Report No. DODIG-2014-039

INSPECTOR GENERAL

U.S. Department of Defense

FEBRUARY 12, 2014

Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement

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Results in Brief

Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement

February 12, 2014

Objective

We determined whether DoD officials authorized and administered progress payments in DoD contracts in accordance with selected Federal Acquisition Regulation (FAR) and DoD policies. We examined progress payments for two contracts for the Ground Combat Vehicle (GCV) Technology Development Phase.

Findings

U.S. Army Contracting Command–Warren (ACC–Warren) procurement contracting officers (PCOs) inappropriately permitted unusual contract financing when they modified two GCV development contracts with award values totaling $889.7 million. The contract modifications authorized the contractors to receive additional financing payments, although the contracts already included customary progress payments.

In addition, the PCOs did not follow FAR and DoD guidance when negotiating consideration for the modifications. This occurred because the PCOs misunderstood the proper use and approval of contract financing payments. In one instance the PCO disregarded advice from the administrative contracting officer that the proposed contract actions did not comply with the FAR.

As a result, ACC–Warren PCOs provided two DoD contractors the ability to obtain $110 million more in financing payments than were allowable under the FAR and increasing the effective progress payment rate above the 80 percent FAR threshold without proper approval. Additionally, ACC–Warren PCOs did not request or obtain an adequate amount of consideration. Using DoD guidance, the PCOs should have requested at least an additional $1.3 million in consideration from the contractors.

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Findings Continued

Recommendations

Among other recommendations, the Executive Director, U.S. ACC–Warren, should:

- review and initiate contracting actions to ensure the GCV contracts comply with the FAR contract financing requirements;
- issue internal guidance that prohibits the authorization of contracts containing both progress payments and performance-based payments, and
- consider appropriate action against the PCOs, including requiring additional contracting officer training.

Management Comments

Comments from the Director, Defense Procurement and Acquisition Policy addressed all of the specifics of the recommendation. As a result of the Director's comments, we are referring Recommendation 2 to the Director, Defense Pricing. Since the Director, Defense Procurement and Acquisition Policy coordinated with the Director, Defense Pricing to implement the recommendation we are not requesting additional comments. Comments from the Executive Director, ACC–Warren, were generally responsive. However, comments on Recommendations 1.d and 1.e did not adequately address the recommendations. Because the contract ends in less than six months, we do not request additional comments. Please see the Recommendations Table on the back of this page.

Recommendations Table

Management	No Additional Comments Required
Executive Director, U.S. Army Contracting Command–Warren	1.a, 1.b, 1.c, 1.d, 1.e
Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics	2

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

February 12, 2014

MEMORANDUM FOR DIRECTOR, DEFENSE PROCUREMENT AND ACQUISITION POLICY
DIRECTOR, U.S. ARMY CONTRACTING COMMAND–WARREN

SUBJECT: Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement (Report No. DODIG-2014-039)

We are providing this report for information and use. U.S. Army Contracting Command–Warren contracting personnel provided DoD contractors the ability to obtain $110 million more in financing payments than were allowable under the Federal Acquisition Regulation. This increased the effective progress payment rate above the 80 percent Federal Acquisition Regulation threshold without proper approval.

We considered management comments on a draft of this report when preparing the final report. DoD Directive 7650.3 requires that recommendations be resolved promptly. Comments from the Director, Defense Procurement and Acquisition Policy addressed all of the specifics of the recommendation and we do not require additional comments. At the request of the Director, Defense Procurement and Acquisition Policy, we redirected Recommendation 2 to the Director, Defense Pricing. Since the Director, Defense Procurement and Acquisition Policy coordinated with the Director, Defense Pricing to implement the recommendation we are not requesting additional comments. Comments from the Executive Director, Army Contracting Command–Warren, were generally responsive. However, comments on Recommendations 1.d and 1.e did not adequately address the recommendations. Because the contract ends in less than six months, and comments from the Director, Defense Procurement and Acquisition Policy, state that they will focus on future contracts, we do not request additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-8905.

Amy J. Frontz
Principal Assistant Inspector General
for Auditing

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Introduction

Objective

Our initial announced objective was to determine whether DoD officials authorized and administered progress payments in DoD contracts in accordance with selected Federal Acquisition Regulation (FAR) and DoD policies. During the course of the audit, we found significant issues related to the authorization of contract financing for the Ground Combat Vehicle (GCV) development contracts. As a result, we modified the audit objective to determine whether DoD officials complied with selected FAR and Defense Federal Acquisition Regulation Supplement Subpart (DFARS) clauses for progress payments awarded for the GCV Technology Development Phase. In the future, we may announce additional audits of DoD progress payment topics. See the Appendix for a discussion of our scope and methodology.

Background

The Government can provide contract financing to contractors before it accepts the supplies or services. FAR Part 32, "Contract Financing," prescribes the policies and procedures for providing contract financing payments and provides the rationale for contract financing. Specifically, FAR 32.104, "Providing contract financing," states that prudent contract financing can expedite the performance of essential contracts. FAR 32.104 further states that contracting officers should only provide financing to the extent needed for prompt and efficient performance.

Customary Contract Financing

The FAR allows for several types of customary contract financing. FAR Part 32 defines customary contract financing as financing deemed for routine use by contracting officers, without specific reviews or higher management approvals. Two types of customary contract financing are progress payments based on costs and performance-based payments (PBP).

FAR Subpart 32.5 states that the customary rate for progress payments based on costs for a large business is 80 percent and is applicable to the total costs of performing the contract. FAR Subpart 32.10, "Performance-Based Payments," states that PBPs are the preferred Government financing method and are based on specifically defined events or some measurable criterion of performance. FAR 32.113, "Customary contract financing," specifically states that progress payments or PBPs may be used for contract financing, but not both.

FAR 32.005, "Consideration for contract financing," and the April 27, 2011, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, Defense Procurement and Acquisition Policy (DPAP) guidance, "Cash Flow Tool for Evaluating Alternative Financing Arrangements," require the contracting officer to obtain adequate consideration for a change in contract financing. Specifically, FAR 32.005 requires that contracting officers obtain and document that the Government receive adequate consideration for the additional financing awarded after the initiation of the contract. Further, the DPAP issued additional guidance to the contracting officer on how to calculate consideration.

Unusual Contract Financing

According to FAR 32.114, "Unusual contract financing," a contract financing arrangement that deviates from FAR Part 32 is unusual and shall be authorized only after approval by the head of the agency or as provided for in agency regulations. FAR 32.501-2, "Unusual progress payments," allows unusual progress payment rates if the:

- contract necessitates predelivery expenditures that are large in relation to contract price and the contractor's working capital;
- contractor fully documents an actual need to supplement private financing;
- contractor's request is approved by the head of the contracting activity; and
- unusual progress payment rate approved beyond the customary progress payment rate is the lowest amount possible under the circumstances.

DFARS and Procedures, Guidance, and Information (PGI) 232.501-2, "Unusual progress payments," specifically require the procurement contracting officer (PCO) to obtain approval from the Director of DPAP for unusual progress payment financing. Further, DFARS 232.070, "Responsibilities," states that the DPAP Director is responsible for ensuring uniform administration of DoD contract financing. Therefore, other DoD departments and agencies should submit unusual contract financing proposals to that office for approval.

GCV Developmental Contracts

The Army established the GCV development program to replace the Bradley Fighting Vehicle. On August 18, 2011, the PCO from the U.S. Army Contracting Command–Warren, Michigan site (ACC–Warren) awarded two contracts with a 24-month period of performance for the GCV Technology Development Phase.

Specifically, the PCO awarded contract W56HZV-11-C-C001 to BAE Systems Land and Armaments (BAE) for $449,964,969 and contract W56HZV-11-C-C002 to General Dynamics Land Systems Inc. (GDLS) for $439,713,950. According to an Army sponsored website, the purpose of the GCV Technology Development Phase is to reduce risk of entering into the Engineering and Manufacturing Development Phase while developing an efficient and effective preliminary design. When awarded, both of these contracts included the option for the contractor to request monthly progress payments based on costs.

Review of Internal Controls

DoD Instruction 5010.40, "Managers' Internal Control Program (MICP) Procedures," May 30, 2013, 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 the authorization of progress payment contracts as defined by DoD Instruction 5010.40. Specifically, ACC–Warren officials did not have adequate controls to verify that their contracting personnel authorized contract financing to DoD contractors in accordance with FAR Subpart 32.5 and DFARS Subpart 232.5. We will provide a copy of the final report to the senior official responsible for internal controls in ACC–Warren.

Finding

Improving the Authorization of Contract Financing Payments

ACC–Warren PCOs inappropriately permitted unusual contract financing when they modified two GCV development contracts with award values totaling $889.7 million. The contract modifications authorized the contractors to receive additional financing although the contracts already included customary progress payments. In addition, the PCOs did not follow FAR 32.005 and DPAP guidance when negotiating consideration for the modifications. This occurred because the PCOs misunderstood the proper use and approval of contract financing payments and the procedures for calculating consideration needed to compensate DoD for the increase in contract financing. In one contract, the PCO disregarded advice from the Defense Contract Management Agency administrative contracting officer that the PCO's proposed actions did not comply with the FAR.

As a result, ACC–Warren PCOs provided BAE and GDLS the ability to obtain $110 million more in financing payments than were allowable under the FAR. This increased the effective progress payment rate above the 80 percent FAR threshold without proper approval. Additionally, ACC–Warren PCOs did not request or obtain an adequate amount of consideration as specified in FAR 32.005 and DPAP guidance. Using the DPAP guidance, the PCOs should have requested at least an additional $1.3 million in consideration from the contractors.

Authorization of Performance-Based Payments on the Ground Combat Vehicle Contracts Was Not in Accordance With the Federal Acquisition Regulation

ACC–Warren PCOs inappropriately permitted unusual contract financing when they modified two GCV contracts valued at $889.7 million. The contract modifications authorized the contractors to receive additional financing although the contracts already included customary progress payments at 80 percent of costs. Total progress payments for both contracts were originally estimated to be $640.3 million. FAR 32.113 states customary contract financing includes progress payments or PBPs, but not both. Therefore, when the PCOs established the additional contract financing, they did not use customary contract financing payments and did not comply with FAR 32.113.

By approving both progress payments and the additional financing, these contracts established unusual contract financing arrangements, which require that the PCO obtain advance approval from the DPAP Director in accordance with FAR 32.114 and DFARS PGI 232.501-2.

The ACC–Warren PCOs did not obtain this approval. We discussed the PCO actions with DPAP personnel and they stated that they were unaware that these contract actions had occurred.

In addition, DFARS 232.070, "Responsibilities," states it is DoD policy to attain uniformity with all contract financing to protect DoD from authorizing inappropriate contract financing. Specifically, the DPAP Director is responsible for ensuring contract financing uniformity.

Procurement Contracting Officer Contract Financing Actions

Since August 2011, the PCO for the GCV development program made five significant decisions related to contract financing, of which three were not appropriate. The following chain of events provides a detailed description of the PCO's contract financing decisions, as well as an analysis as to whether the decisions complied with FAR and DFARS criteria:

August 18, 2011, Decision to Authorize Progress Payment Financing Complies with FAR Usual Financing Requirements. The PCO awarded both GCV development program contracts with the progress payment financing clause FAR 52.232-13, "Notice of Progress Payments," authorizing a progress payment financing rate of 80 percent. The PCO stated he determined it was in the Government's best interest to award progress payments because it increased the potential pool of companies that could participate, increased the likelihood of success for a GCV design, and still held back enough funding to motivate the contractor to perform to completion. He also stated the Office of the Under Secretary of Defense (OSD), specifically DPAP, approved this decision through the peer review process.

This decision was permissible under FAR 32.113, which states that the contracting officer may award usual contract financing (which includes progress payments based on costs) in contracts.

April 5, 2012, Memorandum Denying Request for PBPs Was Acceptable Per FAR Requirements. The PCO issued a memorandum to GDLS rejecting its February 28, 2012, request for PBPs, stating that switching to a PBP plan was not in the Government's best interest. Specifically, the PCO stated the "short period of performance for the program and the key deliverables being delivered toward the end of the contract make it difficult to assess appropriate performance based payment amounts against any interim performance activities or deliverables that, individually or collectively, do not represent the value or benefit to the Government that GDLS has proposed." Two of the contractor requested PBP events the PCO rejected were the Systems Functional Review and the Preliminary Design Review.

...the PCO stated the "short period of performance for the program and the key deliverables... make it difficult to assess appropriate performance based payment amounts..."

The PCO's rationale was consistent with FAR Subpart 32.10, which states that the contracting officer should award PBPs only when the performance can be measured by objective and quantifiable methods.

September 6, 2012, Modification Award to GDLS Deviated from FAR Requirements and Peer Review. On June 11, 2012, GDLS requested that the PCO consider a revised plan identified as a "Progress Payment Deliverable Plan." GDLS requested the PCO to consider this revised financing plan, and GDLS stated that it was concerned about its "negative cash flow." As a result, the PCO issued modification P00011 to the GDLS contract that authorized the current customary progress payments be supplemented with additional financing payments for the successful completion of the Systems Functional Review, the Preliminary Design Review, and the end of the period of performance. The Systems Functional Review and Preliminary Design Review were included in the original GDLS contract under the Contract Data Requirements List, which was a "not separately priced" contract line item. The modification stated that its purpose was to establish "a change to the current contract financing arrangement" and also included a payment plan for event completion to incorporate the terms and conditions of the additional financing payments. Documents provided by ACC–Warren contracting personnel referred to the additional financing payments as a "Performance Based Payment scheme."

This modification was not in accordance with FAR 32.113. It also was not in line with the OSD peer review approval to award the GCV contracts, which originally included customary progress payments, and the April 5, 2012, memorandum that stated performance events did not represent value or benefit to the Government. Additionally, the PCO did not follow the FAR 32.104 requirement that the PCO provide financing only to the extent necessary for successful contract completion. Finally, the PCO actions did not adequately follow FAR 32.005 and the April 27, 2011, DPAP guidance to obtain adequate consideration. The following is a detailed summary of the criteria the PCO did not follow when he awarded this modification.

Compliance with FAR 32.113 Requirements Needed. The additional financing authorized by modification P00011 deviated from the FAR 32.113 requirement for usual contract financing. Specifically, FAR 32.113 states that usual contract financing cannot include progress payments and PBPs on the same contract at the same time. All internal Government documentation and the GDLS request clearly identify that this modification would add performance-based events in addition to the usual progress payments, and the modification included wording that the events were additional contract financing.

All internal Government documentation and the GDLS request clearly identify that this modification would add performance-based events in addition to the usual progress payments...

Before approving the contract modification, the PCO needed to comply with the FAR and DFARS requirements for unusual contract financing. Both the FAR and DFARS require contracting officers to obtain approval from DPAP before awarding unusual contract financing. However, the PCO did not obtain the required advanced approval from DPAP.

PCO Changes Subsequent to the OSD Peer Review and April 5, 2012, Memorandum. The PCO significantly changed the contract terms after the OSD peer review process without obtaining additional approval for the modification from OSD. The PCO also changed his decision contained in the April 5, 2012, memorandum in which he initially rejected performance events that were ultimately included in modification P00011 because key deliverables made it difficult to assess appropriate PBP amounts. The PCO did not explain why the Government's contract financing positions expressed in the April 5, 2012, memorandum were no longer valid.

FAR 32.104 Requirements Were Not Followed. The PCO's records did not include support that GDLS demonstrated a need for additional contract financing as required by FAR 32.104. FAR 32.104 states the contracting officer must provide Government financing only to the extent actually needed for prompt and efficient performance. In a June 11, 2012, memorandum, GDLS requested additional contract financing because of concerns with the "negative cash flow" related to the GCV development contract. However, the PCO's records did not include support that the GDLS "negative cash flow" would have impacted the successful completion of the contract or created a financial consequence that was any different from other contracts with customary progress payments—as the Government only pays 80 percent of costs and the contractor must carry the remaining 20 percent of costs until it delivers the contract end items. Specifically, based on the target contract cost amount, the maximum contractor-carried incurred costs at the end of the GDLS contract would be $76.0 million (calculated as 20 percent of the contract target cost of $380.2 million). However, this $76.0 million is not the amount of unfinanced costs the contractor would carry through the entire contract, since the unfinanced contractor costs increase to this amount throughout the life of the contract. For example, at the time of modification P00011, the GDLS progress payment request showed that GDLS had incurred $52.0 million of allowable contract costs and had been paid using the contractual 80 percent. This resulted in GDLS carrying $10.4 million of incurred contract costs. The PCO did not document why GDLS, one of the fiscal year 2012 top five DoD contractors in dollars obligated according to the Federal Procurement Data System website, could not obtain private financing for the 20 percent of unpaid costs. See Table 1 for an example of the amount of carrying costs GDLS could have at contract end and reported having as of September 2012.

Table 1. Analysis of GDLS Unpaid Incurred Costs (millions)

Target Contract Cost	Total Maximum Estimated Incurred Costs Carried Through End of Contract	Eligible Total Progress Payment Costs as of September 5, 2012	Amount of Contractors Unpaid Incurred Costs as of September 5, 2012
$380.2	$76.0	$52.0	$10.4

The PCO did not... obtain and document that the Government received adequate consideration for the additional financing awarded after the initiation of the contract.

Compliance with FAR 32.005 and the April 27, 2011, DPAP Guidance Needed. The PCO did not follow FAR 32.005, which requires that he obtain and document that the Government received adequate consideration for the additional financing awarded after the initiation of the contract. In addition, the PCO did not follow DPAP guidance that requires DoD contracting officials to calculate consideration at no less than a 2 percent interest rate.

In an attempt to obtain adequate consideration, the PCO used a 0.25 percent interest rate, which was far below the minimum 2 percent required by DPAP guidance and did not calculate the amount of time used for carrying (interest) costs appropriately. The PCO stated the Government received additional work concurrent with the change in financing, and the additional work approximated the value of the consideration that he calculated. Internal ACC–Warren memorandums show the additional work included the contractor allowing Government representatives to attend subcontractor program management reviews and the Government received additional status reports and assessments on the GCV program.

December 5, 2012, Modification Award to BAE Deviated from FAR Requirements. The PCO[1] issued modification P00014 on the BAE contract, which included identical language as modification P00011 on the GDLS contract with one exception. Specifically, modification P00014 on the BAE contract did not include the end of the period of performance as a specific performance event. The liquidation events added in modification P00014 were included in the original BAE contract under the Contract Data Requirements List, which was a "not separately priced" contract line item. ACC–Warren documents for this modification also stated the additional financing was a "Performance Based Payment scheme." The PCO awarded this modification despite no indication that contract completion was at risk due to a cash flow concern. Specifically, a September 7, 2012, memorandum from BAE stated the alternate payment terms will positively impact BAE's cash flow.

The PCO awarded this modification despite no indication that contract completion was at risk due to a cash flow concern.

Because this modification was the same as the GDLS modification, it also was not in accordance with FAR 32.113 and was not in line with either the OSD peer review approval to award the GCV contracts, which originally included customary progress payments, or the April 5, 2012, memorandum which stated performance events did not represent value or benefit to the Government. Finally, the PCO did not follow the FAR 32.104 requirement that the PCO only provide financing to the extent necessary for successful contract completion, nor the FAR 32.005 and April 27, 2011, DPAP guidance to obtain adequate consideration.

[1] The original PCO was replaced by a new PCO for both contracts between the August and December modifications.

Table 2 shows the potential amount of unfinanced incurred costs BAE may need to carry through the end of contract, and unfinanced costs that had accumulated at the time of this modification.

Table 2. Analysis of BAE Unpaid Incurred Costs (millions)

Target Contract Cost	Total Maximum Estimated Incurred Costs Carried Through End of Contract	Eligible Total Progress Payment Costs as of November 29, 2012	Amount of Contractors Unpaid Incurred Costs as of November 29, 2012
$420.2	$84.0	$125.3	$25.1

Modification P00021 for the GDLS and BAE Contracts Did Not Comply with the FAR. The PCO issued modification P00021 on May 28, 2013, to GDLS and to BAE on June 7, 2013.[2] The modifications described the financing events identified in previous contract modifications as deliverables in section B of the contracts. The modifications specifically established a narrative statement identifying future payment for completion of events under one contract line item number in the contract. The modifications did not increase the quantity of deliverables identified in section B of the contract, but instead increased the number of PBP events. The additional PBP events added in modification P00021 were included in the original GCV contracts under the Contract Data Requirements List, which were "not separately priced" contract line items. The modifications did not change the original delivery items established in the basic contracts, although they enabled the contractors to obtain DoD funds sooner than if the contracts solely provided progress payments. The PCO issued the modification to BAE subsequent to the audit team notifying her that the contract actions were not compliant with the FAR.

The modifications did not change the original delivery items established in the basic contracts, although they enabled the contractors to obtain DoD funds sooner than if the contracts solely provided progress payments.

The issuance of modification P00021 on the BAE and GDLS contracts continued the noncompliance with FAR 32.113 because the contracts continued to include both progress payments and PBPs. In addition, the modifications were not in compliance with DFARS 204.71, "Uniform Contract Line Item Numbering System," which describes how a contracting officer should create a contract deliverable.

2 The issuances of modification P00021 were separate actions taken on the GDLS and BAE contracts despite having the same contract modification number.

DFARS 204.7106, "Contract modifications," states that if new items are added through a contract modification, the contracting officer is required to create a new line item or identify new items under existing contract line item numbers. However, the PCO did not establish new line items or change the number of deliverables under the one contract line item number. Specifically, the PCO established a narrative in section B of the modifications identifying the PBP events as deliverables but did not assign new line item numbers or increase the number of deliverables under the existing contract line item for each event.

Further, when negotiating modifications P00021 for both contracts, the PCOs did not comply with FAR 32.005 and DPAP guidance when they did not calculate any new consideration that would compensate the Government for a change in contract financing. The additional contract financing shifted the levels of investment that the contractors and ACC–Warren shared on the contracts, so that the contractors had less financial risk and the Government more. The Army and the U.S. Treasury bore the additional costs for these modifications.

U.S. Army Contracting Command–Warren Contracting Personnel Misunderstood or Disregarded Federal Acquisition Regulation Requirements

The PCOs either did not understand the proper use and approval of contract financing, or disregarded key FAR contract financing guidance. Specifically, both PCOs stated they did not consider the additional financing payments to be unusual contract financing payments. Instead, all internal ACC–Warren documents called the extra events PBPs and the modifications referred to the revisions as additional financing, the PCOs stated that they never intended the events to be additional financing. The PCOs stated the events were actually contract deliverables with a discrete price. The PCOs believed they only erred by using the financing and PBP wording choices. Therefore, the PCOs stated they did not obtain the approval for unusual financing required by FAR 32.114 and DFARS PGI 232.501-2 because they did not believe they were providing unusual financing. They could not explain why they used the financing and PBP wording originally, and then later determined it was in error. However, based on the evidence the ACC–Warren PCOs provided, including comparison of the original contract terms to the modification, the modifications on the two contracts most closely exhibited payments for specific performance events, as opposed to distinct deliverables; and therefore, the payments represented PBPs.

In addition, the PCO who calculated the consideration for the modified GDLS financing terms stated he could not find any guidance on how to determine consideration, and therefore stated he used the Treasury bill rate of 0.25 percent to calculate the consideration. The PCO should have calculated the consideration using guidance contained in FAR 32.005 and the DPAP guidance. In the future, ACC–Warren should ensure that all PCOs are aware of the DPAP cash flow tool that requires contracting officers to calculate consideration and verify that they are using the tool as intended when modifying contract financing terms.

During the coordination of modification P00014 to the BAE contract, the PCO disregarded advice from the Defense Contract Management Agency administrative contracting officer that the PCO's proposed actions did not comply with the FAR. The PCO's actions in issuing modification P00014 included adding payment events for the successful completion of the Systems Functional Review and Preliminary Design Review, while continuing customary progress payments. The administrative contracting officer provided the PCO an e-mail, dated November 14, 2012, stating the BAE modification P00014 was not in compliance with the FAR because progress payments and PBPs cannot be used simultaneously on a contract. The PCO ignored the e-mail. In response to questions during the audit, the PCO stated she awarded modification P00014 because GDLS had already received the additional financing and it was only "fair" for BAE to have the same competitive edge. The PCO could not explain how an additional inappropriate modification on the second contract complied with the FAR.

The administrative contracting officer provided the PCO an e-mail, dated November 14, 2012, stating the BAE modification P00014 was not in compliance with the FAR because progress payments and PBPs cannot be used simultaneously on a contract. The PCO ignored the e-mail.

In a follow-up discussion with the ACC–Warren PCO regarding the issuance of modifications P00011 and P00014, she stated the wording associated with the modifications identifying each as a "Performance Based Payment scheme" had been incorrect. She also stated that they were in the process of issuing a modification to identify additional PBP events as contract deliverables, as well as including more performance events. The audit team informed the current PCO and her supervisor that a modification to include more PBP events (and associated payments) and call them deliverables was not in compliance with the FAR. Despite the information from the audit team, ACC–Warren contracting personnel planned to continue modifying the contracts and thereby provide excessive contract financing payments to the contractors without proper authorization. The PCO stated that the contractors requested the modification so they could obtain more cash flow. As discussed above, on May 28 and June 7, 2013, the PCO subsequently signed a modification for the GDLS and BAE contracts, respectively, which stated the PBP events should be considered contract deliverables and also added more PBP events to the contract. However, despite the modification statement, the modifications did not change the actual contract deliverables, contract price, or the contract end dates. In addition, the modifications conflicted with the PCO's decision on April 5, 2012, to reject additional contract financing and the administrative contracting officer's concern that the PCO's proposed actions did not comply with the FAR.

ACC–Warren should issue internal guidance specifically prohibiting the contracting officers from including both progress payments and PBP events in the same contract. They should also provide additional training to contracting officers on what the FAR and DFARS requirements are for progress payments and PBPs, as well as how to adequately calculate consideration. In addition, the Executive Director of ACC–Warren should perform a review of the actions of the PCOs that provided inappropriate financing to contractors for inadequate consideration to the Army, increased costs to the Army and U.S. Treasury for providing the financing; and, as appropriate, initiate corrective measures and actions to hold personnel accountable.

DPAP should perform a review of the contracts to verify that the contract terms were changed so that the contractors receive only the financing needed.

Excessive Contract Financing on the Ground Combat Vehicle Program

Through the series of contract modifications, ACC–Warren PCOs provided BAE and GDLS the ability to obtain an additional $110 million in contract financing prematurely without proper authorization, and thereby increased the effective progress payment rate to more than 80 percent of the contractor's incurred costs allowable under FAR Subpart 32.5. In addition, the PCOs did not request or obtain an adequate amount of consideration as specified in FAR 32.005 and DPAP guidance. Specifically, the PCOs should have requested at least an additional $1.3 million in consideration from the contractors.

Additional Contract Financing Issued Prematurely. When awarding the original GCV development program contracts to BAE and GDLS, ACC–Warren PCOs permitted the contractors to obtain 80 percent of their contract costs through the usual progress payment financing. However, ACC–Warren PCOs subsequently authorized the contractors to receive $110 million of additional financing. FAR 32.104 required that contracting officers must provide Government financing only to the extent actually needed. The FAR also discourages the use of unusual contract financing. Specifically, FAR 32.106, "Order of preference," states that unusual contract financing and advance payments are the least preferred methods of contract financing. Because they did not determine contractor need or obtain the required level of approval, ACC–Warren acted prematurely and without an established factual basis. Additionally, these actions were contrary to FAR 32.114 and DFARS PGI 232.501-2, which require further coordination and approval before additional financing can be approved. Table 3 breaks out the $110 million of additional financing.

...ACC–Warren PCOs subsequently authorized the contractors to receive $110 million of additional financing.

Table 3. Additional Financing Provided by Contract Modification (millions)

Performance Event	BAE Value	GDLS Value	Event Totals
Systems Functional Review	$11.3	$15.9	$27.2
Preliminary Design Review	42.4	40.4	82.8
Total	$53.7	$56.3	$110.0

Effective Progress Payment Rate Was Increased. The additional contract financing increased the effective progress payment rate above the usual rate of 80 percent. FAR 32.104 required that contracting officers must provide Government financing only to the extent actually needed. Because they did not determine contractor need or obtain the required level of approval, ACC–Warren acted prematurely and without an established factual basis. Additionally, these actions were contrary to FAR 32.114 and DFARS PGI 232.501-2, which require further coordination and approval before additional financing can be approved. The FAR also discourages the use of unusual contract financing. Specifically, FAR 32.106, "Order of preference," states that unusual contract financing and advance payments are the least preferred methods of contract financing.

ACC–Warren's additional financing payments to the contract increased the effective progress payment rate. FAR 32.501-1, "Customary progress payment rates," states the customary progress payment rate is 80 percent of total applicable costs of the contract. Once ACC–Warren PCOs authorized the two contractors to receive additional financing in addition to progress payments, they increased the effective progress payment rate above the 80 percent limit. We used information in the progress payment requests associated with the GCV contracts to calculate the effective progress payment rate that ACC–Warren authorized. According to the contractors' incurred costs reported on the progress payment requests (and subsequent to the first PBP disbursement), ACC–Warren contracting personnel provided BAE 87.22 percent and GDLS 99.96 percent of their total costs to date when they paid the first PBP event. These percentages far exceeded the customary progress payment threshold established in FAR 32.501-1. Before the first additional financing payments, the rate for both contracts was the customary progress payment rate of 80 percent.

According to the contractors' incurred costs... ACC–Warren contracting personnel provided BAE 87.22 percent and GDLS 99.96 percent of their total costs to date when they paid the first PBP event.

Because the additional financing was a set dollar value for each event, the effective progress payment percentage fluctuated based on the contractor's current incurred costs. Tables 4 and 5 show that the effective progress payment rates increased above 80 percent after the initial PBP disbursement, and that the effective progress payment rate will decrease in subsequent months.

Table 4. Increased Contract Financing Rate for BAE After Paying the First PBP Event (millions)

Shipment Number after PBP Disbursement	Contractor Cost ($)	80 Percent of Cost ($)	Additional PBP Net Disbursement ($)	Total Costs Paid ($)	Percent of Cost Financed after PBPs
PPRA0012	156.6	125.3	11.3	136.6	87.22*
PPRA0013	172.3	137.8	11.3	149.1	86.57*

*The sum does not total due to rounding.

Table 5. Increased Contract Financing Rate for GDLS After Paying the First PBP Event (millions)

Shipment Number after PBP Disbursement	Contractor Cost ($)	80 Percent of Cost ($)	Additional PBP Net Disbursement ($)	Total Costs Paid ($)	Percent of Cost Financed after PBPs
PPRA0012	79.7	63.8	15.9	79.7	99.96*
PPRA0013	102.9	82.3	15.9	98.2	95.47*

*The sum does not total due to rounding.

Adequate Consideration Was Not Obtained. ACC–Warren PCOs did not request or obtain adequate consideration when modifying contract financing terms after contract award. FAR 32.005 states when modifying contract financing terms after contract award the contractor may provide new consideration by monetary or nonmonetary means provided the value is adequate. ACC–Warren PCOs chose to request nonmonetary consideration using a calculation of the interest cost of the additional financing. However, ACC–Warren PCOs did not receive adequate consideration for the additional contract financing because they used the 0.25 percent Treasury bill rate and not the minimum 2 percent rate established by DPAP guidance. As a result, ACC–Warren PCOs received only $171,476 in consideration in exchange for providing the two contractors an additional $110 million in contract financing. However, using the

...using the DPAP guidance, the PCOs should have negotiated at least $1,463,898 in consideration.

DPAP guidance, the PCOs should have negotiated at least $1,463,898 in consideration. By not calculating the consideration in accordance with the DPAP guidance, the PCOs did not negotiate an additional $1,292,422 in consideration to compensate the Government for providing the additional contract financing to the contractors. For example, the ACC–Warren PCOs could have negotiated a reduced contract price, additional contract performance, or earlier delivery with the benefit valued at $1,292,422. In addition, had the PCOs negotiated a lower contract price, additional funds may have been available to ACC–Warren for other use. Further, ACC–Warren PCOs did not request or obtain consideration when issuing contract modification P00021 on both contracts, which further changed the contract financing terms. Specifically, modifications P00021 allowed the contractors to receive part of the $110 million in additional financing authorized in modification P00011 and P00014 four months sooner. The PCO did not request or obtain consideration for these actions.

...modifications P00021 allowed the contractors to receive part of the $110 million in additional financing... four months sooner.

Since ACC–Warren contracting personnel provided BAE and GDLS additional financing that exceeded established FAR thresholds, did not comply with FAR 32.104, and did not obtain approval through higher authorities, ACC–Warren should take appropriate actions to remedy the improper events that have occurred.

Recommendations, Management Comments, and Our Response

Redirected Recommendation

As a result of management comments, we redirected Recommendation 2 to the Director, Defense Pricing, because the Director, Defense Procurement and Acquisition Policy, stated the Director, Defense Pricing, is responsible for overseeing the complete renovation of DoD's pricing capability.

1. **We recommend that the Executive Director, U.S. Army Contracting Command–Warren:**

   a. **Issue internal guidance that prohibits the authorization of contracts containing both progress payments and PBPs as contract financing to the contractor unless unusual contract financing procedures are followed.**

b. **Provide training to contracting officials on what the FAR and DFARS requirements are for contract financing (including progress payments and PBPs), consideration for contract financing, and the establishment of contract deliverables.**

c. **Perform a review of the actions of the PCOs that provided inappropriate financing to contractors for inadequate consideration to the Army, increased costs to the Army and U.S. Treasury for providing the financing; and, as appropriate, initiate corrective measures and actions to hold personnel accountable.**

Army Contracting Command–Warren Comments

The Executive Director, Army Contracting Command–Warren agreed with Recommendations 1.a, 1.b, and 1.c and stated that his office will complete the recommendations by June 30, 2014. Specifically, ACC–Warren personnel will issue additional guidance advising its contracting officials that awarding contracts containing both progress payments and PBPs as contract financing are prohibited, unless they follow the unusual contract financing procedures. In addition, the Executive Director will institute mandatory face-to-face training for all contracting officers and contract specialists on FAR and DFARS requirements and how they relate to contract financing, consideration for contract financing, and the establishment of contract deliverables. Further, the Executive Director stated that his office will initiate a review of the contracting official's decisions related to inadequate consideration to the Army, increased costs to the Army and U.S. Treasury, and as appropriate, initiate administrative actions.

Our Response

Comments from the Executive Director, Army Contracting Command–Warren on Recommendations 1.a, 1.b, and 1.c addressed all of the specifics of the recommendations, and no additional comments are required. Although the Director agreed with the recommendations, the Director continued to identify the payments as deliverables and stated they are not additional contract financing payments, as evidenced by his response to Recommendation 1.d. For these reasons, there is a risk that the actions taken by the Director in response to Recommendations 1.a, 1.b, and 1.c will not prevent future contracting actions from containing both progress payments and PBPs. Therefore, we will make a specific request that the DoD IG Quality Assurance and Report Follow-up Division monitor the ACC–Warren actions to ensure that ACC–Warren fully adhered to FAR and DFARS contract financing guidance.

d. **Direct contracting officials to review the financing terms and payment histories on contracts W56HZV-11-C-C001 and W56HZV-11-C-C002 and (1) initiate appropriate contracting actions to eliminate additional financing payments authorized in addition to progress payments; (2) recover the amount of any financing payments to date that exceed the total contract cost percentage limitations authorized by the contract financing provisions that are proper for each contract; and (3) remove improper contract deliverables that exist to permit a means for additional contract financing.**

e. **Monitor and ensure contracting officials comply fully with the direction given in Recommendation 1.d.**

Army Contracting Command–Warren Comments

The Executive Director, Army Contracting Command–Warren partially agreed with Recommendation 1.d and stated that no additional action is required on this recommendation. He did agree with Recommendation 1.e and stated that ACC–Warren will comply as indicated in his response to Recommendation 1.d. Specifically, the Executive Director stated that ACC–Warren performed a review on the contract actions and determined that the contract terms do not permit unusual contract financing or allow the contractors to receive PBPs in addition to progress payments. He further stated that the GCV contracts were problematic from the time of contract award because they did not include deliverables as liquidation points. The Executive Director stated that without including deliverables in the contracts the contractors would not be able to receive any type of payment for contract execution and the Government could not liquidate the progress payments until contract completion. He further stated that despite a former ACC–Warren PCO's memorandum, which suggested that PBPs in addition to progress payments were issued to the contactor, this did not occur. The Executive Director stated that ACC–Warren personnel will ensure that financing other than progress payments is not authorized on the GCV contracts.

The Executive Director stated that the contractors have not received progress payments that exceed the total contract cost percentage limitations authorized by the proper contract pricing provisions and that no improper deliverables were added to the contracts as a means of providing additional contract financing. He stated that both contractors have received payment for all deliverables included on the GCV contracts except for the data deliverables and the reports resulting from the preliminary design review. He further stated that the work performed between

December 2013 and the end of the period of performance, June 4, 2014, will consist of unpriced change orders issued in contract modification P00019. He also stated that the contractors would be unwilling to sign a bi-lateral contract modification removing payment for the preliminary design review and if ACC–Warren issued a unilateral contract modification the contractor would be able to file an actionable claim for monies owed. The Executive Director stated that contract modifications P00011, P00014, and P00021 are legally binding and therefore, it would be difficult for ACC–Warren to defend against any claim filed by the contractors. He included attachments of the contract deliverables and contractor payment detail to support his statements.

Our Response

Comments from the Executive Director, Army Contracting Command–Warren on Recommendations 1.d and 1.e did not adequately address the recommendations because he disagreed with the conclusions reached in the audit. Specifically, the Executive Director concluded that ACC–Warren did not permit unusual contract financing by awarding PBPs in addition to awarding progress payments. We disagree with the conclusions reached by the Executive Director with respect to contract financing, which are not supported by the documentation provided. For example, modification P00011 and P00014 authorized current customary progress payments be supplemented with additional financing payments for the successful completion of events, to include a payment plan for event completion. In addition, ACC–Warren personnel also issued internal memorandums that classified the additional financing payments established in the contract modifications as a "Performance Based Payment scheme." As discussed in the body of the report, while the wording in modification P00021 stated the additional events were deliverables in the GCV contracts, the number of proper deliverables did not change from the original contracts, which remained only one per contract. The additional events added in the contract modifications were included in the original GCV contracts under the Contract Data Requirements List. This contract line item is a "not separately priced" deliverable. In addition, DFARS 204.7106, "Contract modifications," states that if new items are added through a contract modification, the contracting officer is required to create a new line item or identify new items under existing contract line item numbers. However, the PCO did not establish new line items or change the number of deliverables under the one contract line item number. Therefore, the additional events included in the modifications were in effect PBPs.

In addition, the Executive Director's comments that the contactor would not receive payment unless ACC–Warren added more liquidation events is not accurate. Specifically, over the life of the contract, the two contractors were authorized to request up to $640.3 million in progress payments, assuming the contractor incurred the necessary costs. Prior to the contractors receiving payment for the additional liquidation events, BAE and GDLS had actually received $191.6 million of the $640.3 million in authorized progress payments. Therefore, the additional liquidation events were not needed for the contractors to receive payment.

Based on the fact that the contract is less than six months from completion, and DPAP comments state that they will focus on future contracts, we no longer request that ACC–Warren take any action on W56HZV-11-C-C001 and W56HZV-11-C-C002.

2. **We recommend that the Director, Defense Pricing, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, perform a review of contracts W56HZV-11-C-C001 and W56HZV-11-C-C002 to ensure that the contracting officer's actions in response to Recommendation 1.d comply with FAR requirements for customary contract financing.**

DPAP Comments

The Director, Defense Procurement and Acquisition Policy agreed with the recommendation and requested the action be re-assigned from his office to the Director, Defense Pricing. He stated the Director, Defense Pricing in concert with the Defense Contract Management Agency will review the GCV contractors; specifically, modifications P00011, P00014, and P00021. He also stated that the Director, Defense Pricing, intends to work with the Army to review future modifications to ensure compliance with FAR and DFARS requirements and limit the contractors to financing needed.

Our Response

Comments from the Director, Defense Procurement and Acquisition Policy addressed all of the specifics of the recommendation, and no additional comments are required. Since the Director, Defense Procurement and Acquisition Policy coordinated with the Director, Defense Pricing to implement the recommendation we are not requesting additional comments.

Appendix

Scope and Methodology

We conducted this performance audit from March 2013 through October 2013 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 finding and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

To accomplish our audit objective, we interviewed contracting personnel from the Army, Defense Contract Management Agency, and OSD. We obtained and reviewed FAR Part 32, "Contract Financing," FAR Subpart 32.5, "Progress Payments Based on Costs," and DFARS Subpart 232.5, "Progress Payments Based on Costs," as they relate to contract financing and progress payments.

Specifically, we interviewed PCOs, contract specialists, administrative contracting officers, and a legal advisor for the ACC–Warren contracts and obtained documentation such as contract solicitations, contract modifications, coordination between the Army and the contractor, and payment data from the Mechanization of Contract Administration Services system to determine how the progress payments were negotiated and paid. We also reviewed progress payment requests submitted through Wide Area Workflow to determine the amounts requested to be paid. In addition, we obtained and reviewed the contracts and supporting documentation to determine whether they were in compliance with FAR Subpart 32.5 and DFARS Subpart 232.5.

Sample Selection. We obtained the Defense Finance and Accounting Service–Columbus Mechanization of Contract Administration Services records, which contained $33.3 billion in obligated progress payment contracts through March 30, 2013. We nonstatistically selected five progress payment contracts at ACC–Warren for our sample. Specifically, we selected the five contracts based on high-dollar and small business contracts. We added an additional ACC–Warren contract to our sample when our audit site visit revealed a systemic issue with the GCV contract. The contracts were awarded from FY 2011 through FY 2012 and were solely funded by DoD. Due to a change in audit priorities, we modified the scope of the audit and reported on issues identified with the two GCV contracts. The other four contracts in our sample did not contain the issues identified in the GCV contracts, and therefore, our report did not address these contracts.

Use of Computer-Processed Data

We used computer-processed data from the Mechanization of Contract Administration Services system to determine our universe and select our sample contracts. We also used computer-processed data from the Wide Area Workflow system. We assessed the reliability of the data by ensuring that the computer-processed data from our sample selection was supported by independent documentation. From this testing, we determined that the data were sufficiently reliable for the purposes of our analysis.

Use of Technical Assistance

We did not use technical assistance in conducting this audit.

Prior Coverage

During the last 5 years, the Naval Audit Service issued one report discussing the authorization and administration of progress payments. Naval Audit Service reports are not available over the Internet.

Navy

Report No. N2011-0057, "Incentive and Progress Payments at Naval Supply Systems Command," September 7, 2011

Management Comments

Defense Procurement and Acquisition Policy

Final Report Reference

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

ACQUISITION, TECHNOLOGY, AND LOGISTICS

MEMORANDUM FOR PROGRAM DIRECTOR, FINANCIAL MANAGEMENT AND REPORTING, OFFICE OF THE INSPECTOR GENERAL

THROUGH: DIRECTOR, ACQUISITION RESOURCES AND ANALYSIS

SUBJECT: Response to DoD Inspector General Draft Report on Authorization of DoD Progress Payments for Ground Combat Vehicle Contracts Needs Improvement (Project No. D2013-D000DD-0135.000)

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

Recommendation 2:
We recommend that the Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics, perform a review of contracts W56HZV-11-C-C001 and W56HZV-11-C-C002 to ensure that the contracting officer's actions in response to recommendation 1.a. comply with FAR requirements for customary contract financing.

Response:
Concur with the DOD IG findings, but recommend that the action be re-assigned from the Director, Defense Procurement and Acquisition Policy to the Director Defense Pricing. The Director, Defense Pricing in concert with the DCMA shall review the contracts W56HZV-11-C-C001 and W56HZV-11-C-C002 in the Electronic Document Access, specifically modifications P00011, P00014, and P00021. The Director intends to work with the Army to review future modifications to confirm that the contract terms are changed to conform to the FAR and DFARS and ensure that future modifications limit the contractors to the financing needed. We believe that it is most useful to focus on ongoing and future contract actions.

Redirected Recommendation 2

DoD established, as a direct report, the position of the Director of Defense Pricing to oversee the complete revamping of the Department's pricing capability. He has established a centralized pricing capability within DCMA to assist contracting offices improve pricing strategies and execute payments.

Please contact [redacted] if additional information is required.

Richard Ginman
Director, Defense Procurement
and Acquisition Policy

U.S. Army Contracting Command–Warren

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
4400 MARTIN ROAD
REDSTONE ARSENAL, AL 35898-5000

REPLY TO
ATTENTION OF:

AMCIR

DEC 4 2013

MEMORANDUM FOR Department of Defense Inspector General (DoDIG), ATTN: DoD Payments and Accounting Operations (Ms. Lorin T. Venable), 4800 Mark Center Drive, Alexandria, VA 22350-1500

SUBJECT: Command Comments on DoDIG Draft Report, Audit of the Authorization and Administration of DoD Progress Payment Contracts, Project D2013DD-0135

1. The US Army Materiel Command (AMC) has reviewed the subject draft report and the response from the US Army Contracting Command (ACC). AMC endorses the enclosed ACC response.

2. ACC also provided supporting documentation for actions taken to date.

3. The AMC point of contact is [redacted] or email: [redacted].

Encl

JOHN B. NERGER
Executive Deputy to the
Commanding General

U.S. Army Contracting Command–Warren (cont'd)

DEPARTMENT OF THE ARMY
U.S. ARMY CONTRACTING COMMAND
3334A WELLS ROAD
REDSTONE ARSENAL, AL 35898-5000

REPLY TO
ATTENTION OF:

AMSCC-IR

2 0 NOV 2013

MEMORANDUM FOR Mr. Randy Flisak, Director, Internal Review and Audit Compliance Office, Headquarters, U.S. Army Materiel Command, 4400 Martin Road, Redstone Arsenal, AL 35898-5340

SUBJECT: Inspector General, Department of Defense Draft Report: Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement, (D1329) (1245)

1. Memorandum and Draft Report, Inspector General, Department of Defense, 30 October 2013, subject: Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement (Project No. D2013-D000DD-0135.000).

2. The Headquarters, Army Contracting Command (ACC) concurs with the enclosed ACC-Warren response to the referenced report.

3. The ACC point of contact is [redacted], Evaluator, Internal Review and Audit Compliance Office, [redacted], or email: [redacted].

Michael R Hutchison

MICHAEL R. HUTCHISON
Deputy to the Commanding General

Encl

U.S. Army Contracting Command–Warren (cont'd)

DEPARTMENT OF THE ARMY
UNITED STATES ARMY CONTRACTING COMMAND - WARREN
6501 EAST 11 MILE ROAD
WARREN, MICHIGAN 48397-5000

REPLY TO

CCTA-A

14 November 2013

MEMORANDUM THRU Director, Internal Review and Audit Compliance Office, U.S. Army Contracting Command, 3334F Wells Road, Redstone Arsenal, AL 35898-5000.

FOR Commanding General, U.S. Army Contracting Command, 3334A Wells Road, Redstone Arsenal, AL 35898-5000

SUBJECT: Draft Report: Authorization of DoD Progress Payments For Ground Combat Vehicle Contracts Needs Improvement (Project No: D2013-D000DD-135.000)

1. Reference memorandum, DODIG, dated 30 October 2013, subject as above.

2. We have reviewed subject DODIG Draft Report and our specific comments are contained in the enclosed reply.

3. Point of contact for this reply is [redacted], Internal Review Office, AMSTA-CSC-J, [redacted] or email: [redacted]

Encls

Kenneth Bousquet
Acting Executive Director

ENCL

U.S. Army Contracting Command–Warren (cont'd)

Recommendation 1: We recommend that the Acting Executive Director, Army Contracting Command-Warren:

a. Issue internal guidance that prohibits the authorization of contracts containing both progress payments and PBPs as contract financing to the contractor unless unusual contract financing procedures are followed.

Acting Executive Director, Army Contracting Command – Warren (ACC-WRN)
Comments: Concur

The Acting Executive Director,(ACC-WRN), will incorporate additional guidance within our existing contracting clause guide advising contracting officials the prohibition of awarding contracts containing both progress payments and Performance Based Payments (PBPs) as contract financing to the contractor unless unusual contract financing procedures are followed. ACC-WRN employees are notified of all changes to the clause guide via a monthly email sent by the Contract Advisory Team.

Target completion: 30 Jun 2014

b. Provide training to contracting officials on what the FAR and DFARS requirements are for contract financing (including progress payments and PBPs), consideration for contract financing, and the establishment of contract deliverables.

Acting Executive Director, Army Contracting Command – Warren (ACC-WRN)
Comments: Concur

The Acting Executive Director, (ACC-WRN) will institute mandatory face-to-face training for all Contract Specialists and Contracting Officers on FAR and DFARS requirements and how they relate to contract financing (including progress payments and PBPs), consideration for contract financing, and the establishment of contract deliverables.

Target completion: 30 Jun 2014

c. Perform a review of the actions of the PCOs that provided inappropriate financing to contractors for inadequate consideration to the Army, increased costs to the Army and U.S. Treasury for providing the financing, and as appropriate, initiate corrective measures and actions to hold personnel accountable.

Acting Executive Director, Army Contracting Command – Warren (ACC-WRN)
Comments: Concur

U.S. Army Contracting Command–Warren (cont'd)

The Acting Executive Director, (ACC-WRN) will initiate a review of the contracting official's decision relating to inadequate consideration to the Army, increased costs to the Army and U.S.Treasury for providing the financing and, as appropriate, initiate any administrative actions warranted by the review.

Target completion: 30 June 2014

d. Direct contracting officials to review the financing terms and payment histories on contracts W56HZV-11-C-C001 and W56HZV-11-C-C002 and (1) initiate appropriate contracting actions to eliminate payments authorized in addition to progress payments; (2) recover the amount of any financing payments to date that exceed the total contract cost percentage limitations authorized by the contract financing provisions that are proper for each contract; and (3) remove improper contract deliverables that exist to permit a means for additional contract financing.

Acting Executive Director, Army Contracting Command – Warren (ACC-WRN)
Comments: Partially Concur

The Acting Executive Director, U.S Army Contracting Command-Warren (ACCWRN) directed contracting officials to review the financing terms and payment histories on Contracts W56HZV-11-C-C001 (BAE) and W56HZV-11-C-C002 (GDLS). As a result of this review, no further action is required regarding payments or deliverables on the GCV contracts. ACC-WRN contracting officials determined that the GCV contracts do not authorize any financing payments in addition to progress payments. During the review of Modification P00011 to Contract W56HZV-11-C-C002 and Modification P00014 to Contract W56HZV-11-C-C001, along with all supporting documentation, it was determined that verbiage utilized in the execution of these modifications gave the appearance that both progress payments and performance based payments would be permitted on the GCV contracts. The purpose of Modifications P00011 and P00014 was to include deliverables on both contracts; it was not ACC-WRN's intention to include performance-based payments as an additional form of contract financing. Modification P00021 to both contracts was issued to reform the contracts and correct issues with the verbiage utilized in Modifications P00011 and P00014.

(1) The review performed by ACC-WRN determined that the deliverables added to these contracts do not permit unusual contract financing or allow the contractors to receive performance-based payments in addition to the customary progress payments already authorized. Financing, other than progress payments, has not been provided under the GCV contracts.

U.S. Army Contracting Command–Warren (cont'd)

A fixed price contract, which includes a progress payment provision, does not function properly or effectively unless it calls out deliverables for which the contractor can receive payment and provides the Government with progress payment liquidation points. Without the inclusion of deliverables, the contractor does not receive payment for contract execution until the end of the contract period of performance and the contractor is forced to rely on progress payments, which are essentially interest free loans provided to the contractor by the Government. In addition, without the inclusion of deliverables on the contract, liquidation of the progress payments also does not occur until the end of the contract period of performance.

The GCV contracts were problematic in that they did not include deliverables as liquidation points at initial contract award. This resulted in the contractors being unable to receive any type of payment for contract execution and the Government being unable to liquidate the progress payments that the contractors received until contract completion. Modifications P00011 and P00014 were issued to remedy the problem by adding deliverables/liquidation points to the GCV contracts. While these modifications provided a means for the contractors to be paid for delivery of contract requirements, they also enabled the Government to liquidate the funds it advanced to the contractors in the form of progress payments.

Modification P00011 to Contract W56HZV-11-C-C002, Modification P00014 to Contract W56HZV-11-C-C001 and Modifications P00021 to both contracts did not permit unusual contract financing or allow the contractors to receive performance-based payments in addition to the customary progress payments already being received by both contractors. The modifications added specific deliverables to the contracts and allowed the contractors to invoice for those deliverables upon acceptance by ACC-WRN. Attached to this document is the GCV Contract Deliverable list, which details the hardware and data, associated with each contract deliverable added via modification. These deliverables have allowed the GCV Product Management Office (PMO) to knowledgeably assess the status of each contractor's GCV design. Of particular note, the delivery of the certain assets on contracts W56HZV-11-C-C001, W56HZV-11-C-C002 and all associated test reports and data have allowed the PMO to make an early assessment of the contractor's designs in relation to vehicle survivability. They have provided the PMO an opportunity to identify weak spots in both design and fabrication so that corrections could be made earlier in the program, resulting in a reduction in program risk. The PMO has informed ACC-WRN that specific assets will be utilized by other Army organizations to test future technologies and conduct additional research that is not related to the GCV program. In addition, the deliverables have provided the PMO with insight into each contractor's execution of and progress on the GCV Technology Development phase that it would not have had otherwise.

U.S. Army Contracting Command–Warren (cont'd)

The addition of deliverables on a contract after award is not considered to be a form of contract financing, unusual or otherwise. FAR 32.001(2) states that contract financing payments do not include invoice payments and that invoice payments do not include financing payments. The FAR defines an invoice payment as "a Government disbursement of monies to a contractor under a contract or other authorization for supplies or services accepted by the Government."

A former PCO's memorandum stating that P00011 "would continue Progress Payments at the current rate of 80% of incurred costs, but provide a delta amount to 90% of total price (per event) for successful completion of the Systems Functional Review (SFR) and the Program Design Review" was deemed by the IG to be evidence that the Modification permitted progress payments and performance-based payments on the same contract, which is forbidden by FAR 32.1003. Despite the memorandum's statement suggesting that performance-based payments were issued to the contractor, this did not occur. As explained above in the first paragraph, the deliverables were items accepted by the Government. They are not performance-based payments, and the Government did not pay the contractors more than the 80% rate set forth in FAR 32.501-1. Financing, other than progress payments, has not been provided under the GCV contracts. This is further explained below in paragraph (2).

FAR 32.1001(b) states, "performance-based payments are contract financing payments that are not payment for accepted items." The payments that the contractors are to receive for the deliverables added via contract modification are for items accepted by the Government and are not contract finance payments. ACC-WRN will ensure that financing other than progress payments is not authorized for these contracts.

(2) To date, the contractors have not received progress payments that exceed the total contract cost percentage limitations authorized by the contract financing provisions that are proper for each contract. If at any time during execution of the GCV contracts, ACC-WRN determines that the total value of the progress payments made to the contractors exceed the total contract cost percentage limitations, it will recover any excess payments. The contractors have been requesting and receiving financing in the form of progress payments in accordance with FAR 52.232-16. These payments have been made monthly at the rate of 80 percent of the contractor's total costs incurred under these contracts. As of November 2013, progress payments in the amount of $305,247,313 or 50.1% of the contract value have been dispersed against Contract W56HZV-11-C-C001; progress payments in the amount of $276,890,391 or 44.7% of the contract value have been dispersed against Contract W56HZV-11-C-C002. In accordance with FAR

U.S. Army Contracting Command–Warren (cont'd)

32.501-3 (a) (3) the total contract value is calculated by adding the target price with the not-to-exceed amount of unpriced modifications. BAE's total contract value is $609,242,375 (target price of $449,742,375 plus the not-to-exceed ceiling price for Modification P00019 of $159,500,000) and GDLS' contract value is $620,019,425 (target price of $439,619,449 plus the not-to-exceed ceiling price for Modification P00019 of $180,399,976).

Progress payment requests submitted by the contractors have been processed by DCMA in accordance with Appendix G of the DCMA Contract Financing Progress Payment Application Guide ("the Guide"). The Guide states that progress payments shall be determined by multiplying the progress payment rate times the eligible incurred costs, which are based on actual costs. Spreadsheets and payment information prepared by DCMA, which are provided as attachments to this document detail the amount of contract financing that each contractor has received through progress payments. As indicated in the table below, neither contractor has received more than the 80% authorized by the contracting provisions included in each contract.

GCV Contracts Value & Payment Summary

	BAE W56HZV-11-C-C001	GDLS W56HZV-11-C-C002
Contract Value		
Base Contract Value	$449,742,375	$439,619,449
UCO Value Prior to Definitization	$159,500,000	$180,399,976
Total Contract Value Prior to Definitization	$609,242,375	$ 620,019,425
Contract Payments		
Progress Payments (PP) on Base Contract	$301,583,363	$276,890,391
PP on UCO	$3,663,950	-

U.S. Army Contracting Command–Warren (cont'd)

Total Payments Made	**$305,247,313**	**$276,890,391**
Total Liquidated	**$232,549,956**	**$199,330,810**
Unrecouped PP Unliquidated Obligation	**$72,697,357**	**$77,559,581**
Percentage		
Percentage of Base Contract Paid	**67.1%**	**63.0%**
Percentage of UCO Portion Paid	**2.3%**	**0.0%**
Total Percentage of Contract Paid	**50.1%**	**44.7%**

*** Based on DCMA Payment Data Provided 06-November-2013**

(3) No improper deliverables were added to the contracts as a means of providing additional contract financing. The contractors have received payment for all deliverables included on the GCV contracts except for the data deliverables and reports resulting from the Preliminary Design Review (PDR). Both contractors have conducted their PDRs and are in the process of preparing and submitting the deliverables that are required for them to invoice and receive payment for the PDR deliverable. This payment will be the final payment received by the contractors for requirements included on the base contract. The contract effort from December 2013 until the end of the contract period of performance, 4 June 2014, will consist of activities associated with Unpriced Change Orders issued for both contracts via Modification P00019. The GCV contractors would be unwilling to sign a bi-lateral modification, which removes payment for the PDR deliverable from their contracts. If ACC-WRN were to unilaterally change the terms of the contract by removing this final deliverable from the contracts, the contractors would be able to file an actionable claim for monies owed to them since this payment for accepted deliverables represents the final deliverable payment for the base contract. Modifications P00011, P00014, and P00021 were legally binding; therefore it is unlikely that ACC-WRN would be able to defend against any claim filed by the contractors.

U.S. Army Contracting Command–Warren (cont'd)

Target completion date: No further action required.

e. Monitor and ensure contracting officials comply fully with the direction given in recommendation 1.d.

Acting Executive Director, Army Contracting Command – Warren (ACC-WRN)
Comments: Concur

Command Response: The Acting Executive Director, Army Contracting Command-Warren (ACC-WRN) concurs and will comply as indicated in 1.d.

Target completion: 30 Jun 2014

Acronyms and Abbreviations

ACC–Warren	U.S. Army Contracting Command–Warren
BAE	BAE Systems Land and Armaments
DFARS	Defense Federal Acquisition Regulation Supplement
DPAP	Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics
FAR	Federal Acquisition Regulation
GCV	Ground Combat Vehicle
GDLS	General Dynamics Land Systems Inc.
OSD	Office of the Under Secretary of Defense
PBP	Performance-Based Payment
PCO	Procurement Contracting Officer
PGI	Procedures, Guidance, and Information

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