

**IMPROVEMENTS IN
COST-PLUS-AWARD-FEE PROCESSES ARE
NEEDED TO ENSURE MILLIONS PAID IN FEES
ARE JUSTIFIED**

Department of Transportation

*Report Number: ZA-2010-092
Date Issued: August 25, 2010*



Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation
Office of Inspector General

Subject: ACTION: Improvements in Cost-Plus-Award-Fee
Processes Are Needed To Ensure Millions Paid In
Fees Are Justified
Department of Transportation
Report Number ZA-2010-092

Date: August 25, 2010

From: Lou E. Dixon *Lou Dixon*
Principal Assistant Inspector General for
Auditing and Evaluation

Reply to
Attn. of: JA-60

To: Acting Deputy Assistant Secretary for Administration
Office of the Secretary of Transportation

Ramesh K. Punwani
Assistant Administrator for Financial Services/CFO

As of June 2008, the Department of Transportation (DOT) had 47 open cost-plus-award-fee (CPAF) contracts—contracts that provide financial incentives based on contractor performance. These contracts have a potential maximum value of approximately \$5.5 billion, including over \$271 million in available award-fee pools. While CPAF contracts can encourage excellence in contract performance, they require effective monitoring to ensure contract dollars are spent wisely and award fees are justified based on contractor performance and related expected outcomes.

In December 2007, the Office of Management and Budget's (OMB) Office of Federal Procurement Policy issued guidance to chief acquisition officers and senior procurement executives to review and update their acquisition policies on the appropriate use of incentive contracts, which includes CPAF contracts. Concerns about the use of CPAF contracts across the Government prompted us to examine how DOT's Operating Administrations manage the use of CPAF contracts. Specifically, we:

- (1) assessed award-fee ratings and payments made by Operating Administrations based on documentation used to support them;

(2) evaluated Operating Administrations' award-fee guidance, payment structure, and evaluation criteria; and

(3) identified challenges in DOT's management of CPAF contracts.

To conduct our work, we reviewed relevant policies and guidance, including Federal Acquisition Regulations (FAR), OMB directives, the Federal Aviation Administration's (FAA) Acquisition Management System (AMS), and guidance from other Federal agencies.¹ We reviewed 24 CPAF contracts from 7 Operating Administrations—FAA, Federal Highway Administration (FHWA), Federal Railroad Administration (FRA), Maritime Administration (MARAD), Office of the Secretary (OST), Pipeline and Hazardous Material Safety Administration (PHMSA), and the Research and Innovative Technology Administration (RITA)—to evaluate their design, implementation, and amount of award fees paid. Twenty-one of these contracts were randomly selected from a universe of 41 CPAF contracts as of December 31, 2006; the remaining 3 were follow-on contracts.² The 24 contracts have a potential maximum value of over \$3 billion, including about \$170 million estimated in available award fees.

We conducted this audit in accordance with generally accepted government auditing standards. Exhibit A contains the details of our scope and methodology, including the unique acquisition regulations applicable to DOT and its Operating Administrations.

RESULTS IN BRIEF

Operating Administrations consistently gave contractors high ratings and substantial award fees, totaling about \$15 million for the rating periods we reviewed. However, the ratings associated with \$14 million—or 92 percent—of the award fees lacked sufficient support to demonstrate that the contractor met or exceeded the award-fee evaluation criteria, as OMB guidance directs. On almost all contracts, performance monitors assigned an adjectival rating,³ such as excellent or satisfactory, or a numerical rating without explaining the reasons for the rating. For the majority of contracts where performance monitors documented their support, the examples and comments provided were often too general to determine

¹ Departments of the Army, Navy, and Air Force; the Environmental Protection Agency (EPA); and the National Aeronautics and Space Administration (NASA). We used guidance from these agencies as a benchmark for identifying practices that we considered most beneficial to ensure effective use of award fees. FAA also issued an Award-Fee Contracting Guide in September 2007.

² A new contract that calls for the same supplies and services as a previous contract.

³ Adjectival ratings describe what constitutes each level of performance within each performance category and provide assistance in establishing evaluation criteria.

whether the ratings and award fees were warranted. For example, on a Volpe⁴ contract for a broad range of information technology support services, a performance monitor gave a work assignment a rating of excellent for timeliness of deliverables. The support for this rating was “There were no schedule issues.” The performance monitor did not provide further descriptions relating how the contractor exceeded expectations or timeliness was excellent. Due to these findings, we extrapolated the results of our sample to the universe of 41 DOT CPAF contracts and estimate with 90 percent confidence⁵ that as of December 31, 2007, approximately \$140.6 million was paid in award fees without proper justification, which we therefore identified as unsupported costs.

With the exception of FAA, Operating Administrations lack specific guidance on the use of award-fee contracts. Further, Operating Administrations’ award-fee payment structures provide little incentive for contractors to excel in carrying out the terms of their contracts. For example, 9 of the 10 contracts we reviewed that include a base fee allowed awards ranging from 20 percent to 75 percent of the award-fee pool to be paid for average performance—a practice not allowed by other Federal agencies. In addition, performance evaluation plans⁶ for 13 contracts we reviewed allow awards for below-average results. For example, the contractor on an FHWA contract for non-personnel support services could receive 70 percent of the award-fee pool—more than a half million dollars—for performance slightly below the minimum acceptable standards. Operating Administrations’ performance evaluation plans also used vague criteria, such as “quality and timeliness of deliverables” and “quality of planning,” making it difficult for performance monitors to understand and consistently apply the ratings. In addition, for almost all contracts, the evaluation criteria simply required the contractor to meet normal contract expectations, such as submitting accurate invoices and maintaining an effective relationship with government staff.

We found a number of weaknesses in the management of the Department’s CPAF contracts. First, DOT has not developed adequate training for performance monitors and other personnel involved in the award-fee process. Second, DOT has failed to ensure adequate separation of duties in evaluating contractor performance and awarding fees. Other Federal agencies provide for separation of such duties by requiring evaluation teams to consist of a fee-determining official (FDO), performance evaluation board (PEB), and performance monitors. The PEB is responsible for reviewing the performance monitors’ evaluations, the contractor’s

⁴ Volpe is part of the Research and Innovative Technology Administration (RITA) of the Department of Transportation.

⁵ Relative precision of the estimate is ± 46.3 percent.

⁶ A performance evaluation plan is an important element of a CPAF contract usually containing performance evaluation criteria, the award-fee pool allocated by evaluation period, organizational structure, roles and responsibilities, payment structure (ratings/grades/weights), and the award-fee process.

self-evaluation, and any other information available in order to arrive at an overall objective and impartial position on the contractor's performance. The FDO is independent of the PEB and makes the final decision on the amount of award fee earned. At DOT, however, this is not always the case. In some instances, DOT officials not only assessed contractor performance but also recommended and approved award-fee amounts. At the same time, it is unknown whether DOT's use of CPAF contracts has been appropriate. This is largely because Operating Administrations commit to these contracts without justifying their cost-effectiveness, as required by the FAR and recommended by FAA's AMS, and DOT has not determined whether its CPAF contracts have produced better outcomes than other contract types. Finally, inactive funds on completed CPAF contracts are not always deobligated. About \$4.6 million remained obligated on an FAA contract that had been completed for about 2 years.

Our report makes a number of recommendations that could greatly improve the design, administration, and overall management of DOT's CPAF contracts and therefore, increase the effectiveness of award fees as motivators for excellent contractor performance.

BACKGROUND

Federal agencies use several contract types to acquire a variety of products and services. Contract types are grouped into two broad categories: fixed-price and cost-reimbursement. Cost-reimbursement contracts, which include CPAF contracts, are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use a fixed-price-type contract. Unlike other cost-reimbursable contracts, a CPAF contract provides financial incentives intended to control program risk and encourage excellence in contract performance. The FAR provides that CPAF contracts should be used to achieve acquisition outcomes, such as delivering products and services on time, within cost goals, and with optimal technical results. A CPAF contract allows the Government to evaluate a contractor's performance according to specified criteria and grant an award amount within designated parameters. A contractor may receive a base fee on a CPAF contract regardless of performance. To evaluate contractor performance and determine appropriate award fees, agencies must implement an effective award-fee process.

Within DOT, the Office of the Senior Procurement Executive is responsible for Department-wide acquisition policy and oversight, with the exception of FAA,

which has independent procurement authority.⁷ This includes the oversight for the Transportation Acquisition Regulation (TAR) system, which establishes acquisition policies and procedures that implement and supplement the FAR. For CPAF contracts, DOT personnel conduct periodic—usually semiannual—evaluations of the contractor’s performance against specified criteria, document their observations and conclusions, and then recommend the amount of award fee to be paid. Performance criteria are typically provided in the contract’s performance evaluation plan, which also states the award-fee pool⁸ to be allocated by evaluation period; roles and responsibilities of acquisition and procurement staff, including performance monitors; and a payment structure for computing award-fee amounts.⁹

In December 2007, OMB’s Office of Federal Procurement Policy issued guidance¹⁰ to chief acquisition officers and senior procurement executives to review and update their acquisition policies on the appropriate use of incentive contracts, which includes CPAF contracts. Specifically, the guidance directs them to ensure that award fees are linked to cost, schedule, and other performance outcomes and are not earned if the contractor’s performance is judged to be below satisfactory or does not meet the basic requirements of the contract. OMB guidance instructed agencies to design evaluation factors that motivate contractors to achieve superior results by making clear distinctions in possible award earnings between satisfactory and excellent performance. In addition, guidance from other Federal agencies, such as the Army, does not recommend that contracts with a base fee¹¹ provide an award fee for performance that is deemed satisfactory, as the base fee is intended to compensate such performance. Additionally, provisions in the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009¹² seek to prevent unjustified award fees paid to contractors. The Act also directs that the FAR be amended to provide executive agencies other than the Department of Defense with additional guidance on the use of award fees.¹³

⁷ In the Department of Transportation’s FY 1996 Appropriations Act, Congress provided FAA with broad authority to develop its own acquisition process without having to comply with Federal acquisition laws or regulations. FAA established its Acquisition Management System, a set of policies and guidance designed to address the unique needs of the Agency. FAA updated its AMS (Section T3.2.4, Types of Contracts) to include additional award-fee guidance in July 2008 and January 2010.

⁸ Under a CPAF contract, a pool of money is negotiated in advance, and periodic assessments are made by the Government to determine how much of the award-fee pool will be earned based on contractor performance and attainment of the program goals and objectives.

⁹ Payment structures typically weigh adjectival ratings (such as excellent, fair, and poor) and numeric scores (between 0 and 100).

¹⁰ Office of Management and Budget, *Appropriate Use of Incentive Contracts*, Memorandum for Chief Acquisition Officers and Senior Procurement Executives, December 4, 2007.

¹¹ The base fee is an amount of money (from 0–3 percent of the estimated cost of the contract) fixed at the inception of the contract, which is paid to the contractor for its performance.

¹² Public Law 110-417, Section 867, enacted on October 14, 2008.

¹³ These changes were published in the Federal Register, Volume 74, No. 197, October 14, 2009.

In 2008, we issued four interim reports on problems Operating Administrations have experienced in designing and justifying CPAF contracts. Overall, we found that performance evaluation plans did not include measurable criteria to adequately evaluate contractor performance; descriptions defining adjectival ratings were vague and/or inconsistent and did not clearly define the basis for rating performance; and contracting officials did not justify the cost effectiveness of selecting a CPAF contract. Exhibit B briefly summarizes these reports.

CONTRACTOR RATINGS ARE NOT ADEQUATELY SUPPORTED TO JUSTIFY SUBSTANTIAL AWARD-FEE PAYMENTS

Despite the significant award-fee payments made to contractors, Operating Administrations often did not demonstrate that the payments were warranted. We reviewed a total of 24 contracts; however, rating periods were not yet completed for 2 contracts. For the 22 contracts we reviewed with completed rating periods, only 2 had sufficient documentation supporting performance monitors' evaluations and ratings, and 3 had no assigned ratings even though the rating period ended and such ratings were required. The remaining 17 contracts lacked adequate support to determine whether the assigned ratings and the resulting award fees were justified. For some contracts, performance monitors did not provide comments or examples to support their adjectival or numeric ratings¹⁴ or to indicate key evaluation criteria were satisfied. For those contracts where performance monitors did provide narrative to support ratings, the comments or examples were general and lacked the detail needed to demonstrate the ratings were warranted. For example, support for 285 of 310 "superior" ratings on a MARAD contract¹⁵ included comments such as "most pleased with the progress and quality of work to date" and "the contractor has overcome obstacles and made it work." Despite this vagueness, MARAD paid the contractor 99 percent (about \$142,000) of the available award-fee pool over the two rating periods in our sample.

In a 2008 report on FAA's System Engineering and Technical Assistance II (SETA II) contract,¹⁶ we noted that FAA no longer required performance monitors to provide detailed comments on contractor performance—including identifying specific strengths, weaknesses, and deficiencies—although it continued to

¹⁴ Adjectival ratings are terms such as "excellent" and "satisfactory"; numeric ratings use a scale of 1 to 4.

¹⁵ The MARAD contract was for comprehensive support services to maintain and enhance logistics programs. Performance areas included quality/timeliness of work, effectiveness in controlling and/or reducing cost, integration/coordination of effort, and effectiveness of program management.

¹⁶ Report Number FI-2009-002, "Interim Report on Award-Fee Criteria for the System Engineering and Technical Assistance II Contract," dated October 7, 2008. All OIG reports and testimonies can be viewed on our website at: www.oig.dot.gov.

encourage monitors to do so.¹⁷ While it is unclear to what extent performance monitors continue to provide detailed comments on FAA's CPAF contracts, we could not find adequate documentation for the SETA II contract to support the contractor's consistently high ratings and award fees—approximately \$2 million or 90 percent of the available award-fee pool for two completed rating periods.

Table 1. Percentage of Award Fees Paid for Rating Periods Reviewed

Operating Administration	Available Award-Fee Pool	Amount of Award Fee Paid	Percentage of the Available Award-Fee Pool Paid
PHMSA	\$29,212	\$29,212	100%
FAA	\$10,315,731	\$9,740,490	94%
MARAD	\$486,103	\$453,731	93%
FHWA	\$397,660	\$370,995	93%
FRA	\$71,806	\$61,467	86%
RITA	\$5,097,965	\$4,353,537	85%
OST	\$81,325	\$66,687	82%
Total:	\$16,479,802	\$15,076,118	91%

For the ratings we reviewed, Operating Administrations paid contractors about \$15 million of the \$16.5 million (about 91 percent) of available award fees (see table 1). However, the ratings associated with \$14 million of the award fees lacked adequate support to determine whether the assigned ratings and resulting award fees paid were justified. Due to these findings, we extrapolated the results of our sample to the universe of 41 DOT CPAF contracts and estimate with 90 percent confidence¹⁸ that as of December 31, 2007, approximately \$140.6 million was paid in award fees without proper justification, which we therefore identified as unsupported costs.

OPERATING ADMINISTRATIONS' AWARD-FEE PROCESSES PROVIDE LITTLE CONTRACTOR INCENTIVES

Operating Administrations' award-fee processes do not support the goal of motivating contractors to excel in carrying out the terms of the contract. Unlike other Federal agencies, DOT, with the exception of FAA, has little to no guidance on the use of award fees. Most Operating Administrations' payment structures allow for award-fee payments for average or below-average performance.

¹⁷ According to an FAA senior official, removing the documentation requirement was intended to increase the number of evaluation responses submitted by performance monitors, and the response rate has since increased. We did not verify this.

¹⁸ Relative precision of the estimate is ± 46.3 percent.

Operating Administrations' performance plans also lacked clear evaluation criteria, leaving ratings open to interpretation.

Lack of Specific Guidance on the Use of CPAF Contracts Underlies Inappropriate Performance Ratings and Award Payments

Senior acquisition officials at DOT and FAA acknowledged that specific award-fee guidance is needed to ensure CPAF contracts achieve acquisition outcomes. However, DOT's TAR does not provide specific award-fee guidance. For example, the TAR does not instruct contracting officials to make clear distinctions between satisfactory and excellent performance, nor does it state that award fees should not be paid to contractors whose performance is judged to be below satisfactory or does not meet the basic requirements of the contract. The guidance also lacks clarity on how to link performance outcomes—such as cost and schedule—to award fees.

Operating Administrations' large award-fee payments to contractors who perform satisfactorily are mainly the result of a lack of detailed guidance and training on how to design and administer CPAF contracts. DOT's Office of the Senior Procurement Executive has yet to issue new or update existing policies in accordance with OMB's December 2007 memorandum calling for chief acquisition officers and senior procurement executives to review and update their acquisition policies. DOT's TAR, which includes general guidance on the use of CPAF contracts, was last revised in April 2005; the section on performance evaluation plans has not been updated since October 1994. In contrast, other agencies have developed guidance that explicitly states how to properly administer CPAF contracts. For example, NASA and the Departments of the Air Force, Army, and Navy state that performance monitors should observe contractor performance based on the criteria specified in the performance evaluation plan and document results by giving specific examples to support their conclusions.

Operating Administrations' Payment Structures Do Not Adequately Discriminate Between Poor, Satisfactory, and Excellent Contractor Performance

To encourage contractor excellence, OMB guidance states that there should be clear distinctions in possible award earnings between satisfactory and excellent performance. OMB guidance further states that no award fee should be paid for performance that does not meet contract requirements or is judged to be unsatisfactory. NASA and the Department of the Army have developed guidance that similarly states that poor performing contractors should not be paid an award fee. Guidance from NASA and the Departments of the Air Force and Army further

states that contracts with a base fee¹⁹ should not provide an award fee for performance that is deemed satisfactory, as the base fee is intended to compensate such performance.²⁰

Despite OMB guidance and best practices from other Federal agencies, Operating Administrations continue to allow contractors to earn award fees without performing at a level that is acceptable to the Government under the terms of the contract. Specifically, the performance evaluation plans for 13 contracts reviewed allow award-fee payments for below-average results. For example, the payment structure for FHWA's Long-Term Pavement Performance Studies-Southern Regional Support contract—a 5-year contract for non-personnel support services—allows the contractor to receive up to 70 percent of the fee for poor performance. Ultimately, the contractor could receive over \$555,000 of the available award fee over the life of the contract without meeting the contract's terms. This type of payment structure not only allows contractors to receive substantial payments for poor performance, it leaves little in the award-fee pool to encourage contractors to meet or exceed expectations and achieve desired contract outcomes. In the FHWA contract, less than \$240,000 is available to motivate the contractor to carry out the contract's terms.²¹

Operating Administrations also developed payment structures that allow compensation for satisfactory performance on contracts with a base fee, which already award for satisfactory performance. Specifically, 9 of the 10 contracts we reviewed that include a base fee allow significant award fees to be paid for satisfactory performance in addition to the base fee—essentially rewarding the contractor twice for satisfactory performance. For example, FAA's payment structure for an engineering, technical, and administrative support contract for civilian and military aircraft guidance and surveillance systems currently allows the contractor to earn an award fee for "good" performance—which the contract defines as meeting contract requirements with some weaknesses—in addition to the received base fee of \$1.7 million. The payment structure would allow up to 72.5 percent, about \$3 million, of the award-fee pool for good performance, leaving only about \$1 million to motivate performance that exceeds expectations.

Vague Evaluation and Award-Fee Criteria Make It Difficult for Monitors to Appropriately Rate Contractor Performance

Clear evaluation criteria are critical to ensuring award fees are commensurate with contractor performance. Without clearly defined metrics and outcomes,

¹⁹ The base fee is an amount of money (from 0–3 percent of the estimated cost of the contract) fixed at the inception of the contract, which is paid to the contractor for its performance.

²⁰ The Department of Defense has also issued a policy memorandum to improve the design and strengthen controls over use of CPAF contracts.

²¹ For this contract, we did not document any instances where the contractor was paid award fees for poor performance.

performance ratings are open to subjective interpretation and can result in unsupported contractor performance evaluations and awards. Accordingly, OMB guidance calls for CPAF contracts to establish specific performance objectives prior to contract award, such as delivering products and services on time, within cost goals, and of a stated level of quality. OMB guidance also states that awards must be tied to demonstrated results, as opposed to effort, in meeting or exceeding specified performance standards. Guidance from NASA and the Departments of the Air Force, Army, and Navy similarly indicates that using measurable criteria to evaluate contractor performance is preferred and warns that using broad evaluation criteria can result in monitors being unable to provide meaningful comments to support ratings.

None of the evaluation plans for the 24 DOT contracts we reviewed had clear and measurable criteria to evaluate contractor performance. For example, the plan for FHWA's Adaptive Control Software contract includes vague phrases such as "quality and timeliness of deliverables;" "quality of planning;" "effectiveness of cost and business management;" and "timeliness and quality of financial reports, processing of contract modifications, and compliance with contract clauses" as standards to measure technical performance, schedule management, and cost management.

For 23 contracts, the adjectival rating²² descriptions in the performance evaluation plans were vague and/or inconsistent and did not clearly define the basis for assigning such a rating, making it difficult for monitors to determine the appropriate rating of the contractor's performance. For example, Volpe's TRIPS contract,²³ which provides for a broad range of information technology support services, uses phrases such as "above standard," "highly effective results," and "timely manner" as standards for a rating of very good. Discussions with eight performance monitors revealed that each had a different interpretation on how to apply these ratings to contractor performance. One performance monitor interpreted a very good rating as the contractor performing only minor rework, while another interpreted the rating as the contractor performing "above and beyond meeting the requirements." Interpretations of an excellent rating also varied. For example, one performance monitor stated that excellent equated to having one error on a task, while another stated that it equated to having three errors on a task. Inconsistent interpretations of adjectival rating descriptions significantly increase the risk of the Government overpaying or unfairly distributing award fees.

²² Adjectival ratings describe what constitutes each level of performance within each performance category and provide assistance in establishing evaluation criteria.

²³ Report Number FI-2008-070, "Interim Report on Award-Fee Criteria for the Transportation Information Project Support Contract," dated August 14, 2008.

For 21 contracts, Operating Administrations simply required the contractor to meet basic contract requirements. For example, in May 2008, we reported that FAA's National Airway Systems contract required the contractor to assign qualified personnel to accomplish the work—a standard expectation, which normally does not merit an award.²⁴ Guidance from the Departments of the Army and the Air Force states that award-fee criteria should focus on the most important aspects of the procurement that will motivate the contractor to perform in an exceptional manner.

DOT'S MANAGEMENT OF CPAF CONTRACTS FACES MANY CHALLENGES

The Department has not effectively managed its CPAF contracts. DOT lacks sufficient training and has failed to ensure adequate separation of duties for employees responsible for administering CPAF contracts. At the same time, it is unknown whether DOT's use of CPAF contracts has been appropriate. This is largely because Operating Administrations commit to contracts without justifying their cost-effectiveness, as required by the FAR and recommended by FAA's AMS, and DOT has not determined whether its CPAF contracts have produced better outcomes than other contract types. Finally, inactive funds on completed CPAF contracts are not always deobligated in a timely manner, leaving funds idle when they could be used for other purposes. Together, these challenges raise significant concerns about the appropriateness and equity of award-fee payments.

Inadequate Training on the Use of CPAF Contracts Has Resulted in Errors That Make it Difficult To Manage CPAF Contracts

DOT does not provide adequate training on the use of CPAF contracts. The Department of the Air Force recommends that such training provide a clear understanding of the award-fee process; performance evaluation plans; roles and responsibilities; documentation requirements; and evaluation techniques, including gathering information related to specific criteria, techniques to be used, and frequency of observations. Based on our reviews of evaluation documents and interviews with some performance monitors, we concluded that this type of training for CPAF contracts is not currently in place. For example, performance monitors were unaware of requirements to provide documentation to support their ratings and provisions to make certain modifications to performance evaluation plans. Training is also critical given that contracting actions change hands quickly as staff leave or are reassigned, and contracting personnel have become less familiar with contracts assigned to them.

²⁴ Report Number FI-2008-054, "Interim Report on Award-Fee Criteria for the National Airway Systems Contract," dated May 28, 2008.

The need for training is especially apparent at FAA. FAA issued an Award-Fee Contracting Guide in September 2007, which mirrors NASA's Award-Fee Contracting Guide. The guide states that using outcome-based factors is preferred because they are better indicators of performance. However, we found that some FAA contracting and program officials were unaware of FAA's Award-Fee Contracting Guide, and the contract actions we reviewed did not always demonstrate use of award-fee criteria outlined in the guide. In February 2008, we reported that the award-fee criteria for FAA's follow-on National Airspace System Implementation Support (NISC) II contract were vague and not linked to acquisition outcomes.²⁵

Overlapping Award-Fee Responsibilities Create Additional Risks

To minimize the risk of fraud, waste, and abuse in Federal contracting, OMB Circular A-123 requires that key responsibilities in authorizing, processing, recording, and reviewing official agency transactions be separated among individuals performing these duties. The Departments of the Air Force and Army have guidance that underscores OMB's circular. Specifically, their guidance states that it is especially important for all personnel to understand the overall evaluation process and their specific roles and responsibilities within their agency to evaluate the contractor's performance. FAA's award-fee guide similarly indicates that a three-level organizational structure should generally be employed using separate individuals for performance monitor, PEB, and FDO duties.

However, on half of the DOT Operating Administrations' contracts we reviewed, personnel simultaneously fulfilled multiple key roles in the award-fee process, such as performance monitor, voting member on PEB, and FDO. For example, on two MARAD contracts for logistics support, the performance evaluation plans designated employees to act as performance monitors as well as members on the PEB. For both contracts, the PEB Chairperson was also a performance monitor. In other words, performance monitors are reviewing their own ratings. Allowing personnel to simultaneously carry out both performance monitor and PEB responsibilities exacerbates the risks inherent to CPAF contracts because the PEB is expected to provide an objective assessment of the contractor's overall performance based on performance monitors' evaluations, contractors' self-evaluations, and any other information available in order to recommend the earned award-fee amount.

²⁵ Report Number FI-2008-027, "Interim Report on Award-Fee Criteria for the National Airspace System Implementation Support II Contract and Bridge Contract," February 27, 2008.

DOT's CPAF Contracts Are Entered Into Without Sufficient Knowledge About Their Appropriateness

While CPAF contracts can provide incentives to spur innovation and reduce costs, they require greater effort and more resources than other contract types to monitor and document contractor performance. Before committing to this contract type, the FAR²⁶ requires, and FAA's AMS recommends, that agencies justify the cost-effectiveness of a CPAF contract. OMB reinforced this requirement by directing contracting officers to conduct and document risk and cost-benefit analyses when determining whether to use CPAF contracts.²⁷ NASA and the Departments of the Army, Air Force, and Navy similarly recommend justifying the use of these contracts. Specifically, they require their agencies to conduct a cost-benefit analysis to ensure that the benefits gained through a CPAF contract outweigh the additional costs of overseeing and administering the contract.

None of the 24 contracts we reviewed provided justification on the cost-effectiveness of selecting a CPAF contract. For example, in May 2005, FHWA awarded an approximately \$21 million contract—which includes both CPAF and cost-plus-fixed-fee line items—without justification. According to FHWA officials, they lacked the resources to adequately evaluate contractor performance—and consequently did not pay an award fee—raising questions as to whether the CPAF portion of the contract was appropriate to begin with.

In September 2007, FAA issued an award-fee guide calling for a consideration of the costs and benefits of using CPAF contracts because of the cost and administrative burden involved. In May 2008, we reported that FAA's National Airway Systems contract—awarded a few months before the new guidance was issued—had not evaluated the administrative costs to justify its use of a CPAF contract.²⁸ In response to our audit and recommendations, FAA determined that the cost and time required to oversee, monitor, and document the award-fee process outweighed the potential benefits of the contract and therefore, changed the contract to a cost-plus-fixed-fee contract. However, FAA did not justify the costs for a CPAF contract awarded after the guidance was issued. Specifically, in February 2008, FAA awarded a \$234 million follow-on bridge contract to its NISC II contract without justifying its cost-effectiveness. According to FAA contracting

²⁶ As of October 14, 2009, the FAR explicitly requires agencies to perform and document a risk and cost-benefit analysis to justify any additional administrative effort and cost required to monitor and evaluate performance (FAR 16.401). Prior to this revision, the FAR limited use of CPAF contracts to where the contract amount, performance period, and expected benefits were sufficient to warrant the additional administrative effort and cost involved (FAR 16.405-2(c)(2), as of October 1, 2009). The FAR also required that the contracting office contract file include acquisition planning information (FAR 4.803); and an acquisition plan must include a discussion of contract-type selection (FAR 7.105).

²⁷ Office of Management and Budget, *Appropriate Use of Incentive Contracts*, Memorandum for Chief Acquisition Officers and Senior Procurement Executives, December 4, 2007.

²⁸ Report Number FI-2008-054, "Interim Report on Award-Fee Criteria for the National Airway Systems Contract," dated May 28, 2008.

and program officials, it was too late in the evaluation process to change the contract type.

Contracting officials cited three reasons for not justifying their use of CPAF contracts:

- They were unaware of FAR and FAA requirements to provide justification.
- The FAR and FAA did not specifically require a cost-benefit analysis.
- Individuals who made the decision to use a CPAF contract are no longer with the responsible contracting office.

In addition to Operating Administrations not justifying their use of CPAF contracts, DOT has not conducted analyses to determine whether its CPAF contracts actually produce better outcomes than other contract types might have. Without such analyses, DOT cannot ensure that its CPAF contracts are the most beneficial to the Government.

Inactive Funds on Completed CPAF Contracts Run the Risk of Not Being Deobligated

Obligations²⁹ that are no longer needed or exceed estimated needs should be deobligated and made available to fund other projects. The timely deobligation of funds could result in real time savings to DOT and can also be used to fund other DOT priorities. However, about \$4.6 million in obligations on one contract we reviewed—FAA’s University of Oklahoma contract for air traffic controller training—remained outstanding after the contract ended in July 2006. Specifically, work was completed on the contract, yet unexpended balances, including award fees, were not released. Further, FAA awarded a follow-on contract for the same services in August 2006. We notified FAA about this issue in February and September 2008, and FAA acknowledged it had not deobligated the funds. Soon after our second notification, FAA made several transactions to deobligate all but approximately \$42,000, which was needed to close out the contract.

This example by itself does not indicate a systemic problem but may suggest that other CPAF contracts can run the same risk of not deobligating inactive funds, warranting Operating Administrations to better manage this process.

²⁹ An obligation represents a liability that is created when an agency enters into a binding legal agreement, such as a CPAF contract.

CONCLUSION

When award fees are tied to performance, CPAF contracts can encourage contractors to reduce costs, stay on schedule, and achieve acquisition outcomes, mitigating risk to the Government. However, based on the contracts reviewed, there is almost no assurance that the significant award fees paid to contractors are commensurate with actual performance. Further, DOT and FAA's current practices do not establish a rigorous process for effective design, implementation, and payment of award fees. As a result, these award fee practices provide little incentive for contractors to meet minimum contract requirements, much less exceed them. Until DOT and FAA take action to ensure contracting officials effectively design and implement CPAF contracts, the Department will continue to put taxpayer dollars at risk.

AGENCY ACTIONS

FAA and Volpe provided written comments on our 2008 interim reports that describe the agencies' vague and/or inconsistent adjectival rating descriptions, performance evaluation plans that do not include measurable criteria to adequately evaluate contractor performance, and lack of justification on the cost effectiveness of selecting a CPAF contract. In their comments, both FAA and Volpe concurred with all recommendations made in those reports and to date, have completed all corrective actions.

RECOMMENDATIONS

We recommend that the Senior Procurement Executive:

1. Update or expand the TAR guidance to:
 - a. Develop specific award-fee criteria for assessing contractor performance by providing more measurable and outcome-based criteria linked to acquisition outcomes.
 - b. Define adjectival ratings so there will be a clear basis for assessing performance and ratings consistent with the grading table.
 - c. Develop award-fee payment structures that 1) incentivize excellent contractor performance and 2) prohibit contractors from receiving award fees (when a base fee is included) for simply meeting contract requirements or for performance that is judged to be unsatisfactory.
 - d. Establish clear division of responsibility for the evaluation team (FDO, PEB, performance monitors) and prohibit the same official from performing multiple roles.

- e. Require performance monitors to document the basis for performance ratings or scores given and include specific examples of strengths and weaknesses.
 - f. Conduct a cost-benefit analysis in choosing a CPAF contract and document how the benefits will offset the additional cost associated with administering such a contract.
2. Deobligate funds from CPAF contracts that have ended or from completed rating periods with unused award fees.
 3. Train contracting and program office personnel on designing and administering CPAF contracts consistent with revised guidance.
 4. Develop performance measures to evaluate the effectiveness of award fees as a tool for improving contractor performance and achieving desired program outcomes.

We recommend that the Vice President of Acquisition and Business Services, FAA:

5. Establish a process for monitoring implementation of FAA's Acquisition Management System and Award-Fee Contracting Guide.
6. Train contracting and program office personnel on designing and administering CPAF contracts, emphasizing future prevention of the types of deficiencies noted in this report.
7. Deobligate about \$4.6 million in obligations on the University of Oklahoma contract for air traffic controller training (DTFA02-01-D-03699).
8. Deobligate funds from CPAF contracts that have ended or from completed rating periods with unused award fees.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided a draft of our report to OST and FAA, with separate recommendations to each. In a consolidated response from OST, FAA concurred with our recommendations targeted for FAA. OST concurred with two of our recommendations for OST and partially concurred with the other two—recommendations 1 and 4. We acknowledge that the Department has reduced its use of CPAF contracts considerably since our assessment, and we encourage continued careful use of these types as they present significant cost risk to the

government and taxpayers. The agency's response and our sustained position with regard to our recommendations are detailed below.

For recommendation 1, OST stated that rather than modify the TAR, it will develop a CPAF Guidebook incorporating planning, implementation, and administration of CPAF contracts based on guidance available from best practice agencies. According to OST, the guidebook, along with training, will meet the intent of our recommendation—to ensure Operating Administrations obtain detailed guidance on how to design and administer CPAF contracts. Because OST does not plan to implement its guidebook before July 2011, we are asking the Acting Deputy Assistant Secretary for Administration to ensure acquisition officials involved with the administration of CPAF contracts are aware of the new FAR 16.4 requirements for award-fee contracts.

For recommendation 4, OST stated that its reduction in the use of CPAF contracts and the absence of a control group makes it difficult to determine CPAF effectiveness based on performance measures. The intent of our recommendation was to ensure DOT complies with the FAR, which now requires agencies to include performance measures to evaluate if award fees are an effective tool for improving contractor performance and achieving desired program outcomes (FAR 16.401(f)). Because OST's response does not provide assurance that OST will implement this FAR requirement, we are asking the Acting Deputy Assistant Secretary for Administration to provide us more details on the specific actions OST will take to implement the recommendation—such as describing whether OST or Operating Administrations will develop performance measures and confirming whether the requirement will be incorporated in the guidebook—as well as a timeframe for implementation.

Despite concurring with many of our recommendations, OST raised several concerns with our findings. First, OST notes that our draft report overstated FAR's requirement to complete a cost-benefit analysis before selecting a CPAF contract. We found that a cost-benefit analysis was not performed for any of the 24 CPAF contracts we reviewed and, therefore, concluded that Operating Administrations have committed to CPAF contracts without justifying their cost effectiveness. OST believes that our conclusion calls for an evaluation of full costs and benefits of CPAFs versus other alternatives. However, our report does not call for such an evaluation. Instead, it recommends that OST contracting officials complete a cost-benefit analysis to determine whether use of a CPAF contract justifies the added costs to administer and monitor the contract effectively.

Second, OST disagreed with our statement that Operating Administrations allowed large award-fee payments for contractors who perform satisfactorily because the

FAR currently states that up to 50 percent of the award-fee pool can be earned for satisfactory performance. However, we found that Operating Administrations allowed contractors to earn more than 50 percent of the available award-fee pool for satisfactory performance. Specifically, in 9 of the 10 contracts we reviewed that include a base fee, Operating Administrations also allowed contractors to earn award fees over 50 percent and up to 75 percent of the available award-fee pool for satisfactory performance. The FAR states that a CPAF contract "is a cost-reimbursement contract that provides for a fee consisting of (1) a *base amount fixed at inception of the contract*, if applicable...and (2) *an award amount that the contractor may earn* in whole or in part during performance and that is sufficient to provide motivation for excellence in the areas of cost, schedule, and technical performance." Best practices used throughout the Federal Government recommend that contracts with a base fee—a fixed amount that the contractor earns for satisfactory performance—should not provide an award fee for performance that is deemed satisfactory since this would essentially reward the contractor twice for satisfactory performance.

OST also questioned our finding that \$14 million of the award fees for CPAF contracts we reviewed lacked adequate support to determine whether assigned ratings and resulting awards were justified. Accordingly, OST did not agree with our estimated \$140.6 million in unsupported award fees. Our extrapolation is based on the results of our review of 22 contracts, which identified that 17 contracts lacked adequate documentation to support performance monitors' ratings. Without detailed performance monitors' reports and examples, the Department is forced to rely on contractors' self-assessments and high-level assessments to recommend award fees, which could result in overstated award fees. Without sufficient documentation from the performance monitors, we could not determine whether the high fees awarded were justified. We estimated the magnitude of the unsupported payments for all contracts in the universe with 90 percent confidence³⁰ to determine the impact of the unavailable or inadequate documentation.

Finally, OST commented that our draft report does not recognize that the TRIPS contract rating panel provided detail to substantiate their ratings. While we reviewed panel rating reports, we focused on the lack of rating support from their performance monitors, who are responsible for observing contractor performance, documenting results, and justifying their conclusions. We found performance monitors simply selected a rating, such as excellent or satisfactory, without explaining the reason or providing examples, or provided comments that were too general to demonstrate whether the contractor complied with the criteria. Given that members of the contract rating panel subsequently review the performance

³⁰ Relative precision of the estimate is ± 46.3 percent.

monitors' evaluations for dozens of task orders performed during any period, it is critical that evaluations be as specific and detailed as possible.

It should be noted that during our review, we identified critical conditions on specific CPAF contracts, which we presented to the Department in four interim reports between February and October 2008. We worked with contracting and program officials who concurred with our findings and implemented corrective actions to ensure that pending awards for new CPAF contracts were designed to encourage contractors to perform efficiently and effectively.

DOT's current CPAF contracts and contracts with significant CPAF provisions are valued at approximately \$5.4 billion. Considering the significance of these contracts, we will closely monitor OST's actions implementing our recommendations.

ACTIONS REQUIRED

In accordance with Department of Transportation Order 8000.1C, we request that you provide a response within 30 days to this report that clearly indicates how you will resolve Recommendations 1 and 4. You may provide alternative courses of action that meet the intent of Recommendations 1 and 4, and indicate the specific actions planned and the target dates for completion.

We appreciate the courtesies and cooperation of DOT representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-1427 or Terry Letko, Acting Assistant Inspector General for Acquisition and Procurement Audits, at (202) 366-2001.

cc: Assistant Secretary for Administration
Federal Aviation Administrator
Associate Administrator, Regions and
Center Operations, FAA
Vice President of Acquisition and
Business Services, FAA
Martin Gertel, M-1
Anthony Williams, ABU-1

EXHIBIT A. SCOPE AND METHODOLOGY

We conducted this audit in accordance with generally accepted government auditing standards.³¹ Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted this audit between June 2007 and May 2010. We reviewed Federal Acquisition Regulations (FAR), Transportation Acquisition Regulations (TAR), and guidance from other Federal agencies (Departments of the Army, Navy, and Air Force; Environmental Protection Agency; and the National Aeronautics and Space Administration) to identify practices that we considered most beneficial in helping ensure effective use of award fees.

In addition, we reviewed FAA's Acquisition Management System (AMS), which establishes acquisition policies and procedures for FAA. FAA adheres to its AMS Guidance in place of the TAR. We also reviewed FAA's Award-Fee Contracting Guide issued in September 2007.

In addressing our objectives, we performed the following steps for the contracts we reviewed:

- Obtained a copy of the contract and other documentation pertaining to the award-fee process.
- Interviewed the contracting and program officials for each contract.
- Performed a detailed review of a minimum of two rating periods for each contract.
- Held meetings with contracting and program officials throughout the audit regarding our analysis of contracts and DOT's process for managing them.

CPAF contracts are used by 7 of the 13 Operating Administrations that make up DOT. As of December 31, 2006, DOT had 41 open CPAF contracts with a potential maximum value of approximately \$3.4 billion, including about \$171 million in available award fees.

From that universe of open CPAF contracts, we reviewed a randomly selected sample of 21 CPAF contracts with a potential maximum value of about \$2.5 billion, including about \$144 million estimated as the available award-fee

³¹ The audit completion date was delayed due to the issuance of four interim reports on individual CPAF contracts. See exhibit B.

pool.³² We also reviewed three follow-on contracts³³ in addition to those randomly selected, which totaled approximately \$572 million, including about \$26 million in available award fees. The total number of CPAF contracts reviewed was 24 (see table 2).

Originally, we selected a statistical sample of 30 out of a universe of 44 CPAF contracts. We reviewed the sampled contracts and found that three were not CPAF contracts. Due to this finding, we verified with Operating Administrations that all remaining 41 contracts in the universe were CPAF contracts. Based on management's decision, we reviewed the first 21 contracts in our sample. From these 21 sampled contracts, we subsampled 46 of 213 rating periods (22 percent) using a fixed-interval method. Only 1 contract had documentation to support performance awards, 3 contracts had not paid any performance awards, and the remaining 17 contracts did not have sufficient documentation to support performance awards. Because 3 contracts had not paid any award fees, we reviewed the ratings for 40 rating periods. Ultimately, out of the \$14.3 million paid on the 21 contracts during the 40 rating periods we reviewed, the amount of unsupported awards totaled \$13.9 million (97.1 percent). Based on the results of our sample, we estimate with 90 percent confidence³⁴ that approximately \$140.6 million was paid in award fees as of December 31, 2007, without proper justification, thus identified as unsupported costs.

In addition, due to significant and ongoing deficiencies found in the 21 contracts randomly selected, we also reviewed three follow-on contracts related to three contracts in our random sample. For two of the follow-on contracts, we found that rating periods were not yet completed. For the remaining one follow-on contract, we selected and reviewed 2 rating periods and found documentation to support performance awards. The amount paid and supported on these three follow-on contracts totaled \$738,117.

³² Under a CPAF contract, a pool of money is negotiated in advance, and periodic assessments are made by the Government to determine how much of the award-fee pool will be earned based on contractor performance and attainment of the program goals and objectives.

³³ A new contract that calls for the same supplies and services as a previous contract.

³⁴ Relative precision of the estimate is ± 46.3 percent.

Exhibit A. Scope and Methodology

Table 2. DOT Operating Administrations' CPAF Contracts Reviewed

Operating Administration	Number of CPAF Contracts Reviewed
Federal Aviation Administration (FAA)	7
Federal Highway Administration (FHWA)	7
Federal Railroad Administration (FRA)	1
Maritime Administration (MARAD)	3
Office of the Secretary Administration (OST)	1
Pipeline and Hazardous Material Safety Administration (PHMSA)	1
Research and Innovative Technology Administration (RITA)	4
Total CPAF Contracts Reviewed	24

EXHIBIT B. INTERIM REPORTS

OIG Report Number FI-2008-027, “Interim Report on Award-Fee Criteria for National Airspace System Implementation Support II Contract and Bridge Contract,” February 27, 2008.

Our report on the National Airspace System Implementation Support II contract (NISC II) demonstrated that FAA did not structure and implement the ongoing NISC II CPAF contract in a way that effectively motivated the contractor to improve performance and achieve acquisition outcomes—defined in terms of program costs, schedule, and performance. Additionally, FAA contracting officials did not justify the cost effectiveness of selecting a CPAF contract by evaluating administrative costs versus expected benefits to the Government. FAA contracting and program officials are implementing actions to meet the intent of our recommendations by clearly identifying measurable award-fee criteria for assessing contractor performance and linking the criteria to acquisition outcomes. Implementing the planned corrective actions will put approximately \$18 million in expected award fees for the bridge contract to better use by ensuring that FAA’s contract objectives are being met. We also recommend FAA acquisition officials reevaluate the use of CPAF contracts for future NISC procurements.

OIG Report Number FI-2008-054, “Interim Report on Award-Fee Criteria for the National Airway Systems Contract,” May 28, 2008.

Our report on FAA’s National Airway Systems contract demonstrated that contracting officials did not justify the cost effectiveness of selecting a CPAF contract by evaluating administrative costs versus expected benefits to the Government. Without this evaluation, the Aeronautical Center had no assurance that a CPAF contract was appropriate. Additionally, the performance evaluation plan did not include measurable criteria needed to adequately evaluate contractor performance. Further, a portion of the award-fee criteria required the contractor to merely comply with basic contractual requirements. The performance evaluation plan allowed award-fee payments up to 72.5 percent of the award-fee pool for average or below results. The problems cited in this report existed, in part, because Aeronautical Center personnel did not have detailed guidance on how to structure performance evaluation plans to incentivize contractors. FAA contracting and program officials agreed to select another contract type more suitable for obtaining engineering and technical support and revise Aeronautical Center guidance. Implementing the planned corrective actions will put approximately \$199 million in remaining contract funds to better use.

OIG Report Number FI- 2008-070, “Interim Report on Award-Fee Criteria for the Transportation Information Project Support Contract,” August 14, 2008.

Our report on the Volpe National Transportation Systems Center’s Transportation Information Project Support (TRIPS) contract demonstrated that the performance evaluation plan did not include measurable criteria needed to adequately evaluate contractor performance. Further, descriptions defining adjectival ratings were vague and inconsistent and did not clearly define the basis for rating performance. This resulted in performance monitors arbitrarily determining which ratings they believed best reflected how well the contractor performed. Additionally, contracting officials did not justify the cost effectiveness of selecting a CPAF contract by evaluating administrative costs versus expected benefits to the Government. Without this evaluation, Volpe had no assurance that a CPAF contract was appropriate. Senior Volpe officials are implementing actions to meet the intent of our recommendations by clearly identifying measurable award-fee criteria for assessing contractor performance. Implementing the planned corrective actions will put approximately \$4 million in expected award fees to better use.

OIG Report Number FI-2009-002, “Interim Report on Award-Fee Criteria for the System Engineering and Technical Assistance II Contract,” October 7, 2008.

Our report on FAA’s System Engineering and Technical Assistance II contract demonstrated that the performance evaluation plan did not include measurable criteria needed to adequately evaluate contractor performance. Further, descriptions defining adjectival ratings were vague and did not clearly define the basis for rating performance, and performance evaluators were not required to document the rationale for the performance ratings. This allows for unsupported personal opinions for judging contractor performance. Additionally, contracting officials did not justify the cost effectiveness of selecting a CPAF contract by evaluating administrative costs versus expected benefits to the Government. Without this evaluation, FAA had no assurance that a CPAF contract was appropriate. Senior FAA contracting and program officials are implementing actions to meet the intent of our recommendations. Implementing the planned corrective actions will put approximately \$8 million in expected award fees to better use.

EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

<u>Name</u>	<u>Title</u>
Terrence Letko	Program Director
Dory Dillard-Christian	Project Manager
Chris Minovich	Senior Auditor
Stacie Seaborne	Senior Analyst
Jelilat Ojodu	Auditor
Narja Hylton	Auditor
Petra Swartzlander	Statistician
Krista Kietrys	Writer-Editor

APPENDIX. AGENCY COMMENTS



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Memorandum

ACTION: Management Response to OIG Draft Report,
Subject: “Improvements in Cost-Plus-Award-Fee Processes Are
Needed To Ensure Millions Paid In Fees Are Justified”

Date: June 17, 2010

From: Linda J. Washington 
Assistant Secretary for Administration

Reply to
Attn. of:

To: Mark H. Zabarsky
Assistant Inspector General for
Acquisition and Procurement Audits

The OIG draft report overstates the issues associated with the use of Cost Plus Award Fee (CPAF) contracts at DOT and relies upon arguments that do not always provide complete substantiation, resulting in an unduly critical review of these contracts, and their limited implementation at the Department. With less than 59 CPAF contracts let thus far in fiscal year 2010, CPAF contract use has declined considerably over the last few years, and represents less than 1 percent of DOT’s contracting activity. As described in the Federal Acquisition Regulations (FAR) CPAF contracts are useful vehicles when it is not feasible or effective to devise predetermined, objective incentive targets applicable to cost, schedule, or technical performance. Within DOT, useful applications of CPAF include obtaining engineering or information technology services, which do not always lend themselves well to quantitative performance metrics.

The OIG draft report makes a number of assertions that are not well supported. These assertions form a basis for several of the primary concerns expressed in the draft report. For example, the draft report states that it is unknown whether CPAF use has been appropriate because Operating Administrations commit to CPAF contracts without justifying their “cost effectiveness” as required by the FAR. However, the FAR does not require a demonstration that CPAF will be “cost effective” in order to justify its use. Rather, the FAR at 16.401(e)(1)(iii) requires only that “any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits.” This narrow consideration of performance monitoring cost compared to the benefits associated with CPAF contracts does not equate to a requirement for an overall cost effectiveness analysis as indicated in the OIG draft report. Further the report indicates that Operating Administrations “large award fee payments” for contractors who perform satisfactorily are mainly the result

of a lack of detailed guidance and training on how to design and administer CPAF contracts. While the Department acknowledges the overall need to enhance guidance and training to more strongly link performance objectives to adjectival ratings for CPAF contracts, Table 16-1 currently in the FAR provides up to 50 percent of the award fee pool can be earned for satisfactory performance. As a result, such awards can be in compliance with FAR guidance and should not be assumed to be inappropriate or due to lack of guidance. The OIG draft report should also clarify its treatment of “base fees” compared to “award fees,” and the standards and analytical approach applied to each, as these are not clear in the version we reviewed. Finally, the report is also critical of ratings which lacked support offering brief statements, such as, “there were no schedule issues,” to demonstrate insufficient review of contractor performance. However, these statements are not representative of the full extent of performance evaluation documentation available, particularly with regard to several of the contracts cited in the report.

The Department does not concur with the OIG draft report’s assertion that \$14 million in award fees for the contracts reviewed, or its extrapolation to \$140.6 million in award fees across the Department, were “without appropriate justification,” and therefore unsupported. While the Department recognizes that CPAF implementation may not have been consistent across all organizations, we do not concur with the extent or amount of these findings. To the contrary, the Department’s implementation of CPAF in some organizations reduced costs compared to available alternative contract types for these services, such as Cost Plus Fixed Fee (CPFF). Had the Department used CPFF in lieu of CPAF, it could have cost an additional \$1.4 million for the contracts included in the draft report’s table 1, because CPAF affords enhanced potential for management evaluation and consideration of contractor performance in determining fees. Under CPFF, the Department would have been required to pay this amount based only on a contractor’s best efforts, rather than any assessment of results. For the RITA/Volpe Transportation Information Project Support (TRIPS) contract cited in the draft report, the OIG report shows that RITA/Volpe reduced costs by about 15 percent of what the contract could have cost using CPFF.

While we have disagreements with aspects of the OIG draft report findings, we recognize that implementation of CPAF could be improved and made more consistent across the Department with enhanced guidance and training. Steps have already been taken to improve CPAF implementation, through measures including FHWA’s 2008 CPAF training for 164 Contracting Officer Technical Representative’s (COTR’s). Additional actions will be taken to improve our use of CPAF contracts, including providing improved guidance and further training, as discussed below in response to the draft report’s recommendations.

FAR Defined Adjectival Subjective Ratings for CPAF Contracts

Currently, the FAR at Subpart 16.401 specifically directs agencies to utilize the adjectival rating and associated description shown in table 16-1. This table includes adjectival ratings of excellent, very good, good, etc., along with associated operational definitions. The FAR allows, but does not require agencies to supplement these rating descriptions as long as the method used to determine the adjectival rating is documented in the award-fee plan and

Appendix. Agency Comments

linked to performance objectives. Although management offered examples of detailed evaluations, they are not recognized in the OIG draft report. For example, RITA/Volpe officials on the TRIPS contract rating panel provided detail to substantiate their ratings. According to RITA/Volpe officials, the rating reports for the TRIPS contract have run from 15 to 20 pages for each evaluation period of the contract. Nonetheless, the OIG draft report offers none of this detail, instead inferring on page 3 that the sole support for performance was “there were no schedule issues.” This depiction of the support for the TRIPS contract performance evaluation is incomplete and inaccurate. Similarly, on page 6 of the report, OIG states that support for 285 of 310 “superior” ratings on a MARAD contract included comments such as “most pleased with the progress and quality of work to date” and “the contractor has overcome obstacles and made it work.” Here again, the report relies on two summary statements and does not reflect the level of effort or detail by MARAD’s contract evaluators as part of the award fee determination.

Draft Report Overstates FAR Cost Benefit Analysis Requirement

While the FAR required agencies to document their consideration of the potential for additional costs associated with overseeing CPAF contracts, as described in 16.401(e)(1)(iii), it did not require a “justification of cost effectiveness,” as asserted in the draft report. Specifically the FAR calls for, “any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits as documented by a risk and cost benefit analysis.” This is not equivalent to a full cost effectiveness determination, which would require a far more comprehensive evaluation of full costs, and benefits of CPAF versus other alternatives. As a result, we do not concur with the draft report’s finding that, “it is unknown whether DOT’s use of CPAF contracts has been appropriate....because operating administrations commit to these contracts without justifying their cost effectiveness.” We believe that this finding is likely based on an over-interpretation of the FAR’s requirement for a more limited consideration of performance evaluation costs as part of the justification process for use of this contract type.

OST to Enhance CPAF Guidance and Training

The Department recognizes that improvements can be made in the utilization of CPAF contracts. The Office of the Senior Procurement Executive (SPE) will develop a DOT CPAF Guidebook incorporating planning, implementation and administration of CPAF contracts, based on best practice agencies identified in the OIG report. Once the guidebook has been completed the SPE will incorporate these processes for CPAF contracts into a training program to support its contracting and program personnel. This will include annual sessions highlighting best practice CPAF award and administration, and related OIG findings detailed in this report.

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RECOMMENDATIONS AND RESPONSES

The OIG draft report offers recommendations to both the SPE within OST and FAA. Responses for both sets of recommendations are included in this response, starting with those pertaining to OST.

Recommendation 1: Update or expand the TAR guidance to:

- a. Develop specific award-fee criteria for assessing contractor performance by providing more measurable and outcome-based criteria linked to acquisition outcomes.
- b. Define adjectival ratings so there will be a clear basis for assessing performance and ratings consistent with the grading table.
- c. Develop award-fee payment structures that 1) incentivize excellent contractor performance and 2) prohibit contractors from receiving award fees (when a base fee is included) for simply meeting contract requirements or for performance that is judged to be unsatisfactory.
- d. Establish clear division of responsibility for the evaluation team (FDO, PEB, performance monitors) and prohibit the same official from performing multiple roles.
- e. Require performance monitors to document the basis for performance ratings or scores given and include specific examples of strengths and weaknesses.
- f. Conduct a cost-benefit analysis in choosing a CPAF contract and document how the benefits will offset the additional cost associated with administering such a contract.

Response: Concur in part. While the SPE will be taking the actions discussed above to enhance guidance available to contracting officials regarding the use and administration of CPAF contracts, and reinforcing that guidance with training, we do not see the need to modify the TAR, as FAR Subpart 16.4 provides ample direction for establishing and administering CPAF contracts. Instead, the SPE plans to implement the intent of this recommendation through alternative actions. Specifically, the SPE will develop a DOT CPAF Guidebook incorporating planning, implementation and administration of CPAF contracts, based on guidance available from best practice agencies. We believe a guidebook tied to appropriate training will provide a more useful tool than a TAR update. Upon completion of the guidebook the SPE will seek to provide appropriate training to contracting and program personnel involved in the use of this type of contracting vehicle or to those organizations that may continue to make use of CPAF type contracts. This training will highlight proper CPAF award and administration. We anticipate completing these actions by July 1, 2011.

Recommendation 2: Deobligate funds from CPAF contracts that have ended or from completed rating periods with unused award fees.

Appendix. Agency Comments

Response: Concur. DOT will continue conducting reviews of ended and current CPAF contracts, and deobligate unused funds where legally acceptable, practicable and appropriate. These actions will be conducted continuously.

Recommendation 3: Train contracting and program office personnel on designing and administering CPAF contracts consistent with revised guidance.

Response: Concur. The SPE will provide appropriate CPAF training using the new DOT CPAF guidebook discussed earlier in this response. We anticipate being prepared to initiate such training by July 1, 2011.

Recommendation 4: Develop performance measures to evaluate the effectiveness of award fees as a tool for improving contractor performance and achieving desired program outcomes.

Response: Concur in part. Use of CPAF contracts has declined considerably through 2010, to a small fractional percentage of DOT contracting. While the Department will continue to monitor the use of CPAF contracts, it is difficult, in the absence of a control group, to determine the effectiveness based on performance measures for these contracts, as we will not know what would have been if we had used a different incentive contract type. Nonetheless, during the course of completing the guidance, we will assess the potential for identifying and implementing performance measures as recommended. These actions will be completed by July 1, 2011.

OIG RECOMMENDATIONS TO FAA AND RESPONSES

Recommendation 5: Establish a process for monitoring implementation of FAA's Acquisition Management System and Award-Fee Contracting Guide.

FAA Response: Concur. FAA will monitor the implementation of the Acquisition Management System (AMS) and associated guidance through its National Acquisition Evaluation Program (NAEP). This monitoring will include random reviews of FAA's planned and awarded CPAF contracts. This action has already been completed and incorporated into FY2010 NAEP reviews.

Recommendation 6: Train contracting and program office personnel on designing and administering CPAF contracts, emphasizing future prevention of the types of deficiencies noted in this report.

FAA Response: Concur. FAA will incorporate specific requirements and processes for CPAF contracts into the training program supporting its contracting and program personnel. This will include sessions at its Acquisition Training Conference to highlight proper CPAF award and administration, and related OIG findings detailed in this report. FAA anticipates incorporating this training by September 30, 2010.

Recommendation 7: Deobligate about \$4.6 million in obligations on the University of Oklahoma contract for air traffic controller training (DTFA02-01-D-03699).

Appendix. Agency Comments

FAA Response: Concur. As detailed in this report, FAA has already deobligated all but approximately \$42,000, retained for closing costs, on contract DTFA02-01-D-03699 with the University of Oklahoma. This action has been completed.

Recommendation 8: Deobligate funds from CPAF contracts that have ended or from completed rating periods with unused award fees.

FAA Response: Concur. FAA will conduct a review of ended and current CPAF contracts, and deobligate unused funds where needed. FAA anticipates completing this activity by September 30, 2010.