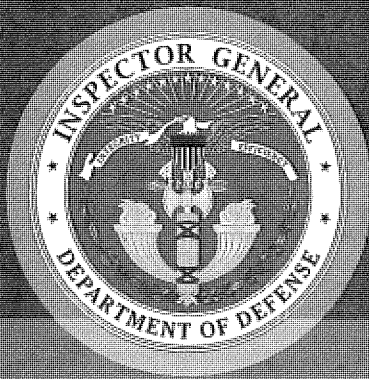


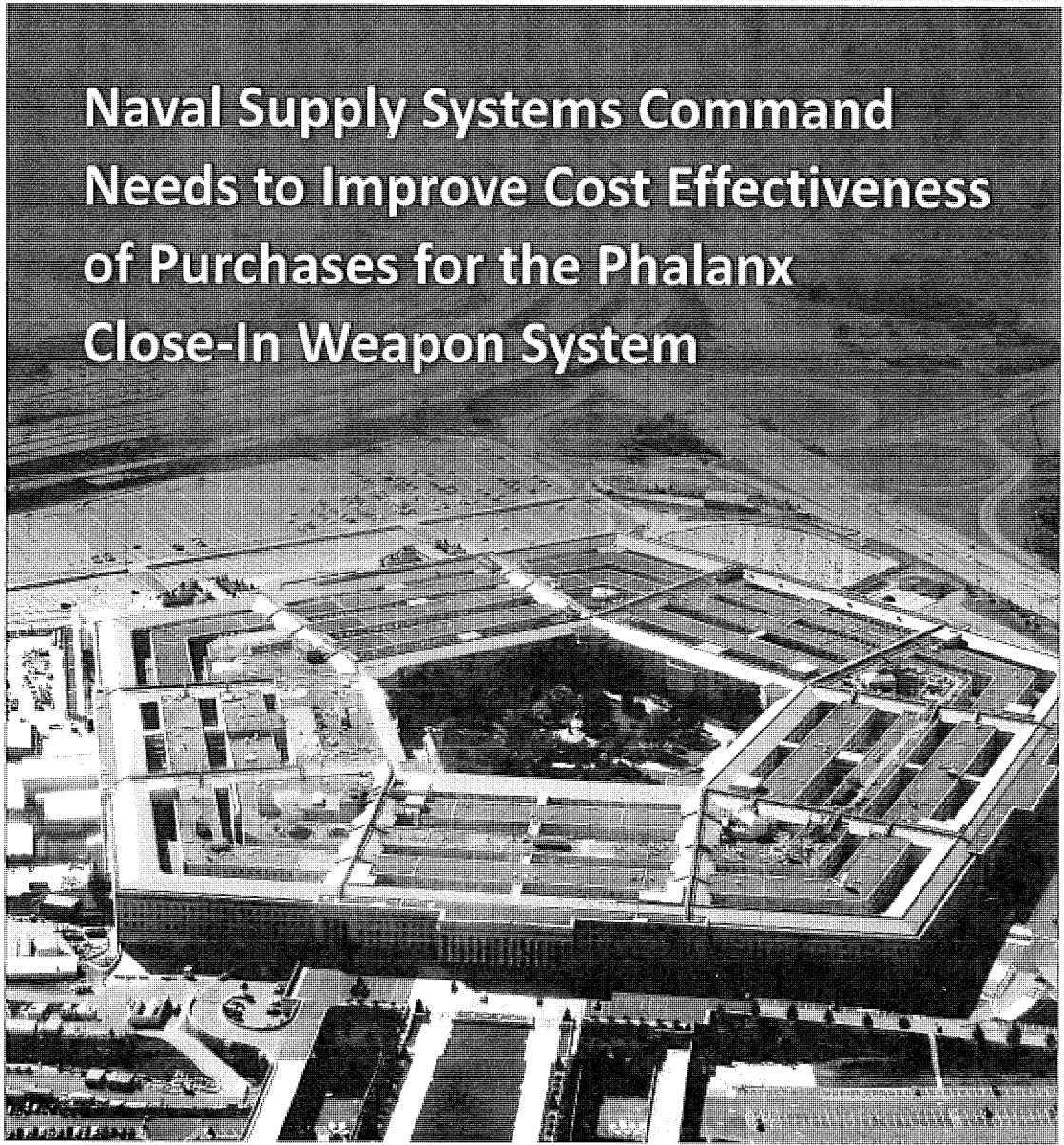
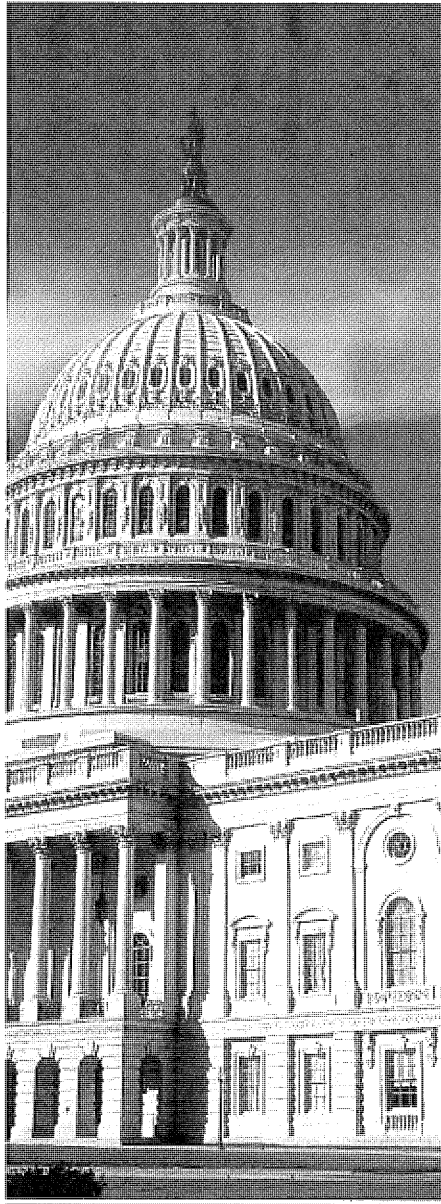
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INSPECTOR GENERAL

U.S. Department of Defense

DECEMBER 19, 2014



Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

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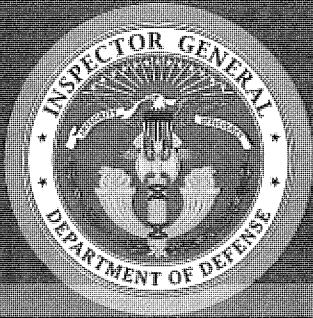
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Results in Brief

Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System

December 19, 2014

Objective

Our objective was to determine whether DoD was making cost-effective material purchases for the Phalanx Close-In Weapon System through performance-based logistics contracts with Raytheon Missile Systems Company (Raytheon).

Finding

Naval Supply Systems Command Weapon Systems Support (NAVSUP WSS) contracting officers did not adequately manage the performance-based logistics contracts with Raytheon to make cost-effective purchases for the Phalanx Close-In Weapon System. This occurred because contracting officers did not:

- perform adequate price-reasonableness analysis when determining the ceiling price,
- complete timely variation in quantity reviews to reconcile the contract's forecasted and actual demand,
- provide clear contract requirements related to Defense Contract Management Agency's roles and responsibilities and NAVSUP WSS's variation in quantity review process, or
- comply with Defense acquisition regulations for undefinitized contract actions.

Finding (cont'd)

As a result, NAVSUP WSS may be overpaying Raytheon. In addition, NAVSUP WSS cannot quantify the work Raytheon performed for the \$69.6 million spent on the current performance-based logistics contract.

Recommendations

We recommend the Commander, NAVSUP WSS:

- ~~(FOUO)~~ require contracting officers to perform price-reasonableness analysis, ^{NAVSUP: (b) (5)} [REDACTED]
- establish internal controls for following the Defense Federal Acquisition Regulation Supplement; and
- review the contracting officers' failure to perform thorough price-reasonableness analysis, complete timely variation in quantity reviews, and comply with the Defense Federal Acquisition Regulation Supplement, and, as appropriate, take administrative action.

Management Comments and Our Response

Comments from the Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, addressed four recommendations. However, the Vice Commander's comments did not fully address the remaining three recommendations. We request additional comments to the final report by January 20, 2015. Please see the Recommendations Table on the back of this page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Commander, Naval Supply Systems Command Weapon Systems Support	1.a, 1.c, 2	1.b, 1.d, 1.e, 3

Please provide comments by January 20, 2015.



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

December 19, 2014

MEMORANDUM FOR NAVAL INSPECTOR GENERAL

SUBJECT: Naval Supply Systems Command Needs to Improve Cost Effectiveness of Purchases for the Phalanx Close-In Weapon System (Report No. DODIG-2015-053)

We are providing this report for review and comment. The Naval Supply Systems Command Weapon Systems Support contracting officers did not adequately manage the performance-based logistics contracts with Raytheon Missile Systems Company (Raytheon) to make cost-effective purchases for the Phalanx Close-In Weapon System. Therefore, Naval Supply Systems Command Weapon Systems Support may have overpaid for work Raytheon performed under performance-based logistics contracts and cannot quantify the work Raytheon performed for the \$69.6 million spent on the current contract. We conducted this audit in accordance with generally accepted government auditing standards.

We considered management comments on a draft of this report when preparing the final report. DoD Directive 7650.3 requires that recommendations be resolved promptly. The Vice Commander, Naval Supply Systems Command, responding for the Commander, Naval Supply Systems Command Weapon Systems Support, provided comments that were generally responsive; however, we require additional comments on Recommendations 1.a, 1.c, and 2. Therefore, we request additional comments on those recommendations by January 20, 2015.

Please send a PDF file containing your comments to audclev@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to Jacqueline L. Wicecarver at (703) 604-████ (DSN 664-████).

Handwritten signature of Amy J. Frontz in cursive.

Amy J. Frontz
Principal Assistant Inspector General
for Auditing

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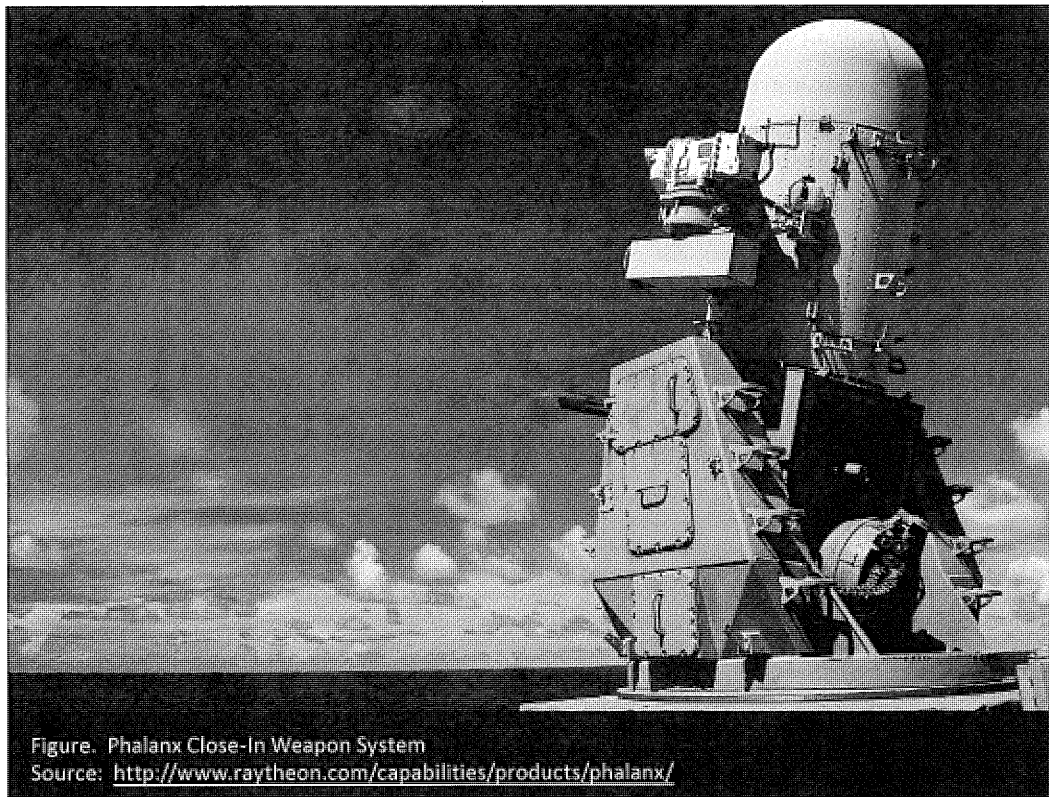
Introduction

Objective

The objective of our audit was to determine whether DoD was making cost-effective material purchases for the Phalanx Close-In Weapon System (Phalanx) through the performance-based logistics (PBL) contracts with the Raytheon Missile Systems Company (Raytheon). This audit focused on cost and price analysis with the associated PBL contracts with Raytheon. See Appendix A for a discussion of the scope and methodology and Appendix B for prior audit coverage related to the objective.

Background

The Phalanx is a radar-guided weapon system that automatically detects, evaluates, tracks, engages, and destroys the target. It provides ships a defense against missiles, aircraft, and other threats that have penetrated other fleet defenses. Naval Supply Systems Command (NAVSUP) Weapon Systems Support (WSS) awarded Raytheon three PBL contracts to manufacture and repair spare parts for the Phalanx.



Raytheon Missile Systems Company

Raytheon is the original equipment manufacturer, design agent, repair parts manager, and system overhaul provider for the Phalanx. Raytheon administers the contract at its headquarters in Tucson, Arizona, and performs most PBL operations at a facility in Louisville, Kentucky.

Naval Supply Systems Command

NAVSUP manages supply chains that provide material for Navy aircraft, surface ships, submarines and their associated weapons systems. NAVSUP WSS provides program and supply support for the weapon systems that keep Navy forces mission ready. NAVSUP WSS performs variation in quantity (VIQ) reviews to reconcile the contract's forecasted and actual demands. The Price Fighters group, a subcomponent of NAVSUP WSS, performs various types of cost and price analysis on spare parts and weapon systems to help contracting officers negotiate lower prices with contractors.

Phalanx Performance-Based Logistics Contracts

NAVSUP WSS contracting officers awarded PBL contracts in which Raytheon was responsible for manufacturing and repairing spare parts for the Phalanx. In March 2000, NAVSUP WSS awarded contract N00104-00-D-ZD21 (PBL1) as a fixed-price award fee PBL contract totaling \$96.8 million, with a period of performance from March 2000 to March 2006. In March 2006, NAVSUP WSS awarded contract N00104-06-C-L008 as an undefinitized contract action (UCA).¹ In July 2006, NAVSUP WSS awarded contract N00104-06-D-L007 (PBL2)² as a fixed-price award-fee PBL contract totaling \$203.5 million with a 5-year period of performance. NAVSUP WSS awarded a UCA in April 2011 to extend PBL2 until NAVSUP WSS could award contract N00104-11-D-ZD43 (PBL3). In September 2011, NAVSUP WSS awarded PBL3 as a UCA with a not-to-exceed ceiling price of \$162.2 million. NAVSUP WSS paid Raytheon a percentage of the ceiling price each month. As of September 2014, NAVSUP WSS had not definitized the contract and spent approximately \$69.6 million on PBL3.

¹ A UCA is an action for which the contract terms, specifications, or price are not agreed upon before performance begins.

² PBL2 included work performed on contracts N00104-06-C-L008 and N00104-06-D-L007.

Review of Internal Controls

DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses related to NAVSUP WSS contracting officers' price-reasonableness analysis, VIQ reviews, contract language, and Defense Federal Acquisition Regulation Supplement (DFARS) compliance. We will provide a copy of the report to the senior official responsible for internal controls in the Department of the Navy.

Finding

Improvements Needed for Cost-Effective Purchases on the Performance-Based Logistics Contracts for the Phalanx

NAVSUP WSS contracting officers did not adequately manage the PBL contracts with Raytheon to make cost-effective purchases for the Phalanx. Specifically, NAVSUP WSS contracting officers:

- may not have received fair and reasonable prices from Raytheon because they did not perform adequate price-reasonableness analysis when determining the ceiling price for PBL3;
- awarded PBL3 before determining an accurate inventory on which to base their forecasted demand because they did not complete timely VIQ reviews to reconcile the contract's forecasted and actual demand;
- may not have ensured adequate oversight of the work Raytheon performed because they did not write clear contract requirements in PBL3 related to the Defense Contract Management Agency's (DCMA) roles and responsibilities and NAVSUP WSS's VIQ review process; and
- purchased parts on PBL3 since September 2011 without having a price list because they did not comply with Defense acquisition regulations for undefinitized contract actions.

As a result, NAVSUP WSS may be overpaying Raytheon and cannot quantify the work that Raytheon performed for the \$69.6 million already spent on PBL3.

Inadequate Price-Reasonableness Analysis Led to Unsupported Ceiling Price

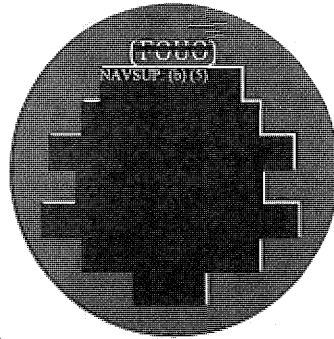
NAVSUP WSS contracting officers did not adequately manage the PBL contracts with Raytheon to make cost-effective purchases for the Phalanx. Specifically, NAVSUP WSS contracting officers may not have received fair and reasonable prices from Raytheon because they did not perform adequate price-reasonableness analysis to determine the ceiling price for PBL3. In May 2011, NAVSUP WSS contracting officers requested that the Price Fighters perform an analysis to determine the reasonableness of PBL2 unit prices because the PBL3 ceiling price

was based on the previous contract's prices. However, the contracting officers did not consider the analysis results when determining the contract ceiling (FOUO) NAVSUP: (b) (5)

(FOUO) NAVSUP: (b) (5)
(FOUO) NAVSUP: (b) (5)

Contracting Officers Did Not Fully Evaluate the Price Fighters' Results

(FOUO) NAVSUP WSS contracting officers selected 37 parts with the highest demand from Raytheon's proposal for PBL3. The Price Fighters reviewed PBL2 unit prices for those parts. The Price Fighters submitted seven requests for data and clarification to complete the review. However, Raytheon did not respond to one request and took nearly 2 months to provide a response for the other six requests. The Price Fighters completed its review based on the available information. For each selected part, the Price Fighters developed a recommended unit price and compared that price with Raytheon's proposed unit prices.



(FOUO) NAVSUP: (b) (5)
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(FOUO) NAVSUP: (b) (5)

The contracting officers stated they were not able to fully evaluate the Price Fighters' results before awarding the contract on September 1, 2011.

(FOUO) Based on the findings in the Price Fighters' report, we calculated a fair and reasonable sales price to NAVSUP WSS for Raytheon subcontractor purchases on PBL2. Raytheon provided purchase orders that identified the per-unit material cost and Raytheon's process for determining the cost for each part. Raytheon purchase orders in support of PBL2 showed that 312 unique parts were purchased from subcontractors 1,221 times. We used the process Raytheon provided to calculate a fair and reasonable price for those 1,221 purchases. Specifically, we multiplied the per-unit material cost by Raytheon's material burden and general and administrative burden rates. We then applied the profit percentage agreed to by Raytheon and NAVSUP WSS. Our initial analysis identified differences between the contract price for each part (list price) and our calculated fair and reasonable price.

³ (FOUO) NAVSUP: (b) (5)

(FOUO) After coordinating with Raytheon personnel, they agreed that we correctly applied their process. However, they stated that we also needed to include their allocated direct costs in our calculation. We added those costs and still identified differences that Raytheon could not explain.

(FOUO) For 397 of the 1,221 purchases, the list price was below Raytheon's cost. For example, we calculated a fair and reasonable price of \$14,315 for a part purchased by Raytheon. The list price for the part was \$2,845. If NAVSUP WSS purchased this part at the list price, Raytheon would have lost \$11,470 per unit. For

140 of the 1,221 purchases, the list price was above Raytheon's cost but did not include all of the agreed-upon profit rate.

(FOUO)
 NAVSUP WSS
 would have potentially
 overpaid approximately
 \$17.8 million net if
 NAVSUP WSS had bought
 all of the parts associated
 with Raytheon's
 1,221 purchases
 supporting PBL2.

For example, we calculated a fair and reasonable price of \$2,948 for a part purchased by Raytheon. The list price for the part was \$2,705. While Raytheon would have received some profit if NAVSUP WSS purchased the part, it would not have received the agreed-upon profit rate. If NAVSUP WSS purchased this part at the list price, Raytheon would have lost \$243 per unit. For 684 of the 1,221 purchases, the list price was above our calculated fair and

reasonable price. For example, we calculated a fair and reasonable price of \$10,940 for a part purchased by

Raytheon. The list price for the part was \$84,614. If NAVSUP WSS purchased this part at the list price, it potentially would have overpaid by \$73,674 per unit.

Overall, our price-reasonableness analysis identified that NAVSUP WSS would have potentially overpaid approximately \$17.8 million net if NAVSUP WSS had bought all of the parts associated with Raytheon's 1,221 purchases supporting PBL2.

NAVSUP WSS contracting officers should assess and implement available contractual remedies and options to recover from Raytheon any overpayments for purchases on PBL2, as appropriate. Additionally, NAVSUP WSS contracting officers should perform a thorough price-reasonableness analysis on future PBL contracts to limit potential overpayments. See the Table for a summary of the price reasonableness analysis.

Table. Summary of Price-Reasonableness Analysis

Purchase Type	Raytheon Purchases Analyzed	List Price Below Raytheon's Cost	Potential Loss to Raytheon*	List Price Below Agreed-Upon Profit	Potential Loss to Raytheon	List Price Above Fair and Reasonable Price	Potential Overpayment to Raytheon
Supplier Buys	320	75	\$697,646	35	\$166,484	210	\$17,035,910
Supplier Repairs	901	322	1,596,396	105	219,763	474	3,395,781
Total	1,221	397	\$2,294,042	140	\$386,247	684	\$20,431,691

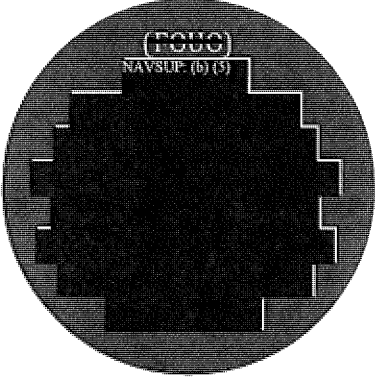
Note: NAVSUP WSS's net potential overpayment to Raytheon would be approximately \$17.8 million, based on the \$20,431,691 potential overpayment to Raytheon minus the \$2,294,042 and \$386,247 potential losses to Raytheon.

*Includes Raytheon's cost and agreed-upon profit.

Contract Ceiling Price Was Not Supported

(FOUO) The Price Fighters developed a business case analysis to determine the PBL3 contract ceiling price. [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
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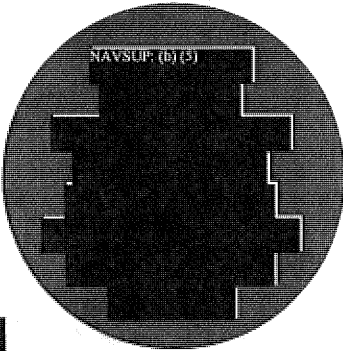
[REDACTED] NAVSUP WSS annually obligated 75 percent of the ceiling price, which is the maximum amount DFARS allows for an undefinitized contract. In accordance with the contract, NAVSUP WSS paid Raytheon one-twelfth of this amount each month. NAVSUP WSS contracting officers could have identified lower unit prices and reduced the ceiling price, as well as the monthly payments to Raytheon, if they had thoroughly reviewed the PBL2 unit prices. The Navy could have put the excess funds to better use, supporting the warfighter. The Commander, NAVSUP WSS, should review the contracting officers' failure to perform a thorough price reasonableness analysis to determine the PBL3 ceiling price, and as appropriate, take administrative action.

Untimely Variation in Quantity Reviews Led to Inaccurate Beginning Inventory

NAVSUP WSS contracting officers awarded PBL3 before determining an accurate inventory on which to base their forecasted demand. This occurred because they did not complete timely VIQ reviews to reconcile the contract's forecasted and actual demand on PBL2. The contracting officers conduct a VIQ review when supplied parts for the preceding year are different from the annual forecasted demand for that part. According to the PBL2 contract, VIQ reviews should begin within 4 months of the end of the contract year. However, the NAVSUP WSS contracting officers completed the first VIQ review for PBL2 on August 6, 2008, approximately 22 months after the contract's first year ended. In addition, the NAVSUP WSS contracting officers completed the final VIQ review on April 1, 2014, 3 years after the final delivery order was issued on April 1, 2011. As a result, NAVSUP WSS contracting officers did not have an accurate beginning inventory for PBL3. NAVSUP WSS contracting officers should complete timely VIQ reviews to identify an accurate beginning inventory for determining forecasted demand.

~~(FOUO)~~ The quantity and condition of the beginning inventory available for issue at Raytheon has a significant effect on NAVSUP WSS contracting officers' determination of annual demand. Although the Navy knew how many parts it owned, the contracting officers did not know how many parts were ready for issue or awaiting repair. Therefore, NAVSUP WSS may have forecasted for a new part when it had a part that could be repaired. Additionally, NAVSUP WSS may have forecasted for a repair when it already had a part ready for issue.

~~NAVSUP (b) (5)~~
[Redacted text block]



[Redacted text block] In addition, the Commander, NAVSUP WSS, should review the contracting officers' failure to perform the VIQ reviews on PBL2, and as appropriate, take administrative action.

Unclear Contract Language Allowed for Inadequate Oversight

NAVSUP WSS contracting officers may not have ensured adequate oversight of the work Raytheon performed on PBL3 because they did not write clear contract requirements outlining DCMA's roles and responsibilities⁴ related to beyond economic repair⁵ determinations. Paragraph C.III.4.b of PBL3 states that Raytheon has the authority to make all beyond economic repair determinations. However, paragraph C.III.7.H.4 states that Raytheon must get written concurrence from DCMA for all parts determined to be beyond economic repair. According to DCMA officials, they requested clarification from a contracting official on several occasions, but as of April 4, 2014, they had not received direction or guidance. NAVSUP WSS's cost to purchase a new part is greater than the cost to repair a part that the Navy owns. If DCMA does not review and concur with Raytheon's determination of beyond economical repair parts, NAVSUP WSS may pay for unnecessary new procurements when the part could have been repaired at a lower cost. NAVSUP WSS contracting officers should clarify the contract to specify DCMA's responsibilities for determining whether parts are beyond economic repair.

In addition, NAVSUP WSS contracting officers would not be able to perform adequate VIQ reviews on PBL3 because the contract referenced the wrong attachment in the section detailing the VIQ process. When NAVSUP WSS contracting officers perform VIQ reviews, they are required to compare forecasted demand with actual parts purchased or repaired to determine if they underpaid or overpaid Raytheon and if a reimbursement is due to either party. Attachment A to the contract only outlines the forecasted demand, which is the number of parts that NAVSUP WSS expected to need throughout the year. Attachment M identifies whether the forecasted demand should be filled with a new part or a repair. However, PBL3 only refers to Attachment A for conducting the VIQ reviews. If Attachment M is not added to the section of the contract detailing the VIQ review process before the contract is finalized, the contracting officers may inaccurately determine the reimbursement amount when performing VIQ reviews on PBL3. For example, Attachment A identified a demand of 14 computer system parts in the first year of the contract. Attachment M identified that all 14 computer system parts should be filled by repairing the parts currently owned by the Navy. Raytheon proposed an average PBL3 price of \$28,844 for a new computer system part and \$7,334 for a repaired computer system part. If a VIQ review is conducted only using Attachment A and the average prices Raytheon proposed

⁴ DCMA accepts outgoing items and performs various facility surveillance reviews.

⁵ A part is beyond economic repair when the cost to repair it is greater than a specific percentage of the cost to procure a new part.

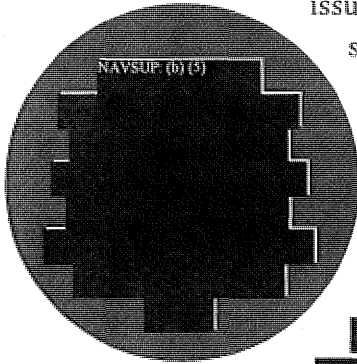
for PBL3, Raytheon could receive payment for providing 14 new computer system parts to the Navy at a total of approximately \$403,816, as opposed to the cost for repairing 14 computer system parts that the Navy already owns at a total of approximately \$102,676. Without the correct attachments referenced, NAVSUP WSS could potentially overpay Raytheon \$301,140 for the 14 computer system parts that Raytheon should have repaired. NAVSUP WSS contracting officers should reference both attachments within the section of the contract detailing the VIQ review process before definitizing PBL3.

Noncompliance with the Defense Federal Acquisition Regulation Supplement Left the Contract Undefined

Since September 2011, NAVSUP WSS contracting officers purchased parts on PBL3 without having an established price list because they did not definitize⁶ PBL3 in accordance with DFARS 217.7404-3, "Undefined Contract Actions." The DFARS section states that UCAs must be definitized within 180 days of

issuance or, if extended, within 180 days after the contractor submits a qualifying proposal. On March 2, 2012,

NAVSUP WSS received a qualifying proposal from Raytheon. However, PBL3 remains undefined approximately 2 ½ years after Raytheon submitted a qualifying proposal. As a result, contracting officers did not perform VIQ reviews on PBL3. NAVSUP: (b) (5)



[REDACTED]
[REDACTED]
[REDACTED] NAVSUP WSS contracting officers should definitize PBL3 and comply with the DFARS on all future contracts. In addition, the Commander, NAVSUP WSS, should review the contracting officers' failure to comply with DFARS, and as appropriate, take administrative action.

Conclusion

NAVSUP WSS contracting officers relied on pricing data from PBL2 and have not established fair and reasonable prices for PBL3. In addition, the contracting officers did not perform timely oversight on the work Raytheon performed under the PBL contracts or clearly define DCMA's responsibilities within the contract. Without an established price list or knowledge of the work Raytheon performed for the \$69.6 million NAVSUP WSS spent since 2011 on PBL3, the contracting officers

⁶ Definitization is the agreement on, or determination of, contract terms, specifications, and price, which converts an undefined contract action to a definitized contract.

have increased the likelihood that DoD is and will continue overpaying Raytheon for its work on the Phalanx. By definitizing PBL3 with fair and reasonable prices, completing timely VIQ reviews, and clarifying DCMA's responsibilities, contracting officers could achieve more cost-effective spending for NAVSUP WSS and use resources more effectively to support the warfighter.

Recommendations, Management Comments, and Our Response

We recommend that the Commander, Naval Supply Systems Command Weapon Systems Support:

Recommendation 1

Require the Naval Supply Systems Command Weapon Systems Support contracting officers to:

- a. **Perform a thorough price-reasonableness analysis.**

Naval Supply Systems Command Comments

~~(FOUO)~~ The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, disagreed, stating that NAVSUP WSS contracting officers performed a thorough price-reasonableness analysis before awarding the PBL3 UCA. The Vice Commander stated that the contracting officer complied with DFARS PGI 217.7404-2, which requires the ceiling price to be documented with support such as price analysis based on prior buys and the contractor's proposal. He stated that the contracting officer compared Raytheon's proposed ceiling price of \$162 million for PBL3 to the Government demands of \$166 million for PBL2 when awarding the PBL3 UCA. Therefore, the proposed \$162 million ceiling price for PBL3 compared favorably with the \$166 million on the previous PBL contract. The Vice Commander also stated that the contracting officer rejected Raytheon's original proposal of \$206 million and negotiated a ceiling price that was \$44 million, or 21 percent, lower to reduce the Government's liability.

~~(FOUO)~~ The Vice Commander stated that Raytheon's \$162 million ceiling price proposal contained a bottom line total price and total price for the new parts and repair parts. However, it did not contain all of the information that constitutes a fully detailed proposal, such as unit prices. Raytheon could not provide the data because of deficiencies in its accounting system and inability to track costs at the piece part level. The Vice Commander stated that if that pricing data were current and easily available, there would not have been a need to award a UCA.

~~(FOUO)~~ Furthermore, the Vice Commander stated that the contracting officer requested the Price Fighters' report to help determine definitized unit pricing on the 37 parts and repairs with the highest demand and that the report was never intended to help develop the ceiling price for the PBL3 UCA. He stated that the Price Fighters' report analyzed data from an outdated proposal that included significant deficiencies that were later adjusted in the final proposal for the PBL3 UCA. The Vice Commander said that the contracting officer is using the Price Fighters' expertise throughout the negotiation process to definitize PBL3.

~~(FOUO)~~ As part of his comments, the Vice Commander stated that Footnote 3 of our report is not factually accurate. He stated that NAVSUP WSS contracting officers use the business case analysis to determine whether NAVSUP WSS should use a PBL contract or return to traditional support.

Our Response

~~(FOUO)~~ Comments from the Vice Commander partially addressed the recommendation. We agree that the contracting officer is taking the appropriate action to determine price-reasonableness by using the Price Fighters' expertise throughout the negotiation process to definitize PBL3. We also recognize that negotiating \$44 million from Raytheon's original proposal for PBL3 significantly reduced the Government's liability. However, we do not agree that the contracting officer performed a thorough price-reasonableness analysis when determining the ceiling price for PBL3. Specifically, we do not agree that comparing the ceiling prices of similar contracts constitutes price analysis of prior buys. DFARS PGI 215.403-3 states, "before relying on a prior price paid by the Government, the contracting officer must verify and document that sufficient analysis was performed to determine that the prior price was fair and reasonable." Contracting officers create problems when they assume that other contracting officers adequately analyzed prior prices to determine whether the prices were fair and reasonable. Sole-source commercial items, such as those on PBL2 and PBL3, require extra attention to verify that those prices are fair and reasonable. The contracting officer only compared Raytheon's proposed ceiling price for PBL3 to the Government forecasted demand for PBL2. The contracting officer did not perform further reviews to verify that the work performed on the prior PBL prices was sufficient to ensure PBL2 prices were fair and reasonable. In addition, while we agree that it is impossible to extrapolate pricing data based on 37 parts to arrive at a ceiling price, the contracting officer did not consider the results of the Price Fighters' analysis, which identified overall lower recommended prices for most of the parts reviewed. Instead, the contracting officer awarded the

(FOUO) UCA at the value included in Raytheon's August 2011 proposal that had no unit pricing information to justify the bottom line pricing. Therefore, we request that the Commander, NAVSUP WSS, provide additional comments on the final report identifying the actions that NAVSUP WSS will take to ensure that contracting officers perform thorough price-reasonableness analysis on future sole-source, commercial item contracts.

(FOUO) In addition, although not directly related to the recommendation, the Vice Commander stated that Footnote 3 is factually inaccurate. However, during our audit, NAVSUP contracting officers stated that the business case analysis was used to develop a contract ceiling for negotiations with contractor. The Vice Commander's comment does not impact the results of the audit or the recommendation to perform a thorough price-reasonableness analysis.

- b. (FOUO) ^{NAVSUP: (b)(5)} [REDACTED]

Naval Supply Systems Command Comments

(FOUO) The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, agreed that if Raytheon was overpaid on PBL2 and PBL3, the overpayment must be recovered. He stated that the contracting officer relied on Raytheon's certified cost and price data available at the time of award. The Vice Commander stated that Raytheon's actual incurred costs for PBL2 at the unit price level that the audit team used during analysis were not available to the contracting officers when awarding PBL2. As a result, the contracting officer requested a defective cost and pricing audit from the Defense Contract Audit Agency on November 13, 2014.

(FOUO) In addition, NAVSUP WSS will pay only for the actual costs incurred for parts delivered for years one through three on the PBL3 contract. If any excess funds remain after definitization, the NAVSUP WSS contracting officer will recoup those funds.

Our Response

Comments from the Vice Commander addressed all specifics of the recommendation, and no further comments are required.

c. Complete timely reviews for variations in quantity before determining forecasted demand.

Naval Supply Systems Command Comments

The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, agreed that the VIQ reviews should be completed timely. However, he stated that the recommendation to complete all VIQ reviews before determining forecasted demand is ill-advised and would shut down support for critical weapon systems. The Vice Commander stated that the current method for establishing a beginning inventory is accurate and prevents a break in warfighter support. In addition, the VIQ review process for PBL2 has resulted in savings of \$6 million. The Vice Commander stated that the contract requires that if Raytheon chooses to request an equitable adjustment, Raytheon must submit the request within 120 days after the end of the contract year. The Government cannot begin the VIQ review until Raytheon submits this request. The Vice Commander also stated that Raytheon submitted each request for equitable adjustment after the 120-day contract requirement, sometimes as much as 2 ½ years after the due date. In addition, the VIQ review process can take up to a year for contracting officers to negotiate and complete. Therefore, completing the VIQ reviews before determining the forecasted demand could result in a lapse of the contract for that year.

Our Response

Although the Vice Commander agreed with the recommendation, his comments only partially addressed the recommendation. While we agree that the contracting officers do not need to complete all VIQ reviews before awarding follow-on contracts, we identified that the VIQ reviews consistently took several years for the contracting officers to complete. If the contracting officers completed the VIQ reviews more timely, they would have had a more accurate beginning inventory balance to determine the forecasted demands for the contract and potentially less money to recoup later. We request the Commander, NAVSUP WSS, provide additional comments on the final report that address the specific actions the contracting officers will take to ensure the VIQ reviews are completed more timely, including adhering to the contract terms.

- d. Clarify the PBL3 contract to specify the Defense Contract Management Agency's responsibilities and reference the correct contract attachments for Naval Supply Systems Command Weapon Systems Support contracting officers to use for variations in quantity reviews.**

Naval Supply Systems Command Comments

The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, agreed and stated that the NAVSUP WSS contracting officer recently met with DCMA representatives to reiterate what their roles and responsibilities are on PBL3. In addition, the Vice Commander stated that the NAVSUP WSS contracting officer will modify the contract to clarify any conflicting provisions for beyond economic repair determinations and references to the attachments for the contracting officers to use for VIQ reviews. The estimated date to modify the contract is January 2015.

Our Response

Comments from the Vice Commander addressed all specifics of the recommendation, and no further comments are required.

- e. Definitize PBL3.**

Naval Supply Systems Command Comments

(FOUO) The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, agreed. He stated that NAVSUP WSS contracting officers are negotiating with Raytheon to definitize PBL3. He said that for years one through three, NAVSUP WSS will pay Raytheon for actual costs incurred with a reduced profit rate based on a lower risk level. For years four and five, NAVSUP WSS will definitize the contract based on Raytheon's audited proposal.

Our Response

Comments from the Vice Commander addressed all specifics of the recommendation, and no further comments are required.

Recommendation 2

Establish internal controls for Naval Supply Systems Command Weapon Systems Support contracting officers to comply with the Defense Federal Acquisition Regulation Supplement on future contracts.

Naval Supply Systems Command Comments

~~(FOUO)~~ The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, agreed that internal controls are needed to ensure compliance with DFARS on future contracts. He stated that the contracting officer complied with DFARS PGI 217.7404-3⁷ on the PBL3 UCA by alerting the approval authority when the definitization schedule was not met. He stated that the contracting officer will continue to keep the Chief of the Contracting Office updated on the status of definitizing PBL3. In addition, the Vice Commander stated that the contracting officer is in compliance with DFARS PGI 217.7405 by reporting the status of PBL3 semiannually to the Deputy Director, Defense Procurement and Acquisition Policy (Contract Policy and International Contracting). The Vice Commander stated that deficiencies in Raytheon's accounting systems delayed the definitization of PBL3. It was not by any action or inaction of the contracting officer. The Vice Commander stated that NAVSUP WSS will continue to use the existing controls for the management of UCAs.

Our Response

Although the Vice Commander agreed with the recommendation, he did not address the specifics of the recommendation. The Vice Commander agreed that NAVSUP WSS needs internal controls to ensure contracting officers comply with procurement regulations and stated that NAVSUP WSS will continue using existing controls for the management of UCAs. However, the current controls did not ensure that NAVSUP WSS contracting officers definitized PBL3 within 180 days of issuance or within 180 days after the contractor submits a qualifying proposal as prescribed in DFARS 217.7404-3. According to the NAVSUP contracting officer, Raytheon submitted a qualifying proposal on March 2, 2012. However, PBL3 remains undefinitized more than 2 ½ years after Raytheon submitted a qualifying proposal. Although the contracting officer complied with the reporting criteria in DFARS PGI 217.7404-3 and PGI 217.7405, NAVSUP WSS needs a quality control to ensure that UCAs are definitized in a timely manner. Therefore, we request that the Commander, NAVSUP WSS, respond to the final report, specifying additional actions NAVSUP WSS will take to establish quality controls for ensuring contracting officers definitize future contracts within the timeframe required by the DFARS.

⁷ The Vice Commander's comments reference to DFARS 217.7404-3; however, the information discussed is in the DFARS PGI.

Recommendation 3

Review the Naval Supply Systems Command Weapon Systems Support contracting officers' failure to perform a thorough price-reasonableness analysis, complete timely variation in quantity reviews, and comply with the Defense Federal Acquisition Regulation Supplement, and, as appropriate, take administrative action.

Naval Supply Systems Command Comments

The Vice Commander, NAVSUP, responding for the Commander, NAVSUP WSS, disagreed. He stated that the contracting officer performed a thorough price-reasonableness analysis when establishing the UCA for PBL3 and the ceiling price was adequately supported. In addition, the Vice Commander stated that the contracting officer negotiated the VIQ reviews in accordance with the Federal Acquisition Regulation and provisions within the contract. The Vice Commander stated that there was no contractual or regulatory required timeframe for NAVSUP WSS contracting officers to negotiate the request for equitable adjustment and modify the contract. Furthermore, the Vice Commander stated that the contracting officer negotiated the definitization of PBL3 in accordance with the Federal Acquisition Regulation and DFARS. He stated that Raytheon did not submit a qualifying proposal until approximately 210 days after the UCA was awarded and approximately 120 days after Raytheon was contractually required to submit a proposal. The Vice Commander stated that the contracting officer could not comply with the UCA definitization schedule in the DFARS while also complying with contract pricing requirements in the Federal Acquisition Regulation. However, he said that the contracting officer complied with the requirements in the DFARS to provide a report when the definitization schedule differed from the 180-day definitization requirement in the contract.

Our Response

Although the Vice Commander disagreed with the recommendation, his comments satisfied the intent of the recommendation to review the contracting officers' actions. No further comments are required.

Appendix A

Scope and Methodology

We conducted this performance audit from February 2014 through October 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We reviewed contracts N00104-06-D-L007 (PBL2) and N00104-11-D-ZD43 (PBL3) awarded to Raytheon for support of the Phalanx. PBL2 was a fixed-price award-fee PBL contract totaling \$203.5 million, and PBL3 was a UCA with a ceiling price of \$162.2 million. As of September 2014, NAVSUP WSS had spent \$69.6 million of the \$162.2 million on PBL3.

~~(FOUO)~~ We reviewed purchase order data for 1,221 subcontractor procurements and repairs of parts that Raytheon purchased in support of PBL2. This review consisted of data for 312 of the 1,101 parts available on PBL2. We did not review parts pricing on PBL3 because the contract was not definitized and final prices have not been agreed upon between Raytheon and NAVSUP WSS.

To accomplish the audit objectives, we:

- interviewed personnel from NAVSUP WSS, the Naval Sea Systems Command, the Defense Logistics Agency, the Defense Contract Audit Agency, DCMA, and Raytheon to identify the roles and responsibilities related to PBL2 and PBL3;
- reviewed applicable policy, including the DFARS 217.74, "Undefinitized Contract Actions" and the contracts, to identify requirements for determining price reasonableness and managing contracts;
- reviewed contract files to identify whether the contracting officers performed sufficient analysis to determine whether Raytheon's prices were fair and reasonable; and
- ~~(FOUO)~~ obtained Raytheon's purchase-order data for subcontractor procurements and repairs. We compared the unit prices from the purchase-order data to the associated invoices. We also calculated Raytheon's costs after applying material burden, general and administrative rates, allocated direct costs, and profit information provided by Raytheon. We compared Raytheon's costs to the prices from the PBL2 price list to determine whether it included excess costs.

Use of Computer-Processed Data

~~(FOUO)~~ We used computer-processed data from the Electronic Document Access system and Raytheon's Computer Financial Service/Manufacturing Resource Planning system. The Electronic Document Access system is a web-based system providing secure access, storage, and retrieval of contracts and contract modifications to users throughout DoD. We obtained contract documentation from the Electronic Document Access system. To test the data, we compared the documents obtained from the Electronic Document Access system with the documents from the hard-copy contract file.

~~(FOUO)~~ Raytheon's Computer Financial Service/Manufacturing Resource Planning system is used to track items at the part level. Raytheon's Computer Financial Service/Manufacturing Resource Planning system includes the Integrated Manufacturing Intelligence application as a web-based portal that provides reports and data presentation. We obtained a list of purchase orders with the parts Raytheon procured to support PBL2 from Raytheon's Integrated Manufacturing Intelligence application of Raytheon's Computer Financial Service/Manufacturing Resource Planning system. We requested the subcontractor invoices from Raytheon that aligned with the system-provided purchase-order data. Raytheon provided a non-statistical sample of 12 subcontractor invoices. We compared the purchase order number, subcontractor name, part number, part description, quantity, and unit cost from the invoices to the system-provided purchase-order data and did not identify any differences. We determined the information we obtained from the Electronic Document Access system and Raytheon's Computer Financial Service/Manufacturing Resource Planning system was sufficiently reliable for the purposes of our audit.

Appendix B

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO) and the DoD Inspector General (DoD IG) issued 16 reports discussing pricing and UCA issues. Unrestricted GAO reports can be accessed at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/pubs/index.cfm>.

GAO

GAO-10-299, "Defense Contracting: DoD Has Enhanced Insight into UCA Use, but Management at Local Commands Needs Improvement," January 2010

DoD IG

Report No. DODIG-2014-088, "The Defense Logistics Agency Aviation Potentially Overpaid Bell Helicopter for Sole-Source Commercial Spare Parts," July 3, 2014

Report No. DODIG-2014-054, "The Defense Logistics Agency Land and Maritime Paid Too Much for High Mobility Multipurpose Wheeled Vehicle Repair Parts," April 4, 2014

Report No. DODIG-2014-038, "Air Force Life Cycle Management Center Could Not Identify Actual Cost of F119 Engine Spare Parts Purchased From Pratt and Whitney," February 10, 2014

Report No. DODIG-2014-020, "U.S. Army Contracting Command Did Not Obtain Fair and Reasonable Prices for Communications Equipment," December 5, 2013

Report No. D-2013-090, "Improved Guidance Needed to Obtain Fair and Reasonable Prices for Sole-Source Spare Parts Procured by the Defense Logistics Agency from the Boeing Company," June 7, 2013

Report No. DODIG-2012-102, "Better Cost-Control Measures Are Needed on the Army's Cost-Reimbursable Services Contract for Logistics Support of Stryker Vehicles," June 18, 2012

Report No. DODIG-2012-039, "Summary Report on DoD's Management of UCAs," January 13, 2012

Report No. D-2011-104, "Pricing and Escalation Issues Weaken the Effectiveness of the Army Contract With Sikorsky to Support the Corpus Christi Army Depot," September 8, 2011

Report No. D-2011-097, "U.S. Army Contracting Command Redstone Arsenal's Management of UCAs Could be Improved," August 12, 2011

Report No. D-2011-068, "Additional Actions Can Improve the Naval Air Systems Command's Use of UCAs," June 8, 2011

Report No. D-2011-061, "Excess Inventory and Contract Pricing Problems Jeopardize the Army Contract with the Boeing Company to Support the Corpus Christi Army Depot," May 3, 2011

Report No. D-2011-047, "Improvements Needed in Contract Administration of the Subsistence Prime Vendor Contract for Afghanistan," March 2, 2011

Report No. D-2010-080, "Air Force Electronic Systems Center's Use of UCAs," August 18, 2010

Report No. D-2011-001, "Marine Corps Systems Command's Use of UCAs," October 27, 2010

Report No. D-2011-024, "Air Force Space and Missile Systems Center's Use of UCAs," December 16, 2010

Management Comments

Naval Supply Systems Command



DEPARTMENT OF THE NAVY
NAVAL SUPPLY SYSTEMS COMMAND
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IN REPLY REFER TO
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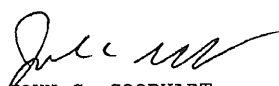
From: Commander, Naval Supply Systems Command
To: Department of Defense Office of Inspector General,
Assistant Inspector General for Acquisition, Parts, and
Inventory

Subj: DODIG DRAFT AUDIT REPORT - NAVSUP NEEDS TO IMPROVE COST
EFFECTIVENESS OF PURCHASES FOR THE PHALANX CLOSE-IN
WEAPON SYSTEM (D2014-D000AT-0110.000)

Ref: (a) Draft Audit Report D2014-D000AT-0110.000 of 22 Oct 14

Encl: (1) DoDIG Draft Report, "NAVSUP Needs to Improve Cost
Effectiveness of Purchases for the Phalanx Close-In
Weapon System" (Project No. D000AT-0110.000)

1. Per reference (a), enclosure (1) provides our comments on
Recommendations 1a, 1b, 1c, 1d, 1e, 2 and 3.
2. For any questions, please contact [REDACTED]
[REDACTED]


JOHN C. GOODHART
Vice Commander

Copy to:
NAVINGEN

Naval Supply Systems Command (cont'd)

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DEPARTMENT OF DEFENSE INSPECTOR GENERAL (DoDIG) DRAFT REPORT,
"Naval Supply Systems Command Needs to Improve Cost
Effectiveness of Purchases for the Phalanx Close-In Weapon
System" (Project No. D2014-D000AT-0110.000) OF 22 October 2014

Finding-

Naval Supply Systems Command Weapon Systems Support (NAVSUP WSS) contracting officers did not adequately manage the performance-based logistics (PBL) contracts with Raytheon Missile Systems Company to make cost-effective purchases for the Phalanx Close-In Weapon System. This occurred because contracting officers did not: 1) perform adequate price-reasonableness analysis when determining the ceiling price; 2) complete timely variation in quantity reviews to reconcile the contract's forecasted and actual demand; 3) provide clear contract requirements related to Defense Contract Management Agency's roles and responsibilities and NAVSUP WSS's variation in quantity review process; 4) comply with Defense acquisition regulations for undefinitized contract actions.

As a result, NAVSUP WSS may be overpaying Raytheon Missile Systems Company. In addition, NAVSUP WSS cannot quantify the work Raytheon Missile Systems Company performed for the \$69.6 million spent on the current PBL contract.

Recommendation 1: We recommend that the Commander, Naval Supply Systems Command Weapon Systems Support require NAVSUP WSS contracting officers to:

Recommendation 1a: Perform a thorough price-reasonableness analysis.

NAVSUP response: Non-concur.

NAVSUP WSS asserts that a thorough price-reasonableness analysis was conducted to award CIWS PBL3. The not-to-exceed price for the Undefinitized Contractual Action (UCA) was adequately supported. DFARS PGI 217.7404-2, states that the rationale for the not-to-exceed price will be documented and retained in the contract file. Examples of such supporting rationale include, (i) The Independent Government Cost Estimate; (ii) Price analysis based on prior buys; and (iii) The contractor's proposal. The documentation to support the UCA was contained in the Business Clearance Memorandum approved by the Chief of the

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Contracting Office (CCO) on August 25, 2011. In that document, the contracting officer explained in full detail the rationale for establishing the not-to-exceed price at \$162M. Specifically, the not-to-exceed price was based on the Raytheon Missile Systems Company (RMSC) not-to-exceed proposal and a comparison to the price of the most recent Close-In Weapon System (CIWS) Performance Based Logistics (PBL) contract. This is in full compliance with DFARS PGI 271.7404-2.

~~(FOUO)~~

~~(FOUO)~~ When making the award decision for the PBL3 UCA, the contracting officer compared Raytheon's proposed not-to-exceed price of \$162M to the contract value on the previous PBL2, contract N00104-06-D-L006 with a total value of \$203M. Of that \$203M, \$166M was allocated to U.S. government demands with the balance of \$37M for foreign military sales. The \$166M value compares favorably with the contractor's not-to-exceed proposal of \$162M.

~~(FOUO)~~ RMSC originally proposed a not-to-exceed price of \$206M in March 2011 for PBL3. The contracting officer rejected this not-to-exceed price. Fact-finding conversations were held with RMSC and upon the Government's request, RMSC submitted a fully detailed proposal of \$185M. A proposal walk-through was conducted with RMSC revealing that they did not provide the method of how they would fill the projected demands (either repair or procurement actions). In response to the rigorous and persistent evaluation by the Government contracting team, RMSC subsequently submitted another not-to-exceed price proposal on August 11, 2011, at a not-to-exceed price of \$162M. The efforts of the Government contracting team drove the contractor's not-to-exceed price downward 21% for a reduction of

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(FOUO) \$44M, resulting in a concurrent reduction of the Government's liability.

(FOUO) The RMSC \$162M not-to-exceed price proposal contained a bottom line total price and a total price for the repair and procurement actions for each year of the contract. However, it did not contain all of the information that constitutes a fully detailed proposal, such as procurement and repair unit pricing for each of the over 1,000 NSNs (National Stock Numbers) on the PBL contract. If that type of pricing were current and easily available from RMSC, it would have obviated the need to award a UCA. There is a tremendous amount of contractor effort to prepare unit pricing. It was anticipated that RMSC's detailed unit pricing information would not be available until the negotiations for definitization of PBL3 were underway. This was due in large part to deficiencies in RMSC's accounting system and RMSC's inability to track costs to the individual piece part level. This situation was and still is being addressed by RMSC. DCAA is monitoring RMSC's pro

NAVSUP (b) (5)

(FOUO) NAVSUP (b) (5)

(FOUO) It should be noted that the contracting officer utilized the expertise of the PriceFighters organization throughout the preparation of going

NAVSUP (b) (5)

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~~(FOUO)~~ ~~NAVSUP (b)(5)~~

~~(FOUO)~~ **Recommendation 1b:** ~~NAVSUP (b)(5)~~

NAVSUP response: Concur.

~~(FOUO)~~ ~~NAVSUP (b)(5)~~

~~(FOUO)~~ It is the contention of the DoDIG that NAVSUP WSS overpaid for parts on PBL2. At the time PBL2 was awarded, the contracting officer relied upon the RMSC's proposal containing their certificate of current cost and pricing data as required under FAR 15.403-4. The PBL2 proposal was analyzed in a DCMA consolidated pricing report, dated November 2005, which contained the DCAA audit of the contractor's proposal. This analysis was required by FAR 15.404-2. The DoDIG review was based on RMSC's actual incurred costs for PBL2 at the unit price level. This data was not available ~~er~~ at the time of award in June 2006. ~~NAVSUP (b)(5)~~

~~NAVSUP (b)(5)~~

~~(FOUO)~~ Under PBL3, years one through three are being definitized based upon the actual costs incurred for material that has shipped under the contract. The contracting officer's position for those shipments is based ~~PriceFighters and DCAA.~~ ~~NAVSUP (b)(5)~~

~~NAVSUP (b)(5)~~ If any excess funds for PBL3, years one through three are discovered at time of definitization, they will be recovered by the contracting officer.

Recommendation 1c: Complete timely reviews for variations in quantity before determining forecasted demand.

NAVSUP response: Concur.

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NAVSUP WSS concurs that Variation-In-Quantity (VIQ) reviews should be accomplished in a timely manner. While NAVSUP WSS agrees that the VIQs should be completed on a timely basis, the DoDIG's recommendation that all the VIQs be completed in order to establish forecasted demand for a follow-on PBL is ill-advised. The existing methodology used by NAVSUP WSS to establish a beginning inventory position for follow-on PBLs is accurate and prevents an untenable break in war-fighter support.

The current NAVSUP WSS methodology for establishing a starting inventory for PBLs is based on the snapshot of inventory taken at time of contract award. This snapshot identifies for each item, both its Ready-For-Issue status and the count. The award snapshot is compared to a previous snapshot taken for the PBL solicitation, which was used for proposal submission and analysis. A mutual agreement is reached between the parties after contract award to compensate for any relevant inventory variations. This process accurately establishes the beginning inventory for the PBL without endangering war-fighter support.

Implementing the DoDIG's recommendation that all VIQs be finalized in order to identify an accurate beginning inventory for the follow-on PBL would shut down support for critical weapon systems.

The VIQ provision in the Statement of Work for CIWS PBL2 required the contractor, if submitting a Request for Equitable Adjustment (REA) under the provision, to submit the request within 120 days following the end of the contract year. The contracting officer would then have to negotiate and definitize the REA in accordance with FAR 43.204. This could take up to a year to complete, depending on the necessary level of review. To follow the DoDIG's recommendation that the contracting officer complete review of VIQ REAs before determining forecasted demand for the follow-on PBL would result in a lapse of contract coverage and warfighter support for up to a year. Inventory would have to stay "on-hold" until the VIQ was adjudicated and follow-on PBL inventory levels established.

It should also be noted that there are no contractual or regulatory required timeframes for the government to negotiate the REA and modify the contract. Pursuant to the VIQ provision, the Government takes no action until an REA is submitted by the contractor. For each VIQ REA under PBL2 submitted by RMSC,

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every submission was delinquent, some submissions were delinquent by as long as two and one half years. This fact significantly affected the turn-around time for the processing of the VIQ REAs. Additionally, the contracting officer using the cost and pricing data provided by RMSC and audited by DCMA, was able to negotiate savings of \$6M on PBL2 VIQs.

Recommendation 1d: Clarify the PBL3 contract to specify the Defense Contract Management Agency's responsibilities and reference the correct contract attachments for NAVSUP WSS contracting officers to use for variations in quantity reviews.

NAVSUP response: Concur.

NAVSUP WSS concurs. The NAVSUP WSS contracting officer recently met with the DCMA team again to re-iterate their roles and responsibilities on this contract.

NAVSUP WSS will make a clarifying modification to PBL3. This includes clarifying any conflicting provisions in the contract regarding assets that are beyond economical repair and references for the VIQs. Estimated completion date for the modification is January 2015.

Recommendation 1e: Definitize PBL3.

NAVSUP response: Concur.

~~(FOUO)~~ NAVSUP WSS concurs. The PBL3 definitization negotiation is underway. The approved pre-negotiation business clearance was provided to the DoDIG team on July 14, 2014. It details the contracting officer's plan to definitize PBL3, year one, using actual incurred costs. NAVSUP WSS negotiation plan has expanded to include definitization of PBL3 based on actual costs incurred. NAVSUP: (b) (5)

PBL3, years four and five, will be definitized based upon the contractor's audited proposal. Those negotiations will be enhanced by the negotiations of the previous year's actual costs incurred which protects the Government from unnecessary risk.

Recommendation 2: We recommend that the Commander, Naval Supply Systems Command Weapon Systems Support establish internal

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Naval Supply Systems Command (cont'd)

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controls for NAVSUP WSS contracting officers to comply with the Defense Federal Acquisition Regulation Supplement on future contracts.

NAVSUP response: Concur.

NAVSUP WSS concurs that internal controls are necessary to ensure compliance with procurement regulations. NAVSUP WSS will continue to utilize existing controls currently in place for the management of UCAs.

Pursuant to DFARS 217.7404-3, the contracting officer should alert the approval authority for any reason, when the definitization schedule appears to be in jeopardy. The contracting officer has and will continue to comply with this provision, keeping the CCO informed of the definitization status of PBL3. Additionally, NAVSUP WSS provides a monthly status report of UCAs over 180 days to the CCO. The Director of Contracting, NAVSUP HQ, as well as DASN are, and will continue to be kept informed of the status of PBL3 definitization.

~~(FOUO)~~ The contracting officer remains in compliance with DFARS PGI 217.7405, by reporting the status of PBL3 UCA on a semi-annual basis through the contracting officer's chain of command to the Deputy Director, Defense Procurement and Acquisition Policy (Contract Policy and International Contracting). It should be noted that the delays in definitization of PBL3 are driven primarily by the deficiencies in RMSC's accounting system, which created delays for the DCAA audit of the proposal. The delay was not caused by any action or inaction of the contracting officer.

Recommendation 3: We recommend that the Commander, Naval Supply Systems Command Weapon Systems Support review the NAVSUP WSS contracting officers' failure to perform a thorough price-reasonableness analysis, complete timely variation in quantity reviews, and comply with the Defense Federal Acquisition Regulation Supplement, and, as appropriate, take administrative action.

NAVSUP response: Non-concur.

NAVSUP WSS does not concur. The contracting officer performed in accordance with all applicable procurement laws, regulations and policies.

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Naval Supply Systems Command (cont'd)

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The contracting officer performed a thorough price reasonableness analysis, in conformance with the regulations, when establishing the UCA. The not-to-exceed price for the UCA was adequately supported. DFARS PGI 217.7404-2, states that the rationale for the not-to-exceed price will be documented and retained in the contract file. The documentation to support the UCA was contained in the Business Clearance Memorandum approved by the CCO on August 25, 2011. In that document, the contracting officer explained in full detail the rationale for establishing the not-to-exceed price at \$162M. Specifically, the not-to-exceed price was based on the RMSC not-to-exceed proposal and a comparison to the price of the most recent CIWS PBL contract. This is in full compliance with DFARS PGI 271.7404-2.

~~(FOUO)~~ As stated previously, the contracting officer was unable to utilize the PriceFighter's analysis of 37 NSNs from PBL2, dated August 11, 2011 because it was based on a flawed proposal. The contracting officer did request and utilize a Technical Analysis from PriceFighters, received on October 24, 2013, which analyzed RMSC's \$174M qualifying proposal.

The contracting officer negotiated the VIQs in accordance with FAR 43.204 and the VIQ provisions in the Statement of Work. The VIQ provision for CIWS PBL2 required the contractor, if submitting an REA under the provision, to submit the request within 120 days following the end of the contract year. Pursuant to FAR 43.204 the contracting officer required field pricing reviews of the REA as appropriate, and negotiated and definitized the REA in accordance with regulations and NAVSUP policy. There is no contractual or regulatory required timeframe for the government to negotiate the REA and modify the contract.

The contracting officer complied with the FAR and DFARS while negotiating the definitization of the UCA for PBL3. After award of the UCA on August 30, 2011, RMSC did not submit a qualifying proposal until February 29, 2012, approximately 210 days after the UCA was awarded, and approximately 120 days after they were contractually required to submit their proposal. Between award of the UCA and the submission of the qualifying proposal, there were numerous conversations between DoD and RMSC personnel regarding the submission of the proposal in accordance FAR 15.404-2, the contracting officer immediately sent the proposal to DCAA for field pricing assistance.

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(FOUO) It took six months and another proposal revision until DCAA had adequate data to determine that the proposal was qualifying per DFARS 217.7401(c). This delay was due in large part to deficiencies in the RMSC accounting system. Because of these same deficiencies, DCAA was not able to complete their audit until March 21, 2013. In compliance with FAR 15.404-2, the contracting officer requested further field pricing assistance from DCMA as well as PriceFighters. These reports were received on July 3, 2013 and October 24, 2013. The contracting officer subsequently established a pre-negotiation position, which was approved by NAVSUP Headquarters with a subsequent Peer Review by Assistant Secretary of the Navy for Research, Development and Acquisition. On May 1, 2014 the contracting officer received authorization to negotiate with RMSC.

In order to comply with the requirements of FAR 15.4, *Contract Pricing*, the contracting officer was unable to comply with the UCA definitization schedule found in DFARS 217.7404-3. However, the contracting officer complied with the reporting requirements of DFARS PGI 217.7404-3 and PGI 217-7405 when the definitization schedule varied from the 180-day requirement of the contract.

Enclosure (1)

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Acronyms and Abbreviations

DCMA	Defense Contract Management Agency
DFARS	Defense Federal Acquisition Regulation Supplement
NAVSUP WSS	Naval Supply Systems Command Weapon Systems Support
PBL	Performance-Based Logistics
UCA	Undefinitized Contract Action
VIQ	Variation in Quantity

Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

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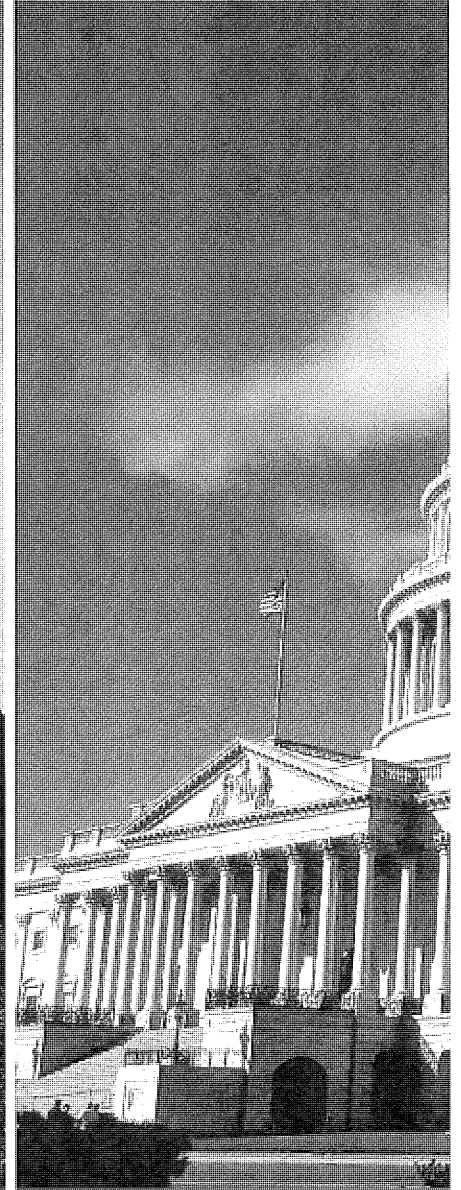
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