DEPARTMENT OF DEFENSE

AUDIT REPORT

CONTRACTOR SUPPORT AT MAJOR RANGE AND
TEST FACILITY BASES - CONTRACTORS' FEES

No. 91-068 March 21, 1991

Office of the
Inspector General

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

March 21, 1991

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
DEPUTY ASSISTANT SECRETARY OF DEFENSE FOR PROCUREMENT
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)

SUBJECT: Audit of Contractor Support at Major Range and Test Facility Bases - Contractors' Fees (Report No. 91-068)

This is our final report on the audit of Contractor Support at Major Range and Test Facility Bases - Contractors' Fees for your information and use. Comments on a draft of this report were considered in preparing the final report. We performed the audit from October 1989 through June 1990. The audit objective was to evaluate the adequacy and cost-effectiveness of contractor support at Major Range and Test Facility Bases (test ranges). Early in the audit, we narrowed the objective to specifically evaluate the cost-effectiveness of fees awarded and paid to contractors for performing support services at the test ranges. We also evaluated the criteria used to negotiate fee rates, the adequacy of award fee evaluation plans, and the effectiveness of award fee evaluation boards; and we determined the frequency of fee payments to contractors. We also reviewed applicable internal controls. We identified 14 of 21 test ranges that had 31 cost-plus-award-fee service contracts during FY's 1988 through 1990. The total dollar value of the 31 contracts was $3.7 billion. We selected and reviewed 22 of the 31 contracts awarded by 9 of the 14 test ranges. The value of the 22 contracts reviewed was $1.7 billion.

The audit showed that base fees were inappropriately included on cost-plus-award-fee service contracts, a structured approach for determining the award fee pool was needed, and better management of award fee service contracts could have further reduced contract costs. Contract cost-reduction initiatives implemented at two of the test ranges were particularly noteworthy and are discussed in Part I of this report. The results of the audit are summarized in the following paragraphs, and the details, audit recommendations, and management comments are in Part II of this report.

Base fees were inappropriately included on nine cost-plus-award-fee service contracts. As a result, the test ranges will pay approximately $5.5 million in excessive fees on these contracts. We recommended that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to clarify in the DoD Federal Acquisition Regulation Supplement (DFARS) that base fees shall not be included in procurements where the award fee is used to motivate and reward contractor performance. We also recommended that the Deputy Assistant Secretary of Defense for Procurement issue an interim policy directing DoD agencies and Military Departments to instruct their procurement officials that base fees will not be used on award fee contracts when the award fee is used to motivate and reward contractor performance. The latter recommendation is necessary because we believe that the condition we found at the test ranges is an example of a larger, systemic problem within DoD (page 7).

The test ranges had inconsistently applied award fees on cost-plus-award-fee service contracts. As a result, the test ranges could potentially pay excessive and unearned award fees. We recommended that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to develop and publish a structured approach for determining the dollar amount of award fee pools, specify in the DFARS that an award fee will not be paid for performance that is submarginal or unsatisfactory, and specify in the DFARS that performance evaluation scores equate to a range of award fee dollars earned. We also recommended that the Secretaries of the Military Departments instruct their contracting officials to limit the maximum award fee percentage that is derived from using the alternate structured approach in the Government's requests for proposals (page 13).

On October 9, 1990, a draft of this report was provided to the addressees. Based on comments received from the Deputy Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; and the Assistant Secretary of the Navy (Research, Development and Acquisition), we deleted draft Recommendation B.2., which entailed the issuance of an interim policy on award fees. Therefore, Recommendation B.3. in the draft report has been renumbered Recommendation B.2. in the final report.

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; and the Assistant Secretary of the Navy (Research, Development and Acquisition) nonconcurred with

Recommendations A.1. and A.2. concerning the inappropriate use of base fees on cost-plus-award-fee service contracts. The Assistant Secretaries stated that DFARS, section 216.404-2(S-70), addresses the prohibition of base fees in those situations where award fee provisions are included in other-than-cost-plus-award-fee contracts. However, the draft revision of the DFARS, section 216.404-2, issued October 31, 1990, states that base fees shall not be included in procurements where the award fee is used to motivate and reward contract performance. If this provision is included in the final publication, the action taken by management would be responsive to our recommendations.

The Office of the Assistant Secretary of the Army, Contracting Support Agency, and the Assistant Secretary of the Navy (Research, Development and Acquisition) partially concurred with Recommendation B.1.a. concerning a structured methodology for determining the size of the award fee pool. We have accepted their comments concerning the use of the weighted guidelines method for determining the size of the award fee pool and have revised Recommendation B.1.a. accordingly. Therefore, we request that the Office of the Assistant Secretary of the Army, Contracting Support Agency, and the Assistant Secretary of the Navy (Research, Development and Acquisition) provide final comments on Recommendation B.1.a., including proposed corrective actions and completion dates.

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; and the Assistant Secretary of the Navy (Research, Development and Acquisition) nonconcurred with Recommendation B.1.b., which stated that the DFARS should specify that performance evaluation adjective ratings and score ranges be contained in award fee plans. We believe the recommendation is still warranted for reasons discussed in Part II of this report.

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; and the Assistant Secretary of the Navy (Research, Development and Acquisition) concurred with Recommendation B.1.c.

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; the Assistant Secretary of the Navy (Research, Development and Acquisition); and the Associate Deputy to the Assistant Secretary of the Air Force (Contracting) nonconcurred with Recommendation B.2. concerning the inclusion of a maximum award fee percentage in the Government's requests for proposals. We believe the recommendation is still warranted for reasons discussed in Part II of this report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Accordingly, final comments on the unresolved issues in this report should be provided within 60 days of the date of this memorandum.

We appreciate the courtesies extended to our staff during the audit. Please contact Mr. Raymond A. Spencer, Program Director, at (703) 614-3995 or Mrs. Yvonne M. Speight, Acting Project Manager, at (703) 693-0373 if you have any questions concerning this report. This report does not claim quantifiable monetary benefits (Appendix H). However, we believe that when our recommendations are implemented, DoD service contract costs will be reduced. A list of the audit team members is in Appendix J. Copies of this report are being provided to the activities listed in Appendix K.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force
Director, Defense Acquisition Regulatory Council

REPORT ON THE AUDIT OF CONTRACTOR SUPPORT AT MAJOR RANGE AND TEST FACILITY BASES - CONTRACTORS' FEES

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Prepared by:
Acquisition Management
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Project No. 0AB-0010.01

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REPORT ON THE AUDIT OF CONTRACTOR SUPPORT AT MAJOR RANGE AND TEST FACILITY BASES - CONTRACTORS' FEES

PART I - INTRODUCTION

Background

Effective and efficient management of cost-reimbursement service contract costs contribute to DoD's overall objective of reducing the Defense budget. The Defense budget for cost-reimbursement and service contracts was $23.5 billion and $11.7 billion, respectively, for FY 1989. We identified 14 test ranges that had cost-plus-award-fee service contracts that were effective during FY's 1988 through 1990. The total value of the contracts was $3.7 billion.

The Government has the flexibility to use various types of contracts to acquire the large variety and volume of materiel and services that it requires. One type of contract is a cost-reimbursement contract, which provides payment of allowable incurred costs. An example of a cost-reimbursement contract is a cost-plus-award-fee contract. Cost-plus-award-fee contracts provide a fee consisting of a base amount, which may be zero, that is established at the contract's inception and an award amount, which is based on a subjective evaluation by the Government, that is sufficient to maximize the contractor's performance.

The draft revision of the Defense Federal Acquisition Regulation Supplement states that the "award amount" portion of the fee may be used in other types of contracts when the Government wishes to motivate and reward a contractor for management performance in areas that cannot be measured objectively and where normal incentive provisions cannot be used. Logistics support, quality, timeliness, ingenuity, and cost-effectiveness are areas under the control of management that may be susceptible only to subjective measurement and evaluation. In addition, when the award fee is used under the above conditions, the "base fee" (fixed amount portion) is not used.

The draft revision of Defense Federal Acquisition Regulation Supplement (DFARS), section 216.404-2(b)(3)(A), states that a board may be established to evaluate the contractor's performance and to determine the amount of the award fee or recommend an amount to the contracting officer.

Objective and Scope

Our initial objective was to evaluate the adequacy and cost-effectiveness of contractor support at Major Range and Test Facility Bases (test ranges). This evaluation included a review of work performed by contractors, costs to perform services, statements of work and supporting documents, and contractor charges to the test ranges. Early in the audit, we narrowed the objective to evaluate the cost-effectiveness of fees awarded and paid to contractors for performing support services at the test ranges. Specifically, we evaluated the fee rate negotiation criteria, the adequacy of award fee evaluation plans, and the effectiveness of award fee evaluation boards. We also determined the frequency of fee payments to contractors.

In addition, we reviewed initiatives implemented by two test ranges to reduce contract costs. We did not recommend the implementation of these cost-reduction initiatives because time and resources did not allow us to fully evaluate their use on test range support service contracts. However, we are considering an audit of the implementation of the White Sands Missile Range's "Service Contract Cost Engineering Study" for test range service contracts. We believe the Eastern Space and Missile Center "Biweekly Provisional Award Fee Payments" initiative is worthwhile and should be considered as a negotiation tool to reduce fee rates on contracts obtained under the Small Business Administration program. Other Matters of Interest contains a description of the initiatives.

Our review was limited to cost-plus-award-fee service contracts that had an annual cost of $1 million or more and that were in effect during FY's 1988 through 1990. We randomly selected for our review 9 of 14 test ranges with contracts that met our criteria. The 9 test ranges had 22 cost-plus-award-fee service contracts, valued at $1.7 billion. We reviewed DFARS guidance on profit or fee negotiations, award fee evaluation plans, award fee evaluation board minutes, frequency of award fee payments, and award fee dollars earned in relation to performance ratings. We also interviewed contracting officials. Details of the audit universe and sample selection are in Appendix A.

This economy and efficiency audit was made from October 1989 through June 1990 in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. The activities visited or contacted during the audit are listed in Appendix I.

Internal Controls

We evaluated management control programs related to award fee administration and management. Specifically, we reviewed compliance with regulations and procedures for determining award fees. We also reviewed Government prepared internal control or management control programs. We found that managerial review of cost-plus-award-fee service contracts was not sufficient to ensure that base fees were not applied on these contracts when the award fee was used to motivate and reward contractor performance. The internal control weakness found is discussed in Part II of the report.

Prior Audit Coverage

General Accounting Office Report No. NSIAD 90-33 (OSD Case Number 7679-A), "Compensation of Defense Contractors' Working Capital Financing Costs," January 1990, stated that DoD's profit policy generally recognized factors affecting contractor's working capital financing costs. However, on individual contracts, if contracting officers did not adjust for the specific circumstances of that contract, too much or too little profit could be included in the contract price. The report made no recommendations.

DoD Inspector General Report No. 91-025, "Audit of the Adequacy and Implementation of DoD Profit Policy," December 28, 1990, reported that the DoD Profit Policy-Final Rule was generally adequate and that additional changes were not required. However, contracting officers were not adequately documenting their profit decisions, and internal control weaknesses in training, supervisory reviews, and reporting on DD Form 1547, "Record of Weighted Guidelines Application Method" were identified. The report recommended that the Military Departments' acquisition offices establish adequate training procedures to ensure that DD Forms 1547 are correctly prepared. Additionally, the report recommended that specific internal controls be established to ensure that contracting officers perform adequate supervisory reviews of completed DD Forms 1547 before conclusion of the negotiation process. Management's comments were not responsive to the recommendation to establish training procedures. Therefore, management was requested to comment on the training issue in response to the final report. In response to the internal control deficiency reported, management concurred and stated that the Military Departments had developed, or planned to develop, software programs that will identify mathematical and other errors before conclusion of the negotiation process.

Army Audit Agency Report No. SO 88-301, "Report of Audit Engineering Services Contracts, U.S. Army Materiel Command," December 29, 1987, reported that award fees in cost-plus-award-fee contracts for engineering services were not properly structured to motivate contractors toward excellence in performance. The report recommended that the Defense Acquisition Regulatory Council change the DFARS to eliminate payment of award fees when contractor performance is submarginal and to minimize payment of award fees when performance is marginal. In response to the recommendation, the Assistant Secretary of the Army issued Acquisition Letter 90-008, which states that under no circumstances should the award portion of the fee be paid for minimum acceptable performance.

Other Matters of Interest

Audit Conclusions. During the audit, we determined that the White Sands Missile Range and the Eastern Space and Missile Center had implemented initiatives that could effectively reduce contract costs. These initiatives are summarized below.

White Sands Missile Range

Cost Analysis. The White Sands Missile Range has two management tools to control contract costs. The first is the "Service Contract Cost Projection System (SCCPS)," which monitors service contract costs. SCCPS uses data from cost and performance reports to develop graphic representations of historical and projected costs under various scenarios. It allows contract managers and budget analysts to view trends in the cost of contracts, over a designated period, based on negotiated elements of cost. SCCPS highlights existing and potential cost problems.

The second is the "Service Contract Cost Engineering Study," which helps provide a "should cost" for service contracts. It is designed to provide negotiators with sufficient data to better evaluate the bidder's cost proposal. It also provides a baseline that can be realistically measured against costs. The White Sands Missile Range also developed and prepared a proposed draft instruction entitled "Service Contract Cost and Performance Report (SCCPR)," which was submitted to the Office of the Secretary of Defense for approval. SCCPR would require contractors to report their costs in a standardized format. The SCCPR would allow contract managers to use the cost reports to make and validate management decisions, detect early contract cost problems, report the effects of management actions taken to resolve problems affecting cost performance, and determine funds in excess of contract needs for deobligation.

Eastern Space and Missile Center

Biweekly Provisional Award Fee Payments. The Eastern Space and Missile Center initiated biweekly provisional award fee payments on two contracts to improve the contractors' cash flow. We believe biweekly provisional award fee payments could be an effective negotiation tool to reduce the dollar amounts of the award fee pool. After the award fee rate has been determined, the contracting officer could offer biweekly provisional award fee payments to the contractor as an incentive to reduce the proposed award fee rate. However, a cost-of-money analysis must be done to determine the cost-effectiveness of such a proposal.

We believe biweekly provisional award fee payments to small business contractors would be cost-effective because these contractors are more receptive to initiatives that improve their cash flow. The provisional award fee payments would allow the contractors to receive 50 percent of the potential, semiannual fee in biweekly installments over a 6-month period. At the conclusion of the contractor's semiannual performance evaluation period, the contractor would receive as payment the difference between the total award fee earned, as determined by the performance evaluation process, and the provisional payments received. For example, if the potential semiannual award fee were $50,000, the contractor would receive $25,000 in 13 biweekly provisional payments over a 6-month period. Also, if a contractor's performance evaluation resulted in an award fee of $45,000 at the end of the performance evaluation period, the contractor would receive an additional $20,000 ($45,000 minus $25,000). Conversely, if the contractor's performance evaluation resulted in an award fee of $20,000, the contractor would have to repay the Government $5,000. Award fees not paid during an evaluation period are not carried over to later evaluation periods.

The White Sands Missile Range and the Eastern Space and Missile Center are to be commended for their attention to reducing service contract costs.

PART II - FINDINGS AND RECOMMENDATIONS

A. Use of Base Fees

FINDING

The Major Range and Test Facility Bases (test ranges) inappropriately included base (fixed) fees on cost-plus-award-fee services contracts. This condition was due to conflicting guidance in the Defense Federal Acquisition Regulation Supplement. As a result, the test ranges will pay approximately $5.5 million in excessive fees on nine cost-plus-award-fee contracts.

DISCUSSION OF DETAILS

Background. A base fee is an amount negotiated at the inception of the contract. The base fee does not vary with actual contract cost, but may be adjusted as a result of changes in the work to be performed under the contract. The use of a base fee on cost-plus-award-fee contracts provides the contractor only a minimum incentive to control costs or to provide above average performance.

Defense Federal Acquisition Regulation Supplement (DFARS), section 216.404-2(b)(71), states that base fees shall not exceed 3 percent of the estimated cost of the contract, exclusive of the fee, and the maximum fee (base fee plus award fee) shall not exceed 10 percent on service contracts.

DFARS, section 216.404-2(70), states that the base fee will not be applicable to cost-plus-award-fee contracts in cases where the award fee is used to motivate a contractor for performance over and above that which can be objectively measured and incentivized under other forms of contracts.

Air Force Systems Command Federal Acquisition Regulation Supplement, section 216.404-2(90)a(3), states that the "base" fee for cost-plus-award-fee contracts will be zero.

We randomly selected 9 of the 21 test ranges to review their cost-plus-award-fee service contracts, which had an annual cost of $1 million or more, and were in effect during FY's 1988 through 1990. Of the 21 test ranges, 14 test ranges had 31 contracts, valued at $3.7 billion, that met our criteria. We reviewed the business clearance memorandum fee provisions and award fee evaluation plans for these 22 contracts. We determined that nine contracts included base fees, contrary to DFARS guidance.

Base Fees. Contrary to DFARS, section 216.404-2(S-70), base fees were inappropriately awarded on 9 (4 Army, 3 Navy, and 2 Air Force) cost-plus-award-fee contracts when the award fee was used to motivate and reward the contractor for above average performance. As a result, $5.5 million in excessive fees will be paid over the life of these contracts.

We believe that base fees were awarded because the DFARS provides conflicting guidance. DFARS, section 216.404-2(b)(71), states that base fees will be limited to 3 percent of the estimated cost exclusive of the maximum fee (base fee plus award fee). DFARS, section 216.404-2(70), states that when an award fee is used to motivate contractor performance, base fees would not be applicable. These two sections of the DFARS provide unclear and seemingly conflicting guidance concerning the appropriate use of base fees.

We reviewed the fee provisions in the business clearance memorandum and the award fee evaluation plans to determine the justification for using a cost-plus-award-fee contract for the nine contracts that included base fees. These documents clearly stated that the intent of the award fee was to motivate the contractor to perform at an above average level. We believe that when a base fee is used in conjunction with an award fee, the base fee reduces the motivation intended by the award fee. A base fee is a set amount established at the inception of the contract, is paid when the contractor bills the activity, and is not based on timeliness, quality, technical ingenuity or cost-effective management.

To ensure that contracting officers do not apply base fees to cost-plus-award-fee contracts, when the intent of the award fee is to motivate and reward the contractor for above average performance, DFARS, section 216.404-2(b)(71), should be revised as follows.

> Fee. The amount of the base fee shall not exceed 3 percent of the estimated cost of the contract, exclusive of the fee; and the maximum fee (base fee plus award fee) shall not exceed 10 percent on service contracts and 15 percent on research and development contracts (Federal Acquisition Regulation 15.903). A base fee will not be applicable when the intent of the award fee is to require continuous exemplary performance from the contractor (DFARS 216.404-2(70).

However, to clarify the DFARS guidance, the Air Force Systems Command issued supplemental guidance, which states that base fees will be zero on all cost-plus-award-fee contracts. We do not take issue with the Air Force Systems Command's policy on zero base fees.

We believe the above revision should be included in the DFARS. If it had been previously included, we believe that contracting officers would not have been confused about the appropriate use of base fees. Accordingly, the test ranges would not be obligated to pay $5.5 million in base fees on the nine cost-plus-award-fee service contracts shown in Appendix B.

Conclusion. Contracting officials must be cognizant of the appropriate use of base fees on cost-plus-award-fee contracts. Base fees can only be used when objective measurement criteria are established for evaluating contractor performance. However, when contractor performance is susceptible only to subjective measurement and evaluation, and the intent of the award fee is to motivate contractors to achieve outstanding performance in areas that cannot be objectively measured, the use of base fees is inappropriate.

Because of unclear guidance in the DFARS, contracting officials have inappropriately used base fees on cost-plus-award-fee contracts. We believe DFARS, section 216.404-2(b)(71), should be revised as presented in this report.

Although we reviewed contracts at the test ranges only, we believe that the inappropriate use of base fees is a systemic, DoD-wide problem. We believe the following recommendations will effectively reduce contract costs on cost-plus-award-fee contracts when the purpose of the award fee is to motivate and reward contractor performance.

RECOMMENDATIONS, MANAGEMENT COMMENTS, AND AUDIT RESPONSE

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; the Assistant Secretary of the Navy (Research, Development and Acquisition); and the Associate Deputy to the Assistant Secretary of the Air Force (Contracting) provided comments on the finding and recommendations. The complete texts of the comments are in Appendixes D, E, F, and G.

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to clarify Defense Federal Acquisition Regulation Supplement, section 216.404-2(b)(71), guidance stating that base fees shall not be applied in procurements where the award fee is intended to motivate and reward contractor performance.

2. We recommend that the Deputy Assistant Secretary of Defense for Procurement issue interim policy directing DoD agencies and the Military Departments to instruct procurement officials that base fees will not be used on award fee contracts when the award fee is used to motivate contractor performance.

The Assistant Secretary of the Defense (Production and Logistics) comments. The Assistant Secretary nonconcurred with both recommendations and commented that DFARS, section 216.404-2(S-70), has been clarified in the draft revision of the DFARS, which was issued for comment on October 31, 1990.

The Office of the Assistant Secretary of the Army, Contracting Support Agency comments. The Assistant Secretary nonconcurred with both recommendations and commented that the DFARS, section 216.404-2(S-70), is clear and that it provides guidance on the use of the award fee provision in conjunction with other types of pricing arrangements, such as cost-plus-incentive-fee/award-fee contracts. The guidance was not intended to apply to a straight cost-plus-award-fee pricing arrangement, hence, no conflict with DFARS 216.404-2(b)(71).

The Assistant Secretary of the Navy (Research, Development and Acquisition) comments. The Assistant Secretary nonconcurred with both recommendations and commented that DFARS, sections 216.404-2(b)(71) and 216.404-2(S-70), are not in conflict; rather, one deals with cost-plus-award-fee contracts while the other deals with the award fee approach on other than cost-plus-award- fee contracts. However, DFARS, section 216.404-2(S-70),

has been made somewhat clearer in the version of the DFARS published in the October 31, 1990, Federal Register under DFARS cite 216.404-2.

Audit response. Actions taken by the Defense Acquisition Regulatory Council are responsive to our recommendations.

B. Application of Award Fees

FINDING

The Major Range and Test Facility Bases (test ranges) had inconsistently applied fees on cost-plus-award-fee service contracts. We attributed this condition to inadequate DoD guidance for developing the dollar value of the award fee pool, standardizing performance rating standards, and converting performance evaluation scores to a range of award fee dollars earned. As a result, test ranges could potentially pay excessive and unearned award fees.

DISCUSSION OF DETAILS

Background. Award fees are provided in service contracts to motivate contractors to strive for excellent performance. Award fees might be earned, in whole or in part, for performance that is sufficient to provide motivation for excellence in such areas as quality, cost-effective management, timeliness, or technical expertise. Award fees cannot be earned for submarginal or unsatisfactory performance.

Federal Acquisition Regulation (FAR), section 16.404-2(b)(2), states that the number of evaluation criteria and the requirements they represent will differ widely among contracts. The FAR further states that the criteria and rating plan should motivate the contractor to improve performance in the areas rated, but not at the expense of at least minimum acceptable performance in all other areas.

The Defense Federal Acquisition Regulation Supplement (DFARS), section 215.902(ii)(F), states, in part, that contracting officers may use an alternate structured approach for cost-plus-award-fee contracts to develop a prenegotiation objective. However, the draft revision of DFARS, section 216.404-2(c)(ii)(2)(A), states that the weighted guidelines method does not apply to cost-plus-award-fee contracts with respect to either the base fee or the award fee. The draft revision of DFARS, section 216.404-2(b)(3), states that the contracting activity may establish a board to evaluate the contractor's performance and to determine the amount of the award fee or recommend an amount to the contracting officer. Also, the contract shall identify the criteria to be used in evaluating the contractor's performance to arrive at the award fee.

Neither the FAR nor the draft revision of the DFARS established criteria for minimum acceptable performance. Army Acquisition Letter 90-008, "Structuring Award Fees in Cost-Plus-Award-Fee Contracts," states that the base portion of the fee is fixed and

payable if the contractor meets the contract requirements. The Acquisition Letter also states that the award portion of the fee is payable, in whole or in part, only if the contractor earns an award fee by performing at a level above the minimum acceptable level under the contract. The Acquisition Letter further states that under no circumstances should the award portion of the fee be "earned" by the contractor for merely providing only minimum acceptable or marginal performance.

In contrast, the Air Force Systems Command's "Award Fee in Systems Acquisition, A Handbook for Program Directors and Contracting Officers" (AFSC Handbook) establishes a numerical range (26 to 50 points) for a satisfactory performance level, which allows AFSC contractors to earn a percentage of the award fee for an evaluation period.

Of the 21 test ranges, 14 test ranges had 31 award fee contracts, valued at $3.7 billion. We visited 9 test ranges and reviewed 22 [1/] contracts, valued at $1.7 billion. We also reviewed criteria used to develop the dollar value of the award fee pool, price negotiation memorandums, business clearance memorandums, and award fee plans.

Application of Award Fees. Based on our review of 22 contracts, we concluded that contracting officers were not developing independent estimates for the award fee pool; there was no consistency within the Military Departments for establishing a numerical score for the earning of an award fee; and the award fee plans for 11 contracts did not equate performance evaluation scores with award fee dollars earned. The causes for the test ranges' inconsistent application of award fees are discussed in the following paragraphs.

DoD Guidance for Establishing Award Fee Pools. DFARS does not provide a structured approach for determining the dollar amount of the award fee pool. DFARS, section 216.404-2(b)(70), states that the weighted guidelines method for performing a profit analysis shall not be applied to cost-plus-award-fee contracts. However, DFARS, section 215.902(ii), states that contracting officers may use an alternate structured approach for cost-plus-award-fee contracts when performing a profit analysis,

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1/ Twenty cost-plus-award-fee contracts and two fixed-price-award-fee contracts.

and that this alternate structured approach must address performance risk, contract type risk, and contractor facilities capital.

We believe that the alternate structured approach should be used to establish the award fee pool for cost-plus-award-fee contracts. We further believe that the procedures established for the weighted guidelines method can be used with the alternate structured approach because these procedures provide a uniform approach and a familiar mechanism for ensuring that all of the components of the alternate structured approach are considered in computing the award fee pool.

The Air Force Systems Command (AFSC) provided procedures in its AFSC Handbook for establishing the size of the award fee pool for noncompetitive and competitive procurements. The AFSC Handbook requires the use of the alternate structured approach but suggests that the weighted guidelines method be used because it "establishes a uniform approach and convenient mechanism for assuring that all the components of the alternate structured approach are considered."

As required by AFSC contracting officers, we believe that before the Military Department contracting officers solicit bids, they should be required to use the procedures in the AFSC Handbook to determine the dollar value of the award fee pool, as required by AFSC contracting officers. This fee should be commensurate with the type of service acquired to avoid overcompensation. For example, at the Yuma Proving Ground, contract DAAD0189C0042 had a fee percentage of 10 percent (a 3-percent base fee and a 7-percent award fee). The contract was for operation and maintenance of the equipment, transportation pool, and supply system (including storage). After reviewing the statement of work, we determined that the contractor's technical and management risks were minimal. Also, the level of effort was relatively routine and did not require highly skilled personnel.

In contrast, the fee percentage on White Sands Missile Range contract DAAD0786C0002 was 5 percent. The contractor was required to provide engineering, technical, and maintenance services. The level of effort required highly skilled personnel because analytical effort was of the utmost importance and had to be performed to exacting standards. Management efforts required a high degree of integration and coordination. Also, the contractor implemented cost controls to reduce overall contract costs.

Although both contracts were competitively awarded, competition alone did not ensure that the Government obtained a fair and reasonable fee percentage on the Yuma contract. We believe that

the alternate structured approach would have produced a fee percentage commensurate with the services acquired. To control contract cost, we believe the award fee percentage derived using the alternate structured approach should be included in the request for proposals as the Government's maximum fee percentage allowable on the contract.

The AFSC Handbook requires that contracting officers state in the request for proposal that the contract will contain an award fee, and that the total award fee pool will be a specified percentage of proposed costs and not subject to negotiation. The AFSC Handbook explains that the reasons for specifying the award fee pool as a percentage of proposed costs are to preclude contractor "gaming" of the award fee pool and to maintain the relationship between the size of the award fee pool and the cost that was derived from the weighted guidelines profit analysis (the alternate structured approach).

The Eastern Space and Missile Center (ESMC), an AFSC test range, had stated the maximum award fee percentage in the requests for proposals for two of its contracts. The following statement was included in the requests for proposals for the ESMC's contracts, "Government Contemplates an Award Fee Not in Excess of 'X' Percent of Total Estimated Cost." [2/] Contractor proposals that ESMC received that contained an award fee rate in excess of the Government's stated maximum were rejected as being nonresponsive and outside the competitive range. Proposals conforming to the solicitation were evaluated. A contract was awarded to the offeror whose proposals were the most advantageous to the Government. Of the two contracts for which the award fee percentage was limited to 5 percent, one contract was awarded at a 4-percent fee rate and the other was awarded at 5 percent.

We believe that if the test ranges use the alternate structured approach to determine the award fee percentage on their cost-plus-award-fee contracts, they could reduce total contract costs.

Performance Rating Standards. Based on our review of 22 award fee plans, we concluded that the performance rating score range for satisfactory performance was too lenient for 17 (77 percent) contracts. This condition existed because the DFARS did not specify a numeric score for submarginal or unsatisfactory performance nor did it state that an award fee

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2/ The contracting officials determined the fee percentage that was appropriate for the service acquired. In these two instances, contracting officials proposed a 5-percent maximum fee.

cannot be earned for submarginal or unsatisfactory performance. For our review, we used the numeric score of 60 or below to identify award fee plans that would allow the contractor to potentially be paid an award fee for submarginal or unsatisfactory performance. We believe that a minimum performance score of 61 or above should be required for a contractor to receive an award fee. We also believe that the following rating scale should be included in all DoD award fee performance evaluation plans to provide uniformity in rating DoD contractors: submarginal (0 to 60), marginal (61 to 70), good (71 to 80), very good (81 to 90), and excellent (91 to 100).

Based on our rating scale, we found 17 award fee plans that provided award fees for submarginal or unsatisfactory performance. We believe that the score ranges were established at such a low level that contractors were provided minimal motivation to strive for excellent performance. For example, 2 award fee evaluation plans established 0 out of 100 as an acceptable performance evaluation score, and 5 contracts established 26 out of 100 as an acceptable performance evaluation score. Appendix B lists the contracts that had adjective ratings and corresponding score ranges established in award fee plans that we believe were too lenient. In our opinion, the test ranges could potentially pay award fees for submarginal or unsatisfactory performance on these contracts.

Converting Performance Evaluation Scores. Of the 22 award fee plans reviewed, 8 (36 percent) did not have a conversion table equating performance evaluation scores with a range of award fee dollars earned. Neither the DFARS, nor the Army, nor the Navy provides guidance that specifies that award fee plans must establish a conversion table translating performance evaluation scores with a range of award fee dollars earned. In contrast, the AFSC Handbook does provide guidance. The AFSC Handbook states that the contractor will earn a percentage of the award fee that equals the contractor's overall score for the evaluation period, as provided in the Handbook. The range (26 to 50) that the AFSC established for the "satisfactory" rating is below the range that we believe is appropriate. However, the AFSC should be commended for establishing contractor performance evaluation guidance.

The DFARS requires that the contract identify criteria to be used in evaluating the contractor's performance to arrive at the award fee. In our opinion, the contract should also establish the rating plan to include the percent of award fee earned corresponding to the performance score. For example, if a contractor's numerical performance evaluation score is 75, the contractor would be entitled to 71 to 80 percent of the available award fee pool. Accordingly, award fee evaluation boards may

recommend higher percentages if extenuating and mitigating circumstances, related to contractor performance, are adequately justified.

For example, the performance evaluation reports for Holloman Air Force Base contract F0863585C0141 [3/] showed the following scores and the percentage of award fee earned by the contractor for eight evaluation periods.

Evaluation Period	Score	Percentage of Award Fee Earned	Percentage of Award Fee That Should Have Been Earned
1	75.02	75.04	71 to 80
2	66.09	57.18	61 to 70
3	81.94	86.94	81 to 90
4	75.54	76.07	71 to 80
5	77.03	79.00	71 to 80
6	78.61	82.22	71 to 80
7	81.05	86.05	81 to 90
8	79.00	83.00	71 to 80

As the above example shows, during evaluation period 2, the contractor was awarded less than the recommended percentage range (61 to 70). However, during evaluation periods 6 and 8, the contractor was awarded more than the recommended percentage range (71 to 80 percent in each case).

Although we found only one contract where the award fee payments were inconsistent with our criteria, the potential existed for contractors to be paid unearned award fees. We believe that the Defense Acquisition Regulatory Council amending the DFARS and the Army and Navy establishing guidance that states that performance evaluation scores should equate to a range of award fee dollars earned would provide uniformity and consistency in the award fee evaluation process. Further, such an approach would greatly reduce the potential for payment of unearned award fees.

Conclusion. In the award fee determination process for cost-plus-award-fee contracts, contracting officers and award fee determining officials need to effectively apply cost controls. Establishing a uniform approach for developing a fair and reasonable award fee pool for cost-plus-award-fee contracts would effectively control costs. Requiring that award fee plans state

[3/] Eglin Air Force Base contract administration.

that an award fee will not be paid for submarginal or unsatisfactory performance (a performance evaluation score below 61) would provide uniformity and maximize contractor performance. Establishing a conversion table translating performance evaluation scores into a range of award fee dollars earned would also provide uniformity.

Maintaining an appropriate system of cost controls would protect the Government's interest and would contribute to DoD's overall objective of reducing the Defense budget. Furthermore, DoD management is required to maintain economical and efficient use of its resources. In addition, corrective actions can be implemented DoD-wide because we believe that these conditions are representative of a larger, systemic problem within DoD. Implementation of the following recommendations would adequately address the conditions found at the test ranges and DoD-wide.

RECOMMENDATIONS, MANAGEMENT COMMENTS, AND AUDIT RESPONSE

The Assistant Secretary of Defense (Production and Logistics); the Office of the Assistant Secretary of the Army, Contracting Support Agency; the Assistant Secretary of the Navy (Research, Development and Acquisition); and the Associate Deputy to the Assistant Secretary of the Air Force (Contracting) provided comments on the findings and recommendations. The complete texts of the comments are in Appendixes C, D, E, and F.

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

a. Develop and publish, in the Defense Federal Acquisition Regulation Supplement, a structured approach for establishing the performance risk criteria to be applied when developing the dollar value of the award fee pool and the award fee rate on cost-plus-award-fee contracts. Such an approach should be the alternate structured approach as described in Defense Federal Acquisition Regulation Supplement, section 215.902. However, the weighted guidelines method or format should be used because it considers all the components of the alternate structured approach.

The Assistant Secretary of Defense (Production and Logistics) comments. The Assistant Secretary nonconcurred with the recommendation and commented that the DoD weighted guidelines method and the alternate structured approach, are the usual methods for establishing profit objectives for noncompetitive, negotiated procurements, and that using these methods would be a serious misapplication of the DoD profit policy to situations that it was not designed for, that is, cost-plus-award-fee contracting.

The Office of the Assistant Secretary of the Army, Contracting Support Agency comments. The Assistant Secretary partially agreed with the recommendation and commented that it would be beneficial to have a structured methodology for calculating award fee objectives. The methodology should be flexible and should also address base fees.

The Assistant Secretary of the Navy (Research, Development and Acquisition) comments. The Assistant Secretary nonconcurred with the recommendation and commented that the DFARS specifically states that the weighted guidelines method shall not be applied to cost-plus-award-fee contracts with respect to either the base (fixed) fee or the award fee, and that the Federal Acquisition Regulation (FAR) states that the amount of the award fee to be paid is based on contractor performance. However, the Navy would agree to using a structured approach for determining award fee pools, provided the criteria considered are related solely to contractor performance.

Audit response. Although the alternate structured approach is presented in DFARS, part 15, "Contracting by Negotiation," we believe it is a useful tool in developing the award fee pool or percentage for both noncompetitive and competitive cost-plus-award-fee contracts. The AFSC Handbook provides procedures for using the alternate structured approach for establishing the size of the award fee pool for noncompetitive and competitive procurements. The AFSC Handbook requires that contracting officers use the weighted guidelines method as the basic structure of the alternate structured approach because it provides a uniform approach and a convenient mechanism for ensuring that all the components of the alternate structured approach are considered. We request that the Assistant Secretaries consider implementation of the procedures described in the AFSC Handbook for establishing the size of the award fee pool in cost-plus-award-fee contracts and provide additional comments to the final report.

b. Specify in the Defense Federal Acquisition Regulation Supplement, section 216.404-2, that an award fee shall not be paid for performance that is rated submarginal or unsatisfactory.

Assistant Secretary of Defense (Production and Logistics) comments. The Assistant Secretary partially concurred with the recommendation and stated that he will recommend that the Defense Acquisition Regulatory Council include in DFARS, section 216.404-2, the following statement: "Normally, award fee is not earned when the fee-determining official has determined that contractor performance has been submarginal or unsatisfactory."

Office of the Assistant Secretary of the Army, Contracting Support Agency comments. The Assistant Secretary concurred with the recommendation and commented that Acquisition Letter 90-008 (March 1990) was issued because the U.S. Army Audit Agency found that some Army contracting offices were paying contractors an award for less than satisfactory performance. Acquisition Letter 90-008 states that under no circumstances should the award portion of the fee be "earned" by the contractor for merely providing only minimum acceptable or marginal performance.

Assistant Secretary of the Navy (Research, Development and Acquisition) comments. The Assistant Secretary concurred with the recommendation.

c. Specify in the DoD Federal Acquisition Regulation Supplement, section 216.404-2, that performance evaluation scores equate to a range of award fee dollars earned. Also, specify that award fee determining officials must provide adequate written justification for award fees approved at a level higher than recommended ranges.

Assistant Secretary of Defense (Production and Logistics) comments. The Assistant Secretary partially concurred with the recommendation and commented that he objected to mandating the use of particular rating plans or scoring mechanisms; however, he will recommend to the Defense Acquisition Regulatory Council that the following statement be included in DFARS, section 216.404-2: "The fee-determining official shall document the basis for all award fee determinations."

Office of the Assistant Secretary of the Army, Contracting Support Agency, comments. The Assistant Secretary concurred with the recommendation.

Assistant Secretary of the Navy (Research, Development and Acquisition) comments. The Assistant Secretary nonconcurred with the recommendation and commented that mandating a specific conversion technique and establishing recommended ranges diminishes contracting officers' flexibility to allow for only verbal ratings with no numeric scoring and to develop ranges that best fit their needs.

Audit response. An Air Force study indicated that when award fee plans did not contain standards against which contractor's performance could be evaluated or did not identify ranges of scores assigned to each level of performance, the communication value of the award fee was greatly decreased, both government and contractor managers became frustrated, and the contractor was discouraged from attaining the highest level of achievement. We believe that contractors would favor, and be more motivated by, a conversion table that equates award fee dollars earned with the evaluation score percentage. We believe that contractors would also favor a unified DoD rating plan. Establishing and implementing a DoD rating plan that equates award fee dollars with the evaluation score percentage would clearly define to the contractor and Government evaluators the performance standards that are expected. We believe that DoD prepared performance standards would communicate to evaluators and contractors the value of the award fee. DoD performance standards would also enable evaluation boards to effectively measure the contractor's performance and convert it into an award fee recommendation. A unified DoD rating plan would not diminish contracting officers' flexibility because the contracting officers will still retain the flexibility of changing the performance criteria as changes in the program occur. We request that the Assistant Secretaries reconsider their position and provide additional comments.

2. We recommend that the Secretaries of the Military Departments instruct their procurement officials to include a maximum award fee percentage that is derived from using the alternate structured approach in the Government's request for proposals.

Assistant Secretary of Defense (Production and Logistics) comments. The Assistant Secretary nonconcurred with the recommendation and commented that the DoD weighted guidelines method, or the alternate structured approach, are the usual methods for establishing profit objectives for noncompetitive, negotiated procurements, and that using these methods would be a serious misapplication of the DoD profit policy to situations that it was not designed for, that is cost-plus-award-fee contracts. The Assistant Secretary commented that the size of the award fee pool is best determined by the competitive marketplace, subject only to the regulatory limits of fees established in FAR, subpart 15.903.

Office of the Assistant Secretary of the Army, Contracting Support Agency, comments. The Assistant Secretary nonconcurred with the recommendation and commented that in a competitive environment, the maximum award fee should be determined by the marketplace and FAR, subpart 15.903.

Assistant Secretary of the Navy (Research, Development and Acquisition) comments. The Assistant Secretary nonconcurred with the recommendation and commented that DFARS specifically states that the weighted guidelines method shall not be applied to cost-plus-award-fee contracts with respect to either the base (fixed) fee or the award fee, and that the FAR states that the amount of the award fee to be paid is based on contractor performance. However, the Navy would agree to using a structured approach for determining award fee pools, provided the criteria considered are related solely to contractor performance.

Associate Deputy to the Assistant Secretary of the Air Force (Contracting) comments. The Associate Deputy nonconcurred with the recommendation and commented that the recommendation should be addressed to the Deputy Assistant Secretary of Defense for Procurement because the issue affects the contracting community Government-wide.

Audit response. As previously stated in our response to Recommendation 1.a., the AFSC Handbook provides procedures for using the alternate structured approach for establishing the size of the award fee pool for competitive and non-competitive procurements. In addition, the AFSC Handbook requires that contracting officers state in the request for proposals that the contract will contain an award fee, and that the total award fee pool will be a specified percentage of the proposed costs and not subject to negotiation. For example, the Eastern Space and Missile Center, an AFSC test range, stated the maximum award fee percentage in the request of proposals in two of its contracts. The maximum percentage stated in each request for proposals was 5 percent, as a result, the fee percentage awarded on each contract was 5 percent and 4 percent. We found that competition alone did not ensure that the award fee rate allowed in the contracts reviewed was fair and reasonable to the Government for the services performed. We believe that the total award fee pool should be a specific percentage of the proposed contract cost and should not be subject to negotiation, and the percentage should be determined using the alternate structured approach. We request that the Assistant Secretaries reconsider their position and provide additional comments.

SCHEDULE OF AWARD FEE CONTRACTS

ACTIVITY	UNIVERSE NO. OF CONTRACTS	UNIVERSE VALUE (millions)	SAMPLE NO. OF CONTRACTS	SAMPLE VALUE (millions)
White Sands Missile Range	5	$ 230.9	5	$ 230.9
Kwajalein Missile Range 1/	2	456.6	2	456.6
Yuma Proving Ground	2	10.7	2	10.7
Dugway Proving Ground	0	0	0	0
Electronic Proving Ground	2	63.5	0	0
Aberdeen Proving Ground	0	0	0	0
Pacific Missile Test Center	2	27.9	2	27.9
Naval Air Test Center	0	0	0	0
Naval Weapons Center	2	29.0	2	29.8
Naval Air Propulsion Center	0	0	0	0
Atlantic Undersea Test and Evaluation Center	1	249.4	0	0
Atlantic Fleet Weapons Training Facility	0	0	0	0
Eastern Space and Missile Center	5	661.6	5	661.6
Western Space and Missile Center	1	265.8	0	0
Arnold Engineering Development Center	3	1,042.7	0	0
Tactical Fighter Weapons Center	2	154.0	2	154.0
Air Force Flight Test Center	2	361.0	0	0
Utah Test and Training Range	0	0	0	0
Armament Division - 3246th Test Wing 2/	2	163.0	2	163.0
Aeronautical Systems Division-4950th Test Wing	0	0	0	0
Totals	31	$3,716.1	22	$1,734.5

1/ Contract administration performed by Strategic Defense Command, Huntsville, Alabama.
2/ Includes Holloman Air Force Base, Alamogordo, New Mexico.

CONTRACTS WITH INAPPROPRIATELY APPLIED BASE FEES

ACTIVITY	CONTRACT NO.	TYPE	BASE/AWARD FEE PERCENTAGE	TOTAL COSTS (INCLUDING BASE)	TOTAL COSTS (LESS BASE FEE)	SAVINGS
ARMY						
Strategic Defense Command	DASG6088C0132	CPAF	3/4	$ 49,691,976	$ 48,298,525	$1,393,451
White Sands Missile Range	DAAD0787C0013	CPAF	1/4	80,608,062	79,758,607	849,455
Yuma Proving Ground	DAAD0189C0042	FPAF*	3/7	3,603,664	3,506,229	97,435
Yuma Proving Ground	DAAD0189C0054	CPAF	2/3	7,099,226	6,967,217	132,009
Army Subtotal				$141,002,928	$138,530,578	$2,472,350
NAVY						
Naval Weapons Center	N6053087C0057	CPAF	3/7	$ 12,271,385	$ 11,926,437	$ 344,948
Naval Weapons Center	N6053088C0047	CPAF	3/4	17,511,161	17,063,283	447,878
Pacific Missile Test Center	N0012386C0506	CPAF	2/8	17,752,217	17,429,447	322,770
Navy Subtotal				$ 47,534,763	$ 46,419,167	$1,115,596
AIR FORCE						
Nellis Air Force Base	F2660086C0003	CPAF	1/5	$112,712,424	$111,572,713	1,139,711
Nellis Air Force Base	F2660086C0004	CPAF	2/6	41,253,446	40,481,637	771,809
Air Force Subtotal				$153,965,870	$152,054,350	$1,911,520
TOTAL				$342,503,561	$337,004,095	$5,499,466

*This is a fixed price, base/award fee contract; no profit was included in the fixed price.

CONTRACTS WITH LENIENT PERFORMANCE EVALUATION CRITERIA 1/

Activity	Contract No.	Award Fee Plan Score Range and Adjective Rating
Strategic Defense Command	DASG6088C0132	0 to 64 Poor
Strategic Defense Command	DASG6087C0115	0 to 75 Acceptable
White Sands Missile Range	DAAD0787C0060	0 to 39 Average
Yuma Proving Ground	DAAD0189C0042	0 to 19 Poor
Yuma Proving Ground	DAAD0189C0054	0 to 19 Poor
Naval Weapons Center	N6053087C0057	2/
Naval Weapons Center	N6053088C0047	2/
Pacific Missile Test Ctr.	N0012386C0506	0 to 50 Unsatisfactory
Eastern Space Missile Ctr.	F0860688C0014	1 to 25 Unsatisfactory
Eastern Space Missile Ctr.	F0860688C0003	1 to 25 Unsatisfactory
Eastern Space Missile Ctr.	F0860688C0030	1 to 25 Unsatisfactory
Eastern Space Missile Ctr.	F0860688C0015	1 to 25 Unsatisfactory
Eastern Space Missile Ctr.	F0860688C0001	1 to 25 Unsatisfactory
Eglin Air Force Base	F0863585C0141	0 to 49 Unsatisfactory
Eglin Air Force Base	F0863587C0014	0 to 49 Unsatisfactory
Nellis Air Force Base	F2660086C0004	0 to 49 Unsatisfactory
Nellis Air Force Base	F2660086C0003	0 to 49 Unsatisfactory

1/ Schedule shows the minimum score range only.
2/ Award fee plan does not equate contractor performance evaluation scores to a percentage range of award fee dollars earned. Also, the award fee plan does not state that the contractor must perform at a satisfactory or better performance level to receive an award fee.

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C 20301-8000

PRODUCTION AND
LOGISTICS

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MEMORANDUM FOR THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Draft Report on Audit of Contractor Support at Major Range and Test Facility Bases - Contractor's Fees, Project No. OAB-0010.01

This is in response to the memorandum of October 9, 1990, from the Director, Acquisition Management Directorate, Inspector General, Department of Defense, which requested our comments on the subject draft audit report. Our detailed responses to the report findings and recommendations are attached.

The subject report sets forth two findings and a series of recommendations for actions to be taken by the Deputy Assistant Secretary of Defense for Procurement (DASD(P)). It must be stated at the outset that we take exception to virtually all the proposed recommendations included in the draft report. Clearly, there is basic disagreement over the fundamental nature and purpose of award-fee contracting.

Both the Federal Acquisition Regulation (FAR), Section 16.404-2, and the Defense FAR Supplement (DFARS), Section 216.404-2, recognize that cost-plus-award-fee (CPAF) contracts are available for those situations where an appropriate fee can best be determined through subjective, judgmental evaluation. All of the fee-determination criteria and procedures, however objective and detailed they may appear to be, are in essence advisory to the fee-determining official. For that reason the determinations of the fee-determining official are not subject to the disputes provisions of the contract. Since it is not possible for a contractor to contest the amount of an award fee determination, we believe that it is also not really appropriate to conclude, as the subject draft audit report does, that certain fees have been excessive. Only if the fees exceed regulatory limits or available award fee pool dollars could they be properly deemed excessive.

The report recommends that the size of award fee pools be determined through the use of the DoD Weighted Guidelines, or other alternate structured approach, which are the usual methods for establishing profit objectives for non-competitive, negotiated procurements. We believe that this would be a serious misapplication of the DoD profit policy to situations that it was not designed for, i.e., CPAF contracting. Likewise, to

compel the use of a scoring system to determine an appropriate fee is contrary to the fundamental reasoning behind CPAF contracting. Both the size of the available award fee pool and the size of any subsequent payout of fee must be left to the best judgment of the fee-determining official, with the advice of the Contracting Officer, requiring activities, and/or any other evaluation panel, as appropriate. The mandatory use of structured approaches, Weighted Guidelines or otherwise, is inappropriate. The only valid constraint is that total available fee (base fee plus award fee) not exceed regulatory limits on fees for cost-type contracts.

We agree that parts of DFARS 216.404-2 (S-70) can be misinterpreted. Fortunately, the pending rewrite of the DFARS makes clear what we believe has always been the intent of this section of the regulation, namely, that it may be appropriate to use an award fee provision in a contract that is not itself a CPAF contract. In such instances no base fee is appropriate, as it would be a duplication of profit or fee provided elsewhere in the contract. However, to prohibit base fees on all CPAF contracts, as recommended in this report, when the purpose of the award fee is to motivate and reward contractor performance, would directly contradict the description of CPAF contracts contained in FAR 16.404-2 (a). The fact that the Government has not terminated a contract for default, but has instead accepted services or products, means that the contractor has at least performed to a minimally acceptable level. The base fee is intended as appropriate consideration for such performance. While it may be appropriate to have no base fee in certain circumstances, we do not think that a prohibition of base fees has ever been the intent of award fee contracting.

In sum, we do not believe any of the findings noted in the subject report reveal instances of award fee contracting that are noncompliant with either FAR or DFARS provisions. Thank you for the opportunity to comment on the subject draft report.

David J. Berteau
Principal Deputy

Attachment

IG DRAFT REPORT - AUDIT OF CONTRACTOR SUPPORT AT MAJOR RANGE AND TEST FACILITY BASES - CONTRACTORS' FEES PROJECT NO. 0AB-0010.01 DATED OCTOBER 9, 1990

ASD(P&L) RESPONSE TO THE DRAFT REPORT

FINDING A. Inappropriate Use of Base Fees: The Major Range and Test Facility Bases (test ranges) inappropriately included base (fixed) fees on cost-plus-award-fee (CPAF) service contracts. This condition resulted from conflicting guidance in the Defense Federal Acquisition Regulation Supplement (DFARS). As a result, the test ranges will pay approximately $5.5 million in excessive fees on nine CPAF contracts.

ASD(P&L) RESPONSE: Nonconcur. This finding is based upon the IG's interpretation of DFARS 216.404-2(S-70), to wit, that no base fee is applicable where the award fee is used to motivate a contractor for performance over and above that which can be objectively measured and incentivized under other forms of contracting. This interpretation results from a misreading of the purpose of DFARS 216.404-2(S-70). This section was created to address those situations where award fee provisions are included in other-than-CPAF contracts. A pool of money is established, along with evaluation criteria, to incentivize the achievement of a particular goal or level of performance over and above what is called for in the balance of the contract. In such situations a profit or fee has already been provided elsewhere in the contract, so there is no need for a base fee. The language in DFARS 216.404-2(S-70) was not intended to prohibit base fees in CPAF contracts; that would contradict the description and application of CPAF contracts set forth in FAR 16.404-2(a) and (b). Consequently, we do not agree with the finding that payment of base fees of approximately $5.5 million is excessive. In fact, such payments reflect the intent of the parties in using a CPAF contract. However, we do note that the pending rewrite of the DFARS, which was issued for public comment on October 31, 1990, restates the provisions of DFARS 216.404-2(S-70) in simpler language which makes clear that this provision applies when an award fee provision is used on other types of contracts.

RECOMMENDATION A.1: We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to clarify Defense Federal Acquisition Regulation Supplement, section 216.404-2(b)(S-71) guidance stating that base fees shall not be applied in procurements where the award fee is intended to motivate and reward contractor performance.

RECOMMENDATION A.2: We recommend that the Deputy Assistant Secretary of Defense for Procurement issue interim policy directing DoD

agencies and the Military Departments to instruct procurement officials that base fees will not be used on award fee contracts when the award fee is intended to motivate and reward contractor performance.

ASD(P&L) RESPONSE: Nonconcur with both recommendations. As noted above, DFARS 216.404-2(S-70) is being clarified to preclude any interpretation similar to that of the subject audit, i.e., that base fees should not be used on CPAF contracts when the award fee is intended to motivate and reward contractor performance. In fact, such motivation and reward are the very basis for use of CPAF contracts, as noted in FAR 16.404-2. Implementation of these recommendations would directly contradict the description of CPAF contracts in FAR 16.404-2.

FINDING B. Inconsistent Application of Award Fees: The Major Range and Test Facility Bases (test ranges) have inconsistently applied fees on cost-plus-award-fee service contracts. We attributed this condition to inadequate DoD guidance for developing the dollar value of the award fee pool, award fee plans establishing too lenient contractor performance evaluation criteria, and inadequate DoD guidance for converting performance evaluation scores to a range of award fee dollars earned. As a result, test ranges could potentially pay excessive and unearned award fees.

ASD(P&L) RESPONSE: Nonconcur. We do not consider it valid to make a comparison of award fee determinations, or the criteria, scoring mechanisms, or judgments which led to those determinations. The availability of the CPAF-type contract is based upon the need to accommodate a wide variety of unique contracting situations. The fact that an award fee pool for one activity is 5 percent of estimated total cost while that of a similar activity is 10 percent is no cause for alarm. That is because the award fee size and criteria are created to address the specific contracting needs of a given circumstance. Perhaps quality control is of overriding importance at a given facility due to a history of quality problems. It might be appropriate to create an award fee pool whose size and evaluation criteria emphasize quality. Next year it might be appropriate to emphasize safety, or some other aspect of performance. Different contracts will incentivize and provide for evaluation criteria according to their needs.

The examples of criteria and scoring contained in DFARS 216.404-2 are not directive, but are intended only as suggestions for what is fundamentally the subjective evaluation of the fee-determining official. Indeed, it would be disturbing to find that award fee pools are being established and fee determinations being made in a purely formulaic manner, according to a set pattern. That would

suggest that the very usage of the CPAF-type contract may not have been appropriate.

Contracting officers use the CPAF contract in order to accommodate a wide variety of circumstances, where a subjective evaluation of performance against a set of criteria, uniquely designed for that contract, results in fair compensation for the effort expended. Since the evaluation is ultimately subjective, it is quite probable that two different fee-determining officials could reach different conclusions about a contractor's performance.

In sum, it is simply not possible to compare CPAF contracts in the manner in which the IG report attempts to compare them. As a result, we cannot concur with the finding that potentially excessive and unearned award fees could be paid. Only a total fee (i.e., base fee plus award fee) in excess of regulatory limits, as noted in FAR 15.903(d)(2), or the payment of a fee in excess of available award fee pool dollars, can properly be termed excessive.

RECOMMENDATION B.1.a: We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

a. Develop and publish, in the Defense Federal Acquisition Regulations Supplement, a structured approach for establishing the performance risk criteria to be applied when developing the dollar value of the award fee pool and the award fee rate on cost-plus-award-fee contracts. Such an approach should be the procedures used for the weighted guidelines method, as described in Defense Federal Acquisition Regulations Supplement, section 215.970, or the alternate structured approach described in Defense Federal Acquisition Regulations Supplement, section 215.902.

ASD(P&L) RESPONSE: Nonconcur. Both the weighted guidelines method and alternate structured approaches, as established in DFARS 215.970 and 215.902, respectively, were designed for the purpose of deriving a reasonable profit objective prior to the negotiation of non-competitive procurements. Cost and pricing data are obtained for such procurements, and a profit objective is arrived at that is appropriate for a given contract and contractor. Use of weighted guidelines, or another structured approach, to arrive at either the size of an award fee pool, or the amount of an award fee determination on a CPAF contract, would be 1) a serious misapplication of the DoD profit policy to circumstances for which it was not designed, and 2) a contradiction of the concepts that underlie and support usage of the CPAF contract. Flexibility is needed to arrive at an award fee pool and evaluation criteria that suit the circumstances of a particular procurement. Applying

weighted guidelines, or other structured approaches, to arrive at a fee suggests that performance can be measured objectively; this would indicate that another type of contract may be more appropriate than CPAF. For these reasons, the pending rewrite of the DFARS will make clear that neither the weighted guidelines method nor an alternate structured approach may be used in connection with CPAF contracts.

RECOMMENDATION B.1.b: We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Regulatory Council to:

b. Specify in the Defense Federal Acquisition Regulations Supplement, section 216.404-2(S-70) that an award fee shall not be paid for performance that is rated submarginal or unsatisfactory (60 or less). Also, specify that performance evaluation adjective ratings and score ranges contained in award fee plans be in accordance with Defense Federal Acquisition Regulation Supplement, section 216.4-5.

ASD(P&L) RESPONSE: Partially concur. We agree with the principle that no award fee should be given for submarginal or unsatisfactory performance. We do not believe that the determination of what constitutes that kind of performance should be tied to some pre-established numerical cut-off point (e.g., a score of 60 or less), as the IG recommends. Nor do we believe that CPAF contracts should be required to contain scoring systems that in turn will result in various ranges for fee determinations. While rating systems may be useful tools in the evaluation process, the fee-determining official must retain the latitude to determine what he or she considers an appropriate fee without having to rebut the results of a pre-determined rating system.

Consequently, we will recommend that the Defense Acquisition Regulatory Council include in DFARS 216.404-2 the following statement:

> "Normally, award fee is not earned when the fee-determining official has determined that contractor performance has been submarginal or unsatisfactory."

While evaluation criteria and rating plans are normally included in CPAF contracts, their ultimate application is subservient to the fee-determining official's subjective judgment. The examples of contractor performance evaluation criteria set forth in DFARS 216.4-5 are meant to be examples only. Elaborate rating systems are meant to guide the fee-determining official; they are not meant to be

determinative, as that would obviate the need to have a fee-determining official. Moreover, not all CPAF contracts require a detailed rating system to evaluate performance, nor is one kind of rating system useful in all situations. Consequently, we object to mandating the use of a particular rating system, or to usage of scoring systems in all cases. FAR 16.404-2(b)(2), in noting the need for a wide variety of criteria, requires only that the criteria and rating plan motivate the contractor to improve performance in the areas rated. We believe that the examples in DFARS 216.404.4-5 should remain as examples.

RECOMMENDATION B.1c.: We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

c. Specify in the DoD Federal Acquisition Regulations Supplement, section 216.404-2(70) that performance evaluation scores equate to a range of award fee dollars earned. Also, specify that award fee-determining officials must provide adequate written justification for award fees approved at a level higher than recommended ranges.

ASD(P&L) RESPONSE: Partially concur. As noted previously, we object to mandating the use of particular rating plans or scoring mechanisms, or to directing that fee-determining officials tie their subjective judgments to a pre-established range or score. However, we do agree that the fee-determining officials should set forth the basis for their fee determinations.

Accordingly, we will recommend to the Defense Acquisition Regulatory Council that the following statement also be included in DFARS 216.404-2:

"The fee-determining official shall document the basis for all award fee determinations."

RECOMMENDATION B.2: We recommend that the Deputy Assistant Secretary of Defense for Procurement issue an interim policy directing DoD agencies and Military Departments to instruct award fee-determining officials that contractors do not earn award fees for submarginal or unsatisfactory performance and to provide adequate written justification for award fees approved at levels higher than recommended ranges. Deleted

ASD(P&L) RESPONSE: Nonconcur. As noted above, we do not concur with that part of the IG's recommendation that would require establishment of scoring systems that produce "ranges" of performance. While the DFARS provides examples along those lines, we do not believe it is

appropriate to mandate their use in all cases. Moreover, while we will ask the Defense Acquisition Regulatory Council to add the new language previously noted, we believe that the need to document the basis for fee determinations, and the denial of award fee for submarginal or unsatisfactory performance, are implicit in current FAR and DFARS regulations, and that many buying activities already have similar policy in place. Therefore, we do not believe that interim policy guidance is necessary.

RECOMMENDATION B.3: We recommend that the Secretaries of the Military Departments instruct their procurement officials to include a maximum award fee percentage, that is derived from using the weighted guidelines method or the alternate structured approach, in the Government's requests for proposals.

Renumbered B.2.

ASD(P&L) RESPONSE: Nonconcur. We strongly object to the mandated use of either the weighted guidelines, or any other structured approach, in deriving an award fee percentage for inclusion in solicitations for CPAF awards. The reasons are numerous. As noted earlier, the weighted guidelines (or alternate structured approach) are used to derive a pre-negotiation objective in non-competitive, negotiated procurements. Each weighted guidelines is based upon the specific cost and pricing data submitted by each individual offeror. Judgments are made regarding technical risk, cost risk, and facilities investment, based upon the contracting officer's assessment of each proposal. There is no weighted guidelines that could be valid for all potential offerors. Moreover, we are concerned that a potential offeror could, with validity, protest a predetermined award fee percentage arrived at in this manner as being inequitable and unfair, since the percentage would have been derived without reference to the content of his proposal. Since a solicitation is protestable, this runs counter to the basic concept that award fee determinations should not be subject to dispute.

We believe that the size of the award fee pool is best determined by the competitive marketplace, subject only to the regulatory limits on fee established in FAR 15.903. In a noncompetitive situation, award fee pool dollars are best determined by the requiring activity at the time that evaluation criteria are determined, based upon the Government's judgment of what amounts are necessary to motivate performance and realize the benefits of using the CPAF form of contract.

DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY
U.S. ARMY CONTRACTING SUPPORT AGENCY
5109 LEESBURG PIKE
FALLS CHURCH, VIRGINIA 22041-3201

REPLY TO
ATTENTION OF

SFRD-KP

14 DEC 1990

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: ACQUISITION MANAGEMENT DIRECTORATE,
400 ARMY NAVY DRIVE, ARLINGTON, VA
22202-2884

Final Report
Page Number

SUBJECT: Draft Report on the Audit of Contractor Support at Major Range and Test Facility Bases - Contractors' Fees (Project No. OAB-0010.01)

1. We have reviewed subject draft report and take exception to it in several areas. Our comments and rationale follow.

2. We do not agree with Finding A that there is conflicting guidance in the Defense Federal Acquisition Regulation Supplement (DFARS) pertaining to use of base fees. The guidance in DFARS is clear. We believe you may have misinterpreted DFARS 216.404-2(S-70). This subpart provides guidance pertaining to use of the award fee provision in conjunction with other types of pricing arrangements, e.g., cost-plus-incentive-fee/award-fee (CPIF/AF). It is not intended to apply to a straight CPAF pricing arrangement, hence, no conflict with DFARS 216.404-2(b)(71). Therefore, your conclusions on page 15 of the draft report are not valid. 9

3. Further, base fee should be viewed in the same light as minimum fee in a cost-plus-incentive-fee arrangement. It provides for coverage of unallowable costs and a basic management fee. The award portion of the fee provides incentive for the contractor to exceed minimum performance requirements.

4. Based on the foregoing, we nonconcur with recommendations A.1 and A.2. There is neither a need to clarify DFARS to state "that base fees shall not be applied in procurements where the award fee is intended to motivate and reward contractor performance" nor to direct the Military Departments to restrict use of base fees. We also nonconcur with the stated internal control weakness that "inadequate managerial reviews were performed to make sure that base fees were not included on award fee contracts."

5. We partially agree with Finding B. It would be extremely beneficial to have a structured methodology for calculating award fee objectives. The methodology should be flexible and also address base fee. Developing such will be difficult.

6. There are two areas of your discussion on Finding B that concern us. First, we believe your comment on page 24 that "These adjective ratings and corresponding score ranges illustrated in the DFARS are to be used as a baseline and are not subject to deviation." is not correct. It is our position that those charts are provided only for guidance. Further, DFARS 216.404-2(b)(S-72)(ii) clearly states, "See examples of criteria set forth in charts below." Thus, it is not clearly established that the contracts listed in Appendix C have lenient performance evaluation criteria.

7. Also note that the U.S. Army Audit Agency (Report No. SO 88-301) found that some Army contracting offices erroneously assumed the DFARS examples to be mandatory and based their award fee provisions on them. This resulted in payment of award fee for less than satisfactory performance. The Army subsequently issued Acquisition Letter 90-008 (March 1990) which provided the following:

"A cost-plus-award-fee (CPAF) type contract is an incentive contract. Therefore, when using a CPAF contract, contracting officers must ensure that the award portion of the fee is structured to give the contractor the incentive to perform at a level exceeding the minimum acceptable level of the contract. The base portion of the fee is a fixed fee, payable if the contractor meets the requirements of the contract. The award portion of the fee is payable (in whole or in part), only if the contractor earns award-fee by performing at a level above the minimum acceptable level under the contract. Under no circumstances should the award portion of the fee be 'earned' by the contractor for merely providing only minimum acceptable or marginal performance."

8. The second area of "concern" is that of including a maximum award fee in the solicitation. Determining fee objectives prior to receipt of proposals puts the "cart before the horse." Unless we have cost history from a prior similar contract, we would have nothing against which to apply our objective fee methodology. We could use an

independent government estimate as the baseline for such a calculation, but there is little likelihood that this would always be representative of final proposed costs.

8. In a competitive environment, the maximum award fee should be determined by the marketplace and Subpart 15.903 of the Federal Acquisition Regulation. Including a maximum award fee percentage in the solicitation may discourage potential competition, affect proposed total cost and stifle the negotiation process.

9. Based on the discussion in paragraphs 5 - 8 above, we concur with Recommendations B.1.b., B.1.c, and B.2. We partially concur with B.1.a. (development of a structured approach). We do not concur with B.3.

10. The point of contact for this action is Thomas W. Colangelo, SFRD-KP, who may be reached at (703) 756-7564.

for J. Bruce King
NICHOLAS R. HURST
Brigadier General, GS
Director, U.S. Army Contracting
Support Agency

CF:
SARD-DER (ATTN: Ms. Willey)
SAIG-PA (ATTN: Ms. Flanagan)
DASD(P)(CPF) (ATTN: Mr. Brown)

J. BRUCE KING
Acting Director
U.S. Army Contracting
Support Agency

THE ASSISTANT SECRETARY OF THE NAVY
(Research, Development and Acquisition)
WASHINGTON, D.C. 20350-1000

JAN 11 1991

MEMORANDUM FOR DIRECTOR ACQUISITION MANAGEMENT
OFFICE OF INSPECTOR GENERAL DEPARTMENT OF DEFENSE

Subj: DRAFT REPORT ON THE AUDIT OF CONTRACTOR SUPPORT AT MAJOR RANGE AND TEST FACILITY BASES - CONTRACTOR'S FEES (PROJECT NO. OAB-0010.01)

Ref: (a) DoD IG(AM) Memo of 9 October 1990

Encl: (1) Navy Comments on Proposed Recommendations

As requested by reference (a) comments on the findings, recommendations, and internal control weaknesses described in the subject report are provided in enclosure 1.

The Navy shares the DoD IG's concerns with the proper use of cost-plus-award fee contracts, and with support service contracting in general. We agree that award fees should not be paid to contractors for submarginal or unsatisfactory performance.

However, we disagree with other points raised in the audit report. The finding of Section A that base fees should not be used on cost-plus-award fee contracts is an incorrect interpretation of the DFARS. The Plain English rewrite of the DFARS makes it clear that the base fee prohibition applies when award fee provisions are to be used on contract types other than cost-plus-award fee. Also, we disagree with the use of weighted guidelines for the development of the award fee pool. The weighted guidelines method uses considerations of risk, performance and capital investment to determine profit or fee. With award fee contracting, providing motivation for excellence in contract performance is the sole criterion. Further, we are opposed to mandating ranges for use in evaluating fees. The contracting officer and the program manager need the flexibility to develop ranges that best fit their needs. The ranges provided as examples in the current DFARS are in the process of being deleted.

Let me know if we can be of any further assistance.

GERALD A. CANN

NAVY COMMENTS ON PROPOSED RECOMMENDATIONS

Section A - Inappropriate Use of Base Fees

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to clarify Defense Federal Acquisition Regulations Supplement (DFARS), section 216.404-2(b)(71) guidance stating that base fees shall not be applied in procurements where the award fee is intended to motivate and reward contractor performance.

Navy Comment: Nonconcur. The audit report states that there is a conflict between DFARS 216.404-2(b)(71) which limits base fees under CPAF contracts to 3%, and DFARS 216.404-2(S-70) which allegedly states that base fees are not to be used when award fees are used to motivate contractor performance. Actually, DFARS 216.404-2(S-70) discusses the use of the "award amount" portion of the CPAF arrangement on "other types and kinds of government contracts" when desirable to motivate a contractor in areas such as logistics support and quality, and notes that the "base fee" portion would not be applicable under this arrangement. This section has been made somewhat clearer in the Plain English version of the DFARS published in the October 31, 1990 Federal Register under DFARS cite 216.404-2. The two provisions in the DFARS are not in conflict; rather, one deals with CPAF contracts while the other deals with the award fee approach on other than CPAF contracts. As to the recommendation, we would not agree that the DFARS should be changed to preclude the use of base fees on award fee (CPAF) contracts. We note that an award fee is always used to "motivate and award contractor performance" so the effect of the recommendation would be a blanket prohibition on the use of base fees on CPAF contracts. The Armed Services Pricing Manual states that the base fee is "designed to compensate the contractor for profit evaluation factors such as risk, investment, and the nature of the work to be performed, but in an amount commensurate with the minimum acceptable performance." While we may agree that contractors should not receive award fees for submarginal or unsatisfactory performance, this position combined with a prohibition against base fees would probably not be acceptable to contractors in a non-competitive environment. It is noted however, that for competitive support services, several Navy purchasing offices set the base fee at zero.

2. We recommend that the Deputy Assistant Secretary of Defense for Procurement issue interim policy directing DoD agencies and the Military Departments to instruct procurement officials that base fees will not be used on award fee contracts when the award fee is intended to motivate and reward contractor performance.

Navy Comment: Nonconcur. See answer to 1 above.

Section B - Inconsistent Application of Award Fees

1. We recommend that the Deputy Assistant Secretary of Defense for Procurement direct the Defense Acquisition Regulatory Council to:

a. Develop and publish, in the Defense Federal Acquisition Regulations Supplement, a structured approach for establishing the performance risk criteria to be applied when developing the dollar value of the award fee pool and the award fee rate on cost-plus-award-fee contracts. Such an approach should be the procedures used for the Weighted Guidelines Method, as described in Defense Federal Acquisition Regulations Supplement, section 215.970, or the alternate structured approach described in Defense Federal Acquisition Regulations Supplement, section 215.902.

Navy Comment: Nonconcur. DFARS 216.404-2(b)(S-70) specifically states that the weighted guidelines (WGL) method shall not be applied to CPAF contracts with respect to either the base (fixed) fee or the award fee. DFARS 215.902(a)(1)(i) states that the WGL method is used to determine profit or fee based on three criteria; risk, performance and capital investment. FAR 16.404-2(a) states that the amount of award fee to be paid is based on contractor performance. Therefore, fees on award fee contracts are based only on one of the three criteria used to determine profit and fee using the WGL. The Navy would agree to using a structured approach for determining award fee pools provided the criteria considered is related solely to contractor performance.

b. Specify in the Defense Federal Acquisition Regulations Supplement, section 216.404-2(70) that an award fee shall not be paid for performance that is rated submarginal or unsatisfactory (60 Or less).

Navy comment: Concur.

Also, Specify that performance evaluation adjective ratings and score ranges contained in award fee plans be in accordance with Defense Federal Acquisition Regulations Supplement, section 216.4-5.

Navy comment: Nonconcur. Performance evaluation criteria are unique to each contract and should be developed to meet the specific needs and desired results. The contracting officer and the program managers need the flexibility to develop evaluation criteria, ratings and ranges that best fits their needs. Further, in the rewrite of DFARS section 216, Federal Register of 31 October 1990, the evaluation examples are being dropped.

C. Specify in the DoD Federal Acquisition Regulations Supplement, section 216.404-2(70) that performance evaluation scores equate to a range of award fee dollars earned.

Navy comment: Nonconcur. The Navy does not recommend mandating any specific conversion technique. For example, flexibility should exist to allow for only verbal ratings with no numeric scoring. However, we do agree that the conversion from rating to fee earned must be in accordance with the approved award fee evaluation plan.

Also, specify that award fee determining officials must provide adequate written justification for award fees approved at a level higher than recommended ranges.

Navy comment: Nonconcur. We disagree with establishing recommended ranges for use by all contracting offices. The contracting officer and the program managers need the flexibility to develop ranges that best fit their needs.

2. We recommend that the Deputy Assistant Secretary of Defense for Procurement issue an interim policy directing DoD agencies and Military Departments to instruct award fee determining officials that contractors do not earn award fees for submarginal or unsatisfactory performance and to provide adequate written justification for award fees approved at levels higher than recommended ranges. Deleted

Navy comment: Concur with policy for no award fees for submarginal or unsatisfactory performance, but not with the establishment of recommended ranges.

3. We recommend that the Secretaries of the Military Departments instruct their procurement officials to include a maximum award fee percentage, that is derived from using the weighted guidelines method or the alternate structured approach, in the Government's requests for proposals. Renumbered B.2.

Navy comment: See paragraph 1a.

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC 20330-1000

OFFICE OF THE ASSISTANT SECRETARY

DEC 11 1990

MEMORANDUM FOR DIRECTOR (ACQUISITION MANAGEMENT DIRECTORATE)
INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

Final Report
Page Number

SUBJECT: DoD(IG) Draft Audit Report on Contractor Support at Major Range and Test Facility Bases - Contractors' Fees (Project No. OAB-0010.01) - ACTION MEMORANDUM

The Air Force has reviewed subject document and the following management comments are provided in response to the audit. Note that we are only addressing recommendation 3 of page 29 of your audit report which is addressed to the Secretaries of the Military Departments.

Recommendation 3. We recommend that the Secretaries of the Military Departments instruct their procurement officials to include a maximum award fee percentage, that is derived from using the Weighted Guidelines method or the alternate structured approach, in the Government's request for proposals.

Renumbered B.2.

Answer. Do not concur. The reason for our nonconcurrence is that this recommendation addresses an issue affecting the contracting community Government-wide and therefore, it should be addressed to the Deputy Assistant Secretary of Defense for Procurement.

If your staff has any questions concerning our comments, have them call Captain Mariaisabel Hernaez, SAF/AQCP, at 697-6522.

SUMMARY OF POTENTIAL MONETARY AND OTHER BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefits	Amount and/or Type of Benefit
A.1.	Internal control. Clarify Defense Federal Acquisition Regulation Supplement to restrict the use of base fees in award fee contracts	Nonmonetary.
A.2.	Internal control. Issue an interim policy to restrict the use of base fees in award fee contracts	Nonmonetary.
B.1.a.	Economy and Efficiency. Develop a structured approach for establishing performance risk criteria applied to developing award fee rates.	Nonmonetary.
B.1.b.	Economy and Efficiency. Specify that award fees shall not be paid for unsatisfactory performance.	Nonmonetary.
B.1.c.	Economy and Efficiency. Specify that performance evaluation scores equate to a range of award fee dollars earned. Also, specify that award fee determining officials provide adequate written justification for award fees approved at a level higher than the recommended range.	Nonmonetary.
B.2.	Economy and Efficiency. Specify a maximum award fee percentage in request for proposals.	Nonmonetary.

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Assistant Secretary of Defense (Production and Logistics)
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Department of the Army

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Army Strategic Defense Command, Huntsville, AL (Kwajalein)
White Sands Missile Range, White Sands, NM
Yuma Proving Ground, Yuma, AZ

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Naval Air Test Center, Patuxent River, MD
Naval Regional Contracting Center, Long Beach, CA
Naval Weapons Center, China Lake, CA
Pacific Missile Test Center, Point Mugu, CA

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Office of the Secretary of the Air Force, Directorate of Contracting and Manufacturing Policy, Washington, DC
Armament Division-3246th Test Wing, Eglin Air Force Base, FL
Armament Division-6585th Test Group, Holloman Air Force Base, NM
Eastern Space and Missile Center, Patrick Air Force Base, FL
Tactical Fighter Weapons Center, Nellis Air Force Base, NV

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Deputy Assistant Secretary of Defense for Procurement
Director, Defense Acquisition Regulatory Council

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