

Acquisition Advisory Panel
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Presentation of Steve Ayers,
SAIC Senior Vice President, Contracts and Procurement

Good afternoon, Madam Chair, Panel Members.

I am Steve Ayers of Science Applications International Corporation. I am responsible for contracting and procurement in SAIC. Accompanying me is Larry Trammell who is involved in business development. By way of context, SAIC, a Fortune 500® company, currently ranks as the eighth largest defense contractor and is the largest employee-owned research and engineering firm in the United States. SAIC and its subsidiaries have more than 43,000 employees with offices in over 150 cities worldwide and annual revenues of over \$7 billion. We are predominately a provider of engineering and technical services to the federal government but also have a commercial business unit with over \$500 million in revenues from information-centric work in the commercial energy and life sciences markets.

We very much appreciate the opportunity to address the Acquisition Advisory Panel. I am going to briefly cover 10 topics of concern to us. Some of these topics, among them cascading set-asides, are issue-specific, while others, such as organizational conflicts of interest and fragmentation of acquisition policymaking and practices, are overarching or process-oriented issues. We also offer a number of recommendations, or course corrections, if you will, that are intended to help you arrive at answers that will promote the effective and appropriate use of commercial practices and performance-based contracting. In addition to my remarks I am submitting for the record answers to several of the questions linked to your Web page concerning SAIC's commercial business.

1. Performance-based services acquisition. Let me begin with some observations on the state of practice in Performance-Based Services Acquisition. Although a generalization, most end-users that we support do not understand nor want to use performance-based contracting. They are comfortable with being able to specify what and how they want work performed and have not accepted the premise that they should focus on outcomes and let us find more efficient ways to get the job done. Many actually are concerned about “losing control” of the solution delivery if they just specify the outcomes. It will take a lot more education to change the culture of the end-users so that they embrace and reach for performance-based contracted support rather than view it as a top-down imposition of policy from the administration.

The current processes used for solicitations performance-based service contracts are very uneven. We see quite a few RFPs that claim to be performance based but are in reality “how to” statements of work—in fact, some are exact replicas of the previous procurement documentation, simply relabeled as a Statement of Objectives (SOO). Frequently, performance-based solicitations have measures and standards, but there is no linkage from performance to incentives and/or penalties. Many of these still engage an

award or incentive fee, but it's based entirely on a subjective evaluation of the contractor's performance. We also see solicitations using SOOs accompanied by significant resistance to providing the necessary baseline data that would enable a contractor to understand details of the outcomes necessary to be able to propose an improved and more cost effective and efficient way to get the desired outcomes.

If PBSA is going to achieve its promise, federal departments and agencies are going to have to mount a very significant and sustained effort to socialize and train end-users on the benefits of performance-based contracting that is focused on improved outcomes. The seven steps training provides some procedural help, but doesn't go the distance to changing the mindset of the community engaged in writing performance-based procurements.

2. Cascading set-asides. Another problematic area is the issue of cascading set-asides, also known as cascading procurements. What started as an experiment by the Department of Housing and Urban Development in awarding management and marketing contracts has now spread to a growing number of agencies, including the departments of Agriculture, Health and Human Services, and Veterans Affairs and the Air Force.

Cascading set-asides are a source selection process in which an agency invites all interested offerors—be they large businesses, HUBZones, 8(a) businesses, and so on to submit proposals at the same time. The evaluation process is then tiered—hence the term “cascading”—by socioeconomic category, beginning with the highest tier, HUBZone businesses, and then proceeding to 8(a) businesses, and so forth until the agency identifies a winner, at which point the competition comes to a halt. In the event no winner is selected from among the small business categories the source selection proceeds to the last category—unrestricted/full and open.

While this novel approach affords an agency a convenient way to avoid deciding its acquisition strategy at the outset, it forces competitors—both large and small—to expend bid and proposal costs needlessly. A portion of those costs, incidentally, are ultimately borne by the federal government.

Interestingly, nowhere does the term “cascading set-aside” appear in the Federal Acquisition Regulation (FAR). It is wholly the creation of agencies.

In sum, cascading set-asides is a bad idea.

3. Time and materials payment provisions. Another troubling development that has surfaced in recent months is the treatment of subcontracted costs under GSA schedules contracts that contain the time and materials payment clause. Defense Contract Audit Agency auditors are selectively disallowing profit on the subcontracted effort, thus limiting the prime contractor to charging the government only what the subcontractor in turn is charging the prime. DCAA has created a fiction in which subcontracted effort is treated as “material” rather than “time.” This view is short-sighted, as it ignores not only the significant time and effort that primes must expend to manage their subcontracts but also the inherent risk entailed in such efforts. Subcontract costs can account for upwards of 50% of the total value of a contract. To expect a contractor to absorb such costs and risk is not only unfair but also counterproductive, as it will encourage contractors to take work in-house rather than place it with subcontractors. This would in turn be unfortunate for subcontractors, many of whom are small businesses. Government contractors, like

any other for-profit enterprise, have a legitimate right to be able to make a reasonable return on the entire contract. It would be unthinkable for a homeowner, having contracted with a general contractor to put an addition on his or her house, to expect that contractor to charge only what the individual carpenters, electricians, plumbers, etc. were paid on an hourly basis. So, too, it is grossly unfair to expect contractors providing services to the federal government to forgo profit on a substantial amount of their work.

Part of the problem, as Director of Defense Procurement and Acquisition Policy Deidre Lee acknowledged in a May 3 e-mail to the Information Technology Association of America, is that the existing T&M Payments clause at FAR 52.232-7 is oriented toward a non-commercial market, whereas the context in which it is being applied is commercial item procurement under the GSA schedules. Ms. Lee assured industry that the situation will be remedied. Two FAR cases have been opened. One would revise the existing clause for non-commercial items; the other would add a new payment clause that is geared specifically to the payment provisions needed for commercial items.

Meanwhile, as I speak, the Senate is considering putting language into the fiscal year 2006 defense authorization bill (S. 1042) that would allow prime contractors that use subcontracted labor to make a profit only at the level specified in the subcontract. Adoption of such language, particularly without benefit of any public hearing on the subject, would be most unfortunate.

It needs to be recognized that T&M contracts are a customary commercial practice that is successfully used in many situations where the customer is not buying an end item with acceptance criteria. T&M is a flexible approach that is appropriate whenever the extent or duration of the work cannot be estimated with certainty at the outset. It also should be recognized that contractors providing commercial services have a strong built-in incentive to manage their labor force—including subcontracted labor—efficiently.

A separate but related development is the inconsistent treatment of other direct costs—ancillary or incidental items obtained by agencies through the schedules vehicles. Some schedules contain explicit guidance on the use of ODCs while others provide none. GSA is drafting guidance on the treatment of ODCs to address this issue, but meanwhile, contractors are left in the lurch.

4. Post-award audits of GSA schedules contracts. Still another looming problem is the advance notice of proposed rulemaking (ANPR) issued by GSA March 11 and revised April 12 calls for revising the Examination of Records clause, GSAR 552.215-71, to reinstate post-award audit access to a GSA schedule contractor's records to verify that preaward/modification pricing, sales, or other data were accurate, current, and complete.

Comments were due May 10, and industry is waiting with bated breath for the next development.

Quite simply, the case for reinstating post-award audits has not been made. The Federal Acquisition Reform Act of 1996 (FARA), incorporated as Division D of the fiscal year 1996 National Defense Authorization Act (P.L. No. 104-106), eliminated post-award audits of commercial item contracts. Yet, only a few months later, GSA took it upon itself to propose regulations to permit post-award audits of certain commercial item contracts.

The House National Security (now Armed Services) Committee, in response, reiterated its intent in the report accompanying the FY 1997 National Defense Authorization Act (P.L. No. 104-563) reiterated its previously stated intent that “the only remaining authority for the government to pursue such information is the authority of the General Accounting Office to audit contractor records.”

In yet another unequivocal expression of congressional intent that there be no post-award audits of commercial item contracts, the three primary authors of FARA—Sen. William Cohen (R-Maine), and Reps. William Clinger (R-Pa.) and Floyd Spence (R-S.C.)—wrote to the then-head of the Office of Management and Budget on Sept. 18, 1996 stating: “The clear intent of Congress was that these audits would no longer be performed by Federal agencies. Congress clearly did not intend that this statutory change permit Federal agencies to subsequently determine through agency supplements to the Federal Acquisition Regulation whether and to what extent post award audit access is appropriate on commercial item contracts.”

The government’s case for reinstating post-award audits rests in large part on a report by the Government Accountability Office criticizing GSA’s administration of schedule contracts, “Contract Management: Opportunities to Improve Pricing of GSA Multiple Award Schedules Contracts” (GAO-05-229). GAO examined 62 MAS contracts—out of roughly 15,000—and determined that 37, which equates to nearly 60 percent, “lacked sufficient documentation to clearly establish that the contracts were effectively negotiated. Roughly 40 percent “lacked adequate price analysis or price negotiation documentation.” But nowhere does GAO assert that the government was prejudiced as a result of these alleged lapses on GSA’s part. Rather, it appears to be saying that there is the potential for a problem, based on a sample of less than half a percent.

The GSA inspector general also has expressed concerns with regard to MAS pricing. To the extent those concerns are valid, we emphasize that the time to conduct audits is upfront, at the preaward stage. The IG itself recognizes that, and has undertaken to substantially increase the number of preaward audits of GSA MAS contracts.

We contend that the fears of GAO and the GSA IG are largely unfounded. Given market forces, not to mention the recent statutory requirements for competition in placing orders under schedule contracts, contractors have a strong built-in incentive to offer competitive pricing.

The fact is that the government has ample access to a contractor’s data. FAR 52.212-5 authorizes the Comptroller General to examine a contractor’s directly pertinent records involving contractually related transactions. Also, GSAR 515.209-70(b) permits a contracting officer to modify the Examination of Records clause for other than MAS contracts to define a specific area of audit. For MAS contracts, GSAR 515.209-70(c) permits the contracting officer to modify the clause at 51.215-71 to provide for post-award access to and the right to examine records to verify that pre-award/modification pricing, sales or other data related to the supplies or services offered under the contract which formed the basis for award/modification was accurate, current, and complete.” Before modifying the clause, the CO must determine that absent such access there is a likelihood of significant harm to the Government and obtain the approval of the Senior Procurement Executive.

Moreover, reinstating post-award audits would be highly burdensome, particularly for small businesses, which constitute approximately 80 percent of all schedule contractors. The records retention policies in FAR 4.7 do not contemplate retaining voluminous data for periods of more than 20 years (assuming the initial five-year base period of a MAS contract and exercise of three five-year options, plus three years after final payment).

Yet, in the face of all these strong arguments against reinstating post-award audits of commercial item procurements, GSA has taken it upon itself to initiate a rulemaking effort that would do just that.

5. Organizational conflicts of interest. Another specific policy and procedural area that we believe needs attention is organizational conflicts of interest. We would have no quarrel with the language on OCIs in FAR Part 9.5 if it were applied with reason. However, we are troubled by the uneven application of this policy. At one extreme we see where a technical services firm is allowed to continue to support government oversight of programs being developed by the very aerospace firm that purchased the technical services firm. At the other end of the spectrum, elements of a major buying command of a military department will not even consider an OCI mitigation plan—it is just black and white that OCI cannot be mitigated. The latter is very troubling because no one can define the limits on the reach of the OCI associated with a task under large, multiyear contracts like Seaport-e and multiyear platform programs that indirectly touch all kinds of subcomponents and related programs. We urge you to consider the over-reach of OCI and steer toward a policy that presumes, except in extraordinary circumstances, that appropriate mitigation plans and non-disclosure agreements will provide the government suitable protection against organizational conflicts of interest.

6. Low cost vs. best value awards. Another area that calls for attention is low cost vs. best value awards. This is directly applicable to evaluating performance-based contracts. At some time or other nearly all contractors lose a competition where the winning price is significantly lower—up to 25% lower—than the range of all the other bids. This means either the winning contractor did not understand the work or bid to win and not to perform. This is also known as “buying in.”

We wondered about the post-award results of such low bids that the government accepted and hired Paul DeLottinville Communications to do an independent analysis of these bids. His conclusion: “Government buyers beware.” The old adage has been affirmed: “You get what you pay for.” Two-thirds or better of all federal government bids for IT outsourcing services are awarded to the low-cost bidder even though it is often a best-value competition. Unfortunately, nearly 60% of all contracts awarded to the low-cost bidder resulted in increased contract costs. This is because the awardee could not deliver the contracted services as promised and the government, to avoid another recompetition, chose to renegotiate the contract for higher rates, more staffing, longer deliverable schedules, and augmented funding to fix problems. We recommend that you ensure that the procedures used in evaluating performance-based contracts take into account the price realism of the proposed solution, including the availability in the specific labor market of qualified personnel at the price offered.

7. Fragmentation of acquisition policy, procedures, and contracts. A further area that warrants attention is the continuing trend toward fragmentation of acquisition policy and procedures and indefinite delivery, indefinite quantity contracts and multi-agency contracts. It is very expensive to keep up with all the variations in acquisition policy that have developed because of the various streamlining efforts that have been legislated in recent years. We no longer have a single, uniform FAR to look to for guidance. The Department of Homeland Security has its still-evolving processes, the Federal Aviation Administration has its own acquisition system, the Department of Defense and the military departments continue to have unique processes added both by Congress and internally. In addition, each region of the General Services Administration seems to have a unique interpretation of acquisition policy.

SAIC is a long-time player in the federal market, so we work hard at keeping current on all these variations in policy and procedures. However, this jumble of policy, regulation, and procedure is a significant barrier to entry of commercial firms into the federal market. The government should strive for consistency and simplicity of process and procedure across departments, agencies, and regions if it wants to attract and retain talented players in the federal market.

As to the various IDIQ contracts, the question is: How much is enough? We believe the GSA schedules and GWACs have worked well but clearly did not have sufficient internal oversight to ensure sound acquisition policies were followed. It now seems as if every franchise fund and every agency wants to roll out its own IDIQ contract for services that is more or less a copy of the GSA Federal Supply Schedules or the GSA multi-award contracts. It costs companies a lot to bid on these duplicative contractual vehicles and it will cost the taxpayers a lot to administer them. If the legislation pending in the Senate becomes law we expect each of the military departments and the Defense Logistics Agency also will issue duplicative IDIQ contracts for services. It might be better to focus on getting the new GSA Federal Acquisition Service in place, ensure consistent policies are used across the regions, and then use that organization as the principal method—across all of government—for buying commercial goods and services. If the fragmentation continues, then I expect we will see more acquisition problems as the many organizations with multi-agency IDIQs compete for the federal customer and apply their local understanding of acquisition policy.

8. Lack of transparency in the rulemaking process. The increasing decentralization of acquisition policy and procedures is further complicated by the lack of transparency of the process. The American Bar Association Section of Public Contract Law, in a white paper discussed in August 2004 at the group's annual meeting, expressed concern over the tendency of federal agencies to carve out guidance from the Code of Federal Regulations and treat it as internal procedures. One example is the effort on the part of the National Aeronautics and Space Administration to subdivide the NASA FAR Supplement (NFS) into two parts—one for policies, procedures, and contract provisions, the other for internal administrative procedures that ostensibly have no bearing on the contracting relationship between NASA and its contractors. The Department of Veterans Affairs likewise has made a practice of not putting procurement-related procedures in its FAR supplement but rather having a separate repository that only those who are familiar with the agency's practices are able to access. Even the Defense Department is headed in

this direction; the ongoing effort to transform the DOD FAR Supplement (DFARS) is in large part being accomplished by removing chunks of material from the DFARS and placing them in a separate repository called Procedures, Guidance, and Information (PGI). Such practices complicate the private sector's dealings with agencies, forcing contractors needlessly to invest time and effort to track all relevant rules and guidance. A portion of the resulting costs ultimately is borne by the government customer. More important, such practices run counter to the principle of open government upon which this nation was founded. Moreover, they run counter to the e-Government initiative that is one of the pillars of the President's Management Agenda. We recommend that agencies be required to clearly post all of their procurement rules, procedures, guidance, and information on their Web sites. Further, we recommend that OFPP issue guidance delineating when it is and is not appropriate to carve out guidance from the FAR and FAR supplements.

9. Early input/intervention in rulemaking process. Currently, OFPP gets involved in acquisition policy problems only when they reach the rulemaking stage. By then, considerable damage has been done. The current process for issuing changes to the FAR and agency FAR supplements is slow and cumbersome and does not afford the private sector a meaningful opportunity to weigh in. As you know, a FAR case is typically opened in either the Defense Acquisition Regulations Council or the Civilian Agency Acquisition Council. Once the initiating council has finished drafting a rule—a process that can take months—it is sent to the other council for action, followed by a process to reconcile the differences between the two versions, which likewise can take months. All council deliberations are shrouded in secrecy. By the time a rule is issued for public comment in the *Federal Register*, the statutory deadline is fast approaching—or, in some cases—has already passed, and an interim rule allowing for comment is often the preferred route.

Then, industry has 60 days in which to weigh in, which is not a very long time, especially when a number of proposed or interim rules are issued at about the same time, which often happens. When the issue is controversial or has far-reaching consequences, the agency may hold a public meeting and/or issues an advance notice of proposed rulemaking and/or a second proposed rule after it has analyzed the public comments, further delaying the process and needlessly expending scarce agency resources.

We submit that industry be given an opportunity to get involved sooner in the rulemaking process, before issuance of an advance/proposed/interim rule. One option is to revise the Federal Advisory Committee Act (FACA) to require the councils to hold public meetings on pending regulatory initiatives on a quarterly basis. Such meetings would serve as a forum that would allow industry representatives to make known their concerns with respect to particular matters. In this way the government would have greater awareness early on that something is amiss as well as better insight into possible alternative regulatory or policy avenues to pursue. After all, the purpose of FACA is not to limit industry access to government but only to ensure that that access is not manipulated to exclude legitimate interested parties.

By involving industry upfront, concerns could be vetted before the government has expended considerable time and effort drafting a rule. In addition to better informing

the rulemaking process, early involvement on the part of industry would expedite the process.

Another option is to devise an early warning mechanism within OFPP. Currently, there is no procedure for handling acquisition policy issues *before* they become crises. Contractors are reluctant to bring problems to the attention of their government customers for fear of being labeled as not team players, and so must use trade and professional associations as intermediaries. The indirect route can be time-consuming and frustrating. The better, and earlier, the communication, the greater the likelihood that issues like cascading set-asides and subcontractor labor under T&M contracts can be resolved before they get out of hand.

10. Institutionalized approach to lessons learned. To help upgrade the sophistication of the government buyer of commercial and performance-based services, we recommend that you consider the establishment of a Lessons Learned office under the Defense Acquisition University that would analyze and document what worked and what didn't work on procurements, with particular emphasis on troubled programs. This shouldn't be seen as an audit function or an effort to pin blame on individuals. Rather, it should be a an opportunity for professionals from the defense and civilian agency acquisition workforce to take a hard look at procurement programs and review case studies of procurements to assess how the reality of contract performance compared to the promise of the proposal. This sort of analytical exercise would go a long way to ensuring that success stories are memorialized as best practices and mistakes are avoided. This body of knowledge also should be made available to procurement officials to better inform policy development and help shape future procurements. We have a lessons learned program within SAIC that looks at our wins and loses in the competitive market and find it to be a very valuable undertaking and a good way to avoid repeating mistakes.

Conclusion. In conclusion, we urge the Section 1423 Panel to address the issues concerning the procurement of services by the government with a view toward recognizing the commercial business environment in which such procurement takes place. We believe that restoring greater consistency and predictability to the acquisition of services, minimizing nonvalue-added requirements, putting in place mechanisms to nip problems in the bud, and, lastly, recognizing the inherent limitations of any system and working within realistic parameters, will ultimately work to the government customer's benefit by better enabling the government to acquire a wide array of services efficiently and effectively and in a timely manner.

This concludes my prepared remarks.

I would be pleased to answer any questions you might have.