

## ***Earned Value Management System challenges in a changing environment: Are you ready?***

*“Contractor business systems and internal controls are the first line of defense against fraud, waste, and abuse.”<sup>1</sup>*

### **Change and challenge: the new EVMS environment**

The Department of Defense (DoD) considers an Earned Value Management System (EVMS) to be one of the agency's most powerful program management tools. An EVMS integrates a contractor's program cost, schedule, and technical scope data and the DoD uses this information to ensure contractor adherence to ever-tightening budget and schedule targets. As the DoD is operating under the threat of massive sequestration-driven budget cuts, defense contractors, in turn, must operate at their highest levels of performance in managing programs. In this dynamic environment, DoD contractors are further challenged with changes to the EVM ground rules involving both reporting requirements and business systems compliance: They are under heightened oversight for executing programs to cost and schedule targets, and maintaining compliant systems for monitoring and reporting program performance.

### **New reporting requirements, regulations, and heightened oversight**

With the intent of improving the integration of cost and schedule reporting, the DoD approved changes to contractor EVMS reporting formats. The DoD issued this new guidance on June 20, 2012, in DI-MGMT-81861, Integrated Program Management Report (IPMR), Data Item Description (DID), which replaces the Contract Performance Report (CPR) DID, DI-MGMT-81466A, and the Integrated Master Schedule (IMS) DID, DI-MGMT-81650. The IPMR DID is effective for all applicable contracts awarded based on solicitations or requests for proposals issued on or after July 1, 2012, and may be applied to follow-on contracts subject to negotiation with the government customer. This change promotes the integration and analysis of cost and schedule information to better capture the intent of the EVMS governing ANSI/EIA 748 standard and sound project management principles. Aerospace & Defense (A&D) contractors must be prepared to support the new IPMR DID, as it will ultimately impact their existing EVMS. Existing contracts will continue to perform to the older DID requirements, unless otherwise negotiated with the government customer, but new contracts will be held to the IPMR DID. Contractors will need to reference the old and new terms and forms, and update existing EVMS supporting documentation and training materials.

Even more impactful to the implementation and execution of a contractor's EVMS, the DoD earlier this year finalized the Defense Federal Acquisition Regulation Supplement (DFARS) Business Systems Rule, which penalizes contractors with 5%-10% payment withholdings when they are deemed to have “significant deficiencies” in specified business systems.

<sup>1</sup> “Defense Federal Acquisition Regulation Supplement; Business Systems-Definition and Administration (DFARS Case 2009-D038),” Department of Defense, 24 Feb 2012.

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*“Weak control systems increase the risk of unallowable and unreasonable costs on government contracts.”<sup>1</sup>*

*The Government Accountability Office reported \$135 billion in cost growth for 98 major weapon systems over two fiscal years starting in 2008.<sup>2</sup>*

The rule was put in place in February 2012 to improve the effectiveness of Defense Contract Management Agency (DCMA) and Defense Contract Audit Agency (DCAA) oversight by clarifying the definition and administration of contractor business systems.

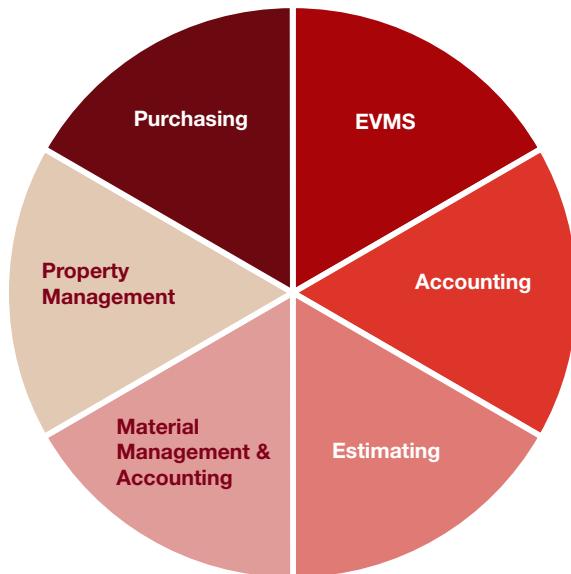
This regulatory change has significantly impacted the fundamentals of how A&D contractors conduct business. Contractors are now facing: (1) higher standards of self-governance and accountability, (2) “contractual” standards of compliance for previously what was “guidance,” and (3) enforcement of penalties for certain instances of non-compliance.

The Business Systems Rule’s impact on A&D contractors is heightened when compounded with the ongoing US government (USG) budget deficit; this deficit is driving increased scrutiny over DoD spending and focusing attention on cutting the funding of programs experiencing cost overruns or behind schedule execution. An indicator of a contractor’s ability to meet contractually required cost and schedule criteria is if the contractor has compliant or non-compliant business systems; of most significance in this regard is a contractor’s EVMS. The DoD must have confidence in the validity of the EVMS performance data.

An EVMS is one of the six key systems noted in the DFARS Business Systems Rule and is now under increased scrutiny by both the DCMA and DCAA, and contractors with known business system deficiencies are clear targets for this heightened level of USG oversight. A compliant EVMS must effectively interface with a contractor’s estimating, accounting, and material management and accounting (MMAS) systems. One significant system deficiency can impact multiple systems and potentially result in a 10% withhold on applicable contracts.

Driven by the budget deficit, the DoD is closely examining programs to their cost, schedule, and quality commitments; instances of penalties and fee reductions for non-compliance are on the rise. A&D companies risk losing contracts for failure to comply with EVMS requirements. In worst-case situations, troubled A&D programs may be

## Six business systems



<sup>1</sup> “Defense Federal Acquisition Regulation Supplement; Business Systems-Definition and Administration (DFARS Case 2009-D038),” Department of Defense, 24 Feb 2012.

<sup>2</sup> “Assessments of Selected Weapon Programs: GAO-11-233SP”, United States Government Accountability Office, March 2011.

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targeted for funding reductions or even contract termination. A&D companies need to decide whether to continue business as is or raise their game and adapt to the new compliance environment.

## **Increased contractor accountability**

In the current A&D environment, contractor responsibility for business system compliance is not only emphasized, it is required. The burden of demonstrating compliance with business system requirements falls squarely on the contractor. As contractors now have higher standards for self-governance and accountability, management of DFARS business systems becomes more strategic and reliant on strong control systems leveraging advanced business processes and technology. Given the critical role of an EVMS to help ensure that programs perform to cost and schedule requirements and, therefore, keep out of view of DoD budget cutters, it is essential for contractors' health that this DFARS business system be compliant.

## **Earned Value Management is far more than just a compliance challenge**

An EVMS is not only a decision-making tool for management — it is a way of doing business that is essential to improved program planning and execution. An effective EVMS achieves improved transparency into costs and provides increased visibility at all program levels. The data presented in EVMS reports can provide key indicators to help management make financial and operational decisions on program performance, priorities, resources, issues, risks, and investments.

## **EVMS cultural change management**

Implementing an EVMS is broader than installing a solution on people's computers; it requires a change in processes, behaviors, and ways of working. System users and stakeholders should understand why the change is needed, the benefits of that change, and how they will be impacted. People should feel involved in the change process and be provided with opportunities to voice opinions and concerns. A change that is well managed and involves stakeholders is more likely to achieve its targeted benefits and be sustainable. Sustaining change requires a continuous, holistic approach to training and education in order to achieve a cultural transformation.

## ***Key Earned Value Management-related questions senior aerospace and defense decision makers are asking***

### **CFOs:**

“What are the likely impacts of a non-compliance finding by the DCMA on our progress payments, award fees, and other revenues? And what, among other financial issues, are the most efficient ways to remediate these deficiencies — both now and over the long term?”

*An EVMS can help provide CFOs with contract-specific information on financial performance, estimates to complete, and risk analysis that can be used to identify and assess program performance deficiencies, evaluate alternatives for remediation, and then select and plan the appropriate path forward while minimizing financial exposure.*

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Maximize the use of Earned Value Management to run your business.

## Program executives:

“How can we leverage our current capabilities — without unnecessarily drawing funding away from other critical priorities or unwittingly assuming risks that, if accurately identified, can be mitigated?”

*An EVMS is a decision-making tool for management. If an EVMS is in place and producing accurate and timely data, it facilitates executive decision-making for more effective program management.*

## CIOs:

“EVMS compliance is intimately connected to many of the IT initiatives we are pursuing. How should we best address the program’s EVM compliance issues in the context of our other IT projects?”

*In an enterprise environment CIOs are managing many portfolio initiatives. A compliant EVMS must effectively interface with the following contractor’s business systems: (1) estimating, (2) accounting, and (3) MMAS.*

## Senior risk and compliance officers:

“Our EVMS compliance requirements represent only one dimension of our risk and compliance challenge. How do we effectively integrate the EVMS compliance initiatives with our other compliance initiatives?”

*The integration of risk management and EVM increases the probability of program success.*

## **EVMS compliance requires an integrated approach to addressing many different issues. Which challenges are you facing?**

Few companies can afford to continue business as usual. PwC views EVMS not just as a growing compliance priority but as a critical component of a broader approach to improving program management effectiveness, identifying risks and — by extension — improving margins and profits, competitive positioning, and shareholder value.

In short, we believe it is increasingly essential that A&D organizations address EVMS compliance requirements in the context of the full “business picture” with a holistic perspective that takes into account a wide range of related issues — from alignment with other compliance initiatives to integration with various program management and IT effectiveness initiatives.

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## PwC's EVMS point of view

We view EVMS compliance as an integral component of program management. The most successful A&D contractors leverage EVM to create a competitive advantage in an environment of increasing pressure on program performance and budgetary constraint. What distinguishes these contractors from others are the following:

1. Executive management “Walks the EVMS Talk.” EVMS is endorsed and used as the program management tool by all levels of company management.
2. EVMS is culturally adopted to provide timely, accurate, complete, and useful information on program performance.
3. EVMS is leveraged across the company, on both commercial and USG contracts, in a consistent, holistic, and efficient manner to *profitably* manage programs/projects. One program management system is deployed and used, thereby eliminating competing or duplicative systems.
4. EVMS is deployed on fixed-priced contracts to: (1) minimize company financial risk on such contracts, and (2) establish a single, consistent, across-the-entity program management process. As companies bear the financial risk of fixed-price contracts, EVMS can be leveraged to reduce/manage the company's exposure on programs with strict pricing commitments where cost overruns would hit the bottom line. Although EVMS is typically not contractually required for fixed-price USG contracts, its use on such contracts helps facilitate a company's culture of program management excellence.
5. Real-time, online, single-source EVMS data is consistently used by all levels of company and program management. Everyone follows the same EVMS playbook and alternative sources of data are eliminated.
6. Technology is leveraged to implement and run EVMS better, faster, and cheaper, with less risk (e.g., Web EVMS).
7. EVMS and related business systems are maintained and monitored to be compliant.
8. Sufficient staffing and training is provided to the EVMS core team.
9. EVMS control account managers, functional analysts, and schedulers are trained, motivated, and incentivized.

We believe that contractors need a balanced framework to guide them in transforming their culture, processes, and technology to support the successful design, deployment, and use of EVMS to its fullest advantage. Shared goals, open communication, integration, proactive mindset, and knowledge management are the five principles that support our program management effectiveness framework.

## How PwC can help

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