



UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548



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DEFENSE DIVISION

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JUN 2 1969

Dear Mr. Secretary:

We recently completed a review of the use of performance and delivery incentives in contracts awarded by the military services.

The 27 contracts we selected for review were awarded during fiscal years 1964-69 and were priced at \$1.2 billion. The contractors stood to realize additional payments of up to about \$41 million under 51 incentive provisions which we examined. Of primary interest to us were the circumstances under which the services found it appropriate to offer performance and delivery incentives to the contractors inasmuch as we had found some earlier indications that incentives were being offered when there was little reason to anticipate that the Government would derive benefits commensurate with the costs.

It appears that 38 incentive features, or 75 percent of those we examined, were included in contracts when they may not have been needed to obtain the performance desired or otherwise may not have been of practical benefit. These represented potential payments to contractors of about \$35.8 million.

Misuse of performance and delivery incentives resulted from over-reaction in the field to the emphasis by the Department of Defense on inserting incentive features in contracts, and from an absence of critical reviews at a sufficiently high level to ascertain whether their use was proper in the circumstances. Generally, analyses were not made to ascertain the value of the added performance in relation to its cost.

As examples we found instances where incentive features were applied to quality assurance or to delivery requirements that the contractor already was obligated to meet. In other cases incentives were used to induce accomplishments which the contractors had achieved consistently for a number of years or in circumstances which indicated that the contractors could attain the objectives without the incentives.

In responding to our draft report the Deputy Assistant Secretary of Defense (Installations and Logistics) did not agree that our findings could support a conclusion that performance and delivery incentives had been generally misused. He added, however, that revisions incorporated in the October 1969 Incentive Contracting Guide, and other published guidance, should help assure appropriate use of multiple incentive contracts. The reply also cited the reviews made of major incentive

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contract awards by the military services and, in particular, reviews by the Program Office for Evaluating and Structuring of Multiple Incentive Contracts (POESMIC) established in April 1968, as providing an adequate value analysis of incentive provisions included in contracts.

The current guidance, in our opinion, represents an improvement over the earlier publications and the POESMIC program would be a useful tool in evaluating and structuring incentive contracts. We recommend that the effects of these innovations be closely monitored at an appropriate command level to ensure that they are resulting in more judicious use of incentives. We plan to examine the operation of the current procedures at a later date.

Copies of this report are being sent to the Chairmen of the House and Senate Committees on Government Operations and to the Chairmen of the House and Senate Committees on Appropriations. Copies are also being sent to the Director, Office of Management and Budget and the Secretaries of the Army, Navy, and Air Force.

Sincerely yours,



Director

The Honorable
The Secretary of Defense