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The Honorable Henry Waxman
2204 Rayburn House Office Building
Washington, D.C. 20515

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Subject: Award Fees, Contract Oversight and Lockheed Martin

Dear Representative Waxman:

This letter supplements my letter of June 22, 2007. I had informed you that I support your initiatives to prevent unjustified award fees to federal contractors and discussed my concerns with a defense industry position paper on award fee incentives. The paper was sent to the Deputy Under Secretary of Defense. It stated that some defense contracts have misused incentives that were tied to achieving contractually-required reports of cost and schedule performance, called Earned Value Management (EVM) reports. The paper stated that the use of these incentives poses a risk that the contractors might sacrifice providing objective program status reporting in favor of "making the number" and that they may "manage data and reports."

I have evidence that Lockheed Martin (LM) has "managed data" in order to "make the number" on the F-35 Joint Strike Fighter (JSF) program. LM's practices were not in compliance with the EVM Standard (EVMS) that is required by the Federal Acquisition Regulation (FAR) and Defense FAR (DFAR). LM submitted monthly EVM reports which are the basis of semi-annual award fee claims. These reports misstated cost and schedule performance. Consequently, LM received unjustified award fees and also understated the final program costs, thereby avoiding Nunn-McCurdy scrutiny.

Although my evidence pertains to only the JSF program, it is pertinent that both DoD and the U.S. Navy issued policy memoranda (attached) which disclose that EVM is not working for acquisition management. The DoD memorandum states that:

- EVM is not serving its intended function in the internal control process
- DoD is committed to resolve systemic, DoD-wide weaknesses
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The Navy memo is explicit regarding contractor issues. It states that:

- Numerous Navy contractors are not compliant with the EVM guidelines
- Reviews have found broad deficiencies across multiple contractor sites including
 - Intentionally masking cost and schedule variances
 - Failure to document and manage changes to the baseline

The conditions described above exist on the JSF program. LM has been non-compliant with EVMS guidelines and with its internal procedures. The guidelines preclude a contractor from using Management Reserve (MR) to offset accumulated cost overruns. LM has reported cost overruns that were subsequently reduced by using MR. By doing so, it has managed the data and reports in order to obtain higher award fees and mask the real cost overrun. LM has also ignored an EVMS guideline by understating the most likely program Estimate at Completion (EAC).

I have documented evidence of the allegations regarding the reduction of cost overruns and suppression of the EAC. The evidence is in my reports that were prepared while doing EVM surveillance, a type of audit, with the Defense Contract Management Agency at the JSF major subcontractor, Northrop Grumman Corporation (NGC). I have been an employee of NGC for thirty-one years.

LM has managed the schedule performance data as well as the cost performance data. It has repeatedly fallen behind schedule with regard to the schedule baseline. However, after reporting a schedule variance to the baseline, LM has frequently changed both the schedule and budget baselines and administratively eliminated the schedule variance. I did not report this practice as a deficiency in complying with the EVMS standard because the DoD Program Office approved the frequent changes to the schedule baseline.

Subsequent to changing the schedule baseline, LM received award fees that were based on improved schedule performance even though the improvements were perceptual, not real. For example, an improvement in schedule performance was the result of the Program Office's approval of a revised schedule baseline with milestones that were deferred from the original completion dates. There was also a tacit approval of the concurrent elimination or reduction of the reported schedule variance. However, I believe that the award fee decision ignored the fact that the reported improvement in schedule performance was artificial. In fact, the technical maturity and functionality of the weapon system, including software functionality, is way behind the original baseline but the reported schedule data did not disclose the variance from the original baseline as of the last time I reviewed it in mid-2007.

The bottom line is that the cognizant DoD contracting officer approved the payment of award fees to LM prior to October 2007 that were based on reported progress towards meeting cost and schedule objectives. In my opinion, the reported cost performance was based on improper budgeting of past efforts from Management Reserve. The perception of improved cost performance was buttressed by a suppressed EAC and by masking the true schedule variance from the original baseline. The award fees were subsequently shared with LM's subcontractors, NGC and British Aerospace.

I am asking your help both as my representative and as Chairman of the Committee on Government and Oversight Reform. I am a Vietnam War Veteran, an expert on EVM, and of course, a taxpayer. I have worked on the B-2 Stealth Bomber, Global Hawk, and JSF programs. I am a recipient of the DoD David Packard Award for Excellence in Acquisition for my work on the team that wrote the EVM Standard which contains the guidelines that were ignored.

You can learn more about EVM in the Congress Research Service Report, *Earned Value Management as an Oversight Tool for Major Capital Investments*, Order Code RL34257, dated November 21, 2007. The report states that the usefulness of EVM metrics depends on the quality and reliability of the cost, schedule, and functionality data that underlie both a project's baseline plan and its reports on work performed.

The report raises potential oversight questions for Congress such as:

1. Are underlying EVM metrics fully, forthrightly, and timely, and transparently reported?

2. Should EVM metrics be inputs to Congressional oversight, appropriation of funds, and authorization of agency and presidential activities?
3. What might be the advantages of requiring independently, publically accessible assessments, including verification and validation, of the underlying quality of EVM data, including cost estimates and assessments of the functionality that is delivered in comparison with what was planned?

I recommend that you also consider another potential oversight issue with regard to civilian agencies, as follows.

The FAR requires that agencies have "written acquisition plans" in which they "discuss the methodology the Government will employ to analyze and use the earned value data to assess and monitor contract performance. In addition, discuss how the offeror's/contractor's EVMS will be verified for compliance with the American National Standards Institute/Electronics Industries Alliance standard" (EVMS). Given the widespread problems that DoD is having with contractors that are not in compliance with the EVMS, as discussed in the DoD and Navy memoranda, it is likely that civilian agencies, who only recently initiated EVM, are having similar problems. Consequently, additional oversight question should be:

1. Do civilian agencies have trained resources, processes and plans to adequately verify their contractors' compliance with the EVMS?
2. Do civilian agencies also have widespread problems with contractors that are not compliant with the EVMS?

You can also find useful information about EVM and review my credentials at my website www.pb-ev.com . The website includes excerpts from recent OMB and DoD policy and authorization bills that preclude the payment of award fees to contractors that do not meet cost, schedule and performance objectives.

I recommend that you request the GAO to verify my specific allegations regarding the JSF program. After they are verified, you may want to consider the need for additional oversight or legislation. You may also choose to address the potential oversight questions raised in the CRS report and in this letter.

Your office may contact me to obtain additional information regarding these matters.

Sincerely,

Paul Solomon