Why do we care about innovation?

It's not contract compliance; it's not cost accounting. It's not a legal case.

So why do we care, other than it's something that the Pentagon's leadership obviously cares about?

Well, it's like this: First, the CAS Board has gone silent and the DCAA hasn't updated its website in a while. And the DCAA hasn't gotten around to publishing its GFY 2014 Report to Congress yet, and the DoD OIG Semi-Annual Report to Congress is still a few weeks away. And we're tired of writing about banal fraud stories.

So we'll write about innovation.

Again.

Now, if you're tired of reading about innovation—or perhaps just tired of reading about our thoughts about innovation—then you can feel free to click away right now. Go on. We

understand. No guilt here.

Buh-bye.

If you are still with us then we assume you are also interested in this rather faddish notion that the Pentagon will, somehow, avail itself of Silicon Valley innovation and agility. Somehow, in some manner, the Pentagon and Silicon Valley will come to an agreement; meet halfway, as it were. And in that middle ground will be a roll-back or carve-out of all the burdensome business rules that the traditional defense contractors have come to accept. (It won't even have to be *all* of those business rules; but let's assume it will be
most
of them.)

As we wrote **previously**, we believe some of the fundamental rules associated with selling to DoD will need to be significantly revised or eliminated altogether, if those Silicon Valley companies are going to be willing to do business with the Pentagon bureaucrats. For instance—

-

No competition. And no cost analysis either.

-

Because there will be no price or cost analysis the notion of "price reasonableness" is going to be hard to achieve. We suspect "price reasonableness" will be an irrelevant concept in our hypothetical middle ground.

-

Basically, we envision a grant of money in order to research some idea or to achieve some poorly defined goal. The money gets handed over and the Pentagon gets whatever it gets in return. Maybe. Assuming the company achieves some success. Failure is always an option.

-

That funding can be increased, or not. But no Limitation of Cost/Limitation of Funds nonsense. You want more efforts? Great, then pay more. Otherwise no.

-

No Business System nonsense. You want adequate business systems? Go hire Raytheon or General Dynamics.

-

No DCAA audit nonsense. The companies already have independent CPA auditors and those will have to be sufficient.

-

Periodic progress reports, but not too many and nothing burdensome.

-

The Intellectual Property problem gets solved. Somehow.

In our view, such carve-outs or roll-backs or exemptions can happen in one of two ways: (1) certain businesses are exempted based on what they do, or (2) certain phases of the acquisition are exempted, with exemptions falling away (and being replaced by compliance requirements) based on the project's current position on the DoD Directive 5000.1/DoD Instruction 5000.02 acquisition lifecycle.

In the first scenario, certain companies are exempted as a class. The rules simply don't apply to them. Think FAR deviation, but the deviation covers statutory rules as well. Companies designated as being "innovative" or "agile developers" have special CAGE Codes, and those CAGE Codes work like a "get out of jail free" card with respect to all the stuff identified above. Or else those CAGE Codes get to access a special funding source that works the same way in terms of relaxed requirements.

For instance, contractors in the SBIR (Small Business Innovative Research) Program are exempted. Forget that nonsense about Phase 2 awards being cost-type and thus requiring an adequate accounting system and an incurred cost proposal and lots of DCAA interaction. SBIR contractors are simply exempted from that stuff. And not just SBIR contractors, but any Silicon Valley company, of any size, is similarly exempted. That's just how the rules work now. Or maybe companies with the special CAGE Codes get to apply for certain funding (a new or improved "color of money"), and with those new funds come fewer strings—a lot fewer strings.

And how might a company with that special CAGE Code submit an application to access the special funds? The application would be simple and the evaluation process would be streamlined. Basically, answer two questions: who are you and what do you want to do? Then a high-powered committee reviews the application and makes an award decision in 5 working days; a decision that is not subject to protest. *Boom!* Done.

Just to be fair to the traditional defense contractors, they can apply for special CAGE Codes and/or special exempted funding as well. But in order to qualify, they have to spin-off their R&D shops. For example, the Skunk Works and the Phantom Works need to spin-off from their motherships. Anybody who wants to apply needs to be an independent (or semi-independent) R&D shop. Back in the 1960's every aerospace/defense company worth its salt had an independent R&D outfit that was both geographically and managerially separate from Corporate HQ. If those traditional defense companies want access to the magic funding, they need to go back to their roots.

And because those independent R&D outfits now have access to "magic funds" they will be subject to a whole lot less administrative requirements. Consequently, they won't have to staff up in areas that are non-value-added to the R&D efforts. Thus: the funding provided will go further because there will be less overhead to eat it up.

Sounds good to us!

The second possible approach is to start out with almost no administrative requirements and layer them on as the project/program progresses along the DoD acquisition life-cycle. That life-cycle is defined in DoD Instruction Directive 5000.1 and DoD Instruction 5000.02, and (from the contractor's perspective) basically includes the following—

1. Engineering and Manufacturing Development (EMD)
2. Low-Rate Initial Production (LRIP) or Limited Deployment
3. Full-Rate Production or Full Deployment

There's more to it, of course. In fact, DoD Instruction 5000.02 is 154 pages long. Here's **a link** for the masochists among our readership.

Our point being, DoD could focus on the EMD phase of the program and decide that companies performing in that phase wouldn't be burdened with the same requirements that would be applied to contractors in the later phases of the acquisition lifecycle. DoD could decide that companies in the LRIP phase would have a few more regulatory burdens, but not as many as those in the FRP phase. It could be done.

The idea behind that approach would be that innovation occurs in the earlier stages, such that by the time you get to Full-Rate Production you have a solid design with a mature technological approach. Any innovation is behind you, so now you have to comply with the full panoply of rules and regulations.

That could work, we think.

So here are two approaches that we believe could foster innovation. Both approaches are practical and feasible, and either one would create an environment where innovation and agile development could flourish, unmolested by DCMA functional specialists and DCAA auditors

and all the other rules primarily intended to combat fraud, waste, and abuse, but whose unintended consequences have been that programs subject to them cost more, take longer, and generally fail to achieve meaningful innovation.