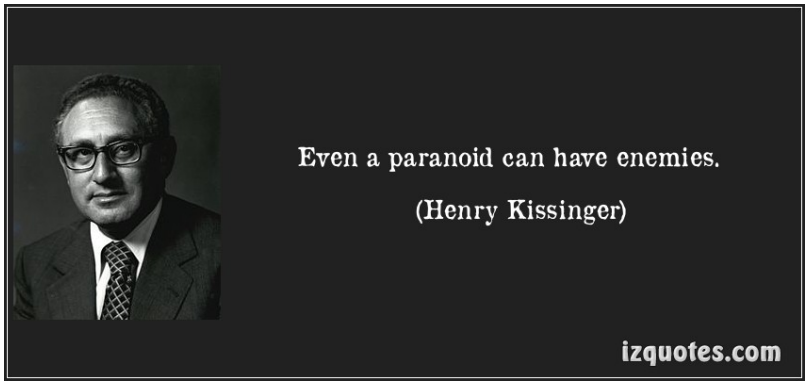

It's hard to keep from pointing out that we saw this one coming from a mile away.

So we won't bother to try.

We have long been concerned that what Secretary of Defense Gates announced in 2010 as an urgent initiative to cut Pentagon "overhead costs" and to reduce bloated Pentagon bureaucracy has been seized by certain leaders as an opportunity to attack the contractors who enable the warfighters to, uh, fight wars. Not two months after SECDEF Gates' speech, the "Better Buying Power" initiative was birthed, with the goal of "restoring affordability and productivity in defense spending." Over time, the drive for Pentagon efficiency—spear-headed by the SECDEF himself—seems to have virtually dropped off the radar screen, while the drive for weapon system affordability seems to be quite healthy and, as we've told our readers, it's morphed into "Better Buying Power 2.0" (or "BBP 2.0," for short).

When we say we've "long been concerned," allow us to elaborate a bit.

In December, 2011, we published **a screed** about how the words and deeds of the Defense Procurement & Acquisition Policy (DPAP) Directorate indicated an intention to work to reduce defense contractors' profits, despite public protestations to the contrary from higher levels of Pentagon leadership. We continued in that vein nearly a year later,
ranting
about attempts to limit the allowable compensation of contractors' personnel—which seemed to us to be, fundamentally, an attempt to reduce contractors' profits once again. And a couple of months after that, we
told you

about the Navy's "price fighters" and we asked you to consider who they were fighting and what they were targeting. (Hint: they were *not* fighting foreign terrorists, nor were they targeting international drug cartels.)

In that last article we also discussed the fairly recent phenomenon of "should cost" pricing, which is where the government demands thousands upon thousands of pages of cost information from the contractor, so that government personnel can then engage in long, drawn-out, adversarial, negotiations—with the expressed objective being to *tell the contractor what its own products are going to cost* (as opposed to relying on the contractor's official cost estimate, which of course would almost certainly have been subject to the requirements of the Truth-in-Negotiations Act).

Please note: the contractor is required to submit its TINA-compliant cost estimate anyway, even though the government will then proceed to ignore it in favor of its own estimate of what the product "should cost." Thus, under the "should cost" initiative, the contractor now has to support the government's estimate *in addition to its own estimate*—and the additional costs associated with that effort will end up in its overhead.

So while "should cost" sounds nice, in practice it's been a nightmare, resulting in additional overhead costs and delays in finalizing contract prices. Ironically, much of the Pentagon's recent cost-cutting efforts have focused on assisting contractors to reduce their overhead expenses. Consequently, "should-cost" may turn out to be a viable approach to creating a perpetual motion machine—one where contractors are required to incur increased overhead costs so as to provide government personnel with information to enable them to tell the contractor where to cut its overhead costs.

Should-cost negotiations that do not result in significant price reductions (when compared to the contractor's own estimate) seem to be seen as a failure by the government's negotiators. In other words, the objective of "should cost" does not seem to be to arrive as a "best guess" or "most probable" estimated product cost; the objective appears to be to brow-beat the contractor into price concessions so that victory can be claimed in the fight against contractor profits.

At least, that's the way we see it; your mileage may vary.

Despite our perhaps overly harsh rhetoric, we do not seem to be alone in our concerns about the adversarial relationship between the Pentagon and its contractors. For example, in December, 2012, the Los Angeles/South Bay Chapter of the National Contract Management Association (NCMA) hosted a workshop with the title: "Is DoD Waging a War on Contractor Profits?" Speakers included senior contractor representatives as well as representatives from DCMA Western Region and the US Air Force Space and Missile Center's contracting team. We were unable to attend (but would have loved to!). But just the fact that the workshop was held (and attended by more than 100 members) is indicative of the widespread concern felt over this issue.

Recently, the Honorable Frank Kendall, Under Secretary for Defense (Acquisition, Technology, and Logistics) issued **additional guidance** to assist in implementing Better Buying Power 2.0. We are now dubbing this latest version *BBP 2.1* .
(You heard it here first.)

Now, you know that we've been keeping our readers up-to-date with BBP goings-on. (For example: **right here** .) This lengthy article continues that trend. Let's discuss, shall we?

Mr. Kendall's BBP 2.1 memo was interesting for several reasons, not the least of which was a seeming desire to give detailed direction to government acquisition professionals, as opposed to the high-level strategic objectives that characterized BBP 1.0 and BBP 2.0.

Predictably, most news reports focused on the direction to Shay Assad (Director, DOD Pricing) to "review" and "modify" contractor profit policies. And we'll get to that: it was our headline, after all. But we want to build to that, and then cover some other relevant stuff in the Memo.

Should-Cost under BBP 2.1

The first thing we want to discuss is new implementing guidance on the "should-cost" initiative. (If you've read this far, you may have gleaned a slight clue about how we feel about that particular initiative—but now we're just going to report the facts, by quoting the Kendall BBP 2.1 Memo.)

According to Mr. Kendall's memo, managing to "should-cost" targets instead of to program budgets "is fundamental to proactive cost control throughout the acquisition lifecycle". The Memo continued that thought as follows—

Managers should scrutinize each element of cost under their control and assess how it can be reduced without unacceptable reductions in value received. Should cost applies to all acquisition activities and it spans product and service acquisitions. The key is to seek out and eliminate, through discrete actions, low-value-added ingredients of program cost and to appropriately reward those who succeed in doing this, both in Government and in industry. … For industry, it is a matter of tying financial incentives to overall cost reduction. … The Defense Contract Management Agency (DCMA), in collaboration with the CAEs, will implement an annual planning process to maximize the use of the DCMA Cost and Pricing Center capability for assisting program offices and PEO organizations with should cost activities by June 1, 2013.

That's pretty clear, right?

DOD managers are directed to "scrutinize each element of cost … and assess how it can be reduced." This is to be done by focusing on "low-value-added ingredients of program cost." What part of that direction is ambiguous?

You. You in the back. What did you say? *Speak up.* Did you identify some ambiguity in that clear direction? Yeah? Okay; then tell us what you found.

You think that the part about "low-value-added ingredients" is ambiguous? So you're saying that identification of such costs might be subjective—that what is perceived as being "low-value-added" (or "LVA") by the government might not be the same as the contractor's perception of what is LVA?

Bingo.

Obviously, from the government's perspective the lowest value-added ingredient is contractor profit. Profit adds *zero* value to the product. Reduce profit, and you've accomplished the

directive without sacrificing product quality in the slightest.

We're just saying.

Evaluating Reasonable Contractor Profit under BBP 2.1

Speaking of profits, the Memo did *not* declare war on contractors' profits. Instead, it linked contractor profits to accomplishment of Pentagon objectives. The Memo stated—

Profit is the key lever in motivating contractors to perform in alignment with DoD goals. The defense industrial base must be profitable or there will not be a defense industrial base, but the profits DoD provides should be consistent with the risks industry takes and the return needed to attract the required capital to defense companies. *Current profit levels in the aggregate are reasonable and sustainable, but they are not tied tightly enough to successful performance in meeting DoD goals.* Traditionally, the Government's objective position for contract profitability has been a function of perceived risk and the anticipated value to be achieved by successful contract performance. DoD profit policy and our acquisition strategies should provide effective incentives to industry to deliver cost-effective solutions in which realized profitability is aligned and consistent with contract outcomes.

[Emphasis added.}

No, that's not a declared, open war. Instead, we think that Mr. Kendall just called for some covert activity to be initiated, for some SPECOPS types to be mobilized and inserted to create deniable mischief. And we think he also identified the exact SPECOPS team he's mobilized.

The Memo states that, to accomplish the foregoing objectives, the Director of Pricing (Mr. Shay Assad) will "review," among other things, the current DOD Weighted Guidelines approach to profit analysis, and will "modify" them in order to "motivate[ ] behaviors of value to the Government."

And that's where our headline comes from.

We don't know about you, but that last bit sounds kind of scary to us. Given that the DOD and its contractors are no longer in a trust-based partnership, and are instead locked into an adversarial relationship—fighting each other for every last taxpayer dollar—we are *concerned* that "behaviors of value to the Government" might not always align with contractors' responsibilities to their owners and/or shareholders. We are concerned that profit will be transformed from a carrot into a stick: "Do what we (the Pentagon customers) say, or you'll get no profit." That doesn't sound very good to us.

We'll have to see how the SPECOPS forces accomplish their mission—*i.e.*, what recommended changes to the current weighted guidelines approach that Mr. Assad's team comes up with

Moving on….

Focusing on DCAA in BBP 2.1

Another aspect of BBP 2.0 (as we've previously reported) is to focus DCAA on reducing its ginormous backlog of incurred cost submissions awaiting audit. The BBP 2.1 Memo stated—

I have worked with DCAA and we agreed upon goals for the Agency to reduce the current incurred cost backlog by the end of FY2014 and achieve a steady state on all incurred cost audits (defined as 2 years' worth of incurred cost inventory) by the end of FY2016.

Again, no surprises in the above statement. We have reported, several times, that DCAA is telling everybody that it is just a couple of years away from whittling down its audit backlog to a manageable state—at least in the area of contractors' proposals to establish final billing rates. DCAA's assertions (and the BBP 2.1 Memo) ignore the elephant in the room: **the impact** of DOD budgets constraints and sequestration on the DCAA workforce, which is expected to *actually fall*
in GFY 2013, in contrast to the planned headcount increase. Moreover, the DCAA assertions and the Kendall Memo also ignore the statistical fact that, to date, DCAA's productivity is running roughly 25 percent below its planned levels. To say that accomplishment of the FY2016 "steady state" objective is
doubtful
seems (to us) to be very fair assessment of the situation.

Regardless of the foregoing challenges to meeting DCAA's publicly proclaimed objectives, the BBP 2.1 Memo states that "DCAA has agreed to issue a memorandum describing the incurred cost backlog initiatives undertaken by the Agency by June 1, 2013." We feel compelled to point out that the act of simply describing historical initiatives—initiatives that are *already failing* to produce necessary results—does not appear to be helpful in the slightest. But we suppose Mr. Kendall had to say
something
.

Superior Supplier Incentive Program in BBP 2.1

Getting back to the adversarial relationship between the Pentagon and its contractors, let us now discuss the BBP 2.1 Superior Supplier Incentive Program (SSIP). The intent of the SSIP is to "publicly acknowledge and reward top-performing defense companies." Top-performing contractors, designated as "SSS" will "receive more favorable contract terms and conditions in contracts." That sounds nice, doesn't it?

The devil, as they say, is in the details.

The devil is in how the term "top-performing" is defined. According to the BBP 2.1 Memo—

Under the SSIP, contractors that have demonstrated exemplary performance at the business unit level in the areas of cost, schedule, performance, quality, *and business relations* would be granted Superior Supplier Status (SSS).

Okay. See that part we italicized—that phrase "business relations"? What do you suppose *that* means? Go back and read it again; try to guess what it might mean.

Then go back up this lengthy article and read the part about reviewing the weighted guidelines and modifying them so as motivate "behaviors of value to the Government." Now try to guess what "business relations" might mean in the context of becoming a Superior Supplier.

Are you nervous yet?

According to the Memo, the SSIP will start with contractors' past performance information contained in the CPARS. However, the Memo states that "we may also identify other sources of data, including information available to program offices and Government contract administration organizations that the Department may use to supplement CPARS data in implementing the SSIP."

Oh, we're sure that we are being overly sensitive. *Of course* the intent would *never* be to give contractors that "play nice" with DCMA and DCAA and buying commands by (for example) caving-in during negotiations and offering significant reductions to proposed profit rates, a competitive advantage over contractors that stick to their guns during negotiations. We're sure that nobody would ever
dream
of rewarding compliant contractors with a competitive advantage (in terms of "more favorable terms and conditions") while contractors who submit change orders and Requests for Equitable Adjustment and claims, who dispute contracting officer findings (as is their statutory right), would be penalized with less favorable contract terms and conditions.

That could *never* be what Mr. Kendall meant, could it?

It must be just us.

Oh, for those who are interested, Mr. Kendall's BBP 2.1 Memo stated—

DCAA has agreed to coordinate the results of the low-risk sampling initiative as a potential incentive element of DoD plans to implement a SSIP. DCAA has agreed to work with the Navy to incorporate low-risk sampling into the SSIP and will provide a recommendation on incorporating low-risk sampling into the DoD SSIP incentives for presentation to the BSIG by October 1, 2013.

What does *that* mean? We could tell you what we think it might mean, but you already think we're paranoid as it is. We don't want to add any fuel to that particular fire.

And even though this article is lengthy, there’s quite a bit more we could write about. You really should read the Kendal BBP 2.1 Memo in its entirety. But in the meantime, we trust you found our focus areas to be of some interest. And perhaps we’ve moved your needle on the paranoia meter, as well.

Remember, just because you’re paranoid, it doesn’t mean they aren’t really out to get you.