



Over the course of three or so years, we’ve published several articles discussing our view of the relationship between the Department of Defense and the contractors that comprise the “defense industrial base” (DIB).

We wrote in [this article](#) that –

The Pentagon’s policy problem may be described as one of ‘defense industrial policy’—*i.e.*, how to effectively manage the defense industrial base to cut the costs of weapon systems, while at the same time preserving critical skills unique to the aerospace/defense industry and making sure key strategic suppliers don’t fold-up their tents and sneak away in the night, leaving landlords looking for back rent money. It’s not a skill that the Pentagon historically has been known to possess.

Our most recent article is [right here](#). In that article, we opined that—

If the DOD and its industrial base were in a marriage, we think it would be fair to say that we are long past the honeymoon phase. We think the current relationship might be fairly characterized as a ‘separation.’

But of course we’re not the only source of concerns with the relationship between DOD and its contractors. In fact, many others, ranging from [Congressional committees](#) to the [Defense Science Board](#) itself, have voiced similar concerns. The latest source is the House Armed Services Committee

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Written by Nick Sanders
Monday, 02 April 2012 00:00

(HASC) and its Panel on Business Challenges within the Defense Industry, who just published a 114-page, comprehensive, survey of concerns with the state of DOD’s business environment—including many recommendations on what to do about those concerns.

The HASC has a history of influencing legislation affecting DOD and its contractors. For example, when the HASC Committee’s Panel on Defense Acquisition reform published [its final report](#) in April, 2010, it sparked reforms that made their way into H.R. 5013—including a little ditty about requiring DOD to establish criteria for the reviews of contractor business systems. And we know how *that* turned out, don’t we?

So when this HASC Panel issues a report, you need to review it closely. You may be reading the future of Defense contracting.

The current HASC Panel’s report, entitled “Challenges to Doing Business with the Department of Defense,” can be [found here](#).

We like it. We like it a *lot*.

We don’t like it just because we agree with it. In fact, we don’t agree with every finding or with every recommendation. For example, the ones about Small Business don’t really float our boat, if you know what we’re saying. We like the report because it includes lots of input from members of the actual DIB. You know, the folks most affected by DOD policies? Yeah, the contractors.

We like the fact that the Panel gave industry a number of opportunities, via eight separate “industry roundtables,” to discuss their impressions of DOD policies—including opinions of DOD culture, DCAA audit policies, export controls, and many other facets of DOD contractor administration and oversight. Because the Panel members went out of their way to get lots of industry input, this document differs from others we have read in the past, in that it is more accurate and more thorough.

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Now, we’re not going to rehash the entire report. You should go read it for yourself. But here are some of the highlights, as we see them.

First, the document is organized into five parts, as follows—

Part I The Defense Industrial Base

Part II The Use of Mandates and Incentives to Shape the Defense Business Environment

Part III Department of Defense Acquisition Environment

Part IV Barriers to Transitioning Technology

Part V Navigating the Defense Acquisition System

And there are twelve Appendices, many of which convey important information that was only alluded-to in the body of the document itself. We’ll cover that bit at the end of this article.

Each Part contains discussion, quotes from testimony, findings, and recommendations. We’re going to start with some of the quotes (because we like them).

“We need two things. We need budgets that produce programs that are profitable and that reach out to the talent we need, and we need an industrial base strategy that gives direction and predictability that the industry leaders need to make sound strategic business decisions.” --Fred Downey, Aerospace Industries Association

“There is no doubt that the DOD acquisition community is very risk-averse, and we have to find ways to meter that risk-aversion and reduce the bureaucracy and leverage this critical sector of our economy to meet our national security requirements.” --Mr. Joel L. Johnson Former Vice President, International Aerospace Industries Association of America, Inc.

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“Contracting officers are often overworked and under-equipped. Collaboration between program and contract staff is poor. And, there is a lot of confusion on what Government can say to industry and when.” --Dr. Allan V. Burman President, Jefferson Solutions

“We don't have the experience base in our defense acquisition workforce today. And if there is only one thing that this panel does, you have got to reinforce the need and the efforts to rebuild the capability of that workforce, because we rely on their judgments in making those contracting decisions.” --David J. Berteau Senior Vice President and Director of International

Security Program, Center for Strategic and International Studies

“There are three big challenges facing the industry today. The first is the impact of the planned reductions and the budget reductions that are under way. The second is the importance to recognize that industry today, unlike industry in the past, has to remain competitive in the global financial markets. We can no longer rely on just the Federal Government to provide the funding for these companies. They have got to be competitive financially. And the third is where innovation is coming from in the 21st century, because we have a history of relying on defense contractors to come up with innovation.” --Mr. David J. Berteau Senior Vice President and Director of International Security Program Center for Strategic and International Studies

“Long procurement lead times typically encountered at DOD are also a barrier, particularly for commercial companies. They are unaccustomed to such long lead times and usually operate in environments using agile development in incremental models for short cycles of 6 months to a year. The DOD's 24-or-more-month lead times are not conducive to attracting the innovation these companies could bring to bear.” --Trey Hodgkins Senior Vice President

National Security & Procurement Policy TechAmerica

“Contract auditors measure their success by the numbers of costs that are questioned

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and the amount of those questioned costs that are sustained. What they really ought to measure their success by is the timeliness and value of the ultimate delivery of the results of those contracts.” --Mr. David J. Berteau Senior Vice President and Director of International

Security Program Center for Strategic and International Studies

“If there is anything more mysterious than FAR and DFARS, it is ITAR. And if there is anything that small companies know less about than FAR and DFARS, it is ITAR.” --Mr. Joel L. Johnson Former Vice President, International Aerospace Industries Association of America, Inc.

The executive summary of the report provides an illustrative example of the Panel’s findings. It said (in part)—

DOD has, in some cases, outsourced program management and divested itself of critical skills that are difficult to develop – contracting officials, cost estimators, and systems engineers. This reliance on private contractors can create a potential conflict of interest and blur the lines between what work must be performed by federal employees and what work is permitted to be performed by private contractors. The Panel notes that just as it takes many years to develop a military leader capable of commanding at the senior ranks of the operational force, it takes a similar amount of time to develop an acquisition professional with the knowledge, skills, and experience needed to manage large defense acquisition efforts. In addition, the Panel found that constantly changing regulations leads to unnecessary complexity, confusion, and poor execution, only furthering challenges for the acquisition workforce. The Panel also found that the DOD acquisition system lacks sufficient emphasis on small business participation.

The Executive Summary also stated—

The Panel also found that a number of hurdles make it challenging for companies to compete for defense contracts. The plethora of regulations specific to government and defense contracting dissuades many companies from competing for government contracts. The acquisition process is often bureaucratic and rigid, with insufficient flexibility to allow appropriate application of management, oversight, and monitoring of small businesses. The defense business environment is also complicated, and some argue hindered, by current

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export control requirements. The high rate of personnel turnover in government acquisition personnel, from program managers to Defense Contract Audit Agency (DCAA) auditors affects the quality and consistency of policies. Oversight and management agencies such as DCAA are under-resourced and lack consistently trained, skilled personnel, hampering the ability of these agencies to provide appropriate contract oversight and management. In addition, a backlog of audits has caused DCAA to prioritize work on high dollar contracts, leaving unresolved many of the open audits of small businesses who are holding small dollar contracts.

We want to focus on Part V of the report—“Navigating the Defense Acquisition System.” In this section, the report stated—

Contracting with the federal government is a highly regulated process governed by a myriad of statutes and regulations. These regulations govern such issues as how DOD solicits, negotiates, and awards a contract; what costs DOD will reimburse and how contractors must account for those costs; the information systems used by contractors; and how contractors must comply with rules regarding such socio-economic goals as affirmative action, trafficking in persons, and maintaining a drug-free workplace. The complexity of the regulations can make it difficult for some companies to enter the government contracting arena. As one observer noted, ‘contracting with the federal government is a highly regulated process with many traps for the unsuspecting.’ ...

A number of analysts argue that the complexity of the acquisition system dissuades a number of companies from competing for government contracts.¹⁷⁹ Small and midsize businesses, which often do not have the resources to hire in-house counsel or experts in government contracting, may find government contracting too difficult to navigate. Not only is the defense acquisition process complex, defense acquisition rules are constantly changing, making it challenging for companies to keep up with changes that can impact their business. ...

The ever-changing nature of the laws and regulations governing defense acquisitions can make it difficult for companies with limited resources to stay abreast of the changes that could impact their contracts or business strategies. The extent of legislative and regulatory change has fueled a cottage industry dedicated to helping businesses stay informed of the most recent changes. Every year, books, seminars, and webinars are aimed at keeping business owners abreast of changes that could affect their business. Some analysts believe that companies may shy away from government contracts out of concern that the contracting rules could be changed in the middle of the game, making it more risky to pursue a business strategy geared towards winning government contracts.

The report also addressed “Management, Oversight and Audit Agencies.” In this section, the report stated—

In addition to the financial cost of complying with some regulations, the numerous audit and oversight bodies with jurisdiction to investigate DOD contracts may dissuade some companies

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from competing for DOD contracts. These oversight bodies include the Defense Contract Audit Agency (DCAA), Defense Contract Management Agency (DCMA), GAO, Inspectors General (including in some cases the Special Inspector General for Iraq Reconstruction and the Special Inspector General for Afghanistan Reconstruction), and Congress itself in the form of hearings. On December 13, 2011, the Panel met with the Director of the DCAA, Patrick Fitzgerald and the Director of DCMA, Charlie Williams for a briefing to discuss challenges within the contracting community in the DOD. Over the past two decades, both the DCAA and DCMA have substantially decreased staffing while DOD spending and contracting increased exponentially. DCAA's staffing has decreased by approximately 40% since 1990 while workload has increased approximately 140%. GAO officials reported in recent congressional testimony that DCMA's workforce decreased from an estimate of about 24,000 in 1990 to a low of about 9,300 in 2008, that a rebuilding effort was underway but may require increased funding to sustain. Both Mr. Fitzgerald and Mr. Williams emphasized the need for regrowing their workforces to meet the demand within the Department and are making strides to do so.

One method of checking the effectiveness of DOD audit organizations is through a peer review process. According to the Department of Defense Inspector General, DCAA has not had an audit organization peer review in approximately five years. The DLA audit organization failed its peer review and some observers are concerned that defense audit organizations will also fail peer reviews.

The report offered many recommendations. (Remember when we told you that HASC report recommendations have a habit of becoming law?) Among the recommendations that caught our attention were the following—

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Congress should direct the Secretary of Defense to increase oversight of the management, functionality, and operations of DCAA and DCMA to reduce the backlog of audits, and to improve the audit agencies' relationship with the industrial base. The Panel is aware that DCAA executives have met with a variety of industry associations over the last few years to further ensure that they have effective communication with their contracting community. These meetings and other forms of engagement with industry should be continued into the future.

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Congress should direct the Secretary of Defense to examine the Department's organizational structure and assess the feasibility and advisability of reorganizing the Department to realign DCAA and DCMA to improve communications, audit performance, oversight, and management.

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Congress should direct the Secretary of Defense to establish a small business advocacy office and a contract close out unit in DCAA and DCMA to ensure that the needs of small businesses are safeguarded and that all contracts are closed out in a timely fashion. Closing out contracts in a timely fashion is a key element in having auditable financial statements.

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The Directors of DCMA and DCAA should ensure coordination between their agencies and the SBA when conducting audits that include factors of interest to or duplicative of reviews conducted by SBA. For example, SBA's Commercial Market Representatives visit large contractors with subcontracting plans to assess compliance with the subcontracting plan. However, DCAA also looks at subcontracting as part of its cost audits, especially when subcontracting performance is related to a company's award fee. Furthermore, DCMA also reviews subcontracting performance and processes. These three entities should coordinate their reviews to more efficiently conduct audits and to potential reduce the number of audits performed.

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Congress should examine other alternatives, to include the establishment of a self-regulatory option, to providing auditing, accounting and advisory services regarding contracts and subcontracts and examine the feasibility of using such alternatives for the DIB to potentially reduce or eliminate many of DOD's internal audit organizations while ensuring compliance with statutory, regulatory, and contractual requirements.

We think those are some *very interesting* recommendations, don't you agree?

Before we conclude this rather long article, we want to discuss some of the “industry roundtable” comments regarding DCAA and DCMA. These comments didn't make it into the

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body of the report; however, they may provide some background information as to why the Panel made some of the foregoing recommendations. Here are some quotes from those appendices.

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Several participants indicated that continued and significant backlogs at DCAA and the complexity of incurred cost audits tend to hold up contract closeouts. A comment was made that one person was needed full time simply to support compliance/audit requirements and that it was difficult to self-audit.

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Comments were made that lengthy contracting periods (3-5 years) on firm-fixed price contracts require industry to “guess” on costs to procure raw materials for the period of performance. While larger industry may be able to absorb price fluctuations, many small business do not have the cash flow to do so. Industry participants indicated that commercial sales contracts use a price index and/or review at the 2- and 4-year points to address this issue and suggest that DOD and the defense industrial base would benefit from adopting that model.

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One participant cited an example of their company still working with DCAA to try to close out an audit from 2006. He mentioned that the environment with DCAA is very hostile and it appears as if they simply do not want any more suppliers. He went on to reference a 2007 DOD Directive that gave DCAA authority to subpoena information if a contractor failed to respond to a request in less than 3 days.

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Another participant felt that DCAA is not satisfied when provided sufficient documentation – they want to know “why” a decision was made even when it was in scope of the contract and fully justifiable. He claimed that if one tried to question DCAA or otherwise disagree with their findings, the auditors threaten to broaden the scope of the audit to other contracts.

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It was also stated that DCAA auditors used to sit down at the table with the business and go over the books, allowing for a dialogue and exchange of information that would not only clear up any audit concerns quickly, but would also help the business to learn the audit process so that they could do better in the future. It was noted that auditors seem to no longer do that and instead appear to be solely on a search for any bit of information that might cast a negative light on the business.

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A participant felt strongly that DCAA needs to exist and plays an important role in oversight, ‘even as much as we [industry] hate spending 3 days to find \$58 from 4 years ago.’

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Several participants expressed frustration with DCAA’s failure to close out incurred cost audits in a timely manner. One company was last audited in 2005 and the audit was still open, costing the company an estimated \$3-4 million in lost business over the last six years. The participant noted that the contracting officers requested indirect rate audits but DCAA was non-responsive and the company was prohibited from moving forward from a successful SBIR Phase II contract because the audit was still open. It was suggested that the Panel should consider mandating maximum turn-around times for audits such as 60 days for rate audits, and 6 months for incurred cost audits. It was also suggested that contracting officers should be allowed to issue letter contracts so that they can proceed with a contracting action while an audit is still open and make adjustments, if necessary, after the audit is closed. Another participant felt that turnover and inexperience with DCAA auditors was part of the problem. It was stated that every year they get a new auditor and they have to start all over because the new auditor uses different processes and has different audit requirements. In order to address this issue, it was suggested that DCAA should be required to report performance metrics in order to highlight regional shortcomings and more uniform [military member] involvement at DCAA was needed to balance the inexperienced civilian workforce.

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A participant commented that DCAA is underfunded and is very slow to close out a contract. It was also stated that waiting nine months on DCAA [to complete an audit] can put a small business out of business.

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A participant commented that innovative or creative program offices can ‘get slapped upside the head by leadership’. It was implied that more flexibility needs to be given to program offices in order to deal with many of the issues in the acquisition process.

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A participant who was working to become a prime contractor commented that DCAA and DCMA were working to see which of them could make it harder on industry. It was stated that they have too many branches and that none of them talk to any of the others.

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Another participant noted that DCAA had become more adversarial over the last two years and they are becoming increasingly inefficient. Frustration was expressed over their audit methodologies even when dealing with a known, proven product and a known supplier.

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A participant cited grave challenges with DCAA and indicated that his business was at risk due to actions of a prior employee and DCAA audit response.

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A participant noted that each of the military services do things very differently even when procuring the same item. An example was cited that in buying the same product the Army used a FAR Part 12 (commercial item) contract and the Air Force used a FAR Part 15 (negotiated acquisition) contract; one service considered the procurement to be a services contract and the other service looked at it as an end-item procurement. It was suggested that DOD needs to develop an enterprise wide approach to contracting to improve efficiency.

According to the report, the Department of Defense reacted to the foregoing comments with the following comment of its own—

The report contains a summary the roundtable discussions held at different locations throughout the United States. These summaries contain several references to DCAA. Many of the references to DCAA in the roundtables were issues that reflected negatively on the Agency (i.e., audits taking too long to complete, backlog of incurred cost audits, issues with effective communications). If the Panel thought it would be productive, the Agency would like to follow-up of the issues described in the report to ensure these concerns have been resolved.

Readers, we have devoted considerable wordcount to this HASC report. This article is roughly four times as long as our average. From that fact, you may be able to glean that we view this report as extremely important. We very much hope that recent history continues and the Panel’s recommendations find their way into future legislation ... and from there into the DOD’s acquisition regulatory framework.