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BEFORE THE

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Chairman Davis, Congressman Turner, and Members of the Subcommittee, I appreciate the opportunity to appear before you again today to continue our discussion on the "Services Acquisition Reform Act" (SARA). SARA challenges the procurement community to take a fresh and focused look at several key aspects of our acquisition processes and policies -- from the way we manage contracts and incentivize our contractors, to the approaches we employ for capitalizing on the ingenuity of the commercial marketplace. I thank the Subcommittee for reaching out to engage the Administration in this important dialogue. As responsible stewards of the $220 billion in goods and services the federal government buys each year, I share your desire to ensure these subjects receive the priority attention of our federal procurement officials.

Since I last appeared before you in November, the President has unveiled a budget that reiterates the Administration's commitment to results. The FY 2003 budget places a newfound emphasis on how well programs -- and the initiatives we have designed to manage them -- serve the needs of our citizenry. In describing the budget, the Director of the Office of Management and Budget (OMB) emphasized that "[t]he days when programs float along year after year, spending taxpayer dollars with never a showing of reasonable results or return, must give way to an era of accountable government."

I'm confident you will agree that our procurement personnel are going to be major players in the transformation to accountable government. They are the creators and guardians of the vehicles that most directly influence how effective our contractors are in helping carry out the business of government. The Administration and Congress must therefore work together to ensure the procurement workforce is well equipped to shoulder this critical responsibility.

SARA gives us the opportunity to more carefully study the Subcommittee's vision for positioning the procurement workforce to meet the many challenges that face our country in the 21st century. Since results are what count in the end, our review must consider whether processes, as SARA would change them, will help agencies to better execute the programs that you have entrusted them to carry out.

In this regard, I am pleased by several features of SARA, which offer the promise of greater return on our investment of federal resources. These aspects of SARA include, for instance, a pilot to stimulate performance-based service contracting (PBSC) and the concept of statutorily reinforcing more integrated decision making among the various

disciplines that are responsible for the acquisition process. However, I cannot express similar enthusiasm for some other aspects of SARA, at least not in their current formulation. In those cases, the tie-in between the change that SARA would bring about and the potential for improved performance is too tenuous.

Given the evolving nature of the bill's provisions during the drafting process (to which most agencies have not been privy), and the fact that it was formally introduced just this week, the Administration is not prepared at this time to provide a comprehensive assessment of SARA. However, I would like to speak conceptually about some of SARA's more prominent themes, namely: (1) strengthening the management of the procurement process and skills of the workforce, (2) improving use of contract incentives, and (3) taking greater advantage of the commercial marketplace. My comments (which are generally based on the February 27th draft of the bill) assume familiarity with, and elaborate on, my statement from your November hearing. Since that statement addressed most of the questions posed in your letter of invitation for this hearing, I will not generally repeat those responses in my discussion with you today.

Managing the Procurement Process

SARA includes a variety of provisions that seek to address shortcomings in current management practices and human capital needs. Among other things, SARA would require each executive agency to appoint a "chief acquisition officer" to achieve better integration of its acquisition activities. SARA also would establish a central fund

to cover acquisition workforce training needs, and authorize a government-industry exchange program.

Achieving Better Integration of Acquisition Activities

As you know from my last appearance before the Subcommittee in November, I believe the path to improved performance begins with ensuring that processes are shaped to effectively balance all "acquisition basics." Balance is achieved by giving appropriate attention to acquisition planning, competition, contract structure, and contract management. We also must be sensitive to operational efficiency, but, in doing so, recognize it is not an end in itself.

Unfortunately, lax application of acquisition basics continues to be a major contributor to shortfalls in program performance. Insufficient attention to requirements development, weak cost and price analyses, inconsistent use of competition, ineffective negotiations, poorly structured contracts, and inadequate contract management plague even the most streamlined and protest proof of our acquisition tools.

To improve performance, agencies must recognize that acquisitions are the shared responsibility of a variety of disciplines, including program, technical, contracting, budget, financial, logistics and legal personnel. These disciplines must work together so the respective expertise that each offer is better integrated in agency decision making. In particular, program offices must be willing to commit sufficient attention to acquisition planning and contract management. They must understand that no amount of training on

the part of procurement personnel and no degree of operational expediency afforded by contracting tools can serve as a substitute for these activities.

For their part, agency procurement officials must not allow pressures for expediency to divert attention away from the application of fundamental contracting principles that lie at the heart of any successful acquisition process, no matter the agency or the requirement. Far from the mechanical or administrative-laden label that some might like to assign to the contracting function, procurement personnel are the *key* component of our acquisition workforce and are looked upon to ensure sound application of the varied contracting tools now available to them.

SARA's solution for better integration: the chief acquisition officer (CAO). section 201 of SARA would require an agency to appoint a CAO. Under SARA, a CAO would assume the responsibilities currently assigned to agency senior procurement executives (SPE). These responsibilities include, among others, providing management direction of the agency procurement process, increasing use of full and open competition, and maintaining clear lines of authority, accountability, and responsibility for procurement decision making. In addition, the CAO would become primarily responsible for "acquisition management." In particular, SARA would make the CAO responsible for evaluating performance of agency acquisition programs on the basis of applicable performance measurements and develop appropriate business strategies. The CAO would also assess knowledge and skill in acquisition resources management and develop plans for addressing deficiencies.

A modified management construct. As noted, I agree that agencies need to foster better integration between traditional contracting functions, such as contract negotiation, and other related functions that are integral to the acquisition process, but not directly within the responsibility of the contracting officer. These other functions include activities such as requirements development and financing. I further agree that there may be benefits from reinforcing the principle of integration in statute. However, two important modifications to SARA's current construct need to be carefully considered.

First, we need to retain the SPE position. There remains a very real ongoing need for committed management attention focused on traditional procurement activities. We cannot allow this attention to be diluted. Thus, the Subcommittee should consider clarifying that, in addition to their current responsibilities, senior procurement executives, shall provide contract management advice to agency senior program officials who, in turn, shall confer with the senior procurement executive as is necessary to enable the respective officials to effectively monitor and evaluate a program's acquisition performance activities.

Second, I would authorize -- but not require -- the appointment of a CAO. As one industry witness observed during your November hearing, it is difficult to legislate agency cultures. The establishment of a CAO within a given agency should be the product of a well-deliberated business decision by senior management driven by the need, and the likely ability of a CAO, to improve operational and management shortcomings. The agency head, who is familiar with, and ultimately accountable for,

mission performance, will be best able to assess the need for a CAO based on the nature of the agency's mission and prominence of acquisition in carrying out this mission. Perhaps, the Subcommittee could offer guideposts to help agencies in deciding when the function is likely to be of greatest benefit – e.g., when an agency has a large procurement budget, routinely undertakes a significant number of complex major acquisitions, and is especially reliant on contractors to help carry out its mission.

Overall, I support the Subcommittee's desire to ensure agency procurement personnel are meaningful and real partners in agency decision making on acquisition matters. At the same time, senior agency management must have the flexibility to determine how this attention is most effectively applied and integrated with other acquisition-related functions. Indeed, a CAO mandate might be especially constraining in small agencies with minimal procurement budgets and personnel. At the other end of the scale, I would note that the Department of Defense (DOD), with one of the largest procurement budgets and personnel workforces, already has, by statute (10 U.S.C. 133), a CAO -- i.e., the Under Secretary of Defense for Acquisition, Technology, and Logistics -- and we would not want CAO legislation to interfere with that statute.

I much appreciate the modifications the Subcommittee has already made in response to my prior comments, by dispensing with a construct that would have defined where the function is placed within the agency. This is a step in the right direction, but even more management flexibility must be vested in the agency head. Otherwise, a good concept could become a force-fit restraint on good management.

Tending to the Needs of our Acquisition Workforce

The Subcommittee's interest in improving the management of human capital is certainly understandable. Agencies can ill afford imbalances in the experience, skills, or knowledge base of their acquisition workforce. A well equipped workforce is tantamount to successful mission performance.

Funding. Section 102 of SARA would establish a central acquisition workforce training fund. Funding would be generated through fees paid by federal agencies making purchases from government-wide acquisition contracts (GWACs), multi-agency contracts for information technology (IT) and the Multiple Award Schedules (MAS) program operated by the General Services Administration.

I appreciate well the need for adequate funding. At the same time, I continue to believe acquisition training programs should be funded through the normal budget and appropriations process. Among other things, funding training through fees generated from purchases made from GWACs, multi-agency contracts, and MAS could create a hardship on small agencies that may rely more heavily on these vehicles to meet their needs.

Developing management expertise. SARA would create an executive exchange program between the federal government and the private sector to foster the development of management expertise. If it can be properly structured, this concept may offer an opportunity to improve understanding between, and broaden the perspectives of, the respective sectors' acquisition workforces. As the Director of the Office of Personnel Management (OPM) stated to the Subcommittee last Summer on an industry-exchange

program for IT, improved communication and cooperation between the government and the private sector can help identify more effective ways for the two sectors to work together and can spur the flow of new approaches to technical problem-solving. At the same time, I am sensitive to possible ethics implications. For this reason, I have asked the Office of Government Ethics and the Department of Justice to carefully review these SARA provisions. (Of course, OPM will also be reviewing the provisions as well.)

Eliminating Unnecessary Reporting Requirements

Before leaving the topic of procurement management, I would like to note briefly that my office is reviewing some of the current Congressional reporting requirements related to government-wide acquisition activities to determine if they should be eliminated or otherwise modified. Unnecessary reporting can be a costly drain on resources and divert attention away from our priority initiatives.

We are generally looking to assess the continued utility of various reporting requirements, in light of the burden that such requirements create and steps that may have been taken since the requirements were originally imposed to provide visibility and accountability through other means. We are also taking into account the benefit that might be achieved if the resources currently dedicated to Congressional reporting were redirected to other efforts that may offer a greater long-term payoff. Such alternative efforts might include some of those identified in SARA, such as participation on a government-industry panel to help agencies gain a better and broader understanding of

how performance-based service contracting (PBSC) can be used most effectively, or examination of opportunities to foster greater collaboration as agencies address common acquisition activities. I hope you will work with us to eliminate unnecessary reporting requirements that may remain on the books.

Using Contract Incentives

Several of SARA's provisions address the use of incentives. This interest is understandable. For any effort involving contractors to ultimately succeed, contracts must be well structured to produce cost-effective quality performance. Although SARA does not specifically identify PBSC as an incentive, per se, I would like to address it at this point in my discussion, since it is designed to foster the creativity and initiative of our contractors to help agencies achieve better solutions to meet their needs. Let me now briefly elaborate on my November comments on PBSC and reiterate our views regarding share-in-savings.

Refocusing our PBSC efforts. As your letter of invitation notes, PBSC is underutilized. To help energize and refocus our PBSC efforts, I am taking the following steps.

First, I am forming an inter-agency group to resolve disagreements among the agencies regarding the requirements to qualify a contract as performance-based. I anticipate, as one output of this effort, improved guidance regarding the scope and nature of PBSC. There must be a common understanding of the definition upon which to build experience and track progress.

Second, I am supporting pilot efforts that can help agencies gain experience with the PBSC concept. In this regard, I support government-wide expansion of the pilot that Congress established for DOD in the Defense Authorization Act for FY 01. (I am assuming that this is the sole intent of sections 401(a) and (b) of the bill.) Under that pilot, DOD may treat acquisitions for services of $5 million or less as commercial items if the purchases are performance-based and made on a firm-fixed-priced basis, and certain other conditions are met. Expansion of this pilot to civilian agencies should help to incentivize greater use of PBSC.

Third, in response to section 204 of SARA, I am carefully considering the merits of a government-industry advisory panel to review PBSC. Such a panel might help agencies to gain a better and broader understanding of how PBSC can be used most effectively. However, if such an initiative is undertaken, I would urge the Subcommittee to keep it focused on PBSC (as opposed to the broader scope currently reflected in section 204) and to make the Federal Advisory Committee Act inapplicable, so as to eliminate unnecessary and work-inhibiting burdens on the advisory effort. In this way, the attention and energies of the participants will provide concentrated effort to support this results-oriented initiative.

As a footnote to our discussion on PBSC, I feel compelled to comment briefly on language in Title III of SARA that would encourage contracting offices to expend efforts to incentivize contractors performing under level-of-effort type contracts. This provision is puzzling. Level-of-effort contracts are the antithesis of PBSC. Payment is based upon

reimbursement for time and effort expended (i.e., best efforts) rather than being tied to a completed and delivered product or service for which there is a contract specified firm-fixed price (i.e., tangible results). Although the SARA provision is designed to encourage efficient performance under these contracts, it is unclear how successful such efforts would ultimately be. Since profit is built into the price of each hour, there would appear to be little incentive to work fewer hours than are authorized under the contract. Rather than seeking to improve a contract type that is inherently weak, we should, in my opinion, motivate greater use of those contractual arrangements that can better protect the government's interest.

Expanding use of "share-in-savings" contracts. SARA would significantly expand and make permanent the share-in-savings pilot authority created in the Clinger-Cohen Act. We recognize that agency interest in the pilot authority has been weak and agree that consideration should be given to adding incentives. However, expansion must be tempered by the following considerations.

First, even as expanded, the authority should remain as a pilot for IT until there are demonstrable benefits. To date, we have not seen results. In fact, our sense is that agencies will need to gain greater experience in developing baselines. Proper baselines, in combination with guaranteed savings clauses, are critical to ensuring savings can be validated and realized. As one procurement official recently told me: "We are struggling to do PBSC well. Share-in-savings is like graduate level PBSC. You gotta walk before you can run."

Understanding results achieved under the pilot, including cost reductions, will help Congress decide whether or not a provision of general authority would be beneficial for the government. We should also consider the impact of these contracts on other activities in light of the extended contract duration that may be required to recoup savings and the generally high termination costs.

Second, added incentives need to be consistent with established fiscal policy (i.e., where agencies, at a minimum, are required to fund the first year of the contract plus termination costs). Moreover, provisions allowing agencies to use retained savings (after paying the contractor) should limit the allocation of such funds to the acquisition of additional IT to ensure responsible program development.

Third, section 301(e)(2) of the bill, which purports to require the Director of OMB to submit legislative recommendations to Congress, shall be construed consistently with the President's constitutional authority to supervise the unitary executive branch and to recommend to Congress such measures as he judges necessary and expedient.

Contracting in the Commercial Marketplace

As you know well, this Administration is actively striving to create a market-based government that is unafraid of competition, innovation, and choice. From our competitive source initiative, which is already beginning to give the private sector a greater opportunity to compete for work, to our planned efforts to reinvigorate the acquisition of commercial-off-the-shelf items, we are committed to ensuring that

agencies are effectively positioned to take better advantage of the commercial marketplace.

In this regard, Mr. Chairman, I was pleased to see that the bill you introduced at the end of last year to address federal emergency procurement flexibilities (H.R. 3426) included a provision to reinforce the importance of conducting effective market research – including consideration of small businesses and new entrants into federal contracting. Such a provision will serve as a useful reminder of the importance of considering the full range of marketplace capabilities.

With respect to SARA, it contains several provisions addressing commercial item acquisitions. My attention is especially drawn to sections 402, 403, and 404, which would expand application of Part 12 of the Federal Acquisition Regulation (FAR). For context, let me take just a moment to review the nature of FAR Part 12.

Part 12 establishes a preference for the acquisition of commercial items and lays a foundation for taking advantage of customary commercial practices. It creates an environment that is largely free from government-unique standards, specifications and accounting requirements. Among other things, Part 12 provides standard provisions and clauses that are intended to address commercial market practices for a wide range of potential government acquisitions.

Consistent with the Federal Acquisition Streamlining Act (FASA) and the Clinger-Cohen Act, Part 12 is rather broad in its scope. Its applicability even extends to purchases where there may not be adequate price competition. In fact, the commercial

item provisions of FASA, and especially the Clinger-Cohen Act, were designed, in part, to prove the government could forego its traditional safeguards in a non-competitive environment. To appreciate this point, one need not look further than the Truth In Negotiations Act (TINA). Long before Clinger-Cohen barred application of this law to commercial item contracts, TINA provided an exception for any commercial or non-commercial purchase where there was adequate price competition.

Notwithstanding its already broad scope, SARA would expand application of Part 12 even further. One apparent goal is to create greater uniformity in our treatment of commercial contractors. To this end, section 403 would eliminate caveats in law that currently result in more limited application of Part 12 policies to services than are authorized for products. Use of Part 12 would no longer be predicated on services being sold competitively in substantial quantities and based on established catalog or market prices for specific tasks performed under standard commercial terms and conditions. section 402 would endorse the acquisition of services through time-and material or labor-hour contracts using the same terms, conditions, and safeguards that Part 12 provides for the acquisition of commercial services through firm-fixed-price contracts. Finally, section 404 would require an agency to purchase the *non-commercial items* of a "commercial entity" using the clauses and policies prescribed by Part 12 if at least 85 percent (in dollars) of the sales of the enterprise over the past three business years have been made to nongovernment entities or under FAR Part 12.

I am concerned about the potential impact of these provisions, which would eliminate certain safeguards from Part 12. As we have come to learn (or relearn) in

recent years, protecting the public fisc is not easy in environments where the government's market leverage has been marginalized. To be more specific, Part 12 (in conjunction with the definition of "commercial item" set forth in FAR Part 2) requires that: (1) the risk of performance be placed on the contractor through the use of firm-fixed-price contracts or fixed-price contracts with economic price adjustments, (2) a contractor offer products that, at a minimum, are "of a type" sold or offered for sale in the commercial marketplace, and (3) offered services are sold competitively in substantial quantities in the commercial marketplace. SARA's effective elimination of these safeguards would leave the government unnecessarily vulnerable. Consider the following:

Use of flexibly-priced contracts. Since the enactment of FASA, agencies have been precluded from acquiring commercial items under FAR Part 12 using cost-type contracts. This limitation makes sense. There should be no need for the government to assume performance risk to purchase goods and services that have been market tested, either directly or through a commercial analog.

Putting aside whether time-and-material and labor-hour contracts should be considered cost-type contracts, they certainly share many of the risk characteristics of a cost-type contract. In particular, the government assumes the performance risk. A contractor has no obligation to deliver a finished product; it must only make best efforts. Some may point out that the government is protected by the establishment of a "ceiling price" while others will argue that the government's interest can be protected if a labor rate is fully loaded (i.e., it includes overhead, general and administrative expense, and

profit, in addition to direct costs). However, as I noted in my comment on level-of-effort contracting, profit is included in the price of each hour. As a result, both of these so-called safeguards will offer little positive incentive for cost control, labor efficiency, or delivery of a completed product or service. The FAR recognizes this problem and restricts use of time-and-material and labor-hour contracts to circumstances where no other contract type is appropriate.

Part 12 in its current structure appropriately avoids these potential problems by requiring use of firm-fixed-price contracts or fixed-price contracts with economic price adjustments for the acquisition of commercial items. Agencies may award contracts that identify fixed labor rates, provided that orders reflect a firm-fixed-price for a specific task. Given the problems inherent in time-and-material and labor-hour contracts, and the fact that they are the antithesis of PBSC, I am hard-pressed to see how their use will produce beneficial results if applied to Part 12 in its current form, as sections 402 and 403 envision.

Acquisition of non-commercial items from commercial entities. As I noted a moment ago, section 404 would require an agency to purchase the non-commercial items of a "commercial entity" using the clauses and policies prescribed by Part 12 if certain conditions are met. This would mark the first time non-commercial items could be acquired under FAR Part 12 on other than a performance-based, firm-fixed-price, and pilot basis. The rationale underlying section 404 ostensibly is that the government will be protected when it buys non-commercial items (i.e., items that are not sold or even of a type offered or sold in the marketplace) as long as the company has a demonstrated track

record in selling commercial items at fair and reasonable prices. In the absence of marketplace competition or another appropriate safeguard, I am opposed to relying upon the results of a track record unrelated to the offered product or service as protection that the prices for non-commercial items are fair and reasonable.

The bottom line: one size does not fit all. My point in raising these concerns is not to signal a retreat in the federal government's commercial item policies. To the contrary, we must remain steadfast in our effort to take advantage of the marketplace. And, in doing so, we must recognize that Part 12 can effectively address many of the relationships with our contractors. At the same time, we must accept that Part 12 has boundaries. It assumes that prices are determined by the interplay of competitive market forces. Not every relationship with a contractor can be satisfied with its terms, conditions and safeguards.

The boundaries of Part 12 are best viewed in the context of the differences between the government and the private sector. Fundamentally, we can never escape the fact that the government is not a private entity, does not report to shareholders, and does not have a profit incentive.

Taxpayers demand that our program and contracting officials use competition as a matter of course and operate in a manner that is citizen-centric and fair. These demands are well founded and not to be ignored. While effective investment of resources is critical, the varied needs of our citizenry preclude profit motive from operating as an incentive. In this context, competition, where applicable, and transparency (especially

where competition is absent) have proven themselves to be the most reliable prescriptions for yielding results and ensuring our government remains accountable to those we serve.

By contrast, shareholders of a private entity are focused on profit. As a result, they will be more quick to allow their companies to forego competition or transparent source selections when doing so will increase the profitability or price of the companies' stock. While this behavior is certainly understandable, it cannot appropriately serve as a public policy to meet the many needs of our Nation.

Part 12's current limitations reflect tradeoffs that have been made between the desire to eliminate barriers to the marketplace and the need to protect the interests of the government in an environment which demands that competition and transparency be used -- not withheld -- to ensure effective contracting. In particular, Part 12 ties our use of commercial items and practices to those situations where there is a "yardstick" in the commercial marketplace (e.g., competition, substantial sales of services, a firm-fixed-price for a completed task) to serve as a surrogate for the imposition of government-specific requirements in determining price and product quality. While the loss of this yardstick may be of little consequence to a private entity that can easily employ other leveraging tools to protect its shareholders, this yardstick is critical to the government's ability to effectively meet its varied needs.

I therefore urge the Subcommittee to reconsider the impact of sections 402, 403 and 404. I welcome the opportunity to discuss these concerns further, as well as to explore with the Subcommittee improvements that might make Part 12 policies more

effective where alternatives exist to enable the government to protect its interests and maintain the public's confidence.

Conclusion

As this year's budget illustrates, the Administration takes seriously the assessment of government performance. To use the President's own words: "We are not here to mark time, but to make progress to achieve results, and to leave a record of excellence."

The message is clear: we must remain firm in our resolve to improve the performance of government and the culture that drives our investment decisions. The importance of agency procurement offices in this transformation cannot be emphasized enough. Program offices across government, from those that serve the needs of our war fighters to those that support the government's efforts to promote educational excellence for our students, must ultimately depend on our procurement personnel to draft and negotiate the sound contracts that form the underpinning for successful performance.

I thank the Subcommittee for recognizing the critical role played by procurement officials throughout government and also for challenging us to revisit the principles that lie at the heart of our procurement processes. On behalf of the Administration, I accept this challenge. In doing so, I intend both to ensure that our procurement processes are results oriented and to work with this Subcommittee and the other members of Congress to change them where they are not.

This concludes my prepared remarks. I am happy to answer any questions you might have.