THE UNDER SECRETARY OF DEFENSE

3010 DEFENSE PENTAGON
WASHINGTON, DC 20301-3010

ACQUISITION AND TECHNOLOGY

OCT 15 1998

MEMORANDUM FOR THE SECRETARIES OF THE MILITARY DEPARTMENTS
CHAIRMAN OF THE JOINT CHIEFS OF STAFF
UNDER SECRETARY OF DEFENSE (COMPTROLLER)
ASSISTANT SECRETARY OF DEFENSE (COMMAND, CONTROL, COMMUNICATIONS, AND INTELLIGENCE)
GENERAL COUNSEL OF THE DEPARTMENT OF DEFENSE
INSPECTOR GENERAL OF THE DEPARTMENT OF DEFENSE
DIRECTOR, OPERATIONAL TEST AND EVALUATION
DIRECTOR, PROGRAM ANALYSIS AND EVALUATION
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING SERVICE
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Establishment of a Study Group to Analyze Implementation of Price-Based Acquisition within the Department of Defense

Section 912(d) of the National Defense Authorization Act for Fiscal Year 1998, directs the Secretary of Defense to conduct a review of the organizations and functions of the Department of Defense acquisition activities and of the personnel required to carry out those functions. In his letter to Congress transmitting the implementation plan directed by section 912(c), the Secretary of Defense committed to undertaking a Department-wide effort to identify changes necessary in the Department's basic management systems. The effort would create processes that allow for valuing goods and services, and for focusing on the value the good or service has over its useful life.

Accordingly, I direct the establishment of a study group, to be led by Mr. William Stussie, Deputy Assistant Secretary of the Navy (Air Programs) to analyze implementation of a price-based acquisition system on a Department wide basis. The charter for the study group is attached. The study group will require bi-weekly participation on a part-time basis. Please forward the names of your study group members to Ms. Karen Dunn, phone (703) 697-6399, fax (703) 614-1690, or e-mail dunnks@acq.osd.mil, within three days of charter approval.

A final report of the study group will be provided to the Under Secretary of Defense (Acquisition & Technology), as specified in the attached charter, by March 1, 1999.

J. S. Gansler

Attachment:
As stated

CHARTER FOR THE PRICE-BASED APPROACH TO ACQUISITION STUDY GROUP

INTRODUCTION AND BACKGROUND

In order for the Department to continue its Revolution in Business Affairs, DoD must eliminate or reduce the differences between the Department and commercial buyers in obtaining goods and services from the national industrial base. DoD needs to do this in order to reduce the price of military products by enabling Defense companies to integrate their military business with their commercial business or potential commercial business, and to ensure greater access to commercial products, technology and services. This will provide the warfighters with the best value goods and services they need to perform their mission.

We have already begun to eliminate the differences by changing the way in which we describe our needs from the use of military specifications and standards to the use of the performance specifications for all new acquisitions. We also have begun to change the way in which we administer contracts that have already been awarded through the Single Process Initiative. The next step is to determine how price-based acquisition (outcome oriented) works in the commercial environment, as opposed to cost-based acquisition (input oriented) and how it can best be used in the DoD environment.

Cost-based acquisition, i.e., contracts that are based on costs incurred or projected to be incurred by the contractor, require the tracking and allocation of costs, often in Government-unique accounting systems, governed by Federal Cost Accounting Standards (CAS) and that an offeror often provides certified cost or pricing data. Both the Government and industry have created and maintained infrastructures to administer the process of determining the allowability and allocability of all contractor costs and compliance with CAS. Defense contractors must maintain a cost accounting system, frequently different from a commercial cost accounting system based on generally-accepted accounting principles, in order to meet the CAS requirements. In addition, there is a need to understand what accounting practices commercial firms use to account for costs and track cost/schedule status and how these practices might fit DoD acquisitions.

Price-based acquisition is the establishment of contractual relationships using price instead of cost. Price may be established by comparisons to prices of other offers, market prices, competitive alternatives, and parametric analysis based on price, rather than cost. Price-based acquisition is a well established approach in the commercial world.

AUTHORITY AND DIRECTION

The Deputy Under Secretary of Defense (Acquisition Reform) is directed to establish a study group to analyze implementation of a price-based approach to acquisition. The study group membership shall include representatives from the Office of the Secretary of Defense staff (including Defense Procurement, the CAIG, Small and Disadvantaged Business Utilization, and the Comptroller), the Military Departments, the Joint Staff, DoD/Inspector General, the Defense Contract Management Command, and the Defense Contract Audit Agency). The Defense Finance and Accounting Service shall review Issues that may have major impacts on the financial accounting and contractor payments in order to identify any costs that may be incurred

in moving to price-based acquisition. Finally, industry representatives shall be asked to provide their views as part of the study process.

STUDY OBJECTIVES

The study group shall determine how to implement a price-based approach to acquisition within DoD. The study group shall be guided by, but not limited to, the following objectives:

- Develop a set of attributes that would be used to determine value in terms of the performance DoD requires. Develop a methodology that describes how those attributes would be managed to support a price-based value determination. Consider how Cost as an Independent Variable or Price as an Independent Variable should be addressed.

- Determine how to price alternative solutions based upon market alternatives without requiring the supplier to justify its price based upon the component costs of the goods or services being offered and without the need to use cost accounting standards. Determine how to track program progress and estimate future program costs without cost data and cost reports. Include consideration of contract modifications, contract changes, claims, work suspensions/stop work orders, terminations, etc.

- Identify alternative acquisition strategy approaches to use price-based acquisition (e.g., incremental development and risk reduction, modular development, dissimilar competition, etc.). Identify alternative contracting approaches to use price-based acquisition (e.g., share-in-savings contracts, level of effort contracts with incentives based on performance, time and materials contracts with incentives, other transactions, fixed price with non-cost incentives, non-cost task and delivery order contracts, etc.). Identify alternative financing approaches to use price-based acquisition (e.g., milestone billings in place of progress payments, other periodic payments tied to performance, etc.).

- Define "best value contracting" in a price-based acquisition environment and discuss appropriate source selection methodology and approaches.

- Assess the impact of the changes to the Federal Acquisition Regulations resulting from the Federal Acquisition Streamlining Act of 1994 on the number of requests for pricing data versus cost data or cost or pricing data.

- Determine how government-furnished property (currently owned or new property) will be handled in price-based acquisition.

- Identify changes needed in statutes, regulations, policies, and practices necessary to implement a price-based approach to acquisition. Provide draft language to implement the necessary changes.

- Identify methods to incentivize the adoption of price-based acquisition and the training needed to change the behavior of the workforce (and industry).

- Identify expected outcomes and metrics for both Government and industry once price-based acquisition is implemented (to include organizational changes, staffing, lead time, savings, cost of implementation, etc.).

- Develop a schedule and funding requirements, including any DFAS required changes, to move to a price-based environment.

- Determine any risks associated with price-based acquisition and when cost-based contracts are appropriate/required.

- Quantitatively evaluate the projected economic benefits of the price-based approach for different types of contracting actions on different contract types (from services through research and development and production).

- Create examples of how to operate in a price-based environment, including the estimated dollar value of benefits from price-based acquisition, using various types of programs including: development programs (to possibly the Joint Strike Fighter (JSF), Advanced Amphibious Assault Vehicle (AAAV)), a modification program, a non-system component, and a contract for services.

SCHEDULE

The study group shall report its conclusions and recommendations to the Under Secretary of Defense (Acquisition & Technology) by March 1, 1999. The study group will provide interim reports on its progress to the Under Secretary of Defense (Acquisition & Technology) each 60 days after the effort begins. A draft report will be prepared for the Under Secretary's review by February 1, 1999.