Report No. DODIG-2012-039

January 13, 2012

Inspector General

United States Department of Defense

Summary Report on DoD's Management of Undefinitized Contractual Actions

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Acronyms and Abbreviations

ACC-RSA	Army Contracting Command-Redstone Arsenal
DFARS	Defense Federal Acquisition Regulation Supplement
DPAP	Defense Procurement and Acquisition Policy
ESC	Air Force Electronic Systems Center
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
GAO	Government Accountability Office
IG	Inspector General
MCSC	Marine Corps Systems Command
NAVAIR	Naval Air Systems Command
PNM	Price Negotiation Memorandum
SMC	Air Force Space and Missile Systems Center
UCA	Undefinitized Contractual Action
U.S.C.	United States Code

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

January 13, 2012

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION, TECHNOLOGY, AND LOGISTICS
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/ CHIEF FINANCIAL OFFICER
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
NAVAL INSPECTOR GENERAL
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Summary Report on DoD's Management of Undefinitized Contractual Actions (Report No. DODIG-2012-039)

We are providing this report for review and comment. DoD contracting personnel did not consistently comply with statutory and DoD requirements for managing undefinitized contractual actions, resulting in the Government assuming additional risk in the award and negotiation process and possibly paying more profit than necessary. This summary report is the sixth and final report in a series of reports and is part of a congressionally mandated periodic review of DoD use of undefinitized contractual actions. We considered management comments on a draft of the report in preparing the final report.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. The comments were partially responsive. The Director, Defense Procurement and Acquisition Policy's, response to Recommendation 2 did not indicate agreement or disagreement, planned corrective actions, or a suspense date. Therefore, we request additional comments from the Director, Defense Procurement and Acquisition Policy, by March 13, 2012.

Please provide comments that conform to the requirements of DoD Directive 7650.3. If possible, send management comments in portable document format (.pdf) to audacm@dodig.mil. Copies of management comments must have the actual signature of the authorizing official for your organization. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9077 (DSN 664-9077).

Jacqueline L. Wicecarver

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Assistant Inspector General
Acquisition and Contract Management

Results in Brief: Summary Report on DoD's Management of Undefinitized Contractual Actions

What We Did

Public Law 99-591, section 908(b) requires the DoD Inspector General to periodically audit undefinitized contractual actions (UCAs) and submit a report to Congress. This is a summary of five reports discussing DoD compliance with section 2326, title 10, United States Code.

We reviewed a nonstatistical sample of 251 UCAs with a total not-to-exceed value of about $15 billion awarded by the Army Contracting Command-Redstone Arsenal, Naval Air Systems Command, Marine Corps Systems Command, Air Force Electronic Systems Center, and Air Force Space and Missile Systems Center from FY 2004 through FY 2009 to determine whether contracting personnel complied with the restrictions of the United States Code and whether they appropriately justified and definitized UCAs at reasonable prices.

What We Found

DoD contracting personnel did not consistently comply with statutory and DoD requirements for managing UCAs for 216 of the 251 UCAs that we reviewed. DoD contracting personnel did not:

- definitize 132 UCAs within the 180-day time frame because of inadequate contractor proposals, staffing shortages, and changing Government requirements;
- adequately support their profit determination for 118 UCAs because they did not adequately document their consideration of reduced cost risk or the inputs used to create the profit objective;
- obligate funds within allowable limits for 109 UCAs because they miscalculated the obligation amount and decreased the not-to-exceed value without adjusting the amount obligated or they did not take steps to comply with the Office of Defense Procurement and Acquisition Policy requirements for obligating funds;
- properly justify the issuance of 60 UCAs because they did not adequately describe the necessity of a UCA to meet requirements;
- adequately prepare authorization requests to issue 59 UCAs because they did not clearly define UCA approval delegations or adequately address requirements in the authorization requests; and
- adequately support the determination of price reasonableness for 15 UCAs because personnel were unable to provide documentation to support fair and reasonable pricing.

As a result, DoD assumed additional cost risk and may have paid excessive profit and more than fair and reasonable prices.

What We Recommend

Defense Procurement and Acquisition Policy personnel should revise the Defense Federal Acquisition Regulation Supplement Procedures, Guidance, and Information 217.74 to provide additional guidance for managing UCAs.

Management Comments and Our Response

The Director, Defense Procurement and Acquisition Policy, partially agreed with our recommendations and stated that revisions to the weighted guidelines were under review, but did not indicate agreement or disagreement, specific planned corrective actions, or a date when corrective actions will be completed. Therefore, we request that the Director, Defense Procurement and Acquisition Policy, provide additional comments. Please see the recommendations table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Defense Procurement and Acquisition Policy	2	1

Please provide additional comments by March 13, 2012.

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Introduction

Audit Objectives

This summary report is the sixth in a series of reports discussing DoD compliance with section 2326, title 10, United States Code (10 U.S.C. § 2326 [2009]). We determined DoD compliance with restrictions on undefinitized contractual actions (UCAs) imposed by 10 U.S.C. § 2326 [2009], "Undefinitized contractual actions: restrictions." We also determined whether UCAs were appropriately justified and definitized at reasonable prices. In addition, for this summary report we reported on the number of UCAs used by Services. See Appendix A for the scope and methodology and prior coverage related to the objectives.

Legislation and Congressional Report Requirement

The DoD Inspector General (IG) is required by Public Law 99-591, "Continuing Appropriations for Fiscal Year 1987," section 908(b), to periodically conduct audits of UCAs. DoD IG Report No. D-2004-112, "Undefinitized Contractual Actions," August 30, 2004, was our last audit before beginning this series of UCA audits. Section 908(b) of Public Law 99-591, "Requirements Relating to Undefinitized Contractual Actions," states:

> (b) Oversight by Inspector General.—The Inspector General of the Department of Defense shall—
>
> (1) periodically conduct an audit of contractual actions under the jurisdiction of the Secretary of Defense (with respect to the Defense Logistics Agency) and the Secretaries of the military departments; and
>
> (2) after each audit, submit to Congress a report on the management of undefinitized contractual actions by each Secretary, including the amount of contractual actions under the jurisdiction of each Secretary that is represented by undefinitized contractual actions.

Background on UCAs

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. Contracting officers should use UCAs only when the negotiation of a definitive contractual action is not possible in sufficient time to meet the Government's requirement. The Government's requirement must also demand that the contractor be given a binding commitment so that contract performance can begin immediately.

UCA Restrictions

Section 2326, title 10, United States Code, requires that the request to issue a UCA be sent to the head of an agency, contain the anticipated impact on agency requirements if a UCA is not used, and establish limitations on the obligation of funds, on

the definitization of terms, and on the allowable profit for UCAs. The Government limits the use of UCAs because these contracts place the Government at a distinct disadvantage in negotiating final prices.

UCAs for foreign military sales, purchases that do not exceed the simplified acquisition threshold, special access programs, and congressionally mandated long-lead procurement contracts are not subject to compliance with 10 U.S.C. § 2326, but must comply with Defense Federal Acquisition Regulation Supplement (DFARS) 217.74, "Undefinitized Contract Actions," to the maximum extent practicable. Both 10 U.S.C. § 2326 and the DFARS provide additional restrictions for the approval, definitization, obligation of funds, and determination of allowable contractor profit.

For each of the five reports we reviewed the following four areas to determine whether UCAs issued by DoD contracting personnel were in compliance.

- Authorization to use a UCA: We evaluated whether contracting personnel issued UCAs only after obtaining proper authorization. In addition, we reviewed the requests to issue a UCA to verify that the requests adequately address potential adverse impacts on agency requirements if a UCA was not issued.

- Contract definitization: We evaluated whether DoD contracting personnel definitized UCAs within the 180-day time limit.

- Allowable profit: We evaluated whether DoD contracting personnel's determination of contractor profit reflected the work performed during the undefinitized period.

- Compliance with obligation limitations: We evaluated whether DoD contracting personnel obligated funding within allowable amounts.

We also reviewed UCAs to determine whether DoD contracting personnel appropriately justified the need to use a UCA and whether DoD contracting personnel adequately documented that the UCAs were definitized at fair and reasonable prices. In addition, we reviewed UCAs issued after August 2008 to determine whether DoD contracting personnel obligated funds according to the requirements stated in the Office of Defense Procurement and Acquisition Policy (DPAP) memorandum, "Management Oversight of Undefinitized Contract Actions," August 29, 2008, (August 2008 DPAP memorandum).

Enhanced Reporting Requirements

DPAP issued the August 2008 DPAP memorandum requiring semiannual reporting of DoD UCAs for actions with an estimated value of more than $5 million. See Appendix B for a copy of the memorandum. DPAP introduced the enhanced reporting requirement in response to the Government Accountability Office (GAO) Report No. GAO-07-559, "Defense Contracting: Use of Undefinitized Contract Actions Understated and

Definitization Time Frames Often Not Met," June 19, 2007, and Public Law 110-181, "The National Defense Authorization Act for Fiscal Year 2008," section 809, "Implementation and Enforcement of Requirements Applicable to Undefinitized Contractual Actions."

DFARS Case Rulings

The 2007 GAO audit report resulted in DFARS Case 2007-D011, which clarified that, in accordance with 10 U.S.C. § 2326, DFARS 217.74 provides the criteria (not Federal Acquisition Regulation [FAR] 16.603-2, "Application") for planning the definitization schedule for a letter contract.[1] DFARS Case 2008-D034 expanded the definition of "contract action" in DFARS 217.74 to include change orders and other un-priced modifications. Previously, change orders and other un-priced modifications adhered to guidance to the maximum extent practicable.

Contracting Activities Visited

We reviewed the Services' management of 251 UCAs with not-to-exceed values of about $15 billion at the following five locations (see Table 1).

- **Army Contracting Command – Redstone Arsenal (ACC-RSA):** is responsible for contracting for Army Aviation and Missile Command. Army Aviation and Missile Command provides sustainment support to joint warfighters and allies ensuring aviation and missile system readiness. Army Aviation and Missile Command develops, acquires, fields, and sustains aviation, missile, and unmanned vehicle systems.

- **Naval Air Systems Command (NAVAIR**): provides full life-cycle support of naval aviation aircraft, weapons, and systems operated by sailors and marines. The support includes research and development, systems engineering, acquisition, and logistics support to the operating force including aircraft, avionics, air-launched weapons, electronic warfare systems, and all other equipment related to Navy and Marine Corps air power.

- **Marine Corps Systems Command (MCSC):** is responsible for acquiring and sustaining systems and equipment used to accomplish the Marine Corps warfighting mission. MCSC provides systems and equipment to the operating forces and manages the systems and equipment during their entire lifecycle.

- **Air Force Electronic Systems Center (ESC):** develops, acquires, modernizes, and integrates net-centric command and control, intelligence, surveillance, and reconnaissance capabilities, as well as combat support information systems. ESC also provides warfighting commanders with battlefield situational awareness and accurate and relevant information on a global information grid.

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[1]A letter contract is a written preliminary contractual instrument that allows a contractor to start work before the finalization of the contract terms.

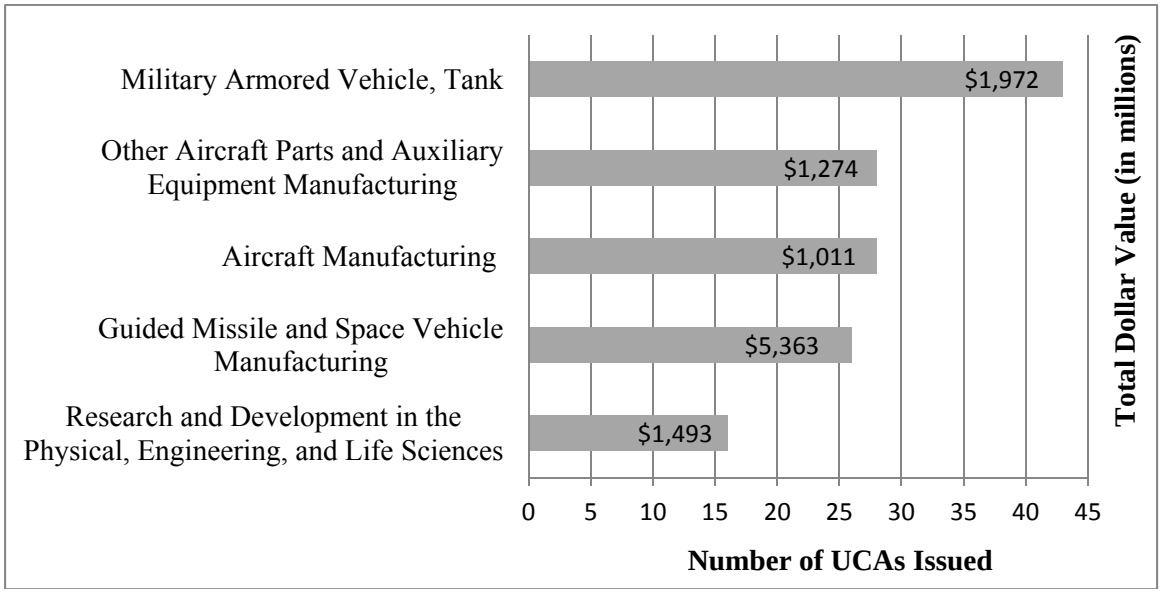
- **Air Force Space and Missile Systems Center (SMC):** delivers space and missile systems to the joint warfighter and our nation. SMC is a center for researching, developing, and purchasing military space systems. SMC is also responsible for on-orbit, check-out testing, sustainment, and maintenance of military satellite constellations and other DoD space systems.

Table 1. Total UCAs Reviewed at Each Contracting Activity

Contracting Activity	Number of UCAs	Not-to-Exceed Value
ACC-RSA	43	$ 3,088,871,618
NAVAIR	52	1,594,376,628
MCSC	88	2,750,208,696
ESC	41	2,758,417,177
SMC	27	4,766,405,745
Totals	**251**	**$14,958,279,864**

For the 251 UCAs that we reviewed, DoD contracting personnel procured a wide range of products and services. The products and services DoD contracting personnel procured included tanks and armored vehicles, aircraft, parts and equipment, guided missile and space manufacturing, and research and development. Figure 1 identifies the five most common products or services procured for the 251 UCAs reviewed.

Figure 1. Five Most Common Products or Services Procured for the 251 UCAs Reviewed



Reporting on DoD UCA Use

Public Law 99-591 requires that the DoD IG report on the amount of UCAs under the jurisdiction of each Secretary. According to Federal Procurement Database System-Next Generation (FPDS-NG), DoD contracting personnel issued 2,004 letter contracts with a total value of about $17.9 billion from FY 2004 through June 9, 2011; however, those values understate DoD UCA use. Letter contracts are UCAs and are clearly identified in FPDS-NG. However, contracting personnel may issue a UCA on instruments other than letter contracts such as modifications to an existing letter contract or as delivery or task orders on indefinite-delivery, indefinite-quantity contracts. Those transactions are not easily or reliably identified in FPDS-NG. Both GAO and DoD IG have noted in previous reports the inadequacies of UCA data contained in the FPDS-NG and earlier versions of the system.[2] Table 2 illustrates the number of letter contracts issued by DoD from FY 2004 through June 9, 2011. See Appendix C for the number and not-to-exceed amounts of UCAs issued by each DoD Component. See Appendix D for the number of UCAs definitized and the definitization amounts by DoD Component.

Table 2. Letter Contracts Issued by DoD From FY 2004 Through June 9, 2011

Fiscal Year	Letter Contracts	Value
2004	333	$2,448,505,463
2005	378	3,128,711,034
2006	282	1,421,272,978
2007	242	1,541,350,990
2008	240	2,182,182,957
2009	263	2,383,811,189
2010	215	4,020,505,806
2011	51	809,159,204
Totals	**2,004**	**$17,935,499,622**

DoD UCAs Reported to DPAP

DoD contracting offices began reporting their UCAs to DPAP following the issuance of the August 2008 DPAP memorandum. The DPAP report includes all UCAs with a not-to-exceed value greater than $5 million (not only letter contracts) that were issued, outstanding, or definitized during the 6-month reporting period. Beginning with the October 2010 report, DoD contracting offices began reporting on UCAs falling within statutory exception categories (foreign military sales, congressionally mandated long-lead time items, and special access programs). For the April 2011 report, DoD contracting offices reported 367 UCAs with a total not-to-exceed value of more than $38 billion.

[2] DoD IG Report D-2004-112 and GAO Report GAO-07-559.

A UCA and the associated dollar value may be reported in more than one reporting period until it is definitized. Table 3 shows the number of UCAs reported to DPAP, semiannually, from October 2008 through March 31, 2011.

Table 3. UCAs Use Reported Semiannually to DPAP

DPAP Report	UCAs Reported	Not-to-Exceed Value
October 2008	205	$5,298,727,311
April 2009	332	30,313,227,534
October 2009	316	23,655,334,952
April 2010	342	29,389,493,298
October 2010*	490	52,203,194,106
April 2011*	367	38,277,643,706

*Includes UCAs occurring within statutory exception categories (foreign military sales, congressionally mandated long-lead time items, and special access programs).

Review of Internal Controls Over UCA Use

DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," July 29, 2010, 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. We identified internal control weaknesses in DoD's management of UCAs. Specifically, DoD contracting personnel did not definitize UCAs within allowable time frames and did not adequately document how costs incurred during the undefinitized period impacted the contractor's profit. In addition, DoD contracting personnel did not adequately document allowable profit. We will provide a copy of the report to the senior officials responsible for internal controls and policy for DoD management of UCAs.

Finding. Inconsistent Management of Undefinitized Contractual Actions

DoD contracting personnel did not comply with statutory and DoD requirements for managing UCAs for 216 of 251 UCAs we reviewed. For the 216 UCAs, valued at about $13.2 billion, DoD contracting personnel did not:

- definitize 132 UCAs within allowable time frames because of inadequate contractor proposals, staffing shortages, and changing Government requirements;
- adequately support whether the reduced risk during the undefinitized period was reflected in profit determination for 108 UCAs because they prepared DD Forms 1547, "Record of Weighted Guidelines Application," and price negotiation memoranda (PNM) that did not provide sufficient detail to determine the basis for profit determination;
- reflect the contractor's reduced risk in the Government's negotiation position on profit for 10 UCAs because they did not follow applicable guidance;
- obligate funds in accordance with allowable amounts for 64 UCAs because they were unaware of obligation limits, miscalculated obligation amounts, and changed the not-to-exceed value without adjusting obligations;
- obligate funding in accordance with contractor's spending requirements during the undefinitized period for 45 UCAs because they had not taken steps to comply with the August 2008 DPAP memorandum;
- adequately justify UCAs because of a lack of individual requests supporting use, poor planning, and lack of timely identification of contract requirements for 60 UCAs;
- adequately document the authorization to issue UCAs because they did not describe the need to begin performance before definitization or the impact on agency requirements if a UCA was not issued for 59 UCAs; and
- document whether the definitized prices the Government paid were fair and reasonable for 15 UCAs because the efforts were completed before the UCAs were definitized.

As a result, DoD assumed additional cost risk and may have paid excessive profit and more than fair and reasonable prices.

UCA Deficiencies

Our review of 251 UCAs issued by DoD contracting personnel identified 493 total deficiencies. Some UCAs had more than one deficiency. UCA deficiencies consisted of seven different types: untimely definitization, noncompliance with requirements to reflect the impact of the undefinitized period on allowable profit, obligating funds in excess of the allowable amounts, obligation of funds not in accordance with requirements outlined in the 2008 DPAP memorandum, improper justification to issue a UCA, UCA authorization requests not adequately supported, and insufficient documentation supporting whether the Government received a fair and reasonable price. Table 4 identifies the reasons we considered the UCAs to be deficient.

Table 4. Reasons for 216 Deficient UCAs

Reasons UCA Was Deficient	Number of Deficiencies*
Untimely definitization	132
Noncompliance with requirements to reflect the impact of the undefinitized period on allowable profit	118
Obligation of funds in excess of allowable amounts	64
Obligation of funds not in accordance with 2008 DPAP memorandum	45
Improper justification to issue a UCA	60
UCA authorization requests not sufficiently supported	59
Inadequate price reasonableness determination	15
Total	**493**

*A UCA may have more than one deficiency.

Untimely Definitization

DoD contracting personnel exceeded the statutory time limits for 132 of the 251 UCAs reviewed.

DoD contracting personnel did not definitize 132 UCAs within the 180-day time frame specified by 10 U.S.C § 2326 and DFARS 217.74. DoD contracting personnel did not definitize 132 UCAs in a timely manner because of inadequate contractor proposals, personnel shortages, and changes in Government requirements during the undefinitized period. In addition, DoD contracting personnel cited several other contributing factors that led to untimely definitization.

Section 2326(b), title 10, United States Code, states:

> A contracting officer of the Department of Defense may not enter into an undefinitized contractual action unless the contractual action provides for agreement upon contractual terms, specifications, and price by the earlier of—
>
> **(A)** the end of the 180-day period beginning on the date on which the contractor submits a qualifying proposal to definitize the contractual terms, specifications, and price; or
>
> **(B)** the date on which the amount of funds obligated under the contractual action is equal to more than 50 percent of the negotiated overall ceiling price for the contractual action.

Section 2326(g)(2) defines a "qualifying proposal" as:

> . . . a proposal that contains sufficient information to enable the Department of Defense to conduct complete and meaningful audits of the information contained in the proposal and of any other information that the Department is entitled to review in connection with the contract, as determined by the contracting officer.

DoD contracting personnel averaged 363 days from UCA issuance to definitization for the 132 late actions. In addition, for the 132 late actions, DoD contracting personnel took an average of 169 days to receive a qualifying proposal and 228 days to definitize the UCA after a qualifying proposal was received. Table 5 illustrates the average elapsed days for UCAs that exceeded the 180-day definitization time frames.

Table 5. Elapsed Days for Late UCA Definitization

Contracting Activity	Number of UCAs	Number of Late UCAs	Average Days		
			To Receipt of a Qualifying Proposal	From Proposal to Definitization	From Issuance to Definitization
ACC-RSA	43	16	113	199	314
NAVAIR	52	29	70	280	344
MCSC	88	57	307	96	378
ESC	41	12	142	349	442
SMC	27	18	139	230	335
Totals	**251**	**132**	**169***	**228***	**363**

*Qualifying proposal was received before issuance for 34 actions

Importance of Definitization Time Frames

DoD contracting personnel placed the Government at additional cost risk when they definitized UCAs beyond the allowable 180-day time frames. Definitization time frames are relevant because they signal when the Government is exposed to increased cost risk. In some circumstances, DoD contracting personnel have little control over the factors causing untimely definitization. For example, customer-directed changes to the item to be procured resulted in definitization delays. However, contracting personnel are responsible for ensuring the Government's negotiation position reflects the reduced risk of incurred costs during a prolonged undefinitized period. DoD contracting personnel's use of UCAs transfers additional risk to the Government because all costs during the undefinitized period are considered allowable, and a prolonged undefinitized period can effectively change the contract type from a fixed-type contract to a cost-type contract. In addition, changes in requirements can delay the delivery of urgently needed goods and services.

Primary Reasons for Untimely Definitizations

DoD contracting personnel did not definitize UCAs in a timely manner primarily because contractors submitted inadequate proposals, contracting activities experienced personnel shortages, and contract requirements changed during the undefinitized period. In addition, DoD contracting personnel cited several reasons contributing to untimely definitization. Table 6 illustrates the direct and contributing reasons behind untimely definitization.

Table 6. Reasons Identified by DoD Contracting Personnel for Untimely Definitization

Reason for Untimely Definitization	Direct Cause	Contributing Cause
Contractor proposal problems	23	13
Personnel shortages	29	6
Change in Government requirements	16	5
Complexity and scope	0	10
Extended contract negotiations	5	5
Pricing delays	3	5
Audit problems	3	0
Undefinitized	4	0
Reasons not specified	13	0
Other*	10	16

*Other reasons for untimely definitization include delays in acquiring truth in negotiations disclosure updates, disagreements over subcontracting plan, administrative delays, and a contractor's sale of part of its business.

Inadequate Contractor Proposals

DoD contracting personnel were unable to definitize 23 UCAs within allowable time frames because contractors did not provide an adequate qualifying proposal. In addition, contracting personnel cited 13 instances that inadequate proposals contributed to untimely definitization. The contractor proposals were inadequate because the contracting officers determined that they did not contain sufficient information to enable DoD contracting personnel to conduct complete and meaningful audits, were submitted in an untimely manner, or contained questionable costs. DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to incorporate a template with standard prompts for completing authorization requests to include a definitization schedule of agreed-upon events that supports timely definitization.

Personnel Shortages

DoD contracting personnel were unable to definitize 29 UCAs within allowable time frames because of personnel shortages, changes in workload, and transition of assigned contracting personnel. In addition, contracting personnel cited six instances in which

personnel shortages and changes in workload contributed to untimely definitization. MCSC contracting personnel identified 26 instances when personnel shortages were determined to be the cause of untimely definitization. NAVAIR contracting personnel cited seven instances in which personnel shortages or changes in workload contributed to untimely definitization. We did not consider this a DoD-wide issue; therefore, we are not making a recommendation.

Changes in Government Requirements

DoD contracting personnel were unable to definitize 16 UCAs within allowable time frames because Government requirements changed after DoD contracting personnel issued the UCA. In addition, DoD contracting personnel cited five instances in which changes in Government requirements contributed to untimely definitization. Each significant change in requirements requires that the contractor prepare or revise a proposal that contracting personnel and possibly Defense Contract Audit Agency personnel must then review. DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to emphasize the importance of coordination among contracting personnel, program office personnel, and customers.

DoD Contracting Personnel's Noncompliance With Requirements to Reflect the Impact of the Undefinitized Period on Allowable Profit

DoD contracting personnel definitized 118 UCAs without adequately documenting or reflecting the reduced risk of incurred costs during the undefinitized period. DoD contracting personnel issued 108 UCAs that did not include sufficient support to determine the basis for their profit determination because they relied upon the DD Forms 1547 without a thorough discussion of the weights assigned when developing the Government's profit positions. DoD contracting personnel's profit determination for the 108 UCAs was insufficient because supporting documentation did not contain key required information including:

- the degree to which costs were incurred before definitization,
- the risk factors assigned to the incurred cost and projected cost when the weighted guidelines application was used, and
- the resulting impact on the contractor's profit or fee.

DoD contracting personnel definitized 118 UCAs without adequately documenting or reflecting the reduced risk of incurred costs during the undefinitized period.

In addition, DoD contracting personnel issued 10 UCAs that did not reflect the contractor's reduced cost risk because personnel relied upon guidance with a lower precedent[3] when developing the Government's negotiation positions or because personnel did not comply with applicable guidance. As a result, DoD contracting personnel's reliance on guidance

[3] Contracting personnel adhered to FAR 15.404-4(c)(6) instead of 10 U.S.C. § 2326(e).

with a lower precedent resulted in negotiation positions that did not adequately consider potential reduced risk. In addition, DoD contracting personnel may have entered into negotiations with an inaccurate profit position for 108 UCAs that they did not adequately document the determination of profit. During the undefinitized period, the Government bears increased risk, and the contractor generally bears reduced risk. If the contractor's reduced risk is not reflected in the negotiated profit rate, then the Government could pay too much profit. Table 7 illustrates profit deficiencies by contracting activity.

Table 7. Profit Deficiencies by Contracting Activity

Contracting Activity	Profit Deficiencies	UCAs Reviewed
ACC-RSA	29	43
NAVAIR	5	52
MCSC	45	88
ESC	25	41
SMC	14	27
Totals	**118**	**251**

Inadequate Documentation of Profit Determination

DoD contracting personnel did not adequately document the profit determination for 108 UCAs. This occurred because DoD contracting personnel did not include essential information including the costs incurred before definitization, how incurred costs were factored into profit positions entering into negotiations, and the impact of incurred cost on cost risk because profit determinations were only supported by the DD Forms 1547.

DD Form 1547

The DD Form 1547 did not include incurred cost nor provide sufficient detail for us to determine the effect of the incurred costs on profit. It should not be used as the sole documentation for profit determination. Contracting personnel used the weighted guidelines application to assign a value for item 24 for contract type risk, which focuses on the degree of cost risk accepted by the contractor. When used correctly, the weighted guidelines application takes into consideration the possible reduced risk of the undefinitized period by separating the incurred costs and the remaining costs to develop the profit position. The application then produces a composite contract type risk factor. However, the DD Form 1547 did not display all of the factors entered by the contracting activity. Figure 2 illustrates the profit factors section of the current DD Form 1547.

Figure 2. Screenshot of the Current DD Form 1547

		WEIGHTED GUIDELINES PROFIT FACTORS			
ITEM	CONTRACTOR RISK FACTORS	ASSIGNED WEIGHTING	ASSIGNED VALUE	BASE (Item 20)	PROFIT OBJECTIVE
21.	TECHNICAL	0%	50.00%		
22.	MANAGEMENT/COST CONTROL	0%	50.00%		
23.	PERFORMANCE RISK (COMPOSITE)		50.00%	$ 1,000	$ 500
24.	CONTRACT TYPE RISK		1.00%	$ 1,000	$ 10
25.	WORKING CAPITAL	COSTS FINANCED	LENGTH FACTOR	INTEREST RATE	
			0	4.75%	$ -
	CONTRACTOR FACILITIES CAPITAL EMPLOYED		ASSIGNED VALUE	AMOUNT EMPLOYED	
26.	LAND				
27.	BUILDINGS				
28.	EQUIPMENT		25%		
29.	COST EFFICIENCY FACTOR		ASSIGNED VALUE	BASE (Item 20)	
			0.00%		$ -
30.				TOTAL PROFIT OBJECTIVE	$ 510
		NEGOTIATED SUMMARY			

DoD personnel could provide a more transparent means of assigning reduced risk for incurred cost during the undefinitized period in a variety of ways. One way of presenting the information could be revising DD Form 1547 to include a separate line within item 24 so contracting personnel can assign lower than normal factors to reflect reduced risk.

Discussion of Impact on Profit Position

DoD contracting personnel may have documented the cost incurred during the undefinitized period and used the weighted guidelines application to develop a profit objective, but they did not consistently document the resulting effect on the contractor's allowable profit. Without adequate discussion of the contracting officer's consideration of the cost incurred within contract documentation, we were unable to determine to what extent the impact of the undefinitized period was reflected in the contractor's profit. DoD contracting personnel identified and entered a profit factor but did not state the degree to which costs were incurred before definitization, the risk factors assigned to the incurred cost and projected cost, or the resulting impact on the contractor's profit or fee.

Contracting personnel should document the costs incurred before definitization and their impact on profit determination in the PNM. Both GAO and DoD IG recommended in previous reports that DoD revise the DFARS to include instructions on how to perform an assessment of any reduced cost risk on profit or fee during the undefinitized period.[4] DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to include guidance on how contracting personnel can factor substantial incurred costs into profit position when completing the weighted guidelines.

[4] GAO Report No. GAO-10-299, "DoD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvements," January 28, 2010, and DoD IG Report No. D-2004-112.

DoD Contracting Personnel Did Not Comply With Applicable Guidance

DoD contracting personnel did not comply with the requirements in 10 U.S.C. 2326(e) to reflect the undefinitized period in the contractor's profit or fee for 7 UCAs because they relied on guidance with a lower precedent when developing the Government's negotiation positions. Instead of following the requirements of 10 U.S.C. 2326(e), contracting personnel adhered to FAR 15.404-4(c)(6), "Profit" which permits contracting officers to use the basic contract's profit or fee rate as the prenegotiation objective for a change or modification to a contract if the change or modification calls for essentially the same type and mix of work as the basic contract and is of relatively low dollar value compared to the total contract value. Additionally, DoD contracting personnel did not factor substantial incurred costs into negotiation positions for three UCAs because they did not comply with DFARS guidance when using the weighted guidelines to develop profit positions when they entered into negotiation. DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to emphasize the importance of sufficiently documenting compliance with requirements to reflect reduced risk for undefinitized contractual actions with substantial incurred cost.

Both 10 U.S.C. 2326 and the DFARS provide guidance on profit determination, and the FAR provides guidance on documentation of the price negotiation. Title 10 U.S.C. 2326(e), states:

> The head of an agency shall ensure that the profit allowed on an undefinitized contractual action for which the final price is negotiated after a substantial portion of the performance required is completed reflects—
>
> > (1) the possible reduced cost risk of the contractor with respect to costs incurred during performance of t he contract before the final price is negotiated; and
> >
> > (2) the reduced cost risk of the contractor with respect to costs incurred during performance of the remaining portion of the contract.

DFARS 215.404-4, "Profit," requires that contracting officers use a structured approach for developing a prenegotiation profit or fee objective on any negotiated contract action when the contractor provides cost or pricing data, except for cost-plus-award-fee contracts or contracts with Federally Funded Research and Development Centers. DFARS 215.404-4 further states that the weighted guidelines method is the structured approach that must be used, with certain exceptions. FAR 15.406-3, "Documenting the Negotiation," states that the PNM is the required document in which the contracting officer must document the basis for the profit or fee prenegotiation objective and the profit or fee negotiated.

DoD Contracting Personnel Generally Complied with Obligation Limitations

DoD contracting personnel complied with obligation limitations for 187 of 251 UCAs issued. Contracting officers are limited by 10 U.S.C. § 2326 in the amount of funds they

may obligate on a UCA to 50 percent of the not-to-exceed value before receipt of a qualifying proposal and to 75 percent after receipt of a qualifying proposal. Exceeding the allowable obligation thresholds puts the Government in a poor position to negotiate a contract at definitization because contractors are less inclined to submit a qualifying proposal when there is adequate funding available to continue the work. Table 8 indicates the number of obligation deficiencies at each contracting activity.

Table 8. Obligation Deficiencies at Each Contracting Activity

Contracting Activity	Deficiencies	UCAs Reviewed
ACC-RSA	2	43
NAVAIR	3	52
MCSC	54	88
ESC	2	41
SMC	3	27
Totals	**64**	**251**

Section 2326(b)(2) and (3), title 10, United States Code, states:

> (2) Except as provided in paragraph (3), the contracting officer for an undefinitized contractual action may not obligate with respect to such contractual action an amount that is equal to more than 50 percent of the negotiated overall ceiling price until the contractual terms, specifications, and price are definitized for such contractual action.
>
> (3) If a contractor submits a qualifying proposal (as defined in subsection (g)) to definitize an undefinitized contractual action before an amount equal to more than 50 percent of the negotiated overall ceiling price is obligated on such action, the contracting officer for such action may not obligate with respect to such contractual action an amount that is equal to more than 75 percent of the negotiated overall ceiling price until the contractual terms, specifications, and price are definitized for such contractual action.

DoD contracting personnel issued 64 UCAs that did not comply with obligation limitations. MCSC contracting personnel did not comply with obligation limitations for 54 of the 64 UCAs issued before September 2008 because they were unaware of requirements limiting the amount of obligations. MCSC financial personnel informed contracting officials that their practice of obligating 100 percent of the contract was in violation of the 10 U.S.C. 2326 (b) (2) and (3). MCSC personnel properly obligated funds on the 21 UCAs issued after August 29, 2008. Because MCSC personnel took corrective actions, we did not make a recommendation to the MCSC. For the remaining 10 UCAs, DoD contracting personnel did not comply with obligation limitations because of miscalculations, inappropriately over-obligating the UCA, changes to the not-to-exceed value without adjusting the corresponding amount obligated, treating a UCA as a

change order, and trying to avoid an Antideficiency Act violation. We are not making a recommendation because the 10 deficiencies were not indicative of a DoD-wide problem. Table 9 indicates the reasons obligation limitations were deficient.

Table 9. Reasons for Exceeding Obligation Limitations

Reasons	Deficiencies
Unaware of requirements	54
Miscalculation	4
Decreased not-to-exceed amount without adjusting obligation amount	2
Inappropriately overobligated	2
Treated UCA as a change order	1
To avoid an Antideficiency Act violation	1
Total	**64**

DoD Contracting Personnel Did Not Obligate Funds in Accordance With 2008 DPAP Memorandum

DoD contracting personnel obligated the maximum permissible funding before definitization for 45 of 68 UCAs after the August 2008 DPAP memorandum. DoD contracting personnel obligated the maximum amount permissible because DoD contracting personnel had not taken steps to comply with the August 2008 DPAP memorandum. The August 2008 DPAP memorandum instructed contracting officers to assess the contractor's spend plan for the undefinitized period and to obligate funding in an amount consistent with the contractor's requirements for the undefinitized period. DoD contracting personnel should take steps to comply with the August 2008 DPAP memorandum requirement by obligating funding according to the contractor's requirements rather than to the maximum amount permissible. In addition, DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 with instructions on how to establish and determine obligation levels that will sustain contractor operations for an estimated undefinitized period of 180 to 360 days.

Improper Justification to Issue a UCA

DoD contracting personnel issued 60 UCAs without adequate justification. DFARS 217.7403, "Policy," limits the use of a UCA to situations when negotiating a definitive contract is not possible and the Government's interest demands contract performance begin immediately. MCSC personnel improperly issued 33 UCAs because personnel issued UCAs without individual requests supporting the use. As a result of our recommendations, MCSC developed a quick reference and process guide for personnel to use to ensure documentation supporting UCA use is adequately justified. DoD contracting personnel also issued UCAs without adequate justification because they issued UCAs for known or recurring acquisition requirements and for requirements that were not identified in a timely manner. Issuing UCAs for known requirements or for

requirements not identified in a timely manner places the Government at unnecessary and avoidable cost risk. DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to emphasize the acquisition circumstances in which UCA use places the Government at unnecessary and avoidable risk and the means by which contracting personnel can mitigate this risk. Table 10 illustrates justification deficiencies by type and contracting activity. Each contract action could have more than one justification deficiency.

Table 10. Justification Deficiencies by Type and Contracting Activity

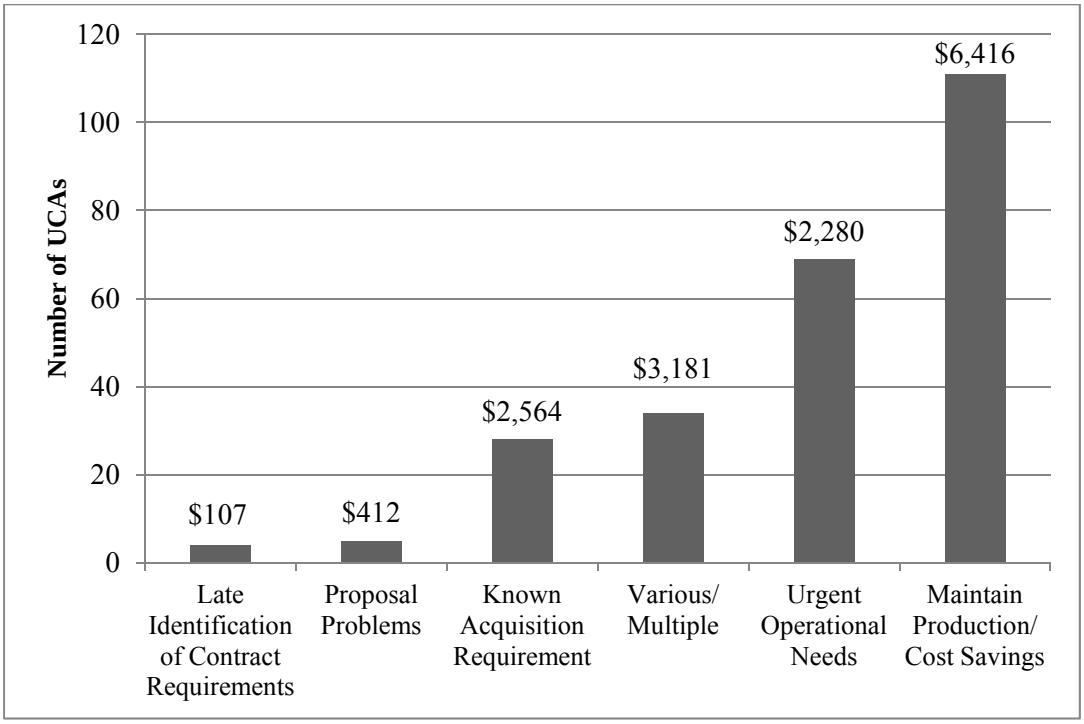
Contracting Activity	Contracts Issued Without Statements Justifying UCA Use	Known or Recurring Acquisition Requirements	Late Identification of Contractual Requirement
ACC-RSA	0	3	0
NAVAIR	0	4	0
MCSC	33*	1	0
ESC	0	15	4
SMC	0	0	0
Totals	**33**	**23**	**4**

*Issued without separate requests.

Reasons for DoD UCA Use

DoD contracting personnel adequately justified issuing 191 UCAs and generally limited use to circumstances in which the negotiation of a definitive contract was not possible within the time available to meet urgent DoD requirements. DoD contracting personnel primarily issued UCAs to meet urgent operational needs and to maintain production and development efforts. Figure 4 illustrates the six primary reasons that DoD contracting personnel used for the UCAs that we reviewed.

Figure 3. Primary Reasons DoD Contracting Personnel Used UCAs and the Amount Spent
(in millions)



UCA Authorization Requests Not Sufficiently Supported

DoD contracting personnel issued 55 UCAs with inadequate authorization requests and 4 UCAs without proper approvals. DoD contracting personnel issued UCAs with inadequate authorization requests because they did not comply with applicable guidance either by not explaining the need to begin performance immediately or by not explaining the impact on agency requirements if a UCA was not issued, or both. As a result, DoD contracting personnel placed the Government at avoidable risk when issuing UCAs without complete documentation explaining the need for UCA use. Table 11 identifies the number of deficient authorization requests at each of the five contracting activities.

Table 11. Authorization Deficiencies for the 251 UCAs Reviewed

Contracting Activity	Deficiencies	UCAs
ACC-RSA	0	43
NAVAIR	7	52
MCSC	34	88
ESC	17	41
SMC	1	27
Totals	**59**	**251**

Both 10 U.S.C. § 2326 and the DFARS provide guidance on issuing UCAs. Section 2326(a), title 10, United States Code, states:

> The head of an agency may not enter into an undefinitized contractual action unless the request to the head of the agency for authorization of the contractual action includes a description of the anticipated effect on requirements of the military department concerned if a delay is incurred for purposes of determining contractual terms, specifications, and price before performance is begun under the contractual action.

DFARS 217.7404-1, "Authorization," requires that the contracting officer obtain approval from the head of the contracting activity before entering into a UCA and that the request for UCA approval include a complete explanation of why contract performance needs to begin before contract definitization and the adverse impact on agency requirements resulting from delays in performance.

Noncompliant Requests to Issue a UCA

DoD contracting personnel issued 55 UCAs with inadequate authorization requests because they did not comply with applicable guidance when preparing authorization requests. DoD contracting personnel did not fully explain the adverse impact on agency requirements resulting from delays in performance or the need to begin performance before definitization. MCSC contracting personnel issued 33 UCAs on 2 requests but did not comply with requirements to use a request for each UCA to explain the need to begin performance before definitization and the adverse impact resulting from delays in performance.

SMC and ACC-RSA contracting personnel had only one deficient authorization request between the two because the head of the contracting activity requires that contracting personnel complete a standardized authorization request with descriptive prompts before approving UCA use. The standard authorization request requires contracting personnel to explain the urgent need and impact on agency requirements if a UCA is not used. In addition, SMC required contracting personnel to explain the steps taken to avoid UCA use in the future. DPAP personnel should revise the DFARS Procedures, Guidance, and Information 217.74 to emphasize the importance of contracting personnel addressing: why performance must begin immediately, the impact on agency requirements, and why UCA use is justified when completing authorization requests

DoD Contracting Personnel Obtained Proper Approval to Issue UCAs

DoD contracting personnel obtained proper approval to issue 247 UCAs. Contracting officers obtained approval from the head of the contracting activity or their authorized delegate before entering into a UCA. ESC contracting personnel were unable to locate the signed authorization document for one UCA. In addition, MCSC contracting personnel issued one UCA without signed approval by the head of the contracting activity. Finally, NAVAIR contracting personnel issued two UCAs without proper approval because the UCA approval delegations did not specify who would sign

in the absence of the approving official. None of these instances were indicative of a DoD-wide problem for the approval to issue a UCA; therefore, we are not making a recommendation on this issue.

DoD Contracting Personnel Adequately Documented Fair and Reasonable Prices

DoD contracting personnel adequately documented their determination of price reasonableness but did not adequately document the determination of profit as discussed in this report. FAR 15.403-3, "Requiring information other than cost or pricing data," requires that the contracting officer obtain information that is adequate for evaluating price reasonableness. Further, FAR 15.406-3, "Documenting the negotiation," states that the contracting officer must document fair and reasonable price in the contract file. We reviewed the contract files for the 251 definitized UCAs and determined that, with the exception of 15 UCAs issued by MCSC contracting personnel, the contract files contained adequate documentation, such as PNMs, certificates of current cost or pricing data, technical evaluations, forward pricing rate agreements, and related audit reports to support the contracting officers' determination of price reasonableness.

MCSC contracting personnel did not adequately support their determinations of price reasonableness for 15 UCAs because they were unable to provide documentation to support fair and reasonable pricing. Of the 15 UCAs, 13 were delivery orders issued on a single contract. Of the 13 delivery orders, 4 delivery orders had no information available for our review. For the other 9 delivery orders, the contractor claimed expenses for greater than 100 percent of the not-to-exceed value of the award. MCSC contracting officials had no leverage to obtain a fair and reasonable price for these awards and, instead, definitized the award at 100 percent of the obligated amounts. We are not making a recommendation because most of the deficient UCAs were on a single contract and were not indicative of a systemic DoD-wide issue.

Impact of Revised DPAP Requirements on Compliance

DPAP personnel's efforts to enhance visibility and management oversight of UCAs have improved DoD contracting personnel's compliance with guidance applicable to UCAs. DPAP personnel improved performance by issuing guidance and enhanced reporting procedures that required mandatory semiannual reporting of UCAs valued at more than $5 million. DoD contracting personnel did not always report the actions they were required to but improved their compliance over time. In addition, DPAP personnel required each Service to create, maintain, and semiannually submit UCA management plans that detailed the efforts undertaken by each to improve compliance and oversight. The average deficiency per UCA has declined and visibility of UCAs has increased.

Enhanced Reporting Requirements

DPAP issued the August 2008 DPAP memorandum requiring the creation of UCA management plans and semiannual reporting of DoD UCA use for actions with an estimated value of more than $5 million. DPAP introduced the enhanced reporting requirement in response to GAO Report No. GAO-07-559 and Public Law 110-181.

DPAP personnel overcame the shortcomings of identifying UCAs in FPDS-NG by requiring the Services and DoD agencies to manually report UCA use to DPAP semiannually (see Table 3 in the report Background for the number of UCAs reported to DPAP, semiannually, from October 2008 through March 31, 2011).

Effect of August 2008 DPAP Memorandum on Compliance

DoD contracting personnel reduced the number of deficiencies per UCA since DPAP issued the August 2008 DPAP memorandum. Specifically, DoD contracting personnel reduced the number of inadequate requests to issue a UCA and the number of inadequate profit determinations per UCA after the 2008 DPAP memorandum was issued. We identified no improvement in the number of instances per UCA that exceeded the obligation limitations. In addition, the number of instances per UCA that exceeded the 180-day definitization time frames increased after the memorandum was issued. Table 12 illustrates the number of deficiencies and the average deficiencies per UCA before and after issuance of the 2008 DPAP memorandum.

Table 12. Effect of Enhanced Reporting Requirements on Deficiencies

	Before 2008 DPAP Memorandum	After 2008 DPAP Memorandum	Percentage Increase / (decrease)
Number of UCAs	183	68	
Total Deficiencies	375	118	
Deficiencies Per UCA	2.05	1.74	(15.3)
Untimely definitization per UCA	87 (48 percent)	45 (66 percent)	(48.3)
Noncompliance with requirement to reflect the impact of the undefinitized period on allowable profit per UCA	102 (56 percent)	16 (24 percent)	(84.3)
Obligation of funds in excess of allowable amounts or not in accordance with 2008 DPAP memorandum per UCA	62 (34 percent)	47 (69 percent)	(24.2)
Improper justification to issue a UCA per UCA	53 (29 percent)	7 (10 percent)	(86.8)
UCA authorization request not sufficiently supported per UCA	56 (31 percent)	3 (4 percent)	(94.6)
Inadequate price reasonableness determination per UCA	15 (8 percent)	0 (0 percent)	(100.0)

Accuracy of DoD Reporting of UCAs Reviewed

DoD contracting personnel improved their reporting of newly issued or outstanding UCAs to DPAP over the five semiannual reporting periods. We reviewed a nonstatistical sample of 107 UCAs that the contracting activities should have included in their UCA reports to DPAP over five reporting periods. For the three initial reporting periods, DoD contracting personnel did not report 76 of the 143 UCAs that should have been reported.

However, for the next two reporting periods, DoD personnel did not report only 11 of the 33 UCAs that should have been reported. Since the 2008 DPAP memorandum, DPAP has issued additional guidance clarifying how the contracting activities should be reporting UCA use.

UCA Management Plans

Army, Navy, and Air Force personnel developed UCA management plans to provide enhanced oversight of UCAs in response to the requirements of the 2008 DPAP memorandum. The memorandum required that the plans describe actions planned and taken to:

- ensure the appropriate use of UCAs,
- timely definitization of UCAs,
- minimize obligation amounts at time of UCA award (consistent with contractor's requirements for the undefinitized period), and
- recognize in profit/fee the contractor's reduced cost risk during the undefinitized performance period and to document the risk assessment in the contract file.

The management plans were created by conducting roundtable discussions, working groups, and internal policy and procedure reviews. As a result of the actions taken to create the plans, the Services developed additional guidance. However, the Army did not add additional guidance to their acquisition supplements, but implemented additional guidance. Although the management plans resulted in additional guidance to ensure proper oversight of UCAs, the effect the management plans had on compliance with restrictions applicable to UCAs cannot be determined.

- **Army UCA Management Plan:** The Army required that the contracting officer fully examine all aspects of the risk assessment and document the assessment in the prenegotiation objective memorandum and PNM. The Army also requires the contracting officer to provide documentation to the Principal Assistant Responsible for Contracting when the UCA will not be definitized within the 180-day time frame or when funding will exceed the 50 percent or 75 percent limitations.

- **Navy UCA Management Plan:** The Navy identified the proper use of UCAs as a special interest item for Department of Navy Procurement Performance Management Assessment Program Reviews at both the headquarters and field activity levels. In addition, UCA best practices and lessons learned were included as a regular agenda item for their quarterly Department of Navy Naval Contracting Council meetings.

- **Air Force UCA Management Plan:** The Air Force added mandatory procedures to the Air Force Federal Acquisition Regulation, section 5317.74, that require approval to use a UCA and include proposal instructions, reporting requirements, and required contracting file documentation. Air Force acquisition officials took additional action to provide better oversight of UCAs. On March 17, 2010, the Office of the Assistant Secretary of the Air Force issued Policy Memorandum 10-C-03, "Undefinitized Contract Actions." The memorandum established a management review and reporting requirement for any UCA more than 14 days behind schedule at any point

in the definitization process. In addition, on March 24, 2010, the Assistant Secretary of the Air Force issued Policy Memorandum 10-C-04, "Timely Undefinitized Contract Action (UCA) Definitization/Negotiated Awards - Contractor Responsiveness." The memorandum encouraged contracting personnel to work with industry counterparts to receive quality documentation in a timely manner.

Corrective Actions Taken in Response to Contracting Activity Audits

We identified discrepancies on 216 of the 251 UCAs at 5 DoD contracting activities. We prepared an audit report for each of the activities that included findings and recommendations to local management. Many of the areas highlighted in this report were addressed in the previous reports. Overall, management at the activities agreed with our findings and recommendations. As of October 1, 2011, management at ESC, SMC, and MCSC implemented most of our recommendations, and NAVAIR and ACC-RSA began implementing them. Additional guidance issued by DPAP personnel should further improve DoD compliance with restrictions applicable to UCAs.

Conclusion

DPAP personnel's efforts improved oversight and DoD contracting personnel's compliance with guidance applicable to UCAs. DoD personnel have adequate policy for complying with restrictions applicable to UCAs. However, given the infrequency of UCA use and contracting officers lack of familiarity with procedures, DPAP should provide contracting personnel with additional guidance through an update to the DFARS Policy, Guidance, and Information 217.74. This update can be used in conjunction with DFARS 217.74 to provide personnel with instructions on how to comply with restrictions applicable to UCAs.

Recommendations, Management Comments, and Our Response

We recommend that the Director, Defense Procurement and Acquisition Policy:

1. Revise the Defense Federal Acquisition Regulation Supplement Procedures, Guidance, and Information 217.74, "Undefinitized Contract Actions," to:

a. Incorporate a template with standard prompts for completing adequate authorization requests submitted to the head of the contracting activity to include:

(1) Why performance must begin immediately, the impact on agency requirements, and why undefinitized contractual action use is justified.

(2) A definitization schedule of agreed-upon events that supports timely definitization.

(3) Circumstances in which undefinitized contractual action use places the Government at unnecessary and avoidable risk and the means by which contracting personnel can mitigate this risk.

b. Emphasize the importance of coordination and communication among contracting personnel, program office personnel, and customers when using a undefinitized contractual action.

c. Include instructions on how contracting personnel can factor substantial incurred costs into profit position when completing the weighted guidelines.

d. Emphasize the importance of sufficiently documenting compliance with requirements to reflect reduced risk for undefinitized contractual actions with substantial incurred cost.

e. Include guidance for contracting personnel on how to determine and establish obligation levels that will sustain contractor operations for an estimated undefinitized period between 180 to 360 days.

Office of Defense Procurement and Acquisition Policy Comments

The Director, Defense Procurement and Acquisition Policy, agreed and stated that a Defense Federal Acquisition Regulation Supplement case had been opened to incorporate the recommended changes into the Defense Federal Acquisition Regulation Supplement Procedures, Guidance, and Information. He stated that the recommendation will be implemented by February 28, 2012.

Our Response

The Director, Defense Procurement and Acquisition Policy, comments were responsive, and no additional comments are required.

2. Develop a transparent means to document incurred costs and reduced cost risk related to substantial incurred costs during the undefinitized period. For example, revise the Department of Defense Form 1547, "Record of Weighted Guidelines," to include a separate line in item 24 for assigning lower than normal factors to reflect reduced risk.

Office of Defense Procurement and Acquisition Policy Comments

The Director, Defense Procurement and Acquisition Policy, stated that revisions to the weighted guidelines remain under review.

Our Response

The Director, Defense Procurement and Acquisition Policy, comments were partially responsive. Although the Director, Defense Procurement and Acquisition Policy, stated

that revisions to the weighted guidelines were under review, the comments did not indicate agreement or disagreement, specific planned corrective actions, or a date when corrective actions will be completed. Therefore, we request that the Director, Defense Procurement and Acquisition Policy, provide comments in response to the final report.

Appendix A. Scope and Methodology

We conducted this summary audit from May 2011 through November 2011. This report summarizes a series of five performance audits conducted during the period July 2009 through June 2011. We conducted the audits in accordance with generally accepted government auditing standards. Those 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. We initially planned to review DoD's use of UCAs as part of a single tri-Service audit beginning in July 2009. In September 2009, we decided to conduct a separate audit for each of the six contracting activities that we had initially identified to be included in the tri-Service audit. In March 2011, DoD IG management decided not to conduct the sixth planned UCA audit of U.S. Army Communications-Electronics Command because of staffing considerations and higher priority work.

This project summarized the results from the following five audit reports on the Services' use of UCAs. For this report we updated the results from the previous reports for UCAs that contracting personnel definitized after the report date. Each of the five audits focused on a single contracting activity's compliance with 10 U.S.C. Section 2326.

- DoD IG Report No. D-2011-097, "Army Contracting Command-Redstone Arsenal's Management of Undefinitized Contractual Actions Could Be Improved," August 12, 2011

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

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

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

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

In addition, this project reported on the total number of UCAs under the jurisdiction of each Secretary.

GAO was conducting a review on the use of UCAs when our audit began. We limited our site selection to contracting activities that were not included in the GAO engagement.

Universe and Sample Information

For this summary report our universe consisted of the 251 UCAs identified in the 5 audit reports on contracting activities use of UCAs. For each of the five UCA audits, we used the FPDS-NG database to identify the universe of UCAs to review. We identified action obligations coded as letter contracts that the Services issued from FYs 2004 through 2009.[5] We classified the action obligations by contract number and contracting office code to identify the contracting activities responsible for the 15 largest aggregate UCA dollar values and selected six contracting activities but only reviewed five activities. Personnel from each of the contracting activities provided a list of UCAs awarded during FYs 2004 through 2010. Based on the FPDS-NG data and the list of UCAs provided by the contracting activities, we selected a nonstatistical sample of UCAs for review.

Our audit universe was limited to the contracts identified in FPDS-NG. Within the FPDS-NG system, we were unable to reliably identify three types of UCAs: "provisioned item orders," "indefinite-delivery, indefinite-quantity," and "basic ordering agreements." These types of UCAs were identified in a field that the user or input staff created and were subject to individual manipulations of the field, which made searching across the databases unreliable. We supplemented our judgment selection of UCAs from lists of UCAs provided by personnel at the contracting activities. Our final nonstatistical sample consisted of 251 UCAs with a total not-to-exceed value of $15 billion from five contracting activities.

Review of Documentation and Interviews

We reviewed the final reports and associated workpapers from the five DoD IG audits on five contracting activities' use of UCAs. We analyzed information from the five projects to determine overall DoD compliance with 10 U.S.C. § 2326 and whether contracting personnel adequately supported their determination of price reasonableness when definitizing UCAs. We also reviewed the Services' reporting of UCA use and management plans required by the August 29, 2008 DPAP memorandum. We reviewed documentation compiled from the five contracting activities in the audit series against applicable criteria including:

- Statutes and Public Laws: Public Law 99-591, "Continuing Appropriations for Fiscal Year 1987"; Public Law 110-181, "National Defense Authorization Act for Fiscal Year 2008"; 10 U.S.C. § 2304, "Contracts: Competition Requirements"; 10 U.S.C. § 2326, "Undefinitized contractual actions: restrictions";

- Federal Acquisition Regulation Requirements: FAR Subpart 6.3, "Other than Full and Open Competition"; FAR Subpart 15.4, "Contract Pricing"; FAR Subpart 16.6, "Time-and-Materials, Labor-Hour, and Letter Contracts"; FAR Subpart 52.2, "Text of Provisions and Clauses";

[5] We performed the query on June 9, 2011.

- Defense Federal Acquisition Regulation Supplement: DFARS 215.404, "Proposal Analysis"; DFARS Subpart 216.6, "Time-and-Materials, Labor-Hour, and Letter Contracts"; DFARS 217.74, "Undefinitized Contract Actions"; DFARS case 2008-D034, "Management of Unpriced Change Orders"; DFARS case 2007-D011, "Letter Contract Definitization Schedule"; and

- Memoranda: Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics memorandum, "Management Oversight of Undefinitized Contract Actions," August 29, 2008; Department of the Air Force Office of the Deputy Assistant Secretary (Contracting) Policy Memo 10-C-03, "Undefinitized Contract Actions," March 17, 2010; Department of the Air Force Office of the Deputy Assistant Secretary (Contracting) Policy Memo 10-C-04, "Timely Undefinitized Contract Action (UCA) Definitization/Negotiated Awards-Contractor Responsiveness," March 24, 2010.

Use of Computer-Processed Data

We relied on computer-processed data from 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 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 FPDS-NG and Electronic Document Access was sufficiently reliable to accomplish our audit objectives when compared with contract records.

We also used the FPDS-NG to report on the total number of UCAs under the jurisdiction of each Secretary from FY 2004 through June 9, 2011. We reported on the number of letter contracts issued and definitized. However, those values understate that actual amount of UCA use. We identified numerous discrepancies between information contained in FPDS-NG when compared to information contained in Electronic Document Access and actual contract records. The discrepancies include FPDS-NG incorrectly identifying transactions as UCAs or the reverse and inaccurate dollar values. Further, FPDS-NG does not reliably capture other UCAs transactions such as modifications to an existing letter contract, as a delivery or task orders on indefinite-delivery, indefinite-quantity contracts. Because of the unreliability of UCA data in FPDS-NG, we also reported on UCA use as reported by the Services to DPAP in their semiannual reports.

Use of Technical Assistance

We met with personnel from the DoD IG Quantitative Methods and Analysis Division and determined that we would use FPDS-NG data to select a nonstatistical sample of contracting activities and then we would use FPDS-NG data in combination with contract data provided by the contracting activity 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

During the last 5 years, GAO has issued two reports discussing DoD use of UCAs and the DoD IG has issued five reports discussing DoD use of UCAs. Unrestricted GAO reports can be accessed over the Internet at http://www.gao.gov. Unrestricted DoD IG reports can be accessed at http://www.dodig.mil/audit/reports.

GAO

GAO Report No. GAO-10-299, "Defense Contracting: DoD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvements," January 28, 2010

GAO Report No. GAO-07-559, "Defense Contracting: Use of Undefinitized Contract Actions Understated and Definitization Time Frames Often Not Met," June 19, 2007

DoD IG

DoD IG Report No. D-2011-097, "Army Contracting Command-Redstone Arsenal's Management of Undefinitized Contractual Actions Could Be Improved," August 12, 2011

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

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

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

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

Appendix B. August 29, 2008, Office of Defense Procurement and Acquisition Policy Memorandum*

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

ACQUISITION, TECHNOLOGY AND LOGISTICS

AUG 29 2008

MEMORANDUM FOR COMMANDER, UNITED STATES SPECIAL OPERATIONS COMMAND (ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY (POLICY AND PROCUREMENT), ASA(ALT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY (ACQUISITION AND LOGISTICS MANAGEMENT), ASN(RDA)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE (CONTRACTING), SAF/AQC
DIRECTORS, DEFENSE AGENCIES
DIRECTORS, DOD FIELD ACTIVITIES

SUBJECT: Management Oversight of Undefinitized Contract Actions

An undefinitized contract action (UCA) is one for which the contract terms, specifications, or price are not agreed upon before performance is begun. Examples include letter contracts or undefinitized orders issued against basic ordering agreements or task/delivery order contracts. A UCA is a valuable tool for meeting urgent requirements. However, without appropriate management and controls, these instruments can lead to increased cost risks for the Department.

A recent Government Accountability Office (GAO) review of DoD UCAs (GAO-07-559) identified a need for enhanced oversight. In addition, section 809 of the FY 2008 National Defense Authorization Act requires issuance of detailed instructions to ensure oversight of UCAs. Specific issues include appropriate use of UCAs; timely definitization; obligation amounts prior to definitization; and appropriate recognition in profit or fee of the contractor's reduced risk during the undefinitized period.

DFARS 217.74, Undefinitized Contract Actions, provides DoD policies and procedures for the appropriate use of UCAs and related approval requirements. When possible, to discourage extended periods of performance prior to definitization, contracting officers should avoid obligating the maximum permissible funding at the time of UCA award. Contracting officers should assess the contractor's spend plan for the undefinitized period, and obligate funds only in an amount consistent with the

* Attachments to the memorandum have been removed from the draft report.

contractor's requirements for the undefinitized period. 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). Contracting officers should note the guidance at DFARS 215.404-71-3(d)(2) which indicates that, when costs have been incurred prior to definitization, generally the contract type risk should be regarded to be in the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, contracting officers may assign a value as low as 0 percent, regardless of contract type. Contracting officers must document the risk assessment in the contract file.

To provide enhanced management insight and oversight of UCAs, we have established the attached templates for UCA Management Plans and semi-annual Consolidated UCA Reports for UCAs with an estimated value of more than $5 million. Together, the plans and reports provide information on key aspects of UCA use and management, including actions taken to ensure timely and effective definitization. Initial UCA Management Plans are due no later than 30 days after the date of this policy memorandum. The initial Consolidated UCA Reports are due on 31 October 2008. Plan Updates and Consolidated UCA Reports are due semi-annually thereafter.

Please provide your UCA management point of contact as soon as possible to Mr. John Tenaglia who can be reached at john.tenaglia@osd.mil or 703-697-8334.

Shay D. Assad
Director, Defense Procurement,
Acquisition Policy, and
Strategic Sourcing

Attachments:
As stated

Appendix C. Letter Contracts Issued and Not-to-Exceed Amounts for FY 2004 Through June 9, 2011

	Army		Navy		Air Force		Other DoD Agencies			
Fiscal Year	**Number**	**Amount***	**Number**	**Amount***	**Number**	**Amount***	**Number**	**Amount***	**Total Number**	**Total Amount***
2004	116	$1,211.8	102	$513.7	68	$674.7	47	$48.3	333	$2,448.5
2005	157	1,615.0	135	408.4	67	1,076.7	19	28.6	378	3,128.7
2006	92	680.9	100	325.9	49	352.2	41	62.2	282	1,421.3
2007	92	459.4	65	187.5	61	870.1	24	24.4	242	1,541.4
2008	89	777.0	57	223.6	78	1,157.4	16	24.1	240	2,182.2
2009	92	644.3	98	735.0	54	788.2	19	216.3	263	2,383.8
2010	97	2,161.8	77	1,524.3	28	279.8	13	54.6	215	4,020.5
2011	29	270.8	12	143.6	9	376.7	1	18.0	51	809.1
Totals	**764**	**$7,821.1**	**646**	**$4,062.0**	**414**	**$5,575.8**	**180**	**$476.6**	**2,004**	**$17,935.5**

*Not-to-exceed amounts are in millions.

Appendix D. Definitization Modifications Issued and Definitization Amounts on Letter Contracts for FY 2004 Through June 9, 2011

	Army		Navy		Air Force		Other DoD Agencies			
Fiscal Year	**Number**	**Amount***	**Number**	**Amount***	**Number**	**Amount***	**Number**	**Amount***	**Total Number**	**Amount***
2004	37	$438.8	13	$763.9	11	$55.2	1	$.7	62	$1,258.7
2005	119	741.0	14	838.5	44	348.7	2	3.7	179	1,932.0
2006	91	1,002.9	12	705.9	27	135.8	5	6.5	135	1,851.1
2007		223.5	12	69.7	32	2,342.7	8	8.6	120	2,644.4
2008	66	358.3	15	380.2	41	701.7	2	4.5	124	1,444.7
2009	47	443.3	13	596.7	18	799.2	13	21.0	91	1,860.3
2010	47	1,159.1	27	515.2	11	163.0	7	11.0	92	1,848.3
2011	16	32.0	2	66.0	2	43.4	1	2.0	21	143.5
Totals	**491**	**$4,399.3**	**108**	**$3,936.2**	**186**	**$4,589.7**	**39**	**$58.0**	**824**	**$12,983.1**

*Not-to-exceed amounts are in millions.

Defense Procurement and Acquisition Policy Comments

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

ACQUISITION, TECHNOLOGY AND LOGISTICS

DEC 19 2011

MEMORANDUM FOR PROGRAM DIRECTOR, ACQUISITION AND CONTRACT MANAGEMENT, DoDIG

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS NS 12/20/11

SUBJECT: Response to DoDIG Draft Report on DoD's Management of Undefinitized Contractual Actions (Project No. D2009-D000CG-0248.005)

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

Recommendation:
We recommend Defense Procurement and Acquisition Policy personnel should revise the Defense Federal Acquisition Regulation Supplement (DFARS) Procedures, Guidance, and Information (PGI) 217.74 to provide additional guidance for managing UCAs.

Response:
The Department concurs with the recommendation. We have opened a DFARS case to incorporate the recommended changes into DFARS PGI. We anticipate publishing the revision by February 28, 2012.

Recommendation:
We recommend developing a transparent means to document incurred costs and reduced cost risk related to substantial incurred costs during the undefinitized period. For example, revise the Department of Defense Form 1547, "Record of Weighted Guidelines," to include a separate line in item 24 for assigning lower than normal factors to reflect reduced risk.

Response:
Revisions to the weighted guidelines remain under review.

Please contact [redacted] at [redacted] or [redacted] if additional information is required.

Richard Ginman
Director, Defense Procurement
and Acquisition Policy

Inspector General
Department of Defense