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U.S. HOUSE OF REPRESENTATIVES

WRITTEN STATEMENT OF

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BEFORE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON ARMED SERVICES  
OVERSIGHT AND INVESTIGATIONS SUBCOMMITTEE

ON

ASSESSING THE DEPARTMENT OF DEFENSE'S EXECUTION OF RESPONSIBILITIES  
IN THE U.S. FOREIGN MILITARY SALES PROGRAM

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Chairwoman Hartzler, Ranking Member Speier, and distinguished members of the Subcommittee, thank you for the opportunity to appear before you to discuss our responsibilities in executing the U.S. Foreign Military Sales program. I am Claire Grady, Director, Defense Procurement and Acquisition Policy (DPAP). In that capacity, I serve as the principal advisor on procurement matters to the Under Secretary of Defense for Acquisition, Technology, and Logistics (USD (AT&L)) and as the functional leader for the more than 30,000 military and civilian contracting professionals across the Department of Defense (DoD). I am a career civil servant, with more than 20 years' experience in procurement and acquisition.

The defense acquisition community plays an important role supporting Foreign Military Sales (FMS) and in doing so we contribute in advancing both national security and foreign policy goals of the U.S. Government. We recognize that foreign military sales strengthen the relationship with our international partners, equip them with defense capabilities to provide for their own national defense, increase interoperability with our allies, and support the U.S industrial base.

In acquiring goods and services on behalf of FMS customers, the Department's acquisition workforce employs the same rigorous policies and procedures that we use to meet our own requirements. DoD Instruction 5000.02, "Operation of the Defense Acquisition System," provides the framework and detailed procedures that govern the operation of the Defense Acquisition System. This Instruction directs DoD program managers to consider the potential demand and likelihood of Foreign Military Sales early in the acquisition planning process for our own requirements, considering U.S. export control laws, regulations, and DoD policy.

The Military Departments employ Program Management (PM) offices to develop and acquire major weapon systems. A PM team typically consists of a program manager, supported by professionals from several functional disciplines including engineering, contracting, logistics, financial management, and testing. When an FMS customer seeks to acquire a major weapon system, the same PM office that oversees the DoD acquisition of that system, also is responsible for delivering the FMS requirements. The PM office may acquire FMS end items under stand-alone contracts, or by merging FMS requirements with DoD's requirements on the same DoD contract. In this way, the Department enjoys the benefits of synergy, not only from the perspective of staffing, but also in realizing efficiencies in achieving economies of scale which results in lower negotiated prices from industry.

To increase the efficiency and effectiveness of the acquisition system for the benefit of both U.S. and foreign military sales requirements, the Under Secretary of Defense for Acquisition, Technology and Logistics has advanced a series of incremental, continuous improvement initiatives under the moniker, Better Buying Power (BBP). One of the central elements of BBP is the recognition that the most important factor in the performance of the Defense Acquisition System is the professionalism of our acquisition workforce. Our focus is on ensuring we provide the training and tools for our people to enable them to secure the best possible value for our warfighters, the American taxpayer, and for our FMS customers. The Department has invested significant resources, with the support of Congress, to ensure that our acquisition workforce is properly sized with the right skills, experience and training to execute the U.S. taxpayer and FMS customer dollars entrusted to us. Last year, DoD's talented contracting officers obligated over

\$274 billion on contract actions, of which about \$26 billion was for Foreign Military Sales. DoD training and certification programs for the Defense Acquisition Workforce are considered to be the “gold standard” within the Federal government and the professionalism and capability of our acquisition workforce is a significant contributing factor in our international partners’ choice to acquire goods and services through the FMS program.

In addition to the rigorous acquisition training for the functional career fields, such as program management, systems engineering and logisticians, DoD also established an International Acquisition Career Path in 2007 for Program Managers and expanded the coding to all communities in 2014. The Director, International Cooperation provided workforce guidance in late 2015 to identify and code billets for those engaged in International Acquisition. Individuals serving in those positions receive specialized training. The staff at Defense Acquisition University (DAU) developed and now offers seven “school house” courses covering the core information for International Acquisition and Foreign Military Sales. DAU has also added a number of online continuous learning courses in International Acquisition such as the most recent, “Export Controls for the Contract Specialist.” In addition, the International Acquisition Department will provide specialized, ad hoc training as requested to meet operational needs and to provide specialized training in International Acquisition that are designed to benefit both the acquisition and the security cooperation communities engaged in the FMS process. To date, a total of 7,489 students have completed International Acquisition DAU courses. Additionally, DAU continues to work closely with the Defense Institute of Security Assistance Management (DISAM) to ensure that the FMS training provided to U.S.

security cooperation personnel and representatives of foreign government, FMS customers, is consistent with and compliments that provided to DoD acquisition personnel. My staff has worked with the DAU staff and DISAM to publish training materials relating to FMS contracting on their websites, and DAU is working to integrate and keep current key aspects of these training materials into the formal international contracting training courses.

Another pillar of BBP is to incentivize productivity and innovation in industry and in Government. A key tenant of that is the need to employ appropriate contract types and to properly align incentives. Last month, I issued a document entitled, "Guidance on Using Incentive and Other Contract Types." This guidance is intended to provide a comprehensive set of considerations that DoD contracting and acquisition professionals should take into account when selecting and negotiating the appropriate contract type for a given requirement. The guidance does not indicate a preference for any particular contract type that should be considered as uniquely appropriate to satisfy either U.S. or FMS requirements. Rather, the guidance emphasizes the need to assess the cost, schedule and performance risk inherent in the business arrangement and select the appropriate contract type to balance risk between the government and industry and motivate successful performance under the contract. Contract type is just one element of the overall contractor compensation arrangement, which includes contract financing, profit or fee, incentives, and contract terms and conditions.

Since the contract type and the negotiated contract pricing are interrelated, they must be considered together. Ultimately, the contract type that is negotiated should result in a reasonable degree and balance of risk between the Government and the contractor;

and provide the contractor with the greatest incentive for efficient and economical performance. The decision about which contract type to use to fulfill a U.S. or FMS requirement is typically made by the contracting officer and the program manager and approved as part of the acquisition plan.

Frequently, we combine DoD requirements with FMS requirements on a single contract, or have contractors concurrently producing weapon systems for our requirements and FMS requirements under separate contracts. In either case, these systems are typically being produced at the same production facility and coming off of the same production line, and the contracts we negotiate have similar, if not virtually identical, terms and conditions. For programs in production, with stable designs, proven manufacturing techniques, and predictable costs, firm fixed price contracts are typically chosen. However, for production efforts where on prior contracts the difference between the anticipated cost to produce the item and the actual incurred costs exceeds four percent, since 2006, we have required contracting officers to consider the use of a Fixed Price Incentive (FPI) contract when negotiating future contracts. Under a Fixed Price Incentive contract, the difference between the forecasted and the actual costs is split between the government and the prime contractor using pre-established ratios. In a sole source production environment for a mature system, an FPI contract is indicative of cost uncertainty that can come from a number of factors, including difficulties in accurately pricing prime, subcontractor or vendor costs, estimating system limitations, inadequate historical pricing data, or unreliable estimating techniques. The use of an FPI contract in a sole source, mature production environment signals that we lack confidence in the ability to forecast costs that will ultimately reflect the actual cost outcome.

We have reviewed proposals from industry associations that have advanced the notion that the Department should be constrained in our selection of contract type for FMS contracts. While there are some administrative costs associated with using FPI type contracts, those costs are small in comparison to the benefits received; the appropriate use of an FPI contract will result in a lower overall cost to the customer. Under an FPI contract, when the contractor performs below the target cost, a portion of that underrun is returned to the customer and a portion is kept by industry. Under a firm fixed price contract, when the contractor performs below the target cost, 100% of that underrun is kept by the contractor. Responsibility for costs that exceed the target are similarly distributed based on the contract type. For mature sole source production efforts, it is highly unusual for costs to exceed the negotiated target. If the Department were precluded from using the appropriate type contract in any particular environment, it would effectively constrain our ability to deliver best value to the FMS customer, and eliminate opportunities to achieve efficiencies by combining U.S. and FMS requirements on the same contract. As is shown in the tables below of dollars obligated over the past two fiscal years, the Department has employed a variety of contract types that will best support the FMS customer's needs, with the predominant contract type being Firm Fixed Price:

**Total DoD Contract Obligations for FMS in FY2015**

Type of Contract	Actions	Action Obligation	% of Total
COMBINATION	9	-\$216,197.73	0.00%
COST NO FEE	678	\$273,868,160.24	1.06%
COST PLUS AWARD FEE	513	\$954,999,173.64	3.70%
COST PLUS FIXED FEE	2,689	\$2,087,150,964.87	8.10%
COST PLUS INCENTIVE FEE	309	\$1,604,348,185.65	6.22%
FIRM FIXED PRICE	38,441	\$15,496,732,834.10	60.12%
FIXED PRICE AWARD FEE	2	\$1,263,878.54	0.00%
FIXED PRICE INCENTIVE	118	\$4,924,682,074.73	19.11%
FIXED PRICE LEVEL OF EFFORT	20	\$155,210,186.67	0.60%
FIXED PRICE REDETERMINATION	1	-\$377.16	0.00%
FIXED PRICE WITH ECONOMIC PRICE ADJUSTMENT	1,085	\$226,432,936.21	0.88%
LABOR HOURS	57	\$10,866,132.91	0.04%
ORDER DEPENDENT (DETERMINED SEPARATELY FOR EACH TASK ORDER)	27	\$0.00	0.00%
TIME AND MATERIALS	214	\$41,356,557.59	0.16%
	<b>44,163</b>	<b>\$25,776,694,510.26</b>	<b>100.00%</b>

**Total DoD Contract Obligations for FMS in FY2016**

Type of Contract	Actions	Action Obligation	% of Total
COST NO FEE	425	\$477,450,994.50	2.86%
COST PLUS AWARD FEE	259	\$273,978,927.94	1.64%
COST PLUS FIXED FEE	1,155	\$851,916,018.25	5.10%
COST PLUS INCENTIVE FEE	172	\$284,463,711.37	1.70%
COST SHARING	1	\$14,500.00	0.00%
FIRM FIXED PRICE	22,633	\$10,097,532,827.70	60.47%
FIXED PRICE AWARD FEE	7	\$2,534,552.43	0.02%
FIXED PRICE INCENTIVE	107	\$4,493,754,667.63	26.91%
FIXED PRICE LEVEL OF EFFORT	15	\$60,878,281.51	0.36%
FIXED PRICE WITH ECONOMIC PRICE ADJUSTMENT	1,386	\$124,674,419.54	0.75%
LABOR HOURS	14	\$895,809.77	0.01%
ORDER DEPENDENT (IDV ALLOWS PRICING ARRANGEMENT TO BE DETERM)	21	\$0.00	0.00%
TIME AND MATERIALS	100	\$30,820,492.15	0.18%
NULL	1	-\$7,462.59	0.00%
	<b>26,296</b>	<b>\$16,698,907,740.20</b>	<b>100.00%</b>

Advocates for firm fixed price (FFP) contracts suggested that FPI contracts require customers to commit an average of 5-10% in excess funds for 5-10 years even when those funds are rarely used. The actual requirement is to ensure that sufficient funds are available to pay for the final cost of the contract. This amount is adjusted over the course of the contract based on actual performance. Simply put, sufficient funding needs to be in place to ensure that the FMS customer can pay the final bill, no more, no less. While FPI contracts may require additional time to closeout (beyond that which



may be required for a FFP contract) due to the time needed for Defense Contract Audit Agency (DCAA) to conduct incurred cost audits, the costs of performance are largely known as assets near delivery, allowing return of any excess funds. Additionally, our policies and procedures allow for the subsequent conversion of FPI contracts to FFP at a point in which the Government and the contractor have confidence in the cost estimate.

Recognizing that the deliberative process to ensure an FMS sale is consistent with and will further U.S. security cooperation interests, uncertainty of requirements and timing of FMS customers' needs, differing budget cycles, and the time required to procure and deliver the needed capability to the FMS customer, we are continuing to work with VADM Rixey and DSCA to shorten the time involved in the portion of the process that USD(AT&L) can influence, principally the acquisition cycle time. As is the case with U.S. requirements, sole source FMS contracts for military items require the contractor to submit certified cost and pricing data in accordance with the Truth in Negotiations Act. We recognize there are opportunities to reduce procurement lead time and realize efficiencies by reducing the administrative cost for contractors to submit and certify to proposals FMS requirements. Under the FY 2016 National Defense Authorization Act (NDAA), we were granted a limited pilot authority to explore what efficiencies can be gained by waiving the requirements for certified cost or pricing data for low risk contract actions. Similarly, we are examining how we might tailor certified cost and data requirements in situations where we have recently concluded negotiations or where there is good insight into actual cost performance, in concert with employing FPI contracts to balance risk of future cost variations fairly between Government and industry. This methodology could significantly speed up the procurement cycle;

however, the ability to use FPI contracts for FMS production requirements is the cornerstone of this initiative.

Another area we are looking to improve is in the final pricing of undefinitized contract actions. The preferred practice is to finalize the terms and conditions of a contract and negotiate the price prior to award of a contract. However, due to urgent needs of the FMS customer and the timelines associated with establishing an FMS case, it is often necessary to authorize the contractor to begin work prior to reaching final agreement on price and other terms. Thus, the Department frequently employs the technique of initiating FMS contracts using an undefinitized contract action (UCA). We selectively use this technique to satisfy our own requirements as well, but on a less frequent basis due to greater insight and ability to forecast future requirements.

To ensure proper use and management of undefinitized contract actions, regulation, policy and procedures are already in place for DoD. Section 2326, title 10, United States Code, requires that when we employ UCAs, we establish limitations on the obligation of funds and a prescribed timeline to definitize. By law, UCAs for FMS are exempt from compliance with 10 U.S.C. § 2326, but by policy, the Department has mandated these UCA management procedures be applied “to the maximum extent practicable” and to notify both their acquisition leadership and my office when that won’t be possible. Both 10 U.S.C. § 2326 and the DFARS provide additional requirements for the approval, definitization, obligation of funds, and determination of allowable contractor profit. DFARS requires UCAs to be definitized within 180 days after issuance of the action (though this date may be extended to 180 days after the contractor submits a qualifying proposal). Since 2009 when the Congress enacted Section 809 of the FY 2008

NDAA, the Department has placed additional management attention on our use of UCAs. We instituted internal reporting procedures to provide management attention and visibility on our use of UCAs and we provide semi-annual reports to the Congress. In our most recent submission, we reported that the Department had a total of 347 UCAs valued at over \$5 million dollars each for the Reporting period April 1, 2015 through September 30, 2015. FMS UCAs account for 25% (87 of 347) of all reported UCA actions and 62% of reported UCA Not-to-Exceed dollar amounts. There were a total of 11 UCAs reported during period that remained undefinitized for a period in excess of 730 days. Two years is too long, we can and will do better and are working to address this problem. Definitizing UCAs in a timely manner requires the mutual cooperation of both parties—Government and contractor. In the past, one of the contributing factors in delays in definitization has been the quality of contractor proposals. When a contractor submits a proposal that is incomplete or insufficient for our auditors to assess, we ask the contractor to re-submit or provide additional data. This takes time. To address this aspect, the Department published a standard proposal review checklist to convey to industry the specific elements that a proposal must contain in order to be deemed sufficient. In addition, we have instituted the practice of having all stakeholders (Government and contractor) meet at the outset to establish expectations and timelines for proposal submission.

Another challenge that can slow pricing of FMS good and services is while DoD contracting officers negotiate contracts for FMS requirements using the same statutory, regulatory, and procedural requirements as those that apply to DoD requirements, there are some variations in terms of allowable costs. For example, the DFARS recognizes that

defense contractors that fulfill FMS contract requirements may incur legitimate additional business expenses they would not normally incur in DoD-only contracts. In pricing FMS contracts, DoD contracting officers may recognize reasonable and allocable costs such as sales promotions, demonstrations, and related travel for sales to foreign governments, and offset costs. Through training and policy we are exploring ways to expedite the negotiation of these costs in order to arrive at a fair and reasonable price for FMS requirements.

Offset requirements, which are agreements between the purchasing country and the contractor on contracts solely funded with FMS customer money, have been identified by both industry and government personnel as a significant source of delay. The U.S. Government does not encourage, enter into or enforce offset agreements entered into between a foreign government and any U.S. firm. The U.S. Government is not a party to offset agreements and does not have any obligation to enforce the contractor's performance of the offset agreement. However, a contractor may recover costs incurred for offset agreements with a foreign government or international organization if the agreement between the U.S. Government and that entity is financed wholly with customer cash or repayable foreign military finance credits. In the past, our contracting officers were not provided sufficient substantiating information necessary to render a determination that contractor-proposed costs associated with offsets were fair and reasonable. Contractors were challenged to provide accurate estimates given the uncertain nature of such costs. As a result, there were a number of contract negotiations that were protracted over a significant length of time. On June 2, 2015, DoD issued an interim DFARS rule to clarify that industry is responsible for establishing the

requirements and corresponding cost for indirect offsets with the FMS customer and consequently, the contracting officer would not subject those indirect offset costs to additional scrutiny. Subsequent to the issuance of the interim DFARS rule, the Congress enacted Section 812 of the FY 2016 NDAA which exempts contractors from having to submit certified cost and pricing data for certain offset costs under FMS contracts. The Department intends to issue a proposed DFARS rule to implement Section 812 to seek public/industry inputs in rulemaking while the aforementioned interim rule remains in effect. These actions are expected to address one of the most difficult elements to price in an FMS contract.

I would also like to update you on our progress on improvements to Technology Security and Foreign Disclosure (TSFD) process, and to the Defense Exportability Features (DEF) Pilot Program. From a strategic perspective, DoD leadership has taken steps to improve the U.S. Government and industry's ability to promote defense exports in support of our foreign policy and national security objectives. Through this cooperation we seek to increase interoperability with partners; reduce our own costs through economies of scale in production and partner contributions to research and development; enhance the military capability of allied forces; and build strategic relationships.

#### Technology Security and Foreign Disclosure

One such example of process improvements is the on-going DoD implementation of the TSFD Reform initiative launched by the Deputy Secretary of Defense in July 2010, to consolidate and improve existing DoD-led TSFD policies and processes. Following an

extensive review, on October 14, 2014, the Deputy Secretary signed DoD Directive 5111.21, Arms Transfer and Technology Release Senior Steering Group and Technology Security and Foreign Disclosure Office. This directive establishes policy, assigns responsibilities and describes authorities for the Arms Transfer and Technology Release Senior Steering Group (ATTR SSG). The ATTR SSG, co-chaired by the Office of the Under Secretary of Defense (Acquisition, Technology & Logistics and the Office of the Under Secretary of Defense (Policy), leads the continued reform of TSFD processes in order to synchronize efforts, minimize complexities, and to help implement holistic DoD-wide TSFD release review procedures. The ATTR SSG oversees the DoD's pre-vetting of technology transfers in anticipation of partner requirements, thus greatly reducing decision times on technology releases.

As a result of TSFD reform, the DoD, with oversight and leadership by ATTR SSG, manages priority TSFD Reviews for critical transfer issues for several countries, including Poland and India.

The ATTR SSG established the Poland Integrated Air and Missile Defense (IAMD) TSFD Working Group, which has worked to anticipate TSFD issues to ensure that U.S. industry could be competitive in competing for approximately \$9 to \$12B in funds that Poland earmarked for IAMD.

In addition, in support of interagency defense advocacy efforts, the DoD recommended establishment of an interagency Poland "Deal Team." The Department of Commerce's Advocacy Center chairs regular sessions of the deal team; DoD has been an active participant in working group meetings, contributing DoD insights to "whole-of-government" messaging.

The DoD has made the Defense Technology and Trade Initiative (DTTI) with India a key focus. With the DoD playing a lead role, the U.S. Government interagency process has put unprecedented effort into looking for ways to streamline our processes and to identify significant opportunities for co-production and co-development with India. Through partnership among the Office of the Under Secretary of Defense for Policy, the Office of the Under Secretary of Defense for Acquisition, Technology and Logistics, the Military Departments, and DoD agencies, the Department has succeeded in completing expedited TSFD reviews to support the Administration's policy objectives for engagement with India. The DTTI model and the fundamentals of making tough TSFD decisions are serving our efforts on multiple fronts in support of US industry and key allies.

The DoD is committed to continuing these TSFD process improvements by making export controls and related transfer processes more transparent, efficient and effective. As part of these efforts, the DoD continues to work very closely with U.S. industry as well as the Departments of Commerce and State, and other agencies.

### Defense Exportability

The export of defense products to our friends and allies provides opportunities for economies of scale, greater commonality and interoperability with global partners, and strengthened relationships. An important element of Under Secretary Kendall's Better Buying Power 2.0 initiatives is the Defense Exportability Features (DEF) initiative, which focuses on the opportunity for DoD program management and contractor teams to work together to assess, design, develop, and incorporate defense exportability features in

their systems during the early development phases. In support of this initiative, acquisition leaders in the Military Departments and OSD have been asked to consider defense exportability in their acquisition planning efforts, including during early acquisition milestone reviews.

Authorized by section 243 of the FY 2011 NDAA, as amended, the Defense Exportability Features Pilot Program further facilitates efforts to change the exportability paradigm. The Pilot Program enables the Department to offer supplemental funding, with industry co-sharing expenses, the assessment, design, and incorporation of exportability features early in the acquisition process. The authority for the Pilot Program is temporary and currently extends through October 1, 2020.

Since its inception, the DEF Pilot Program has selected a total of 18 programs to participate from Service Acquisition Executive nominations. Five selected programs are currently conducting DEF feasibility studies or design activities during FY 2016.

Although it is a relatively new business model, reports from several programs show promising signs of success. Thus far, the DEF initiative suggests that early exportability planning can save money, improve system security, save time and has the potential to make our industries more competitive globally.

Across these reform efforts, the DoD remains focused on ensuring that process improvements remain in line with U.S. export control laws, TSFD equities, weapon certifications, and other U.S. requirements. The DoD will continue to work with our partners and industries involved to identify what level of support is appropriate and to assist their navigation through the system.



Finally, the acquisition community recognizes that while we employ the same rigor and thought process in structuring terms and negotiating FMS contracts as we do for our own requirements, there will be instances where, in consultation the Director of DSCA, the Department must tailor our approach to account for and advance the objectives of the FMS program. We are committed to ensuring that our processes and our workforce have the capability and capacity to deliver the needed goods and services to our FMS customers in a timely manner and at a fair price.

In conclusion, I wish to reiterate the Department's appreciation for your continued commitment to our nation's warfighters and your support to our professional acquisition workforce that efficiently and cost effectively provide the goods and services essential to our national defense. I thank you for the opportunity to provide you with the Department's view about the FMS program from an acquisition perspective.