported

Service 1 Does Not Support Change.

Agency 3 Does Not Support Change: The cost risk to the Government is too great.

4. Increase statutory TINA threshold for subcontractors to \$2 million or \$5 million.

Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study.

Service 1 Does Not Support Change: Most major defense contractors' proposals are 60-70 percent subcontractor costs. Raising the requirement that high would increase the cost to the Government. TINA requirements are an impetus for subcontractors to submit fully supported proposals and thus hold costs to the Government lower.

Agency 3 Supports Change: We believe that the change should be the same amount as the TINA threshold change for prime contractors (\$5 million).

5. Revise statutory requirement that all subcontractors above TINA threshold of \$700,000 must provide certified CoP data, exempting smaller suppliers as long as certified CoP data is provided for suppliers comprising 90 percent of the estimated contract value.

Change is not supported

Service 1 Does Not Support Change.

Agency 3 Does Not Support Change: Implementing such a recommendation would introduce complexities that may lead to confusion or uncertainty by contractors. The potential exists that

prime contractors could alter their subcontractor sourcing strategy to reduce the numbers of subcontractors subject to TINA (by further splitting orders among suppliers).

6. *Revise/relax FY 2003 NDAA statutory language that defines conditions for obtaining an Exceptional Case Exception or Waiver to TINA.*

Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study

Service 1 Does Not Support Change: Getting the waiver to CoP data is supposed to be hard and only done in exceptional circumstances. Easing the requirements to make it easier to obtain goes against the purpose of the Exceptional Case Exception. Also, as FAR 15.403-3 states, the PCO is still to obtain other than certified cost or pricing data in order to determine a fair and reasonable price, so in the end making it easier to obtain a waiver may still not alleviate work from the contractor.

Agency 3 Does Not Support Change: We agree that proposed cost savings would likely be offset or negated by increased contract costs as a result of DoD's reduced negotiating advantage in the absence of certified CoP data.

7. *Revise statutory TINA language that prevents delegation of TINA waiver approval authority below the head of the contracting activity.*

Change is not amenable to a quantitative cost/benefit assessment, but may be worthy of consideration by DPAP and/or further study.

Service 1 Does Not Support Change: We do not support lower approval authority (see 6 above). Consider lower threshold only for contracts below a certain threshold vs all contracts.

Agency 3 Does Not Support Change: Pressure on PCOs to award contracts quickly could lead to inappropriate application of TINA waiver approval authority.

PARCA Recommendation 1: Consider revising the FAR to eliminate the requirement that a defective pricing claim and associated audit *must* be initiated if a contractor voluntarily discloses defective pricing post-award.

Agency 1 Comment: We do not agree with Recommendation 1 and believe that the mandatory audit requirement is essential to hold contractors accountable for not providing information on known costs to the Government during negotiations. Currently, contractors know that if they violate this standard they will be subject to an independent audit conducted under professional standards to account for the impact on the negotiation. The division from the contracting officer in the current regulations was intentionally setup to ensure independence of contracting officers and protect the Government and taxpayers. Providing contracting officers with the authority to accept voluntary disclosures and pushing the decision down to an already overburdened contracting

officer without standards or requirements could blur independence and will result in a varying degree of enforcement. Furthermore, not having DCAA audit these contractors and understanding the reasons for the defective pricing could inadvertently conceal systemic estimating and proposal issues that could affect other procurements. In addition, contractors providing information for this study have not expressed comments stating that the mandatory audit requirement is a problem, and there is no data to support that relaxing the requirement would lead to more voluntary contractor disclosures. If adopted, DoD would essentially remove an existing internal control (i.e. audit requirement) in its acquisition process without mitigating the risks that exist that led to the creation of this control. In addition, there is no consideration of risk that exist in the proposed process. This approach does not synchronize with the primary goal of the Department's Better Buying Power initiative – "to get the best deal for the taxpayer."

PARCA Recommendation 2: Consider implementing a pilot effort to reduce resubmissions of certified cost or pricing data based on one or both of the approaches described below:

- a) Although the FAR requires contractors to provide certified CoP data "as of the date price negotiations were concluded or, if applicable, an earlier date agreed upon between the parties that is as close as practicable to the date of agreement on price," it also encourages PCOs to reach a prior agreement on criteria for establishing cut-off dates when appropriate. Therefore, if determined to be in DoD's interest, cut-off dates might be used to limit resubmission of CoP data and reduce acquisition lead time. For selected large dollar acquisitions, DoD could test whether providing cut-off dates to subcontractors that exceed TINA but are below a PCO-established threshold reduces lead time and unnecessary CoP data resubmissions without adding significant risk. Test parameters would need to be established and consider circumstances that might require resetting the cut-off dates.
- b) Rather than submitting a complete FAR 15.2-compliant proposal, subcontractors could submit and certify to actual cost and prices based on recent sales. This would likely minimize proposal development efforts required by subcontractors as well as proposal analysis efforts by prime contractors and DoD.

Agency 1 Comments to Recommendation 2a:

As stated in our initial comments to the assessment, we believe the intent of the recommendation to reduce repeated submissions of certified cost or pricing data has merit. However, implementation of an effective cutoff date needs to be at the time of final price/handshake agreement to protect DoD and taxpayers. Please refer to our earlier comments for more details on our position. Understanding this distinction in the current recommendation and our comments, we agree with the intent of the part of the recommendation that relates to providing the contracting officer more authority to establish requirements at the subcontract level for major procurements with a substantial number of subcontracts. However, DoD will need to establish common standards or requirements for this authority; otherwise, implementing the flexibility will result in a wide variance of its use.

Agency 1 Comments to Recommendation 2b:

We do not agree with the Recommendation 2b to eliminate the requirement for subcontractors to submit a compliant FAR 15.408 Table 15-2 proposal when it is required. This again would reduce an existing internal control (i.e., requirement to provide certified cost or pricing data) without mitigating risks that would be inherent in the process. The implementation of this recommendation will also be troublesome as how do you define “recent sales” and how do you account for changes in vendors. For example, there are instances when a long-term agreement has been in place for 10 years, the company is paying the price agreed-to many years ago, but that is not sufficient to ensure that the agreed-to pricing is still fair and reasonable. In addition, the company could switch to lower price from a different vendor for this procurement. This is part of the audit/evaluation process that establishes the validity and reliability of cost or pricing data. Under the proposed recommendation of requiring only recent sales, the Government would lose the protection to recover the impact of paying higher prices by not having adequate disclosure of known costs, and there would be no mitigation of this risk when removing the internal control.

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6 Application of the Buy American Act

Purpose. Assess contractors' recommended changes to the Buy American Act (BAA) and Federal Acquisition Regulation (FAR) and Defense Federal Acquisition Regulations Supplement (DFARS) guidance pertaining to BAA.

Overview. The assessment of recommended changes to BAA is based on information provided by two participating contractors, independent analysis by PARCA and IDA of statutory and regulatory intent and effects, and discussions with subject matter experts in the OUSD(AT&L)/Defense Procurement and Acquisition Policy (DPAP) and Logistics and Materiel Readiness. Section 6.1 provides a summary assessment of the contractors' recommendations, and Section 6.2 provides a white paper contributed by one of the participating contractors.

BAA-related changes proposed by contractors can be grouped into the following categories:

- (1) DoD should exempt certain purchases from BAA and provide information to contractors on BAA compliance of directed sourcing items (statutory and regulatory);
- (2) DoD should increase use of legally-permissible BAA exceptions and waivers (regulatory).

Recommendations

Contractors provided three recommendations in the first category:

1. If DoD specifies an item and manufacturer that must be used on an IDIQ or order, the Government data item description should show whether the item is compliant with BAA.
2. Provide a formal definition of end items for service contracts. Alternatively, do not apply the BAA clause on service contracts where the main service is not acquiring material.
3. Make BAA inapplicable for all purchases below the micropurchase threshold.

The first recommendation would shift the burden for determining BAA compliance from the contractor to the DoD buying command for cases in which DoD compels acquisition of an item from a specific manufacturer. While this would reduce BAA compliance related costs borne by industry (which are allowable charges to the Government), it would simply shift those costs from industry to the DoD buying command, rather than reducing net costs of the goods acquired. Since contractors must routinely determine BAA compliance for the wide range of items they sell to the Government, shifting this responsibility to the Government for a subset of BAA-applicable items is not likely to reduce overall costs or decrease acquisition procurement lead times, and in fact may reduce the efficiency of the BAA compliance determination process.

Regarding the second recommendation, the FAR defines *End Product*¹²⁷ and specifies that the BAA applies to supplies provided on services contracts if those supplies exceed the micropurchase threshold.¹²⁸ Exempting items purchased on service contracts appears to be inconsistent with congressional intent as expressed in the BAA statute, which clearly specifies legally-permissible exceptions.

Similarly, the third recommendation would expand the BAA exemption to the purchase of products that are currently subject to BAA and are not currently covered by legally-permissible BAA exceptions. A contractor asserted that for purchases below the micropurchase threshold, “the amount of administration it takes to buy an item is cost prohibitive and leads to increased overhead costs.” However, only sparse quantitative evidence was provided—it was asserted that in one instance purchasing \$6,000 worth of material resulted in \$4,000 in unburdened labor costs, but this was primarily due to uncertainty in that instance whether the material qualified for a BAA exemption. The data provided by contractors to date does not provide a compelling argument for expanding BAA exemptions to products currently not covered by legally-permissible exceptions.

The second category of BAA-related recommended changes involve cases in which, according to a participating contractor, DoD “has missed, and continues to miss, legally-permissible opportunities to implement the statute and its exceptions in a way that would minimize the unnecessary, unintended and costly consequences of overzealous application.” In particular, this contractor asserted that DoD does not take full advantage of the following exceptions and waiver:

1. Public Interest (exception)
2. Nonavailability (exception)
3. Trade Agreements Act (TAA) (waiver)

The statutory and regulatory basis for these exceptions is outlined in Section 6.2, provided by a contractor that contributed to this study.

Data provided by the contractors are insufficient to determine whether DoD is missing opportunities to apply legally-permissible exceptions to the BAA. No specific examples were provided in which DoD could or should have applied the Public Interest exception but did not. However, the participating contractor asserted that DoD is missing the opportunity for substantial savings if it applied this exception more frequently to spare or replacement parts. One example was provided of a case in which DoD could or should have applied the Nonavailability Exception, but did not. However, because of the proprietary nature of the information provided, we were

¹²⁷ FAR 25.003 Definitions. End product means those articles, materials, and supplies to be acquired for public use.

¹²⁸ FAR 25.100 Scope of Subpart. (a) This subpart implements—(1) 41 U.S.C. chapter 83, Buy American; (2) Executive Order 10582, December 17, 1954, and (3) Waiver of the component test of the Buy American statute for acquisition of commercially available off-the-shelf (COTS) items in accordance with 41 U.S.C. 1907. (b) It applies to supplies acquired for use in the United States, including supplies acquired under contracts set aside for small business concerns, if— (1) The supply contract exceeds the micro-purchase threshold; or (2) The supply portion of a contract for services that involves the furnishing of supplies (e.g., lease) exceeds the micro-purchase threshold.

unable to determine the DoD agency's rationale for denying the exception, making it impossible to determine whether the decision was sound. The examples provided concerning DoD's failure to grant TAA exceptions to certain products indicate there is uncertainty (by contractors and possibly by DoD buying commands) about the criteria governing eligibility for a TAA exception. A contractor participating in this study questioned how their company could request that DoD change the Federal Supply Group (FSG) or Federal Supply Code (FSC) assigned to their products (products they believe should be eligible for a TAA exception, but are currently not based on the assigned FSG). As a result, OUSD(AT&L)/L&MR provided the process outlined in Section 6.3. More extensive information is provided in DoD 4100.39-M, Vol 4, the Federal Logistics Information System Procedures Manual Item Identification, available at:

http://www.dtic.mil/whs/directives/corres/pdf/410039m/410039m_vol04.pdf

Pursuant to title 41, U.S.C., section 8305, DoD provides an annual report to Congress on DoD Purchases from Foreign Entities. Excerpts from the FY 2013 report are provided in Section 6.4, and previous reports dating to FY 2004 can be obtained at the following DPAP website: http://www.acq.osd.mil/dpap/cpic/cp/congressional_reports.html

In FY 2013, DoD made 5,888 purchases totaling \$966 million based on waivers to the BAA (to Qualifying Countries and countries covered by WTO GPA and Free Trade Agreements). Also, in FY 2013, DoD made 3,343 purchases totaling \$495 million based on Authorized Exceptions to the BAA (including 1841 based on Public Interest or Nonavailability exceptions). Figure 6.1 and Figure 6.2 show the number and total dollar amounts from FY 2007 to FY 2013, respectively, for the TAA waiver and two exceptions that the contractor claimed were not being fully utilized. Although this data do not demonstrate that DoD is availing itself of *all* legally-permissible exceptions and waivers, they do indicate that DoD regularly employs such authorities. Although the dollar value peaked in FY 2009, the annual number of these types of exceptions and waivers has changed little since FY 2008.

OUSD(AT&L) welcomes suggestions on how DoD can more effectively implement the BAA. Section 6.5 provides an example of a previous determination by USD(AT&L) that changed DoD policy concerning application of the BAA. However, the data submitted in response to this study are insufficient to determine whether DoD is indeed missing legally-permissible BAA exception and waiver opportunities. Further details from contractors or industry associations on specific missed opportunities would be required to support a case for changing DoD policy or practice.

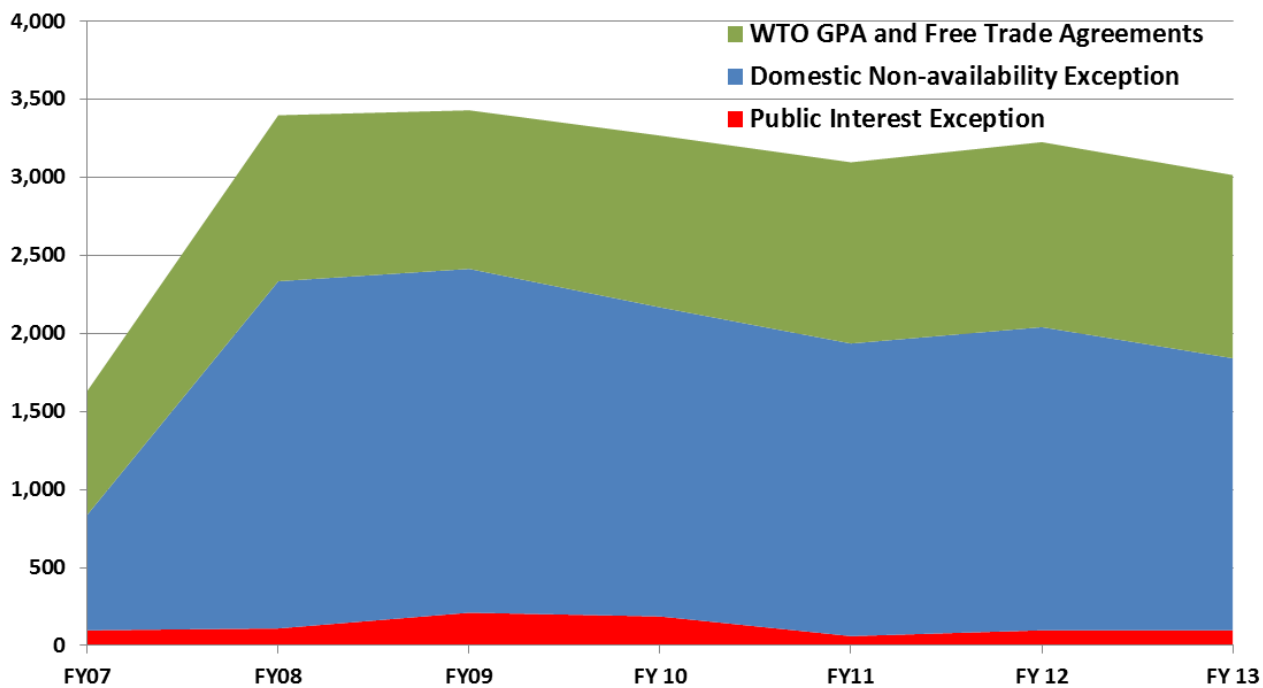


Figure 6.1 BAA Waivers and Exceptions by DoD (Number)

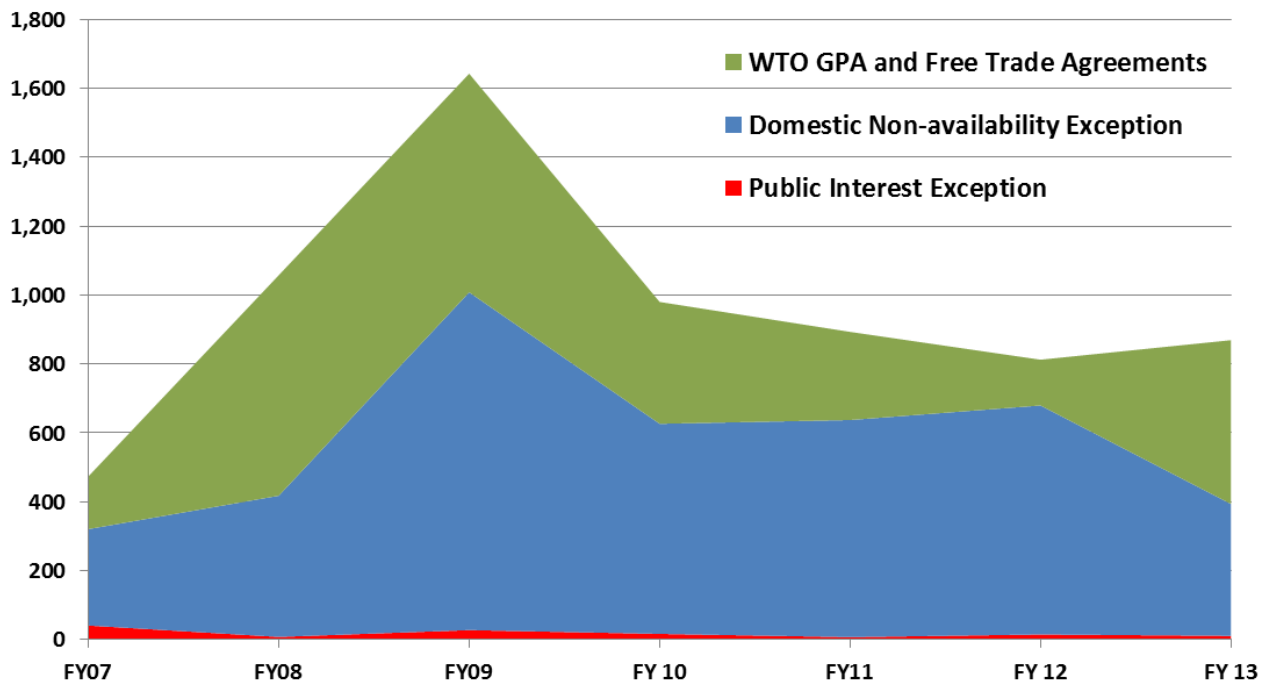


Figure 6.2 BAA Waivers and Exceptions by DoD (\$M)

6.1 Summary Assessment of Contractors' Recommendations

- If DoD specifies an item and manufacturer that must be used on an IDIQ or order, the Government data item description should show whether the item is compliant with BAA.
 - Change is not supported.
 - Evidence provided does not indicate such a change would reduce costs or procurement acquisition lead time or increase efficiency of BAA-compliance determinations.
- Provide a formal definition of end items for service contracts. Alternatively, do not apply the BAA clause on service contracts where the main service is not acquiring material.
 - Change is not supported.
 - FAR provides definition of End Product and exempting materials on service contracts appears to be inconsistent with congressional intent for BAA.
- Make BAA inapplicable for all purchases below the micropurchase threshold.
 - Change is not supported.
 - Exempting *all* purchases below the micropurchase threshold (rather than just contracts above the micropurchase threshold) appears to be inconsistent with congressional intent for BAA.
- DoD should increase use of the legally-permissible Public Interest exception to BAA.
 - Data provided were insufficient to determine if a policy change is warranted.
 - No examples were provided of cases in which DoD could or should have applied the Public Interest exception and did not do so, although a participating contractor asserted that DoD is missing the opportunity for substantial savings if it applied this exception more frequently to spare or replacement parts. Recommend follow-up with industry associations to solicit additional data.
- DoD should increase use of the legally-permissible Nonavailability exception to BAA.
 - Data provided were insufficient to determine if a policy change is warranted.
 - One example was provided of a case in which DoD could or should have applied the Nonavailability Exception, but did not. Additional data would be required to support a case for changing DoD policy or practice.
- DoD should increase use of the legally-permissible TAA exceptions to BAA.
 - Data provided were insufficient to determine if a policy change is warranted.

6.2 Buy American Act Exceptions Authorizing Agencies to Procure Foreign End Products, Including Spare and Replacement Parts¹²⁹

This White Paper and supporting materials are submitted in response to a Department of Defense (“DoD” or the “Department”) inquiry regarding cost and other burdens imposed on industry by the Buy American Act (“BAA”), as implemented by DoD. We understand this request is made as part of the Department’s study on “Eliminating Requirements Imposed on Industry Where Costs Outweigh Benefits.”

We very much appreciate the Department’s focus on identifying and eliminating unnecessary costs and burdens uniquely imposed on those who choose to do business with the United States Government – costs ultimately born by the taxpayer. We acknowledge the Buy American Act has historically benefited the US economy – and for that reason, do not advocate its recession. We do, however, believe the Department has missed, and continues to miss, legally-permissible opportunities to implement the statute and its exceptions in a way that would minimize the unnecessary, unintended and costly consequences of overzealous application. As will be demonstrated in our responses to specific DoD questions,¹³⁰ imprecise application of BAA (1) drives significant cost to industry, DoD and the taxpayer; (2) negatively impacts quality and delivery; and (3) reduces supply chain certainty.

Opportunities to implement BAA in a manner that reduces unnecessary costs and burdens are found in existing DoD regulations that implement BAA exceptions. In this White Paper, we identify multiple regulatory provisions that authorize agencies to avoid the statute’s restrictions, and acquire foreign end products. We also discuss the Department’s unnecessarily restrictive application of the Trade Agreements Act (“TAA”) exception to the Buy American Act – the result of employing a Federal Supply Group (“FSG”) code filter.

Exceptions Authorized Under The FAR And DFARS

Subpart 25.103 of the FAR sets forth exceptions to BAA-imposed restrictions and evaluative preferences, including a “public interest” and “nonavailability” exception. The DFARS also contains additional, specific guidance - including identification of those within DoD who are authorized to approve the exceptions. A brief summary is followed by a more detailed discussion of the “spares and replacement parts” exception below. It is in this last category of “end products” (*i.e.*, spare and replacement parts) that we believe the Department has greatest immediate opportunity to reduce unnecessary cost and burdens.

The Public Interest Exception

Components of the Department of Defense have broad authority to procure foreign end products under the “public interest” exception to the Buy American Act. The implementing DFARS provision contains several bases of justification, including where there is a need “to maintain the same source of supply for spare and replacement parts . . . [f]or an end item that qualifies as a domestic end product.” (DFARS 225.103(a)(ii)(A)(3)(i)). In short, regulators have determined that

¹²⁹ Section 6.2 was provided by one of the contractors that participated in this study.

¹³⁰ Further responses to specific Department questions will be submitted under separate cover.

it is within the “public interest” not to apply BAA restrictions where there is a need to maintain the same source of supply for spares and replacement parts that match those used in the original domestic end product. This addresses directly the situation we believe is often present before the Department - a previously acquired domestic end product (*e.g.*, aircraft, ship, system) contains certain permissible quantities of foreign components or subcomponents (permissible under the 50 percent component cost test), which components or subcomponents the Department now has need to purchase as spare or replacements parts. In this circumstance, what was a “component” or subcomponent for purposes of applying the original BAA tests of domesticity at the platform or system level, suddenly changes status and becomes an “end product” of a subsequent procurement now subject to BAA certification.¹³¹ In this circumstance, although there may be domestic sources for the components, the BAA recognizes that it may be in the public interest to acquire spare and replacement parts from the original manufacturer - rather than seeking new, domestic suppliers.

Except where a “public interest” is already expressed in the FAR or DFARS, section 225.103(a)(ii)(B) requires that a public interest exception determination be processed at the following levels:

- (1) At a level above the contracting officer for acquisitions valued at or below the simplified acquisition threshold;
- (2) By the head of the contracting activity (Chief of the Contracting Officer per PGI) for acquisitions with a value greater than the simplified acquisition threshold but less than \$1.5 million; or
- (3) By the agency head for acquisitions valued at \$1.5 million or more.

The Nonavailability Exception

The nonavailability exception authorizes an agency to acquire foreign end products where the agency believes the product is not manufactured in the United States in sufficient and reasonably available quantities of a satisfactory quality. (FAR 25.103(b)). This provision may be utilized on an individual acquisition basis, or the agency may seek to have the relevant product(s) added to lists of non-available articles maintained at FAR 25.104 and DFARS 225.104 to avoid making the determination on a procurement-by-procurement basis. (FAR 25.103(b)(2)(ii)).

Determinations that articles, materials or supplies are not available in sufficient quantities and quality are made at levels above the contracting officer. (DFARS 225-103(b)(ii)). There are, however, certain items DoD already has determined to be unavailable in sufficient supply and quality in the United States - thereby fully authorizing an exception to the BAA. One such category

¹³¹ Under BAA, a “domestic end product” may contain foreign “components” as long as the cost of domestic “components” exceeds 50 percent of the cost of all “components.” (FAR25.003 (“Domestic end product”)). An “end product” substantially transformed in a foreign country from various materials and components is considered a product of that foreign country under the TAA regardless of the source of the materials and components. (*Id.* (“Free Trade Agreement country end product” and “WTO GPA country end product”)).

is “[s]pare or replacement parts that must be acquired from the original foreign manufacturer or supplier.” (DFARS 225.103(b)(iii)(B)). As to this category, the DFARS explains that no further determination is necessary. (DFARS 225.103(b)(iii) (for spares and replacement parts required from the original foreign manufacturer, “[a] separate determination as to whether an article is reasonably available is not required.”)).¹³²

The “Nonavailability” Exception As Applied To Spare Or Replacement Parts

While each of the forgoing exceptions to BAA should be utilized by the Department as appropriate to avoid unnecessary cost and other negative consequences, we believe one exception in particular presents substantial opportunity for savings – the exception for spare or replacement parts.

As is explained above, when components of a previously acquired domestic end product are purchased separately as spare or replacement parts, they, themselves, become “end products” subject to BAA certifications and restrictions. The DFARS, however, recognizes that DoD has a practical and operational need to acquire spare and replacement parts from the original manufacturer, even if that manufacturer is foreign, to ensure, among other things, the dependability, safety, and effective operation of the end product (*e.g.*, aircraft). The Department has already determined that “[s]pare or replacement parts that must be acquired from the original foreign manufacturer or supplier” are in fact “not reasonably available from domestic sources” – effectively authorizing contracting officers to utilize the exception without seeking further determinations or approvals. (See DFARS 225.103(b)(iii)(B)) Thus, DFARS authorizes buying commands to acquire foreign-manufactured spare and replacement parts from the original manufacturer, regardless of the location of the manufacturer at the time of original manufacture or at the time the spares and replacements are needed.¹³³ By this exception, the regulators recognized that dependability, safety, and operation of the end product is best assured by replacing worn or damaged parts with parts manufactured by the company that manufactured them originally.

¹³² In addition to the two exceptions detailed above, FAR Subpart 25.103 authorizes an exception based on cost considerations. The BAA permits contracting officers to determine that “the cost of a domestic end product would be unreasonable,” thereby creating an exception to application of the BAA restrictions. (FAR 25.103(c)). Consequently, even assuming sufficient domestic sources exist and such products are available with satisfactory quality, the unreasonable cost provision authorizes the contracting officer to make the determination that the cost of the domestic end product would be unreasonable. Where there is a basis for comparison, DFARS 225.105(b) provides for the application of a 50-percent evaluation factor to the foreign end product (we question whether such a significant evaluative “penalty” is actually warranted). If the offered domestic spare or replacement part remains higher priced after application of the 50-percent factor to the foreign item, the cost of the domestic end product is deemed unreasonable. The decision as to whether this exception is available, therefore, rests with the contracting officer. A contracting officer also possesses inherent authority to resolve issues arising during the course of contract administration, including the determination as to whether to accept non-conforming products. (See FAR 49.402-3(f) (describing factors a contracting officer must consider when contemplating adverse contract action over the delivery of non-compliant products, including “the urgency of the need for the supplies or services and the period of time required to obtain them from other sources”). Neither the terms of the BAA nor its implementing regulations appear to alter this well-accepted principle. Thus, putting aside the aforementioned exceptions, the contracting officer may accept non-conforming products pursuant to his or her authority to administer contracts.

¹³³ DFARS 225.103(b) implements the “non-availability” exception.

We believe a review of the regulatory history underlying this provision may be helpful in understanding the full scope of the exception. On December 1, 1966, DoD revised the Armed Services Procurement Regulation (“ASPR”)¹³⁴ to include a “nonavailability” exception for the “procurement of spare and replacement parts for foreign manufactured items, if the procurement must be restricted to the *original manufacturer* or his supplier in accordance with 1-313.” (ASPR ¶ 6-103.2, Dec. 1, 1966, Rev. 20) (emphasis added). In relevant part, ASPR 1-313 authorized agencies to restrict acquisitions of spare and replacement parts to the “original manufacturer” or “his supplier” when necessary to ensure the “requisite safe, dependable, and effective operation of the equipment.”¹³⁵ (ASPR ¶ 1-313, July 1, 1960). While a policy statement did not accompany ASPR 6-103.2, DoD did issue a policy statement for ASPR 1-313 (a related provision), which indicates that it was added to “set forth the policy that the Department of Defense should buy its spare parts for military items from the *original manufacturer* or his sources whenever the part may be critical to the high rated performance of the equipment or to the safety of the operator and crew, subject to exception in appropriate cases.” (ASPR 1-313, May 2, 1960, “Notes Regarding Substantive Changes,” Rev. 54). Thus, in promulgating the nonavailability exception for spare and replacement parts, it is clear DoD was concerned with ensuring agencies would be able to acquire safe and dependable spare and replacement parts – and believed that allowing them to acquire such parts from the original manufacturer would accomplish that end.

From 1966 to 2003, ASPR 6-103.2 and its subsequent forms underwent minor, non-substantive changes, including re-numbering the provision as part of creating the DFARS. Statements accompanying several of these revisions indicate that DoD implemented these changes in an attempt to simplify and rewrite the provisions in “plain English.”¹³⁶ As of 2000, the provision was phrased: “Acquisitions for spare/replacement parts when the acquisition is restricted to the *original manufacturer* or his supplier.” (65 Fed. Reg. 19849, Final Rule, DFARS

¹³⁴ The ASPR pre-dated the promulgation of the FAR, the Defense Acquisition Regulation (“DAR”), and DFARS.

¹³⁵ ASPR 1-313 provided, in relevant part: “[p]arts for military equipment, to be used for replenishment of stock, repair, or replacement, must be procured so as to assure the requisite safe, dependable, and effective operation of the equipment. Where it is feasible to do so without impairing this assurance, parts should be procured on a competitive basis, as in the kind of cases described in (b) below [describing parts that can be obtained from a number of known sources and parts where fully adequate manufacturing drawings and necessary data are available]. However, where this assurance can be had only if the parts are procured from the original manufacturer of the equipment or his supplier, the procurement should be restricted accordingly, as in the kind of cases described in (c) below [stating that parts not within the scope of (b) generally should be procured from sources that have satisfactorily manufactured or furnished such parts in the past].” (ASPR ¶ 1-313, July 1, 1960).

¹³⁶ As of October 31, 1980, the provision was phrased, “Spare and replacement parts, if the acquisition must be restricted to the original manufacturer or his supplier in accordance with 1-313.” (ASPR 6-103.2(c)(i), Defense Acquisition Circular (“DAC”) 76-25, October 31, 1980). Without any explanation, in 1984, with the promulgation of the DFARS, many of the provisions previously appearing in the ASPR, and its immediate successor, the DAR, were revised, including the provision in question. As revised, it provided: “Spare and replacement parts, if the acquisition must be restricted to the original manufacturer or his supplier.” (49 Fed. Reg. 38549, DAC 84-1, DFAR 225.102, October 1, 1984). In 1991, DoD issued another rule further revising the language of DFARS 225.103, as well as other provisions, stating, in relevant part, that the purpose of the revisions was to “rewrite the remaining text and clauses in *plain English*.” (56 Fed. Reg. 36280-01, Final Rules and Interim Rules, July 31, 1991) (emphasis added). As revised, the provision provided: “Acquisitions for spare/replacement parts when the acquisition is restricted to the original manufacturer or his supplier.” (*Id.*)

225.103, April 13, 2000) (emphasis added). As of 2000, DFARS 225.103(b)(iii)(B) did not clearly pertain to foreign manufactured parts. This presumably led to some confusion, which caused DoD to revise the provision once again. In 2003, DoD revised the DFARS Part dealing with Foreign Acquisitions. As revised, DFARS 225.103 focused on “[s]pare or replacement parts that must be acquired from the original *foreign* manufacturer or supplier.” (68 Fed. Reg. 15616, Final Rule, DFARS 225.103, March 31, 2003) (emphasis added)).

From the regulatory history, it is evident that DoD did not intend to alter the application of the provision or its original purpose through any of the revisions, including the 2003 revision, which added the term “foreign.” Rather, DoD indicated that its revisions to the DFARS section dealing with Foreign Acquisitions were to “simplify and clarify policy pertaining to the acquisition of supplies and services from foreign sources.” (*Id.*). Importantly, DoD addressed a comment received regarding the addition of the word “foreign” to DFARS 225.103 as follows:

One respondent objected to the replacement of ‘original manufacturer’ with ‘original foreign manufacturer’ at 225.103(b)(iii)(B), as it changes the focus.

DoD Response: Do not concur. DFARS 225.103(b)(iii)(B) relates to a DoD determination that certain articles are not reasonably available from domestic sources because they are spare or replacement parts that must be acquired from the original manufacturer. *If the original manufacturer were domestic, the spare or replacement parts could be obtained from a domestic source and no exception would be required.*

(*Id.*) (Emphasis added).

Thus, by adding the word “foreign,” DoD clarified that the exception was only needed where there was *foreign* manufacture, without requiring that the foreign manufacture be of the original components. In other words, the term “original” designates that the exception applies where spare and replacement parts must be purchased from the original manufacturer. The term “foreign” is used to designate that the exception applies only where there is some foreign manufacture – otherwise there would be no need for a BAA exception.

Based on the foregoing authorities and analysis, we respectfully submit that under current and prior iterations of the DFARS, DoD is authorized to acquire foreign-manufactured spare and replacement parts from the original manufacturer, regardless of the location of the original manufacture.¹³⁷ In our experience, the Department has not taken full advantage of this significant

¹³⁷ As is evident from the foregoing regulatory history and analysis, a determination that the DFARS 225.103(b)(iii)(B) exception is limited in application to spare and replacement parts that have always and only been manufactured in a foreign location would be inconsistent with applicable regulatory history and would undermine DoD’s stated objective to enhance dependability, safety, and operation of equipment by purchasing spare and replacement parts from the original manufacturer – which manufacturer may have first manufactured the spare or replacement parts domestically. Such a limited determination would also have the unintended effect of rewarding foreign companies while penalizing domestic companies who happen to have a manufacturing arm in a foreign country. Again, the better interpretation – an interpretation that is consistent with both the applicable regulatory history and these policy considerations – is that DFARS 225.103(b)(iii)(B) authorizes buying commands to acquire foreign-manufactured spare

exception to BAA. As a legally-permissible mechanism to reduce unnecessary cost and burdens associated with BAA, we respectfully suggest that DoD reevaluate immediate opportunities available here.

DoD's Limited Application Of The TAA Exception To BAA

The Department's limited application of the Trade Agreements Act ("TAA") exception to the BAA (see FAR 25.402) is also concerning.¹³⁸ The Trade Agreements Act implements various Free Trade Agreements that are otherwise inconsistent with BAA's domestic end product preference. Accordingly, the FAR explains:

The Trade Agreements Act (19 U.S.C. 2501, *et seq.*) provides the authority for the President to waive the Buy American Act and other discriminatory provisions for eligible products from countries that have signed an international trade agreement with the United States, or that meet certain other criteria, such as being a least developed country. The President has delegated this waiver authority to the U.S. Trade Representative. *In acquisitions covered by the WTO GPA, Free Trade Agreements, or the Israeli Trade Act, the USTR has waived the Buy American Act and other discriminatory provisions for eligible products. Offers of eligible products receive equal consideration with domestic offers.*

(FAR 25.402(a)(1) (emphasis added)).

Consequently, end products substantially transformed in countries with which the United States has entered into a free trade agreement are not subject to BAA's evaluative penalty notwithstanding the fact that they are identified as "foreign end products" in a contractor's BAA certification – *enabling the contractor to offer the Government less expensive "designated country" end products.*

"Designated countries" whose end products may qualify for protection under TAA include, for example,

- World Trade Organization Procurement Agreement countries (*e.g.*, Bulgaria, Czech Republic, Finland, Greece, Hong Kong, Hungary, Japan, Republic of Korea, Lithuania, Poland, Singapore, Taiwan, *etc.*);

and replacement parts from the original manufacturer, regardless of the location of the manufacturer at the time of original manufacture.

¹³⁸ For Department of Defense acquisitions, the TAA exception is available for end products that meet the TAA criteria, *i.e.*, end products that (1) fall within one of the Federal supply groups ("FSG") provided in DFARS 225.401-70, are (2) from a country which is signatory to one of the international trade agreements covered by the TAA and (3) the procurement is valued in excess of a dollar threshold for the source country that is established by the Government from time to time. (See FAR 25.402(b)).

- Free Trade Agreement countries (*e.g.*, Australia, Canada, Chile, Mexico, Singapore, *etc.*) and several others. (*See, e.g.*, FAR 25.003 (definition of “Designated country”).¹³⁹)

Under TAA, value of the acquisition is the only remaining threshold factor for determining applicability (and therefore the BAA exception (*see* FAR 25.402(b))). DoD, however, imposes yet another unique, requirement that further limits TAA application to end products sold to the Department. To qualify for the TAA exception *for DoD acquisitions*, end products substantially transformed in a designated country must *also* fall within one of a limited number of Federal Supply Group codes. (*see* DFARS 225.401-70) Accordingly, DFARS section 225.401-70 includes the following statement:

Acquisitions of end products in the following Federal supply groups (FSG) are covered by trade agreements if the value of the acquisition is at or above the applicable trade agreement threshold and no exception applies. *If an end product is not in one of the listed groups, the trade agreements do not apply.*

(DFARS 225.401-70)(emphasis added).

This additional FSG code requirement, which DoD uniquely imposes on the end products it purchases, significantly limits application on the TAA exception Congress has already recognized and approved – driving the cost and burden of the BAA up unnecessarily for DoD. Under the DFARS, “Engine accessories” (FSG code 29), for example, may qualify for a TAA exception to BAA, but “Engines, Turbines and Components” (FSG code 28), and “Aircraft Components and Accessories” (FSG Code 16) do not. *Id.* Notwithstanding this disparate treatment, there is no meaningful explanation in the regulations with regard to what distinguishes “Engine accessories” from “Engine components” such that one group should qualify for TAA protection while the other does not. A further example of this limitation imposed by DoD is the exclusion of “Electrical and Electronic Equipment Components” (FSG code 59) from TAA coverage.

The Department has the ability to modify the list at DFARS 225.401-70 to more fully benefit from the Congressionally-approved Trade Agreement Act exception to BAA. Given the significant opportunities we will summarize under separate cover, we respectfully suggest doing so would be worthwhile endeavor.

¹³⁹ We acknowledge the TAA “[p]urchase restriction” which is applicable to certain non-designated country end products manufactured, for example, in places like China. (*See* FAR 25.403(c)).

6.3 Process to Request a Change to the Federal Supply Group or Federal Supply Code FSG/FSC assigned to a National Stock Number (NSN)¹⁴⁰

REQUIREMENTS:

- Only a Military Service, Federal/civil agency, or International partner can request a FSG/FSC or NSN change from DLA Defense Logistics Information Service (DLIS)
- A Service or Agency must sponsor a contractor's product for NSN assignment/change. A sponsor should be the inventory manager of the item or the program manager of the weapon system.
- The contractor must provide compelling rationale and supporting technical data to show that the current FSG/FSC should be changed.
- Cataloging and Standardization Act, Public Law 82-436 reads: "To uphold this act it is imperative that the DoD Agency responsible for cataloging, DLA Logistics Information Service, is granted access to technical data."

PROCESS:

1. Contractor must provide the following standard set of technical and logistics data to the Government sponsor:

- Item name
- Manufacturer's part number
- Unit of issue
- Unit price
- Form
- Fit
- Function
- Physical and performance characteristics
- Precious metals or hazardous materials
- Interchangeability and substitutability
- Shipping data
- Special handling
- Storage
- Shelf life
- Disposal requirements (how to dispose of the item) when no longer needed

¹⁴⁰ Section 6.3 was provided by Ms. Jan B. Mulligan, OUSD(AT&L)/L&MR.

2. Once the contractor provides all required information to the sponsor, and if the sponsor agrees the request is warranted, the sponsor follows internal procedures to process the request and forward the request to DLIS.

HOW A CONTRACTOR CAN FIND A SPONSOR:

Go to the managing Military Service public website:

- Army TACOM: <https://www.tacom.army.mil/main/index.html>
- Army Joint Munitions & Lethality (JM&L) LCMC: <http://www.pica.army.mil/jml/default.asp>
- Army Aviation and Missile LCMC (AMCOM):
<http://www.army.mil/info/organization/unitsandcommands/commandstructure/AMCOM/>
- Marine Corps: <http://www.logcom.marines.mil/>
- Naval Supply Systems Command: <http://www.navsup.navy.mil/>
- Naval Sea Systems Command: <http://www.navsea.navy.mil>
- Air Force Oklahoma City Air Logistics Center (OC-ALC): <http://www.tinker.af.mil/library/factsheets/>
- Air Force Ogden Air Logistics Center (OO-ALC):
<http://www.hill.af.mil/library/factsheets/factsheet.asp?id=5594>
- Air Force Warner Robins Air Logistics Center (WR-ALC):
<http://www.robins.af.mil/units/wrairlogisticscomplex.asp>

Go to the managing Service or Agency Small Business Office public website:

- Army: www.sellingtoarmy.info/user/showpage.aspx?SectionID=9
- Marine Corps: <http://www.logcom.marines.mil/Business/SmallBusiness.aspx>
- Navy: http://www.navsup.navy.mil/navsup/business_opps
- Air Force: www.airforcesmallbiz.org
- OSD: www.acq.osd.mil/osbp/
- DLA: www.dla.mil/db/
- GSA: www.gsa.gov/portal/content/105221
- PTAC: www.dla.mil/db/ptap.asp

6.4 Excerpt from Report to Congress on FY 2013 Purchases from Foreign Entities

REPORT TO CONGRESS ON DEPARTMENT OF DEFENSE FISCAL YEAR 2013 PURCHASES FROM FOREIGN ENTITIES



Office of the Under Secretary of Defense for
Acquisition, Technology, and Logistics

May 2014

The estimated cost of this report or study for the Department of Defense is approximately \$1,220 in Fiscal Years 2013. This includes \$5 in expenses and \$1,210 in DoD labor.

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Background.

Pursuant to section 8027 of the Consolidated and Further Continuing Appropriations Act, 2013 (Public Law 113-6), this is the required report on Department of Defense (DoD) purchases from foreign entities in fiscal year (FY) 2013. The report is to separately indicate the dollar value of items for which the Buy American Act (BAA) was waived pursuant to any reciprocal defense procurement memorandum of understanding (MOU), the Trade Agreements Act (TAA) of 1979, or any international agreement to which the United States is a party.

Discussion.

The information contained in this report is based on FY 2013 contract data from the Federal Procurement Data System – Next Generation (FPDS-NG) and data compiled and distributed by the DoD Defense Manpower Data Center, Statistical Analysis Information Division. The FPDS-NG data addresses contracting procedures, competition, financing, statutory requirements, socioeconomic programs, and other information relating to DoD acquisitions. The data was then certified by the Military Departments and Defense Agencies. Additionally, this report is modified from prior year's reports to present the data in Table 1 by the foreign entities' country of origin rather than the country where the place of performance occurred. This change is intended to provide a clear picture of purchases by those entities in terms of actions and dollars.

Section 1 – All procurements from foreign entities

DoD procurement actions recorded and certified in FPDS-NG during FY 2013 totaled approximately \$308 billion. Of that amount, approximately \$19.7 billion or 6.4 percent was expended on purchases from foreign entities.

The \$19.7 billion covers military hardware, subsistence, fuel, construction, services, and other miscellaneous items. Defense equipment constitutes approximately four percent of the purchases from foreign entities. Fuel, services, construction, and subsistence account for approximately 79 percent of the total purchases from foreign entities. The remaining 17 percent of the purchases cover a variety of categories. Table 2 provides a breakout of the \$19.7 billion by category and percentage of the total.

Section 2 – Dollar value of manufactured articles for which the restrictions of the BAA were not applied pursuant to MOUs, the TAA, or other international agreements

The restrictions of the BAA were not applied to 28,887 DoD purchases totaling \$13.2 billion due to waivers, authorized exceptions, and inapplicability. The breakout of these purchases is as follows:

- The total authorized **waivers** pursuant to MOUs, the TAA, or other international agreements represented 5,888 purchases totaling approximately \$1.0 billion.

- The total authorized **exceptions** to the BAA represented 3,343 purchases for approximately \$500 million. These exceptions provided in the law include: (1) manufactured outside the United States – Resale; (2) manufactured outside the United States – Commercial Information Technology; (3) manufactured outside the United States – Public Interest Determinations; (4) manufactured outside the United States – Determination made based on Domestic Non-Availability; and (5) manufactured outside the United States – Unreasonable Cost of Domestic End Product.
- The remaining 19,656 purchases totaling approximately \$11.7 billion represent those contract actions for which the restrictions of the BAA **are not applicable** because they are for items manufactured and used outside the United States.

Table 3 provides a detailed breakout of the actions and dollars by category and an explanation of the authority for each of the categories.

TABLE 2. DoD FOREIGN PURCHASES BY CLAIMANT CODE- FY 2013

DOD Claimant Program	Actions	Dollars	Percentage
AIRFRAMES AND SPARES	1,224	\$862,198,823.33	4.38%
AIRCRAFT ENGINES AND SPARES	431	\$54,233,340.70	0.28%
OTHER AIRCRAFT EQUIPMENT	761	\$391,168,400.43	1.99%
MISSILE AND SPACE SYSTEMS	102	\$29,544,530.92	0.15%
SHIPS	5,195	\$233,922,136.27	1.19%
COMBAT VEHICLES	723	\$142,385,324.47	0.72%
NON-COMBAT VEHICLES	340	\$58,925,645.07	0.30%
WEAPONS	560	\$96,511,639.40	0.49%
AMMUNITION	172	\$114,118,371.16	0.58%
ELECTRONICS AND COMMUNICATION EQUIPMENT	803	\$140,115,590.60	0.71%
PETROLEUM	383	\$8,172,435,111.57	41.54%
OTHER FUELS AND LUBRICANTS	357	\$9,792,895.62	0.05%
SEPARATELY PROCURED CONTAINERS AND HANDLING EQUIPMENT	8	\$366,886.63	0.00%
TEXTILES, CLOTHING AND EQUIPAGE	36	\$21,338,782.86	0.11%
BUILDING SUPPLIES	229	\$5,663,657.87	0.03%
SUBSISTENCE	59,819	\$2,468,516,625.45	12.55%
TRANSPORTATION EQUIPMENT (RAILWAY)	14	\$354,525.78	0.00%
PRODUCTION EQUIPMENT	63	\$3,797,601.99	0.02%
CONSTRUCTION	9,797	\$1,921,878,026.69	9.77%
CONSTRUCTION EQUIPMENT	128	\$4,347,714.45	0.02%
MEDICAL AND DENTAL SUPPLIES AND EQUIPMENT	2,677	\$64,416,581.91	0.33%
PHOTOGRAPHIC EQUIPMENT AND SUPPLIES	21	\$720,326.95	0.00%
MATERIALS HANDLING EQUIPMENT	87	\$2,478,228.23	0.01%
ALL OTHERS NOT IDENTIFIABLE TO ANY OTHER PROCUREMENT PROGRAM	27,597	\$1,741,629,968.31	8.85%
SERVICES	39,309	\$3,132,254,836.42	15.92%
NO DATA- UNKNOWN	1	-\$424,021.47	0.00%
Grand Total	150,837	\$19,672,691,551.61	100.00%

TABLE 3. NUMBER OF PURCHASES AND DOLLAR VALUE OF MANUFACTURED ARTICLES
FOR WHICH THE RESTRICTIONS OF THE BAA WERE NOT APPLIED IN FISCAL YEAR 2013

Authority	Number	Dollars
Waivers of the Buy American Act		
Qualifying Countries	4,715	\$490,311,410.47
WTO GPA and Free Trade Agreements	1,173	\$475,558,421.80
Authorized Exceptions to the Buy American Act		
Resale	381	\$11,900,470.64
Commercial IT	1,016	\$87,167,763.43
Public Interest Exception	98	\$11,134,371.59
Domestic Non-availability Determinations	1,743	\$382,544,211.03
Unreasonable Cost	105	\$2,062,031.81
The Buy American Act does not apply		
Use outside the U.S.	19,656	\$11,744,336,002.80
Total	28,887	\$13,205,014,683.57

6.5 USD(AT&L) BAA Exception Findings and Determination, March 14, 2002

Buy American Exception Findings and Determination of Inconsistency with the Public Interest

I, as Under Secretary of Defense (Acquisition, Technology & Logistics), hereby make the following findings and determination regarding the application of the restrictions of Section 2 of Title III of the Act of March 3, 1933, 47 Stat. 1520 (the Buy American Act, 41 U.S.C. 10a-d) to procurements of end items that are subject to the Trade Agreements Act (19 U.S.C. 2501, et seq.) and which are substantially transformed in the U.S.

Findings

1. The Buy American Act (BAA) requires the Government to purchase for public use only those manufactured products that have been manufactured in the United States substantially all from articles, materials or supplies mined, produced or manufactured in the United States. Executive Order 10582 (December 17, 1954), as amended, provides that a product is considered not to be manufactured "substantially all from..." if the cost of the foreign components used in such product constitutes fifty percent or more of the cost of all its components. The BAA does not apply when the head of a federal agency determines that its application is inconsistent with the public interest or that domestic products are unreasonable in cost. The Department of Defense (DoD) implements the unreasonable cost exception by adding an evaluation factor of fifty percent to the offered price of foreign end products.
2. Pursuant to the Trade Agreements Act of 1979 (TAA), the United States Trade Representative has waived application of the BAA for eligible products from certain "designated" countries. Eligible products are largely commercial items. The country of origin for an eligible product, that consists in whole or in part of materials from another country, is the country in which the article has been substantially transformed into a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was so transformed. Since the TAA applies only to products of foreign countries, the BAA is not waived for products substantially transformed in the United States from mostly foreign components, i.e., U.S.-made products.
3. Manufacturers of products covered by the TAA commonly use worldwide sources for components. Under the TAA, a product substantially transformed in a designated country is exempt from application of the BAA regardless of the source of its components. However, for offers of products that are composed of fifty percent or more foreign components but that are substantially transformed in the United States, the BAA evaluation factor must be applied to the offer if doing so would result in the award of a contract to the offeror of a domestic end product. The application of these different rules of origin results in treating products substantially transformed in the United States less favorably than designated country products in similar

circumstances. This may encourage a company to manufacture the product or locate a manufacturing facility in a designated foreign country rather than in the United States.

4. These different rules of origin result in a disproportionately burdensome record keeping requirement on firms offering domestic and U.S.-made products. Because of the component content requirement of the BAA, such offerors must determine, control, and track the source of components. In today's global economy, this has become an extremely difficult, if not impossible, task and creates a disincentive for companies to sell to the Department of Defense. On the other hand, this burden does not apply to offerors of products from designated countries because the TAA substantial transformation rule of origin does not limit similarly the country of origin of components, thus there is no need for record keeping as to the origin of those components.

5. An example of this burden is the Defense Logistics Agency's (DLA) EMall. The EMall is a web-based ordering system that provides access to the commercial catalogs of numerous vendors. As DLA has attempted to expand the number of commercial items available to its customers from existing electronic catalogs, vendors are unable to comply with the requirement to certify the origin of products under the BAA. Because of this, companies have indicated an inability to participate in solicitations subject to the BAA.

6. Today's markets are globally integrated with foreign components often indistinguishable from domestic components. Manufacturers' component purchasing decisions are based on factors such as cost, quality, availability, and maintaining the state of the art, not the country of origin, making it much more difficult in today's market for a manufacturer to guarantee the source of its components over the term of a contract. It is even more difficult for a dealer to determine and guarantee the source for the components included in products on the shelf. In order to certify their products, however, offerors must determine and control the source of components. The difficulty in tracking the country of origin of components is a disincentive for firms to become defense contractors, limiting DoD's ability to purchase products already in commercial distribution systems, and impeding DoD's ability to obtain state-of-the-art modifications incorporating advanced commercial technology to existing products that are available to commercial customers.

7. The requirement to track the country of origin is unique to Government procurement, and represents a significant deterrent to the acquisition of TAA covered items by DoD. In today's globally integrated market, it is expensive for manufacturers to distinguish between foreign and domestic components. Requiring them to do so results in increased costs of procurements for DoD and impedes the ability of DoD to obtain the latest advances in commercial technology.

8. Implementation of the country of origin requirement has resulted in a difficult and confusing regulatory system for international acquisition. This complex interrelationship of statutes and agreements has led to differing interpretations by Executive agencies and confusion to offerors. It also makes it difficult for firms to determine how their products will be evaluated and thus may act as a disincentive for firms to become defense contractors. This determination will result in a simplification of the regulations and significantly reduce the difficulty in implementing and administering them. Waiving the BAA for all TAA covered products substantially transformed in the

U.S. will negate the need to apply the 50 percent evaluation factor associated with U.S.-made end products that do not qualify as domestic products and result in a more streamlined and simplified evaluation process. Further, waiving the BAA for U.S.-made end products would harmonize the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement with regard to the manner in which U.S.-made end products are treated.

9. This determination will enable DoD to procure U.S.-made items if they are lower in cost. Additionally, reducing the record keeping burden on United States firms as well as eliminating the need for separate tracking systems should result in lower costs and better quality for DoD procurements as a result of increased competition from U.S.-made products.

10. For products covered by the TAA, this waiver will deny the fifty percent price advantage that domestic end products currently enjoy over U.S.-made products. Therefore, the cost incentive to manufacture components in the United States will be removed. This disadvantage is counteracted by a reduced incentive to move end product manufacturing facilities to a designated foreign country to avoid the BAA price difference. I believe the advantages of this determination clearly outweigh this disadvantage.

Determination

In accordance with the Buy American Act, and after considering the factors at 10 U.S.C. 2533, I determine that, for procurements subject to the Trade Agreements Act, it would be inconsistent with the public interest to apply the Buy American Act to U.S.-made end products that are substantially transformed in the United States. This determination will remain in effect for all Department of Defense purchases until amended or revoked.

//SIGNED//

E.C. Aldridge Jr.

Under Secretary of Defense
(Acquisition, Technology & Logistics)

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7 Study Recommendations

7.1 Acquisition of Commercial Items

1. Streamline and accelerate commercial item determinations (CID).
2. Provide contracting officers with clearer criteria describing the type and extent of information that is necessary for CID.
 - Establish Cost and Pricing Centers of Expertise to facilitate and prepare updated guidance on CID.

The USD(AT&L) approved these recommendations and assigned them to DPAP for disposition. The Cost and Pricing Centers of Expertise will be established within DCMA.

7.2 Auditing and Contract Management

1. Streamline DFARS contractor business system compliance reviews for large public companies by considering results of Sarbanes-Oxley (SOX) required audits and company internal controls.
 - Establish a jointly-led OUSD(AT&L)/OUSD(C) team to engage with willing contractors on proposed approaches and provide an assessment to OSD leadership.
2. Continue to aggressively address contract closeout backlogs through a risk based approach.
 - Establish a jointly-led OUSD(AT&L)/OUSD(C) team to assess contract closeout initiatives proposed by contractors. Recommend that Directors of DCMA and DCAA provide an update to USD(AT&L) and USD(C) on recent contract closeout progress and promising approaches. Also recommend that Directors of DCMA and DCAA assess status of DoD's implementation of recommendations and SASC-proposed options outlined in GAO Report 13-131 and propose statutory or policy changes that may be required to facilitate implementation of those recommendations and options.
3. Streamline forward pricing rate (FPR) reviews/audits.
 - Process improvements since January 2011 have reduced DoD duplicative effort on FPRR/FPRA reviews and audits. However, additional streamlining opportunities appear possible. Recommend opportunities be assessed by the Directors of DCMA and DCAA and proposals be provided to USD(AT&L) and USD(C).
4. DCAA report progress on Agency initiatives to reduce incurred cost audit backlogs and starts and stops in audits.
 - Director, DCAA continue to analyze and assess progress of on-going Agency efforts to decrease backlogs of incurred cost and business system review audits and minimize

disruption of audits that have been started. DCAA should provide results of their analysis to Government and industry customers.

5. While Director, DCAA may wish to revisit practice on frequency of testing scanned images to original documents, the current policy seems reasonable.

The USD(AT&L) and the USD(C) approved these recommendations. OUSD(AT&L)/PARCA has been assigned to lead a multi-functional OSD team¹⁴¹ to engage with willing contractors on proposed approaches to streamline contract closeouts and to leverage internal company efforts, including SOX, to streamline DoD audits of business systems. DCAA and DCMA have been assigned to provide recommendations to OSD leadership on streamlining forward pricing rate reviews. DCAA has been assigned to report progress on their initiatives to reduce incurred cost audit backlogs and starts and stops in audits.

7.3 Application of Earned Value Management

1. DoD should amend EVM policies to clarify that EVM reporting is required on non-firm-fixed price contracts above the regulatory dollar threshold that have discrete, schedulable, and measureable work scope.
2. DoD should amend EVM policies to establish a single threshold for Compliance Reviews and System Surveillance of \$100 million (the current standard is \$50 million for Compliance Reviews and \$20 million for System Surveillance). Contracts between \$20 million and \$100 million would still be subject to EVM reporting, but surveillance reviews to determine EVMS compliance would be conducted only on an exception basis, e.g., when a contracting officer, program office, buying command or higher headquarters requests DCMA assistance due to a concern about the quality of EVM data reported on a given contract.
3. DoD should amend EVM policies to stipulate that EVM reporting applies to contracts with a period of performance of 18 months or more (the current standard is 12 months).
4. To improve consistency of EVMS implementation, DCMA will streamline EVMS operations, including assuming responsibility for compliance reviews and surveillance based on all 32 ANSI/EIA-748 guidelines and leveraging efforts from DCMA's "Data-Driven EVMS Streamlining Pilot."
5. DCMA will expand "Data-Driven EVM Systems Streamlining Pilot" to conduct streamlined reviews and surveillance at three additional contractor facilities in FY 2015.
6. Using EVMS Interpretation Guide (EVMSIG), DCMA will initiate an EVMS pilot of a shipbuilding contractor's EVMS to determine whether existing contractor management systems and organizational structures adhere to tenants of the EVMSIG.
7. DoD should provide policy guidance concerning optimal level of EVM control account reporting required for program execution situational awareness and decision-making.

¹⁴¹ OSD participants to include OUSD(AT&L)/PARCA, OUSD(AT&L)/DPAP, OUSD(AT&L)/DCMA, OUSD(C), OUSD(C)/DCAA, DoD OGC, DoD IG, and Component representatives.

8. DoD should not direct contractors to move budget from control accounts that have under-runs and apply this budget to new work. This practice threatens the integrity of the contractor's EVMS and it is inappropriate for DCMA to sanction contractors for a non-compliant EVMS as a result of such DoD-directed changes.
9. DoD should provide policy guidance to contracting officers that using metrics such as cost or schedule variances, cost or schedule performance indices, or Variances at Completion to measure performance for award fee purposes is inappropriate.
10. DoD should provide policy guidance on formal reprogramming to address cases in which the performance measurement baseline no longer realistically reflects work scope and schedule.
11. DoD should provide policy guidance on conducting Integrated Baseline Reviews.

The USD(AT&L) approved these recommendations. PARCA was assigned to draft revisions to the DFARS to implement recommendations 1-3 and policy guidance to implement recommendations 7-11. Defense Acquisition University (DAU) was assigned to incorporate concepts related to recommendations 7-11 into DAU Program Management, EVM and Contracting courses. DCMA was assigned to implement recommendations 4-6.

7.4 TINA and Requirements for CoP data

1. DoD will initiate pilot programs to demonstrate and quantify impacts of reducing repeated submissions of CoP data based on one or more of the following approaches:
 - Use of cut-off dates to limit resubmission of CoP data and reduce acquisition lead time. For selected large dollar acquisitions, DoD should test whether providing cut-off dates to subcontractors that exceed TINA but are below a PCO-established threshold reduces lead time and unnecessary CoP data resubmissions without adding significant risk.
 - Rather than submitting a complete FAR 15.2-compliant proposal, subcontractors could submit and certify to actual cost and prices based on recent sales.
2. DoD will submit a revision to FAR 15.407-1(c) that eliminates the requirement that a contracting officer shall request an audit if a contractor voluntarily discloses defective pricing post-award.

The USD(AT&L) approved these recommendations and assigned them to DPAP for disposition.

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8 Conclusions and Plans for Future Work

The framework underpinning this study, in which major DoD contractors provided inputs and supporting data for proposed changes to statutes, regulations, and practices they considered most burdensome, proved effective. Participating contractors clearly expended considerable effort developing thoughtful, data-based arguments supporting their proposed changes, which provided the DoD team a better perspective of and appreciation for industry concerns. Likewise, viewing the proposed changes through the prism of a cost-benefit analysis provided a solid basis for assessing prospective changes. Although assessing the quantitative benefits DoD derives from statutes, regulations, and practices was challenging, by collecting viewpoints from a wide range of DoD stakeholders, the team was able to achieve consensus on a number of recommendations as described in the previous section.

Some general comments on recommendations in this study are warranted. Recommendations related to DoD's acquisition of commercial items range from straightforward and already occurring (streamlining CID) to controversial (requiring that availability of commercial prices paid be a necessary criterion determining that an item or service is commercial). While some in industry disagree that commercial prices paid should be a CID criterion, we reasoned that such a change would be a small step to creating more certainty for industry and the Government about which goods and services should be considered commercial and thus eligible for preferential FAR Part 12 contracting procedures.

For DoD's auditing and contract management procedures, potentially the most significant recommendations are those that would establish a jointly-led OUSD(AT&L)/OUSD(C) team to examine contractor proposals to streamline contract closeouts and leverage results from SOX results and contractor internal controls in DoD's audits. While it is unclear whether actionable changes will result from such an effort, it will afford DoD the opportunity to engage directly with contractors that have specific proposed approaches in these areas.

By far the most substantive and far-reaching recommendations in this study are related to DoD's application of EVM. It is noteworthy that contractors, industry associations and Government teams have been working extensively over the last several years to develop streamlined approaches and in particular to provide more certainty and better communication on DoD's requirements and desired outcomes in this area. Several of this study's recommendations are a confluence of good ideas previously proposed, and to some extent examined, by DoD and industry EVM practitioners. It was a propitious time to put those ideas forward into specific recommendations for consideration by USD(AT&L). The recommended DFARS revision, which is aimed at reducing application of EVM reporting on inappropriate contract types, increasing the threshold for compliance and surveillance reviews, and eliminating the requirement for surveillance unless problems with EVM data are indicated, is expected to have significant positive

effects for DoD and industry, including re-purposing of manpower currently engaged on relatively low-dollar contracts to higher priority efforts.

Assessing contractors' recommend changes to TINA and requirements for providing CoP data proved especially challenging. Intuitively, it seems reasonable that a single TINA threshold (currently \$750,000) makes less sense for very large contracts, e.g., hundreds of millions or billions of dollars, than it does for smaller contracts in the \$10 to \$50 billion range. However, strictly increasing the threshold to \$2 million or \$5 million (as examined in this study) could have appreciable negative effects on DoD's ability to negotiate a fair and reasonable price for the smaller value contracts. One challenge is that the extent of those negative effects is difficult to quantify. Coupled with the relatively small total costs of TINA relative to contract value (at most, approximately 1.8 percent for smaller contracts and much less for very large contracts), there was insufficient evidence to recommend changing the threshold. Likewise, however, there was insufficient evidence to ascertain that the Government's benefits from TINA exceed costs. Follow-on discussions with contractors revealed there is a strong desire for further examination of this issue, which could be a subject for further study. In particular, an approach that might prove viable would be to make the TINA threshold equivalent to a percentage of contract value for sufficiently large contracts.

This study's recommendation that DoD craft approaches to reduce resubmissions of CoP data is not as far-reaching as a statutory change to TINA, but both industry and Government experts agreed that such a change would reduce non-value added efforts and cost.

The Buy American Act was chosen as a study area not because it was anticipated that there would be compelling evidence to change the statute, but rather because of expressed industry concerns that DoD's application was more onerous than intended by statute. In line with this expectation, we received inputs from participating contractors that DoD does not take full advantage of legally permissible exceptions and waivers to the statute. However, the limited number of examples provided did not support making recommendations to DoD policy or practice. It could well be that more numerous examples exist but were not raised by the limited number of contractors participating in this study. The recommendation not to change DoD policy or practice could certainly be re-examined if additional examples are brought forward.

Phase II of this study will continue under the Better Buying Power 3.0 initiative: "Remove Unproductive Requirements Imposed on Industry." Industry will again be invited to play a key role, both in selecting topics for examination as well as providing evidence, ideas, and alternate approaches to achieve mutually beneficial outcomes. Based on industry inputs, some areas under consideration for future study include: DoD's Application of Low Price Technically Acceptable Criteria; Reducing Procurement Administrative Lead-Time for Contract Awards; Providing Greater Clarity on Intellectual Property Policies and Practices; Reducing Undefined Contract Actions; Limiting Flow-Down of FAR/DFARS Clauses; and Consistent Rules for Contract Sun-Setting.

A. Abbreviations

AAC—Advance Acquisition Contracts

ANSI—American National Standards Institute

ASD(A)—Assistant Secretary of Defense for Acquisition

ASPR—Armed Services Procurement Regulation

AT&L—Acquisition, Technology, and Logistics

ATF—Alcohol, Tobacco, Firearms

BAA—Buy American Act

BBP—Better Buying Power

BOM—Bill of Material

C&L—Coopers and Lybrand

CAM—Control Account Manager

CAR—Corrective Action Requests

CAS—Cost Accounting Standards

CASB—Cost Accounting Standards Board

CBAR—Contract Business Analysis Repository

CDRL—Contract Data Requirements List

CFA—Cognizant Federal Agency

CID—Commercial Item Determination

CoP—Cost or Pricing

CON FIPT—Contracting Functional Integrated Product Team

CSART—Combat Support Agency Review Teams

CSDR—Cost and Software Data Reports

D,DP—Director, Defense Pricing

DCAA—Defense Contract Audit Agency

DCMA—Defense Contract Management Agency

DFARS—Department of Defense Federal Acquisition Regulation Supplement

DLIS—Defense Logistics Information Service

DoD—Department of Defense

DP—Defense Pricing

DPAP—Defense Procurement and Acquisition Policy

FAR—Federal Acquisition Regulation

EAC—Estimates at Completion

EMD—Engineering, Manufacturing and Development

ERP—Enterprise Resource Planning

EVM—Earned Value Management	IPMD—Integrated Program Management Division
EVMS—Earned Value Management System	IPMR—Integrated Program Management Report
EVMSIG—EVMS Interpretation Guide	IRS—Internal Revenue Service
FAR—Federal Acquisition Regulation	JPO—JSF Program Office
FASA—Federal Acquisition Streamlining Act	JSA—Joint Surveillance Audits
FFP—Firm Fixed Price	JSCC—Joint Space Cost Council
FPIF—Fixed Price Incentive Firm	L&MR—Logistics and Materiel Readiness
FPR—Forward Pricing Rate	LMA—Lockheed Martin Aeronautics
FPRA—Forward Pricing Rate Agreements	LOE—Level of Effort
FPRR—Forward Pricing Rate Recommendations	MAAR—Mandatory Annual Audit Requirement
FSC—Federal Supply Code	MDA—Milestone Decision Authority
FSG—Federal Supply Group	MDAP—Major Defense Acquisition Program
FY—Fiscal Year	MDD—Materiel Development Decision
GAAP—Generally Accepted Accounting Practices	MIBP—Manufacturing and Industrial Base Policy
GAGAS—Generally Accepted Government Auditing Standards	MMAS—Material Management and Accounting System
GAO—Government Accountability Office	MOU—Memorandum of Understanding
GAO—Government Accountability Office	MRP—Manufacturing Resource Planning
IBR—Integrated Baseline Reviews	MS—Milestone
ICE—Incurred Cost Electronically	NDA—National Defense Authorization Act
IDA—Institute for Defense Analyses	

NDIA—National Defense Industrial Association

NOAA—National Defense Authorization Act

NRO—National Reconnaissance Office

NSN—National Stock Number

OMB—Office of Management and Budget

OTB—Over Target Baseline

OTS—Over Target Schedule

PARCA—Performance Assessments and Root Cause Analyses

PAUC—Program Acquisition Unit Cost

PBL—Performance Based Logistics

PCO—Procurement Contracting Officer

PGI—Procedures, Guidance, and Information

PMSC—Program Management Systems Committee

PRT—Procurement Roundtable

PSR—Procurement Systems Reviews

R—Recommendations

RDT&E—Research Development Test and Evaluation

SAE—Service Acquisition Executive

SAR—Selected Acquisition Report

SASC—Senate Armed Services Committee

SOL—Statute of Limitations

SOX—Sarbanes-Oxley Act

T&M—Time and Material

TAA—Trade Agreements Act

TINA—Truth in Negotiation Act

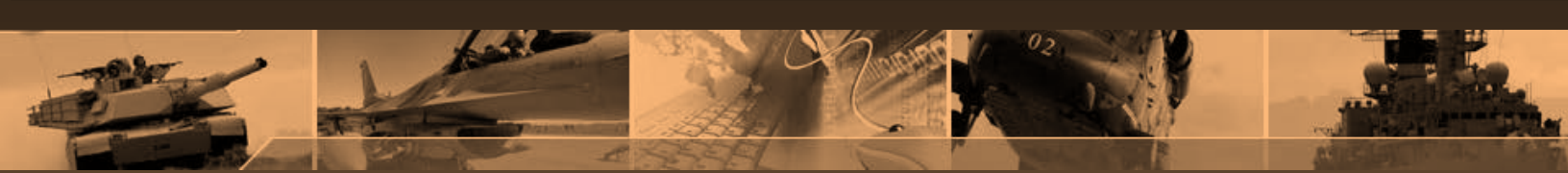
UCA—Undefinitized Contract Actions

ULB—Unified Legislation Budget

USD—Under Secretary of Defense

USD(AT&L)—Under Secretary of Defense for Acquisition, Technology & Logistics

WBS—Work Breakdown Structure



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