STATEMENT OF
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OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
SUBCOMMITTEE ON FEDERAL FINANCIAL MANAGEMENT, GOVERNMENT
INFORMATION, FEDERAL SERVICES, AND INTERNATIONAL SECURITY
COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
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Chairman Carper, Ranking Member McCain, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss award fee contracting and strategies for eliminating waste and maximizing the value achieved from these contracts.

As the Deputy Director for Management at the Office of Management and Budget (OMB), it is my responsibility to lead efforts to improve government performance. This includes providing for a sound acquisition system that operates with the sustained effectiveness and efficiency necessary to meet the extraordinary challenges facing our country. This Administration is committed to creating an environment that can support such a system. At the beginning of March, the President issued a Memorandum on Government Contracting that outlines a series of steps to significantly increase the value received from the more than $500 billion of taxpayer dollars that are spent annually for contracted products and services to meet mission needs. The Memorandum identifies an agency's selection of contract type as a key decision point in the acquisition lifecycle and an area in need of immediate and increased attention to achieve better results from our contractors.

The selection of an incentive contract, where the payment of fees is tied to the contractor's achievement of defined outcomes, can be an effective way to achieve strong performance from a contractor. Fees create an incentive for the contractor to reduce costs, stay on schedule, and meet or exceed performance goals. Fees also help the government to mitigate contract risk by reducing cost to the government where a contractor's performance does not meet or exceed contract requirements. Having the ability to mitigate risk is especially important on a cost-reimbursement contract that otherwise provides limited incentive for a contractor to control cost.

The findings documented by the Government Accountability Office (GAO) and others make clear that certain practices are essential to the successful use of fees, known as award fees, when they are applied to help motivate good results in circumstances where requirements may be difficult to define with sufficient specificity to measure objectively. For example:

- Fees must be linked to specific acquisition outcomes – that is, the cost, timeliness, and quality of the contractor's performance.
- The amount of fee an agency pays must be commensurate with the level of demonstrated performance.
- No fee should be paid where performance is unsatisfactory or does not otherwise meet the overall requirements of the contract.

These and other basic tenets of award fee contracting were laid out by OMB's Office of Federal Procurement Policy (OFPP) in a policy memorandum in 2007. However, as GAO's recent report on award fee contracting documents, agency adherence to these tenets is inconsistent and, in some cases, ineffective, which has led to the unnecessary loss of significant taxpayer dollars over the years. There are examples to show that by turning this trend around,

agencies can save significant resources. For example, the Department of Defense (DoD) will save hundreds of millions of dollars by tying award fee criteria to acquisition outcomes and curtailing its use of "rollover," where a contractor is given a second chance to earn fees in a subsequent performance period that were not earned initially.

All agencies that use award fee contracts must make concerted efforts to consistently apply proven contracting practices to maximize savings and motivate the best performance possible. To achieve effective government-wide implementation of award fee contracting, OMB will: (1) expand and further clarify existing rules in the Federal Acquisition Regulation (FAR) and (2) bring more agency management attention to bear on this contracting tool.

Expanded and clarified guidance

For many years, the FAR has sanctioned the use of award fees. However, the FAR provides few guideposts to help agencies determine how and when fees should be paid. OFPP has been working with the other members of the Federal Acquisition Regulatory Council (FAR Council) and other agencies on FAR changes that will give greater definition and consistency to the general principles laid out in OFPP's 2007 policy memorandum and implement the requirements laid out by Congress in section 867 of the FY 2009 National Defense Authorization Act. These changes will provide a better foundation for eliminating wasteful practices that undermine the incentive to excel, such as allowing contractors to receive fees for unsatisfactory performance, or routinely tying fees to effort rather than achievement of cost, schedule, and performance goals.

The FAR Council is actively working towards the publication of a new FAR rule within the next 30-60 days that will:

- increase the attention an agency must give during acquisition planning to determine that an award fee contract is appropriate for the agency's requirements and circumstances;
- provide evaluation standards to help agencies differentiate between levels of performance and the corresponding percentage of available award fee that could be earned;
- prohibit award fee for contractor performance that is judged to be unsatisfactory; and
- provide clear guidance on the use of rollovers.

With respect to this last point, OMB and the FAR Council share Congress' general concern with rollover practices. In addition to undermining the incentive to perform well consistently, findings show that rollover is costly and significant savings may be achieved by significantly curtailing, if not ending, this practice. These facts are being taken into careful consideration in deliberations over whether the practice should be banned altogether.

Increased management attention and support

Improvements to our regulatory framework must be coupled with increased management attention, especially by the five agencies that are responsible for more than 95 percent of the dollars spent under award fee contracts: DoD, the Departments of Energy, Health and Human Services, and Homeland Security, and the National Aeronautics and Space Administration. OMB will work with the Chief Acquisition Officers, Performance Improvement Council members, and other agency officials at these agencies to identify the supporting steps that are most critical to achieving constructive and sustained practice improvements. Our primary focus will be on: (1) improved monitoring of internal practices, data collection, and evaluation, and (2) training of the acquisition workforce.

(1) Improved monitoring of internal practices, data collection and evaluation. Agencies must put appropriate mechanisms in place to determine if fees are being used effectively. As initial steps to check quality and to take full advantage of the fee determination process, we will:

- ask agencies to conduct periodic reviews of their fee determinations to assess if they are being made in accordance with the agency's approved award fee plan and compare fee determinations to the agency's overall assessment of the contractor's performance, as documented in the Past Performance Information Retrieval System (PPIRS) which, as of the beginning of July, serves as the single, government-wide repository of contractor assessments;
- evaluate how to make PPIRS a repository for award fee determinations so that these evaluations can provide an additional source of information for agencies to consider in future source selections; and
- identify steps to improve current data collection on award fee contracts, which could include collecting information about the award fee pool, award fee paid, and the associated performance rating to facilitate broader trend analyses that we cannot perform today.

(2) Training the acquisition workforce. The acquisition workforce is the backbone of our acquisition system. The quality of their skills and judgment is inextricably tied to whether we achieve good results from our contracting tools. The rollout of our new guidance must be supplemented with training that reinforces the skills that are essential to achieving cost-effective quality performance under award-fee contracts, such as the ability to draft a good award fee plan, tie fees to cost, schedule, and performance results, and define the specific criteria that will be used to evaluate the contractor against standard performance ratings. Equally important, training

materials must highlight best practices as they are identified. NASA, for example, has awarded "multiple incentive-fee" contracts that permit the agency to use objective performance metrics whenever requirements can be measured objectively and limit the use of subjective criteria to those requirements whose outcomes cannot be effectively measured objectively.

Finally, our training efforts must be tailored to the needs and skills of the officials who will be responsible for awarding and managing award fee contracts and making award fee determinations. For example, fee determining officials typically are program managers who will benefit from specific training related to establishing and managing an effective award fee plan. To be most effective, this training must recognize that most program managers do not have a formal acquisition background but share a common goal with contracting officials to improve government performance.

Conclusion

As the President's Memorandum on Government Contracting makes clear, this Administration places a high priority on strengthening our acquisition system, beginning with operations where there is clear evidence of both inefficiency and an opportunity for significant improvement. The effective selection of contract type generally, and award fee contracting in particular, is one such area. When used effectively, award fees provide the type of incentive for cost control and good performance that agencies must have to address the requirements of our taxpayers. Unfortunately, there are a number of significant weaknesses with our current rules and practices. We must work aggressively to change them and create an environment that encourages continual improvement. Recently issued OMB guidance to implement the President's Memorandum should help to facilitate expeditious adoption of improved award fee

practices. Under OMB's guidance, each agency is required to develop an acquisition savings plan. Early adoption of these practices can help agencies achieve their savings targets.

We look forward to working with this Subcommittee in improving the use of award fee contracts and strengthening our acquisition system. This concludes my prepared remarks. I am happy to answer any questions you might have.