In May, 2010, Secretary of Defense Gates unveiled his initiative to drive down the cost of weapon systems and reduce Pentagon bureaucracy. Calling for long-term savings of nearly $102 billion, he said—

The goal is to cut our overhead costs and to transfer those savings to force structure and modernization within the programmed budget. In other words, to convert sufficient 'tail' to 'tooth' to provide the equivalent of the roughly two to three percent real growth – resources needed to sustain our combat power at a time of war and make investments to prepare for an uncertain future. Simply taking a few percent off the top of everything on a one-time basis will not do. These savings must stem from root-and-branch changes that can be sustained and added to over time.

Undersecretary of Defense (Acquisition, Technology & Logistics) Dr. Ashton Carter quickly responded to his leader's call for action. On June 28, 2010, he met with defense industry leaders and called for savings of $66.3 billion over five years, to be found on current programs and activities. He said—

We need to restore affordability to our programs and activities … by identifying and eliminating unproductive or low-value-added overhead; in effect, doing more without more. … The guidance will focus on getting better outcomes, not on our bureaucratic structures. … Most of the rest of the economy exhibits productivity growth, meaning that every year the buyer gets more for the same amount of money. So it should be in the defense economy.

At that time, Dr. Carter issued a Memorandum addressed to Defense acquisition professionals. Entitled “Better Buying Power: Mandate for Restoring Affordability and Productivity in Defense Spending,” the Memo called for “delivering better value to the taxpayer and improving the way the [Defense] Department does business.”

We wrote about the new initiatives **here** .

Despite some initial confusion over terms, what have emerged are two distinct lines of attack: (1) the drive to reduce waste, bureaucracy, and inefficiency within the Pentagon, and (2) the drive to reduce the costs of goods and services by focusing on reducing contract prices. To clarify, we call them the “efficiency” and the “affordability” initiatives. We explored the two lines of attack in **this article** . The drive for Pentagon efficiency seems to be led by SecDef Gates, while the drive for contractor affordability seems to be led by USD (AT&L) Dr. Carter. In our **latest article** , we focused on SecDef Gates’ August 9, 2010, press conference and his “series of initiatives designed to reduce overhead, duplication, and excess in the Department of Defense, and, over time, instill a culture of savings and restraint in America’s defense institutions.”

Today’s article focuses on the other initiative, Dr. Carter’s quest to create billions of dollars of acquisition savings through driving down the prices paid by the Pentagon for weapon systems and services. On September 14, 2010, Dr. Carter unveiled the tactics he will employ in his attack on acquisition costs. We will discuss two documents: (1) a single-page “Guidance Roadmap” that provides plans on five specific areas of attack, and (2) a new “Better Buying Power” Memorandum for Acquisition Professionals.

Dr. Carter’s **Guidance Roadmap** listed five specific areas of attack in the drive to reduce Defense acquisition costs. These areas included:

-

Target Affordability and Control Cost Growth

-

Incentivize Productivity & Innovation in Industry

-

Promote Real Competition

-

Improve Tradecraft in Services Acquisition

-

Reduce Non-Productive Processes and Bureaucracy

The Guidance Roadmap document can be found via the link, above. Note it included specific sub-bullet points beneath each of the five lines of attack listed above.

The accompanying Memo, entitled “Better Buying Power: Guidance for Obtaining Greater Efficiency and Productivity in Defense Spending,” provided details on specific tactics Dr. Carter intends for his acquisition corps to deploy. There are 23 “principal actions to improve efficiency” linked to the five lines of attack listed above. Here is the 9/14/2010 **Memo** , and it is definitely worth reviewing in considerable detail.

We will not go through every word of the 17-page Memo, or review each of the

23 individual “principal actions”. What we want to do is to highlight some of the significant (and dare we say controversial?) tactics the Pentagon has been directed to utilize in the fight against acquisition costs. Here are some of the interesting aspects of Dr. Carter’s affordability initiative—

-

Reward contractors for successful supply chain and indirect expense management. This involves rewarding performance through setting appropriate profit levels. “Higher profit should be awarded to management of higher-risk subcontracts, and higher profit should be given when the prime succeeds in driving down subcontractor costs every year.” The Director of Defense Procurement and Acquisition Policy (DPAP) will “review the Weighted Guidelines … with the aim of emphasizing the tie between profit and performance.” Dr. Carter emphasized, however, that this was not simply an exercise in cost-cutting. He said—

-

It is important to note that the savings to be expected from this direction will be in cost, not in profit. Savings are not expected in profit per se since in some instances profit will increase to reward risk management and performance. But if profit policy incentivizes reduction in program cost, the overall price to the taxpayer (cost plus profit) will be less.

-

Reverse a decade of practice and restore DOD’s preference for using customary progress payments based on cost incurred, with other contract financing options being agreed-upon only with a commensurate reduction in contractor profit, based on increased cash flow.

-

Increase focus on contractor IR&D expenditures, “to improve the return on IRAD investments for industry and government.”

-

When only one bid or offer is received by the DOD, require Contracting Officers to obtain non-certified cost or pricing data, even if the FAR definition of “adequate competition” has been met.

-

The Director of DPAP will “develop guidance that will clearly spell out the roles and responsibilities” of DCMA and DCAA in order to avoid duplication and overlapping roles.

-

Use Forward Pricing Rate Recommendations (FPRRs) in lieu of Forward Pricing Rate Agreements (FPRAs). In particular, “where DCAA has completed an audit of a particular contractor’s rates, DCMA shall adopt the DCAA recommended rates as the Department’s position with regard to those rates.”

While some of Dr. Carter’s plans seem like good ideas, others disappoint us and strike us as counter-productive. For instance, we are disappointed to see the end of DOD’s regulatory preference for Performance-Based Payments and the return of customary progress payments. The debacle of the A-12 program taught many that progress payments had little to do with actually making progress, and everything to do with the ability to spend money. It looks to us like that lesson has been forgotten.

The substitution of DCAA audit findings for DCMA discretion and negotiation ability strikes us as a spectacularly bad idea, one that further shrinks the regulatory role of the Contracting Officer in favor of findings from an agency that has, in recent years, generated audit reports of poor quality that were, at the same time, dramatically untimely. We have reported many times on problems with recent DCAA audit guidance, and we see no indication that Dr. Carter's direction will do anything other than cause financial problems for the defense industrial base.

As always, stay tuned for further developments.