Audit Report

OFFICE OF THE INSPECTOR GENERAL

UNDEFINITIZED CONTRACTUAL ACTIONS

Report No. 97-204 August 15, 1997

Department of Defense

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Acronyms

BOA	Basic Ordering Agreement
DCADS	Defense Contract Action Data System
DFARS	Defense Federal Acquisition Regulation Supplement
UCA	Undefinitized Contractual Action
PIO	Provisioned Item Order

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

August 15, 1997

MEMORANDUM FOR DIRECTOR OF DEFENSE PROCUREMENT
ASSISTANT SECRETARY OF THE ARMY (RESEARCH, DEVELOPMENT, AND ACQUISITION)
ASSISTANT SECRETARY OF THE NAVY (RESEARCH, DEVELOPMENT, AND ACQUISITION)
ASSISTANT SECRETARY OF THE AIR FORCE (ACQUISITION)

SUBJECT: Audit Report on Undefinitized Contractual Actions (Report No. 97-204)

We are providing this audit report for review and comment. We considered management comments on a draft of this report in preparing the final report. The audit was performed in response to Public Law 99-500, "Continuing Appropriations for Fiscal Year 1987," Section 101(c), which requires the Inspector General, DoD, to periodically conduct an audit of undefinitized contractual actions under the jurisdiction of the Secretary of Defense and the Secretaries of the Military Departments.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. As a result of management comments, we combined Recommendations A.3. and A.4. We request that the Navy provide comments on Recommendations A.1., A.2., and A.3., the Army and Air Force provide comments on Recommendation A.3., and the Director of Defense Procurement provide additional comments on Recommendations B.1. and B.2. by October 15, 1997.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. Charles M. Hanshaw, Audit Project Manager, at (703) 604-9256 (DSN 664-9256). See Appendix G for the report distribution. The audit team members are listed on the inside of the back cover.

Robert J. Lieberman

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Office of the Inspector General, DoD

Report No. 97-204 **August 15, 1997**
(Project No. 6CH-0055)

Undefinitized Contractual Actions

Executive Summary

Introduction. We performed this audit in response to Public Law 99-500, "Continuing Appropriations for Fiscal Year 1987," section 101(c), which requires the Inspector General, DoD, to periodically conduct an audit of undefinitized contractual actions. The last audit report issued by the Inspector General, DoD, on undefinitized contractual actions was Report No. 92-048, "Undefinitized Contractual Actions," February 14, 1992. According to the Defense Contract Action Data System, DoD issued 2,654 letter contracts, valued at $9.8 billion, and definitized 1,747 letter contracts, valued at $9.7 billion, from FY 1991 through the second quarter of FY 1996.

Audit Objectives. The audit objective was to determine DoD compliance with restrictions on undefinitized contractual actions imposed by United States Code, title 10, section 2326. The audit was limited to letter contracts because the Defense Contract Action Data System did not identify other types of undefinitized contractual actions. The audit evaluated management control programs applicable to the audit objective.

Audit Results. Although compliance with the statutory provisions on undefinitized contractual actions has improved in some respects, there is still widespread noncompliance, despite much attention by Congress, OSD, and the Military Departments during the last 8 years. For 189 letter contracts reviewed during the current audit and valued at $10.7 billion, contracting officials did not:

- adequately justify the issuance of 65 letter contracts, valued at $3.9 billion;

- definitize 90 letter contracts, valued at $6.8 billion, within the required 180-day timeframe (29 percent were not definitized within 1 year); and

- document the reasonableness of negotiated profit rates for 101 letter contracts, valued at $6.2 billion.

As a result, the Military Departments assumed increased cost risk in the award and negotiation process, and negotiated profits of $26.8 million that were not commensurate with contractor risk.

The Defense Contract Action Data System identifies letter contracts, but does not identify other categories of undefinitized contractual actions defined by United States Code, title 10, section 2326, and Defense Federal Acquisition Supplement 217.7401(d). As a result, DoD does not have an effective system to track the award and definitization of all undefinitized contractual actions.

See Appendix A for details on the management control programs reviewed.

Summary of Recommendations. We recommend that the Service Acquisition Executives issue guidance to their contracting organizations requiring:

- justification documents for all letter contracts to provide specific details on the procurement requirement, the procurement planning performed, and the adverse effect if the procurement is delayed;

- contracting officers to meet milestone dates established for the issuance of letter contracts; and

- each contracting organization to establish performance goals for definitizing undefinitized contractual actions and compliance with other statutory and regulatory requirements for undefinitized contractual actions and to report annually their performance in meeting the goals.

We recommend that the Director of Defense Procurement implement a design change to the Defense Contract Action Data System to collect information on all categories of undefinitized contractual actions defined by Defense Federal Acquisition Supplement 217.74, and request contracting organizations to periodically verify the status of undefinitized letter contracts in the Defense Contract Action Data System.

Management Comments. We received comments on the draft of this report from the Director of Defense Procurement, the Deputy Assistant Secretary of the Army (Procurement), and the Associate Deputy Assistant Secretary of the Air Force (Contracting). The Navy did not provide comments on the draft report. The Army and Air Force agreed to issue memorandums to their contracting organizations reemphasizing the policy and regulatory requirements for undefinitized contractual actions. The Army stated that its memorandum would encourage contracting activities to consider the use of a performance-based management system to track undefinitized contractual actions. The Air Force disagreed with a recommendation to establish Service-wide performance goals for timely definitization of letter contracts and for documenting incurred costs and risk in negotiation memoranda. The Air Force also agreed to emphasize that contracting offices use existing systems for tracking undefinitized contract actions as a management tool. The Director of Defense Procurement nonconcurred with the recommendation to implement a design change to the Defense Contract Action Data System, and partially concurred with the recommendation to request contracting organizations to periodically verify the status of undefinitized letter contracts in the Defense Contract Action Data System. See Part I for a summary of management comments and Part III for the complete text of the management comments.

Audit Response. We consider the issuance of memorandums by the Army and Air Force to be responsive. Based on the Army and Air Force comments, we combined the recommendations to establish performance goals and track performance. We continue to believe that a design change to Defense Contract Action Data System is the most efficient way to improve visibility of undefinitized contractual actions and that contracting organizations should periodically verify the status of undefinitized letter contracts. We request that the Navy provide comments on the recommendations, that the Army and Air Force provide comments on the revised recommendation, and that the Director of Defense Procurement reconsider her position on the recommendations and provide additional comments by October 15, 1997.

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Part I - Audit Results

Audit Background

Undefinitized contractual actions (UCAs) are contractual actions for which the contract terms, specifications, or prices are not agreed to before performance begins. United States Code, title 10, section 2326 (10 U.S.C. 2326), "Undefinitized Contractual Actions: Restrictions," restricts the use of UCAs to an agency's urgent requirements and establishes limitations on the obligation of funds, the definitization of terms, and allowable profit for UCAs. UCAs include the following:

- letter contracts (authorize contractors to begin work immediately),
- unpriced orders placed under basic ordering agreements, and
- unpriced provisioned item orders (initial spare parts).

UCAs do not include:

- foreign military sales,
- purchases that do not exceed the simplified acquisition threshold,
- special access programs, and
- congressionally mandated long-lead procurement contracts.

UCAs have been a long-standing DoD problem area. Since the mid-1980s, Congress has expressed concerns about DoD extensive reliance on UCAs because UCA awards result in the transfer of cost risk from the contractor to the Government. The Government is also placed at a distinct disadvantage in negotiating final prices, since the contractor has already begun work on the contract. Congressional concerns resulted in the codification of restrictions on the use of UCAs in 10 U.S.C. 2326 and language in Public Law 99-500, "Continuing Appropriations for Fiscal Year 1987," section 101(c) [Title X section 908(b)], that requires the Inspector General, DoD, to periodically conduct an audit on the management of UCAs. Defense Federal Acquisition Regulation Supplement (DFARS) 217.74, "Undefinitized Contract Actions," implements 10 U.S.C. 2326 and prescribes DoD policy on UCAs.

During the last 8 years, Congress has amended 10 U.S.C. 2326 on 3 occasions, the Director of Defense Procurement has issued three changes to DFARS 217.74, and the Military Departments have issued 7 guidance memorandums to clarify guidance on the use of UCAs and improve compliance.

Appendix C provides details on the statutory amendments, regulatory changes, and Military Department guidance memorandums.

The Defense Contract Action Data System (DCADS) shows that DoD issued 2,654 letter contracts, valued at $9.8 billion and definitized 1,747 letter contracts, valued at $9.7 billion, from FY 1991 through the second quarter of FY 1996. The dollar values represent the funds obligated when the letter contracts were issued and definitized. When a letter contract is issued the funds obligated normally do not exceed 50 percent of the contract ceiling price. When a letter contract is definitized additional obligations are used to fund the negotiated contract price.

Table 1 shows the number of letter contracts issued and definitized, and amounts obligated by DoD from FY 1991 through the second quarter of FY 1996 as recorded in the DCADS. Appendix D shows additional details on letter contracts issued and definitized by DoD during each fiscal year.

Table 1. Letter Contracts Issued and Definitized by DoD

	Issued		Definitized	
Fiscal Year	Number	Amount Obligated	Number	Amount Obligated
1991	631	$2,048,172,000	433	$ 893,066,000
1992	444	2,149,061,243	289	1,103,994,320
1993	482	2,019,583,308	356	1,468,403,445
1994	502	1,298,143,857	348	2,449,739,745
1995	455	1,813,783,846	271	1,981,724,920
1996[1]	110	431,486,301	50	1,757,398,617
Total	**2,624**	**$9,760,230,555**	**1,747**	**$9,654,327,047**

[1]through the second quarter of FY 1996

According to the Defense Contract Action Data System, the number and value of letter contracts issued by DoD declined from 631, totaling $2.05 billion, in FY 1991; to 455, valued at $1.8 billion, in FY 1995. The number of letter contracts definitized by DoD during that time declined from 433 to 271, but the value increased from $893.1 million to $2 billion.

Statutory and Regulatory Requirements

Approval to Use UCAs. Section 2326(a) of 10 U.S.C. 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 terms, specifications, and price before performance is begun under the contract action.

DFARS 217.7403, "Policy," states that UCAs shall only be used when contracting officials cannot negotiate definitive contracts in sufficient time to meet the Government's requirements. DFARS 217.7404-1, "Authorization," requires that the contracting officer obtain approval from the head of the contracting activity before entering into a UCA. DFARS 217.7404-1 also requires that the contracting officer request for UCA approval must include a full explanation of the need to begin contract performance before contract definitization.

Contract Definitization. Section 2326(b) of 10 U.S.C. 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.

DFARS 217.7404-3, "Definitization Schedule," requires that UCAs contain schedules that provide for definitization within 180 days after issuance. The 180-day period may be extended, but not beyond 180 days after the receipt of a contractor's qualifying proposal. DFARS 217.7404-3(b) further states that the contractor proposal submitted in accordance with the definitization schedule is a

material element of the contract, and if the contractor does not submit a timely qualifying proposal, the contracting officer may suspend or reduce progress payments or take appropriate action.

Allowable Profit. Section 2326(e) of 10 U.S.C. and DFARS 217.7404-6, "Allowable Profit," require that:

> 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 the 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 215.903(b)(1), "Contracting Officer Responsibilities," states that the contracting officer must use "weighted guidelines" for determining profit or fee objectives unless a modified "weighted guideline" applies or an alternate approach is justified. A weighted guideline is a method used by DoD contracting officers to establish a basic profit rate under a formula that focuses on three profit factors:

- performance risk,
- contract type risk, and
- facilities capital employed.

DFARS 215.971-3(d)(2) states that contracting officers shall assess the amount of contractor-incurred costs prior to definitization, before assigning the cost-risk element (contract-type risk) of the profit objective. DFARS 215.971-3(d)(2) also states that, when costs have been incurred prior to contract definitization, contracting officers should generally regard the contract-type risk to be in the low end of the designated risk range. DFARS 215.971-3(d)(2) further states that a contracting officer may assign a value as low as zero percent for contract-type risk when a substantial portion of the cost has been incurred prior to definitization.

Audit Objectives

The audit objective was to determine DoD compliance with restrictions on UCAs imposed by 10 U.S.C. 2326. The audit was limited to letter contracts because the DCADS did not identify other categories of UCAs. The specific objectives were to determine whether the risk to the Government was adequately described in approval documents, and whether obligation amounts, contract definitization, and negotiated profit rates were in accordance with statutory limitations. The audit also evaluated management control programs applicable to the audit objective. See Appendix A for a discussion of the audit scope and methodology and review of management control programs. See Appendix B for a summary of prior audits and reviews of UCAs.

Finding A. Management of Letter Contracts

The Military Department contracting organizations continue to be in noncompliance with the statutory provisions on UCAs despite much attention to their use by Congress, OSD, and the Military Departments during the last 8 years. Since our 1992 audit report, compliance with the limits on obligating funds for UCAs before contract definitization improved significantly. Only marginal improvement occurred in the preparation of adequate justifications for UCAs, the timeliness of contract definitization, and the determination of contractor profits on UCAs. For 189 letter contracts, valued at $10.7 billion and reviewed during the current audit, contracting officials did not:

- adequately justify the issuance of 65 letter contracts, valued at $3.9 billion;

- definitize 90 letter contracts, valued at $6.8 billion, within required time frames; and

- document the reasonableness of negotiated profit rates for 101 letter contracts, valued at $6.2 billion.

The conditions occurred because effective procurement planning was not performed, performance-based management systems did not establish accountability for schedule deviations, and contracting officers deviated from the policies on the use of UCAs. The failure to adhere to policies on UCAs weakened the DoD contractual position in the award and negotiation process and allowed contractors to receive profits of $26.8 million that were not commensurate with the contractor risk.

Letter Contracts Reviewed

We reviewed 189 letter contracts, valued at $10.7 billion, that 17 Army, Navy, and Air Force contracting organizations issued or definitized from FY 1991 through the second quarter FY 1996. The letter contracts were issued for the acquisition of capital assets and services. Appendix E provides details on the contracting organizations, number and value of letter contracts reviewed, and the audit results.

Table 2 summarizes the deficiencies noted.

Table 2. Letter Contract Deficiencies

Deficiency	Army	Navy	Air Force	Total
Issuance Without Adequate Justification	16	27	22	**65**
Untimely Contract Definitization	22	47	21	**90**
Insufficient Justification for Negotiated Profit Rate	32	40	29	**101**

Issuance of Letter Contracts

Contracting officials issued 65 of the 189 letter contracts reviewed without adequate justification. Appendix F provides details on the 65 letter contracts with justification deficiencies. Table 3 summarizes the deficiencies.

Table 3. Justification Deficiencies

Deficiency	Army	Navy	Air Force	Total
Adverse Effect Not Documented	1	8	10	**19**
Awards After Milestones	2	4	0	**6**
Awards for Known Acquisition Requirements	13	15	12	**40**
Total	**16**	**27**	**22**	**65**

Justification Statements. Approval documents for 19 letter contracts, valued at $2.9 billion, did not describe the anticipated effect on requirements if performance under the contractual action had been delayed until contractual terms, specifications, and price were finalized. The approval documents contained vague statements of adverse impact. For example, the March 8, 1994 approval document for Naval Sea Systems Command letter contract N00024-94-C-6203, issued April 4, 1994, for sonar rubber domes, stated that the letter contract was needed to avoid a manufacturing plant closure.

The approval document did not explain:

- when the requirement for the domes became known;
- why the plant was being closed and its planned closure date;
- what action had been taken to find other manufacturing sources;
- describe the administrative and production lead times and the dollar impact; and
- why a definitive contract could not be awarded in sufficient time for the requirements. Without those details, the contracting officials did not have adequate information to approve the letter contract.

Delays in Issuing Letter Contracts. Contracting officers issued 6 letter contracts, valued at $166 million, from 50 to 276 days after the award milestone dates specified in the approval documents. The delays in issuing the letter contracts defeated the urgency and adverse impact statement in the approval documents for letter contracts. For example, the issuance of Naval Air Systems Command letter contract N00019-95-C-0023 on May 4, 1995, was supported by a statement in the approval document dated December 1, 1994, that the Navy could realize cost savings if an upgrade kit for the Hawkeye aircraft could be procured with other production buys by December 31, 1994. The contract was not awarded until May 1995, or 5 months after the contract date identified in the approval document and 6 months after preparation of the approval document. The reason for the delay in awarding the letter contract was not documented in the contract records. The issuance of the letter contract received low priority after approval was granted to use a letter contract.

Letter Contracts Issued for Known Acquisition Requirements. Contracting officers issued 40 letter contracts, valued at $883 million, for known acquisition requirements and to replace existing contracts that were expiring to prevent breaks in contractors' production or services. For example, the approval document for letter contract F34601-92-C-0852 issued by Oklahoma City Air Logistics Center, for integrated data strategy engineering services was approved for known acquisition requirements. The approval document, dated May 6, 1992, stated that the letter contract action must be issued because the program office submitted the purchase request on April 8, 1992, only 53 days prior to contract expiration, which did not provide sufficient leadtime to plan for normal acquisition.

Causes of Deficiencies. It appears that program and contracting officers did not adequately document the adverse effect of a delay on mission objectives in

approval documents because explicitly documenting the requirements, assumptions, constraints, alternatives, monetary costs, and cost schedule performance risks may have contradicted the need to use a letter contract.

It also appears that inadequate procurement planning was a cause for issuance of letter contracts. Procurement planning is the action plan for the acquisition and should be accomplished by an integrated project team led by a program manager, supported by procurement officials, resource management, and program technical staff. The integrated project team concept was developed by leading private companies and adopted by DoD to reduce management decision cycles and improve the structuring of successful programs. Approval documents should state why the issuance of letter contracts was the best alternative, and reflect the systematic analysis of expected benefits and costs. The effective use of integrated project teams should improve procurement planning and result in reduced need to issue letter contracts.

Letter Contract Definitization

Although all 189 letter contracts reviewed required agreement of contract terms and prices within 180 days of the issuance date, contracting officers did not definitize the terms and prices for 90 letter contracts within the specified timeframes. The contract definitizations exceeded the 180-day requirement up to 1,375 days. Table 4 shows days elapsed before the 90 letter contracts were definitized.

Table 4. Elapsed Days to Definitize Letter Contracts

	Letter Contracts	Range of Days to Definitize	Average Days to Definitize
Army	22	182 to 602	267
Navy	47	181 to 1,555	408
Air Force	21	181 to 665	277
Total	**90**		

For the 90 letter contracts:

- 10 contracts were not definitized as of September 30, 1996, although an average of 558 days had elapsed since their issuance; and

- 80 contracts were definitized an average of 316 days after either the contracts were awarded or the contractor proposals were received.

Proposal Receipt and Negotiations. Contracting officers did not show commitment and responsibility to definitize the letter contracts within the required 180 days or within scheduled milestones. Contracting officers received qualifying proposals from contractors an average of 71 days before they issued 40 of the 90 contracts and could have definitized the contract terms within established milestones. In addition, contracting officers negotiated 80 contracts an average of 161 days after the scheduled negotiation dates. For 32 of the 80 contracts, qualifying proposals were received an average of 84 days after the proposals were due as shown in definitization schedules for the letter contracts.

Causes for Delays. The lack of timely definitization occurred because either DoD, the contractor, or both parties did not show commitment and responsibility to definitize the letter contracts within the required 180 days or within scheduled milestones. Contracting officers often did not use performance-based management systems to provide visibility on the achievement or deviation of specific definitization schedule milestones. Accordingly, definitization schedule milestones were not closely maintained to establish accountability for deviations. Further, contracting officers did not provide incentives to contractors to encourage more timely proposal submission. For instance, reducing or suspending progress payments for contractors that had not submitted proposals by the required dates would provide an incentive. Contracting officers should use performance-based management systems that establish accountability for deviations from definitization schedules. The management systems would provide a basis for reducing or suspending progress payments and data on contractor past performance for use during subsequent contract award decisions.

Risk of Delayed Contract Definitizations. Untimely contract definitizations transfer additional cost and performance risk from the contractors to the Government. The DoD normally reimburses contractors for all allowable costs they incur on letter contracts. Therefore, contractors have less cost risk in performing the contractual efforts when definitization is untimely, particularly if a fixed-price contract is contemplated for the procurement. A fixed-price contract puts the greatest amount of risk on the contractor for meeting cost, schedule, and performance goals.

Negotiation of Profits and Fees

For 101 of 189 letter contracts reviewed, contracting officers did not document in the price negotiation memorandums that they considered contractor-incurred costs and the reduced risk in determining profit or fee objectives, and in

negotiating profits and fees on the contracts. Table 5 shows the numbers of letter contracts by Military Department that had price negotiation memorandums that did not discuss reduced contractor risk.

Table 5. Letter Contracts with Price Negotiation Memorandums that did not Document Consideration of Reduced Contractor Risk

Army	Navy	Air Force	Total
32	40	33	**101**

Contractor Profits. On 45 letter contracts where the performance ranged from 181 to 849 days before definitization, the contracting officers developed higher than warranted profit objectives and contractors received excessive profits amounting to $26.8 million. Appendix E identifies the amounts of excessive profits by contracting organization. The excessive profits were calculated by reducing the contract-type risk factor, for each of the 45 contracts, to the lower end of the designated risk range to develop the profit objective.

For example, on Army Missile Command firm-fixed-price letter contract DAAH01-94-C-A005 for the production of multiple launch rocket systems, the contractor had performed contractual efforts and incurred costs for 484 days before the contracting officer definitized the contract. However, the contracting officer did not reflect in the negotiation memorandum that incurred costs or reduced risks were considered in developing the profit objective or negotiating the profit rate. The contracting officer applied a normal (3 percent) contract-type risk factor to the contractor's direct costs, developed a 13-percent profit objective, and negotiated a 13.6-percent profit rate. The contracting officer should have reduced the contract-type risk by one-percent to the lower end of the designated risk range, to account for reduced contractor risk, and adjusted the profit objective accordingly. That adjustment would have avoided $1.3 million in profit that exceeded the contractor's justifiable risk and reduced the profit rate to 12.8 percent. Federal Acquisition Regulation 15.903(d)(1) "Contracting Officer Responsibilities," limits the profit or fee to 10 percent for cost-plus-fixed-fee contracts for other than experimental, developmental, research and architect-engineering services. If the profit rate for contract DAAH01-94-C-A005 was limited to 10 percent, the contract would have reduced the authorized contractor profit by $5.5 million.

Documenting Risk. Negotiation and business clearance memorandums should discuss risk management and document to what extent the risk for contract cost, schedule, and performance goals is transferred to, or assumed, or shared by DoD. The contracting officers should include the percentage of contractor-incurred costs before definitization dates and provide separate

breakouts of profit rates for costs incurred before and after definitization, and document the achievement of, or deviation from, cost and performance goals. Contracting officers stated they considered cost risk in determining profit objectives even though the price and business clearance memorandums did not document the assessment, analysis, and treatment of cost risk in establishing profit and fee objectives. There is a need for additional emphasis and accountability in documenting cost risk in negotiation and business clearance memorandums. By not adjusting profit rates for incurred costs and reduced cost risks, contracting officers definitized letter contracts that included $26.8 million in greater-than-warranted profits. Further, the contracting officials that approved the negotiation and business clearance memorandums should have required the contracting officers to document in the memorandums that they considered contractor incurred costs and reduced risk in negotiating profit rates and fees.

Comparison of Audit Results

The Military Departments improved only marginally their compliance with policies on issuance, definitization, and profit determination since the issuance of Audit Report No. 92-048. Table 6 shows a comparison of the deficiencies identified during the current audit with deficiencies reported in Audit Report No. 92-048.

Table 6. Comparison of Audit Results

	Current Audit			Audit Report No. 92-048		
		Deficiencies			Deficiencies	
Deficiency	Contracts Reviewed	Number	Percent of Contracts Reviewed	Contracts Reviewed	Number	Percent of Contracts Reviewed
Issuance Without Adequate Justification	189	65	34	173	65	38
Untimely Contract Definitization	189	90	48	171	115	67
Insufficient Justification for Negotiated Profit Rate	189	101	53	143	103	72

Conclusion

For the letter contracts reviewed, contracting officers were complying with 10 U.S.C. 2326 and DFARS 217.7404-4 limits on obligating funds for UCAs before contract definitization. This was a significant improvement from Inspector General, DoD. Audit Report No. 92-048 finding that obligations for 105 (61 percent) of the 173 contractual actions reviewed exceeded the statutory limits.

The Military Departments' contracting organizations made only marginal improvements in their compliance with other statutory and regulatory policies on UCA issuance, definitization, and profit and fee determinations. Additional emphasis is needed on compliance with these requirements. Accordingly, we believe that contracting offices should establish performance goals for timely definitization of undefinitized contractual actions and compliance with other statutory and regulatory requirements and should report annually their performance in meeting the goals to the Service Acquisition Executives.

Management Comments on the Finding and Audit Response

The Deputy Assistant Secretary of the Army (Procurement) and the Associate Deputy Assistant Secretary of the Air Force (Contracting) agreed that there was a need for additional emphasis and accountability in managing the use of undefinitized contractual actions. However, the Associate Deputy Assistant Secretary of the Air Force did not agree that failure to document the performance of risk analysis for an action necessarily allowed contractors to receive profits that were not commensurate with their risk.

Audit Response. For the 45 UCAs where definitization exceeded 180 days, we determined that risk analyses were not performed by contracting organizations based on documentation reviewed and interviews with contracting personnel. We calculated the $26.8 million in greater-than-warranted profits for the 45 UCAs by adjusting the portion of contractor profit devoted to contract risk (3 percent) by one percent to reflect the reduced contractor risk for performance and definitization of UCAs.

Recommendations, Management Comments, and Audit Response

Deleted Recommendation. Based on management comments, we combined draft report Recommendations A.3. and A.4.

A. We recommend that the Assistant Secretary of the Army (Research, Development, and Acquisition), Assistant Secretary of the Navy (Research, Development, and Acquisition), and Assistant Secretary of the Air Force (Acquisition) issue guidance to their contracting organizations requiring:

1. Justification documents for all letter contracts to provide specific details on the procurement requirement, the procurement planning performed, and the adverse effect if the procurement is delayed.

2. Contracting officers to meet milestone dates established for the issuance of letter contracts.

3. Each contracting organization to establish performance goals for definitizing undefinitized contractual actions and compliance with other statutory and regulatory requirements for undefinitized contractual actions and to report annually their performance in meeting the goals.

Army Comments. The Deputy Assistant Secretary of the Army (Procurement) stated that a memorandum would be issued to Army contracting activities by July 30, 1997, that emphasizes the need for Army contract managers at all levels to ensure that:

- documents justifying the use of undefinitized contractual actions are sufficient;

- definitizations are timely and consistent with law and unique, unusual, and compelling circumstances;

- existing policies concerning the negotiation of contractor profit are fully implemented; and

- contracting activities consider the use of performance based-management systems to closely monitor undefinitized contract actions.

The Deputy Assistant Secretary also stated that Army contracting activities will also be asked to review the execution and management of undefinitized contractual actions during the conduct of their procurement management reviews.

Air Force Comments. The Associate Deputy Assistant Secretary of the Air Force (Contracting) stated that a memorandum would be issued by August 15, 1997, re-emphasizing the importance of adequately documenting letter contract justifications, timely definitization, and contractor profit risk assessment, in price negotiation memoranda, and emphasizing the use of existing performance-based management systems in contracting offices as a management tool to ensure more effective UCA definitization and use.

The Assistant Secretary of the Navy (Research, Development, and Acquisition) did not provide comments on the draft audit report and is requested to provide comments on the final audit report.

Audit Response. Based on the comments, we combined draft recommendations A.3. and A.4. We believe that contracting organizations should establish performance goals for timely definitization of UCAs and complying with other statutory and regulatory requirements and should report their performance in meeting the goals to the Service Acquisition Executives. We believe such an administrative requirement would improve compliance, not result in a significant administrative burden, and would be consistent with the Government Performance and Results Act. While the issuance of memorandums reemphazising UCA policy requirements is a responsive action, we believe that a requirement for contracting organizations to track and report their performance will have a greater impact in improving compliance. We request the Army and Air Force to provide comments on the revised recommendation and the Navy to provide comments on the recommendations.

Finding B. Unpriced Contractual Action Reporting

The Defense Contract Action Data System (DCADS) does not identify all of the categories of UCAs defined by 10 U.S. C. 2326 and DFARS 217.7401(d). The system identifies letter contracts, but not contract actions that were unpriced orders under basic ordering agreements (BOAs) and unpriced provisioned item orders (PIOs). The reporting system was not designed to distinguish between priced and unpriced orders under BOAs and PIOs. In addition, DCADS contained inaccurate and incomplete data on letter contracts, because DoD did not periodically validate the accuracy of data on undefinitized letter contracts. As result, DoD does not have an effective system for tracking the award and definitization of all UCAs.

DoD Contract Action Data

The DCADS is a management system designed to collect, process, and disseminate information on DoD contract actions. DCADS is the DoD portion of the Federal Procurement Data System that provides information on Government procurements to Congress and other senior Government decision makers.

UCA Data in DCADS. The DCADS contains inaccurate and incomplete data on UCAs that are not useful for oversight of UCAs. The data do not include unpriced orders under BOAs and unpriced PIOs, and include inaccurate and incomplete information for letter contracts. The DCADS was not designed to include data on all UCAs because the data were not required by the Federal Procurement Data System. DoD contracting organizations were to maintain data on all types of UCAs.

DCADS Data Collection. The DCADS would require design changes to collect and categorize unpriced orders under BOAs, unpriced PIOs, and letter contracts as UCAs. Block B13 of the DCADS for "kind of contracting actions" data currently codes unpriced orders under BOAs and unpriced PIOs as though they were priced orders. Unpriced orders under BOAs and unpriced PIOs could be identified in DCADS if codes were established for those contract actions and reported in data block B13.

Contracting Organization Databases. Sixteen of the 17 Military Department contracting organizations visited maintained management information systems on UCAs, primarily to monitor the definitization of UCAs. However, those systems were not effective in establishing accountability for deviation from definitization schedules.

Data on Letter Contracts. The DCADS identified 272 priced contracts, valued at $741 million, recorded as letter contracts from FY 1991 through the second quarter FY 1996. Further, DCADS did not identify the definitization of 47 letter contracts, valued at $2.2 billion, definitized from FY 1991 through the second quarter FY 1996. For the 47 letter contracts the DCADS showed only $183.7 million obligated, although the contracts were definitized for $2.2 billion. As a result, DCADS recorded obligations for letter contracts definitized from FY 1991 through the second quarter FY 1996 were understated by $2 billion. The inaccurate and incomplete records resulted from faulty and incomplete data input and the absence of verification controls. Contracting organizations should establish effective management controls to periodically verify the accuracy of the status of undefinitized letter contracts in the DCADS.

Without accurate and complete data on UCAs, senior DoD managers and other users of the DCADS lack visibility of UCA use. This data may provide useful indicators on the adequacy of acquisition planning, achievement of performance goals, and quality of contract management.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Director of Defense Procurement implement a design change to the Defense Contract Action Data System to collect information on all categories of undefinitized contractual actions as defined by Defense Federal Acquisition Supplement 217.74.

Management Comments. The Director of Defense Procurement nonconcurred with the recommendation, stating that the purpose of DCADS is to track obligations, not UCAs. The Director also stated that DoD contracting organizations use local management systems, not DCADS, to monitor compliance with applicable UCA regulations and believed that changes to DCADS would further complicate the DD Form 350, "Individual Contracting Action Report," generated for the DCADS.

Audit Response. The DCADS collects information on DoD contracts for the Federal Procurement Data System, which is authorized pursuant to the Office of Federal Procurement Policy Act (41 U.S.C. 405(d)(4)(A)). The data collected by the DCADS and Federal Procurement Data System are used to measure and assess the impact of Federal procurement on the economy and for procurement policy purposes. The collection of information on all categories of UCAs would provide visibility on how extensively they are used, by which contracting activities, and for what purposes. We believe that the increased visibility of this long-standing DoD problem area, which has been an interest item to the Congress, could be achieved through a modification that would not complicate completion of the DD Form 350. The local systems for managing UCAs do not provide visibility beyond the contracting organization and often have record

retention requirements only through definitization of the UCA. Therefore, we request that the Director of Defense Procurement reconsider her position and provide additional comments on the recommendation.

B.2. We recommend that the Director of Defense Procurement request contracting organizations to periodically verify the status of undefinitized letter contracts in the Defense Contract Action Data System.

Management Comments. The Director of Defense Procurement partially concurred with the draft report recommendation, stating that the draft report did not disclose enough information to support the recommendation. The Director requested additional detailed data to assess the significance of the problem.

Audit Response. We provided additional information to the Director's staff on the 47 undefinitized letter contracts, valued at $2.2 billion, that were in the sample of UCAs reviewed during the audit. We continue to believe that a requirement to periodically verify the data on undefinitized letter contracts would improve the accuracy and reliability of the DCADS information for oversight and policy-making purposes. Therefore, we request that the Director of Defense Procurement provide additional comments on the recommendation.

Part II - Additional Information

Appendix A. Audit Process

Audit Scope

Universe and Sample Information. We used the DCADS to identify a universe and sample of UCAs for review. As discussed in Finding B, the DCADS identified only letter contracts. We selected a sample of 189 letter contracts, valued at $10.7 billion, issued by 17 Army, Navy, and Air Force contracting organizations. We statistically selected the letter contracts reviewed from a universe of 4,371 letter contract actions, with obligations totaling $19.4 billion. The actions were recorded in the DCADS from FY 1991 through the second quarter of FY 1996. All the letter contracts reviewed were issued by the Military Departments.

Because of the incomplete information on UCAs and errors in the DCADS data, we were unable to project DoD-wide audit results. Therefore, the audit results presented in this report are the analysis of attributes based only on the 189 letter contracts reviewed. The details are summarized in Appendix E.

Use of Computer-Processed Data. We relied on computer-processed data from the DCADS to determine the contracting organizations to visit and to determine audit sample selection. Although we did not perform a formal reliability assessment of the computer-processed data, we determined that DCADS contained incomplete and inaccurate data on UCAs. However, when the sampled data from the system were reviewed in context with official contract records, the opinions, conclusions, and recommendations in this report are valid.

Audit Methodology

Review of Documentation. We reviewed documentation maintained by the Military Department contracting organizations to support letter contracts awarded or definitized from FY 1991 through the second quarter of FY 1996. We reviewed:

- award justification and approval documentation,
- acquisition plans,
- purchase requests,
- appropriation data sheets (obligation documents),
- contract modifications,

- price negotiation memorandums,
- business clearance memorandums,
- Defense Contract Audit Agency audit reports,
- price or cost analysis reports,
- contractors' qualifying proposals,
- reports generated from the DCADS, and
- profit determinations.

Interviews. We interviewed contracting officers and procurement officials on the award and definitization of letter contracts and related management control programs.

Audit period and standards. We performed this economy and efficiency audit from June 1996 through April 1997 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls as were considered necessary.

Contacts During the Audit. We visited or contacted individuals and organizations within DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," dated August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of Army, Navy, and Air Force management control programs over the award and definitization of UCAs, including self-assessments.

Adequacy of Management Controls. We identified material weaknesses as defined by DoD Directive 5010.38. For the 17 Army, Navy, and Air Force contracting organizations visited, 12 did not maintain management control programs that covered the restrictions on the use of UCAs. Further, 16 of the 17 contracting organizations maintained a system to identify and track UCAs, but did not systematically verify the accuracy and completeness of UCA data that they coded and input to the DCADS. In addition, the managers did not maintain documentation to demonstrate that current risk assessment reviews covered the UCA process. If management implements all the report recommendations, then the UCA award, definitization, and reporting processes

would improve, and potential monetary benefits could be realized. However, we could not determine the monetary benefits amount because the amount will depend on the value of future UCA awards. A copy of the report will be provided to the senior official in charge of management controls for the Army, Navy, and Air Force.

Adequacy of Management's Self-Evaluation. Army, Navy, and Air Force officials did not identify the UCA award and negotiation process as a separate assessable unit. Therefore, the Military Departments did not identify or report on the material management control weaknesses identified by the audit.

Appendix B. Summary of Prior Audits and Other Reviews

Inspector General, DoD

Report No. 92-048, "Undefinitized Contractual Actions," February 14, 1992, states that DoD contracting officers did not properly manage UCA actions or adequately control change order modifications. Those conditions resulted in increased cost risks to DoD in the award, obligation, and negotiation of UCAs. The report recommended that action offices establish guidance and procedures to ensure compliance with Defense regulations, establish adequate management controls, and revise DFARS to reflect the statutory requirements. The Assistant Secretary of the Army (Research, Development and Acquisition) and the Deputy Comptroller of DoD concurred with the recommendations. The Assistant Secretary of the Navy (Research, Development and Acquisition) partially concurred, and the Deputy Comptroller of the Defense Logistics Agency nonconcurred with the recommendations. Management issued guidance addressing UCA funding, definitization, and documentation requirements.

Army

U.S. Army Material Command Inspector General, "Nonattribution Report of FY 1995 Procurement Compliance Inspections," March 25, 1996, states that UCAs were not always definitized within prescribed guidelines. The report recommended that management establish adequate procedures and controls for timely contract definitization. The report also recommended that contracting officers use incentives for contractors to promote timely submission of qualifying proposals and to negotiate no or low profit and fees on acquisitions with contractors who were consistently delinquent in submitting qualifying proposals. Management did not comment on the report.

Navy

Office of the Assistant Secretary of the Navy (Research, Development and Acquisition), "Procurement Management Review of Naval Air Systems Command," June 24, 1996, states that even though the management tracking of UCAs was well organized, UCA information in the database was not always accurate and the use of UCAs was increasing. The report recommended that management ensure the data in the UCA database were periodically validated, the backlog of UCAs was reduced, and the use of UCAs was minimized through improved acquisition planning. Management did not respond to the report.

Office of the Assistant Secretary of the Navy (Research, Development and Acquisition), "Procurement Management Review of Naval Sea Systems Command," January 16, 1996, states that ceiling prices were not included in UCAs and the number of UCAs, especially those over 12 months old, was increasing. The report recommended that the Naval Sea Systems Command ensure all UCAs contain a not-to-exceed ceiling price and suggested that management determine the causes of the rising number of UCAs and take corrective actions if necessary. Management did not respond to the report.

Air Force

Air Force Audit Agency, Project No. 92064006, "Followup Audit--Air Force Management of Undefinitized Contractual Actions," May 3, 1993, states that contracting officers were not adequately documenting UCA justifications and were not definitizing UCAs in a timely manner. The report also states that contracting officers were not obtaining approval before exceeding the definitization schedule milestones and were not reducing the not-to-exceed amounts after receipt of the contractor proposals. The report recommended that the Air Force Material Command issue a directive to require documentation of UCA justification rationale. The report also recommended the use of incentives to encourage contractors to submit timely proposals and to obtain approval before exceeding or revising UCA definitization schedules. The report further recommended that UCA not-to-exceed amounts be reduced to the amount of contractor proposals and that excess funds be deobligated. Management generally concurred with the conclusions and issued clarifying guidance emphasizing Air Force Material Command policy to document requirements, to use incentives, and to deobligate funds for UCAs, as appropriate.

Appendix C. Chronology of Statutory Amendments, Regulatory Changes, and Military Department Guidance Memorandums

Amendments to 10 U.S.C. 2326

1989 -- Minor editorial change for clarification.

1991 -- Increased the minimum dollar amount of new contractual actions affected by UCA restrictions to the small purchase threshold.

1994 -- Clarified the limitations on obligating funds when issuing UCAs by changing wording from "expending" to "expending or obligating " no more than 50 percent of the not-to-exceed price before definitization.

Changes to Defense Federal Acquisition Regulation Supplement

May 1995 -- Defense Acquisition Circular 91-7 required that definitization schedules should provide for definitization by the date that obligated funds exceed 50 percent of the not-to-exceed price. Circular 91-7 also clarified the limitations on obligating funds when issuing UCAs by changing wording from "expending" to "obligating" no more than 50 percent of the not-to-exceed price before definitization.

November 1995 -- Defense Acquisition Circular 91-9 required that for each definitization modification, the contracting officer shall include all data required by DFARS 243.171. The required data include the amount of funds obligated by prior actions, the amount of funds obligated by the modification, and the total cumulative amount of the contractual action.

February 1996 -- Defense Acquisition Circular 91-10 increased the minimum dollar amount of new contractual actions affected by UCA restrictions to the small purchase threshold; required the use of Federal Acquisition Regulation 52.216-24, "Limitation of Government Liability," contract clause in all solicitations associated with UCAs, basic ordering agreements, indefinite delivery contracts, and any type of contract providing for the use of UCAs; and required the use of DFARS 252.217-7027, "Contract Definitization," contract clause in all solicitations associated with UCAs, basic ordering agreements, indefinite delivery contracts, and any type of contract providing for the use of UCAs.

Military Departments Supplemental Guidance

Army

June 1992 -- Army Materiel Command Acquisition Letter 90-AMC-4 discussed the findings in Inspector General, DoD, Report Number 92-048, "Final Audit Report On Undefinitized Contractual Actions," February 14, 1992.

April 1993 -- Army Acquisition Letter 93-5 provided guidance on the use of incentives for obtaining contractor qualifying proposals in a more timely manner.

Navy

April 1992 -- Office of the Assistant Secretary of the Navy (Research, Development and Acquisition) memorandum directed the Navy Systems Commands to ensure that UCAs are issued in strict conformance with the guidance and limitations of the DFARS, appropriate internal control procedures must be in place to allow a periodic risk assessment review of UCAs, and the management of UCAs should be a special interest item on all procurement management reviews.

Air Force

December 1989 -- Headquarters, Air Force Logistics Command, directed program managers and contracting officers to include potential adverse program impact in UCA justifications as a requirement for UCA approval.

June 1990 -- The Commander, Air Force Logistics Command, directed program managers to use UCAs only for urgent requirements.

July 1990 -- Air Force Logistics Command directed contracting personnel to:

- ensure that requiring activities provide adequate narrative UCA justifications with specific details of mission impact;
- obtain approval before exceeding the 180-day definitization schedule; and
- use incentives for timely proposal submissions.

The letter also emphasized that:

- the not-to-exceed amount cannot exceed the proposal amount;
- written approval is required to obligate more than 50 percent of the not-to-exceed amount; and
- expenditures cannot exceed 75 percent of the not-to-exceed amount before definitization.

Appendix D. Letter Contracts Issued and Definitized by DoD

Letter Contracts Issued:

Fiscal Year	Army Number	Army Amount	Navy Number	Navy Amount	Air Force Number	Air Force Amount	Defense Agencies Number	Defense Agencies Amount	Total Number	Total Amount
1991	304	$ 721,540,000	101	$ 592,257,000	146	$ 550,096,000	80	$184,279,000	631	$2,048,172,000
1992	203	810,900,921	84	909,134,463	103	370,032,497	54	58,993,362	444	2,149,061,243
1993	168	421,210,746	109	1,281,244,050	120	234,335,548	85	82,792,964	482	2,019,583,308
1994	185	418,370,857	114	465,640,032	122	350,372,717	81	63,760,251	502	1,298,143,857
1995	163	358,747,491	85	797,459,188	146	531,338,035	61	126,239,132	455	1,813,783,846
1996[1]	58	192,341,966	11	201,527,494	31	27,676,821	10	9,940,020	110	431,486,301
Total	**1,081**	**$2,923,111,981**	**504**	**$4,247,262,227**	**668**	**$2,063,851,618**	**371**	**$526,004,729**	**2,624**	**$9,760,230,555**

Letter Contracts Definitized:

Fiscal Year	Army Number	Army Amount	Navy Number	Navy Amount	Air Force Number	Air Force Amount	Defense Agencies Number	Defense Agencies Amount	Total Number	Total Amount
1991	144	$ 229,517,000	23	$324,938,000	176	$ 237,135,000	90	$101,476,000	433	$ 893,066,000
1992	89	206,071,903	23	414,406,112	112	339,017,205	65	144,499,100	289	1,103,994,320
1993	130	246,762,538	17	827,506,380	154	226,563,063	55	167,571,464	356	1,468,403,445
1994	79	342,904,757	26	432,069,445	119	1,570,782,111	124	103,983,432	348	2,449,739,745
1995	92	233,311,318	17	650,071,728	114	1,054,585,382	48	43,756,492	271	1,981,724,920
1996[1]	14	33,959,478	0		26	1,715,507,999	10	7,931,140	50	1,757,398,617
Total	**548**	**$1,292,526,994**	**106**	**$2,648,991,665**	**701**	**$5,143,590,760**	**392**	**$569,217,628**	**1,747**	**$9,654,327,047**

[1]Through the second quarter of FY 1996

Appendix E. Details on Letter Contracts Reviewed

Contracting Organizations	Letter Contracts Reviewed	Total Ceiling Price Amount	Total Amount Definitized	Authorization Adequate Yes	Authorization Adequate No	Definitized Within 180 Days Yes	Definitized Within 180 Days No	Average Days to Definitization	Average Days From Contract Award to Definitization	Price Negotiation Memorandum Considered Incurred Costs Yes	Price Negotiation Memorandum Considered Incurred Costs No	Estimated Excess Profits
Army												
Aviation and Troop Command	20	$ 521,346,205	$ 475,180,422	11	9	11	9	174	231	6	13	$ 795,371
Missile Command	20	540,078,873	1,914,006,242	19	1	12	8	199	280	11	9	1,318,949
Tank-Automotive and Armaments Command	7	397,949,092	388,676,022	7	0	7	0	109	203	2	5	1,579,012
Armament Research, Development, and Engineering Center	7	236,817,442	178,321,769	2	5	4	3	198	199	1	4	254,541
Strategic Defense Command	5	486,468,651	485,103,468	4	1	3	2	153	189	4	1	7,712,280
Total Army	**59**	**$2,182,660,263**	**$3,441,287,923**	**43**	**16**	**37**	**22**	**176**	**237**	**24**	**32**	**$11,660,153**
Navy and Marine Corps												
Naval Air Systems Command	20	$3,435,437,427	$3,954,593,494	8	12	3	17	352	401	5	12	$ 7,159,411
Naval Sea Systems Command	20	748,812,097	671,388,876	11	9	8	12	296	323	4	14	1,612,310
Strategic Systems Programs	7	1,271,274,000	1,596,188,861	6	1	4	3	355	422	1	5	1,048,142
Naval Inventory Control Point-Mechanicsburg	7	17,155,093	14,439,641	2	5	2	5	286	316	2	4	36,151
Air Warfare Center Training Systems Division	7	57,311,009	52,135,949	7	0	1	6	292	339	5	2	0
Marine Corps Logistics Base	7	21,076,160	19,903,407	7	0	3	4	300	342	4	3	5,366
Total Navy and Marine Corps	**68**	**$5,551,065,786**	**$6,308,650,228**	**41**	**27**	**21**	**47**	**317**	**359**	**21**	**40**	**$ 9,861,380**

Contracting Organizations	Letter Contracts Reviewed	Total Ceiling Price Amount	Total Amount Definitized	Authorization Adequate Yes	Authorization Adequate No	Definitized Within 180 Days Yes	Definitized Within 180 Days No	Average Days to Definitization	Average Days from Contract Award to Definitization	Price Negotiation Memorandum Considered Incurred Costs Yes	Price Negotiation Memorandum Considered Incurred Costs No	Estimated Excess Profits
Air Force												
Aeronautical Systems Center	14	$1,804,477,126	$1,154,049,975	7	7	9	5	190	200	6	8	$ 510,294
Electronic Systems Center	7	194,497,796	189,047,067	4	3	5	2	189	237	1	6	584,039
Space and Missile Systems Center	7	438,552,900	538,162,626	4	3	0	7	239	333	3	4	3,449,559
Air Logistics Center, Oklahoma City	7	109,576,619	111,184,701	4	3	5	2	183	217	1	6	627,108
Air Logistics Center, San Antonio	7	139,550,612	145,450,456	3	4	5	2	165	171	4	3	139,762
Air Logistics Center, Warner Robins	20	232,506,616	215,588,276	18	2	17	3	126	169	18	2	0
Total Air Force	**62**	**$2,919,161,669**	**$2,353,483,101**	**40**	**22**	**41**	**21**	**171**	**208**	**33**	**29**	**$5,310,762**
Total Military Services	**189**	**$10,652,887,718**	**$12,103,421,252**	**124**	**65**	**99**	**90**	**225**	**271**	**78**	**101**	**$26,832,295**

Appendix F. Details on Letter Contracts With Justification Deficiencies

Contracting Organizations	Letter Contract Reviewed	Ceiling Price Amount	Amount Definitized	Justification Deficiencies: Adverse Effect Not Documented	Justification Deficiencies: Awards After Milestones	Justification Deficiencies: Awards for Known Acquisition Requirements
Army						
Armament Research, Development, and Engineering Center	DAAA2194C0044	41,451,157	34,926,624			✓
	DAAA2194C0069	800,000	735,000			✓
	DAAE3095C0086	78,775,958	78,354,018			✓
	DAAE3096C0012	25,997,677			✓	
	DAAE3096C0013	24,423,866				✓
Aviation and Troop Command	DAAJ0992C0502	$35,690,763	$ 31,822,263			✓
	DAAJ0993C0410	7,608,248	7,267,885		✓	
	DAAJ0993C0518	2,200,000	1,870,000			✓
	DAAJ0994C0075	50,000,000	42,846,779			✓
	DAAJ0994C0145	45,000,000	37,131,560			✓
	DAAJ0994C0163	7,447,082	5,931,035			✓
	DAAJ0995C0071	51,700,000	48,511,467			✓
	DAAK0194C0119	33,672,400	33,006,234			✓
	DAAK0195C0013	1,270,142	1,245,300			✓
Missile Command	DAAH0192C0023	36,800,000	436,162,000			✓
Strategic Defense Command	DASG6091C0146	145,881,000	145,410,000	✓		
Total Army		**$588,718,293**	**$905,220,165**	**1**	**2**	**13**

Contracting Organizations	Letter Contract Reviewed	Ceiling Price Amount	Amount Definitized	Justification Deficiencies: Adverse Effect Not Documented	Justification Deficiencies: Awards After Milestones	Justification Deficiencies: Awards for Known Acquisition Requirements
Navy						
Naval Air Systems Command	N0001991C0192	$ 40,261,286	$ 44,908,796			✓
	N0001991C0242	8,750,000	8,400,000			✓
	N0001992C0062	2,694,278	1,920,085	✓		
	N0001992C0103	9,040,000	7,575,000			✓
	N0001992C0164	124,500,000	104,000,000	✓		
	N0001993C0006	2,000,000,000	2,650,042,375	✓		
	N0001993C0101	82,000,000	95,500,000		✓	
	N0001993C0145	7,900,000	7,350,000	✓		
	N0001994C0063	12,174,120	11,917,234			✓
	N0001995C0023	6,367,656			✓	
	N0001995C0085	29,000,000			✓	
	N0001995C0236	13,000,000				✓
Naval Inventory Control Point-Mechanicsburg	N0010491CFE15	3,810,030	3,536,817			✓
	N0010493CN003	2,329,242	2,214,288			✓
	N0010494CJ008	5,466,000	5,185,140	✓		
	N0010495CL076	939,544	910,740			✓
	N0010495CL176	1,947,720				✓
Naval Sea Systems Command	N0002490C4066	33,000,000	32,396,754			✓
	N0002493C4127	7,779,679	6,616,017			✓
	N0002493C5206	19,204,500	20,396,322			✓
	N0002493C5316	15,522,158	19,106,928		✓	
	N0002493C5402	6,716,034	6,246,037	✓		
	N0002494C5420	18,900,000	18,900,000			✓
	N0002494C6203	10,577,696	10,073,007	✓		
	N0002495C4067	7,074,556	7,034,724			✓
	N0002495C6533	2,004,000				✓
Strategic Systems Programs	N0003092C0078	6,300,000		✓		
Total Navy		**$2,477,258,499**	**$3,064,230,264**	**8**	**4**	**15**

Contracting Organizations	Letter Contract Reviewed	Ceiling Price Amount	Amount Definitized	Justification Deficiencies: Adverse Effect Not Documented	Justification Deficiencies: Awards After Milestones	Justification Deficiencies: Awards for Known Acquisition Requirements
Air Force						
Aeronautical Systems Center	F3365790C2233	$ 370,520864	$ 330,293,493	✓		
	F3365790C2265	14,709,275	45,710,489	✓		
	F3365791C2419	5,600,000	4,690,000	✓		
	F3365793C0045	49,500,000	49,500,000			✓
	F3365794C0002	8,700,000	7,809,754	✓		
	F3365794C2154	4,976,759	4,590,905	✓		
	F3365795C0067	12,025,296	10,782,287			✓
Air Logistics Center, Oklahoma City	F3460192C0064	1,592,743	1,214,610			✓
	F3460192C0852	4,200,000	4,200,000			✓
	F3460194C0785	1,076,938	1,076,938	✓		
Air Logistics Center, San Antonio	F4160891C1096	7,551,292	6,531,937	✓		
	F4160893C1302	4,600,000	4,600,000			✓
	F4160894C0514	55,340,288	69,504,845			✓
	F4160895C1039	46,186,640	42,018,656			✓
Air Logistics Center, Warner Robins	F0960392C0675	59,000,000	51,000,017	✓		
	F0960395C0063	11,822,294	11,003,273			✓
Electronic Systems Center	F1962891C0037	31,820,626	30,073,093			✓
	F1962891C0038	59,114,382	58,034,943			✓
	F1962892C0049	9,900,000	8,966,964			✓
Space and Missile Systems Center	F0470191C0011	78,000,000	205,917,165	✓		
	F0470192C0005	7,850,000	5,867,762			✓
	F0470194C0031	4,700,000	5,288,240	✓		
Total Air Force		**$ 848,787,397**	**$ 958,675,371**	**10**		**12**
Total Military Services		**$3,914,764,189**	**$4,928,125,800**	**19**	**6**	**40**

Appendix G. Report Distribution

Office of the Secretary of Defense

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  Deputy Under Secretary of Defense (Acquisition Reform)
  Director of Defense Procurement
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Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information and Technology, Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Under Secretary of Defense (Acquisition and Technology) Comments

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000

ACQUISITION AND TECHNOLOGY

July 1, 1997

DP/CPF

MEMORANDUM FOR DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on Undefinitized Contractual Actions (Project No. 6CH-0055)

In response to your request of May 7, 1997, we offer the following comments regarding Recommendations B.1. and B.2. in the subject draft audit report.

DoDIG Recommendation B.1.: We recommend that the Director of Defense Procurement implement a design change to the Defense Contract Action Data System to collect information on all categories of undefinitized contractual actions as defined by Defense Federal Acquisition Supplement 217.74.

DDP Response: Nonconcur. The DoDIG has not presented a compelling reason for making the recommended changes to the Defense Contract Action Data System (DCADS). The purpose of the DCADS is to track obligations, not undefinitized contractual actions (UCAs). DoD contracting organizations utilize local management systems, and not the DCADS, to monitor compliance with the applicable UCA regulations. We are extremely hesitant to further complicate the DD Form 350 in the absence of a clear and convincing need.

DoDIG Recommendation B.2.: We recommend that the Director of Defense Procurement request contracting organizations to periodically verify the status of undefinitized letter contracts in the Defense Contract Action Data System.

DDP Response: Partially concur. We cannot determine from the DoDIG draft audit report alone the causes or extent of the errors alleged to exist in the DCADS data on letter contracts. It is not clear, therefore, that the recommended Director of Defense Procurement request to contracting organizations is the appropriate response to the DoDIG's findings. We suggest instead that the DoDIG provide its detailed audit findings in support of this recommendation to the Director of Defense Procurement for

review, so that the appropriate corrective action, if any, can be determined.

We appreciate the opportunity to review and provide comments on this draft audit report.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Assistant Secretary of the Army (Research, Development, and Acquisition) Comments

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

REPLY TO ATTENTION OF

09 JUL 1997

SARD-PP

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE, 400 ARMY NAVY DRIVE, ARLINGTON, VA 22202-2884

SUBJECT: Audit Report on Undefinitized Contractual Actions (Project No. 6CH-0055)

This responds to your request for comments, subject as above, dated May 7, 1997. Those comments are limited to your **Finding A. Management of Letter Contracts.**

We certainly agree that there is a need for additional emphasis and accountability in managing the use of undefinitized contractual actions. However, the solution to this problem, we believe, lies in more effectively managing and executing **existing** policies, rather than publishing new Pentagon pronouncements. Your report (Part I, "Statutory and Regulatory Requirements" and Part II, "Appendix B, Summary of Prior Audits and Other Reviews"), seems to reinforce this point. Policy guidance is unnecessary and not in keeping with the spirit of acquisition reform, workforce empowerment, and the guiding principles in FAR Part 1.

In response to your finding, we will, however, issue a memorandum to the heads of Army contracting activities by July 30, 1997 which emphasizes the need for Army contract managers at all levels to ensure; 1) that documentation justifying the use of undefinitized contractual actions is sufficient; 2) that these actions are timely definitized consistent with the law and the unique, unusual and compelling circumstances which suggest their use; and 3) that existing policies concerning the negotiation of contractor profits and fees are fully implemented.

This direction will emphasize the necessity of more closely monitoring existing systems for managing undefinitized contractual actions and will encourage Army contracting activities to consider the use of a performance-based management system appropriate to their organization which can be used for tracking these important contract actions. Contracting activities will also be asked to review the execution and management of undefinitized contractual actions during the conduct of their own procurement management reviews.

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We appreciate the opportunity to have our comments concerning your draft findings and recommendations included in your final report.

Edward G. Elgart
Acting Deputy Assistant Secretary of the
Army (Procurement)

Assistant Secretary of the Air Force (Acquisition) Comments

DEPARTMENT OF THE AIR FORCE
WASHINGTON, DC

U.S. AIR FORCE
1947 - 1997

Office Of The Assistant Secretary

14 JUL 1997

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING
OFFICE OF THE INSPECTOR GENERAL
DEPARTMENT OF DEFENSE

FROM: SAF/AQC
1060 Air Force Pentagon
Washington DC 20330-1060

SUBJECT: DoD IG Draft Report, Undefinitized Contractual Actions, 7 May 97
(Project No. 6CH-0055)

This is in reply to your memorandum requesting the Assistant Secretary of the Air Force (Financial Management and Comptroller) to provide Air Force comments on the subject report.

Finding A: Concur that despite improvements since the last audit, full compliance with existing policies is not occurring in the DoD, including the Air Force. However, the finding, in addressing all DoD components, also concludes that failure to adhere to policies on UCAs allowed contractors to receive profits of $26.8 million that were not commensurate with the contractor risk. We do not agree that failure to document an action necessarily means that the action (in this case, risk analysis) was not done in all cases.

Recommendation A: We believe that existing policy and regulatory requirements regarding the management of UCAs are adequate, but need renewed emphasis in light of Finding A. Nearly all of the specific recommendations for policy guidance are already stated in the Defense Federal Acquisition Regulation Supplement (DFARS) and Air Force Federal Acquisition Regulation Supplement (AFFARS).

We believe that additional emphasis on existing policy will serve to address recommendations A.1 and A.2, which essentially require specific detailed justification documents for all letter contracts (A.1), and adherence to milestone dates established for the issuance of letter contracts (A.2). Rather than issuing "policy guidance" as recommended, the Air Force will issue a memorandum re-emphasizing the importance of adequate documentation in justifications, timely definitization, and profit risk assessment and documentation in price negotiation memoranda, by August 15th.

Recommendation A.3 is to establish performance goals for each contracting organization of 90 percent for definitization of letter contracts within the 180 day timeframe and 100 percent for negotiation memoranda documenting the contracting officer's consideration of contractor-incurred cost and reduced risk in establishing profit. We do not

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believe this is appropriate at Air Force level. Compliance with regulation is a responsibility of Air Force MAJCOMs, which should choose enforcement and management mechanisms that are appropriate to their mission and operating environments. Establishment of such performance goals by Air Force-mandated percentages would preclude MAJCOMs from using other methods or from establishing other performance goals which may serve better to manage UCAs within those commands.

Finally, regarding recommendation A.4, which would establish a performance-based management system to track performance in definitizing UCAs, AFFARS 5317.7403 makes the UCA approving authority accountable for controlling the use of UCAs and "ensuring timely definitization." Additionally, AFFARS 5317.7404-90 requires Air Force contracting offices to track UCA status (number, value, and age). For these reasons, we believe a performance based management system is already in place, and only requires increased emphasis as a management tool in ensuring more effective UCA definitization and use.

Although we do not believe it appropriate at the Secretariat level to issue additional policy mandating the specific procedural recommendations from the draft report, it should be noted that Air Force Materiel Command (AFMC) is in the process of finalizing changes to both the AFMC Federal Acquisition Regulation Supplement (AFMCFARS) that does include additional guidance. They are also developing a Price Negotiation Memorandum (PNM) Guide which will address many of the audit recommendations and issues. We entirely support this increased emphasis on UCA management at the MAJCOM level, and will underscore the importance of such management and adherence to existing policy in our memorandum to Air Force contracting activities.

Walker Lee Evey
WALKER LEE EVEY
Associate Deputy Assistant Secretary
(Contracting)
Assistant Secretary (Acquisition)

cc: SAF/AQ
SAF/FMPF

Audit Team Members

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