December 5, 2003

Audit Oversight

Review of Allegations Concerning NAVAIR Contracting Officer Actions (D-2004-6-004)

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Acronyms

BCM	Business Clearance Memorandum
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
DPA	Defective Pricing Action
FAR	Federal Acquisition Regulations
FMS	Foreign Military Sales
LGTR	Laser Guided Training Rounds
LMSI	Lockheed Martin Systems Integration
NAVAIR	Naval Air Systems Command
NCIS	Naval Criminal Investigative Service
PNM	Post-Negotiation Memorandum
SRD	Sierra Research Division of LTV Electronics and Missile Group
TINA	Truth in Negotiations Act
TRE	Teledyne Ryan Electronics, Inc.

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202–4704

December 5, 2003

MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Review of Allegations Concerning NAVAIR Contracting Officer Actions (Report No. D-2004-6-004)

We are providing this report for review and comment. The review was performed in response to allegations made to the Defense Hotline.

We considered management comments on the draft of this report when preparing the final report. DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. As a result of management comments, we have deleted recommendation 1.c. and added a recommendation to clarify our intention. We request that management provide comments by January 5, 2004.

We request that management provide comments that conform to the requirements of DoD Directive 7650.3. If possible, please provide management comments in electronic format (Adobe Acrobat file only). Send electronic transmission to the e-mail addresses cited in the last paragraph of this memorandum. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the /Signed/ symbol in place of the actual signature.

We appreciate the courtesies extended to the staff. Questions should be directed to Mr. Wayne C. Berry at (703) 604-8789 (DSN 664-8789) or Ms. Madelaine E. Fusfield at (703) 604-8739 (DSN 664-8739). See Appendix D for the report distribution. The team members are listed inside the back cover.

L. Jerry Hansen
Deputy Inspector General
Inspections and Policy

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Office of the Inspector General of the Department of Defense

Report No. D-2004-6-004 **December 5, 2003**
(Project No. D2003-OA-0021)

Review of Allegations Concerning NAVAIR Contracting Officer Actions

Executive Summary

Who Should Read This Report and Why? This report should be read by contracting officers who determine contractor compliance with Section 2306a, title 10, United States Code, referred to as the Truth in Negotiations Act (TINA), and negotiate and administer contracts that encompass special tooling and test equipment. The report explains how to properly implement the statutory provisions when requesting and obtaining cost or pricing data.

Background. The review was performed in response to three allegations to the Defense Hotline.

- Contracting officers at the Naval Air Systems Command (NAVAIR), Patuxent River, Maryland, did not recover funds due the Government as a result of contractor violations of TINA;

- A contracting officer did not follow up on special tooling and test equipment that the Government had paid for contrary to Federal Acquisition Regulations and Navy contract negotiation and administrative procedures; and

- NAVAIR had not prepared a procurement negotiation memorandum on a contract contrary to Federal Acquisition Regulations 15.406.3.

Results. The first allegation that NAVAIR did not recover $713,539 on a defectively priced contract was substantiated. NAVAIR prevented recovery by stating that they did not rely on cost or pricing data during the negotiations of the contract. NAVAIR also delayed more than 6 years the resolution and disposition of the Defense Contract Audit Agency defective pricing reports.

The second allegation was partially substantiated. NAVAIR did not followup or alert the administrative contracting officer about the special tooling when the contractor claimed title to Government property valued at more than $145,000.

The third allegation was substantiated.

We recommend that the Assistant Commander for Contracts, NAVAIR:

- provide training to procurement officers and contract specialists on the requirements for cost and pricing data and the preparation of business clearance memorandums;

- establish performance measures for timely resolution and disposition of reports; and

- notify the administrative contracting officer about the special tooling to either identify it as Government property or determine what happened to it.

Management Comments and Our Response. We have summarized NAVAIR comments on the findings and recommendations and our responses to those comments in Appendix C. As a result of Management Comments, we deleted recommendation 1.c. and added recommendation 3 to clarify our intent. The complete text of the comments is in the Management Comments section of the report. Although NAVAIR did not concur with the findings, they concurred with recommendations. However, NAVAIR comment regarding the need for additional training indicated a failure to understand the problem identified in the report. Also, NAVAIR did not provide an action plan to implement recommendation 2 on establishing performance metrics. We request that NAVAIR respond to the final report with an action plan to implement recommendations 1 and 2 and comment on the added recommendation 3.

We request NAVAIR provide comments to the final report by January 5, 2004.

Background

We conducted this evaluation in response to a Defense Hotline complaint that included three allegations involving contracting officers at the Naval Air Systems Command (NAVAIR), Patuxent River, Maryland.

The first allegation was that contracting officers did not recover funds due the Government as a result of contractor violations of Section 2306a, title 10, United States Code, Cost or Pricing Data: Truth in Negotiations, also referred to as the Truth in Negotiations Act (TINA). NAVAIR and IBM Federal Systems (IBM) negotiated a $168 million firm-fixed-price contract number N00019-89-D-0027 on the LAMPS MK III Ship/Air Weapon System on October 26, 1989. Eight months earlier, IBM had negotiated a subcontract with the Sierra Research Division (SRD) of LTV Electronics and Missile Group. One month after negotiating with IBM, SRD signed a purchase order under the same contract with Teledyne Ryan Electronics, Inc. (TRE). (See Chronology of Events at Appendix B).

A second allegation was that a contracting officer did not follow up on special tooling and test equipment that the Government had paid for. The Federal Acquisition Regulations (FAR) defines "special test equipment" as either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. Special test equipment does not include material, special tooling, facilities, and plant equipment items used for general-purpose plant testing purposes. "Special tooling" is defined as equipment and manufacturing aids that are of such specialized nature that their use is limited to the development or production of particular supplies or parts or to the performance of particular services. The allegation concerned the Laser Guided Training Rounds (LGTR) program and included the following seven contracts: N00019-90-C-0006, N00019-91-C-0125, N00019-93-C-0084, N00019-95-C-0024, N00019-96-C-0235, N00019-98-C-0131, and N00019-99-C-1648.

The third allegation was that NAVAIR had not prepared a negotiation memorandum after negotiating contract number N00019-98-C-0131.

Objective

The objective was to determine the validity of the Defense Hotline allegations. See Appendix A for details on our scope and methodology.

Actions by NAVAIR Contracting Officers

NAVAIR contracting officers did not comply with FAR requirements when negotiating and administering the contracts addressed in the Hotline referral.

- The first allegation, that NAVAIR did not recover $713,539 on a defectively priced contract, was substantiated. NAVAIR stated that they did not rely on cost or pricing data during negotiations; therefore, a key element to prove defective pricing did not exist. However, NAVAIR did not comply with statutory and regulatory requirements when negotiating the TINA covered contract and did not properly or promptly settle the defective pricing audit reports.

- The second allegation that a contracting officer did not follow up on special tooling and test equipment was partially substantiated. The contractor notified NAVAIR contracting officials in 1999 that it considered special tooling paid for by the Government to be contractor property. NAVAIR did not follow up or take action to claim the Government property. As a result, special tooling valued at $145,000 was never recorded as Government Property and tracked in accordance with FAR requirements.

- The third allegation, that the contracting officer had not prepared a negotiation memorandum for a specific contract, was substantiated.

Nonrecovery of Funds

The first allegation, that NAVAIR did not recover funds due to TINA violations, was substantiated. NAVAIR prevented recovery by stating that they did not rely on cost or pricing data during the negotiations of the contract. NAVAIR also delayed more than 6 years the resolution and disposition of the Defense Contract Audit Agency (DCAA) defective pricing audit reports. NAVAIR relied on the IBM analysis of subcontractor price proposals, which had not been updated to include current, accurate, and complete cost and pricing data from vendors. Because NAVAIR stated that subcontractor cost or pricing data was not relied on, NAVAIR negated the ability of the Government to recoup under TINA.

NAVAIR Actions During Contract Negotiations. When negotiating with IBM in October 1989, NAVAIR relied on an analysis performed by IBM, which contained noncurrent and incomplete cost or pricing data pertaining to SRD, a first-tier subcontractor, and its vendor, TRE. IBM provided a record of the negotiations conducted with SRD that ended February 24, 1989, which was 8 months before the effective date of the IBM Certificate of Current Cost or Pricing Data, October 26, 1989. The record included a schedule of costs for

purchased parts from vendors, including TRE, and a statement that IBM had pointed out inconsistencies in the SRD proposal, including the use of actual costs from different time periods. IBM also stated that it had repeatedly requested updated cost data from SRD pertaining to its vendor, TRE. SRD had not been able to adequately support its vendor information. Nevertheless, SRD and TRE had executed certificates of current cost and pricing data before IBM certified its data to NAVAIR. Appendix B shows a chronology of significant events related to the IBM and its vendor negotiations and cost and pricing data certifications.

Although the contracting officer was aware of IBM and DCAA concerns about the inadequacies in the SRD price proposal, he relied on the IBM bottom-line negotiations of a subcontract with SRD. IBM negotiators had informed NAVAIR of the difficulties they had experienced in attempting to obtain current, accurate, and complete data from a first-tier subcontractor, SRD, despite repeated requests. Further, two DCAA audit reports, a bid proposal report and an estimating systems report, had questioned SRD vendor information. When informed of the SRD inadequate vendor information through the DCAA price proposal audit reports of the first tier subcontractor, the contracting officer could have requested an audit of the TRE second-tier subcontract proposal. Although a small percentage of the total IBM contracts value, the SRD subcontract and its vendor TRE were still over the TINA threshold. At a minimum, the contracting officer could have requested updated, indirect rate information to verify the accuracy of TRE proposed indirect rates. Instead, the Business Clearance Memorandum (BCM)[1] signed May 17, 1990, merely confirmed that SRD estimates of engineering hours were unreliable. A May 1991 DCAA defective pricing audit report on TRE confirmed that the subcontractor's proposed indirect rates had been obsolete and the labor hours overstated. Yet, SRD had negotiated a favorable price with its vendor but had not provided that information to IBM.

TINA and FAR Provisions. The TINA statute requires contractors and subcontractors to submit cost or pricing data and to certify that the data are current, accurate, and complete. A prime contractor is liable for any defective cost or pricing data submitted by its subcontractors to the Government. FAR Subpart 15.801, Definitions, that governed this contract, defined cost or pricing data as all facts as of the date of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost or pricing data are factual and are therefore verifiable. Cost or pricing data are more than historical data; they are all the facts that can reasonably be expected to contribute to sound estimates of future costs and to the validity of determinations of costs already incurred.

The TINA provisions covered the subcontract and second-tier subcontracts that were valued at more than $500,000. TINA requires the contracting officer to obtain cost or pricing data unless specific exceptions apply and allows the Government, after contract award, to obtain a price reduction based on defective cost or pricing data. The specific exemptions in FAR Subpart 15.804-3 were:

- When the price is based on adequate price competition;

[1] The Business Clearance Memorandum summarizes the contract negotiations.

- When prices are set by law or regulation; or

- When the acquisition is for a commercial item.

None of these three conditions were present when IBM negotiated with NAVAIR. The head of the agency can grant waivers from the TINA requirements in an exceptional case. However, no waiver was requested. When the contracting officer elected not to rely on certified cost or pricing data, as NAVAIR concluded in the July 10, 2001, BCM, he effectively negated the TINA requirements.

DCAA Audit Findings of Defective Pricing. From May 1991 through December 2000, DCAA issued five defective pricing audit reports to identify the initial finding and to update for additional information. On May 8, 1991, DCAA issued the Report on Post-award Review of Purchase Order MS71862-09, Teledyne Ryan Electronics, Inc., that identified the source of the defective pricing. In 2001 and 2002, DCAA issued three supplemental reports to update the previous reports, which had not yet been resolved or closed. The report on Lockheed Martin Systems Integration - Owego (formerly IBM), Report No. 6271-1999G42097001, December 21, 2000, restated the previous finding of defective subcontractor data and recommended a price adjustment of $713,539. The adjustment was based on the TRE defective pricing amount of $413,316 that was increased by indirect expenses and profits applicable to SRD and IBM. The TRE defective pricing amount represented about 34 percent of the second-tier subcontract that was negotiated for $1.22 million.

Although DCAA determined that the second-tier subcontractor, TRE, caused the defective pricing, the prime contractor, IBM, was liable for subcontract price reductions even if it had no knowledge of the defective data. FAR Subpart 15.806-2, Prospective Subcontractor Cost or Pricing Data, required a prime contractor to update a prospective subcontractor's data to ensure that the data were current, accurate, and complete as of the date of price agreement.

NAVAIR Actions to Settle the Defective Pricing Issue. NAVAIR was precluded from settling the defective pricing issue for 3 years, from January 29, 1992, until December 1994, because of a Naval Criminal Investigative Service (NCIS) investigation involving allegations about another SRD vendor on contract N00019-89-D-0027. The NCIS agent discussed the administrative settlement of the defective pricing issues with NAVAIR in December 1994, and the contracting officer agreed to proceed with settlement negotiations. Although settlement actions could proceed, contracting officers did not dispose of the defective pricing reports over the next 6 years and 7 months. Three procurement contracting officers and four contract specialists looked at the defective pricing issue during that time. During the prolonged delay, many of the actual participants in the negotiations had left their positions, and key personnel at the Government and contractor offices were no longer available. Prompt and decisive action taken by parties familiar with the circumstances during the negotiations may have led to a satisfactory solution of the defective pricing issue.

The Office of Management and Budget Circular No. A-50, "Audit Followup," and DoD Directive 7640.2, Contract Audit Followup, require contracting officers to make a determination on audit findings within 6 months of the report issuance. The Directive states that the report is over age if not disposed of or closed within 12 months, when one of several actions occurs: the contractor implements Government recommendations; the contracting officer negotiates a settlement with the contractor; or the audit report is superseded by a new report.

On July 10, 2001, more than 6 years after NCIS advised NAVAIR that they could proceed, the contracting officer signed a Negotiation BCM stating that subcontractor cost and pricing data were not relied on during the negotiation of the prime contract and, therefore, defective pricing did not exist. On July 12, 2001, the contracting officer also sent a letter to DCAA requesting that audit Report No. 6271-1999G42097001 be **rescinded** because the contracting officer did not rely on the certified cost and pricing data in negotiating the contract. The contracting officer can and should request that DCAA **reassess** its conclusions based on additional facts provided by the contracting officer. However, to ask that the report be **rescinded**, although potentially a matter of semantics to the contracting officer, is a technically that could be construed by "knowledgeable third parties" to compromise the auditors independence in accordance with the Government Auditing Standards. These standards require that the auditors be independent both in fact and appearance. As a result of the contracting officers request and based on a review of the documentation, the DCAA legal representative concluded that the contracting officer did rely on the data; therefore, DCAA did not revise its report conclusions. NAVAIR contracting officers should take care not to request DCAA take actions that could be construed by "knowledgeable third parties" to impact the independence of the auditors either in fact or appearance.

Conclusion. The following NAVAIR contracting officer actions were contrary to the Government's best interests:

- Not relying on requested cost or pricing data;
- Not requesting audit assistance from DCAA to obtain any updated cost or pricing information that IBM might have been unable to gather;
- Not acting promptly to resolve and achieve disposition of the defective pricing audit reports while parties involved were available to properly address the issues; and
- Requesting DCAA to rescind their audit report.

It is essential that contracting officers properly implement the TINA and FAR provisions concerning cost and pricing data when negotiating sole-source contracts. Ignoring the requirements for cost and pricing data circumvents the TINA statute and can result in the forfeiture of the legal remedy that price adjustment provides when defective pricing is detected and properly supported. Office of the Inspector General Report No. D-2001-129, May 30, 2001, on "Contracting Officer Determination of Price Reasonableness When Cost or

Pricing Data Were Not Obtained," identified similar issues throughout DoD (Appendix A). In addition, IG Report 99-048, "Dispositioned Defective Pricing Reports at the Naval Air Systems Command," December 8, 1998, reported a continued failure to timely resolve and disposition defective pricing audit reports.

Accounting for Special Tooling and Test Equipment

NAVAIR Followup on Government Property. The second allegation contained three parts:

- NAVAIR had not followed up on special tooling and test equipment;
- The contractor had been paid for two sets of special test equipment but had purchased only one set without returning the funds for the unpurchased equipment;
- The contractor had used the Government property in the performance of Foreign Military Sales (FMS) contracts without paying the Government rent.

NAVAIR had not followed up on property that the Government paid for under the LGTR contracts. Therefore, the first part of the allegation was substantiated. However, we could not substantiate the other two allegations, in part, because contracting officers had not followed the required contract negotiation and administration procedures, and BCMs did not provide adequate information on Government property.

Contract Clauses Governing Special Tooling and Test Equipment. In order to protect the Government's interest, the FAR instructs the contracting officer to insert the contract clause at FAR Subpart 52.245-2, Government Property, in fixed-price contracts. The clause covers special test equipment acquired under the contract and allows the Government to gain title to the test equipment included in the contract. Special tooling is addressed in the contract clause at FAR Subpart 52.245-17, Special Tooling, which the contracting officer must insert in a fixed-price contract that will include such items. The clause provides that the Government has an option to take title to all special tooling subject to the clause until the contracting officer relinquishes the option to take title.

Special Tooling. We reviewed seven contracts and determined that five contracts, numbers N00019-93-C-0084, N00019-95-C-0024, N00019-98-C-0131, N00019-96-C-0235, and N00019-99-C-1648, contained the Special Tooling clause. However, we could not determine what had been purchased or what the Government had paid for tooling on the contracts because there is no requirement to identify special tooling. The contractor proposed about $145,000 of special tooling on a sixth contract, number N00019-91-C-0125. This contract did not contain the required special tooling clause. However, NAVAIR

stated the contract was subject to a class deviation in effect at the time the contract was negotiated. The special deviation provided for coverage of special tooling under the Government Property clause. As a result, the title to special tooling items purchased by the Government under the LGTR program would have passed to the Government. However, in a 1999 letter to the Contracting Officer, LSMI claimed the property as theirs. The contracting files did not contain this letter and the current NAVAIR and DCMA contracting officials did not know about the letter.

NAVAIR could not provide sufficient information regarding special tooling for the remaining contract, number N00019-90C-0006. Therefore, we could not determine the amounts paid by the Government, if any, for special tooling on that contract or whether the clause should have been included.

Special Test Equipment. We could not substantiate the allegation that the contractor had proposed but not purchased two pieces of special test equipment although the Government had paid $163,000 for the equipment. The contractor identified one tester and explained that it had been built to perform the functional tests of the two special testers proposed. We did not review the actual cost of materials that went into the construction of one versus two pieces of test equipment.

Foreign Military Sales. The allegation that the contractor had not paid the Government rent for use of equipment in the performance of foreign military sales contracts was not substantiated. We could not determine whether the contractor had used Government property in the performance of any non-Government contracts. In addition, the Defense FAR Supplement was changed in 1991 and made retroactive to 1989 to allow contractors to use Government property rent-free in the performance of foreign military contracts. Therefore, the costs would have been allowable unless contractor usage on foreign military contracts prior to 1989 could be identified.

DCMA Property Administration. The contractor is required by FAR to account for all Government property in its possession and to tag and identify that property. DCMA Property Administrators have responsibility to oversee the contractor's property management system and perform functional reviews of the contractor's system. DCMA found the contractor's system to be unsatisfactory in 2001; however, the contractor corrected the deficiencies and DCMA pronounced the system satisfactory in 2002. Therefore, we had no information to support an allegation that the contractor had acted improperly.

Documenting the Results of Negotiations

Preparation of Negotiation Documents. We substantiated the allegation that NAVAIR had not documented the negotiation results for contract number N00019-98-C-0131. NAVAIR uses BCMs to document the results of negotiations. The FAR Subpart 15.406-3, Documenting the Negotiation, requires contracting officers to prepare a document with specified information after negotiations have been completed and to forward a copy to the cognizant DCAA offices.

NAVAIR had prepared six BCMs on the LGTR program but had provided only two copies to DCAA. DCAA uses the information in negotiation documents when conducting a post award audit. The information also provides essential feedback on the effectiveness of the audit and on auditor responsiveness to the needs of the contracting officer. Therefore, it is essential that contracting officers forward the documents to the cognizant audit offices.

Management Comments on the Finding and Our Response

Summaries of management comments on the finding and our evaluation response are in Appendix C. Based on management comments, we have deleted recommendation 1.c., and renumbered recommendation 1.d., and added recommendation 3 to require notifying the administrative contracting officer of the special tooling.

Recommendations, Management Comments, and Our Response

We recommend that the Assistant Commander for Contracts, Naval Air Systems Command:

1. Provide training to procurement officers and contracts specialists on:

    a. The proper use of, and reliance on, cost or pricing data submitted by sole source contractors and subcontractors to meet the requirements of Section 2603a, title 10, United States Code.

    b. The requirement for prompt resolution and disposition of contract audit reports in accordance with the Office of Management and Budget Circular No. A-50, "Audit Followup," and DoD Directive 7640.2, "Contract Audit Followup."

    c. Preparation of business clearance memorandums as the Federal Acquisition Regulations require and to forward copies to the cognizant contract audit offices.

2. Establish performance measures for timely resolution and disposition of contract audit reports.

3. Notify the administrative contracting officer about the special tooling to ensure the property is either tagged or identified as Government property or to obtain an explanation of what happened to the special tooling if it no longer exists.

Management Comments. NAVAIR concurred with the recommendations in the draft report. NAVAIR currently provides and will continue to provide training to procurement officers and contract specialists on all areas listed in the recommendations.

OIG DoD Response. NAVAIR comments are only partially responsive to the recommendations.

Recommendation 1. The comment that they provide and will continue to provide training does not reflect the need to provide remedial training and guidance for the requirement and use of cost and pricing data. The NAVAIR comment to the finding that there is "…NO requirement for a contractor to use such data within their proposal, or for the contracting officer to rely on such data to negotiate the contract price" is indicative of their lack of understanding of the requirement of and intent of the Truth in Negotiations Act. They also commented that there was some question of whether the data was defective. However, the only justification expressed to us during our review or in their comments was that they did not rely on the data. To support an ethic that would have the contractor provide the data, require certifications of the data, and then not use the data is contrary not only to TINA but to good business practices. Contractors expend considerable resources to comply with TINA and they deserve to either have the requirement waived, if appropriate, or to have the data relied on by the Government.

Recommendation 2. NAVAIR did not address when they would add performance measures for timely resolution and disposition of contract audit reports. Although they believed that they were timely, they did not consider all factors in this determination. They should provide an action plan for including performance measures in their performance plan.

Recommendation 3. Based on the NAVAIR comments and additional information provided, we deleted draft recommendation 1.c. and added recommendation 3. Based on the additional information provided by NAVAIR, the letter from LMSI to the NAVAIR contracting officer, the resultant confusion surrounding the issue, and the time that has elapsed, we recommend that the NAVAIR contracting officer notify the DCMA to determine the status of the property.

Appendix A. Evaluation Process

Scope and Methodology

We visited NAVAIR Patuxent River, Maryland, and the Navy Criminal Investigative Service to review files pertaining to the three issues in the Defense Hotline complaint for which NAVAIR had responsibility. We also had discussions with NAVAIR contracting officials, DCMA Property Management personnel, DCAA auditors, and the DCAA Liaison Auditor at NAVAIR.

To determine whether the allegations could be substantiated, we reviewed business clearance memoranda and supporting documents in the contract files, information contained in NCIS investigative files, and the following audit reports:

- Report on Post-award Audit of Cost or Pricing Data Under Contract No. N00019-89-D-0027, IBM Federal Systems, Report No. 6351-90A42010009, September 4, 1992.

  - The audit report on IBM included as an appendix Report on Post-award Audit of Cost or Pricing Data IBM Purchase order 651062, LTV Sierra Research Division (SRD) of LTV Electronics and Missile Group, Report No. 2221-90L42030002, September 26, 1991.

  - The defective pricing report on SRD included as an appendix the May 8, 1991, DCAA Report on Post-award Review of Purchase Order MS71862-09, Teledyne Ryan Electronics, Inc. The report identified the source of the defective pricing.

- Report on Post-award of Cost or Pricing Data on Contract No. N00019-89-D-0027, Lockheed Martin Systems Integration - Owego (formerly IBM), Report No. 6271-1999G42097001, December 21, 2000.

  - The report included as appendixes the 1991 report on TRE and a supplemental report on SRD, Report No. 2262-90L42030002-S1, January 20, 1998.

We performed this evaluation from October 2002 through June 2003.

Prior Coverage

During the last 5 years, the Office of the Inspector General, Department of Defense, has issued one report on the determination of price reasonableness without cost or pricing data. Inspector General, DoD, Report No. D-2001-129, "Contracting Officer Determinations of Price Reasonableness When Cost or Pricing Data Were Not Obtained," May 30, 2001, included a systematic, historical review of 145 contract actions. The study concluded that contracting officials lacked valid exceptions from the requirements to obtain certified cost or pricing data and failed to obtain required data in 46 (32 percent) of the 145 contracting actions. Problems contributing to poor price analysis included an atmosphere of urgency caused by a lack of planning, staffing shortages, the need for additional leadership oversight, and a generally perceived lack of emphasis on obtaining cost or pricing data. In addition, IG DoD Report No. 99-048, "Dispositioned Defective Pricing Reports at Naval Air Systems Command," December 8, 1998 reported a continued failure to timely resolve and disposition defective pricing audit reports. Unrestricted Inspector General of the Department of Defense (IG DoD) reports can be accessed at http://www.dodig.osd.mil/audit/reports.

Appendix B. Chronology of Significant Events for IBM and Subcontractor Certifications

Date	Event
August 15, 1988	TRE (Second-tier Subcontractor) submits original Proposal to SRD (First-tier Subcontractor)
November 7, 1988	TRE submits revised proposal to SRD
February 14, 1989	TRE extends validity of its November 7, 1988, proposal to March 31, 1989
February 24, 1989	Date of Negotiation between SRD (First-tier Subcontractor) and IBM (Prime contractor)
February 24, 1989	SRD Certificate of Current Cost or Pricing Data
March 10, 1989	SRD executes Certificate of Current Cost or Pricing Data with effective date as February 24, 1989
March 20-22, 1989	TRE and SRD fact-finding and negotiations begin
March 23, 1989	TRE updates proposal, and TRE and SRD negotiations conclude
March 29, 1989	TRE executes Certificate of Current Cost or Pricing Data with effective date as of March 23, 1989
December 7, 1989	IBM executes Certificate of Current Cost or Pricing Data to the Government with effective date as of October 26, 1989

Appendix C. Summary of Management Comments on the Finding and Our Response

Summary of Management Comments 1, 2, and 5 on Nonrecovery of Funds.

Reliance. NAVAIR nonconcurred with the allegation that the contracting officer did not recover $713,539. NAVAIR decided not to seek additional cost or pricing data for the second tier subcontractor once it decided that ample price analysis data existed. Consequently, NAVAIR does not agree that it violated statutory or regulatory requirements when awarding this contract.

There is no statutory or regulatory requirement to rely on cost or pricing data, and there is some question with respect to whether or not the data would be considered defective. There is no requirement for a contractor to use cost or pricing data within their proposal, or for the contracting officer to rely on such data to negotiate the contract price. It is the contracting officer's responsibility to determine a fair and reasonable price. The contracting officer elected to rely on the IBM bottom-line negotiated price with their first tier subcontractor, SRD. Because the contracting officer did not rely on the allegedly defective SRD/TRE subcontract data, there could be no requisite causal connection between reliance on defective data and an overstatement in contract price.

Response. We disagree that there is not a requirement to use cost or pricing data. For negotiated sole source contracts that exceed the $500,000 threshold, TINA and FAR required that the contracting officer obtain and use cost or pricing data to obtain a fair and reasonable price for the Government, absent a properly documented exemption or waiver. The contracting officers requested and obtained certifications from the contractors and subcontractors to show compliance with TINA. A contracting officer may choose not to obtain certified cost or pricing data on sole source negotiated contracts only if one of the three specific exemptions from cost or pricing data exists, or the head of the agency grants a waiver. In this case, no exemption or waiver was obtained or documented.

In accordance with 10 U.S.C. Section 2306a (e)(B)(3)(C), it is not a defense to an adjustment of the price of a contract that the contract was based on an agreement between the contractor and the United States about the total cost of the contract, and there was no agreement about the cost of each item. FAR subpart 15.806, Subcontract Pricing Consideration, states that subcontract prices must be reviewed and analyzed by the Government even if the prime contractor negotiated subcontract prices before negotiating the prime contract. In no instances should such negotiated subcontract prices be accepted as the sole evidence that these prices were fair and reasonable. DCAA had reviewed the SRD subcontract proposal and evaluated SRD's estimating system and identified sufficient deficiencies in their system to prompt a responsible contracting officer to pursue the necessary second tier subcontractor proposal data through an audit.

TINA was enacted to protect the Government when negotiating noncompetitive fixed price contracts. The contracting officer has a duty to obtain certified data that can be relied on in order to ensure legal protection if defective pricing is subsequently discovered. The law offers protection only if a contracting officer relies on certified data. Because NAVAIR stated they did not rely on cost or pricing data during negotiations, NAVAIR was not in a position to recover any overpricing.

Significance. The negotiated price between Allegheny (subsequently TRE), the second-tier subcontractor, and Sierra was $1,289,680. Negotiations with LMSI were not conducted on an element-by-element basis. LMSI clearly completed negotiations using price analysis for the material position. There was ample historical data upon which the Government could reasonably rely. The Government Contracting Officer accepted the price analysis provided and did not request further cost data at that juncture or thereafter.

Response. Based on DCAA's audit report, the $1.2 million second-tier fixed-price subcontract was overpriced by over $400,000 ($713,539 with higher level loadings), more than 34% of the subcontract, not an insignificant amount. Historical data alone are insufficient as cost or pricing data according to FAR part 15.801, Definitions. Cost or pricing data include all the facts that can reasonably be expected to contribute to the soundness of estimates of future costs to be negotiated. The subcontractor failed to provide current, complete and accurate cost or pricing data.

Summary of Management Comments 1, 6, and 7 on Timeliness. NAVAIR properly and promptly settled the defective pricing audit report. A draft revised audit report was forwarded by DCAA on December 21, 1998. NAVAIR requested that DCAA rescind the audit on May 11, 1999 and on June 24, 1999. On December 21, 2000 a revised audit report, number 6271-1999G42097001, was issued. It replaced audit report 6351-90A42010009. This report reduced the recommended price adjustment to a total of $713,539 and eliminated any reference to all second tier subcontractors with the exception of Allegheny. NAVAIR requested that LMSI respond to the revised audit by March 31, 2001; however, LMSI was unable to respond due to their inability to receive subcontractor documents. On July 10, 2001, NAVAIR approved the business clearance, which resolved the Defective Pricing Action. Based on the information listed above, both DCAA and NAVAIR were actively working this defective pricing action.

NAVAIR nonconcurred that prompt and decisive action taken by parties familiar with the circumstances during the negotiations may have led to a satisfactory solution of the defective pricing issue. Under all applicable case law and regulations, effective with the decision during negotiations to rely on price analysis of the subcontract, there was no defective pricing issue. This fact was documented in the BCM and communicated again via the two 1999 NAVAIR letters requesting rescission of the defective pricing action.

Response. Management comments do not properly address the chronology of the audit finding of defective pricing. The defective pricing issue that required resolution and disposition was initially presented in Report No. 6351-90A42010009, issued September 4, 1992 and updated on September 29, 1995 at the request of NAVAIR after the investigation ended. Report No. 6351-90A42010009-S1, September 29, 1995, on Loral Federal Systems (formerly IBM), confirmed that the defectively priced SRD subcontract costs addressed in the earlier report remained unchanged. Therefore, timely resolution should have occurred within six months of September 29, 1995.

The investigative files showed that changes in NAVAIR contracting personnel resulted in changed opinions of how to disposition the defective pricing issue. Initially, the contracting officer intended to seek an administrative remedy. Successive personnel failed to take action on the issue. No attempt was ever made to approach IBM with a demand for a price adjustment based on subcontractor violations of TINA requirements, as implemented in FAR part 15.8. After being advised by the investigator to proceed with the administrative settlement, the contracting officer did not dispose of the report until over six years later. If the initial contracting officer had not relied on the data, he could have closed the case in 1996 when the investigation was completed rather than planning to seek an administrative remedy.

Summary of Management Comments 3, 4, 9, 10, and 11 on Followup of Special Tooling and Test Equipment. NAVAIR disagrees with the allegation that it had not followed up on special tooling and test equipment. NAVAIR could not find a reply to DCAA letters requesting assistance to determine whether certain ST and STE items were, or were not, part of production contracts N00019-91-C-0125 and N00019-93-C-0084. However, Lockheed Martin acknowledged via correspondence to DCMA and NAVAIR the Government Property accountable to these two contracts. Lockheed Martin estimated residual value of Government Property at $145,340. These items were Government Property under the terms of the LGTR contracts. Due to their age, these items have either been disposed of as part of the contract close out process, sold to Lockheed Martin, or transferred to contract N00019-99-C-1648. Moreover, oversight of LMSI's government property system rests with the cognizant Contract Administration Organization.

As a result, management recommended that the assessment of the second allegation that a contracting officer did not follow up on special tooling and test equipment be revised from partially sustained to not sustained.

Response. This response only addresses Special Tooling because, as stated in the finding, we did not substantiate the allegation on Special Test Equipment. We have however, revised the report on page 6, concerning Special Tooling, to state that contract number N00019-91-C-0125 was subject to the Government Property Clause under a class deviation in effect at the time the contract was negotiated. Therefore the $145,000 of special tooling proposed by the contractor on contract number N00019-91-C-0125 was Government property because of the class deviation even though the special tooling clause was not included.

The BCM was silent on the special tooling. Concerning title information, we interviewed contractor personnel and were informed that IBM claimed title. In 1999, the contractor notified NAVAIR that they claimed title to the property because the Special Tooling clause was not included. The contractor did not realize that the special tooling was covered under the class deviation. Although NAVAIR considered this Government property, NAVAIR neither followed up when the contractor notified them that they claimed title to the property nor contacted the administrative contracting officer to alert them of the discrepancy. We were provided no support for the disposition of the Government property as described in the NAVAIR comments. Therefore, the allegation that NAVAIR did not follow up on the equipment was substantiated.

Based on the confusion surrounding the issue, the time that has elapsed, and management comments, we have deleted the recommendation on training and added the recommendation to have NAVAIR notify the administrative contracting officer about the special tooling to either ensure the property is tagged and identified as Government property or in the event that the special tooling no longer exists, obtain an explanation of what happened to the special tooling.

Summary of Management Comment 7 on Rescinding the DCAA Audit Report. NAVAIR does not consider the requests to rescind the audit to be inappropriate in any way. The intention of the contracting officer when the July 12, 2001 letter was sent to DCAA requesting that Audit Report No. 6271-1999G42097001 be rescinded was to state its position concerning the audit and did not agree that there was a sustainable defective pricing action. Ultimately, it was the failure of proof on the issue of reliance that prevented legal action; the DCAA audit failed to address that weakness in any meaningful way. The NAVAIR Office of Counsel supported this position. The intention of the contracting officer was never to request DCAA to violate the Government Auditing Standard that requires the auditor to be independent in attitude and appearance.

Response. We accept NAVAIR's intent and have revised the report to clarify the sensitivity of auditor independence.

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
    Director, Defense Procurement and Acquisition Policy
Under Secretary of Defense (Comptroller)/Chief Financial Officer
    Deputy Chief Financial Officer
    Deputy Comptroller (Program/Budget)

Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy
Commander, Naval Air Systems Command
Assistant Commander for Contracts, Naval Air Systems Command

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Contract Management Agency

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Government Reform
House Subcommittee on Government Efficiency, Financial Management, and Intergovernmental Relations, Committee on Government Reform
House Subcommittee on National Security, Veterans Affairs, and International Relations, Committee on Government Reform
House Subcommittee on Technology and Procurement Policy, Committee on Government Reform

Naval Air Systems Command Comments

DEPARTMENT OF THE NAVY
NAVAL AIR SYSTEMS COMMAND
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47123 BUSE ROAD, BLDG 2272
PATUXENT RIVER, MARYLAND 20670-1547

IN REPLY REFER TO

4200
Ser AIR-2.0/094-03
11 Sept 03

MEMORANDUM

From: Assistant Commander for Contracts, Naval Air Systems Command (AIR-2.0)
To: DOD Inspector General

Subj: RESPONSE TO REVIEW OF ALLEGATIONS CONCERNING NAVAIR CONTRACTING OFFICER ACTIONS (PROJECT NO. D2003-OA-0021)

Encl: (1) Management Comments to Draft Report, Project No. D2003-OA-0021

1. Enclosure (1) responds to the DOD Inspector General Draft Report, Project No. D2003-OA-0021, dated July 2, 2003.

2. If you have any further questions concerning this matter, please contact Angie Nelson at (301) 757-6557 or Nancy Kuzmick at (301) 757-6596.

T. F. FLORIP

DODIG AUDIT RESPONSE
Project No. D2003-OA-0021

Management Comment #1:
Page 2, DODIG Draft Report: Actions by NAVAIR Contracting Officers
The first allegation, that NAVAIR did not recover $713,539 on a defectively priced contract, was substantiated. NAVAIR stated that they did not rely on cost or pricing data during negotiations; therefore, a key element to prove defective pricing did not exist. However, NAVAIR did not comply with statutory and regulatory requirements when negotiating the TINA covered contract and did not properly or promptly settle the defective pricing audit reports.

Management Comments: Do not concur. Pursuant to the guidance provided at FAR 15.403-3(a)(1), NAVAIR did not seek additional cost or pricing data regarding the second tier subcontractor once it elected to include cost for the first tier subcontract in its overall prime contract price on the basis of price analysis. There was ample price data to support pricing the particular subcontract at issue on the basis of price analysis. Consequently, NAVAIR does not agree that it violated statutory or regulatory requirements when awarding this contract. Such assertion of regulatory noncompliance is erroneous for two reasons: there is no statutory or regulatory requirement to rely on cost or pricing data, and there is some question with respect to whether or not the data would be considered defective. Under specific circumstances, TINA requires the submission of cost or pricing data, the purpose of which is to put the contractor and the Government on an equal footing during the course of negotiations. There is NO requirement for a contractor to use such data within their proposal, or for the contracting officer to rely on such data to negotiate the contract price. In fact, the FAR identifies provisions for when the contracting officer determines not to use the submitted cost or pricing data. It is the contracting officer's responsibility to determine a fair and reasonable price. If a decision is made to use information other than cost or pricing data, the contracting officer may do so and should document why such a decision was made. In this case, the contracting officer elected to rely on the IBM bottom-line negotiated price with their first tier subcontractor, SRD. Such reliance was documented within the requisite Business Clearance Memorandum (BCM). Additionally the BCM confirmed that SRD estimates of engineering hours were unreliable. Because the contracting officer did not rely on the allegedly defective SRD/TRE subcontract data, there could be no requisite causal connection between reliance on defective data and an overstatement in contract price. However, the contracting officer dutifully noted what he did rely upon and indicated why such reliance was necessary. An extensive body of case law exists and regulations are explicit that absent the necessary element of reliance, the Government was never in a position to sustain a claim for damages based on defective data. The NAVAIR Office of Counsel supports this position. In summary, rather than violating any statutory or regulatory requirements, the NAVAIR contracting officer acted fully in conformance with both the spirit and the letter of applicable laws and regulations.

DODIG AUDIT RESPONSE
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NAVAIR properly and promptly settled the defective pricing audit report. The negotiations between NAVAIR and LMSI concluded on 26 October 1989. The initial audit against LMSI was dated 4 September 1992. From 1992 until 4 November 1994, an active NCIS investigation was ongoing. A draft revised audit report was forwarded by DCAA on 21 December 1998. NAVAIR requested that DCAA rescind the audit on 11 May 1999 and on 24 June 1999. On 21 December 2000, revised audit 6271-1999G42097001 was issued. It replaced Audit Report 6351-90A42010009. This report reduced the recommended price adjustment to a total of $713,539 and eliminated any reference to all second tier subcontractors with the exception of Allegheny. NAVAIR requested that LMSI respond to the revised audit by 31 March 2001; however, LMSI was unable to respond due to their inability to receive subcontractor documents. On 10 July 2001, NAVAIR approved the business clearance, which resolved the Defective Pricing Action. Based on the information listed above, both DCAA and NAVAIR were actively working this DPA.

Management Comment #2:
Page 2, DODIG Draft Report: Actions by NAVAIR Contracting Officers
NAVAIR prevented recovery by stating that they did not rely on cost or pricing data during the negotiations of the contract. NAVAIR also delayed more than 6 years the resolution and disposition of the DCAA defective pricing audit reports.

Management Comments: Do not concur. It is a fact that neither LMSI nor NAVAIR relied on the cost or pricing data provided by Sierra during the negotiations of the contract. NAVAIR did rely on the price analysis performed by the prime contractor, LMSI. Therefore, as explained above in Management Comment #1, there was no potential for recovery and so no recovery was delayed. As also explained above, NAVAIR did not intentionally delay the resolution and disposition of this DPA. However, the length of time required to resolve this DPA did not adversely impact the Government's interests, since the Government did not rely on the data.

Management Comment #3:
Page 2, DODIG Draft Report: First part of the allegation. "NAVAIR had not followed up on special tooling and test equipment;"

Management Comments: Do not concur. This allegation is vague and fails to cite any specifics. Letters were sent from DCAA to NAVAIR in 1999 and 2000 requesting assistance to determine whether certain ST and STE items were, or were not, part of production contracts N00019-91-C-0125 and N00019-93-C-0084. While we cannot find a reply to these letters, Lockheed Martin acknowledged via correspondence to DCMC (6 Nov 1998) and NAVAIR (7 Dec 1998) the Government Property accountable to these two contracts. Lockheed Martin estimated residual value of Government Property at $145,340. These items were Government Property under the terms of the LGTR contracts. Due to their age, these items have either been disposed of as part of the contract close

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Added recommendation 3

out process, sold to Lockheed Martin, or transferred to contract N00019-99-C-1648. Moreover, per FAR 45.104(1) and 42.302(a)(26)-(28), oversight of LMSI's government property system, and in particular, the applicable ST/STE, rests with the cognizant Contract Administration Organization (CAO). There is no evidence, either presented in the vague draft report statements, or available in NAVAIR's records of any failure on the part of the CAO to meet its oversight responsibilities. The allegation is mis-directed at NAVAIR, but is nonetheless not sustained.

Management Comment #4:
Page 2, Second Paragraph: DODIG Draft Report:

Management Comments. It is recommended that the Audit Report be revised as follows:

From: "The second allegation that a contracting officer did not follow up on special tooling and test equipment was partially substantiated. Contracting officers had not completed detailed negotiation memorandums and had not inserted the Special Tooling clause in the specified firm-fixed-price contracts. As a result, NAVAIR could not identify the Government Property valued at more than $145,000 associated with the contracts, and it was unclear whether the contractor or the Government should have obtained title to the property."

To: The second allegation that a contracting officer did not follow up on special tooling and test equipment is not substantiated. While Contracting Officer negotiation memorandums did not provide detailed analysis of Special Tooling and Test Equipment, they did adequately document price reasonableness. Per FAR 52.245-2, Lockheed Martin is responsible for tracking all ST / STE. These items were Government Property under the terms of the LGTR contracts. Due to their age, these items have either been disposed of as part of the contract close out process, sold to Lockheed Martin, or transferred to contract N00019-99-C-1648. The allegation is not sustained.

Management Comment #5:
Page 3, DODIG Draft Report: Nonrecovery of Funds
The contracting officer could have requested an audit of the second-tier subcontractor proposal.

Management Comments: Do not concur. The total contract value of the LMSI contract was $168,953,032 million. The total value of the subcontract with Sierra was $13,328,000. The negotiated price between Allegheny, the second-tier subcontractor, and Sierra was $1,289,680. This amount represents 0.76% to the total value of the contract between the Navy and LMSI. It is not uncommon for the Government to rely on price analysis for subcontractors during negotiations. Negotiations with LMSI were not conducted on an element-by-element basis. LMSI clearly completed negotiations using price analysis for the material

position. There was ample historical data upon which the Government could reasonably rely. The Government Contracting Officer accepted the price analysis provided and did not request further cost data at that juncture or thereafter. Per the guidance provided at FAR 15.403-3(a)(1), the investment of government resources to perform the myriad such audits which might be conceivably performed under a contract of that magnitude and the unmeasurable cost of the attendant delays in settlement of the prime contract would be an unconscionable failure to exercise fiduciary responsibility to the taxpayers. The negotiation record confirms that NAVAIR clearly acted properly in exercising the business judgment vested in the contracting officer, by both regulation and extensive case law.

FAR 15.4 vs. FAR 15.8: Technically, the 1/1/99 reissue of the FAR also has Contract Pricing @ FAR 15.4 and the same or similar treatment of this issue. The 1997 reissue of the FAR, where Contract Pricing was, indeed, covered @ FAR 15.8, the following pertinent policy statements, which conveyed much the same sense as the current FAR coverage:

"... the contracting officer shall not obtain more information than is necessary...." @ FAR 15.802(a)

"... The contracting officer should use every means available to ascertain a fair and reasonable price prior to requesting cost or pricing data. Contracting officers shall not unnecessarily require the submission of cost or pricing data, ..." @ FAR 15.802(a)(3)

We also find that the issue of reliance was acknowledged to be pertinent (as case law has always affirmed, also):

"... (2) In arriving at a price adjustment, the contracting officer shall consider-- ...
(ii) The extent to which the Government relied upon the defective data." @ FAR 15.804-7(b)(2)

The contractor is required to submit when required by the PCO, but NO law or regulation has ever required the PCO to rely on the data - and FAR policy has consistently encouraged the PCO to other means where feasible, as discussed in the above citations.

Management Comment #6:
Page 4, DODIG Draft Report: NAVAIR Actions to Settle the Defective Pricing Issue. Prompt and decisive action taken by parties familiar with the circumstances during the negotiations may have led to a satisfactory solution of the defective pricing issue.

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Management Comments: Do not concur.
Under all applicable case law and regulations, effective with the decision during negotiations to rely on price analysis of the subcontract, there was no defective pricing issue. This fact was documented in the BCM and communicated again via the two 1999 NAVAIR letters requesting rescission of the DPA.

Revised to clarify

Management Comment #7:
Page 5, DODIG Draft Report: NAVAIR Actions to Settle the Defective Pricing Issue. On 12 July 2001, NAVAIR also sent a letter to DCAA requesting that Audit Report No. 6271-1999G42097001 be rescinded. The DCAA response stated that they would request legal counsel to determine whether any changes would be required to the audit report. If the auditors had rescinded the report at the request of NAVAIR, they would have violated the Government Auditing Standard that requires the auditor to be independent in attitude and appearance. Therefore, we consider the NAVAIR requests to have been inappropriate.

Management Comments: Do not concur. NAVAIR does not consider the requests to rescind the audit to be inappropriate in any way. The differences in position stem from a different hindsight view of the relevant facts. It is important to mention that resolving matters with the DCAA auditors stems from the fact that there was an intervening NCIS investigation. The intention of the contracting officer when the 12 July 2001 letter was sent to DCAA requesting that Audit Report No. 6271-1999G42097001 be rescinded was to state its position concerning the audit and did not agree that there was a sustainable defective pricing action. Ultimately, it was the failure of proof on the issue of reliance that prevented legal action; the DCAA audit failed to address that weakness in any meaningful way. The NAVAIR Office of Counsel supported this position. The intention of the contracting officer was never to request DCAA to violate the Government Auditing Standard that requires the auditor to be independent in attitude and appearance.

The Evaluation Report issued by OAIG on Dispositioned Defective Pricing Reports at NAVAIR, Report No. 99-048, December 8, 1998 addressed among other issues timely resolution and disposition of defective pricing audit reports. Therefore, NAVAIR diligently pursued corrective action to bring attention to defective pricing audit reports to ensure timely processing of DCAA defective pricing findings and recommendations.

It is important to note here that NAVAIR's practice of requesting such **supplements** was adopted at the strong insistence of the DODIG **auditor, Veronica Harvey**. NAVAIR did so in total agreement with that DODIG auditor's position that proper stewardship of taxpayer dollars would ensue by practices, rather than require DPA's known to be founded on misunderstandings of circumstances to be processed through to a pre-ordained non-recovery resolution. Additionally, based on such previous DODIG guidance and

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suggestion, should a final report be issued and the contracting officer make a subsequent determination that the findings can not be proven, the contracting officer must contact the auditor and request a revision to the findings. Such request must include the rationale for the request and provides DCAA with the opportunity to determine whether or not the rationale and information provided impacts their findings. There is no violation of any Government Auditing Standards, rather the contracting officer is requesting an independent evaluation of the rationale provided. Should DCAA elect not to revise their findings, the previous DODIG guidance has required documentation of both the request and the denial within the defective pricing file. This process has worked well in numerous previous and subsequent instances; NAVAIR has requested that Defective Pricing Reports be **supplemented** and DCAA has concurred and **supplemented**.

Management Comment #8:
Page 6, DODIG Draft report: Second Allegation. NAVAIR Follow-up on Government Property. "The contractor had been paid for two sets of special test equipment but had purchased only one set without returning the funds for the unpurchased equipment;"

Management Comments: Do not concur. Since the referenced contracts are FFP and STE is not a deliverable item, Lockheed Martin was not required to build or deliver any specific pieces of STE. Lockheed Martin was only required to turn over STE should it be acquired and used on the subject contracts (see FAR 52.245-2(c)(3)). The allegation is not sustained.

Management Comment #9:
Page 6, DODIG Draft report: Second Allegation. NAVAIR Follow-up on Government Property. "The contractor proposed about $145,000 of special tooling on a sixth contract, number N00019-91-C-0125. This contract, however, did not contain the required special tooling clause."

Corrected

Management Comments: Do not concur. During the period in question, under a Class Deviation, ST was subject to the provisions of the Government Property Clause (FAR 52.245-2) for contracts N00019-91-C-0125 and N00019-93-C-0084. Under 52.245-2(c)(2) "all property acquired by the Contractor, title to which vest in the Government under this paragraph...are subject to the provision of this clause." Thus, title to ST acquired under contract N0019-91-C-0125 rests with the Government.

Management Comment #10:
Page 6, Accounting for Special Tooling and Test Equipment

Management Comments: The overall tone of the IG report implies NAVAIR did a poor job negotiating the referenced Firm Fixed Price (FFP) Laser Guided

Revised

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Training Round (LGTR) production contracts. From 1991 to 2000, the price of LGTRs dropped from over $5,000 to $2,000 (then year dollars).

The report concludes the Price Negotiation Memorandums (PNM) lack of specificity regarding Special Tooling (ST) and Special Test Equipment (STE) lead to a situation where title to ST and STE could not be determined. While PNM documentation of ST / STE was limited, the report erroneously concludes this prevents the Government from taking title.

Under the referenced FFP LGTR production contracts, ST and STE were not called out as specific deliverables. Rather, the cost of any ST and STE was rolled into the LGTR unit prices. Per FAR 52.245-2(c)(3) "title to special test equipment acquired by the Contractor for the Government under this contract shall pass to and vest in the Government when its use in performing this contract commences or when the Government has paid for it, whichever is earlier, whether or not title previously vested in the Government." Once the STE was acquired and used under the LGTR production contracts, it became Government Property.

Revised

Normally, the Government Property Clause, (52.245-2 ALT I, April 1984), specifically excludes Special Tooling. Special Tooling is covered by FAR 52.245-17. Under contract N00019-91-C-0125, awarded 31 July 1991, a class deviation to the Government Property clause (52.245-2 ALT I, April 1984) was in effect. The deviation revised the language in 52.245-2 ALT-I as follows:

> The language "special tooling accountable to the contract is subject to provisions of the special tooling clause and not the provisions of the Government Property (Fixed-Priced Contracts Contract) clause" in paragraph 52.245-2 (c) (2) is waived for a period of one year beginning OCT 1990 or until the FAR is changed, whichever occurs first.

Thus, the class deviation made title to Special Tooling accountable under the Government Property Clause. Since the referenced contracts are FFP and ST/STE is not a deliverable item, Lockheed Martin was not required to build or deliver any specific pieces of ST or STE. Lockheed Martin was required to turn over ST and STE should it be acquired and used on the subject contracts.

Management Comment #11:
Page 6, DODIG Draft Report:

Management Comments. It is recommended that the Audit Report be revised as follows:

From: "Contract Clauses Governing Special Tooling and Test Equipment. In order to protect the Government's interest, the FAR instructs the contracting officer to insert the contract clause at FAR Subpart 52.245-2, Government

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Property, in fixed-price contracts. The clause covers special test equipment acquired under the contract and allows the Government to gain title to the test equipment included in the contract. Special tooling is addressed in the contract clause at FAR Subpart 52.245-17, Special Tooling, which the contracting officer must insert in a fixed-price contract that will include such items. The clause provides that the Government has an option to take title to all special tooling subject to the clause until the contracting officer relinquishes the option to take title."

To: Contract Clauses Governing Special Tooling and Test Equipment.
In order to protect the Government's interest, the FAR instructs the Contracting Officer to insert the contract clause at FAR Subpart 52.245-2, Government Property, in fixed-price contracts. The clause covers special test equipment acquired under the contract and allows the Government to gain title to the test equipment included in the contract. Under a class deviation, Special Tooling was also accountable under the Government Property Clause for contracts N00019-91-C-0125 and N00019-93-C-0084. Revised

From: "Special Tooling. We reviewed seven contracts and determined that five contracts, numbers N00019-93-C-0084, N00019-95-C-0024, N00019-96-C-0235, N00019-98-C-0131, and N00019-99-C-1648, contained the Special Tooling clause. However, we could not determine what had been purchased or what the Government had paid for tooling on the contracts because NAVAIR did not maintain adequate documentation. The contractor proposed about $145,000 of special tooling on a sixth contract, number N00019-91-C0125. This contract, however, did not contain the required special tooling clause. If the contracting officer erroneously omitted the clause, the title to some special tooling items purchased by the Government under the LGTR program would have passed to the contractor with no requirement to list the items on the Government property list. NAVAIR could not provide sufficient information regarding special tooling for the remaining contract, number N00109-90-C-0006. Therefore, we could not determine the amounts paid by the Government, if any, for special tooling on that contract or whether the clause should have been included."

To: **Special Tooling.** We reviewed seven contracts and determined that five contracts, numbers N00019-93-C-0084, N00019-95-C-0024, N00019-96-C-0235, N00019-98-C-0131, and N00019-99-C-1648, contained the Special Tooling clause. Under contract N00019-91-C-0125, a class deviation to the Government Property clause (52.245-2 ALT I, April 1984) was in effect. The deviation revised the language in 52.245-2 ALT-I as follows: Revised

The language "special tooling accountable to the contract is subject to provisions of the special tooling clause and not the provisions of the Government Property (Fixed-Priced Contracts Contract) clause" in paragraph 52.245-2 (c) (2) is waived for a period of one year beginning OCT 1990 or until the FAR is changed, whichever occurs first.

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Thus, the class deviation made title to Special Tooling accountable under the Government Property Clause. Since the referenced contracts are FFP and ST/STE is not a deliverable item, Lockheed Martin was not required to build or deliver any specific pieces of ST or STE. Lockheed Martin was required to turn over ST and STE should it be acquired and used on the subject contracts.

It was Lockheed Martin's contractual responsibility to properly record ST and STE into its property system as Government property. In accordance with FAR 42.301, DCMA has been delegated responsibility to perform property management at Lockheed Martin's LGTR production facility.

Management Comment #12:
Page 8, DODIG Draft Report: Recommendations.

1. Provide training to procurement officer and contract specialists on:

   a. The proper use of and reliance on cost or pricing data submitted by sole source contractors and subcontractors to meet the requirements of Section 2603a, title 10, United States Code.

   b. The requirement for prompt resolution and disposition of contract audit reports in accordance with the Office of Management and Budget Circular No. A-50, "Audit Follow-up," and DOD Directive 7640.2, Contract Audit Follow-up."

Deleted

   c. The requirement to account for government property in accordance with the contract clause at Federal Acquisition Regulations Subpart 52.245-2, Government Property, and to incorporate the clause at Federal Acquisition Regulations Subpart 52.245-17, Special Tooling, into contracts that cover such equipment.

   d. Preparation of business clearance memorandums as the Federal Acquisition Regulations require and to forward copies to the cognizant contract audit offices.

2. Establish performance measures for timely resolution and disposition of contract audit reports.

Management Comments: Concur. NAVAIR **currently provides and will continue to provide training to procurement officers and contract specialist on all areas listed in the** recommendations. Typically it is 3 or 4 years before Defective Pricing Reports are received at NAVAIR.

Team Members

The Deputy Assistant Inspector General for Audit Policy and Oversight, Office of the Deputy Inspector General for Inspections and Policy of the Department of Defense prepared this report. Personnel of the Office of the Inspector General of the Department of Defense who contributed to the report are listed below.

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