



Highlights of [GAO-06-66](#), a report to the Subcommittee on Readiness and Management Support, Committee on Armed Services, U.S. Senate

Why GAO Did This Study

Collectively, the Department of Defense (DOD) gives its contractors the opportunity to earn billions of dollars through monetary incentives—known as award fees and incentive fees. These fees are intended to motivate excellent contractor performance in areas deemed critical to an acquisition program’s success, with award fees being appropriate when contracting and program officials cannot devise objective incentive fee targets related to cost, technical performance, or schedule.

GAO was asked to determine whether award and incentive fees have been used effectively as a tool for achieving DOD’s desired acquisition outcomes. To do this, GAO selected a probability sample of 93 contracts from the study population of 597 DOD award- and incentive-fee contracts that were active and had at least one contract action valued at \$10 million or more from fiscal year 1999 through 2003.

What GAO Recommends

GAO recommends that DOD improve its use of fees by specifically tying them to acquisition outcomes in all new award- and incentive-fee contracts, maximizing contractors’ motivation to perform, and collecting data to evaluate the effectiveness of fees. In its comments on a draft of this report, DOD concurred or partially concurred with all of the recommendations.

www.gao.gov/cgi-bin/getrpt?GAO-06-66.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Ann Calvaresi-Barr, (202) 512-4841, calvaresibarra@gao.gov.

DEFENSE ACQUISITIONS

DOD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes

What GAO Found

The power of monetary incentives to motivate excellent contractor performance and improve acquisition outcomes is diluted by the way DOD structures and implements incentives. While there were two examples in our sample in which the Missile Defense Agency attempted to link award fees directly to desired acquisition outcomes, such as demonstrating a capability within an established schedule, award fees are generally not linked to acquisition outcomes. As a result, DOD has paid out an estimated \$8 billion in award fees to date on the contracts in our study population, regardless of outcomes. The following selected programs show this disconnect.

Program Performance and Award-Fee Payments on Selected DOD Development Programs

Acquisition outcomes	Comanche reconnaissance attack helicopter	F/A-22 Raptor tactical fighter aircraft	Joint Strike Fighter tactical fighter aircraft	Space-Based Infrared System High
Research and development cost increase over baseline	\$3.7 billion 41.2 percent	\$10.2 billion 47.3 percent	\$10.1 billion 30.1 percent	\$3.7 billion 99.5 percent
Acquisition cycle time increase over baseline	33 months 14.8 percent	27 months 13.3 percent	11 months 5.9 percent	More than 12 months
Percentage and total award fee paid to prime systems contractor (adjusted for rollover) ^a	85 percent \$202.5 million paid through 2004	91 percent \$848.7 million	100 percent \$494.0 million	74 percent \$160.4 million

Sources: DOD submissions to GAO, contract documentation, and GAO-05-301 (data); GAO (analysis).

^aWhen calculating the percentage of award fee paid (i.e., percentage of award fee paid = total fee paid to date / (total fee pool – remaining fee pool)), we included rolled-over fees in the remaining fee pool when those fees were still available to be earned in future evaluation periods.

When DOD programs did not pay all of the available award fee, DOD gave contractors on an estimated 52 percent of award-fee contracts at least a second opportunity to earn an estimated \$669 million in initially unearned or deferred fees. GAO believes these practices, along with paying significant amounts of fee for “acceptable, average, expected, good, or satisfactory” performance, undermine the effectiveness of fees as a motivational tool and marginalize their use in holding contractors accountable for acquisition outcomes. They also serve to waste taxpayer funds. Incentive fees provide a clearer link to acquisition outcomes; however, a majority of the 27 contracts with cost incentives that GAO reviewed failed or are projected to fail to complete the acquisition at or below the target price.

Despite paying billions in fees, DOD has little evidence to support its belief that these fees improve contractor performance and acquisition outcomes. The department has not compiled data, conducted analyses, or developed performance measures to evaluate the effectiveness of award and incentive fees. In addition, when contracts have utilized different fee strategies to focus the contractor’s attention on specific acquisition outcomes, contracting officials have stated that DOD has few mechanisms to share lessons learned and innovative practices outside the local level.