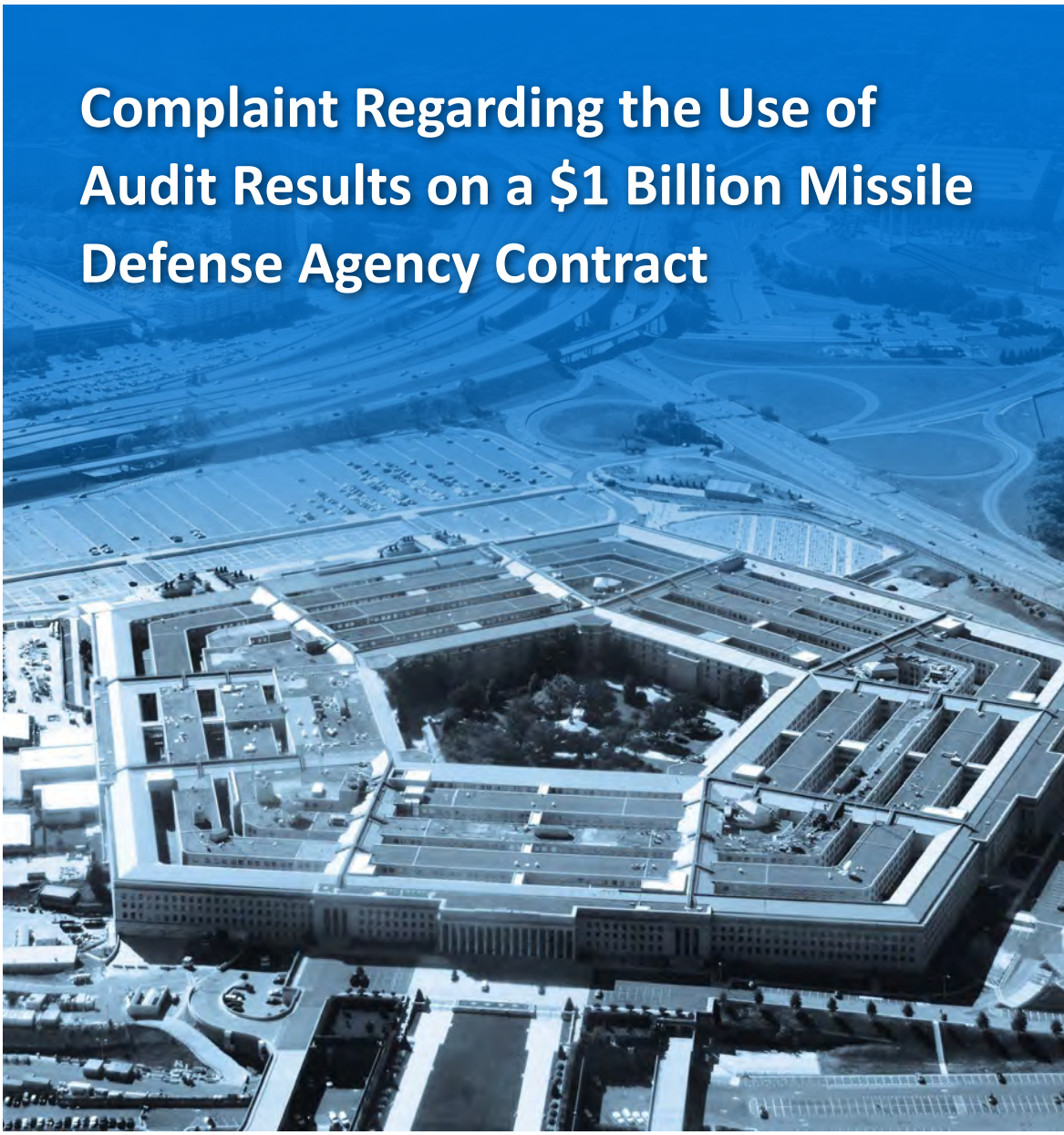
Report No. DODIG-2014-115

Inspector General

U.S. Department of Defense

SEPTEMBER 12, 2014

Complaint Regarding the Use of Audit Results on a $1 Billion Missile Defense Agency Contract



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Results in Brief

Complaint Regarding the Use of Audit Results on a $1 Billion Missile Defense Agency Contract

September 12, 2014

Objective

We conducted this evaluation to determine the validity of a complaint alleging that Missile Defense Agency (MDA) negotiated a $1 billion contract without considering the audit results from Defense Contract Audit Agency (DCAA).

Findings

We substantiated the complaint. MDA contracting officials negotiated the $1 billion contract without considering the results of an audit performed by DCAA. If MDA officials had considered the DCAA results, the Government could have negotiated a significantly lower contract value and thereby saved millions of dollars in reduced contract fees. Although MDA officials had requested a DCAA audit, they did not wait for the results and withheld key information from DCAA, such as MDA's decision to reduce the contract scope by one-half. MDA officials also did not consider the impact of the contractor's business system deficiencies, as Federal Acquisition Regulation 15.406-3(a)(4), "Documenting the Negotiation," requires.

In addition, MDA officials failed to withhold 15 percent (approximately $73 million) from the contractor's billings under the same contract as Federal Acquisition Regulation Clause 52.216-26, "Payments of Allowable Costs Before Definitization," requires. Withholdings were necessary to protect the Government's interests until the Government and the contractor negotiated final contract terms.

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Findings Continued

Although MDA negotiated the contract covered in this report 4 years ago, MDA should improve its use of DCAA audit results and implement required withholds in order to help protect the Government's interests and ensure contracting officers negotiate a fair and reasonable price on future contracts.

Management Actions

During our evaluation, MDA developed procedures to improve its communications with DCAA and to ensure appropriate consideration of DCAA audit results. Among them, MDA now requires coordination with DCAA throughout the acquisition process and consider DCAA audit results. If properly implemented, the new procedures should help to ensure the appropriate consideration of DCAA findings. We will monitor the effectiveness of the procedures.

Recommendations

We recommend that MDA:

- Consider appropriate corrective and/or administrative action for not maintaining effective communications with DCAA or using the audit results in establishing a fair and reasonable contract price. (see recommendation A on page 9)
- Provide training to contracting officials on the requirement to withhold a percentage of payments until the Government and the contractor reach agreement on the contract terms.

Management Comments and Our Response

In a July 15, 2014, response, the Executive Director of Missile Defense Agency disagreed with certain aspects of the reported findings, but agreed with the reported recommendations. The Executive Director's disagreement did not result in changes to our findings. Comments on the recommendations were fully responsive.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director, Missile Defense Agency		A and B

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

September 12, 2014

MEMORANDUM FOR DIRECTOR, MISSILE DEFENSE AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Complaint Regarding the Use of Audit Results on a $1 Billion Missile Defense Agency Contract (Report No. DODIG-2014-115)

We are providing this draft report for your information and use. We substantiated the allegation that contracting officials at the Missile Defense Agency (MDA) negotiated a $1 billion contract without considering audit results from Defense Contract Audit Agency. MDA could have negotiated a significantly lower contract value and saved the Government millions of dollars in reduced fees if it had considered the audit results.

We considered management comments on a draft of this report when preparing the final report. Comments from MDA on the recommendations conformed to the requirements of DoD Directive 7650.3; therefore, we do not require additional comments.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604 8877, or e-mail address carolyn.davis@dodig.mil.

Carolyn R. Davis
Assistant Inspector General
Audit Policy and Oversight

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Introduction

Objective

We conducted this evaluation to determine the validity of a complaint alleging that Missile Defense Agency (MDA) contracting officials negotiated a $1 billion contract prior to receiving the results of a Defense Contract Audit Agency (DCAA) audit report on the contractor's proposal. According to the complaint, DCAA had questioned several millions of dollars in proposed costs, which MDA failed to consider in its negotiations with the contractor.

See Appendix A for details of our scope and methodology. See Appendix B for the sequence of events.

Background

Missile Defense Agency

MDA is a research, development, and acquisition agency within DoD. Its workforce includes government civilians, military service members, and contractor personnel in multiple locations across the United States. MDA works closely with combatant commanders to ensure that a robust ballistic missile defense system is available to protect the United States and its allies against evolving threats of a hostile missile attack.

Defense Contract Audit Agency

In accordance with DoD Directive 5105.36, "Defense Contract Audit Agency (DCAA)," DCAA performs contract audits and provides accounting and financial advisory services in connection with the negotiation, administration, and settlement of contracts and subcontracts. DCAA operates under the authority, direction, and control of the Under Secretary of Defense (Comptroller). DCAA maintains a Headquarters, Field Detachment (for audits involving DoD classified programs), and five regions: Central, Eastern, Mid-Atlantic, Northeastern, and Western. Each region operates several field audit offices (FAOs).

As part of its mission, DCAA audits forward pricing proposals submitted by DoD contractors and subcontractors in connection with the award of Government contracts. DCAA uses criteria in the Federal Acquisition Regulation (FAR), Defense Federal Acquisition Regulation Supplement (DFARS), and Cost Accounting Standards to determine the allowability, allocability, and reasonableness of proposed costs.

Finding A

DCAA Audit Findings Were Not Considered

We substantiated the complaint that MDA contracting officials did not consider the DCAA audit results associated with a $1 billion contract. DCAA had preliminarily questioned $224 million of the contractor's proposed costs, but the MDA negotiation memorandum did not address the DCAA questioned costs. MDA could have achieved significant savings for the Government if it had considered the DCAA audit results. In addition, MDA officials did not consider the impact of significant business system deficiencies on the contractor's proposal, as FAR 15.406-3(a)(4), "Documenting the Negotiation," requires. Furthermore, MDA officials failed to inform DCAA of key events that had significant impact on the conduct of the audit and the negotiations with the contractor. During our evaluation, MDA management implemented several procedures, which should improve communications with DCAA and the use of DCAA audit results.

Audit Request

On December 17, 2009, at MDA's request, a DCAA FAO in Huntsville, Alabama, began auditing a $2.07 billion cost-plus-fixed/award-fee[1] proposal submitted by a DoD contractor for the Ground-Based Midcourse Defense (GMD) Core Completion Contract Extension (hereafter referred to as the GMD proposal.). The FAO initially agreed to provide the audit results on February 15, 2010. On February 11, 2010, DCAA requested an extension to March 15, 2010, in order to incorporate the audit results of major subcontracts and the impact of a Defense Contract Management Agency technical evaluation. MDA granted the requested extension. In January 2010, prior to granting the extension, MDA significantly reduced the scope of work to be performed under the contract by approximately one-half due to funding limitations. On February 1, 2010, MDA and the contractor commenced negotiations. On February 27, 2010, prior to receiving the DCAA audit results, MDA and the contractor reached an agreement on the contract costs. On March 3, 2010, they also reached an agreement on the associated award fees. Table 1 shows a summary of the proposed and negotiated costs and fees.

[1] A cost-plus-award-fee contract provides for the reimbursement of allowable costs incurred plus a fee consisting of (a) a fixed amount that is established at inception of the contract and (b) an award amount, which can vary based upon a judgmental evaluation by the Government as to performance. Both the fixed fee and the maximum award fee are based on a percentage of the estimated costs negotiated under the contract.

Table 1. Proposed and Negotiated Costs and Fees

Cost Element	Originally Proposed	Negotiated Agreement (After Scope Reduction)
Estimated Costs	$1,808,230,972	$967,424,804
Fixed/Award Fees	264,678,915	121,266,261
Total Costs and Fees	**$2,072,909,887**	**$1,088,691,065**

On March 10, 2010, MDA signed a contract that incorporated the negotiated costs and fees of $1,088,691,065. MDA did not notify DCAA of either the scope reduction or the negotiated agreement. On March 16, 2010, shortly after learning from a subcontractor that the contract had been negotiated, DCAA discontinued its audit of the GMD proposal.

MDA Did Not Consider the DCAA Preliminary Audit Results

DFARS Procedures, Guidance, and Instruction (PGI) 215.404-2(a)(i)(c) states contracting officers should consider requesting an audit of cost-type proposals that exceed $10 million. Although MDA asked DCAA to perform an audit of the GMD proposal, MDA did not wait for or use the DCAA audit results in negotiating the GMD contract.

When MDA completed the negotiations and DCAA discontinued its audit, DCAA tentatively questioned $224 million[2] of the $1.8 billion in costs originally proposed by the contractor.

The MDA negotiation memorandum prepared by the contracting officer does not reflect that MDA had considered the preliminary audit results in negotiating the GMD contract. Although DCAA had not formally reported its final results as of February 27, 2010 (the date of agreement on cost), MDA contracting officials could have obtained the preliminary results from DCAA and considered them prior to concluding negotiations. Therefore, we substantiated the allegation that MDA negotiated the GMD contract without considering the DCAA preliminary audit results.

[2] DCAA questioned costs are based on the contractor's $2.1 billion original proposal.

If MDA had considered the audit results, the Government could have negotiated a significantly lower contract value and therefore, saved millions of dollars in reduced fees. For example, if MDA had used the DCAA recommended labor and indirect rates for various cost elements (such as direct labor and general and administrative costs) in negotiating the GMD contract, we estimate that negotiated costs would be approximately $10 million lower and the Government could have saved $1.1 million in reduced fees. Notwithstanding the DCAA recommended rates, MDA also did not use the contractor's latest proposed rates, which would have reduced the GMD contract value by an estimated $3 million and the fees by about $377,000. Instead, the contracting officer used higher, outdated contractor rates to establish the estimated costs and fees to be paid by the Government.

The negotiation memorandum does not explain why MDA officials did not consider the preliminary DCAA results. MDA contracting officials stated that they did not wait for the DCAA audit report or consider the preliminary audit results because they had to adhere to a March 10, 2010, deadline, which the Director, MDA, had established. We interviewed the now former Director, MDA,[3] who served as Director when the GMD negotiations took place. Although the former Director commented that he did not recall establishing a March 10, 2010, deadline, MDA contracting officials were operating under their belief that contract negotiations had to be completed by March 10, 2010, and the deadline could not be extended. The former Director, however, indicated that if he had established such a deadline, he would have extended it if MDA contracting officials had expressed to him a compelling reason to do so. We found no evidence in the contract file suggesting that the contracting officials had requested the former Director to extend the deadline.

The former Director also stated he was not aware that MDA contracting officials negotiated the contract without receiving a DCAA audit of the contractor's proposal. He said it was MDA's typical practice to obtain a DCAA audit prior to negotiating a major contract such as the GMD effort.

MDA contracting officials pointed out that they had incorporated a "reopener" clause into the contract, allowing MDA to negotiate an adjustment to the contract price once DCAA issued its final audit results. Although the officials did incorporate a reopener clause, which they exercised in July 2011, the MDA contract file does not contain any evidence suggesting that they considered the preliminary DCAA audit results when they exercised the reopener clause.

[3] The former Director referred to in this report served as Director, MDA, from November 2008 to November 2012.

Negotiations Were Not Impacted for Business System Deficiencies

FAR 15.406-3(a)(4) requires that contracting officers document the current status of the contractor's business systems to the extent they affected and were considered in the negotiation. In the negotiation memorandum for the GMD contract, the contracting officer stated that all of the contractor's business systems were adequate according to DCAA audit reports issued in 2007 and 2008. However, this statement did not accurately reflect the status of the contractor's business systems as of February 2010, when GMD negotiations commenced. DCAA issued two reports in 2009 that identified significant deficiencies associated with two of the contractor's business systems, the estimating and accounting systems.

Estimating System

On February 6, 2009, DCAA reported deficiencies with the contractor's estimating system, such as the lack of adequate supporting documentation for pricing proposals and the failure to conduct a subcontract cost price analysis. These estimating system deficiencies could have directly affected the proposal submitted by the contractor for the GMD effort. However, we found no evidence in the negotiation memorandum or the contract file that the MDA contracting officer was aware of, or considered, these deficiencies in negotiating the GMD contract.

Accounting System

On March 24, 2009, DCAA reported that the contractor's accounting system was inadequate due to deficiencies, which resulted in unallowable costs being recorded, billed, and forecasted on Government contracts. In addition, DCAA found that the contractor failed to timely disclose to the Government unallowable costs it had discovered. As with the estimating system deficiencies, the MDA contracting officer did not document her consideration of the accounting system deficiencies on the GMD contract, as FAR 15.406-3(a)(4) requires.

The contracting officer's failure to consider the effect of the accounting and estimating deficiencies put the Government at significant risk, such as the risk of accepting a flawed proposal and paying significant unallowable costs under the $1 billion GMD contract.

Failure to Inform DCAA of Several Significant Events

MDA contracting officials failed to effectively communicate with DCAA regarding several significant events that directly impacted the DCAA audit. The following sections address instances of MDA contracting officials not effectively communicating with DCAA.

MDA Did Not Inform DCAA of the Major Scope Reduction

In January 2010, while DCAA was performing its audit at MDA's request, MDA contracting officials elected to reduce the scope of the contract by approximately one-half of the originally planned effort. The scope reduction could have significantly impacted the DCAA audit in terms of planning the audit steps, conducting testing, and reporting the audit results. Although DCAA continued to audit the contractor's outdated proposal through the beginning of March 2010, MDA never advised DCAA of the scope reduction or its impact on the proposal. MDA's failure to advise DCAA of the scope reduction was inconsistent with FAR 15.404-2(c)(3), requiring contracting officials to provide auditors with copies of any updated information that significantly affect the audit.

DCAA Was Not Aware of the Negotiation Deadline

MDA contracting officials did not advise DCAA of the March 10, 2010, deadline for negotiating the GMD contract that contracting officials claim the Director, MDA, had established. MDA officials knew of the deadline, yet they did not advise DCAA of it. If DCAA had known about the deadline, DCAA could have committed additional resources, made adjustments to the audit scope, or taken other appropriate measures to accommodate the deadline.

MDA Granted a Due Date Extension Beyond the Deadline

On February 11, 2010, MDA granted DCAA a due date extension to March 15, 2010, knowing that the audit would be received after the March 10, 2010, deadline for negotiating the contract.

Normally, the contracting officer should receive a DCAA audit report well before the *start* of negotiations, to help establish the Government's prenegotiation "objective." FAR 15.406-1(a), "Prenegotiation Objectives," states that the contracting officer should consider all pertinent information in formulating the objective, including the audit report. MDA documented its prenegotiation objective for the GMD contract in a January 21, 2010, prenegotiation memorandum. In the memorandum, MDA indicated that DCAA was not able to complete their audit in time to meet the

MDA acquisition schedule. On February 11, 2010 (20 days after executing the January 21, 2010 prenegotiation memorandum), MDA granted the March 15, 2010, due date extension even though MDA officials knew it would exceed the March 10, 2010, deadline and the officials had commenced negotiations with the contractor. MDA officials were operating under the March 10, 2010, deadline before they granted the extension to DCAA.

After MDA granted the extension, DCAA continued to expend scarce audit resources and believed the audit would serve a useful purpose in negotiating a fair and reasonable contract price. Although MDA had incorporated a reopener clause, the clause could only be used to adjust the negotiated value of three subcontracts (the majority of the negotiated contract value could not be adjusted, including the prime contract). As previously discussed, we found no evidence suggesting that MDA had exercised the reopener clause to incorporate the DCAA results.

MDA Did Not Advise DCAA of the Negotiation Status

DCAA audits forward pricing proposals in order to determine the allowability, allocability, and reasonableness of the contractor's proposed costs. On February 27, 2010, while DCAA was still conducting its audit, MDA reached an agreement with the contractor on the negotiated GMD costs. However, MDA did not inform DCAA of the negotiated agreement. DCAA first learned about the agreement on March 4, 2010, during a discussion with one of the GMD subcontractors. The DCAA FAO manager responsible for auditing the prime contractor's proposed costs contacted the MDA contracting officer who confirmed that a negotiated agreement had been reached. On March 10, 2010, after learning that the reopener clause did not cover the prime contractor's proposed costs, the DCAA FAO manager discontinued the audit. If the MDA contracting officer had timely informed DCAA of the negotiated settlement, DCAA could have discontinued the audit sooner and saved scarce audit resources. DCAA expended 1,191 hours[4] auditing the contractor's GMD proposal. This effort was wasted in large part because MDA did not appropriately communicate with DCAA during the GMD acquisition effort.

FAR 15.404-2(a)(3), "Information to Support Proposal Analysis," encourages contracting officials to communicate with appropriate field pricing experts (such as DCAA) during the acquisition process, including negotiations. MDA officials did not comply with the spirit or intent of FAR 15.404-2(a)(3) when they repeatedly failed to disclose key events to DCAA.

[4] We estimate the value of the 1,119 audit hours to be approximately $129,486, based on DCAA's FY 2010 reimbursable billing rate of $108.72 per hour.

Management Actions

During our evaluation, we communicated our concerns to MDA officials. In response to our concerns, MDA incorporated several substantial changes to its procedures to help improve MDA's coordination with DCAA and its use of DCAA audit results. Examples of the changed procedures include the requirement that MDA contracting officials:

- coordinate with and keep DCAA apprised throughout the acquisition process;
- make every effort to resolve issues disclosed in DCAA audit reports and document significant disagreements with DCAA audit findings;
- analyze DCAA-questioned costs in establishing the negotiation objective;
- invite DCAA to participate in the negotiation process, advise DCAA of their resolution of the audit findings, and provide a copy of the negotiation memorandum to DCAA;
- document the rationale for all cost elements that make up the MDA negotiation objective; and
- obtain the current status of the contractor's business systems and document their consideration in the negotiation;

If effectively implemented, the revised procedures should improve MDA's audit coordination and use of DCAA audit results. We will monitor the effectiveness of the revised procedures.

However, MDA should also consider appropriate corrective and/or administrative action for the contracting officials who were responsible for working with DCAA and properly using the audit results because MDA withheld key acquisition information from DCAA and failed to consider the DCAA audit results.

Management Comments on the Finding and Our Response

MDA provided several comments to Finding A referred to as "MDA Technical Comments on Draft Report". Details of the MDA comments can be found in the Management Comments section of this report.

Our Response

MDA management comments did not result in changes to Finding A.

Recommendation, Management Comments, and Our Response

Recommendation A

We recommend that the Director, Missile Defense Agency, consider appropriate corrective and/or administrative action for those contracting officials who did not maintain effective communications with the Defense Contract Audit Agency or use the audit results in establishing a fair and reasonable contract price.

Executive Director, Missile Defense Agency Comments

The Executive Director, Missile Defense Agency, agreed and stated that appropriate corrective action was taken to ensure all acquisition personnel have the proper training, education, and certification. MDA made significant improvements in certifications (including the underlying training, education, and experience requirements) that will prevent breakdowns in communications and appropriate actions.

Our Response

The management comments to the recommendation are responsive and no additional comments are required.

Finding B

MDA Failed to Withhold Costs Billed Under Letter Contracts

MDA contracting officials failed to withhold 15 percent (approximately $73 million) from contractor costs billed under a letter contract[5] and the subsequent modification, as FAR 52.216-26 Clause, "Payments of Allowable Costs Before Definitization," requires. Contracting officials had an obligation to enforce the FAR clause and protect the Government's interests until MDA reached an agreement on contract terms with the contractor.

[5] FAR Clause 16.603-1, "Description," defines a letter contract as a written preliminary contractual instrument that authorizes the contractor to immediately begin manufacturing supplies and performing services. A letter contract may be used when (1) the Government's interests demand that the contractor be given a binding commitment that work can start immediately and (2) negotiating a definitive contract is not possible in a sufficient time to meet the requirement.

Letter Contracts

In some instances, Government contracting officials will issue a letter contract before the Government and the contractor reach a definitive agreement on price, terms, or specifications. Although a letter contract allows the contractor to begin work immediately, they carry associated risks to the Government. In recognition of those risks, FAR clause 52.216-26 imposes specific limits on reimbursement of allowable costs incurred by a contractor before contract definitization. For example, payments to a contractor under a cost-reimbursement contract must not exceed 85 percent of allowable costs. In other words, the remaining 15 percent of allowable costs billed by a contractor for cost-reimbursement contracts must be withheld until the Government and contractor definitize the contract terms. The clause serves to protect the Government's interests and incentivize contractors to submit adequate and timely cost proposals in order to facilitate timely contract definitization.

MDA issued a letter contract and a subsequent contract modification for the GMD effort. MDA executed the letter contract on December 30, 2008, covering the inception of the effort through July 2009 (also referred to as "Bridge 1"). MDA definitized the Bridge 1 letter contract on June 23, 2009. On August 9, 2009, MDA officials issued a contract modification covering August 2009 through January 2010 (also referred to as "Bridge 2"), which was later extended to March 10, 2010. MDA definitized Bridge 2 on March 10, 2010. Both the letter contract and the subsequent modification were subject to FAR clause 52.216-26.

MDA Did Not Comply with a Key Contract Clause

In violation of FAR clause 52.216-26, MDA reimbursed 100 percent of the contractor's billed costs prior to definitizing the letter contract (Bridge 1) and the subsequent modification (Bridge 2). We estimate that MDA should have withheld $73 million from the Bridges 1 and 2 billings combined. This estimate is based on the cumulative billings under the GMD contract of approximately $487 million as of March 10, 2010, multiplied by 15 percent.

When we asked MDA contracting officials why they did not withhold billings as FAR clause 52.216-26 requires, MDA officials responded in writing as follows:

> None of the applicable FAR/DFARS clauses in the contract required withholds, nor did the PCO determine such was in the best interest of the Government.

However, the letter contract (Bridge 1) and subsequent modification (Bridge 2) were subject to FAR clause 52.216-26. Therefore, the contracting officer was required to withhold 15 percent of allowable billed costs. The clause does not allow for discretion in implementing the withholding.

The MDA contracting officials' lack of knowledge concerning a key contract clause demonstrates the need for immediate corrective action. The Director, MDA, should consider appropriate corrective actions for the contracting officials' failure to withhold 15 percent from the contractor's billings. Further, the Director should make improvements to MDA procedures to help ensure that MDA contracting officers implement withholdings when they are required by FAR clause 52.216-26.

Management Actions

During our evaluation, MDA developed new procedures to require that contracting officers document any special terms and conditions in the negotiation memorandum, such as special payment procedures and contract clauses.

We examineded the newly developed procedures. Although they represent an improvement, they are insufficient to provide reasonable assurance that contracting officers will implement the withholding requirements for letter contracts addressed in FAR clause 52.216-26. The new procedures should address the specific withholding requirements under FAR clause 52.216-26. In addition, MDA should provide training on the requirements to its contracting officials.

Management Comments on the Finding and Our Response

MDA provided comments to Finding B referred to as "MDA Technical Comments on Draft Report". Details of the MDA comments can be found in the Management Comments section of this report.

Our Response

MDA management comments did not result in changes to Finding B.

Recommendation, Management Comments, and Our Response

Recommendations B

We recommend that the Director, Missile Defense Agency:

1. **Provide training to contracting officials on the specific requirements of Federal Acquisition Regulation clause 52.216-26 to ensure enforcement of required withholdings on letter contracts before definitization.**

Executive Director, Missile Defense Agency Comments

The Executive Director stated that MDA has significantly improved its overall training for contracting and acquisition personnel. The training addresses all areas of the Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and best practices.

Our Response

The management comments to the recommendation are responsive and no additional comments are required.

2. **Consider appropriate corrective and/or administrative action for contracting officials that were responsible for withholding funds before contract definitization in accordance with Federal Acquisition Regulation clause 52.216-26 and the terms of the contract.**

Executive Director, Missile Defense Agency Comments

The Executive Director agreed and stated that MDA has significantly reduced the number of letter contracts and reduced the time required to definitize those contracts.

Our Response

The management comments to the recommendation are responsive and no additional comments are required.

Appendix A

Scope and Methodology

We performed this evaluation in accordance with the Council of Inspectors General for Integrity and Efficiency Quality Standards for Inspection and Evaluation. As part of our evaluation of the complaint, we:

- interviewed MDA contracting officials involved with negotiating the GMD contract;
- interviewed DCAA employees involved in auditing the proposal for the GMD contract;
- interviewed Defense Contract Management Agency employees who conducted a technical evaluation of the proposal for the GMD contract;
- examined MDA, DCAA, and Defense Contract Management Agency records and communications associated with the negotiation of the GMD contract; and
- determined if the actions of MDA contracting officials complied with applicable law, acquisition regulations, and DoD policy.

We recorded and obtained a transcription of the interviews we conducted. We conducted the evaluation from June 2011 through August 2013. Completion of the evaluation was delayed to work on other priority projects.

Use of Computer-Processed Data

We did not rely on computer-processed data as part of our evaluation.

Prior Coverage

During the last 5 years, the DoD IG has issued one report involving MDA acquisition practices. The Government Accountability Office has also issued two reports on MDA acquisition matters.

GAO

Report No. GAO-10-311, "Missile Defense Transition Provides Opportunity to Strengthen Acquisition Approach," February 25, 2010

Report No. GAO-13-432, "Opportunity to Refocus on Strengthening Acquisition Management," April 26, 2013

DoD IG

Report No. DODIG-2014-011, "Missile Defense Agency and Defense Microelectronics Activity Use of Cost-Reimbursement Contracts," November 22, 2013

Appendix B

Chronology of Events

Dates	Description of Event
November 4, 2009	MDA requested that DCAA Huntsville FAO audit the $2.1 billion proposal after receiving it from the contractor.
December 16, 2009	DCAA initiated its audit after receiving the GMD proposal from prime contractor. Three other DCAA offices began auditing proposed major subcontract costs.
December 29, 2009	DCAA and MDA agreed to a February 15, 2010, audit report due date.
January 2010 (exact day unknown)	Due to funding limitations, MDA elected to reduce the scope of the contract effect by nearly one-half.
January 21, 2010	MDA prepared a pre-negotiation memorandum to establish a target negotiated price of $1.188 billion. The memorandum notes that the audit results will be received too late to be considered in negotiations.
February 1, 2010	MDA began negotiations with the contractor. MDA presented the contractor with its first offer.
February 11, 2010	The DCAA FAO in Huntsville coordinated with the contracting officer to extend the due date to March 15, 2010, in order to incorporate technical evaluation and assist audits.
February 24, 2010	The DCAA FAO in Huntsville informed MDA that the assist audits would not be complete until April. MDA requested DCAA to incorporate the assist audits prior to issuing their report.
February 27, 2010	The contractor and MDA reached an agreement on the contract costs, excluding fee, in the amount of $967.4 million. MDA did not advise DCAA of the agreement.
March 4, 2010	Another DCAA FAO performing an assist audit of one of the proposed subcontracts informed the DCAA FAO in Huntsville that negotiations with the contractor were completed.
March 4, 2010	The MDA contracting officer acknowledged to DCAA that MDA had negotiated the costs on the GMD contract, but that the contract would include a reopener clause to consider the audit results.
March 10, 2010	MDA and the contractor signed the GMD contract worth $1.1 billion.
March 12, 2010	DCAA issued its audit report on the prime contractor's forward pricing rates.
March 16, 2010	DCAA received an e-mail from the MDA Director of Contracts confirming that the contract had already been signed.
April 29, 2010	DCAA issued a memorandum of its preliminary audit results to MDA.
June 2, 2010	DCAA sent an e-mail to MDA asking whether MDA intended to pursue its preliminary audit findings.
August through December 2012	MDA made significant policy changes based on concerns expressed by DoD OIG during the evaluation.

Management Comments

Transmittal Letter on GMD Core Completion

DEPARTMENT OF DEFENSE
MISSILE DEFENSE AGENCY
5700 18TH STREET
FORT BELVOIR, VIRGINIA 22060-5573

JUL 14 2014

Ms. Carolyn Davis
Department of Defense Inspector General
Audit Policy and Oversight
4800 Mark Center Drive
Alexandria, Virginia 22350-1500

Dear Ms. Davis:

Thank you for the opportunity to review the DoD IG Draft Report on, "Complaint Regarding the Use of Audit Results on a $1 Billion Missile Defense Agency (MDA) Contract" dated May 2014 (Project No. D2011-DIP0AI-0231.000).

Missile Defense Agency has long recognized the importance of best practices regarding contracting actions and has, since the initiation of the subject audit, taken significant steps to implement best practices, primarily those embodied in the Under Secretary's (Acquisition, Technology, and Logistics) Better Buying Power initiative. We, therefore, concur with all three of your recommendations. After careful consideration of all three of your recommendations, we have determined that no administrative actions are required. The primary rationale— although the contract actions under review were completed prior to MDA implementation of some of the tenants of Better Buying Power, we have concluded there was no intentional wrong doing. In addition, we considered appropriate corrective action across the agency for all MDA personnel that have responsibility for contract actions and implemented appropriate corrective actions applicable to all three recommendations. The attachment addresses each of the three recommendations individually, however central to our corrective actions, as well as the fundamental tenants of Better Buying Power, is appropriate training, education, and certification for all MDA acquisition personnel and a reduction of use of undefinitized contract instruments.

Specifically, MDA has significantly reduced the number of letter contracts since 2010 from 4 to 1 and, in the cases that a contract is undefinitized, we have reduced the time required to definitize from an average of 365 days to 175 days. Acquisition certifications with requisite training, education and experience have increased from 50% to over 88% in the last three years, and MDA is on track to achieve over 90% certification by the end of 2014. We are committed to best contracting practices and USD (AT&L)'s Better Buying Power initiative which provides specific direction to implement best acquisition practices. A critical but related concern is that the recently mandated 20% reduction to headquarters staff over the next five years will reduce

Transmittal Letter on GMD Core Completion (cont'd)

necessary oversight, eroding our significant progress in this area, therefore we welcome your support.

It is in our mutual best interest to ensure that the facts included in your Final Report, which will be available to the public and congressional requestors, are of the highest quality. To ensure this goal, I have enclosed MDA technical comments and responses to the three Recommendations in the Draft Report, and the security/ classification review of the Draft Report content.

We appreciate the opportunity to comment on the Draft Report and stand ready to clarify and/or provide any additional information and documentation to assist you in the preparation of the Final Report. My point of contact for this effort is Mr. Mirza Baig, 571-231-8340, mirza.baig@mda.mil.

Sincerely,

JOHN H. JAMES, JR.
Executive Director

Enclosures:
As stated

cc:
Mr. Randolph R. Stone, Deputy Inspector General Policy and Oversight

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Draft Report Response to Recommendations on GMD Core Completion

DoD IG Project No. D2011-DIP0AI-0231.000 - GMD Core Completion Contract – DRAFT REPORT
Missile Defense Agency Response to DoD IG Recommendations

RECOMMENDATIONS

Recommendation A: We recommend that the Director, Missile Defense Agency, consider appropriate corrective and/or administrative action for those contracting officials who did not maintain effective communications with the Defense Contract Audit Agency or use the audit results in establishing a fair and reasonable contract price.

***MDA Response to Recommendation A*: Concur.**

The Missile Defense Agency has considered whether any corrective and/or administrative action was appropriate. After careful consideration, the appropriate corrective action is to ensure that all acquisition personnel have the proper training, education, and certification. MDA has already made significant improvements in certifications, increasing from 50% in 2010 to 88% today; we are on track to exceed 90% certification by the end of 2014. Certifications, and the underlying training, education, and experience requirements, will prevent breakdowns in communications and appropriate actions. While we considered whether administrative action was appropriate, we determined that, although the outcome could have been different, the government achieved a fair and reasonable price. We request that given MDA's significant improvement in certifications that this recommendation be closed.

Recommendation B1: Provide training to contracting officials on the specific requirements of Federal Acquisition Regulation clause 52.216-26 to ensure enforcement of required withholdings on letter contracts before definitization.

***MDA Response to Recommendation B1*: Concur.**

As stated in Recommendation A, MDA has significantly improved in the overall training for both the contracting and overall MDA acquisition personnel. This training has been in all areas of Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Better Buying Power/acquisition best practices. We request that this recommendation be closed.

Recommendation B2: Consider appropriate corrective and/or administrative action for Contracting officials that were responsible for withholding funds before contract definitization in accordance with Federal Acquisition Regulation Clause 52.216-26 and the terms of the contract.

***MDA Response to Recommendation B2*: Concur.**

As stated in Recommendation A, the appropriate corrective action is to improve training, education, and certification for all MDA acquisition personnel. As such, MDA has significantly

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Draft Report Response to Recommendations on GMD Core Completion (cont'd)

improved in the overall training for both the contracting and MDA acquisition personnel. This training has been in all areas of Federal Acquisition Regulation, Defense Federal Acquisition Regulation Supplement, and Better Buying Power/acquisition best practices. Further, MDA has significantly reduced the number of letter contracts since 2010 from 4 to 1 and, in the cases that a contract is undefinitized, we have reduced the time required to definitize from an average of 365 days to 175 days. Once the letter contract is definitized the requirement to withhold funds is not applicable, therefore, we request that this recommendation be closed.

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Missile Defense Agency Comments

TITLE OF DOCUMENT **MDA TECHNICAL COMMENTS on Draft Report for DoD IG Project # DIP0AI-0231.000**				**DATE OF DOCUMENT** May 2014
ITEM NO.	**PAGE NO.**	**LINE NO.**	**RECOMMENDED CHANGES WITH RATIONALE** **(Exact wording of suggested change)**	**COMMENT VALUE** (C) Critical (S) Substantive (A) Administrative
1	2	Finding A	**Comment:** We find the statement that DCAA had preliminarily questioned $224 million of the contractor's proposed costs, but the MDA negotiation memorandum did not address the DCAA questioned costs inaccurate. **Rationale:** When DCAA requested an extension for the audit report they didn't communicate with MDA that they had preliminary questioned costs. If DCAA had, MDA would have requested them. This data was provided to Ms. Lynne Washburn, Director of Contracts, MDA/DA on July 20, 2010. The questioned costs were not received until after the award of March 10, 2010. DCAA did not communicate that they had any preliminary questioned costs.	(C)

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2	2	Finding A	**Comment:** We find the statement that MDA officials did not consider the impact of significant business system deficiencies on the contractor's proposal, as FAR 15.406-3(a)(4) requires inaccurate. **Rationale:** The DCAA report NO. 1201-2009L24010002, dated February 6, 2009 identified that estimating system deficiencies were cited and required corrective action to improve the reliability of its future cost estimates; however this report is limited to the cited deficiencies and accordingly DCAA did not express an opinion on the adequacy of the contractor's estimating system internal controls taken as a whole. The DCAA report cited that the contractor lacked supporting documentation and sufficient vendor quotes. To ensure compliance, subcontractor proposals were thoroughly reviewed and a detailed technical evaluation was conducted to ensure the price was fair and reasonable. MDA relied on page 9 of the DCAA report which PCO defaulted back to the previous report, 1201-2006L24010001, dated June 27, 2007 which states the Estimating System and internal control policies are adequate. See Page 9 of the DCAA Report No 1201-2009L24010002, dated February 6, 2009, Attachment 1.	(C)

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3	2	Finding A	**Comment:** We find the statement that MDA officials failed to inform DCAA of key events that had significant impact on the conduct of the audit and negotiations with the contractor inaccurate. **Rationale:** MDA provided e-mail and telephonic communications with DCAA. Communications with DCAA were encouraged. However, DCAA failed to communicate with MDA that they had preliminary questioned costs. If they had, MDA would have requested the results be provided. This data was provided to Ms. Lynne Washburn, Director of Contracts, MDA/DA on July 20, 2010. The questioned costs were not received until after the award of March 10, 2010 therefore, not applicable.	(C)
4	2	3rd sentence on 1st paragraph	**Comment:** We find the statement that MDA granted a due date extension of March 15, 2010 to DCAA inaccurate **Rationale:** In an e-mail from Ms. Leonard, DCAA requested an extension to March 15, 2010. The PCO acknowledged and thanked DCAA for the update. While MDA acknowledged the request, an extension was never granted. Later on, MDA discovered why the request was needed. DCAA voluntarily expanded the audit to include a technical evaluation. It is also noted that the original DCAA audit request signed by Ms. Lynne Washburn, MDA/DA never requested a technical evaluation, nor did DCAA communicate to MDA they expanded the audit to include a technical evaluation. DCAA did not inform MDA that preliminary results were available. E-mail dated February 11, 2010 provided to DoD IG on 25 Aug 11	(C)

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Missile Defense Agency Comments (cont'd)

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5	3	Second sentence paragraph 1	**Comment:** We find the statement that MDA did not notify DCAA of either the scope reduction or the negotiated agreement to be inaccurate. **Rationale:** E-Mail traffic from Ms Leonard dated February 18, 2010 indicated that DCAA was aware of possible scope changes; therefore, the statement that DCAA did not know of the contract scope reduction is not accurate. E-mail traffic provided to DoD IG substantiated DCAA was informed by PCO on March 4, 2010 that MDA had reached agreement on cost. Email traffic also provided to DoDIG that MDA requested DCAA to continue with audit since PCO added a reopener clause and would use audit results for resolution. The PCO sent a copy of the contract and the negotiation memorandum with the re-opener clause on March 10, 2010 to Ms. Leonard. Documented e-mail was provided to the DoDIG. E-mail traffic dated 4 Mar 10 was provided to DoD IG on 25 Aug 11.	(C)

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6	3	1st sentence on paragraph 3	**Comment:** We findthe statement that when MDA completed the negotiations and DCAA discontinued the audit, DCAA tentatively questioned $224 Million of the $1.8 Billion in costs originally proposed by the contractor to be inaccurate. **Rationale:** The preliminary data was provided to Ms. Lynne Washburn, Director of Contracts, MDA/DA on July 20, 2010 several months after award. DCAA did not communicate to MDA the questioned costs were available at an earlier time. If MDA had knowledge of the questioned costs, we would have requested the data be provided. This data was provided to Ms. Lynne Washburn, Director of Contracts, MDA/DA on July 20, 2010. The questioned costs were not received until after the award of March 10, 2010.	(C)
7	4	1st paragraph 1st sentence	**Comment:** We find the statement that MDA negotiation memorandum prepared by the contracting officer does not reflect that MDA considered the preliminary audit results in negotiating the GMD contract to be inaccurate. **Rationale:** The preliminary data was provided to Ms. Lynne Washburn, Director of Contracts on July 20, 2010 several months after award. DCAA did not communicate to MDA the questioned costs were available at an earlier date. If MDA had knowledge of the questioned costs, we would have requested the data be provided. This data was provided to Ms. Lynne Washburn, Director of Contracts, MDA/DA on July 20, 2010. The questioned costs were not received until after the award of March 10, 2010.	(C)

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Missile Defense Agency Comments (cont'd)

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8	4	2nd paragraph 2nd sentence	**Comment:** We find the statement that if MDA had used the DCAA recommended labor and indirect rates for various cost elements in negotiating the GMD contract, the negotiated cost would be lower to be inaccurate. **Rationale:** MDA used current data and rates at time of award however; new rates were approved from DCAA on March 12, 2010 two days after award. Audit Report NO. 1201–2010L23000001 dated March 12, 2010, Attachment 2.	(C)
9	4	Last paragraph first sentence	**Comment:** We find the statement that MDA contracting officials stated that they did not wait for the DCAA audit report or consider the preliminary audit results because they had to adhere to a March 10, 2010 deadline to be inaccurate/incomplete. **Rationale:** Again, MDA could not consider the preliminary audit results because DCAA did not communicate to MDA that the data was available. On 10 Mar 10, the Core Completion Contract period of performance expired, therefore to avoid a gap in contract coverage, MDA needed to definitize the unpriced change order on or before that date. As stated during DoDIG interviews, 3-5 Aug 11 an E-mail to Ms. Leonard on March 5, 2010 stated the contract expired on March 10, 2010.	(C)

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10	5	3rd paragraph 2nd Sentence	**Comment:** We find thesecond sentence of the statement to be inaccurate. Negotiations were not impacted for Business System Deficiencies and the contracting officer stated that all of the contractor's business systems were adequate according to DCAA audit reports issued in 2007 and 2008. However, this statement did not accurately reflect the status of the contractor's business systems as of February 2010. **Rationale:** The DCAA report NO. 1201-2009L24010002, dated February 6, 2009 identified that estimating system deficiencies were cited and required corrective action to improve the reliability of its future cost estimates; however, this report is limited to the cited deficiencies and accordingly DCAA did not express an opinion on the adequacy of the contractor's estimating system internal controls taken as a whole. The DCAA report citied that the contractor lacked supporting documentation and sufficient vendor quotes. To ensure that we were compliant, subcontractor proposals were thoroughly reviewed and the technical evaluation was detailed ensuring the price was fair and reasonable. Therefore, since DCAA did not express an opinion; we defaulted back to the previous report, 1201-2006L24010001, dated June 27, 2007 as stated on page 9 of the report which states the Estimating System and internal control policies are adequate. See Page 9 of the DCAA Report No 1201-2009L24010002 dated February 6, 2009, Attachment 1.	(C)

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11	6	1st Paragraph 1st sentence	**Comment:** We find the statement that on March 24, 2009, DCAA reported that the contractor's accounting system was inadequate due to deficiencies to be inaccurate. **Rationale:** March 24, 2009 DCAA audit report cited limited examination of the Corporate control environment which specifically relates to inadequacies cited in St Louis Audit Report dated November 5, 2008. This procurement was for Boeing Huntsville not St. Louis. However, the report stated that Boeing has implemented a new accounting system, the enterprise Accounting System (EAS) effective January 1, 2007. DCAA stated they had not completed a review of the newly implement accounting system on page 14. At time of award, the most current audit report was still dated March 24, 2009 which did not include a finding on the Boeing Huntsville accounting system. On page 14, of the DCAA Audit dated March 24, 2009 stated, a new report was to be issued by DCAA on or before March 28, 2009. At time of award, the most current audit report was still dated March 24, 2009 which did not include a finding on the accounting system.	(C)
12	6	3rd paragraph 2nd Sentence	**Comment:** We find the statement that MDA never advised DCAA of the major scope reduction to be inaccurate. **Rationale:** E-Mail traffic from Ms Leonard dated February 18, 2010 indicated that DCAA was aware of possible scope changes; therefore, the statement that DCAA did not know of the scope reduction is not accurate. E-mail traffic dated 4 Mar 10 was provided to DoD IG on 25 Aug 11.	(C)

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13	6	Last Paragraph	**Comment:** We find the statement that DCAA was not aware of the Negotiation Deadline to be inaccurate. **Rationale:** DCAA was aware of the negotiation deadline. An e-mail March 5, 2010 to Ms. Leonard stated the current contract expires on March 10, 2010 and MDA will not have contract coverage. E-mail traffic dated 5 Mar 10 provided to DoD IG on 25 Aug 11.	(C)
14	7	1st Paragraph	**Comment:** We find the statement that MDA granted a due date extension beyond the deadline to be inaccurate. **Rationale:** In an e-mail from Ms. Leonard, DCAA requested an extension to March 15, 2010. The PCO acknowledged and thanked DCAA for the update. While MDA acknowledged the request, we never granted an extension. DCAA voluntarily expanded the audit to include a technical evaluation. DCAA did not communicate to MDA that they had expanded the audit to include a technical evaluation nor did they provide the preliminary results to MDA. E-mail dated February 11, 2010 provided to DoD IG on 25 Aug 11.	(C)
15	8	1st Paragraph Last sentence	**Comment:** We find thestatement that this effort was wasted in large part because MDA did not appropriately communicate with DCAA during the GMD acquisition effort to be inaccurate. **Rationale:** MDA would have considered the preliminary audit results if DCAA had communicated to MDA that the data was available. MDA would also have used DCAA results on future Engineering Change Orders.	(C)

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16	10	Finding B	**Comment:** We find the statement that MDA did not comply with a key contract clause to be inaccurate. **Rationale:** Finding/Recommendation is not applicable since the contract in question is NOT a Letter Contract. The review only covered Bridge 2 and the Follow-on Efforts, neither of which were letter contracts (which is the only situation where FAR Clause 52.216-26 is applicable). The clause was in the base contract because it was awarded as a Letter Contract in Dec 2008. A copy of FAR 52.216-26- Payments of Allowable Costs Before Definitization and FAR 16.603- Letter Contracts, Attachment 3.	(C)
17	10	2nd Paragraph	**Comment:** We find the statement that MDA issued two letter contracts for the GMD effort to be inaccurate. **Rationale:** MDA executed one (1) letter contract on December 30, 2008 which was definitized on modification P0004, dated June 25, 2009. On August 9, 2009, MDA issued an Undefinitized Change Order, which is referred to as Bridge 2. There were never two (2) letter contracts. The letter contract included FAR clause 52.216-26 and that clause is not applicable for the undefinitized change order. A copy of FAR 52.216-26- Payments of Allowable Costs Before Definitization and FAR 16.603- Letter Contracts, Attachment 3.	(C)

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18	11	1st Paragraph	**Comment:** We find the statement that MDA did not comply with a key contract clause to be inaccurate (continued). On block 6 on the award cover sheet of the letter contract, contract administration is to be done by DCMA HUNTSVILLE, BUILDING 4505 SUITE 301, MARTIN ROAD, REDSTONE ARSENAL AL 35898. Additionally, the clause for invoicing and vouchering below is in the letter contract. **Rationale:** Invoice and vouchering was done in accordance with the following clause in the letter contract. INVOICING AND VOUCHERING A. When authorized by the Defense Contract Audit Agency (DCAA) in accordance with DFARS 242.803(b)(i)(C), the contractor may submit interim vouchers directly to paying offices. Such authorization does not extend to the first and final vouchers. Submit first vouchers to the cognizant DCAA office. Final vouchers will be submitted to the ACO with a copy to DCAA. B. Upon written notification to the contractor, DCAA may rescind the direct submission authority. Should the contractor decline to submit interim vouchers directly to paying offices or if the contractor receives written notification that DCAA has rescinded the direct submission authority, public vouchers, together with necessary supporting documentation, shall be submitted to the cognizant Defense Contract Audit Agency (DCAA) office, prior to payment by the Finance and Accounting Office specified in Block 12, Page 1, Section A, of Standard Form 26.D. DCMA and DCAA were responsible for the invoicing of this letter contract. A copy of FAR 52.216-26- Payments of Allowable Costs Before Definitization and FAR 16.603- Letter Contracts, Attachment 3	(C)

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Acronyms and Abbreviations

DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
FAO	Field Audit Office
FAR	Federal Acquisition Regulation
GMD	Ground-based Midcourse Defense
MDA	Missile Defense Agenc
OIG	Office of Inspector General
PGI	Procedures, Guidance, and Instruction

Whistleblower Protection
U.S. Department of Defense

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