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Acronyms

AFAA	Air Force Audit Agency
ANSI	American National Standard Institute
CLIN	Contract Line Item
IG	Inspector General
EIA	Electronic Industries Alliance
EVM	Earned Value Management
FAR	Federal Acquisition Regulation
GSP	Globemaster III Sustainment Partnership



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

April 9, 2007

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE
(FINANCIAL MANAGEMENT AND COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Report on Award Practices for the C-17 Globemaster III Sustainment
Partnership Contract (Report No. D-2007-078)

We are providing this report for information and use. We performed this audit in response to allegations to the Defense Hotline concerning procedural and contractual inaccuracies in the C-17 Globemaster III Sustainment Partnership contract negotiations. We considered management comments on a draft of this report when preparing the final report. The Department of the Air Force comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Deborah Carros at (703) 604-9217 (DSN 664-9217). See Appendix C for the report distribution. The team members are listed inside the back cover.

By direction of the Deputy Inspector General for Auditing:

A handwritten signature in black ink, reading "Richard B. Jolliffe".

Richard B. Jolliffe
Assistant Inspector General
Acquisition and Contract Management

Department of Defense Office of Inspector General

Report No. D-2007-078

(Project No. D2006-D000CK-0231.000)

April 9, 2007

Award Practices for the C-17 Globemaster III Sustainment Partnership Contract

Executive Summary

Who Should Read This Report and Why? Acquisition, contracting, and logistics personnel within DoD and the Military Departments should read this report because it concerns acquisition decisions on the long-term sustainment of the C-17 Globemaster III that might be similar to problems with other programs.

Allegations. This audit was initiated in response to two Defense Hotline allegations. One allegation claimed that the C-17 program officials provided inaccurate and misleading information to the Secretary of the Air Force, leading to a misinformed decision to award the \$4.9 billion Globemaster III Sustainment Partnership contract to The Boeing Company. An additional allegation claimed that the C-17 program officials took action to prevent the formulation of information that may have contradicted the reasonableness of the Globemaster III Sustainment Partnership negotiated price. See Appendix B for more details on the allegations and the audit results.

Background. The C-17 is a jet-powered strategic airlifter with a cabin offering large-volume capacity and a rear-loading assembly to accommodate wheeled or tracked vehicles. The aircraft was designed to airlift and airdrop loads, including armored vehicles, directly into a combat zone. It was developed by McDonnell Douglas Corporation, a wholly owned subsidiary of The Boeing Company.

The Air Force reached a negotiated agreement with McDonnell Douglas Corporation to sustain the fleet of C-17 aircraft on November 25, 2003, in the amount of \$4.9 billion for FY 2004–FY 2008. However, the contract was not definitized until July 22, 2004. Prior to contract definitization, C-17 program officials took action to revalidate the negotiated contract to ensure the price was still fair and reasonable.

Results. We did not substantiate the allegations. However, the C-17 program officials' decision to definitize the C-17 Globemaster III Sustainment Partnership contract was based on a revalidation effort that may have produced unreliable results. In addition, C-17 contracting officials continue to exercise priced options based, in part, on the results of the revalidation effort. As a result, the Air Force may not have achieved the best price for the Government when it awarded the C-17 sustainment contract, valued at \$4.9 billion (of which \$3.2 billion was fixed-priced). Moreover, the Air Force cannot ensure that exercising priced options at the original negotiated prices are most advantageous to the Government.

Management Comments. The Assistant Secretary of the Air Force (Acquisition) did not fully agree with all of the findings in the report; however, the Assistant Secretary fully concurred with the recommendations, and stated that the C-17 program officials will:

- conduct and thoroughly document analysis performed to support the determination of price reasonableness in accordance with regulatory requirements before exercising priced option year FY 2008,
- require that the contractor provide certified cost or pricing data to support the FY 2009–FY 2011 priced proposal in accordance with Federal Acquisition Regulation 15.403-4, and
- request that the Defense Contract Audit Agency perform a pre-award audit to support determination of the price reasonableness for the FY 2009–FY 2011 contractor’s proposal prior to the FY 2009 contract option.

The Assistant Secretary of the Air Force (Acquisition) also stated that the Defense Contract Audit Agency agreed to consider expanding the current post-award audit to address the concerns of this audit report. The Air Force comments are responsive and meet the intent of the recommendation. See the Finding section of the report for a discussion of management comments and the Management Comments section of the report for the complete text of the comments.

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Background

This audit was initiated in response to two Defense Hotline allegations. One allegation claimed that C-17 program officials provided inaccurate and misleading information to the Secretary of the Air Force, leading to a misinformed decision to formally award the \$4.9 billion Globemaster III Sustainment Partnership (GSP) contract to The Boeing Company (Boeing). An additional allegation claimed that C-17 program officials took action to prevent the formulation of information that may have contradicted the reasonableness of the GSP negotiated price. See Appendix B for more details on the allegations and the audit results.

The C-17 is a jet-powered strategic airlifter with a cabin offering large-volume capacity and a rear-loading assembly to accommodate wheeled or tracked vehicles. The aircraft was designed to airlift and airdrop loads, including armored vehicles, directly into a combat zone. It was developed by McDonnell Douglas Corporation, a wholly owned subsidiary of Boeing.

The Air Force reached a negotiated agreement with McDonnell Douglas Corporation to sustain the fleet of C-17 aircraft on November 25, 2003, in the amount of \$4.9 billion for FY 2004–FY 2008.¹ However, the contract was not definitized until July 22, 2004. Prior to contract definitization, C-17 program officials took action to revalidate the negotiated price to ensure the price was still fair and reasonable.

The C-17 program office is located at Wright-Patterson Air Force Base, Ohio.

Objective

The audit was performed in response to allegations to the Defense Hotline concerning procedural and contractual inaccuracies in the C-17 GSP contract negotiations. The overall audit objective was to determine whether the C-17 GSP contract negotiations and award were conducted in accordance with the Federal Acquisition Regulation (FAR). See Appendix A for a discussion of the scope and methodology and prior coverage related to the objective.

¹ The contract base price year was FY 2004, priced option years were FY 2005–FY 2008, and unpriced option years were FY 2009–FY 2011.

Revalidation of Price Reasonableness

We did not substantiate the allegations. However, the C-17 program officials' decision to definitize the C-17 Globemaster III Sustainment Partnership contract was based on a revalidation effort that may have produced unreliable results. In addition, C-17 contracting officials continue to exercise priced options based, in part, on the results of the revalidation effort.

The revalidation effort may have produced unreliable results because program officials inappropriately included an earned value management (EVM) approach for revalidating the reasonableness of the negotiated fixed-price costs prior to definitization. In addition, program officials did not sufficiently investigate available data prepared by others that did not agree with program office-prepared data and that may not have supported the program office plan to definitize the originally negotiated contract price.

As a result, the Air Force may not have achieved the best price for the Government when it definitized the C-17 sustainment contract, valued at \$4.9 billion (of which \$3.2 billion was fixed-priced). Moreover, the Air Force cannot ensure that exercising priced options at the original negotiated prices are most advantageous to the Government.

C-17 Letter Contract

The Air Force and Boeing began a collaborative Integrated Process Team in July 2002 to establish pricing for the FY 2004–FY 2008 sustainment of the C-17 fleet. The Integrated Process Team goal was to award a fully definitive FY 2004–FY 2008 contract by October 1, 2003. The Secretary of the Air Force approved the long-term sustainment plan for the C-17, but specified that Boeing must be required by contract to provide for significantly increased support by partnering the C-17 workload with the Air Force Air Logistics Centers. Contract negotiations were suspended in order to consider how to accomplish the new requirement. A letter contract was issued for the period October 1, 2003, through December 31, 2003, based on the terms and conditions already agreed to as a result of discussions to date. The Air Force reached a negotiated agreement with Boeing on November 25, 2003, in the amount of \$4.9 billion for FY 2004–FY 2008. Senior Air Force leadership delayed definitization because Congress was in recess and because of concerns about the ongoing investigations into misconduct by Boeing and former Air Force acquisition personnel. As a result, the letter contract was extended through February 29, 2004. On January 23, 2004, the Secretary of the Air Force directed that the contract definitization be delayed an additional 6 months because of the continuing DoD investigation into improper Boeing and Air Force business activities. The letter contract was extended again through September 30, 2004. The period of performance under the letter contract now spanned all of FY 2004. The directed delay caused the C-17 program office to consider its options for definitizing the letter contract and establishing FY 2005–FY 2008 options.

Options for Definitizing C-17 Contract. Before definitizing the C-17 GSP contract, C-17 program officials conducted a series of discussions with senior subject matter experts at the Aeronautical Systems Center, as well as outside the Center, to consider options for definitizing the letter contract and establishing the FY 2005–FY 2008 options. C-17 program officials agreed to conduct an assessment of the original proposal’s estimating methodologies and cost and pricing data before deciding on one of the following:

- finalize the existing proposal and negotiated agreement dated November 25, 2003; or
- set aside the November 25, 2003, agreement and have the contractor update its proposal to reflect actual performance and re-engage the Integrated Process Team pricing process to renegotiate the entire \$4.9 billion business arrangement.

C-17 program officials referred to the assessment as a revalidation of the negotiated contract price.

Revalidation Effort

C-17 program officials’ decision to definitize the C-17 Globemaster III Sustainment Partnership contract was based on a revalidation effort that may have produced unreliable results.

Program Office Analysis. The revalidation effort may have produced unreliable results because program officials inappropriately included an EVM approach to revalidating the reasonableness of the fixed-priced contract costs prior to definitization. C-17 program officials used actual cost data from Boeing and applied EVM formulas to the data to assess the fairness and reasonableness of the fixed-price contract costs.² EVM requires the use of formulas and measures performance by objectively assessing progress. The results from those assessments provide the program manager with information on contractor performance and contract progress.

The C-17 program office analysis indicated that the fixed-price labor costs (part of contract line item [CLIN] 0001) at the end of FY 2004 were estimated to be about \$10 million, or five percent below the \$211 million negotiated value for labor costs. The C-17 program office analysis was based on 8 months of actual FY 2004 data, which were used to project costs for the remaining 4 months in FY 2004 and resulted in a projected \$10 million underrun. The analysis attributed the \$10 million underrun to the labor portion of the fixed costs.

² The program office assessment also considered Defense Contract Audit Agency’s data assessment, a Defense Contract Management Agency assessment of Boeing’s EVM system, and customer satisfaction ratings.

Program Office Analysis³

	Fixed-Price Labor Costs (CLIN 0001 Boeing Direct Labor)	Fixed-Price Contract Cost (CLIN 0001 Subcontract Costs)
Negotiated target cost	\$211,000,000	\$201,000,000
Projected actual cost	\$201,000,000	\$201,000,000
Projected dollar variance (underrun)	\$10,000,000	0
Percentage variance (underrun)	5 percent	0

Earned Value Management Guidance. EVM implementation and use is governed by an industry standard, American National Standard Institute (ANSI)/Electronic Industries Alliance (EIA) 748-A-1998 (R2002), “Earned Value Management Systems,” issued by the American National Standard Institute, August 28, 2002 (the Standard). The Standard establishes 32 minimum management control guidelines for an EVM system to ensure the validity of the information for management use. Using the Standard, DoD, the Federal Aviation Administration, and the National Aeronautics and Space Administration developed the “EVM Implementation Guide,” October 3, 1997. The EVM Implementation Guide provides uniform procedures and guidance for implementing and monitoring of EVM systems. The EVM Implementation Guide was revised and approved in October 2006 by the Director, Defense Contract Management Agency, the DoD executive agent for EVM systems. Additionally, the “Defense Acquisition Guidebook,” December 20, 2004, provides program managers guidance on the applicability of EVM.

EVM Use. EVM is a widely accepted industry best practice for project management that is used across DoD, the Federal Government, and the commercial sector. EVM is an integrated management system that coordinates the work scope, schedule, and cost goals of a program or contract, and measures the progress toward those goals. Managers use the EVM tool to:

- quantify and measure program and contract performance,
- provide an early warning system for deviating from a baseline,
- mitigate risks associated with cost and schedule overruns, and

³ The data presented in the program office analysis table were prepared by the C-17 program office and do not represent exact costs.

-
- provide a means to forecast final cost and schedule outcomes.

The EVM Implementation Guide requirements for EVM use exempt firm-fixed-price contracts and subcontracts. The rationale is that higher risk contracts warrant EVM management, and firm-fixed-price contracts may not be the appropriate contract vehicle in these cases. The use of firm-fixed-price contracts is typically limited to mature, lower-risk production work, and the risks do not warrant EVM to manage contract performance. Higher-risk development work is usually accomplished with cost-type contracts, which require EVM.

Use of EVM on the Sustainment Contract. C-17 program officials used EVM applications to revalidate the fairness and reasonableness of the price for the C-17 GSP contract even though the contract was less than 20 percent complete. In addition, C-17 program officials used the EVM applications to validate the contract line item that was firm-fixed-price. A program office memorandum, “Re-validation of Price Reasonableness, Globemaster III Sustainment Partnership (GSP) Business Arrangement,” dated July 20, 2004, stated that for firm-fixed-price contract costs (CLIN 0001),

The cost performance of the Globemaster III Sustainment Partnership (GSP) contract will be evaluated from an earned value management (EVM) perspective by reviewing the cost performance index (CPI) and the schedule performance index (SPI), which are both efficiency measures, the reasonableness of the estimate at comple[ti]on (EAC) and Boeing’s expenditure projections.

A Defense Contract Management Agency assessment of Boeing’s EVM system stated that the system is accurate. However, based on a review of the EVM data used by the C-17 program office to assess price reasonableness, a Defense Contract Management Agency EVM systems expert concluded that the EVM system was not an appropriate tool for performing fair and reasonable price validation on this contract. The EVM expert based the conclusion on the following information.

- Data in the contractor’s EVM system were “incomplete and showed a lack of discipline in recording information.” This reduces the credibility of the information and its use in analyzing and projecting costs.
- The C-17 GSP contract was only about 15 percent complete at the time of revalidation; contracts should be at least 20 percent complete to rely on EVM data for projecting estimated costs at completion.

Pricing Division Assessment

The revalidation effort may have produced unreliable results because program officials did not sufficiently investigate available data prepared by others. The pricing division assessment did not agree with program office-prepared data and

may not have supported the program office plan to definitize the originally negotiated contract price.

Pricing Division Performed Independent Analysis. The Aeronautical Systems Center Contracting Directorate, Pricing Division performed an independent analysis of the actual cost data from Boeing using the basis of estimates from the Flexible Sustainment Joint Model. The Flexible Sustainment Joint Model uses a spreadsheet to align the basis of estimates with the corresponding contract line items. The formulas in the spreadsheet calculate the estimated costs for those contract line items and do not assess earned value. The pricing division analysis estimated that fixed-price costs (all of CLIN 0001, which includes labor) for FY 2004 would be about \$68 million less than the negotiated value of the contract, and this 16 percent projected underrun would become 19 percent additional profit for Boeing. The pricing division analysis was based on 6 months of actual FY 2004 data, which were used to project costs for the remaining 6 months in FY 2004.

Pricing Division Analysis

	Fixed Price Contract Costs (CLIN 0001)
Negotiated target cost	\$412,574,070
Projected actual cost	\$345,027,739
Projected dollar variance (underrun)	\$67,546,331
Percentage variance (underrun)	16 percent
Projected additional profit percentage	19 percent

July 2004 Meeting to Discuss Options. C-17 program officials did not sufficiently investigate available data prepared by others that did not agree with program office-prepared data and that may not have supported the program office plan to definitize the originally negotiated contract price. In mid July 2004, the Secretary of the Air Force made the decision to proceed with the definitization of the C-17 GSP letter contract on the basis of the program office recommendation. The Deputy Chief of Contracting stated that on July 20, 2004, the pricing division notified the Director of Contracting, Aeronautical Systems Command that the award was not “smart.” The Deputy Chief of Contracting also stated that the following day the Director of Contracting met with senior contracting personnel and pricing personnel to discuss whether to reopen negotiations or proceed with the contract definitization.

At the July 21, 2004, meeting, program office personnel stated that the contract was underrunning labor, on target for engines, and slightly underrunning on material. Program office personnel explained that Boeing would be able to “catch up” on the underruns as time progressed. Pricing personnel, however, specifically questioned charges against the fixed-price line item (CLIN 0001). The pricing analysis indicated that the actual labor hours would be significantly less than the estimated labor hours used in the negotiated agreement and that this cost element could underrun by \$68 million. An internal memorandum prepared by a pricing division employee who attended the July 21, 2004, meeting indicated that the program office analysis claimed that labor costs through May 2004 were \$120 million. The memorandum further stated that the Defense Contract Audit Agency audit stated that labor costs through March 2004 were \$40 million, indicating that labor costs for the first 6 months were averaging \$7 million per month and then increased to \$40 million per month in April and May 2004. Program office files indicate that the program office had little notice of the pricing division data and was, therefore, unable to fully respond. Pricing division personnel did not raise any further objections to the program office continuing with the plan to definitize. The Director of Contracting, Aeronautical Systems Center had responsibility for the pricing division and stated that she did not have the authority to change the decision to definitize the C-17 GSP letter contract, and that she would require more proof to support stopping the definitization decision to the Secretary of the Air Force. On July 22, 2004, the program office definitized the letter contract and established the long-term business arrangements in accordance with the November 25, 2003, negotiated agreement.

Post Discussions Analysis. A post-meeting program office analysis of the pricing data explained that the pricing data was in error because pricing personnel had used “unburdened” labor dollars from the Defense Contract Audit Agency audit when assessing Boeing’s cost performance. However, we confirmed with Defense Contract Audit Agency that the data reported in their audit results included only “burdened”⁴ labor dollars.

Priced Option Years

C-17 contracting officials continue to exercise priced options based, in part, on the results of the revalidation effort.

Federal Acquisition Regulation Requirements. FAR 17.207, “Exercise of Options,” states that a contracting officer may exercise a contract option only after determining that the exercise of the option is the most advantageous method of fulfilling the Government’s need. The contracting officer shall consider price and other factors before making a determination on whether to exercise the option based on one of the following:

- A new solicitation fails to produce a better price or a more advantageous offer than that offered by the option....

⁴ Burdened costs include direct labor, non-direct labor, labor overhead, overhead composite, general and administrative costs, and cost of money.

-
- An informal analysis of prices or an examination of the market indicates that the option price is better than prices available in the market or that the option is the more advantageous offer.
 - The time between the award of the contract containing the option and the exercise of the option is so short that it indicates the option price is the lowest price obtainable or the more advantageous offer. The contracting officer shall take into consideration such factors as market stability and comparison of the time since award with the usual duration of contracts for such supplies or services.

The decision to exercise an option should also take into account the Government's need for continuity of operations and potential costs of disrupting operations.

Option Year Prices Not Reviewed. Although C-17 contracting officials did not violate the FAR requirements when they exercised priced options for FY 2005, FY 2006, and FY 2007, they did not exercise prudent business practices. Contracting officials documented the determination that the priced options were the most advantageous method of meeting the Government's need. However, the documented decisions were not based on any analysis of any data and were not supported. According to documentation in the contract files, each determination to exercise the options for FY 2005–FY 2007 was based on the following rationale.

- A new solicitation would likely fail to produce a better price or an overall more advantageous offer than that available through exercise of the available options....
- Initiating a competitive acquisition for the sustainment of the C-17 fleet at this time is not feasible as Boeing is the sole-source manufacturer of the C-17 aircraft and is currently the only source that has the necessary data, expertise, and infrastructure to provide sustainment of the fielded aircraft. There would be significant transition costs associated with providing the necessary infrastructure and transferring the necessary material to a contractor other than Boeing.
- There have been no significant changes in the pricing assumptions for the Options since their negotiation....

The determination that “a new solicitation would likely fail to produce a better price or an overall more advantageous offer than that available through exercise of the available options” was not based on any analysis of actual contract costs or prices for the option years. In addition, the documented determination states that “while the Government would have the benefit of more recent ‘actuals’ in any negotiation, new negotiations would open all the terms and conditions of the 25 Nov 03 agreed-to business arrangements into play.” However, it is possible that Boeing and the Air Force could agree to reopen negotiations only on the price element of the option. The Deputy Chief of Contracting confirmed that no additional analyses were done and that the official contract file did not indicate

that any analyses of actual contract costs or prices for the option years had been performed.

In the written determinations to exercise the options, C-17 contracting officials only addressed the costs associated with reopening negotiations; the determinations did not address any benefits associated with reopening negotiations. Consideration of the costs and benefits of the options are necessary to support a sound determination. In effect, the C-17 contracting officials did not determine with reasonable support that exercising these options was the best decision for the Government; in particular, the underruns estimated in 2004 by the pricing division prior to contract definitization suggest that the option prices should have been carefully reviewed to ensure that exercising the options was most advantageous to the Government.

Conclusion

Even though the FAR does not dictate acceptable profit margin levels, both analyses indicate that the negotiated contract price may not have been fair and reasonable, and the Air Force may not have achieved the best price for the Government.

The pricing division raised concerns about the negotiated price of the GSP contract and the concerns were not appropriately addressed before the contract was definitized. The Chief of Pricing stated that the process followed for the GSP contract was “clearly not right” and that the award was neither a good deal nor a bad deal, just not the best deal. He stated that Boeing is clearly making a high profit off this contract and he believes that the contract was set up to allow for this.

The C-17 program office and the pricing division performed separate analyses to revalidate price reasonableness, and both analyses showed that projected contract costs would be less than the negotiated contract amount. The analyses prepared by the pricing division showed that the projected cost underruns for the fixed-price portion of the contract could result in as much as 19 percent more in profit.

The Air Force definitized the C-17 sustainment contract, valued at \$4.9 billion, and may not have achieved the best price for the Government. In addition, C-17 contracting officials did not sufficiently support their conclusions that exercising the priced option years at the original negotiated prices was most advantageous to the Government. Because of the information indicating a potential cost underrun, we believe a thorough review of cost data should be conducted before the FY 2008 option is exercised to determine whether the price is still reasonable and a new proposal should be obtained to determine option prices for FY 2009–FY 2011. The review should include documented analysis to support the decision. In addition, since the data indicated a potential underrun in the original negotiated price, we believe that Defense Contract Audit Agency should audit the contractor’s proposal for FY 2009–FY 2011 prices and also perform a post-award review of the original negotiated price.

Recommendations, Management Comments, and Audit Response

We recommend that the Commander, Aeronautical Systems Center, Air Force Materiel Command request the C-17 program officials determine whether to exercise contract options on the C-17 sustainment contract for option years FY 2008–FY 2011. Specifically,

1. Conduct and document analysis to support the determination of price reasonableness and the basis of the determination before exercising priced option year FY 2008.

Management Comments. The Assistant Secretary of the Air Force (Acquisition) concurred, stating that the C-17 program officials will conduct and thoroughly document the analysis performed to support the determination of price reasonableness in accordance with regulatory requirements. The Assistant Secretary also stated that the C-17 program officials plan to complete this action by August 29, 2007. Additionally, the Assistant Secretary stated the program officials plan to review their current processes for documenting and analyzing contract options prior to exercising.

Audit Response. The comments are responsive, and no additional comments are required.

2. Request that the contractor provide a proposal with certified cost and pricing data to support the pricing of option years FY 2009–FY 2011.

Management Comments. The Assistant Secretary of the Air Force (Acquisition) concurred, stating that the C-17 program officials will ensure that the contractor provides certified cost or pricing data to support the FY 2009–FY 2011 priced proposal in accordance with Federal Acquisition Regulation 15.403-4, “Subcontracting Pricing Considerations.” Additionally, the Assistant Secretary stated that the certified cost or pricing data will be examined and confirmed to be current, accurate, and complete in accordance with the Truth in Negotiations Act.

Audit Response. The comments are responsive, and no additional comments are required.

3. Request that the Defense Contract Audit Agency:

a. Audit the contractor’s proposal for FY 2009–FY 2011, and

Management Comments. The Assistant Secretary of the Air Force (Acquisition) concurred, stating that the C-17 program officials will request that the Defense Contract Audit Agency perform a pre-award audit to support the price reasonableness of the FY 2009–FY 2011 contractor’s proposal prior to the FY 2009 contract option. The Assistant Secretary stated that they plan to complete this action 31 days after receipt of the contractor’s proposal on August 1, 2008.

Audit Response. The comments are responsive, and no additional comments are required.

b. Perform a post-award review of the original negotiated price for the C-17 Globemaster III Sustainment Partnership contract.

Management Comments. The Assistant Secretary of the Air Force (Acquisition) concurred, stating that the Defense Contract Audit Agency agreed to consider expanding the current post-award audit to address the concerns of this audit report.

Audit Response. The comments are responsive, and no additional comments are required.

Appendix A. Scope and Methodology

We evaluated whether the C-17 Globemaster III Sustainment Partnership contract negotiations and award were conducted in accordance with the FAR. We focused the review on the revalidation of price reasonableness done by the C-17 program officials and the analysis done by the Aeronautical Systems Center Pricing Division prior to the definitization of the C-17 Globemaster III Sustainment Partnership contract with Boeing.

We collected, reviewed, and analyzed documents dated from March 2003 through December 2006. Specifically, we evaluated acquisition and contracting documents that the Air Force used to support the definitization of the C-17 Globemaster III Sustainment Partnership contract.

We interviewed contracting and logistics personnel at the C-17 program office at Wright-Patterson Air Force Base. We also interviewed contracting and acquisition support personnel at the Aeronautical Systems Center at Wright-Patterson Air Force Base.

We reviewed applicable contracting regulations including the FAR, the Defense Federal Acquisition Regulation Supplement, and the Air Force Federal Acquisition Regulation Supplement. We also reviewed selected guidance on EVM systems.

We performed this audit from July 2006 through January 2007 in accordance with generally accepted government auditing standards.

The scope of the review was limited to the decisions and transactions that occurred prior to the definitization of the C-17 sustainment contract.

Use of Computer-Processed Data. We did not use computer-processed data to perform this audit.

Use of Technical Assistance. We did not require technical assistance for the execution of this audit.

Government Accountability Office High-Risk Area. The Government Accountability Office has identified several high-risk areas in DoD. This report provides coverage of the DoD Contract Management high-risk area.

Prior Coverage

During the last 5 years, the DoD Inspector General (IG) and the Air Force Audit Agency (AFAA) have issued three reports discussing the C-17 Globemaster III Sustainment Partnership contract. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>. Unrestricted AFAA reports can be accessed at www.afaahq.af.mil.

DoD IG

DoD IG Report No. D-2006-101, "Procurement Procedures Used for C-17 Globemaster III Sustainment Partnership Total System Support," July 21, 2006

Air Force

AFAA Report No. F2002-0002-C06400, "C-17 Integrated Product Team Participation (Phase IV)," February 6, 2002

AFAA Report No. F2002-0001-C06400, "C-17 Integrated Product Team Participation (Phase III)," December 7, 2001

Appendix B. Defense Hotline Allegations

Allegations. C-17 program officials provided inaccurate and misleading information to the Secretary of the Air Force, leading to a misinformed decision to formally award the \$4.9 billion GSP contract to Boeing.

C-17 program officials took action to prevent the formulation of information that may have contradicted that the negotiated prices for the GSP contract were still fair and reasonable based on an analysis of actual costs to date.

History. The Air Force reached a negotiated agreement with McDonnell Douglas Corporation to sustain the fleet of C-17 aircraft on November 25, 2003, in the amount of \$4.9 billion for FY 2004–FY 2008. However, the contract was not definitized until July 22, 2004. Prior to contract definitization, C-17 program officials took action to revalidate the negotiated contract to ensure the price was still fair and reasonable.

Audit Results. The allegations were not substantiated. The C-17 program officials:

- adhered to FAR guidelines in negotiating and awarding the C-17 sustainment contract,
- initiated actions to make sure the C-17 sustainment contract price was still fair and reasonable prior to definitization,
- used qualified personnel to negotiate the C-17 sustainment contract price and took action to revalidate the reasonableness of the contract price, and
- did not prevent the collection or formulation of information that may have contradicted the reasonableness of the GSP negotiated price.

Appendix C. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Technology, and Logistics
Under Secretary of Defense (Comptroller)/Chief Financial Officer
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Director, Program Analysis and Evaluation
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Department of the Navy

Naval Inspector General
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force
Commander, Air Force Materiel Command
Commander, Aeronautical Systems Center

Combatant Command

Inspector General, U.S. Joint Forces Command

Other Defense Organizations

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

Non-Defense Federal Organization

Office of Management and Budget

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 Homeland Security and Governmental Affairs
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
House Committee on Armed Services
House Committee on Oversight and Government Reform
House Subcommittee on Government Management, Organization, and Procurement,
Committee on Oversight and Government Reform
House Subcommittee on National Security and Foreign Affairs,
Committee on Oversight and Government Reform

Department of the Air Force Comments



OFFICE OF THE ASSISTANT SECRETARY

DEPARTMENT OF THE AIR FORCE
WASHINGTON DC



MAR 22 2007

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL
ATTN: DEPUTY INSPECTOR GENERAL FOR AUDITING

FROM: SAF/AQ

SUBJECT: Audit on the Award Practices for the C-17 Globemaster III Sustainment
Partnership Contract (Project No. D2006CK-0231)

The Air Force appreciates the opportunity to review and comment on this draft Department of Defense Inspector General (DoD IG) report. Although we do not fully agree with all the findings within your report, we do concur with the recommendations and will:

- a. Conduct and thoroughly document the analysis performed to support the determination of price reasonableness in accordance with the appropriate regulatory requirements before exercising priced option year FY08. This action shall be accomplished on or about 29 Aug 07.
- b. Ensure that the contractor complies with the requirements of FAR 15.403-4 and provides Certified Cost or Pricing Data (CCPD) to support the priced proposal for FY09-FY11. The Draft Request For Proposal was issued on 31 Jan 07 and contained CCPD requirements. The contractor's proposal is scheduled for receipt on or about 1 Jul 08 with negotiations expected to conclude on or about 15 Aug 08. In accordance with the Truth In Negotiations Act, the CCPD will be examined and confirmed by the Air Force to be current, accurate, and complete.

In accordance with Agency Procedures, a pre-award audit shall be requested of the Defense Contract Audit Agency for the contractor's proposal for FY09-FY11 to support the determination of price reasonableness prior to award of the FY09 Contract Option. This action will be completed 31 days after receipt of Boeing's proposal anticipated on or about 1 Aug 08. The resident auditor has agreed to consider expanding the current post-award audit to address the concerns of this draft report. Their decision to expand the audit will be made no later than 90 days after release of the final DoD IG report.

As a result of your comments regarding the need for additional price analysis prior to exercising contract options, the 516 AESG (C-17 Program Office) will review their current processes to ensure they thoroughly document their analysis and continue to exercise future contract options in strict accordance with FAR 17.207 and other appropriate guidance. As with all contract actions, our goal is to ensure the warfighters are provided the best tools for the best value to the taxpayers to execute their missions.

My staff is ready to assist in any way to ensure all concerns are addressed prior to the final report publication. If you require further assistance, please contact Mrs. Karen Fischetti at (703) 588-7047.

A handwritten signature in cursive script, reading "Sue C. Payton".

SUE C. PAYTON
Assistant Secretary of the Air Force
(Acquisition)

Team Members

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Inspector General Department of Defense

