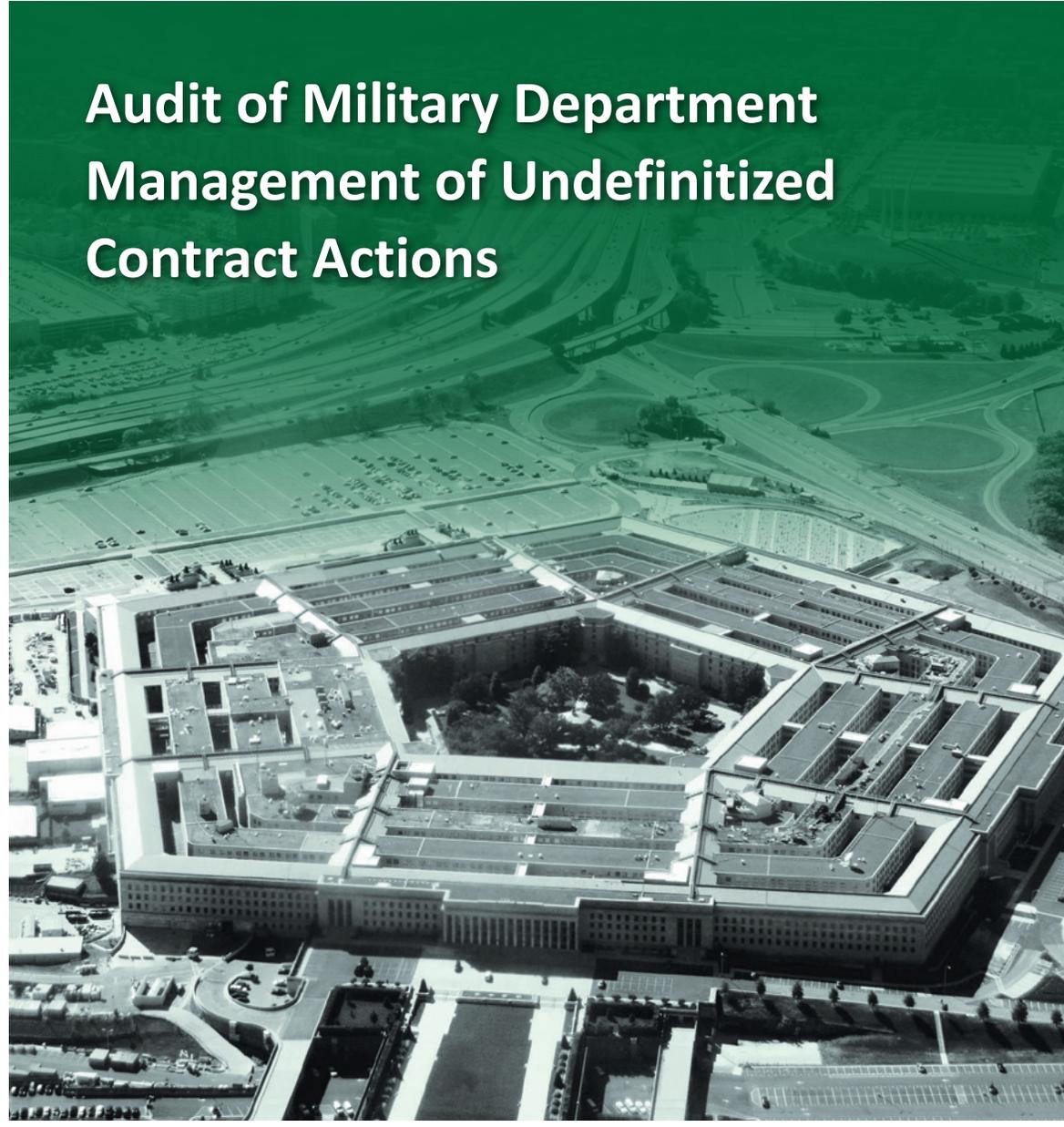


~~FOR OFFICIAL USE ONLY~~

INSPECTOR GENERAL

U.S. Department of Defense

MAY 11, 2020



Audit of Military Department Management of Undefined Contract Actions

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE

The document contains information that may be exempt from mandatory disclosure under the Freedom of Information Act.

~~FOR OFFICIAL USE ONLY~~





Results in Brief

Audit of Military Department Management of Undefinitized Contract Actions

May 11, 2020

Objective

The objective of this audit was to determine whether the Military Departments (MILDEPs) properly managed undefinitized contract actions (UCAs) by obligating funds within required limits, ensuring profit was adjusted for cost incurred, and definitizing actions within required time limits.

Background

UCAs are agreements that allow a contractor to begin work and incur costs before the Government and the contractor have reached a final agreement on contract terms, specifications, or price. Once a UCA is awarded, the contractor immediately begins working and the Government must reimburse the contractor's allowable costs during the undefinitized period. As a result, a UCA is essentially a cost-reimbursable contract during the undefinitized period. When the contractor and Government agree on contract terms, specifications, price, and profit, the UCA is then definitized.

In addition, as contracting officers determine the final price for the UCA, they are required to assess as part of the profit rate for contract type risk the extent to which costs have been incurred before the UCA is definitized. Contract type risk, referred to as contract risk in this report, is the degree of cost risk accepted by the contractor and Government under varying contract types. For example, under a cost-reimbursable contract, the Government has more cost risk than the contractor, while under a fixed-price contract the contractor has more cost risk than the Government. Contracting officers use the assessment of contract risk

Background (cont'd)

to adjust the profit for the UCA up or down depending on how much of the overall cost for the UCA had been incurred before definitization. Before definitization, allowable costs are reimbursable by the Government, and the cost risk to the contractor is lower. The lower the cost risk to the contractor, the lower the profit.

Defense Pricing and Contracting (DPC), under the Office of the Under Secretary of Defense for Acquisition and Sustainment, is responsible for pricing, contracting, and procurement policy for the DoD, including updates to Defense Federal Acquisition Regulation Supplement (DFARS) and its Procedures, Guidance, and Information. DPC also provides guidance for UCAs within the DoD and reports to Congress semiannually on DoD usage and management of UCAs.

Federal Procurement Data System–Next Generation (FPDS-NG) is a web-based tool for Federal agencies to report contract actions, including UCAs. Contracting officers are required by the Federal Acquisition Regulation to populate, complete, and submit contract action reports on all contract actions, including award and modifications, in the FPDS-NG.

Finding

MILDEP contracting officers generally followed requirements when obligating funds for the 116 UCAs we reviewed, valued at \$10.9 billion. However, some contracting officers did not fully comply with requirements for adjusting profit or definitizing UCAs. Specifically, these contracting officers did not:

- adjust the profit rate for contract risk to reflect costs already incurred on the UCA at definitization when they determined the profit for 12 UCAs, valued at \$523.9 million, because the DFARS does not provide clear guidance on how contracting officers should adjust the profit rate for contract risk for costs already incurred on the UCA;
- adequately support their contract risk determinations in the contract file for 56 UCAs, valued at \$5.3 billion, because contracting officers did not prepare price negotiation memorandums with sufficient detail to



Results in Brief

Audit of Military Department Management of Undefinitized Contract Actions

Finding (cont'd)

document incurred costs, and the DD Form 1547 lacked sufficient detail to show the reduced cost risk related to incurred costs during the undefinitized period; or

- definitize 53 UCAs, valued at \$4.8 billion, within the required 180 days after the contracting officers received a qualifying proposal from the contractor because, according to the contracting officers, lengthy negotiations were caused by changing Government requirements and they were working with “inexperienced” or “uncooperative contractors.”

In addition, we determined that some contractors took up to 542 days from award of the contract to provide qualifying proposals for the 116 UCAs we reviewed. This occurred because DFARS lacks contract clauses that contracting officers could use to further incentivize contractors to provide timely qualifying proposals.

Furthermore, while selecting our sample of UCAs, we conducted a reconciliation of the contract actions identified as UCAs in the FPDS-NG to the UCAs reported to DPC for inclusion in the semiannual UCA report to Congress. While this reconciliation only covered the seven contracting offices in our sample, we found that contracting officers did not report accurate or complete information in the FPDS-NG for 402 contract actions, valued at \$12.8 billion, or to DPC for 17 UCAs, valued at \$2.1 billion, because the MILDEPs did not have controls in place to reconcile the FPDS-NG data to the UCA information they reported semiannually to DPC and Congress.

As a result, the DoD assumed more contract risk and potentially paid \$4.6 million more profit than necessary for 12 UCAs. Also, contracting officers could not fully incentivize contractors to submit timely qualifying proposals and control their costs before definitization. In addition, the DPC Principal Director and Congress were not aware of the DoD’s use and management of 17 UCAs, valued at \$2.1 billion, that were not reported to DPC.

Recommendations

Among other recommendations, we recommend that the DPC Principal Director:

- update the DFARS to clarify that when considering the reduced cost risks associated with allowable incurred costs on a UCA, it is appropriate to apply separate and differing contract risk factors for allowable incurred costs and estimated costs to complete according to the United States Code when completing the contract risk sections of DD Form 1547, “Record of Weighted Guidelines.”
- encourage contractors to provide timely qualifying proposals by updating DFARS Subpart 217.7404-3, “Definitization Schedule” to:
 - open the suspension and reduction of progress payments to include all types of contract payments and not just progress payments; and
 - require contracting officers document in the contract file their justification for why payments were not withheld if the qualifying proposal was not received in accordance with the initial definitization schedule.
- update the DFARS clause 252.217-7027, “Contract Definitization,” to include that failure to meet the qualifying proposal date in the definitization schedule could result in the Government withholding a percentage of all payments yet to be paid under a UCA until the qualifying proposal is received, and

Among other recommendations, we recommend that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology), the Deputy Assistant Secretary of the Navy for Procurement, and the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics):

- require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying



Results in Brief

Audit of Military Department Management of Undefined Contract Actions

Recommendations (cont'd)

proposal in accordance with the UCA definitization schedule to immediately report to their Head of the Contracting activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.

Army Contracting Command–Redstone Arsenal, Army Contracting Command–Detroit Arsenal (formerly Army Contract Command–Warren), Naval Air Systems Command, Naval Sea Systems Command, Air Force Life Cycle Management Center–Wright Patterson, Air Force Life Cycle Management Center–Hanscom, and Air Force Space and Missile Systems Center contracting officials took actions to correct contract action reports in the FPDS-NG that were not accurate.

Management Comments and Our Response

The DPC Acting Principal Director, responding for the DPC Principal Director, agreed with 6 of the 8 recommendations and requested that 2 recommendations be combined and revised to take into consideration recent changes made by the 2017 National Defense Authorization Act on how profit is calculated. We revised the recommendations as requested by the Acting Principal Director. Comments from the Acting Principal Director, addressed the recommendations; therefore those recommendations are resolved but will remain open until we receive documentation to support that the Acting Principal Director implemented those recommendations.

The Deputy Assistant Secretary of the Army (Procurement), responding for the Assistant Secretary of the Army (Acquisition, Logistics, and Technology), and the Director of Policy, Deputy Assistant Secretary of the Navy (Procurement), responding for the Deputy Assistant Secretary of the Navy for Procurement, disagreed with the recommendation to require the

head of each contracting activity to establish a process that the contracting officers, who have not received a qualifying proposal in accordance with the UCA definitization schedule, to immediately report to their Head of the Contracting Activity. They stated that the recommendation is not necessary because the requirement already exists in the DFARS or DFARS Guidance and Information (PGI). The Director of Policy also stated that the Navy has processes in place which meet the intent of the recommendation. The Principal Deputy Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), responding for the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), agreed with the specifics of the recommendation.

We disagree that the DFARS requirement is being fully implemented at the Army and Navy sites we visited. We found that all emphasis was placed on meeting the 180-day definitization deadline after receipt of the qualifying proposal and not when the deadline for the qualifying proposal was missed. The Deputy Assistant Secretary of the Army (Procurement) and the Director of Policy, Deputy Assistant Secretary of the Navy (Procurement), did not address the specifics of the recommendation. Therefore, the recommendation is unresolved. We request that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) and the Deputy Assistant Secretary of the Navy for Procurement provide additional comments on the actions that the Army and the Navy will take to implement the recommendations. Comments from the Principal Deputy Assistant Secretary of the Air Force, partially addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open.

Please see the Recommendations Table on the next page for the status of recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Principal Director, Defense Pricing and Contracting		1.a, 1.b.1, 1.b.2, 1.b.3, 1.c, 1.d, and 1.e	None
Assistant Secretary of the Army (Acquisition, Logistics and Technology)	2.b	2.a	None
Deputy Assistant Secretary of the Navy for Procurement	3.b	3.a	None
Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics)		4.a and 4.b	None

Please provide Management Comments by June 10, 2020.

Note: The following categories are used to describe agency management’s comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – OIG verified that the agreed upon corrective actions were implemented.



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500

May 11, 2020

MEMORANDUM FOR PRINCIPAL DIRECTOR, DEFENSE PRICING
AND CONTRACTING
AUDITOR GENERAL, DEPARTMENT OF THE NAVY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Audit of Military Department Management of Undefinitized
Contract Actions (Report No. DODIG-2020-084)

This final report provides the results of the DoD Office of Inspector General's audit. We previously provided copies of the draft report and requested written comments on the recommendations. We considered management's comments on the draft report when preparing the final report. These comments are included in the report.

This report contains recommendations that are considered unresolved because the Deputy Assistant Secretary of the Army (Procurement) and the Deputy Assistant Secretary of the Navy for Procurement did not fully address the recommendations presented in the report.

Therefore, as discussed in the Recommendations, Management Comments, and Our Response section of this report, those recommendations remain open. We will track these recommendations until an agreement is reached on the actions to be taken to address the recommendations, and adequate documentation has been submitted showing that the agreed-upon action has been completed.

DoD Instruction 7650.03 requires that recommendations be resolved promptly. Therefore, please provide us within 30 days your response concerning specific actions in process or alternative corrective actions proposed on the recommendations. Your response should be sent to followup@dodig.mil.

If you have any questions, please contact me at [REDACTED].

A handwritten signature in black ink, appearing to read "Theresa S. Hull".

Theresa S. Hull
Assistant Inspector General for Audit
Acquisition, Contracting, and Sustainment

Contents

Introduction

Background	1
Review of Internal Controls	12

Finding. Military Department Management of UCAs Needs Improvement

.....	13
Military Departments Inconsistently Managed Undefined Contract Actions	14
Contracting Officers Did Not Correctly Report Contract Actions	31
Management Actions Taken	34
Conclusion	34
Management Comments on the Finding and Our Response	34
Recommendations, Management Comments, and Our Response	35

Appendixes

Appendix A. Scope and Methodology	44
Use of Computer-Processed Data	48
Use of Technical Assistance	49
Prior Coverage	49
Appendix B. DoD UCAs Issued by Military Department	52
Appendix C. Management Comments on the Finding, Unsolicited Comments, and Our Response	58

Management Comments

DPC Comments	64
Department of the Army Comments	67
Department of the Navy Comments	70
Department of the Air Force Comments	78

Acronyms and Abbreviations

Introduction

The objective of this audit was to determine whether the Military Departments (MILDEP) properly managed undefinitized contract actions (UCAs) by obligating funds within required limits, ensuring profit was adjusted for cost incurred, and definitizing actions within required time limits. See Appendix A for a discussion of the scope and methodology and for prior coverage.

Background

Undefinitized Contract Actions

UCAs are agreements that allow a contractor to begin work and incur costs before the Government and the contractor have reached a final agreement on contract terms, specifications, or price. Once a UCA is awarded, the contractor immediately begins working and the Government is required to reimburse all the contractor's allowable costs during the undefinitized period. As a result, during the undefinitized period the UCA is essentially a cost-reimbursable contract.

The Defense Federal Acquisition Regulations Supplement (DFARS) states that DoD policy is for contracting officers to use a UCA only when the negotiation of a definitive contract action is not possible in sufficient time to meet the Government's requirement.¹ UCAs can be entered into several different ways, such as a letter contract (a stand-alone contract), a task or delivery order issued against a pre-established contract, or a modification to an already established contract. Contracting officers must follow a series of steps when using a UCA. As shown in Figure 1, contracting officers are responsible for following specific requirements when using a UCA.

¹ DFARS Part 217, "Special Contracting Methods" Subpart 217.74 "Undefinitized Contract Actions" Section 217.7403, "Policy."

Figure 1. The Undefined Contract Action Process



Source: The DoD OIG.

UCAs Restrictions

Both the United States Code (U.S.C.) and the DFARS list restrictions on UCAs.³

- Contracting officers shall obtain approval from the head of the contracting activity before entering into a UCA.
- UCAs shall include an NTE price, and the contracting officer shall document the rationale for the NTE price and retain it in the contract file.

² In September 2019, the definition of a qualifying proposal was updated to a proposal that contains sufficient information to enable the DoD to conduct meaningful analyses and audits of the information contained in the proposal.

³ 10 U.S.C. § 2326 (2010), and DFARS Subpart 217.74, "Undefined Contract Actions."

- UCAs shall contain definitization schedules; additionally, the UCA must provide for definitization (agreement upon contractual terms, specifications, and the price) by the earlier of either: (1) 180 days after the qualifying proposal receipt date; or (2) the date when obligated funds surpass 50 percent of the NTE price.
- The Government shall not obligate more than 50 percent of the NTE price before definitization; however, if the contractor submits a qualifying proposal before obligated funds reach 50 percent, then the Government can obligate no more than 75 percent.
- The allowed profit for the UCA shall reflect any reduced cost risk to the contractor for incurred costs before the final negotiated price and for expected costs for the remainder of the contract.⁴

However, if the requiring activity requests a UCA for a contingency operation, a humanitarian operation, or a peacekeeping operation, then the requiring activity can waive the NTE price, definitization schedule, and limitations on obligations.⁵ During the scope of our audit, January 2012 to December 2017, if the requiring activity requested a UCA for foreign military sales, purchases at or below the simplified acquisition threshold, special access programs, or congressionally mandated long-lead procurement contracts, the contracting officer was only required to follow DFARS requirements to the maximum extent practicable.⁶ In September of 2019, the DFARS was updated and now requires UCAs for foreign military sales to follow the DFARS requirements.

Authorization of a UCA

DFARS states that the standard authorization request for a UCA requires contracting personnel to explain the need to begin performance and the impact on agency requirements if a UCA is not used.⁷ The contracting officer shall then obtain approval from the head of contracting before entering into a UCA. For example, contracting officers for the UCAs we reviewed used UCAs to satisfy urgent needs, such as:

- providing warning and countermeasure capabilities to reduce loss of life;
- addressing emergency fixes for aircraft; or
- providing logistical support for critical mission requirements.

⁴ Cost risk is the degree of cost responsibility accepted by the contractor under varying contract types. The Government carries the risk burden for cost-reimbursable contract types; whereas, the contractor carries the risk burden for fixed-price contract types.

⁵ DFARS Section 217.7404-5, "Exceptions."

⁶ DFARS Section 217-7402, "Exception." and Public Law 115-91, "National Defense Authorization Act for Fiscal Year 2018," December 12, 2017, increased the simplified acquisition threshold to \$250,000.

⁷ DFARS Section 217.7404-1, "Authorization."

Qualifying Proposal

To definitize a UCA, the contractor must provide a qualifying proposal. DFARS states that a qualifying proposal must contain sufficient data for the DoD to completely and meaningfully analyze and audit the proposal data with any other data connected to the contract.⁸ Contracting officers are required to determine whether a proposal is a qualifying proposal based on DFARS guidance. Federal law requires the contracting officer to definitize the UCA by the earlier of either: (1) 180 days after the qualifying proposal receipt date; or (2) the date when obligated funds surpass 50 percent of the NTE price.⁹

Determining Profit

DFARS requires that when determining profit, contracting officers must consider the contractor's reduced cost risk during the undefinitized period and the remainder of the contract.¹⁰ Because the Government reimburses the contractor for its allowable costs during the undefinitized period, the Government holds more of the contract risk and the contractor's profit should reflect this. To determine profit, DFARS directs contracting officers to use the weighted guidelines method for developing a pre-negotiation profit or fee objective and requires the contracting officer to document the profit analysis in the contract file.¹¹

The weighted guidelines method focuses on the four following areas.

- **Performance Risk** addresses the contractor's degree of risk in fulfilling the contract requirements.
- **Contract Type Risk** is the degree of cost risk accepted by the contractor and the Government under varying contract types. For the purpose of this report, we will refer to it as contract risk.
- **Facilities Capital Employed** focuses on encouraging and rewarding capital investment in facilities that benefit the DoD.
- **Cost Efficiency** provides an incentive for contractors to reduce cost by increasing the profit objective to recognize these efforts.

Contracting officers document their determinations for these four areas in the DD Form 1547, "Weighted Guidelines," July 2002, which can be seen in Figure 2.

⁸ DFARS Section 217.7401 "Definitions." In September 2019, the definition of a qualifying proposal was updated to a proposal that contains sufficient information to enable DoD to conduct meaningful analyses and audits of the information contained in the proposal.

⁹ 10 U.S.C § 2326 (2010).

¹⁰ DFARS Section 217.7404-6, "Allowable Profit."

¹¹ DFARS Section 215.404-4, "Profit."

Figure 2. DD Form 1547, "Weighted Guidelines," July 2002

RECORD OF WEIGHTED GUIDELINES APPLICATION						REPORT CONTROL SYMBOL DD-AT&L(Q)1751		
1. REPORT NO.		2. BASIC PROCUREMENT INSTRUMENT IDENTIFICATION NO.			3. SPIIN		4. DATE OF ACTION	
		a. PURCHASING OFFICE	b. FY	c. TYPE PROC INST CODE	d. PRISM		a. YEAR	b. MONTH
5. CONTRACTING OFFICE CODE				ITEM	COST CATEGORY		OBJECTIVE	
6. NAME OF CONTRACTOR				13.	MATERIAL			
				14.	SUBCONTRACTS			
7. DUNS NUMBER		8. FEDERAL SUPPLY CODE		15.	DIRECT LABOR			
				16.	INDIRECT EXPENSES			
9. DOD CLAIMANT PROGRAM		10. CONTRACT TYPE CODE		17.	OTHER DIRECT CHARGES			
				18.	SUBTOTAL COSTS (13 thru 17)			
11. TYPE EFFORT		12. USE CODE		19.	GENERAL AND ADMINISTRATIVE			
				20.	TOTAL COSTS (18 + 19)			
WEIGHTED GUIDELINES PROFIT FACTORS								
ITEM	CONTRACTOR RISK FACTORS		ASSIGNED WEIGHTING	ASSIGNED VALUE	BASE (Item 20)	PROFIT OBJECTIVE		
21.	TECHNICAL		%					
22.	MANAGEMENT/COST CONTROL		%					
23.	PERFORMANCE RISK (COMPOSITE)							
24.	CONTRACT TYPE RISK							
25.	WORKING CAPITAL	COSTS FINANCED		LENGTH FACTOR	INTEREST RATE			
					%			
		CONTRACTOR FACILITIES CAPITAL EMPLOYED		ASSIGNED VALUE	AMOUNT EMPLOYED			
26.	LAND							
27.	BUILDINGS							
28.	EQUIPMENT							
29.	COST EFFICIENCY FACTOR		ASSIGNED VALUE		BASE (Item 20)			
					%			
30.			TOTAL PROFIT OBJECTIVE					
NEGOTIATED SUMMARY								
				PROPOSED	OBJECTIVE	NEGOTIATED		
31.	TOTAL COSTS							
32.	FACILITIES CAPITAL COST OF MONEY (DD Form 1861)							
33.	PROFIT							
34.	TOTAL PRICE (Line 31 + 32 + 33)							
35.	MARKUP RATE (Line 32 + 33 divided by 31)			%	%	%		
CONTRACTING OFFICER APPROVAL								
36. TYPED/PRINTED NAME OF CONTRACTING OFFICER (Last, First, Middle Initial)			37. SIGNATURE OF CONTRACTING OFFICER			38. TELEPHONE NO.		39. DATE SUBMITTED (YYYYMMDD)
OPTIONAL USE								
96.	97.		98.		99.			

DD FORM 1547, JUL 2002

PREVIOUS EDITION IS OBSOLETE.

Adobe Professional 8.0

Source: DoD Forms Management Program.

Except for the cost-efficiency factor, each profit factor has a normal value and a designated range of values; the normal value represents average conditions, and the designated range provides values based on above normal or below normal conditions. DFARS requires that the contracting officer document any conditions that justify using any value other than the normal value.¹² See Figure 3 for an example of the ranges associated with the profit rate for contract risk.

Figure 3. DFARS Profit Rate for the Contract-Risk Factor Normal and Designated Range

Contract Type	Notes	Normal Value (percent)	Designated Range (percent)
Firm-fixed-price, no financing	(1)	5	4 to 6.
Firm-fixed-price, with performance-based payments	(6)	4	2.5 to 5.5.
Firm-fixed-price, with progress payments	(2)	3	2 to 4.
Fixed-price incentive, no financing	(1)	3	2 to 4.
Fixed-price incentive, with performance-based payments	(6)	2	0.5 to 3.5.
Fixed-price with redetermination provision	(3)		
Fixed-price incentive, with progress payments	(2)	1	0 to 2.
Cost-plus-incentive-fee	(4)	1	0 to 2.
Cost-plus-fixed-fee	(4)	.5	0 to 1.
Time-and-materials (including overhaul contracts priced on time-and-materials basis)	(5)	.5	0 to 1.
Labor-hour	(5)	.5	0 to 1.
Firm-fixed-price, level-of-effort	(5)	.5	0 to 1.

Source: DFARS Section 215.404-71-3, "Contract Type Risk and Working Capital Adjustment."

The DD Form 1547 is used by contracting officers to determine the profit objective for the definitized contract. For example, to determine the profit rate for contract risk, the contracting officer would use the table in Figure 3 to determine what profit rate should be used in the assigned value for box 24 of the DD Form 1547 in Figure 2. That percentage rate is then multiplied by the base (total cost in box 20) to determine the profit objective which becomes part of the total profit objective in box 30.

¹² DFARS Part 215 "Contracting by Negotiation," Subpart 215.404 "Contract Pricing," Section 215.404-71, "Weighted Guidelines Method."

We only evaluated the profit rate for the contract risk factor for our audit because UCAs are essentially cost-reimbursable contracts before definitization and can be a different contract type after definitization. This means that contracting officers may need to consider two different degrees of cost risk: (1) under cost-reimbursement contract types the Government has more cost risk than the contractor, and (2) under fixed-price contract types the contractor has more cost risk than the Government.

DFARS requires the contracting officer to assess the extent to which the contractor incurred costs before definitization, including any reduced cost risk on the contract before definitization.¹³ The contracting officer is also required to assess any reduced cost risk to the contractor for costs expected to be incurred during performance of the remainder of the contract after negotiation of the final price.¹⁴ The more costs are incurred on the UCA before definitization, the more the cost risk is reduced to the contractor, and the lower the profit should be for the contractor. Therefore, contracting officers are required to adjust the contract risk factor to reflect the Government and contractor's cost risk before and after contract definitization. If the cost risk is higher to the Government and lower to the contractor, the contractor should earn less profit.

This reduction in profit is shown in the contract risk factor on the DD Form 1547 in Figure 2. When the contractor has incurred costs before definitization, the contracting officer should generally regard the contract risk to be in the low end of the designated range for profit; if a contractor has incurred a substantial portion of the costs, the contracting officer may assign a value as low as 0 percent for profit, regardless of contract type. See Figure 3 for the designated range and normal value by contract type for the profit rate for the contract risk factor. The contracting officer should assign a lower than normal profit rate for contract risk when the Government paid a substantial portion of the contractor's costs before definitization because the cost risk to the contractor was reduced.

For the purpose of the audit, we considered "a substantial portion of the contractor's costs," to be more than 50 percent of the UCA's cost. We reviewed the Defense Contract Management Agency's disbursement data for each contract and the contract file to verify how much of the contractor's incurred costs the Government had paid before UCA definitization.

In addition, the Defense Pricing and Contracting (DPC) memorandum on UCA management oversight states that in general, when negotiating profit or fee, it is appropriate to apply the profit rate for contract risk for cost-reimbursement

¹³ DFARS Subsection 215.404-71-3(d)(2), "Mandatory."

¹⁴ DFARS Subsection 217.7404-6, "Allowable Profit."

contracts to the actual cost of performance before definitization.¹⁵ As shown in Figure 3 above, DFARS recommends a profit range of 0 to 2 percent for cost-reimbursable contract types with a normal value of 0.5 to 1 percent, and a range of up to 6 percent for firm-fixed-price contract types. Therefore, contracting officers should have applied a cost-reimbursable contract type profit rate for contract risk to costs already incurred for the UCA and a profit rate based on the definitized contract type to the remaining costs to be incurred on the contract. However, the memorandum states if a substantial portion of the cost of a UCA was incurred before definitization, a profit rate for contract risk as low as zero could be applied to the incurred costs at definitization. This means that the contractor could earn no profit on incurred cost for the contract risk factor when the contracting officer calculates the profit objective.

Definitization Actions

Definitization actions are actions taken to effectively end the undefinitized period of a contract. This action occurs when the contractor and the Government agree on contract terms, specifications, profit, and price, which converts the undefinitized contract action to a definitive contract. Federal law requires that a contracting officer may not enter into a UCA unless the UCA provides for definitization by the earlier of:

- 180 days after the contractor submits a qualifying proposal to definitize the contractual terms, specifications, and price; or
- the date on which the amount of funds obligated under the contract action is more than 50 percent of the negotiated not-to-exceed (NTE) price for the action.¹⁶

Therefore contracting officers are required to definitize a UCA within 180 days of receiving a qualifying proposal unless they exceed more than 50 percent of the negotiated NTE price for the UCA. However, we only identified 1 of 116 UCAs that exceeded their funding limitations before definitization. As a result, our report focuses on the 180-day definitization requirement.

Enhanced Reporting Requirements

The DPC, formerly Defense Procurement and Acquisition Policy, is under the Office of the Under Secretary of Defense for Acquisition and Sustainment. The DPC is responsible for all pricing, contracting, and procurement policy for the DoD, including updates to DFARS and its Procedures, Guidance, and Information. In 2008, the DPC Director issued a memorandum stating that

¹⁵ Defense Procurement, Acquisition Policy, and Strategic Sourcing, Memorandum, "Management Oversight of Undefinitized Contract Actions," August 29, 2008.

¹⁶ 10 U.S.C § 2326 (2010).

although MILDEP and Defense agencies can meet urgent requirements with UCAs, using these instruments can increase contract risks if not managed properly.¹⁷ The memorandum requires each MILDEP and Defense agency to provide a consolidated report semiannually to Congress for all UCAs with an estimated value over \$5 million.

DPC officials developed a template for the consolidated UCA report to facilitate reporting. Specifically, for each UCA over \$5 million, the MILDEP and Defense agencies should provide the:

- contract number (including any associated modification numbers, task orders, or delivery orders);
- award date;
- reason for the UCA;
- obligation amount;
- qualifying proposal receipt date; and
- scheduled definitization date.

If the MILDEP or agency did not definitize a UCA by the scheduled definitization date, the consolidated UCA report should state the number of days late and the estimated date of definitization. DPC officials indicated that these reports were intended to provide Congress and the DPC enhanced management insight and oversight of UCAs.

Federal Procurement Data System—Next Generation

The Federal Procurement Data System—Next Generation (FPDS-NG) is a web-based tool for Federal agencies to report contract actions. The FPDS-NG collects, develops, and distributes data to Congress, the Executive Branch, Federal agencies, and the private sector. Contracting officers and Federal agencies must populate, complete, and submit accurate data on all contract actions and modifications in the FPDS-NG as required by the Federal Acquisition Regulation (FAR).¹⁸

According to the FPDS-NG, MILDEP contracting personnel issued 13,153 UCA-related contract actions with a total value of about \$67.2 billion from January 2, 2012, through December 31, 2017. Contracting personnel used a field in the FPDS-NG to identify UCA-related actions.

¹⁷ Defense Procurement, Acquisition Policy, and Strategic Sourcing memorandum, "Management Oversight of Undefinitized Contract Actions," August 29, 2008.

¹⁸ FAR Part 4, "Administrative and Information Matters," Subpart 4.6, "Contract Reporting," Section 4.604, "Responsibilities."

Table 1 shows the number of UCA-related actions issued by the Army, Navy, and Air Force from January 2, 2012, through December 31, 2017. The value column represents the amount of funds obligated for the UCA-related actions and not the overall value of the definitized contract. Most UCAs are funded at less than 50 percent before definitization. Once definitized, they are no longer considered UCAs.¹⁹

Table 1. Value of UCA-Related Actions Issued by Calendar Year

Calendar Year	UCA-Related Actions	Value (in Millions)
2012	1,809	\$9,394.1
2013	1,542	3,548.3
2014	1,823	3,178.0
2015	2,203	11,714.7
2016	2,612	11,298.3
2017	2,975	27,142.9
Total	12,964	\$66,276.3

Note: One UCA can have multiple related actions, including the award and modification of the UCA. The UCA-related actions in this table exclude foreign military sales, long lead items, and UCAs below the simplified acquisition threshold. Value total differs due to rounding.

Source: The DoD OIG.

Contracting Activities Visited and UCAs Reviewed

We reviewed the MILDEP management of 116 UCAs on 90 contracts with a value of about \$10.9 billion at the following locations.

- **Army Contracting Command–Redstone Arsenal (ACC-RSA)** purchases parts for research and development, major weapon system products, sub-systems, and services in support of several program offices.
- **Army Contracting Command–Detroit Arsenal (ACC-DTA), formerly ACC Warren**, is responsible for acquisition support and contracting for the Army’s major weapon systems, for systems and equipment supporting other services, and foreign military sales customers.²⁰
- **Naval Sea Systems Command (NAVSEA)** is responsible for the design, construction, delivery, maintenance, and disposal of the Navy’s ships and ship systems.

¹⁹ An obligation of funds is the amounts of orders, contracts awarded, or services received that will require payment during the period they were incurred.

²⁰ According to the Executive Director for ACC-DTA, on January 13, 2020, ACC-Warren’s name changed to ACC-DTA.

- **Naval Air Systems Command (NAVAIR)** provides full life-cycle support of Naval Aviation aircraft, weapons, and systems operated by sailors and Marines.
- **Air Force Life Cycle Management Center (AFLCMC)–Wright Patterson** is responsible for total life cycle management covering all Air Force aircrafts, engines, munitions, electronics, and cyber weapon systems.
- **AFLCMC–Hanscom** provides support and sustainment for developing, deploying and sustaining Air Force, joint, coalition cyberspace, network, cryptologic, and data link systems to enable decisive combat operations.
- **Air Force Space and Missile Systems Center (SMC)** provides space and missiles systems to the joint warfighter and our nation and is a center for research, development, and acquisition of military space systems.

See Appendix B for a list of all UCAs reviewed by Military Department.

We reviewed 30 contracts each for the Army, Navy, and Air Force. The Departments issued UCAs for maintenance and repair of ships; deployment or upgrades to weapons platforms to counter immediate threats; demilitarization and disposal of rockets; or the overhaul of engines. Table 2 shows the number of contracts, the number of UCAs, and the definitized values for each contracting activity that we reviewed.²¹

²¹ Air Force SMC had only eight contracts that were within our scope, so we added contracts awarded by AFLCMC-Hanscom to the sample. Therefore, in addition to the 8 contracts at Air Force SMC, we reviewed 11 contracts at AFLCMC-Wright Patterson and 11 contracts at AFLCMC-Hanscom that totaled 30 contracts reviewed for the Air Force.

Table 2. Value of UCAs Reviewed by Contracting Activity Location

Contracting Activity	Contracts Reviewed	UCAs Reviewed	UCA Definitized Value (in Millions)
ACC-RSA	15	17	\$1,363.3
ACC-DTA	15	19	1,825.3
NAVAIR	15	15	937.9
NAVSEA	15	19	785.9
AFLCMC–Wright Patterson	11	22	4,426.6
AFLCMC-Hanscom	11	15	503.8
SMC	8	9	1,030.6
Total	90	116	\$10,873.4

Legend

ACC-RSA	Army Contracting Command–Redstone Arsenal
ACC-DTA	Army Contracting Command–Detroit Arsenal
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
AFLCMC	Air Force Life Cycle Management Center
SMC	Space and Missile Systems Center

Source: The DoD OIG.

Review of Internal Controls

DoD Instruction 5010.40 requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls.²² We identified internal control weaknesses in MILDEP management of UCAs. Specifically, MILDEP contracting personnel did not adequately consider or document how costs incurred during the undefinitized period impacted the contractor’s profit, or definitize UCAs within the 180-day timeframe. In addition, contracting personnel incorrectly identified non-UCA related contract actions as UCAs in the FPDS-NG, and MILDEP personnel did not reconcile UCA information reported to DPC with UCA information reported in the FPDS-NG. We will provide a copy of the report to the senior officials responsible for internal controls and policy for MILDEP management of UCAs.

²² DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” May 30, 2013.

Finding

Military Department Management of UCAs Needs Improvement

MILDEP contracting officers generally followed requirements when obligating funds for the 116 UCAs we reviewed, valued at \$10.9 billion. However, some contracting officers did not fully comply with requirements for adjusting profit or definitizing UCAs. Specifically, these contracting officers did not:

- adjust the profit rate for contract risk to reflect costs already incurred on the UCAs at definitization when they determined the profit for 12 UCAs, valued at \$523.9 million, because DFARS does not provide clear guidance on how contracting officers should adjust the profit rate for contract risk for costs already incurred on the UCA;²³
- adequately support their contract risk determination in the contract file for 56 UCAs, valued at \$5.3 billion, because contracting officers did not prepare price negotiation memorandum with sufficient detail to document incurred costs, and the DD Form 1547 lacked sufficient detail to show the reduced cost risk related to incurred costs during the undefinitized period; or
- definitize 53 UCAs, valued at \$4.8 billion, within the required 180 days after the contracting officers received a qualifying proposal from the contractor because, according to the contracting officers, lengthy negotiations were caused by changing Government requirements and they were working with “inexperienced” or “uncooperative contractors.”

In addition, contractors took up to 542 days from contract award to provide qualifying proposals for the 116 UCAs we reviewed. This occurred because the DFARS lacks contract clauses that contracting officers could use to further incentivize contractors to provide timely qualifying proposals.

Furthermore, while selecting our sample of UCAs, we conducted a reconciliation of the contract actions identified as UCAs in the FPDS-NG to the UCAs reported to DPC for inclusion in the semiannual UCA report to Congress. While this reconciliation only covered the seven contracting offices in our sample, we found that contracting officers did not report accurate or complete information in the FPDS-NG for 402 contract actions valued at \$12.8 billion, or to DPC for 17 UCAs

²³ For the purposes of our report, we refer to contract type risk as contract risk.

valued at \$2.1 billion, because the MILDEPs did not have controls in place to reconcile the FPDS-NG data to the UCA information they were reporting semiannually to DPC and Congress.

As a result, the DoD assumed more contract risk and potentially paid \$4.6 million more profit than necessary for 12 UCAs. Also, contracting officers could not fully incentivize contractors to submit timely qualifying proposals and control costs before definitization. In addition, the DPC Principal Director and Congress were not aware of DoD use and management of the 17 UCAs, valued at \$2.1 billion, that were not reported to DPC.

Military Departments Inconsistently Managed Undefined Contract Actions

The Army, Navy, and Air Force issued UCAs for maintenance and repair of ships, deployment or upgrades to weapons platforms to counter immediate threats, demilitarization and disposal of rockets, or overhaul of engines. See Appendix B for a full list of the UCAs that we reviewed. MILDEP contracting officers generally followed requirements when obligating funds for the 116 UCAs valued at \$10.9 billion that we reviewed. However, some contracting officers did not fully comply with requirements for adjusting profit or definitizing UCAs.

Contracting Officers Generally Funded UCAs Within Obligation Limitations

MILDEP contracting officers generally obligated funding for the 116 UCAs, valued at \$10.9 billion, in accordance with requirements.²⁴ Specifically, only 1 of the 116 UCAs we reviewed obligated more funds than allowed by DFARS. DFARS requires DoD contracting officers to limit obligations during the undefinitized period of a UCA. Contracting officers cannot obligate more than 50 percent of the not-to-exceed amount before definitization; however, DFARS allows a contracting officer to obligate up to 75 percent if the contracting officer receives a qualifying proposal from the contractor. DFARS also allows exceptions to the limitations through a waiver if the UCA supports a contingency, humanitarian, or peacekeeping operation.²⁵

²⁴ DFARS Section 217.7404-4, "Limitations on Obligations."

²⁵ DFARS Section 217.7404-5, "Exceptions."

(FOUO) We found only one instance where the contracting officer obligated more funds than allowed by DFARS before receiving the qualifying proposal and without obtaining a waiver. The one instance was a UCA resulting from a joint urgent operational need to support contingency operations. The Navy needed

[REDACTED] The contracting officer increased the obligated amount over the 50 percent threshold before receiving a qualifying proposal. The contracting officer stated that she had received a proposal that she thought would be the qualifying proposal and increased the obligated amount to over 50 percent. However, the contracting officer later determined the proposal to be incomplete and inadequate and therefore not a qualifying proposal. The contracting officer finally received a qualifying proposal 7 months after the original proposal submission, but had already increased the obligated amount beyond 50 percent.

Contracting Officers Did Not Consistently Adjust Profit Rates for Contract Risk When Assessing Contract Risk

MILDEP contracting officers did not adjust the profit rate for contract risk to reflect costs that were already incurred on the UCAs at definitization when they determined the profit for 12 UCAs valued at \$523.9 million. When a UCA is definitized the profit for the contract is determined. UCAs are essentially cost-reimbursement contracts before definitization; however, they can be cost or fixed-price contract types after definitization. Therefore, contracting officers should be considering two different degrees of cost risk when determining the profit rate for contract risk: one profit rate for the incurred cost and one profit rate for the remainder of the estimated costs under the contract.²⁶ There were 70 UCAs that definitized to a fixed-price contract type or contained a contract-line item that was fixed-price, out of the 116 UCAs in our sample.²⁷

According to DFARS, when calculating the negotiating position on profit or fee for a UCA, the contracting officer must assess the extent to which costs have been incurred before definitization of the contract action. The assessment must include any reduced contract risk to the contractor because of cost incurred for the UCA before definitization. The more costs are incurred on the UCA before definitization, the more the contract risk is reduced to the contractor, and the lower the profit should be for the contractor.

²⁶ DFARS Subsection 217.7404-6, "Allowable Profit."

²⁷ Contract Line Item Numbers are part of a defense contracts that break the contract down by the commodities being procured (for example, labor hours of services, funding for travel, or quantity of products).

DFARS establishes a designated profit range and normal profit value for each contract type. When costs have been incurred before definitization, contracting officers should generally regard the contract risk to be in the low end of the designated profit range. However, if a UCA incurs substantial costs before definitization, the contracting officer can reduce contract risk to 0 percent, the lowest end of the range, regardless of contract type.²⁸ For this audit, we considered “a substantial portion of the contractor’s costs,” to be more than 50 percent of the UCA’s costs. In addition, the DPC memorandum on UCA management oversight also states that, in general, when negotiating profit or fee, it is appropriate to apply the contract risk rate for cost-reimbursement contracts to the actual cost of performance before definitization.²⁹ Cost-reimbursement contracts have a lower designated profit range; the maximum profit rate for contract risk for a cost-reimbursement contract type is 2 percent, while the maximum profit rate for contract risk for a fixed-price contract type is 6 percent.

We reviewed the Defense Contract Management Agency disbursement data for each UCA and the contracting file to determine how much of the contractor’s incurred costs the Government had disbursed by UCA definitization. We also reviewed the contract’s weighted guidelines form and the price negotiation memorandums to determine if the contracting officer considered a lower contract risk on already incurred costs and applied a profit rate for contract risk for a cost-reimbursement contract type to those costs. Table 3 provides the number of UCAs that did not comply with profit requirements by location and their potential profit overpayment.

²⁸ DFARS Section 215.404-71-3, “Contract Type Risk and Working Capital Adjustment.”

²⁹ Defense Procurement, Acquisition Policy, and Strategic Sourcing memorandum, “Management Oversight of Undefined Contract Actions,” August 29, 2008.

Table 3. UCAs by Contracting Activity Location That Did Not Apply Profit for Contract Risk in Accordance With Guidance

Contracting Activity	UCAs With Potential Excess Profit	UCA Obligation Value (in Millions)	Potential Profit Overpaid (in Millions)
ACC-RSA	5	\$308.5	\$1.8
ACC-DTA	2	78.6	.3
NAVAIR	2	57.4	.7
NAVSEA	2	54.8	1.5
AFLCMC-Wright Patterson	1	24.6	.3
AFLCMC-Hanscom	0	0	0
SMC	0	0	0
Total	12	\$523.9	\$4.6

Legend

ACC-RSA	Army Contracting Command–Redstone Arsenal
ACC-DTA	Army Contracting Command–Detroit Arsenal
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
AFLCMC	Air Force Life Cycle Management Center
SMC	Space and Missile Systems Center

Note: To calculate the potential excess profit paid for the contract risk factor of profit for a UCA, we used the difference between the negotiated profit for contract risk on the DD Form 1547 and our own calculated profit for contract risk. Our calculations took into consideration that profit for contract risk is just one of four profit factors that make up the total profit for a UCA. We based our calculation on the profit rates outlined in the DFARS and the 2008 Defense Procurement and Acquisition Policy Memorandum. We reviewed the contracting files to determine what profit rate the contracting officer should have assigned to the contract risk based on the amount that had already been disbursed for the undefinitized portion of the UCA. We also considered if the contracting officer had justified the use of a higher percentage in the contracting file. If the justification was adequate we accepted the use of a higher rate. Potential profit overpaid total differs due to rounding.

Source: The DoD OIG.

In general, contracting officers applied a cost-reimbursable type profit rate for contract risk to incurred costs or justified applying a higher rate to incurred costs in the price negotiation memorandum. However, contracting officers for the 12 UCAs inconsistently applied profit rates, did not take into consideration incurred costs, or did not justify the use of higher profit rates for contract risk for the following reasons.

- Five UCAs had substantial costs incurred before definitization, but the contracting officer did not apply a zero percent profit rate for contract risk to the incurred costs.
- Five UCAs had a normal or above normal profit rate for contract risk from the definitized contract type's designated range that the contracting officer applied to both incurred costs and the remaining contract costs.

- Two UCAs had a profit rate for contract risk from the undefinitized contract type's designated range that the contracting officer applied to both the incurred costs and the remaining contract costs with no evidence of incurred costs.

The UCAs in our sample were definitized into a variety of contract types, including firm-fixed-price and cost-plus-fixed-fee. Cost-reimbursement contract types have a higher contract risk to the Government and lower contract risk to the contractor because the contractor's cost to perform the contracts are reimbursed by the Government. Under cost-reimbursable contracts, contractors have less incentive to controls costs. Further, as additional costs are incurred before contract definitization, the more the contract risk shifts from the contractor to the Government. DFARS require contracting officers to reflect this shift in the profit rate for contract risk by applying a lower profit rate for contract risk to the incurred costs. This rate can be as low as zero if a substantial portion of the UCA's cost was incurred before definitization.

Contracting officers did not apply a zero percent profit rate for contract risk to incurred costs for five UCAs even though the UCAs had substantial costs that were incurred before definitization. The contracting officers also did not justify the use of a higher rate in the price negotiation memorandum. For example, the Army issued a UCA for the demilitarization and disposal of rockets and their components, systems, and pod containers. The Army had disbursed 100 percent of the funds for the UCA before definitizing the UCA, which was the base year of a 5-year contract. However, when determining the profit for the UCA and overall contract, the Army contracting officer did not reduce the profit rate for contract risk for the costs already incurred on the UCA. Instead, the contracting officer assigned a value of 6 percent for contract risk for all 5 years of the contract. This resulted in a higher profit rate objective before negotiations. The contracting officer did not explain in the contracting file why an above normal rate was used as required by DFARS.

Based on DFARS guidance, the contracting officer should have lowered the profit rate for contract risk to 0 percent for the UCA since the Army had disbursed 100 percent of the total value of the UCA before definitization. DFARS suggests a profit range between 4 to 6 percent with a normal value of 5 percent for the cost associated with the remaining 4 option years, which were firm-fixed-price contracts. A profit rate of 0 percent for incurred costs would have reflected the shift in contract risk to the Government since all costs associated with the UCA had already be incurred. Instead, the Army potentially paid \$1.1 million more in profit to the contractor than the DFARS guidance requires because the contracting officer did not lower the profit rate for contract risk to 0 percent for the incurred costs.

Contracting officers did not consider applying a lower profit rate for contract risk to the incurred costs during the undefinitized period for five UCAs. Instead, they applied a normal or above normal profit rate for contract risk associated with the definitized contract type. This decision did not affect UCAs that definitized as a cost-reimbursement contract type because the designated profit range remained the same. However, the action was notable when the contracting officer definitized the UCA to a fixed-price contract type because the maximum profit rate for contract risk for a cost-reimbursement contract type was 2 percent, while the maximum profit rate for contract risk for a fixed-price contract type was 6 percent.

~~(FOUO)~~ For example, a UCA fulfilling an urgent need [REDACTED] incurred 15 percent of its costs before the UCA was definitized to a firm-fixed-price contract. However, the contracting officer assigned a 5-percent profit rate for contract risk to all costs even though the contracting officer stated that the risk was greatly diminished to both incurred costs and the remaining cost on the contract. A 5-percent profit rate is the normal rate for a firm-fixed-price contract, whereas a normal profit rate for a cost-reimbursement contract is 0.5 percent. If the contracting officer had applied a profit rate for contract risk of 0.5 percent to the costs already incurred on the UCA and a 5-percent rate to the remaining costs for the contract, the DoD could have potentially paid \$195,060 less in profit. There was no indication in the contracting file that the contracting officer had considered applying a lower profit rate for contract risk to the incurred costs.

The DFARS is not clear on which designated range the contracting officers should choose from, but the DPC memorandum on UCA management oversight states that, in general, when negotiating profit or fee, it is appropriate to apply the profit rate for contract risk for cost-reimbursement contracts to the cost incurred before definitization. However, the contracting officers chose a normal or above normal profit rate for contract risk for a firm-fixed price contract, did not consider applying a lower rate, and did not justify the use of a higher rate in the price negotiation memorandum. Cost-reimbursement contracts have a lower designated profit range; the maximum profit rate for contract risk for a cost-reimbursement contract type was 2 percent, while the maximum profit rate for contract risk for a firm-fixed-price contract type was 6 percent. We chose to apply a cost-reimbursable type profit rate for contract risk to our incurred cost calculations for the UCAs based on the DPC memorandum, discussions with DPC on the intent of the DFARS changes, and because in general, we observed that contracting officers applied a cost-reimbursable rate to incurred costs for contract risk. In addition, there was no indication in the contracting file that a higher rate was justified.

Two contracting officers used a profit rate for contract risk from the undefinitized contract type designated range and applied it to both the incurred costs and the remaining contract costs. For example, a contracting officer applied a cost-reimbursable contract type profit rate for contract risk to costs for the entire contract at definitization. We found no indication that costs had been incurred for the UCA prior to definitization and the UCA was definitized to a firm-fixed-price contract. In the risk assessment, the contracting officer indicated that the designated profit rate for contract risk for a firm-fixed-price contract without progress payments was 4 to 6 percent, with a normal value of 5 percent. However, the contracting officer stated that because the contract was a UCA, the range was 0 to 1 percent, and the normal value was 0.5 percent. This is the designated contract risk profit rate range for a cost-plus-fixed-fee contract type. The contracting officer assigned the normal 0.5 percent profit rate for contract risk for the entire contract, including the firm-fixed-price parts of the contract. Because the contracting officer assigned a cost-reimbursement contract type profit rate for contract risk, the contracting officer potentially lowered the profit the contractor received by as much as \$670,000.

The DoD assumed more contract risk and potentially paid \$4.6 million more in profit than necessary for 12 UCAs. DFARS uses the lower profit rates on costs already incurred on the UCA to encourage contractors to control costs and submit timely qualifying proposals for the timely definitization of the UCA. It also recognizes that contract risk is lower for the contractor when the UCA is undefinitized; therefore, the contractor should receive a lower profit for the portion of the UCA expended before definitization. If contracting officers do not apply a lower profit rate for contract risk to incurred costs, there is no difference in compensation or reward between the undefinitized period and the definitized period of the contract. Without this incentive being consistently applied, contracting officers are not fully incentivizing contractors to control costs or submit timely qualifying proposals.

DFARS does not provide clear guidance on how contracting officers should adjust profit for costs already incurred on the UCA. The DPC memorandum encourages contracting officers to apply a profit rate for contract risk associated with a cost-reimbursement contract type to the cost already incurred on the UCA before definitization. However, DFARS does not include this information. When determining the profit rate for contract risk, DFARS does not provide an

explanation of the expected designated range that contracting officers should be choosing from or that they could choose from two different designated ranges as indicated by the DPC memorandum. In addition, the DFARS states that contracting officers can apply a profit rate for contract risk as low as zero if a substantial portion of the UCA's cost was incurred before definitization. However, only one fixed-price profit rate for contract risk goes as low as zero percent.

The DPC Principal Director should update the DFARS to clarify that when considering the reduced cost risks associated with allowable incurred costs on a UCA, it is appropriate to apply separate and differing contract risk factors for allowable incurred costs and estimated costs to complete, in accordance with the requirements in 10 U.S.C. § 2326, when completing the contract risk sections of DD Form 1547, "Record of Weighted Guidelines."³⁰

Contracting Officers Did Not Document Their Determination of Contract Risk When Determining Profit

Contracting officers did not adequately support their profit rate determination for contract risk in the contract file for 56 UCAs valued at \$5.3 billion. According to DFARS, when calculating the negotiating position on profit or fee for a UCA, the contracting officer shall assess the extent to which costs have been incurred before definitization of the contract action. The assessment shall include any reduced contract risk on both the contract before definitization and the remaining portion of the contract.

The DPC memorandum states that contracting officers must document the contract risk assessment in the contract file. In addition, DFARS states that the contracting officer is not required to explain the use of a normal value for contract risk, but the contractor should address conditions that justify the use of other than the normal value in the price negotiation memorandum.³¹ Table 4 provides the number of UCAs where the contracting officers did not adequately document their contract risk determination by location.

³⁰ The FY 2017 National Defense Authorization Act, Section 811 changed 10 U.S.C. § 2326, "Un definitized Contractual Actions: Restrictions," updated how profit for contract risk is calculated. Specifically, when determining the amount of incurred costs for a UCA the cut-off point for incurred costs is now when the qualifying proposal was received instead of when the UCA was definitized, assuming that the UCA was definitized within 180-days after the qualifying proposal was received.

³¹ We determined that the contracting officer applied the normal value for contract risk for 35 of the 116 UCAs in our sample. Therefore contracting officers for at least 81 UCAs should have documented their determination of an above or below normal contract risk rate.

Table 4. Undefinitized Contract Actions by Contracting Activity Location That Did Not Have the Contract-Risk Determination Adequately Documented

Contracting Activity	UCAs Without Documentation	UCA Obligation Value (in Millions)
ACC-RSA	11	\$1,156.1
ACC-DTA	11	965.5
NAVAIR	4	137.5
NAVSEA	13	499.3
AFLCMC-Wright Patterson	8	2,377.0
AFLCMC-Hanscom	5	145.1
SMC	4	62.5
Total	56	\$5,342.9

Legend

ACC-RSA	Army Contracting Command–Redstone Arsenal
ACC-DTA	Army Contracting Command–Detroit Arsenal
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
AFLCMC	Air Force Life Cycle Management Center
SMC	Space and Missile Systems Center

Note: Totals do not equal the actual sum because of rounding.

Source: The DoD OIG.

Contracting officers did not prepare price negotiation memorandums with sufficient detail to document incurred costs and show the reduced profit rate for contract risk related to incurred costs during the undefinitized period. A price negotiation memorandum is the formal approval from leadership to execute a contract after negotiations have been finalized. Contracting officers document their negotiations, including profit determinations, in the memorandum.

In addition, the DD Form 1547 did not contain sufficient detail to support if the contracting office considered incurred costs when determining the profit rate for contract risk. Other than the price negotiation memorandum, the only other place in the contracting file we found the profit rate for contract risk documented is the DD Form 1547. However, the DD Form 1547 did not contain sufficient detail to support if the contracting officer considered incurred costs when determining the profit rate for contract risk.

This finding was previously identified in a 2012 DoD OIG summary report on the management of UCAs.³² In that report, the DoD OIG found that contracting officers did not adequately document their profit determinations. The report

³² Report No. DODIG-2012-039, "Summary Report on DoD's Management of Undefinitized Contractual Actions," January 13, 2012.

stated that the inadequate documentation occurred because contracting officers did not include essential information, including costs incurred before definitization, how incurred costs were factored into profit positions entering into negotiations, and the impact of incurred costs on contract risk because profit determinations were only supported with the DD Form 1547. The DoD OIG recommended that the DPC Principal Director (formerly Defense Procurement and Acquisition Policy) develop a transparent means to document incurred costs and reduced cost risk related to incurred costs during the undefinitized period. In response to the recommendation, the DoD amended DFARS Part 215 in 2018 to provide a more transparent means of documenting the impact of costs incurred during the undefinitized period when determining the profit of a UCA.³³

The updated DFARS Part 215 states that DoD contracting personnel should document their consideration of the reduced risk to the contractor of costs incurred during the undefinitized period of a UCA. The current version of the DD Form 1547, which contracting officers are required to fill out to determine profit, has one line for contract risk. However, as seen in Figure 4, taken from the updated DFARS, the new version of the form should separate contract risk into two lines based on the incurred costs at the time of qualifying proposal submission and the Government’s estimated cost to complete the contract.

Figure 4. Updated DFARS Instructions for Filling Out a DD Form 1547, “Weighted Guidelines”

(b) *Determination.* The following extract from the DD 1547 is annotated to explain the process.

Item	Contractor Risk Factors	Assigned Value	Base	Profit Objective
24a	Contract Type Risk (based on incurred costs at the time of qualifying proposal submission)	(1)	(2)(i)	(3)
24b	Contract Type Risk (based on Government estimated cost to complete)	(1)	(2)(ii)	(3)
24c	Totals		(3)	(3)

Source: DFARS Part 215, “Contracting by Negotiation.”

³³ DFARS Section 215.404-71-3, “Contract Type Risk and Working Capital Adjustment,” June 28, 2019.

These revisions to the form should address the problems we found for documenting the profit rate determination for contract risk by ensuring that contracting officers consider costs incurred during the undefinitized period and document that consideration in the contract file. However, DPC officials have not yet updated the DD Form 1547 form to reflect the changes seen in DFARS Part 215. According to DPC personnel, they were in the process of updating the form in accordance with the DFARS. The DPC Director should issue the new DD Form 1547 for contracting officer use when determining contract risk for UCAs. In addition, the Senior Contracting or Procurement Official at each Military Department should require contracting activities to use the updated DD Form 1547, when it is released, when determining profit for future UCAs.

Contracting Officers Did Not Definitize UCAs in a Timely Manner

Contracting officers did not definitize 53 UCAs within 180 days of receiving a qualifying proposal from the contractor. In addition, contractors took up to 542 days from contract award to provide qualifying proposals for the 116 UCAs we reviewed.

UCAs Were Not Definitized Within DFARS Time Requirements

Contracting officers did not definitize 53 UCAs, valued at \$4.8 billion, within the required 180 days after receiving a qualifying proposal. Federal Law states that contracting officers are required to definitize a UCA within 180 days of receiving a qualifying proposal.³⁴ However, contracting officers took between 181 and 706 days after receiving the qualifying proposal to definitize the 53 UCAs valued at \$4.8 billion.³⁵ See Table 5 for the number of UCAs by contracting activity location that did not comply with the 180-day definitization requirement.

³⁴ 10 U.S.C §2326 (2010) also states exceeding funding limitations should also result in definitization. However, we only identified 1 UCA of the 116 UCAs we reviewed that exceeded its funding limitation before definitization. As a result, our report focuses on the 180 day definitization requirement.

³⁵ If a contracting officer received a qualifying proposal before awarding a UCA, for our calculations we considered the UCA award date to be the date the qualifying proposal was received.

Table 5. UCAs by Contracting Activity That Did Not Comply With the 180-Day Definitization Requirement

Contracting Activity	UCAs	UCA Obligation Value (in Millions)	Days From Proposal to Definitization
ACC-RSA	8	\$654.9	221–706
ACC-DTA	10	894.3	181–364
NAVAIR	5	424.2	192–469
NAVSEA	16	696.1	216–630
AFLCMC-Wright Patterson	12	2,027.3	186–605
AFLCMC-Hanscom	1	38.6	293
SMC	1	24.9	194
Total	53	\$4,760.3	181–706

Legend

ACC-RSA	Army Contracting Command–Redstone Arsenal
ACC-DTA	Army Contracting Command–Detroit Arsenal
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
AFLCMC	Air Force Life Cycle Management Center
SMC	Space and Missile Systems Center

Source: The DoD OIG.

Contracting officers stated that they could not definitize the UCAs within the required timelines because lengthy negotiations were caused by changing Government requirements. For example, the Navy awarded a UCA in January 2015 for the MK 46 Gun Weapon System, a system used to optimize accuracy against small, high-speed surface targets. Although the Navy received a qualifying proposal 81 days after award, the contracting officer did not definitize the UCA until 366 days after receiving the qualifying proposal. The contracting officer stated that changes in Government requirements led to the delay in definitization. As a result of the changes, the contractor had to submit a new proposal.

(FOUO) The Army also experienced the same delay when its contracting officer issued [REDACTED]

The contracting officer received a qualifying proposal before awarding the UCA in November 2016, yet the UCA still took 329 days to definitize. According to the contracting officer, the Government changed the requirements after the contractor submitted its proposal, requiring the contractor to update its proposal four more times with the last update approved in June 2017. According to the contracting officer, until the Government received the final updated proposal based on the Government's changes, the contracting officer could not begin negotiations to definitize the UCA.

Excessive Days From Award to Definitization

Contractors took up to 542 days from contract award to provide qualifying proposals for the 116 UCAs we reviewed. This included the 63 UCAs that were definitized within the 180-day limit established in the United States Code.³⁷

Specifically, contractors took:

- up to 99 days to receive the qualifying proposals for 86 UCAs (45 of these meet the 180-day definitization limit in the United States Code);
- 100 to 199 days to receive the qualifying proposals for 18 UCAs (13 of these meet the 180-day definitization limit in the United States Code);
- 200 to 299 days to receive the qualifying proposals for 6 UCAs (2 of these meet the 180-day definitization limit in the United States Code),
- 300 to 399 days to receive the qualifying proposals for 5 UCAs (3 of these meet the 180-day definitization limit in the United States Code), and
- 542 days to receive the qualifying proposal for 1 UCA which was not definitized within the 180-day definitization limit in the United States Code.

For example, an Air Force contracting officer awarded a UCA in December 2017, but did not receive the qualifying proposal until 202 days later. The UCA established February 28, 2018, as the proposal submission due date. The contracting officer did not receive the qualifying proposal until July 11, 2018. The contracting officer was able to definitize the UCA 156 days after receiving the qualifying proposal, technically meeting the DFARS 180-day definitization requirement.

Although the Air Force met the 180-day limit, the contracting officer took a total of 358 days from UCA award to definitize the UCA. The contracting officer stated that the contractor did not want a UCA and that she “had a difficult time” negotiating and receiving a qualifying proposal from the contractor. The contracting officer also stated that the contractor submitted several proposals that did not have enough information to be deemed a qualifying proposal, which further delayed definitization.

³⁷ 10 U.S.C §2326 (2010) also states exceeding funding limitations should also result in definitization. However, we only identified 1 UCA of 116 UCAs were reviewed that exceeded its funding limitations before definitization. As a result, our report focuses on the 180-day definitization requirement.

Recent Changes in DFARS That Could Impact Definitization

The DoD recently amended DFARS Part 217 in September 2019 to further incentivize contractors to provide a qualifying proposal and definitize in a timely manner. Previously, DFARS required contracting officers to reduce profit for the incurred costs during the undefinitized period, beginning at award and ending at definitization. The revision changed the undefinitized period to begin at award and end when the contractor submitted a qualifying proposal.

DFARS states that if a contractor submits a qualifying proposal and the contracting officer definitizes the contract 180 days later, the profit on the contract should reflect the cost risk to the contractor as if such risk existed on the date the contractor submitted its qualifying proposal.³⁸ This means that contractors can receive a higher profit on the costs incurred after they submit a qualifying proposal, as long as the contracting officer definitizes the UCA within 180 days. The DPC indicated that this rule encourages contractors to submit timely qualifying proposals that would allow contracting officers to definitize the UCA in a timely manner.

Another September 2019 change to DFARS revised the definition of “qualifying proposal.” Previously, a qualifying proposal had to contain sufficient information to conduct complete and meaningful analyses and audits of the proposal data. The revised definition defines a qualifying proposal as one that contains sufficient information to conduct a “meaningful audit” of the proposal data instead of a “complete and meaningful audit.” This change is meant to incentivize a contractor to provide a timely qualifying proposal. Contractors now have a less stringent requirement on what they need to provide, and they have an opportunity to receive a higher profit if they provide a qualifying proposal in a timely manner.

Changes That Could Further Improve Definitization Timeliness

The DFARS lacks contract clauses that contracting officers could use to further incentivize contractors to provide timely qualifying proposals. According to MILDEP contracting officials at various sites, there are no specific consequences for the contractor if a qualifying proposal is not received as scheduled. MILDEP contracting officials stated that they continued to work with the contractors that were late in providing qualifying proposals often because there was no alternative source that could do the work. Of the 116 UCAs in our sample, 105 of those were sole-sourced.

³⁸ DFARS Section 217.7404-6, “Allowable profit.”

The DFARS states that submission of a qualifying proposal in accordance with the definitization schedule is a material element of the contract. It further states that if the contractor does not submit a timely qualifying proposal, the contracting officer may suspend or reduce progress payments or take other appropriate action.³⁹ DFARS does not define timely, but the FAR requires contracting officers to insert a contract clause with the specific definitization schedule for the UCA being awarded.⁴⁰ The clause includes the date that the contractor is expected to submit the qualifying proposal. Therefore, if the contractor does not submit a qualifying proposal by the date listed in the definitization schedule, the qualifying proposal is not timely.

However, the reduction of progress payments only applies to fixed-price contracts that have progress payments, and the DFARS does not expand on what is considered “other appropriate actions.”⁴¹ The FAR states that progress payments are for fixed-price contracts under which the Government will provide progress payments based on costs.⁴² DFARS does not provide clear guidance on what actions the contracting officers could take for the other contracts such as cost-plus-incentive-fee contracts or fixed-priced contracts without progress payments. In addition, the DFARS does not describe what “other appropriate actions” are available to contracting officers if the contractor fails to submit a qualifying proposal in accordance with the definitization schedule established by the UCA.

During the undefinitized period, the Government assumes the cost risk and reimburses the contractor for all its allowable costs incurred. The longer the undefinitized period, the more contract risk the Government would absorb. In addition, because the majority of UCAs in our sample were sole-sourced, the Government only had one supplier to fulfill the requirement, and could not easily terminate the UCA and choose another contractor if the definitization schedule was not met. As a result, the contracting officers could not fully incentivize contractors to submit timely qualifying proposals and control costs before definitization.

³⁹ DFARS Section 217.7404-3, “Definitization Schedule.”

⁴⁰ FAR 16.603-4, “Contract Clauses.”

⁴¹ DFARS 215.404-71-3, “Contract Risk and Working Capital Adjustment.”

⁴² FAR 32.502-4, “Contract Clauses.”

While the changes to DFARS could provide a positive impact on the timeliness of UCA definitization, the DFARS needs to be clarified and updated to include additional clauses that contracting offices could use to further incentivize contractors to provide timely qualifying proposals. The DPC Principal Director should further incentivize contractors to provide timely qualifying proposals by changing the DFARS to:

- open the suspension and reduction of progress payments to include all types of contract payments and not just progress payments;
- provide clarification for contracting officers on “other appropriate actions” that could further incentivize the contractor to provide timely qualifying proposals;
- update the contract definitization clause to include that failure to meet the qualifying proposal receipt date in the definitization schedule could result in the Government withholding a percentage of all invoice payments yet to be paid under an Undefined Contract Action until the qualifying proposal is received; and
- require contracting offices to document in the contract file their justification for why payments were not withheld if the qualifying proposal was not received in accordance with the initial definitization schedule.

In addition, DFARS requires contracting officers to closely coordinate and monitor each UCA to meet definitization dates and to alert the approval authority if, for any reason, the definitization schedule may not be met. However, we found that contracting officers only alerted management when they could not meet the 180-day definitization deadline after receipt of the qualifying proposal. There was no requirement to report if the contracting officer did not receive the qualifying proposal in accordance with the definitization schedule. Contracting officials stated that “nothing happens” if the qualifying proposal is not received in accordance with the schedule; no reporting was required or action plan created. The MILDEPs are required to report their UCA usage to DPC semiannually and even those reports do not track the qualifying proposal milestone. All emphasis is placed on the definitization of the UCA; however, the major milestone to get to the definitization is the receipt of the qualifying proposal. If the qualifying proposal is not received the contracting officers cannot enter into negotiations to definitize the UCA.

The Senior Contracting or Procurement Official at each MILDEP should require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the UCA

definitization schedule to immediately report to their Head of Contracting on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.

Contracting Officers Did Not Correctly Report Contract Actions

Contracting officers did not report accurate information in the FPDS-NG for 402 contract actions valued at \$12.8 billion or complete information to DPC for 17 UCAs valued at \$2.1 billion. While selecting our sample of UCAs, we conducted a reconciliation of the contract actions identified as UCAs in the FPDS-NG to the UCAs reported to DPC for inclusion in the semiannual UCA report to Congress. Although this reconciliation only covered the seven contracting offices in our sample, we found that contracting officers incorrectly labeled contract actions in the FPDS-NG or did not report all UCAs above \$5 million to the DPC. See Table 6 for the number of UCAs that contracting officers did not accurately report in the FPDS-NG or to the DPC by contracting activity.

Table 6. UCAs That Contracting Officers Did Not Accurately Report in the FPDS-NG or Did Not Report to the DPC

Contracting Activity	UCAs Labeled as Non-UCAs	Contract Actions Incorrectly Labeled as UCAs	Contract Action Value (in Millions)	UCAs Not Reported to DPC	UCA Obligation Value (in Millions)
ACC-RSA	15	65	\$539.9	9	\$1,491.0
ACC-DTA	16	2	909.8	1	426.9
NAVAIR	9	41	6,810.9	3	129.9
NAVSEA	32	73	1,381.5	0	0
AFLCMC–Wright Patterson	23	0	2,409.1	2	34.2
AFLCMC-Hanscom	7	1	153.6	0	0
SMC	1	117	613.2	2	15.8
Total	103	299	\$12,818.0	17	\$2,097.7

Legend

- ACC-RSA Army Contracting Command–Redstone Arsenal
- ACC-DTA Army Contracting Command–Detroit Arsenal
- NAVAIR Naval Air Systems Command
- NAVSEA Naval Sea Systems Command
- AFLCMC Air Force Life Cycle Management Center
- SMC Space and Missile Systems Center

Note: Totals do not equal the actual sum because of rounding.

Source: The DoD OIG.

Inaccurate Information Reported in the FPDS-NG

According to the FAR, contracting officers are responsible for the accuracy of the contract action reports that they upload into the FPDS-NG.⁴³ However, we found instances where contracting officers did not accurately report information for UCAs at the seven sites we visited. We reviewed contract actions and modifications labeled as UCAs in the FPDS-NG while developing the sample of UCAs to review for the audit and found that 299 contract actions, valued at \$1.5 billion, were identified as UCAs but were not UCAs. For example, the Navy issued a UCA for material with long lead times as a modification under an existing contract and subsequently definitized the UCA. However, according to a Navy contracting official, the contracting officer used the UCA contract action report as the template for the next contract action report after the UCA was definitized and did not update the field identifying the action as a UCA to the definitized contract type.⁴⁴ Therefore, the contracting officer erroneously identified subsequent contract actions for the contract as UCAs in the FPDS-NG. This action resulted in 35 modifications, valued at \$345.4 million, listed in the FPDS-NG as UCAs rather than correctly coded as the definitized contract type.

~~(FOUO)~~ Contracting officers at the seven sites also incorrectly labeled UCAs as non-UCAs in the FPDS-NG, yet they correctly reported the UCAs in the DPC semiannual report. We identified 103 contract actions, valued at \$11.3 billion, that were not identified as UCAs in the FPDS-NG but were associated with a UCA reported to the DPC. For example, the Air Force reported a UCA for [REDACTED] valued at \$65.9 million, in the DPC semiannual report to Congress. However, the contracting officer did not identify the contract action as a UCA in the FPDS-NG. According to contracting personnel, they did not correctly identify it as a UCA in FPDS-NG because of human error when inputting the contract information into the FPDS-NG.

During the audit, we supplied each site with a list of deficiencies identified in the FPDS-NG. ACC–Redstone Arsenal, ACC–Detroit Arsenal, NAVAIR, NAVSEA, AFLCMC–Wright Patterson, AFLCMC–Hanscom, and Air Force SMC contracting personnel took action to resolve all the contract deficiencies identified.

⁴³ FAR Section 4.604, “Responsibilities.”

⁴⁴ The contract action report is the information about the contract action that the contracting office submits to the FPDS-NG.

Not All UCAs Were Reported to DPC

Between January 2012 and September 2018, contracting officers did not report 17 UCAs, valued at \$2.1 billion, to the DPC to include in its semiannual reports to Congress. The DPC semiannual report is required to include all DoD UCAs for the 6-month period with an estimated value greater than \$5 million that were issued, outstanding, or definitized during the reporting period.

We found that contracting officials did not previously report 17 UCAs valued at \$2.1 billion to the DPC. For example, Army contracting officials awarded a UCA for demilitarization and disposal of rocket and rocket components on September 24, 2013. The contracting officer obligated \$16.7 million of the \$34.1 million not-to-exceed amount at award. This obligation placed the UCA above the \$5 million DPC reporting threshold and, therefore, should have been reported to DPC. However, it was not included in the September 2013, March 2014, or September 2014 semiannual UCA reports to Congress. According to the contracting officer, this was an oversight on their part, and the UCA should have been reported in the semiannual reports. Contracting officers definitized the 17 UCAs that were previously not reported to DPC and those 17 UCAs no longer need to be reported to DPC for inclusion in the semiannual report.

FPDS-NG and UCA Reports to DPC Should Be Reconciled

Contracting officers at the seven sites did not report, or incorrectly reported, contract actions in the FPDS-NG and in the DPC semiannual report to Congress because the MILDEPs did not have controls in place to reconcile the FPDS-NG data to the UCA information they were reporting semiannually to the DPC and Congress. We did not find any controls in place at the Army, Navy, and Air Force to reconcile the DPC report with what was reported in FPDS-NG. The DPC report is intended to provide DPC and Congress enhanced management insight and oversight of UCAs. The report also provides information on key aspects of DoD use and management of UCAs to DPC and Congress, including actions taken to ensure timely and effective definitization.

As a result, Army, Navy, and Air Force contracting officials overstated DoD usage of UCAs in the FPDS-NG and presented incomplete information regarding UCA usage to Congress, Federal agencies, and the general public. Specifically, the DPC Principal Director and Congress were not aware of DoD use and management of 17 UCAs valued at \$2.1 billion because the UCAs were never reported on the semiannual report. The DPC Principal Director should update the DFARS Procedures Guidance and Information (PGI) to include a requirement that the

MILDEPs reconcile Federal Procurement Data System–Next Generation data to the Undefined Contract Action information they are reporting semiannually to Defense Pricing and Contracting before submitting the information.⁴⁵

Management Actions Taken

During the audit, we identified 402 contract actions, valued at \$12.8 billion, that were incorrectly reported in the FPDS-NG. We provided the inaccuracies to contracting office personnel at the seven sites we reviewed and asked that they take corrective action. ACC–Redstone Arsenal, ACC–Detroit Arsenal, NAVAIR, NAVSEA, AFLCMC–Wright Patterson, AFLCMC–Hanscom, and Air Force SMC contracting officials took action to correct all 402 contract actions, valued at \$12.8 billion, in the FPDS-NG to accurately report the contract’s information.

Conclusion

UCAs allow contractors to begin work and incur costs before the Government and the contractor have reached a final agreement on contract terms, specifications, or price. A UCA is one tool that a contracting officer can use if they cannot negotiate a definitive contract to meet the Government’s requirement in a timely manner. However, there is an increased contract risk when contracting officers use a UCA. The Government takes on more contract risk during the undefinitized period of a UCA because the Government reimburses the contractor for all allowable costs, and the contractor has less incentive to control costs.

While MILDEP contracting officers generally followed requirements when obligating funds, some contracting officers did not fully comply with requirements for determining profit or definitizing UCAs. MILDEP contracting activities have an opportunity to improve how they implement UCAs. By implementing the recommendations made in the report, the DoD will be better prepared to minimize the inherent contract risks associated with using UCAs.

Management Comments on the Finding and Our Response

For the full text of the management comments on the Finding and our responses, see Appendix C of this report.

⁴⁵ DFARS PGI 217.7405, “Plans and Reports.”

Recommendations, Management Comments, and Our Response

Revised, Combined, and Deleted Recommendations

We combined and revised the draft Recommendations 1.a.1 and 1.a.2 into Recommendation 1.a based on management comments provided by the DPC Acting Principal Director, responding for the DPC Principal Director. We also deleted draft Recommendation 5 based on management comments received from the Principal Deputy Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), responding for the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics).

Recommendation 1

We recommend that the Defense Pricing and Contracting Principal Director:

- a. **Update the Defense Federal Acquisition Regulation Supplement to clarify that when considering the reduced cost risks associated with allowable incurred costs on a UCA, it is appropriate to apply separate and differing contract risk factors for allowable incurred costs and estimated costs to complete, in accordance with the requirements in 10 U.S.C. § 2326, “Undefinitized Contractual Actions: Restrictions,” when completing the contract risk sections of DD Form 1547, “Record of Weighted Guidelines.”**

Defense Pricing and Contracting Comments

The DPC Acting Principal Director, responding for the DPC Principal Director, disagreed with the recommendation, stating that restrictions on UCAs regarding risk-based profit was modified in FY2017 National Defense Authorization Act, Section 811, which require consideration be given to the reduced cost risk associated with incurred costs when calculating the profit allowed on a UCA.⁴⁶ In addition, the DPC Acting Principal Director stated the DFARS needs to maintain contracting officer flexibility to determine the appropriate contract risk factors to apply. The Acting Principal Director requested that recommendations 1.a.1 and 1.a.2 be revised into a single recommendation to update the DFARS to clarify that when considering the reduced cost risks associated with allowable incurred costs

⁴⁶ The FY 2017 National Defense Authorization Act, Section 811 changed 10 U.S.C. § 2326, “Undefinitized Contractual Actions: Restrictions,” to update how profit for contract risk is calculated. Specifically, when determining the amount of incurred costs for a UCA the cut-off point for incurred costs is now when the qualifying proposal was received instead of when the UCA was definitized, assuming that the UCA was definitized within 180-days after the qualifying proposal was received.

on a UCA, it is appropriate to apply separate contract risk factors for allowable incurred costs and estimated costs to complete, in accordance with the requirements in 10 USC 2326, when completing the contract risk sections of DD Form 1547.

Our Response

Comments from the Acting Principal Director addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Acting Principal Director provides documentation to support that DFARS was updated to address this recommendation.

- b. Encourage contractors to provide timely qualifying proposals by updating the Defense Federal Acquisition Regulation Supplement Subpart 217.7404-3, “Definitization Schedule,” to:**
 - 1. Open the suspension and reduction of progress payments to include all types of contract payments and not just progress payments.**
 - 2. Provide clarification for contracting officers on “other appropriate actions” that could further incentivize the contractor to provide timely qualifying proposals.**
 - 3. Require contracting officers to document in the contract file their justification for why payments were not withheld if the qualifying proposal was not received in accordance with the initial definitization schedule.**

Defense Pricing and Contracting Comments

The DPC Acting Principal Director, responding for the DPC Principal Director, agreed with the recommendation and did not provide further comments.

Our Response

Comments from the Acting Principal Director addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Acting Principal Director provides documentation to support that DFARS was updated to address this recommendation.

- c. **Update the Defense Federal Acquisition Regulation Supplement clause 252.217-7027, "Contract Definitization," to include that failure to meet the qualifying proposal date in the definitization schedule could result in the Government withholding a percentage of all payments yet to be paid under an Undefined Contract Action until the qualifying proposal is received.**

Defense Pricing and Contracting Comments

The DPC Acting Principal Director, responding for the DPC Principal Director, agreed with the recommendation and did not provide further comments.

Our Response

Comments from the DPC Acting Principal Director, responding for the DPC Principal Director, addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Acting Principal Director provides documentation to support that DFARS was updated to address this recommendation.

- d. **Update Defense Federal Acquisition Regulation Supplement Procedures Guidance and Information 217.7405, "Plans and Reports," to include a requirement that the Military Departments reconcile Federal Procurement Data System-Next Generation data to the Undefined Contract Action information they are reporting semiannually to Defense Pricing and Contracting before submitting the information.**

Defense Pricing and Contracting Comments

The DPC Acting Principal Director, responding for the DPC Principal Director, agreed with the recommendation and did not provide further comments.

Our Response

Comments from the Acting Principal Director, DPC responding for the DPC Principal Director, addressed the specifics of the recommendation; therefore the recommendation is resolved but will remain open. We will close the recommendation once the Acting Principal Director provides documentation to support that DFARS was updated to address this recommendation.

- e. **Issue the updated DD Form 1547, “Weighted Guidelines” to include separate boxes for contract type risk for incurred costs and for estimated costs to completion as shown in the Defense Federal Acquisition Regulation Supplement Part 215, “Contracting by Negotiation.”**

Defense Pricing and Contracting Comments

The Acting Principal Director, DPC responding for the DPC Principal Director, agreed with the recommendation and did not provide further comments.

Our Response

Comments from the DPC Acting Principal Director, responding for the DPC Principal Director, addressed the specifics of the recommendation; therefore the recommendation is resolved but will remain open. We will close the recommendation once the Acting Principal Director provides documentation to support that the DPC has updated the DD Form 1547, “Weighted Guidelines” to include separate boxes for contract type risk for incurred costs and for estimated costs as shown in DFARS Part 215.

Recommendation 2

We recommend that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology):

- a. **Implement the use at Army contracting activities of the updated Defense Federal Acquisition Regulation Supplement Part 215 and DD Form 1547, “Weighted Guidelines,” once it is issued, when determining profit for future Undefined Contract Actions**

Department of the Army Comments

The Deputy Assistant Secretary of the Army (Procurement), responding for the Assistant Secretary of the Army (Acquisition, Logistics, and Technology), agreed with the recommendation, stating that upon issuance of the revised DD Form 1547, a policy alert will be issued to the Army contracting enterprise directing use of the new form.

Our Response

Comments from the Deputy Assistant Secretary addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Deputy Assistant Secretary provides documentation to support that a policy alert implementing the use of the revised DD Form 1547 was issued.

- b. Require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the Undefined Contract Action definitization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.**

Department of the Army Comments

The Deputy Assistant Secretary of the Army (Procurement), responding for the Assistant Secretary of the Army (Acquisition, Logistics, and Technology), disagreed with the recommendation, stating that the recommendation is not necessary because DFARS PGI 217.7404-3, "Definitization Schedule," already directs the contracting officer to alert the approval authority if the definitization schedule appears to be in jeopardy.

Our Response

Comments from the Deputy Assistant Secretary did not address the specifics of the recommendation; therefore, the recommendation is unresolved. We request that the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) provide additional comments on the actions that the Army will take to implement the recommendation.

We disagree with the Deputy Assistant Secretary that the recommendation is not necessary. While the Army did track UCA status on a monthly basis no action plan was required to get the UCA back on schedule if the qualifying proposal was not received by the date stated in the contract or if funds would be withheld. Even though the submission of a qualifying proposal is a material element of the contract, a contracting official stated that "nothing happens" if the qualifying proposal was not received in accordance with the schedule. However, the major milestone to the definitization is the qualifying proposal. If the qualifying proposal is not received, the contracting officers cannot enter into negotiations to definitize the UCA. Therefore, it is recommended that the Army establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the UCA definitization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.

Recommendation 3

We recommend that the Deputy Assistant Secretary of the Navy for Procurement:

- a. **Implement the use at Navy contracting activities of updated Defense Federal Acquisition Regulation Supplement Part 215 and DD Form 1547, "Weighted Guidelines," once it is issued, when determining profit for future Undefined Contract Actions.**

Department of the Navy Comments

The Director of Policy, Deputy Assistant Secretary of the Navy (Procurement), responding for the Deputy Assistant Secretary of the Navy Procurement, agreed with the recommendation, stating that the Department of the Navy will follow the DFARS when updated.

Our Response

Comments from the Director of Policy addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Director of Policy provides documentation to support that the Navy has implemented the use of the revised DD Form 1547.

- b. **Require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the Undefined Contract Action definitization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.**

Department of the Navy Comments

The Director of Policy, Deputy Assistant Secretary of the Navy (Procurement), responding for the Deputy Assistant Secretary of the Navy for Procurement, disagreed with the recommendation, stating that the Navy has processes in place which meets the intent of the recommendation. The Director stated that the requirement already exists in the DFARS and the contracting officer monitors and coordinates with the requiring activity to actively manage the definitization schedule.⁴⁷ The Director also stated that if the schedule appears to be in jeopardy, the contracting officer notifies the head of the contracting activity.

⁴⁷ DFARS PGI 217.7404-3, "Definitization Schedule."

Our Response

Comments from the Director did not address the specifics of the recommendation; therefore, the recommendation is unresolved. We request that the Deputy Assistant Secretary of the Navy for Procurement provide additional comments on the actions that the Navy will take to implement the recommendation.

We disagree with the Director of Policy's assertion that the Navy had processes in place that met the intent of the recommendation. Navy contracting officers' alerted management when they could not meet the 180-day definitization deadline after receipt of the qualifying proposal and not when the deadline for the qualifying proposal was missed. Even though the submission of a qualifying proposal is an important element of the contract, we found no internal requirement for the contracting officers to report if the qualifying proposal was not received in accordance with the definitization schedule or if they planned to withhold payment to the contractor.

Navy contracting personnel tracked UCA status on a monthly basis in accordance with information needed to complete the semiannual report to Congress. However, there was no indication that Navy contracting personnel were alerting the approval authority when a contractor did not provide a qualifying proposal by the date listed in the UCA's definitization schedule. The Navy contracting personnel at the two sites we visited relied on the DPC semiannual report template to report on their UCAs to the Head of Contracting. The reporting template primarily focused on the definitization of a UCA, and not on the qualifying proposal submission timeline. Specifically, the template included when the qualifying proposal was received and not when it was due. It also did not include a plan of action for obtaining the qualifying proposal if it was not received in accordance with the definitization schedule. In addition, contracting officials stated that "nothing happens" if the qualifying proposal was not received in accordance with the schedule, such as having to report missing the date or creating an action plan to obtain the proposal.

Recommendation 4

We recommend that the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics):

- a. Implement the use at Air Force contracting activities of the updated Defense Federal Acquisition Regulation Supplement Part 215 and DD Form 1547, "Weighted Guidelines," once it is issued, when determining profit for future Undefined Contract Actions.**

Department of the Air Force Comments

The Principal Deputy Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), responding for the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), agreed with the recommendation, stating that the Air Force will implement any DPC changes to DD Form 1547 for determining profit for future UCAs.

Our Response

Comments from the Principal Deputy addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. We will close the recommendation once the Principal Deputy provides documentation to support that the Air Force has implemented the use of the revised DD Form 1547.

- b. Require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the Undefined Contract Action definitization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.**

Department of the Air Force Comments

The Principal Deputy Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), responding for the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics), agreed with the recommendation, stating that the revised Air Force Federal Acquisition Regulation Supplement 5317.7405, effective October 1, 2019, "Plans and Reports" included the statement, "For any reportable UCA that falls 30 days behind its schedule, update status in the reporting tool to identify actions taken to get back on schedule."

Our Response

Comments from the Principal Deputy partially addressed the specifics of the recommendation; therefore, the recommendation is resolved but will remain open. To close the recommendation, we request that the Principal Deputy Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics) provide additional information on the purposed actions that the Air Force will take to implement the recommendation.

Appendix A

Scope and Methodology

We conducted this performance audit from January 2019 through February 2020 in accordance with Generally Accepted Government Auditing Standards. These standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Criteria and Guidance Reviewed

We reviewed the following criteria and guidance.

- 10 U.S.C § 2326 (2010)⁴⁸
- FAR Part 2, “Definition of Words and Terms”
- FAR Part 15, “Contracting by Negotiations”
- FAR Part 16, “Types of Contracts,” Subpart 16.6, “Time and Materials, Labor Hour, and Letter Contracts”
- FAR Part 52, “Solicitation Provisions and Contract Clauses” Subpart 52.216-1, “Type of Contract”
- FAR Subpart 52.243-1, “Changes-Fixed-Price”
- DFARS Part 217, “Special Contracting Methods,” Subpart 217.7402, “Exceptions”
- DFARS Subpart 217.7404-3, “Definitization Schedule”
- DFARS Subpart 217.7404-4, “Limitation on Obligations”
- DFARS Subpart 217.7404-6, “Allowable Profit”
- DFARS Subpart 217.7405, “Plans and Reports”
- DFARS Part 215, “Contracting by Negotiation,” Subpart 215.404-4, “Profit”
- DFARS Subpart 215.404-74, “Fee Requirements for Cost-Plus-Award-Fee Contracts”
- DFARS Part 243, “Contract Modifications,” Subpart 243.2, “Change Orders”
- DFARS Part 252, “Clauses,” Subpart 252.217-7027, “Contract Definitization”
- DFARS PGI Part 215, “Contracting By Negotiation,” Subpart 215.404-70, “DD Form 1547, Record of Weighted Guidelines Method Application”

⁴⁸ We chose an earlier version to reflect the criteria for our audit sample.

- DFARS PGI Part 217, “Special Contracting Methods,” Subpart 217.74, “Un definitized Contract Actions”
- DFARS PGI Part 217, “Special Contracting Methods” Subpart 217.7404-3, “Definitization Schedule”
- Office of The Under Secretary of Defense(Acquisition, Technology and Logistics) memorandum, “Management Oversight of Un definitized Contract Actions,” August 29, 2008

Universe and Sample

We used the FPDS-NG and the DPC semiannual report to Congress to identify a universe of UCAs to review. We identified action obligations coded as letter contracts and other un definitized actions that the Army, Navy, and Air Force issued from January 2, 2012, through December 31, 2017, in the FPDS-NG. We removed UCAs that were exempt from DFARS requirements, including UCAs for foreign military sales, special access programs, congressionally mandated long-lead procurement contracts, and UCAs at or below the simplified acquisition threshold.⁴⁹

We used the FPDS-NG universe and totaled the UCA dollar values by contract number and contracting office to identify the contracting offices that issued the highest UCA dollar values for each Military Department. We identified the following contracting offices with the highest UCA dollar value.

- Army Contracting Command (ACC)–Redstone Arsenal, Alabama
- ACC–Detroit Arsenal, Michigan
- Naval Sea Systems Command (NAVSEA), Washington DC
- Naval Air System Command (NAVAIR), Maryland
- Air Force Life Cycle Management Command (AFLCMC)–Wright Patterson, Ohio
- AFLCMC–Hanscom, Massachusetts
- Air Force Space and Missile Center (SMC), California

We also obtained information from the DPC semiannual UCA reports to Congress that were reported from 2011 through 2018 for the seven sites. We compared FPDS-NG data to the DPC semiannual reports and identified additional UCAs that we added to our universe. Based on the universe identified using the FPDS-NG and DPC semiannual reports to Congress, there were 12,964 UCA-related actions with a total action obligation of \$66.3 billion issued by the Army, Navy, and Air Force from January 2, 2012, through December 31, 2017.

⁴⁹ In September of 2019, the DFARS was updated and now requires UCAs for foreign military sales to follow the DFARS requirements.

Table 7 shows the amount of UCA-related actions and obligated amounts for each Military Department from January 2012 through December 2017. The value column represents the amount of funds obligated for the UCA-related actions and not the overall value of the definitized contract. Most UCAs are funded to less than 50 percent before definitization and once definitized are no longer UCAs.⁵⁰

Table 7. UCA-Related Actions Awarded by Military Department From January 2012 Through December 2017

DoD Components in Our Scope	Action Obligation Values (in Millions)	UCA-Related Actions	Percent of Universe
Navy	\$45,770.7	9,358	69
Air Force	11,170.8	1,335	17
Army	9,334.9	2,271	14
Total	\$66,276.3	12,964	

Source: The DoD OIG.

We chose the UCAs with the highest dollar value from each contracting office that were not congressionally mandated long-lead items or foreign military sales for our sample. We validated our sample by using the Electronic Document Access system to verify that the selected contracts contained UCAs that were within our scope dates and were not congressionally mandated long-lead items or foreign military sales.

Army

At ACC-Detroit Arsenal, our universe consisted of 27 contracts with a total obligated value before definitization of \$1.5 billion. We chose 15 contracts containing 19 UCAs for review with an obligated value before definitization of \$1.4 billion and a definitized value of \$1.8 billion.

At ACC-Redstone, our universe consisted of 126 contracts with a total obligated value before definitization of \$4.8 billion. We chose 15 contracts containing 17 UCAs for review with an obligated value before definitization of \$474.0 million and a definitized value of \$1.4 billion.

⁵⁰ An obligation of funds is a legal liability to disburse funds immediately or at a later date as a result of a series of actions.

Navy

At NAVSEA, our universe consisted of 206 contracts with obligated value before definitization of \$3.8 billion. We chose 15 contracts containing 19 UCAs for review with an obligation value before definitization of \$451.0 million and a definitized value of \$785.9 million.

At NAVAIR, our universe consisted of 308 contracts with obligated value before definitization of \$25.3 billion. We chose 15 contracts containing 15 UCAs for review with an obligation value before definitization of \$775.9 million and a definitized value of \$937.9 million.

Air Force

At AFLCMC–Wright Patterson, our universe consisted of 50 contracts with obligated before definitization of \$3.2 billion. We chose 11 contracts containing 22 UCAs for review with an obligation value before definitization of \$722.0 million and a definitized value of \$4.4 billion.

At AFLCMC–Hanscom, our universe consisted of 58 contracts from FPDS-NG with an obligated value before definitization of \$384.7 million. We chose 11 contracts containing 15 UCAs for review with an obligation value before definitization of \$223.3 million and a definitized value of \$503.8 million.⁵¹

At SMC, our universe consisted of 20 contracts from FPDS-NG with obligated value before definitization of \$3.7 billion. We chose eight contracts containing nine UCAs for review with an obligated value before definitization of \$552.2 million and a definitized value of \$1.0 billion.

Review of Documentation and Interviews

We reviewed selected contracts and modifications from the Electronic Document Access database and reviewed contract documentation from contract files and the Army’s Paperless Contract Files system. We then combined the data to determine if the contracting offices complied with the United States Code and DFARS requirements.

We interviewed contracting, procurement, and policy personnel covering award and definitization of UCAs and related management control programs at the:

- DPC,
- Department of the Navy,
- Department of the Army, and
- Department of the Air Force.

⁵¹ We chose AFLCMC–Hanscom as an additional site because SMC had a limited number of qualifying contracts that we could review.

We reviewed documentation maintained by MILDEP contracting personnel to support UCAs awarded or definitized from January 2, 2012, through December 31, 2017. We reviewed:

- UCA request and approval documentation,
- justification and approvals,
- contract modifications,
- price negotiation memorandums,
- technical evaluations,
- business clearance memorandums, and
- Defense Contract Audit Agency audit reports.

We reviewed price negotiation memorandums, weighted guidelines, and disbursement histories to calculate potential excess profit paid for contract risk.

Use of Computer-Processed Data

We relied on computer-processed data from the FPDS-NG to determine the contracting activities to visit and to select the nonstatistical sample. We also used Electronic Document Access to obtain contract documentation. The data we obtained were not a basis for our conclusions or findings. To assess the accuracy of computer-processed data, we verified the FPDS-NG and Electronic Document Access data against official records at visited contracting activities. We determined that data obtained through the FPDS-NG were not reliable to determine if a UCA was actually a UCA; however, Electronic Document Access was sufficiently reliable to accomplish our audit objectives when compared with contract records.

We relied on information from the Army's Paperless Contract File system. To assess the accuracy of the computer-process data, we verified the information against official records and the Electronic Document Access. We determined the data obtained from the Army's Paperless Contract File system were sufficiently reliable to accomplish our audit objective.

We also used the FPDS-NG to report on the total number of UCAs under the jurisdiction of each Secretary from January 2, 2012, through December 31, 2017. We reported on the number of UCAs issued; however, those values may not reflect the actual amount of UCA use. We identified numerous discrepancies between information contained in the FPDS-NG when compared to information contained in Electronic Document Access, the DPC semiannual reports and actual contract records. The discrepancies included the FPDS-NG incorrectly identifying transactions as UCAs or the reverse and inaccurate dollar values.

Use of Technical Assistance

We met with personnel from the DoD OIG Quantitative Methods and Analysis Division and determined that we would use FPDS-NG data to select a nonstatistical sample of contracting activities. We also used FPDS-NG data in combination with contract data provided by DPC to select a nonstatistical sample of UCAs to review. Our sample was limited to specific contracts, and our results should not be projected across other contracts.

Prior Coverage

The GAO issued two reports in the last 5 years related to UCAs. The GAO also issued two reports more than 5 years ago that specifically discussed UCAs. Unrestricted GAO reports can be accessed at <https://www.gao.gov/>. Additionally, the DoD OIG issued five reports related to UCAs as well as one summary report on these five reports; however, these reports were issued more than 5 years ago. These reports specifically discussed UCAs; therefore, we included the reports in this summary of prior coverage because they directly related to our objective. Unrestricted DoD OIG reports can be accessed at <http://www.dodig.mil/reports.html/>.

GAO

Report No. GAO-18-324, “Missile Defense: The Warfighter and Decision Makers Would Benefit from Better Communication about the System’s Capabilities and Limitations,” May 2018

The GAO determined that the average length of the undefinitized period and the NTE price of the Missile Defense Agency’s UCAs had increased over the past 5 years.

Report No. GAO-15-496R, “Defense Contracting: Observations on Air Force Use of Undefinitized Contract Actions,” May 2015

The GAO determined that it had previously reported DoD’s efforts to provide oversight of UCAs and meet its definitization time frames. Air Force UCA contracts were reviewed and the GAO determined that AFLCMC did not report UCAs awarded for advance procurement of long-lead items in the Air Force’s monthly reporting tool. Therefore, these UCAs were not reported in DoD’s semiannual UCA report to Congress.

Report No. GAO-10-299, "Defense Contracting: DoD Has Enhanced Insight into Undefined Contract Action Use, but Management at Local Commands Needs Improvement," January 2010

The GAO determined that although the DoD had taken several actions since August 2008 to enhance departmental insight into and oversight of UCAs, data limitation hindered its full understanding of the extent to which they were used.

Report No. GAO-07-559, "Defense Contracting: Use of Undefined Contract Actions Understated and Definitization Time Frames Often Not Met," June 2007

The GAO determined that the DoD faced a potentially large gap in its data and, thus, the DoD did not know the extent to which it was using UCAs.

DoD OIG

The DoD OIG previously issued a series of five UCA reports. On January 13, 2012, DoD issued DoD IG Report No. DODIG-2012-039 "Summary Report on DoD's Management of Undefined Contractual Actions," which summarized these five UCA audits the DoDIG performed July 2009 to June 2011.

The DoD OIG found UCA deficiencies that included untimely definitization, obligating funds in excess of the allowable amounts, improper justification to issue a UCA, and insufficient documentation supporting whether the Government received a fair and reasonable price.

Report No. DoDIG D-2011-097, "Army Contracting Command-Redstone Arsenal's Management of Undefined Contractual Actions Could be Improved," August 12, 2011

The DoD OIG determined that contracting personnel did not definitize UCAs within the 180-day time frame, did not reflect the contractor's reduced risk, did not adequately support whether the reduced risk during the undefined period was reflected in profit, and did not obligate funds within allowable limits.

Report No. DoDIG D-2011-068, "Additional Actions Can Improve Naval Air Systems Command's Use of Undefined Contractual Actions," June 8, 2011

The DoD OIG determined that contracting personnel did not adequately prepare authorization requests, did not properly justify the issuance of UCAs, did not definitize UCAs within the 180-day time frame, and did not adequately support all required elements of profit determination.

Report No. DoDIG D-2011-024, "Air Force Space and Missile Systems Center's Use of Undefined Contractual Actions," December 16, 2010

The DoD OIG determined that contracting personnel did not adequately prepare authorization requests, did not definitize UCAs timely, did not reflect the contractor's reduced risk during the undefinitized period in negotiated profit, and obligate funds within allowable limits.

Report No. DoDIG D-2011-001, "Marine Corps Systems Command's Use of Undefined Contractual Actions," October 27, 2010

The DoD OIG determined that contracting personnel did not adequately prepare authorization requests for UCAs, did not justify the issuance of UCAs, did not definitize UCAs timely, and did not obligate funds within allowable limits.

Report No. DoDIG D-2010-080, "Air Force Electronic Systems Center's Use of Undefined Contractual Actions," August 18, 2010

The DoD OIG determined that contracting personnel did not properly prepare authorization requests for UCAs, did not definitize UCAs within the 180-day time frame, and did not support whether the contractor's reduced risk during the undefinitized period was reflected in negotiated profit.

Appendix B

DoD UCAs Issued by Military Department

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
FA8625-15-D-6591 DO 0005	Air Force	CP	215	605	820	\$65.1
N00024-10-C-2118	Navy	CP	353	415	768	104.8
N00019-16-G-0006 DO 0001	Navy	CP	542	224	766	12.2
W58RGZ-15-C-0085	Army	FFP/CP	56	706	762	39.2
FA8620-16-C-4008	Air Force	CP	323	421	744	51.1
N00024-12-C-4221	Navy	CP	0	630	630	32.4
FA8625-11-C-6600	Air Force	FFP	202	407	609	56.9
N00019-15-C-0122	Navy	FFP/CP	118	469	587	291.1
N00024-12-C-4222	Navy	CP	0	576	576	20.8
FA8808-12-C-0010	Air Force	FFP	372	162	534	887.0
FA8730-18-F-0016	Air Force	FFP/CP	237	293	530	38.6
FA8611-08-C-2896	Air Force	CP	243	270	513	\$419.7
N00024-05-C-5346	Navy	CP	70	435	505	55.1
W56HZV-14-C-0048	Army	FFP	97	364	461	38.0
N00019-16-C-0015	Navy	CP	317	131	448	116.3
N00019-16-C-0036	Navy	FFP/CP	113	335	448	57.9
N00024-15-C-5344	Navy	FFP	81	366	447	23.3
N00024-15-C-6275	Navy	CP	89	325	414	22.3
N00024-13-C-5225	Navy	CP	0	414	414	53.2

DoD UCAs Issued by Military Department (cont'd)

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
W56HZV-12-C-0404	Army	FFP	306	100	406	177.6
FA8611-08-C-2897	Air Force	CP	148	239	387	21.0
W56HZV-12-C-0198	Army	FFP/CP	21	357	378	113.3
W31P4Q-13-C-0231	Army	FFP	30	340	370	24.0
FA8620-17-C-4029	Air Force	FFP	0	370	370	40.3
N00024-05-C-5346	Navy	CP	65	300	365	\$26.3
W56HZV-16-C-0010	Army	FFP/CP	52	311	363	83.9
W31P4Q-17-C-0125	Army	FFP/CP	78	281	359	151.6
FA8625-11-C-6600	Air Force	FFP	202	156	358	3.2
FA8620-11-G-4038 DO34	Air Force	CP	118	225	343	39.4
W31P4Q-15-C-0039	Army	FPIF	219	112	331	46.2
W58RGZ-16-C-0030	Army	FFP	0	329	329	36.2
W56HZV-16-C-0038	Army	FFP/CP	68	260	328	281.3
W31P4Q-15-C-0153	Army	FFP	0	328	328	21.3
N00019-15-G-0026 DO 0503	Navy	CP	125	195	320	35.2
W58RGZ-16-C-0008	Army	FFP/CP	160	154	314	73.0
W58RGZ-17-C-0018	Army	CP	184	127	311	388.0
N00024-14-C-5341	Navy	FFP	0	311	311	16.4
N00024-11-C-6294	Navy	CP	0	308	308	\$20.3
W56HZV-12-C-0344	Army	FFP/CP	165	139	304	99.0
W56HZV-16-C-0225	Army	FFP	50	252	302	74.3
N00024-14-C-5340	Navy	FFP	0	302	302	141.1

DoD UCAs Issued by Military Department (cont'd)

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
FA8726-18-C-0007	Air Force	CP	132	168	300	2.8
W56HZV-12-C-0378	Army	FFP	0	300	300	28.5
N00024-16-C-6230	Navy	CP	0	287	287	18.8
W58RGZ-17-C-0018	Army	CP	0	280	280	290.3
W56HZV-12-C-0344	Army	FFP	94	179	273	335.4
N00024-05-C-5346	Navy	CP	52	217	269	12.5
FA8611-08-C-2896	Air Force	CP	49	218	267	458.4
W56HZV-17-C-0001	Army	FFP	132	133	265	136.1
W58RGZ-15-C-0038	Army	FPIF	99	162	261	30.8
W58RGZ-17-C-0035	Army	CP	33	226	259	\$57.3
W58RGZ-17-C-0027	Army	FFP/CP	102	140	242	25.2
W56HZV-15-C-0119	Army	FFP/CP	0	250	250	30.0
N00024-14-C-5106	Navy	FFP	0	247	247	34.7
N00024-15-C-6275	Navy	FFP	0	245	245	20.1
FA8611-08-C-2896	Air Force	CP	119	125	244	465.4
W56HZV-17-C-0021	Army	FFP/CP	69	169	238	39.1
W31P4Q-17-C-0068	Army	FFP/CP	90	147	237	61.6
W56HZV-14-C-0054	Army	FFP/CP	46	188	234	61.6
FA8730-18-C-0017	Air Force	FFP/CP	79	154	233	10.9
W56HZV-13-C-0358	Army	FFP	30	201	231	140.6
W31P4Q-17-C-0175	Army	CP	153	77	230	36.1
W56HZV-16-C-0038	Army	CP	69	160	229	60.5

DoD UCAs Issued by Military Department (cont'd)

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
FA8730-18-C-0007	Air Force	FFP	94	133	227	\$35.8
FA8611-08-C-2897	Air Force	CP	0	227	227	772.8
N00024-12-C-6306	Navy	FFP/CP	73	153	226	45.6
N00019-11-G-0001 DO 0080	Navy	CP	83	142	225	13.0
FA8620-11-G-4025 DO 1631	Air Force	FFP/CP	0	224	224	24.6
FA8730-17-C-0016	Air Force	FFP	140	82	222	15.6
W31P4Q-16-C-0028	Army	FFP	0	221	221	35.0
FA8807-08-C-0010	Air Force	FFP/CP	134	84	218	31.4
FA8621-13-C-6323	Air Force	FFP	0	217	217	5.5
W56HZV-14-C-0054	Army	FFP/CP	35	181	216	32.5
N00024-09-C-5111	Navy	FFP	0	216	216	93.9
N00019-12-C-0059	Navy	FFP/CP	92	113	205	187.8
W31P4Q-17-C-0193	Army	FFP/CP	124	80	204	22.5
N00019-15-G-0026 DO 0502	Navy	CP	89	113	202	\$10.5
FA8726-18-C-0007	Air Force	CP	60	136	196	63.1
FA8807-10-C-0001	Air Force	CP	0	194	194	24.9
W56HZV-16-C-0047	Army	FFP	108	84	192	15.9
N00019-11-C-0061	Navy	FFP	0	192	192	27.8
FA8620-11-G-4025 DO 1640	Air Force	FFP/CP	0	186	186	72.5
FA8726-09-C-0010	Air Force	CP	36	149	185	133.1
N00024-05-C-5346	Navy	CP	42	140	182	6.7
N00019-12-C-0074	Navy	FFP	34	148	182	24.0

DoD UCAs Issued by Military Department (cont'd)

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
N00019-12-D-0009 DO 0004	Navy	FFP	169	11	180	29.7
N00019-12-D-0011 DO 0007	Navy	FFP	65	115	180	27.7
W56HZV-12-C-0344	Army	FFP	43	132	175	61.0
FA8823-17-C-0001	Air Force	FFP	0	173	173	20.0
FA8611-08-C-2897	Air Force	CP	49	123	172	\$44.2
FA8730-16-C-0015	Air Force	CP	11	161	172	10.3
N00019-10-G-0004	Navy	FFP/CP	29	141	170	15.6
FA8726-09-C-0010	Air Force	CP	74	93	167	5.2
FA8808-17-C-0001	Air Force	FFP	25	141	166	9.5
FA8611-08-C-2897	Air Force	FFP/CP	0	161	161	559.6
FA8726-09-C-0010	Air Force	CP	0	157	157	120.8
FA8730-17-F-0015	Air Force	CP	82	70	152	12.4
FA8621-13-C-6323	Air Force	FFP	53	95	148	5.8
FA8726-17-C-0004	Air Force	FFP	70	77	147	32.0
FA8730-16-C-0016	Air Force	CP	11	133	144	10.2
FA8611-08-C-2897	Air Force	CP	0	126	126	584.4
N00019-11-C-0036	Navy	CP	25	97	122	9.0
FA8611-08-C-2897	Air Force	FFP	0	108	108	\$12.7
FA8611-08-C-2896	Air Force	FFP/CP	0	108	108	221.3
FA8611-08-C-2896	Air Force	FFP/CP	0	102	102	198.3
FA8807-10-C-0001	Air Force	CP	0	97	97	26.7
W58RGZ-16-C-0030	Army	CP	48	44	92	25.1

DoD UCAs Issued by Military Department (cont'd)

Contract Number	Military Department	Contract Type	Days From Award To Qualifying Proposal*	Days from Qualifying Proposal To Definitization	Days from Award to Definitization	Obligation At Definitization (in Millions)
F04701-02-D-0006 DO 0239	Air Force	FFP	7	85	92	2.3
N00019-17-C-0024	Navy	CP	0	89	89	80.0
FA8726-09-C-0010	Air Force	CP	42	46	88	4.5
W56HZV-12-C-0130	Army	FFP	0	85	85	17.0
FA8625-12-C-6598	Air Force	FFP	0	83	83	304.3
FA8730-16-C-0050	Air Force	FFP/CP	31	49	80	8.7
FA8808-10-C-0001	Air Force	FFP	0	80	80	21.0
FA8814-15-C-0006	Air Force	CP	22	30	52	7.7
N00024-14-C-4411	Navy	FFP	0	48	48	37.5

Legend

CP Cost-plus
 FFP Firm-fixed-price
 FPIF Fixed-price-incentive-fee

* A zero means the qualifying proposal was received before the UCA was award. When the qualifying proposal was received before UCA award, we used the date of the UCA award as the qualifying proposal date.

Source: The DoD OIG.

Appendix C

Management Comments on the Finding, Unsolicited Comments, and Our Response

Department of the Army Comments

The Deputy Assistant Secretary of the Army (Procurement), responding for the Assistant Secretary of the Army (Acquisition, Logistics, and Technology), provided the following comments on the finding. For full text of the Deputy Assistant Secretary of the Army (Procurement), comments see Appendix D of this report.

The Deputy Assistant Secretary stated that the report is inconsistent when referencing current statute and regulation. For example, the report states that contracting officers for UCAs for foreign military sales are only required to follow the DFARS UCA requirements to the maximum extent practicable. The Deputy Assistant Secretary also stated that the DFARS was updated in August 2019 making foreign military sales UCAs subject to DFARS.⁵²

In addition, the Deputy Assistant Secretary recommended removing references to the August 2008 DPC memorandum, “Management Oversight of Undefined Contract Actions,” stating that the memorandum was incorporated into the DFARS in July 2009 and is not considered active policy or used by contracting officers as they complete the required actions related to UCAs.

The Deputy Assistant Secretary also disagreed with that UCAs were essentially a cost-reimbursable contract during the undefinitized period. Stating that there is no current statutes, regulations, or DoD policies to support a blanket statement that a UCA in all cases, is the equivalent of a cost reimbursement contract.

The Deputy Assistant Secretary further stated that a UCA is a contract action for which the contract terms, specifications, or price are not agreed upon before performance is begun under the action and this definition does not transform an otherwise fixed-price contract into a cost reimbursable contract. Deputy Assistant Secretary stated that a UCA does not contain cost-reimbursement terms found at FAR Clause 52.216-7, “Allowable Cost and Payment,” and that by making the unsupported blanket assumption, if left uncorrected, risks unnecessary confusion or other unintended consequences.

The Deputy Assistant Secretary stated that Recommendation 1.a.1 should be removed or reworded to avoid the implication that it is appropriate in all cases to apply the profit rate or contract risk for cost-reimbursement contracts to the

⁵² DFARS 217.74, “Undefinitized Contract Actions”, revised September 13, 2019.

actual pre-definitization cost. The Deputy Assistant Secretary also recommended removing or rewording Recommendations 1.b and 1.c and disagreed with expanding the policy on reduction or suspension of progress payments for untimely qualifying proposals. The Deputy Assistant Secretary further stated that it is an incorrect assumption that the Government is powerless, in contracts without progress payments, to use financial leverage to enforce contract terms. The Deputy Assistant Secretary stated that various mechanisms exist across the contract types and financing methods that give the Government financial leverage in enforcing contract terms. The Deputy Assistant Secretary recommends that we update the draft report to acknowledge the existing financial and non-financial levers to use, when appropriate, in enforcing the terms of the contract. In addition, the Deputy Assistant Secretary stated that Recommendation 1.a.2 is unclear whether it should be in addition to, or as a replacement of, the current policy at DFARS 215.4040-71-3(d)(2).

Our Response

We acknowledge and appreciate the Deputy Assistant Secretary's comments. Our scope for this audit project was from January 2012 through December 2017. Therefore, we used the guidance that was applicable at the time the UCAs were awarded. We also noted if the guidance had changed. Therefore, we updated the report to note that the guidance on UCAs for foreign military sales changed in September 2019.

While we appreciate the Deputy Assistant Secretary's unsolicited comments on Recommendation 1.b and Recommendation 1.c, we did not remove or change the recommendations. Based on comments from the DPC Acting Principal Director, we combined and reworded Recommendation 1.a.1 and Recommendation 1.a.2 to give contracting officers more clarification on how to determine profit on incurred costs for contract risk while also making it clear that contracting officers have the discretion to customize their profit determinations based on risks associated with their UCAs. We have worked closely with personnel from the DPC with input from contracting office personnel from the seven sites we visited to develop our recommendations.

The DPC (formerly the Defense Procurement and Acquisition Policy) memorandum "Management Oversight of Undefinitized Contract Actions" from 2008 states that in general, when negotiating profit or fee, it is appropriate to apply the profit rate for contract risk for cost-reimbursement contracts to the actual cost of performance before definitization. We discussed the DPC memorandum with contracting

personnel at all seven sites and with DPC before issuing the draft report and found that the memorandum provided valid guidance and insight into determining how the profit rate for contract risk should be calculated.

While a UCA may not have clauses normally associated with cost-reimbursable contracts, the assertion that UCAs are essentially cost reimbursable contracts before definitization is not an incorrect approximation of how a UCA functions before definitization. Once a UCA is awarded, the contractor immediately begins working and the Government is required to reimburse the contractor's allowable costs during the undefinitized period. There is no fixed prices yet because the UCA has not been negotiated or definitized, but there are limitations on the Government's liability if the contract is terminated before definitization.

Recommendation 1.b.2 mirrors the Deputy Assistant Secretary's concerns about identifying other mechanisms that the DoD can leverage in enforcing contract terms. This recommendation requests that the DPC Principal Director update the DFARS to provide clarification on the "other appropriate actions" that could further incentivize the contractor to provide timely qualifying proposals. Thus allowing contracting officers more flexibility and more leverage when enforcing contract terms.

Department of the Navy Comments

The Director of Policy, Deputy Assistant Secretary of the Navy (Procurement), responding for the Deputy Assistant Secretary of the Navy for Procurement, provided the following comments on the finding. For the full text of the Director of Policy, Deputy Assistant Secretary of the Navy (Procurement)'s comments, see Appendix D of this report.

The Director disagreed with the report, stating that the August 2008 DPC memorandum "Management Oversight of Undefinitized Contract Actions" is not current. The memorandum was implemented into the DFARS in July 2009 and, therefore, the memorandum is no longer current policy or guidance.⁵³ The Director further stated that the DFARS was amended to address the requirements of the DPC memorandum and that responding to the report was difficult since the major basis of the report, the 2008 DPC memorandum, is invalid. The Director noted that the implementing language, currently in the DFARS, weakens and in effect refutes the conclusions being drawn in the draft audit report based upon the 2008 memorandum. The Director also stated that the final DFARS language omits the language from the 2008 DPC memorandum that is being used to support the conclusion in this audit. The Director further stated that implementing

⁵³ DFARS 217.74, "Undefinitized Contract Actions."

language does not reference any contract risk type apart from stating the lower end for the designated “range” would be an appropriate point of reference and does not consider contract types across various stages of performance. The Director noted that the statement giving contracting officers the choice to apply a contract risk factor as low as zero, weakens the audit’s interpretation of the memorandum as ordering use of only cost-reimbursement contract type risk factors to costs incurred before definitization. The Director concluded that all findings in the audit report based upon applying a cost-reimbursement contract type risk factor to incurred costs are inconsistent with the implementation of the 2008 memorandum in the DFARS.

The Director disagreed that UCAs are essentially a cost-reimbursable contract during the undefinitized period. The Director stated that a UCA is not a contract type, it is a special contracting method for which the contract terms, specifications, or price are not agreed upon before work is started under the action. The Director also stated by describing a UCA as any contract type is inconsistent with regulation.

The Director disagreed that the Government is obligated to reimburse all allowable costs incurred during the undefinitized period of a UCA. The Director stated that recognition of costs incurred before definitization is proper within the scope of negotiations and only costs that the Government agree are fair, reasonable, and otherwise allowable and awarded to the contract will be reimbursed.

The Director stated that by making “profit factors” synonymous with “profit rates” is inaccurate and runs the risk of causing considerable confusion and the report should ensure appropriate use of these terms. Specifically, the Director also stated that the audit compares contract type risk “profit factors” set forth in DFARS with the overall “profit rates.”⁵⁴ The Director further stated this characterization is not accurate according to the DFARS which states the weighted guidelines method focuses on four profit factors. The Director noted that the contract type risk factor is only one of the four elements of the weighted guidelines analysis.

The Director disagreed with how the profit was calculated and summarized in the report if those calculations rely on the 2008 DPC memorandum. As a result, the Director requested that we recalculate the profit summarized in the report. The Director stated that the negotiation of profit is a process where a multitude of risks must be evaluated, balanced, and reconciled. The Director also stated that the audit treats negotiation of profit as being predetermined based on a set of mathematical-like formulas and disagrees that profit negotiations are so cut and dry. The Director further stated that the Government does not have the authority

⁵⁴ DFARS 215.404-71-3, “Contract Type Risk and Working Capital Adjustment.”

to unilaterally bind industry to a contract with the Government and since UCAs result in the Government negotiating in a sole-source environment, the contracting parties must mutually agree on final negotiated price.

The Director questions whether it is appropriate for the auditors to substitute their judgement for that of the contracting officer and recalculate profit. The Director stated that contracting officers entrusted with the responsibility and authority to enter into contracts, based on their business expertise. The Director also stated that the FAR states that contracting officers are responsible for exercising the necessary judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement.⁵⁵

Our Response

We acknowledge and appreciate the Director's comments on the recommendations. We coordinated closely with personnel from the DPC with input from contracting office personnel from the seven sites we visited to develop our recommendations. Based on comments from the Acting Principal Director, DPC, we combined and reworded Recommendation 1.a.1 and Recommendation 1.a.2 to give contracting officers more clarification on how to determine profit on incurred costs for contract risk. The DPC Acting Principal Director concurred with the remaining recommendations directed to the DPC, and, therefore, we will not revise the other recommendations.

While a UCA may not have clauses normally associated with cost-reimbursable contracts, the assertion that UCAs are essentially cost reimbursable contracts before definitization is not an incorrect approximation of how a UCA functions before definitization. Once a UCA is awarded, the contractor immediately begins working, and the Government is required to reimburse the contractor's allowable costs during the undefinitized period. There are no fixed prices yet, but there are limitations on the Government's liability if the contract is terminated before definitization. For a cost to be allowable, it has to be reasonable, allocable to the contract, and within the terms of the contract per the FAR.⁵⁶ Therefore, costs are either allowable or not allowable.

We understand that the weighted guidelines method consists of four factors. We provided a detailed explanation of the four factors and why we only reviewed the contract risk factor as part of our audit in the background section of the report. Table 3, "UCAs by Contracting Activity Location That Did Not Apply Profit for Contract Risk in Accordance With Guidance," in the report also discussed

⁵⁵ FAR 15.405(a), "Price Negotiation."

⁵⁶ FAR 31.201-2, "Determining Allowability."

that contract risk is only one of four factors used to calculate the overall profit. We did not consider the determination of what profit rate to use as a set of mathematical-like formula or that profit negotiations were clear and direct. As we stated in the report, we considered whether the contracting officer had justified the use of a higher percentage in the contracting file as required by the DFARS.⁵⁷ If the justification was adequate, we accepted the use of a higher rate.

We chose to apply a cost-reimbursable, contract risk rate to our incurred cost calculations for the UCAs based on the DPC memorandum, discussion with DPC on the intent of the DFARS changes, and because in general we observed that contracting officers applied a cost-reimbursable rate to incurred costs when calculating their negotiation objectives. In addition, there was no indication in the contracting file that a higher rate was justified for those UCAs. We also added language in the report to clarify that contracting officers have the discretion to apply a higher profit rate to the incurred costs if it is justified in the contracting file.

The 2008 DPC memorandum states that in general, when negotiating profit or fee, it is appropriate to apply the profit rate for contract risk for cost-reimbursement contracts to the actual cost of performance before definitization. We discussed the DPC memo with contracting personnel at all seven sites and with DPC before issuing the draft report and found that the memorandum provided valid guidance and insight into determining how the profit rate for contract risk should be calculated. We found that contracting officers were generally following the 2008 Memorandum and applied a cost-reimbursement contract-type risk rate to incurred costs. The 12 UCAs that we identified in the report did not follow the DFARS guidance for adjusting profit for contract risk based on incurred costs. Our report further identified the various ways that contracting officers interpreted the DFARS, and, therefore, our recommendation was intended to provide the contracting officers clarification on how to determine the profit rate for contract risk when determining their negotiation stance.

⁵⁷ DFARS Section 215.404-71-3, "Contract Type Risk and Working Capital Adjustment," June 28, 2019.

Management Comments

DPC Comments



ACQUISITION
AND SUSTAINMENT

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

MEMORANDUM FOR PROGRAM DIRECTOR FOR AUDIT ACQUISITION,
CONTRACTING, AND SUSTAINMENT, OFFICE OF THE
INSPECTOR GENERAL

SUBJECT: Response to Department of Defense Inspector General Draft Report on Audit of
Department of Defense Management of Unfinalized Contract Actions (Project No.
D2019-D000AH-0090.000)

As requested, I am providing responses to the general content and recommendations
contained in the subject report.

Recommendations 1.a.1 and 1.a.2: We recommend that the Defense Pricing and Contracting
(DCP) Director update the Defense Federal Acquisition Regulation Supplement (DFARS) to:

1. Clarify when considering the reduced cost risks associated with incurred costs on an Unfinalized Contract Action (UCA) that it is appropriate to apply the contract risk rate for a cost-reimbursement contract type to the actual cost of performance when completing the contract risk sections of DD Form 1547, "Record of Weighted Guidelines."
2. State that contracting officers can apply profit rates from two different designated ranges, one rate to the incurred costs before finalization and a different rate to the remaining portion of the contract when determining contract type risk.

Response: Non-concur based on the following: Section 811 of the NDAA for FY 2017, Public Law 110-181, modified restrictions on UCAs regarding risk-based profit. These revised requirements were codified in 10 U.S.C. 2326(f), which require consideration be given to the reduced cost risk associated with incurred costs when calculating the profit allowed on a UCA for which the final price is negotiated after a substantial portion of the performance required is completed. Additionally, these requirements include specific direction for considering risk factors applied to incurred costs before and after the submission of a qualifying proposal. DFARS rule 2018-D008 (Attachment 1) incorporated the Section 811 requirements into DFARS 215.404-71-3(d)(2)(i), and was published in August 2019. Unfortunately, while the language at DFARS 215.404-71-3(b) establishes separate applications of risk factors for incurred costs and estimated costs to complete under block 24, the actual revised DD Form 1547 has yet to be made available electronically.

DFARS 215.404-71-3(d)(2)(i) (Attachment 2) directs that "if a substantial portion of the costs have been incurred prior to finalization, the contracting officer may assign a value as low as zero percent, regardless of contract type." While it is paramount that the DFARS maintain contracting officer flexibility to determine the appropriate contract risk factors to apply, the DFARS should specifically state that contracting officers should consider separate and differing risk factors to apply to incurred costs and estimated costs to complete.

DPC Comments (cont'd)

Alternatively, DPC advocates the recommendations be combined into a single recommendation 1.a that states: Update the Defense Federal Acquisition Regulation Supplement (DFARS) to clarify that when considering the reduced cost risks associated with allowable incurred costs on a UCA, it is appropriate to apply separate contract risk factors for allowable incurred costs and estimated costs to complete, in accordance with the requirements in 10 USC 2326, when completing the contract risk sections of DD Form 1547, "Record of Weighted Guidelines."

Recommendations 1.b.1, 1.b.2, and 1.b.3: We recommend that the Defense Pricing and Contracting (DPC) Director encourage contractors to provide timely qualifying proposals by updating the DFARS 217.7404-3, "Definitization Schedule," to:

1. Open the suspension and reduction of progress payments to include all types of contract payments and not just progress payments.
2. Provide clarification for contracting officers on "other appropriate actions" that could further incentivize the contractor to provide timely qualifying proposals.
3. Require contracting officers to document in the contract file their justification for why payments were not withheld if the qualifying proposal was not received in accordance with the initial definitization schedule.

Response: Concur.

Recommendation 1.c: We recommend that the Defense Pricing and Contracting (DPC) Director, update the DFARS 252.217-7027, "Contract Definitization," to include that failure to meet the qualifying proposal date in the definitization schedule could result in the Government withholding a percentage of all payments yet to be paid under an UCA until the qualifying proposal is received.

Response: Concur.

Recommendation 1.d: We recommend that the Defense Pricing and Contracting (DPC) Director, update DFARS Procedures Guidance and Information (PGI) 217.7405, "Plans and Reports," to include a requirement that the Military Departments reconcile Federal Procurement Data System-Next Generation data to the UCA information they are reporting semiannually to DPC before submitting the information.

Response: Concur.

Recommendation 1.e: We recommend that the Defense Pricing and Contracting (DPC) Director, issue the updated DD Form 1547, "Weighted Guidelines" to include separate boxes for contract type risk for incurred costs and for estimated costs to completion as shown in the DFARS Part 215, "Contracting by Negotiation."

Response: Concur.

DPC Comments (cont'd)

Please contact the DPC point of contacts, [REDACTED]

[REDACTED] if you have any questions or concerns.

Sincerely,

[REDACTED]

Kim Herrington
Acting Principal Director,
Defense Pricing and Contracting

Attachments:
As stated

Department of the Army Comments



DEPARTMENT OF THE ARMY
OFFICE OF THE ASSISTANT SECRETARY OF THE ARMY
ACQUISITION LOGISTICS AND TECHNOLOGY
103 ARMY PENTAGON
WASHINGTON DC 20310-0103

SAAL-PS

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, 4800
MARK CENTER DRIVE, ALEXANDRIA, VIRGINIA 22350-5000

SUBJECT: Draft Audit of DoD Management of Undefinitized Contract Actions (Project
No. D2019-D000AH-0090.000)

Attached are the Army's comments to the subject draft report. If there are any

[REDACTED]

[REDACTED]

Encl

Stuart A. Hazlett
Deputy Assistant Secretary
of the Army (Procurement)

Department of the Army Comments (cont'd)

Office of the Deputy Assistant Secretary of the Army (Procurement)
Comments To
DoDIG Draft Report: DoD Management of Undefined Contract Actions
(D2019AH-0090)

1. Many of the statements and recommendations made in the draft report are predicated on incorrect assumptions or outdated policy. Request that these areas be corrected in the draft report, and concomitant changes made to the report's recommendations, prior to re-staffing the draft document for comment to the affected DoD components.

2. A summary of the Army's comments are below:

a. The draft report asserts in several locations that a UCA is essentially a cost-reimbursable contract during the undefinitized period (see, for example, first paragraph under Background section of "Results in Brief" (page (i) of draft report)). There is no current statutes, regulations, or DoD policies to support a blanket statement that a UCA, in all cases, is the equivalent of a cost reimbursement contract. By definition, a UCA is a contract action for which the contract terms, specifications, or price are not agreed upon before performance is begun under the action. This definition does not transform an otherwise fixed price contract into a cost reimbursable contract. A contract awarded as a firm fixed price UCA does not contain cost-reimbursement terms (such as those found in FAR Clause 52.216-7, Allowable Cost and Payment), either before or after definitization. By making the unsupported blanket assumption that, a UCA is essentially a cost-reimbursable contract during the undefinitized period, the draft report--if left uncorrected--risks unnecessary confusion and other unintended consequences.

b. The draft report references in several locations (Page 8) a Defense Procurement and Acquisition Policy memo from August 2008, Subject: Management Oversight of UCAs. The memo appears to be the source of Recommendation 1.a.1. (Page 36) and may have led to the mistaken interpretation that UCAs are essentially cost reimbursement contracts prior to definitization. This memo was incorporated into the DFARS in July 2009 (see DFARS case 2008-D029, 74 FR 37649) and is not considered active policy or used by contracting officers as they grapple with completing the required actions related to UCAs. By continuing to reference this outdated policy memo, the draft report risks unnecessary effort and confusion. References to the memo should be removed and Recommendation 1.a.1. should be removed or reworded as necessary to avoid the implication that all undefinitized UCAs are cost-reimbursement contracts, and the implication that it is appropriate in all cases to apply the profit rate for contract risk for cost-reimbursement contracts to the actual pre-definitization cost.

c. The Army does not agree with expanding the policy on reduction or suspension of progress payments for untimely qualifying proposals beyond the FAR 32.503-6 construct. The basis for this recommendation is an incorrect assumption that

Department of the Army Comments (cont'd)

the Government is powerless, in contracts without progress payments, to use financial leverage to enforce contract terms. In reality, a variety of mechanisms currently exist across the contract types and financing methods (see., e.g., FAR 46.407 policies for nonconforming supplies or services) that give the Government financial leverage in enforcing contract terms. Furthermore, explicit direction to withhold/suspend payments may discourage industry's willingness to enter into UCAs. The draft report should be updated to acknowledge the existing financial and non-financial (e.g., past performance) levers to use, where appropriate, in enforcing the terms of the contract. Recommendations 1.b and 1.c (Page 37), should be reworded or removed.

d. Recommendation 2.b. to the Army (Page 37), and similar recommendations to the other military departments, would require a process for contracting officers to immediately report to the Head of the Contracting Activity (HCA) when a qualifying proposal is not received in accordance with the UCA definitization schedule. This recommendation is not necessary because DFARS PGI 217.7404-3, Definitization schedule, already directs the contracting officer to alert the approval authority if the definitization schedule appears to be in jeopardy. The Army non-concurs with this recommendation.

e. The Army concur with Recommendation 2.a. (Page 37). Upon issuance of the revised DD Form 1547, a policy alert will be issued to the Army contracting enterprise directing use of the new form.

f. It is unclear as to whether Recommendation 1.a.2. (Page 36) should be in addition to, or as a replacement of, the current policy at DFARS 215.404-71-3(d)(2).

g. The report is inconsistent when it comes to referencing current statute and regulation. For example, on Page 3 the report states that contracting officers for UCAs for foreign military sales are only required to follow the DFARS UCA requirements to the maximum extent practicable. However, the DFARS was updated in August 2019 to make FMS UCAs unequivocally subject to DFARS subpart 217.74.

Department of the Navy Comments



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(RESEARCH, DEVELOPMENT AND ACQUISITION)
1000 NAVY PENTAGON
WASHINGTON, DC 20350-1000

From: Director of Policy, Deputy Assistant Secretary of the Navy (Procurement)
To: U.S. Department of Defense Inspector General

Subj: DEPARTMENT OF THE NAVY (DON) RESPONSE TO THE DRAFT REPORT -
AUDIT OF DOD MANAGEMENT OF UNDEFINITIZED CONTRACT ACTIONS
(PROJECT NO. 2019-D000AH-0090.000)

Ref: (1) [REDACTED], same subject, dated 13 February 2020 with attachment
(2) Defense Procurement, Acquisition Policy, and Strategic Sourcing, Memorandum,
"Management Oversight of Undefinitized Contract Actions," dated August 29, 2008

Encl: (1) Detailed support of the DON Response

1. The DON appreciates the opportunity to review the draft audit of DoD Management of Undefinitized Contract Actions (UCAs) provided by reference (1) but non-concurs with the report. The below provides a summary of the DON position resulting in a non-concur with the supporting details in the enclosure.

a) The DON disagrees that the Defense Procurement, Acquisition Policy, and Strategic Sourcing, Memorandum, "Management Oversight of Undefinitized Contract Actions," dated August 29, 2008 DPAP memo is current. The memo was implemented into the Defense Federal Acquisition Regulation Supplement (DFARS) at Subpart 217.74 in July 2009 via DFARS case 2008-D029. Responding to this report was very difficult as its fundamental premise, the 2008 DPAP memo, is invalid.

b) The DON disagrees with the report's treatment/characterization of UCAs as a cost-reimbursable contract type.

c) The DON disagrees that the Government is obligated to reimburse all allowable costs incurred during the undefinitized period of a UCA.

d) The DON disagrees with how the report equates the contract-type risk "profit factors" and "profit rates."

e) The DON disagrees with how the profit was calculated and summarized on page 18, Table 3 and discussed on pages 18-21, as it appears to be relying on reference (2).

Department of the Navy Comments (cont'd)

Subj: DEPARTMENT OF THE NAVY (DON) RESPONSE TO THE DRAFT REPORT -
AUDIT OF DOD MANAGEMENT OF UNDEFINITIZED CONTRACT ACTIONS
(PROJECT NO. 2019-D000AH-0090.000)

2. The below is the DON's response to recommendations 3.a. and 3.b. as required by reference (1).

Recommendation 3.a. was to "Implement the use at Navy contracting activities of updated Defense Federal Acquisition Regulation Supplement Part 215 and DD Form 1547, "Weighted Guidelines," once it is issued, when determining profit for future Undefinitized Contract Actions.

DON Response: The DON will follow the DFARS when it is updated.

Recommendation 3.b. was to "Require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the Undefinitized Contract Action definitization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld."

DON Response: The DON already has processes in place which meets the intent of this recommendation as the requirement already exists in the DFARS PGI at 271.7404-3. The contracting officer closely monitors and coordinates with requiring activity to actively manage the definitization schedule. If that schedule appears to be in jeopardy, the contracting officer notifies the HCA or his delegate.

3. The DON requests that all profit discussion be redacted from the public version of the audit report. Findings that the Government "underpaid" profit should be redacted as they invite a contractor claim based upon the audit report itself. Documenting that the Government "could" have justified paying more for something is not in the Government's best interests of the ongoing health and vitality of the procurement process where contracting officers strive to obtain the maximum value for taxpayer funds by ensuring vigorous and robust negotiations, that are also fair and reasonable. Further, it portends to substitute the judgment of the auditor for the contracting officer's judgement.

4. The details supporting the DON's non-concurrence are contained in the enclosure. The DON offers, and would appreciate the opportunity, to meet with the auditors to conduct a page-by-page discussion of the report to enhance the understanding of our comments. Minimally, in light of the substantive significance of the issues the DON is raising, if substantial revisions are made to this report, the DON requests one final opportunity to review and comment thereto. Should you find this agreeable, or for any other reason, my point of contact is [REDACTED]

[REDACTED]
Denise L. Randolph

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

1. The below is the detailed discussion of the DON's comments supporting our non-concurrence.

a. The DON disagrees that the Defense Procurement, Acquisition Policy, and Strategic Sourcing, Memorandum, "Management Oversight of Undefinitized Contract Actions," dated August 29, 2008 DPAP memo is current. The memo was implemented into the Defense Federal Acquisition Regulation Supplement (DFARS) at Subpart 217.74 in July 2009 via DFARS case 2008-D029. Responding to this report was very difficult as its fundamental premise, the 2008 DPAP memo, is invalid.

- (1) One document the draft report significantly relies upon and applies as a measurement standard is a Defense Procurement and Acquisition Policy memo from August 2008, subject: Management Oversight of UCAs. This memo is not considered active/controlling policy anymore, as it was formally implemented in the DFARS in July 2009 via DFARS case 2008-D029 (See 74 FR 37649 and <https://www.govinfo.gov/content/pkg/FR-2009-07-29/pdf/E9-7947.pdf#page=1>). That DFARS case at Section A., Background, expressly references the August 2008 memo as follows: "...On August 29, 2008, the Director, Defense Procurement and Acquisition Policy, issued a memorandum to DoD departments and agencies as required by Section 809 of Public Law 10-181. This final rule amends the DFARS to address the requirements of the August 29, 2008 memorandum, specifically, requirements for DoD departments and agencies to submit semi-annual reports regarding undefinitized cost actions exceeding \$5 million; for obligation of funds for the undefinitized period consistent with the contractor's proposal for that period; and for compliance with existing DFARS policy relating to profit computation for undefinitized contract actions." Based on this language, the 2008 memo was superseded by the implementing language memorialized in the DFARS and therefore the memo is no longer the current policy or guidance.
- (2) It is also worth noting that the superseding implementing language currently set forth in the DFARS, likewise undercuts and effectively refutes the conclusions being drawn in the draft audit report based upon the 2008 memo. The following language from that memo is the basis for concluding that contracting officers are compelled to apply contract type risk factors associated with cost-reimbursable contracts to cost incurred prior to UCA definitization:

"In general, when negotiating profit or fee, it is appropriate to apply the contract risk factor for cost reimbursement contracts to the actual cost of performance prior to definitization (DD Form 1547, Record of Weighted Guidelines Application, Block 24, Contract Type Risk)." (Emphasis added).

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

- (3) The final implementation language at DFARS 215.404-71-3-(d)(2)(i) omits the very language from the 2008 DPAP memo that is the lynchpin of the conclusion being drawn in the audit:
- (4) "...When costs have been incurred prior to definitization, generally regard the contract type risk to be in the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, the contracting officer may assign a value as low as zero percent, regardless of contract type. ..."
- (5) The implementing language makes no reference whatsoever to any contract risk type apart from stating the lower end of the designated "range" would be an appropriate point of reference. Note the word "range" is in the singular. The DFARS plainly therefore does not contemplate a hodge-podge of contract types across various stages of performance under a profit analysis for an award following the UCA methodology. To be clear, contracting officers are vested with discretion to change contract type profit risk factors for different classes/groups of costs and therefore application of different contract type risk factors is not foreclosed; rather, the point is contracting officers are not compelled to apply cost type risk factors to any particular class/group of costs as the draft audit tacitly assumes. Finally, the statement affording contracting officers discretion to apply a contract risk factor as low as zero, "regardless of contract type" undercuts the audit's interpretation of the memo as per se dictating application of only cost reimbursement contract type risk factors to costs incurred prior to definitization. Per DFARS 215 404-71-3(c), the recognized contract type risk factor range for cost reimbursement type contracts is from 0 to 2. Because the bottom of the recognized range for cost reimbursement type contracts is zero, the words "regardless of contract type" serve no substantive purpose if contracting officers are compelled to utilize a range that already includes a bottom value of zero. As such, the audit's interpretation that contracting officers are compelled to apply the contract type risk factors associated with cost reimbursement contracts can only be correct if the memo language affording contracting officers latitude to apply a value as low as zero, "regardless of contract type", is afforded no substantive meaning. As a general matter, it is not appropriate to interpret a document/text in a manner that renders language within that document/text superfluous/meaningless.
- (6) Based on the foregoing, all findings in the audit report predicated upon per se/compulsory application of contract type risk factors associated with cost reimbursement type contracts to costs incurred prior to UCA definitization are inconsistent with how the 2008 memo has been implemented in the DFARS.

b. The DON disagrees with the report's treatment/characterization of UCAs as a cost-reimbursable contract type. A UCA is not a contract type. It is a special contracting method for which the contract terms, specifications, or price are not agreed upon before

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

performance is begun under the action. As such, characterizing a UCA as any contract type is inconsistent with regulation.

c. The DON disagrees that the Government is obliged to reimburse all allowable costs incurred during the undefinitized period of a UCA. Recognition of costs incurred prior to definitization is properly within the scope of negotiations and only costs that the Government agree are fair, reasonable and otherwise allowable and allocable to the contract will be reimbursed.

d. The DON disagrees with how the report equates the contract-type risk “profit factors” and “profit rates.”

1. In various places throughout the audit, the audit equates contract type risk “profit factors” set forth in DFARS 215.404-71-3 with overall “profit rates”. This characterization is not accurate. Per DFARS 215.404-71-1, General:
 - a. “The weighted guidelines method focuses on four *profit factors* –
 - (1) Performance Risk;
 - (2) Contract type risk;
 - (3) Facilities capital employed; and
 - (4) Cost efficiency.”
2. The contract type profit risk factor is only one of the four elements of the DD 1547 analysis, which in totality yields a final objective profit rate. As such, equating the “profit factors” to be synonymous with/equivalent to “profit rates” is inaccurate and is a characterization that runs the risk of causing considerable confusion. In some places the audit demonstrates the risk of this mischaracterization by expressly stating that a profit “rate” of zero is required to be applied when substantial costs are incurred prior to definitization. For example, the following statement on page 18 of the report:
3. “Seven UCAs had substantial costs incurred before definitization, but the contracting officer did not apply a zero percent *profit rate* to the incurred costs for contract risk;” (Emphasis added)
4. The conclusion that if one of the profit factors set forth above is zero then the profit rate will be zero is only applicable if the factors were part of a multiplication property. However, that is not the case with the factors. The sections in a DD-1547 do not function in that manner – application of a zero percent factor to one of the constituent parts will not, per se, yield an overall profit rate of zero. The audit seems to recognize this outcome in the discussion note beneath Table 3 of page 18 of the draft report but the inconsistent, and at

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

times interchangeable, usage of the terms profit “factor” and profit “rate” creates ambiguity on this point. The report should ensure appropriate use of these terms.

5. Compelling a zero percent profit rate as a general matter is ill advised/not in the Government’s best interest. Mandating that industry’s allowable profit be zero would likely have a detrimental effect on Government’s ability to enter into UCAs to procure necessary goods and services in times of urgent need. UCAs are fundamentally for the benefit to the Government as they are a “special contracting method” which allow performance to begin immediately when negotiation of a definitive contract action is not possible in sufficient time to meet the Government’s requirements. Dis-incentivizing industry with zero percent profit on UCAs would therefore make UCAs decidedly unattractive for industry to entertain and therefore infinitely more difficult to execute. Finally, mandating a profit rate of zero percent fails to recognize the inherent motivating purpose of profit. FAR [15.404-4\(a\)\(2\) and \(3\)](#) state:
6. **“(2) It is in the Government’s interest to offer contractors opportunities for financial rewards** sufficient to stimulate efficient contract performance, attract the best capabilities of qualified large and small business concerns to Government contracts, and maintain a viable industrial base.
7. Both the Government and contractors should be concerned with profit as a motivator of efficient and effective contract performance. Negotiations aimed merely at reducing prices by reducing profit, without proper recognition of the function of profit, are not in the Government’s interest. Negotiation of extremely low profits, use of historical averages, or **automatic application of predetermined percentages to total estimated costs do not provide proper motivation** for optimum contract performance.” (Emphasis added)

e. The DON disagrees with how the profit was calculated and summarized on page 18, Table 3 and discussed on pages 18-21, as it appears to be relying on reference (2).

1. The DON additionally requests the recalculation of profit summarized on page 18, Table 3 and discussed on pages 18- 21, be reconsidered to the extent the basis for those recalculations is reliance on, and application of, the 2008 DPAP memo. See the DON overarching comments, Item 1 above. As a general manner, the DON objects conceptually to “recalculations” of negotiated contract prices based on discrete adjustments to isolated elements of a profit analysis. Negotiation of profit is a nuanced process where a multitude of risks must be assessed, balanced and reconciled. The audit treats negotiation of profit as being predetermined based on a set mathematical-like algorithm. Profit negotiations are not so cut and dry or effectively “automated” that easily. There is a measure of art to the process and

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

for good reason: The Government does not have the authority to unilaterally bind (or force) industry to a contract. When contracting by negotiation, especially on a sole-source basis, the environment the government is in for all UCA definitizations, the contracting parties must mutually agree on final negotiated price. Further, not unduly focusing on one element of contract price aligns with regulation-see FAR 15.405(b) which provides as follows:

*“The contracting officer’s primary concern is the overall price the Government will actually pay. The contracting officer’s objective is to negotiate a contract of a type and with a price providing the contractor the greatest incentive for efficient and economical performance. The negotiation of a contract type and a price are related and should be considered together with the issues of risk and uncertainty to the contractor and the Government. **Therefore, the contracting officer should not become preoccupied with any single element and should balance the contract type, cost, and profit or fee negotiated to achieve a total result—a price that is fair and reasonable to both the Government and the contractor.**” (Emphasis added)*

As an example, under the NAVAIR contract discussed in the second paragraph on page 20, outlined the calculated profit “overpayment” of \$195K represents 0.7% of the total contract value of \$27.7M per the definitization mod. A review of the post-negotiation business clearance memorandum indicates that the overall settlement achieved by the Navy contracting officer reflected a total negotiated contract price 8% less than the price proposed by the contractor. The negotiated settlement in the aggregate/overall yielded a greater overall savings to the taxpayer than a .7 reduction in profit viewed in isolation.

2. Finally, as a general matter, the DON questions whether it is appropriate for the auditors to substitute their judgement for that of the Contracting Officer and recalculate profit in this manner. Contracting Officers are uniquely vested with the responsibility and authority to enter into contracts, based on their demonstrated business acumen. In performing their designated functions, FAR 1.602-2 in particular recognizes that in order to perform their role, “...contracting officers should be allowed wide latitude to exercise business judgment.” This sentiment is echoed at [FAR 15.405\(a\)](#), which states “..the contracting officer is responsible for exercising the requisite judgment needed to reach a negotiated settlement with the offeror and is solely responsible for the final price agreement.” While not a DON contract, the finding on page 21 that a “contracting officer potentially lowered the profit the contractor received by at least \$670,000” is particularly troubling: Publishing such a statement in a publicly available report might invite submission of a claim by industry based on

Department of the Navy Comments (cont'd)

DON DETAILED COMMENTS

an asserted failure to conform to the DPAP 2008 memo as that memo is being construed/interpreted in the audit.

2. The DON requests an in-person review with the auditors to walk through the effect of the content of our changes on the report.

Department of the Air Force Comments



DEPARTMENT OF THE AIR FORCE
WASHINGTON, DC

OFFICE OF THE ASSISTANT SECRETARY

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

FROM: SAF/AQ
1060 Air Force Pentagon Suite 4C149
Washington, DC 20330

SUBJECT: Air Force Response to DoD Office of Inspector General Draft Report, "Audit of DoD Management of Unfinalized Contract Actions" (Project No. D2019-D000AH-0090.000)

1. This is the Department of the Air Force response to the DoDIG Draft Report, "Audit of DoD Management of Unfinalized Contract Actions" (Project No. D2019-D000AH-0090.000). SAF/AQ concurs with the report.
2. SAF/AQ concurs with recommendations 4a, 4b, and 5.:

RECOMMENDATION 4a: The DODIG recommends the Deputy Assistant Secretary (Contracting) Assistant Secretary of the Air Force (Acquisition, Technology, and Logistics):

- a. Implement the use at Air Force contracting activities of the updated Defense Federal Acquisition Regulation Supplement Part 215 and DD Form 1547, "Weighted Guidelines," once it is issued, when determining profit for future Unfinalized Contract Actions.

AIR FORCE RESPONSE: AF will implement any DPC changes to DD Form 1547 for determining profit for future UCAs.

RECOMMENDATION 4b: Require the head of each contracting activity to establish a process by which the contracting officers who have not received a qualifying proposal in accordance with the Unfinalized Contract Action finalization schedule to immediately report to their Head of the Contracting Activity on why a qualifying proposal was not received, how they plan to obtain a qualifying proposal within 60 days or less, and if payments will be withheld.

AIR FORCE RESPONSE: The latest AFAC, effective October 1, 2019, revised AFFARS 5317.7405 Plans and Reports to include the following "For any reportable UCA that falls 30 days behind its schedule, update status in the reporting tool to identify actions taken to get back on schedule."

Department of the Air Force Comments (cont'd)

RECOMMENDATION 5: We recommend that the Head of Contracting at the Air Force Life Cycle Management Center–Hanscom take corrective action to remediate the miscoded contract actions in the Federal Procurement Database System–Next Generation (FPDS-NG).

AIR FORCE RESPONSE: DoDIG communicated with the Air Force (attachment 1) on 10 March 2020. DoDIG has verified the Senior Contracting Official (SCO) at the Air Force Life Cycle Management Center (AFLCMC) Hanscom has remedied all FPDS-NG issues. Therefore, DoDIG will remove recommendation 5 from the final report.

3. In addition, SAF/AQ provides additional comments regarding the draft report in Attachment 2.

4. The point of contact is [REDACTED].

[REDACTED]
[REDACTED]
[REDACTED]
DARLENE J. COSTELLO
Principal Deputy Assistant Secretary of
the Air Force (Acquisition, Technology & Logistics)

Attachments:

1. DoDIG USAF Communication
2. Additional SAF/AQC Comments

Acronyms and Abbreviations

ACC-DTA	Army Contracting Command-Detroit Arsenal
ACC-RSA	Army Contracting Command-Redstone Arsenal
AFLCMC	Air Force Life Cycle Management Center
DFARS	Defense Federal Acquisition Regulation Supplement
DPC	Defense Pricing and Contracting
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System–Next Generation
GAO	Government Accountability Office
MILDEP	Military Department
NAVAIR	Naval Air Systems Command
NAVSEA	Naval Sea Systems Command
NTE	Not-to-Exceed
SMC	Space and Missile Systems Center
UCA	Undefinitized Contract Action
U.S.C.	United States Code

Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

Whistleblower Protection safeguards DoD employees against retaliation for protected disclosures that expose possible waste, fraud, and abuse in government programs. For more information, please visit the Whistleblower webpage at <http://www.dodig.mil/Components/Administrative-Investigations/Whistleblower-Reprisal-Investigations/Whistleblower-Reprisal/> or contact the Whistleblower Protection Coordinator at Whistleblowerprotectioncoordinator@dodig.mil

For more information about DoD OIG reports or activities, please contact us:

Congressional Liaison

703.604.8324

Media Contact

public.affairs@dodig.mil; 703.604.8324

DoD OIG Mailing Lists

www.dodig.mil/Mailing-Lists/

Twitter

www.twitter.com/DoD_IG

DoD Hotline

www.dodig.mil/hotline

~~FOR OFFICIAL USE ONLY~~



DEPARTMENT OF DEFENSE | OFFICE OF INSPECTOR GENERAL

4800 Mark Center Drive
Alexandria, Virginia 22350-1500
www.dodig.mil
DoD Hotline 1.800.424.9098

~~FOR OFFICIAL USE ONLY~~