

Inspector General

United States
Department of Defense



Contracts Issued by TACOM Life Cycle Management
Command to BAE Systems Land and Armaments,
Ground Systems Division

Additional Copies

To obtain additional copies of this report, visit the Web site of the Department of Defense Inspector General at <http://www.dodig.mil/audit/reports> or contact the Secondary Reports Distribution Unit at (703) 604-8937 (DSN 664-8937) or fax (703) 604-8932.

Suggestions for Future Audits

To suggest ideas for or to request future audits, contact the Office of the Deputy Inspector General for Auditing at (703) 604-9142 (DSN 664-9142) or fax (703) 604-8932. Ideas and requests can also be mailed to:

ODIG-AUD (ATTN: Audit Suggestions)
Department of Defense Inspector General
400 Army Navy Drive (Room 801)
Arlington, VA 22202-4704

DEPARTMENT OF DEFENSE

hotline

To report fraud, waste, mismanagement, and abuse of authority.

Send written complaints to: Defense Hotline, The Pentagon, Washington, DC 20301-1900
Phone: 800.424.9098 e-mail: hotline@dodig.mil www.dodig.mil/hotline

Acronyms

ACO	Administrative Contracting Officer
BAE	BAE Systems Land and Armaments, Ground Systems Division
BOM	Bill of Materials
CAM	Contract Audit Manual
CY	Calendar Year
DACO	Divisional Administrative Contracting Officer
DCAA	Defense Contract Audit Agency
DCMA	Defense Contract Management Agency
FAR	Federal Acquisition Regulation
FPRA	Forward Pricing Rate Agreement
HERCULES	Heavy Equipment Recovery Combat Utility Lift and Evacuation System
PCO	Procurement Contracting Officer
PM-HBCT	Project Manager Heavy Brigade Combat Team
PNM	Price Negotiation Memorandum
PROCAS	Process Oriented Contract Administration Services
TACOM LCMC	U.S. Army TACOM Life Cycle Management Command



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

July 3, 2008

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,
TECHNOLOGY, AND LOGISTICS
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE CONTRACT MANAGEMENT
AGENCY
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Report on Contracts Issued by TACOM Life Cycle Management Command
to BAE Systems Land and Armaments, Ground Systems Division (Report
No. D-2008-107)

We are providing this report for review and comment. We performed this audit in response to Defense Hotline Allegations. We considered management comments on a draft of this report when preparing the final report.

We request that management provide comments that conform to the requirements of DoD Directive 7650.3. The Defense Contract Management Agency comments were partially responsive. We request that the Director of the Defense Contract Management Agency provide additional comments on Recommendations 3.a, 3.b, 3.c, and 4 by August 4, 2008.

If possible, please send management comments in electronic format (Adobe Acrobat file only) to AUDACM@dodig.mil. Copies of the management comments must contain the actual signature of the authorizing official. We cannot accept the / Signed / symbol in place of the actual signature. If you arrange to send classified comments electronically, they must be sent over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Questions should be directed to Ms. Deborah Carros at (703) 604-9217 (DSN 664-9217) or Ms. Sarah A. Davis at (703) 604-9031 (DSN 664-9031). See Appendix D for the report distribution. The team members are listed inside the back cover.

A handwritten signature in black ink, appearing to read "Richard B. Jolliffe".

Richard B. Jolliffe
Assistant Inspector General
Acquisition and Contract Management

Department of Defense Office of Inspector General

Report No. D-2008-107

July 3, 2008

(Project No. D2007-D000CK-0256.000)

Contracts Issued by TACOM Life Cycle Management Command to BAE Systems Land and Armaments, Ground Systems Division

Executive Summary

Who Should Read This Report and Why? Army and Defense Contract Management Agency contracting personnel and Defense Contract Audit Agency auditors should read this report. The report addresses issues related to Defense Contract Audit Agency participation in the Alpha contracting process and forward pricing rate agreement negotiations.

Background. We performed this audit in response to anonymous allegations made to the Defense Hotline in August 2007. The complainant alleged that officials at the U.S. Army TACOM Life Cycle Management Command and the Defense Contract Management Agency constrained Defense Contract Audit Agency audit efforts during the award and administration of contracts to BAE Systems Land and Armaments, Ground Systems Division. The complainant also alleged that Defense Contract Audit Agency concerns regarding contracts with BAE Systems Land and Armaments, Ground Systems Division were ignored by both TACOM Life Cycle Management Command and Defense Contract Management Agency personnel and that addressing Defense Contract Audit Agency concerns could result in the Government paying substantially lower prices for contracts at this location. The complainant identified specific concerns with contracts awarded by TACOM Life Cycle Management Command to BAE Systems Land and Armaments, Ground Systems Division for Bradley and Heavy Equipment Recovery Combat Utility Lift and Evacuation System vehicles.

The Alpha contracting process occurs when representatives from a contractor and the Government form a team to prepare a negotiated contract in the best interest of both parties. Alpha contracting includes a simultaneous exchange of information and replaces the traditional "consecutive contracting." During the Alpha contracting process, the Alpha team develops the scope of work, solicitation, and cost elements, and ultimately it awards a contract. TACOM Life Cycle Management Command, Defense Contract Management Agency, and Defense Contract Audit Agency each have documented procedures for executing the Alpha contracting process.

Results. Overall, we substantiated 3 and partially substantiated 3 of the 11 allegations (see Appendix B for allegations and Appendix C for Management Comments on these allegations and the audit response). TACOM Life Cycle Management Command and Defense Contract Management Agency contracting officials constrained the Defense Contract Audit Agency's ability to perform effective and meaningful audits in support of contracts awarded to BAE Systems Land and Armaments, Ground Systems Division. Specifically, contracting officials did not include the Defense Contract Audit Agency in the Alpha contracting process for the FY 2005 Bradley vehicle procurement to ensure the

Defense Contract Audit Agency could perform an effective review of material costs. Additionally, contracting officials did not require BAE Systems Land and Armaments, Ground Systems Division forward pricing rate agreement proposals to be current, accurate, and complete, as required by the Federal Acquisition Regulation. As a result, TACOM Life Cycle Management Command contracting officials may have overpriced firm-fixed-price contracts awarded to BAE Systems Land and Armaments, Ground Systems Division.

TACOM Life Cycle Management Command personnel should follow agency policies and procedures to include Defense Contract Audit Agency auditors during the Alpha contracting process. In addition, the Program Executive Officer, Ground Combat Systems should issue guidance to project managers that establishes time frames for obligating supplemental funding. Defense Contract Management Agency, BAE Systems Ground Systems Division contracting personnel should obtain current, accurate, and complete forward pricing rate agreement proposals from BAE Systems Land and Armaments, Ground Systems Division and request the Defense Contract Audit Agency to audit the forward pricing rate agreement proposals. Additionally, Defense Contract Management Agency, BAE Systems Ground Systems Division contracting personnel should establish procedures to include Defense Contract Audit Agency auditors during the Alpha contracting process. Defense Contract Audit Agency personnel should perform a post award audit of contracts awarded using forward pricing rate agreements for which certified cost and pricing data was obtained and identify defective pricing and make any necessary recommendations to adjust affected contracts. (See the Finding section of the report for the detailed recommendations.)

We identified a material internal control weakness in the award of contracts to BAE Systems Land and Armaments, Ground Systems Division. Specifically, TACOM Life Cycle Management Command and Defense Contract Management Agency personnel did not follow the Federal Acquisition Regulation and their respective internal agency guidance for Alpha contracting. We discuss this issue in detail in the finding.

Management Comments and Audit Response. The Director, Defense Contract Audit Agency; the Director, Defense Contract Management Agency; the Deputy Chief of Staff for the Commander, TACOM Life Cycle Management Command; and the Program Executive Officer, Ground Combat Systems, TACOM Life Cycle Management Command generally concurred with the recommendations to the draft report. The Director, Defense Contract Management Agency partially concurred with the recommendation to request that the Defense Contract Audit Agency perform an audit of forward pricing rate agreement proposals in accordance with FAR Part 42 requirements, and stated that the elements of the rate proposal are evaluated as they are ready, instead of waiting for the contractor to submit a complete proposal. In addition, the Director stated that opportunity for improvement may exist; the Divisional Administrative Contracting Officer had initiated discussions between BAE, TACOM Life Cycle Management Command, and the Defense Contract Audit Agency with the intent to evaluate the impact on the Alpha Proposal Development Process as compared to the process in which a complete proposal is audited after submittal. The comments provided are partially responsive. The Defense Contract Management Agency has taken action to evaluate the Alpha contracting process but did not address the Federal Acquisition Regulation requirement regarding forward pricing rate agreements.

In addition, the Director concurred with the recommendations to obtain current, accurate, and complete forward pricing rate agreement proposals from BAE and submit them to the Defense Contract Audit Agency for audit. However, the comments provided are not responsive and do not address the recommendations; additional comments are required.

We request that the Director, Defense Contract Management Agency, provide additional comments that address the recommendations by August 4, 2008. (See the Finding section of the report for a discussion of management comments and the Management Comments section for the complete text of comments.)

Table of Contents

Executive Summary	i
Background	1
Objectives	3
Review of Internal Controls	3
Finding	
Contracts Awarded to BAE Systems Land and Armaments, Ground Systems Division by U.S. Army TACOM Life Cycle Management Command	4
Appendixes	
A. Scope and Methodology	21
B. Allegations	23
C. Management Comments on Allegations and Audit Response	27
D. Report Distribution	29
Management Comments	
Defense Contract Audit Agency	
Defense Contract Management Agency	
TACOM Life Cycle Management Command	
U.S. Army Materiel Command	

Background

We initiated this audit in August 2007 in response to anonymous Defense Hotline allegations. The complainant alleged that officials at the U.S. Army TACOM Life Cycle Management Command (TACOM LCMC) and the Defense Contract Management Agency (DCMA), BAE Systems Ground Systems Division constrained Defense Contract Audit Agency (DCAA), BAE Systems Ground Systems Division¹ audit efforts during the award and administration of contracts to BAE Systems Land and Armaments, Ground Systems Division (BAE).² The complainant also alleged that DCAA concerns regarding contracts with BAE were ignored by both TACOM LCMC and DCMA personnel and that addressing DCAA concerns could result in the Government paying substantially lower prices for contracts at this location. The complainant identified specific concerns about contracts awarded by TACOM LCMC to BAE for Bradley and Heavy Equipment Recovery Combat Utility Lift and Evacuation System (HERCULES) vehicles.

TACOM LCMC. The TACOM LCMC is headquartered in Warren, Michigan. According to the TACOM LCMC Web site,

TACOM LCMC is one of the Army's largest weapon systems research, development, and sustainment organizations...[TACOM LCMC] provides and sustains mobility, lethality, and survivability for soldiers, other services, and our Allies through ground combat, automotive, marine and armaments technologies....The TACOM LCMC consists of the Acquisition Center, Integrated Logistics Support Center, Program Executive Office Combat Support & Combat Service Support, Program Executive Office Ground Combat Systems, and Program Executive Office Soldier.

The Program Executive Office Ground Combat Systems includes the Project Manager Heavy Brigade Combat Team (PM-HBCT). The PM-HBCT is the life cycle manager for both the Bradley family of vehicles and the Abrams family of vehicles. Specifically, the TACOM LCMC Heavy Brigade Combat Team Acquisition Management Division is responsible for executing contractual actions related to the Abrams family (including the HERCULES) and the Bradley family of vehicles.

The Bradley vehicles are fully armored, fully tracked vehicles designed to carry infantry into close contact with the enemy and provide cross-country mobility, medium- and long-range firepower, and adequate armor to protect the crew from artillery and small arms threats. The HERCULES vehicle is a recovery vehicle

¹ DCMA and DCAA both have sub offices colocated with BAE Systems Land and Armaments, Ground Systems Division. Those offices are referred to as DCMA, BAE Systems Ground Systems Division and DCAA, BAE Systems Ground Systems Division, respectively.

² On June 24, 2005, BAE Systems Inc., acquired United Defense Industries, Inc. The contracts we reviewed were originally awarded to United Defense-Ground Systems Division, which is a subsidiary of United Defense Industries, Inc.

used to safely tow and recover battle-damaged, mired, or inoperative Abrams tanks.

BAE Systems. BAE Systems is a global company that develops, produces, and supports advanced defense and aerospace systems. BAE Systems, Inc., is the U.S. subsidiary of BAE Systems, Public Limited Company, a United Kingdom company. BAE Systems, Inc., contains three operating groups, including the BAE Systems Land and Armaments Operating Group, headquartered in Arlington, Virginia. The BAE Systems Land and Armaments, Ground Systems Division, located in York, Pennsylvania, provides combat vehicle systems in major vehicle families, to include the Bradley family of vehicles and the HERCULES.

Defense Contract Management Agency. DCMA personnel provide acquisition life cycle and combat support by serving as negotiators and in-plant representatives for Government procurement agencies both during the initial stages of the acquisition cycle and throughout the life of resulting contracts. DCMA was established per DoD Directive 5105.64 that states, “The Defense Contract Management Agency shall perform Contract Administration Services for DoD, other authorized Federal Agencies, foreign governments, international organizations, and others as authorized.” Prior to contract award, DCMA provides advice and services to help construct effective solicitations, identify potential risks, select the most capable contractors, and write contracts that meet the needs of the Government. After contract award, DCMA monitors contractors’ performance and management systems to ensure that cost, product performance, and delivery schedules are in compliance with the terms and conditions of the contracts.

Defense Contract Audit Agency. DCAA provides accounting and financial advisory services in connection with the negotiation, administration, and settlement of contracts and subcontracts to all DoD Components responsible for procurement and contract administration, as established by DoD Directive 5105.36. DCAA is also responsible for performing all contract audits for the DoD. Specifically, DCAA performs preaward contract audits of price proposals, preaward surveys, and forward pricing labor and overhead rate reviews. DCAA also performs post award contract audits of incurred costs and annual overhead rates; Truth in Negotiation Act compliance; Cost Accounting Standards compliance; and claims, and financial capability reviews. In addition, DCAA audits contractor internal control systems, including audits of accounting systems, estimating systems, material management, and labor charging.

Scope of Contracts Reviewed. Based on the anonymous Hotline allegations, we reviewed the FY 2005 Bradley vehicle procurement, consisting of contract W56HZV-05-G-0005, delivery orders 0001, 0002, 0003, and 0004, and contract DAAE07-01-C-M016, modification P00123. We also reviewed the FY 2005 and FY 2007 HERCULES vehicle procurements, consisting of contract DAAE07-01-C-N030, modifications P00102 and P00133, because the Hotline allegations specifically referred to these procurements. Additionally, we reviewed basic contract DAAE07-01-C-M016 for Bradley vehicles as a basis for comparison with the FY 2005 Bradley procurement.

TACOM LCMC contracting personnel awarded the FY 2005 Bradley procurement on June 23, 2005, for a total award amount of \$1.1 billion. TACOM

LCMC contracting personnel awarded the FY 2005 HERCULES vehicle procurement on June 23, 2005, for a total award amount of \$143 million and the FY 2007 HERCULES vehicle procurement on November 9, 2006, for a total award amount of \$251.1 million.

Objectives

Our overall audit objective was to evaluate whether the allegations to the Defense Hotline concerning contracts issued by TACOM LCMC to BAE had merit. Specifically, we determined whether contract award and administrative procedures were in compliance with Federal and DoD policy. See Appendix A for a discussion of the scope and methodology. See Appendix B for a summary of the allegations and a discussion on whether they were substantiated.

Review of Internal Controls

We identified a material internal control weakness in the award of contracts to BAE as defined by DoD Instruction 5010.40, "Managers' Internal Control (MIC) Program Procedures," January 4, 2006. Specifically, TACOM LCMC and DCMA personnel did not follow the Federal Acquisition Regulation (FAR) and internal agency guidance for Alpha contracting. We discuss this issue in detail in the finding. Implementing Recommendations 1., 2., 3., 4., and 5. should correct this control weakness. We will send a copy of the report to the senior official in charge of internal controls for the Army, DCMA, and DCAA.

Contracts Awarded to BAE Systems Land and Armaments, Ground Systems Division by U.S. Army TACOM Life Cycle Management Command

TACOM LCMC and DCMA contracting officials constrained DCAA's ability to perform effective and meaningful audits in support of contracts awarded to BAE. Specifically, contracting officials did not:

- include DCAA personnel in the Alpha contracting process for the FY 2005 Bradley vehicle procurement to ensure DCAA personnel could perform an effective review of material costs; and
- require BAE forward pricing rate agreement proposals to be current, accurate, and complete, as required by the FAR.

Contracting officials constrained DCAA's ability to perform effective and meaningful audits because TACOM LCMC and DCMA personnel failed to comply with their respective agency Alpha contracting policies and procedures. Additionally, DCMA officials had not established procedures to implement FAR guidance on forward pricing rate agreements. As a result, TACOM LCMC contracting officials may have overpriced firm-fixed-price contracts awarded to BAE.

Alpha Contracting Process

Alpha contracting is a process where representatives from a contractor and the Government form a team to prepare a negotiated contract in the best interest of both parties. Alpha contracting includes a simultaneous exchange of information and replaces the traditional "consecutive contracting." During the Alpha contracting process, the Alpha team develops the scope of work, solicitation, cost elements, and ultimately awards a contract.

Alpha contracting is used primarily for sole-sourced, negotiated contracts. FAR 6.303-1 states that an approved Justification and Approval for Other Than Full and Open Competition must be in place before the Government can begin negotiations with the contractor. However, fact-finding inquiries and discussions between the Government and the contractor regarding requirements may take place before a Justification and Approval for Other Than Full and Open Competition is approved. TACOM LCMC, DCMA, and DCAA³ each have documented procedures for executing the Alpha contracting process.

TACOM LCMC Guidance. According to TACOM LCMC procurement procedures, the Alpha team should include the contractor, a contract specialist and/or contracting officer, a legal representative for the buying activity, the

³ DCAA guidance refers to the Alpha contracting process as an Integrated Product Team.

customer, and applicable Government personnel. TACOM LCMC procurement procedures state that applicable Government personnel will usually include a pricing specialist, DCAA auditor, DCMA representative, and technical representatives, as needed. The level of complexity and the dollar amount of the acquisition generally determine the members of the Alpha team.

Alpha contracting uses a Process Oriented Contract Administration Services (PROCAS) agreement. The procurement office is responsible for staffing and executing a PROCAS agreement, which lists the members and responsibilities of each team and sub team, and explains the rules and guidelines that the Alpha team will follow. The principal members of the Alpha team should sign the PROCAS agreement.

DCMA Guidance. The DCMA Guidebook defines Alpha contracting as the process by which DCMA, DCAA, and the buying command remain in constant communication with the contractor while the contractor develops a contract proposal. The Alpha team concurrently evaluates, analyzes, fact-finds, and resolves disagreements as the contractor develops the proposal.

DCAA Guidance. According to the DCAA Contract Audit Manual (CAM), during Alpha contracting, the DCAA auditor should provide real-time feedback on such items as proposal support data expectations, proposal estimating techniques, and the impact of outstanding estimating deficiencies on the proposal preparation process. The DCAA auditor should coordinate with the contracting officer to determine whether Alpha contracting will be used for a proposal and exactly what services the Alpha team will require from DCAA, to include an examination of the complete proposal, an examination of part of the proposal, or an application of agreed-upon procedures.⁴

FY 2005 Bradley Procurement

TACOM LCMC contracting personnel awarded contract W56HZV-05-G-0005, delivery orders 0001, 0002, 0003, 0004, and contract DAAE07-01-C-M016, modification P00123 to BAE for a total award amount of \$1.1 billion on June 23, 2005. These contract actions procured 241 M2A3 Bradley vehicles; 156 M3A3 Bradley vehicles; 53 A3 Bradley Fire Support Team vehicles; 50 Operation Desert Storm Bradley vehicles; 100 Operation Desert Storm kit sets; 33 M7 Bradley Fire Support Team Bradley Vehicles; 1 lot of Authorized Stock List spare parts; and 120 Commander's Independent Viewers to be installed on Bradley vehicles. These contract delivery orders and modifications will be collectively referred to as the FY 2005 Bradley procurement throughout this report.

TACOM LCMC and DCMA contracting officials did not include DCAA personnel in the Alpha contracting process for the FY 2005 Bradley vehicle procurement; therefore, DCAA personnel could not perform an effective review of material costs.

⁴ An application of agreed-upon procedures is a review in which the contracting officer, not the auditor, establishes the scope of the steps that the auditor will perform.

Alpha Meetings. BAE personnel began holding Alpha meetings on December 2, 2004, to discuss the FY 2005 Bradley procurement. The December 2, 2004, Alpha meeting minutes indicated that BAE personnel decided to include Government personnel at the next Alpha meeting. Specifically, BAE personnel were assigned to speak with PM-HBCT representatives at TACOM LCMC; the procurement contracting officer (PCO) at TACOM LCMC; and the administrative contracting officer (ACO) at DCMA York. The Alpha meeting minutes also stated that BAE personnel noted that the ACO must decide whether to include DCAA personnel in the Alpha meetings. DCMA personnel began attending the Alpha meetings on December 9, 2004, and regularly attended Alpha meetings until the contract was awarded.

According to Alpha meeting attendance lists, TACOM LCMC personnel attended one Alpha meeting on April 28, 2005. However, TACOM LCMC contracting personnel indicated that they participated in additional Alpha meetings via telephone.

DCAA personnel did not attend any Alpha meetings. DCAA auditors stated that they were unaware that BAE and DCMA personnel conducted Alpha meetings for the FY 2005 Bradley procurement. In response to DCAA auditor inquiries on why DCAA personnel were not notified of the Alpha meetings, BAE personnel responded that because DCAA is a Government agency, it was more appropriate for the PCO or the ACO to invite DCAA to participate. However, BAE personnel invited DCAA auditors to participate in the Alpha meetings for the previous Bradley vehicle procurement in FY 2004.

PROCAS Agreement. On May 2, 2005, the TACOM LCMC PCO e-mailed a PROCAS agreement to DCAA personnel. According to the PROCAS agreement, BAE agreed to include DCAA personnel in the development of cost and technical information, where possible, as it was formulated for the proposal. Additionally, DCAA personnel agreed to participate in efforts sponsored by the contractor in the development of the proposal. The PROCAS agreement also stated that DCAA, DCMA, PM-HBCT, TACOM, and BAE personnel agreed to analyze cost and supporting data as it was developed in an effort to reach an agreement with the contractor prior to final submission of the proposal.

DCAA Participation. TACOM LCMC contracting officials constrained DCAA's ability to provide meaningful audit results for the FY 2005 Bradley procurement. Between May 23 and 25, 2005, the PCO requested, via telephone, that DCAA auditors review BAE's Bill of Materials (BOM), along with the Other Material Costs, and the quotations from the subcontractors not on the BOM.

Timeline of Bill of Materials Review. DCAA auditors initially requested the BOM from BAE personnel on May 25, 2005, and received a copy of the BOM from BAE personnel on May 26, 2005. However, the PCO informed DCAA personnel on May 27, 2005, that the BOM contained errors and BAE personnel needed to update the BOM. DCAA personnel received a copy of the updated BOM on June 1, 2005, and began receiving supporting documentation for the BOM on Friday, June 3, 2005. Also on Friday, June 3, 2005, the PCO requested results of DCAA's review of the BOM by Monday, June 6, 2005.

The PCO stated that he required a short turnaround from DCAA because TACOM LCMC contracting officials were under severe pressure to award

contracts using the FY 2005 supplemental funding. PM-HBCT office representatives stated that TACOM LCMC risked losing supplemental funding if contracting officials did not obligate the supplemental funds within 30 days from receipt. In an e-mail dated May 23, 2005, the former PM-HBCT stated that TACOM LCMC would be receiving FY 2005 supplemental funding within a few days and referenced several preceding messages from the Army Budget Office and the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) which, according to the e-mail, emphasized the need to obligate funding no later than 30 days after receipt of the funding. PM-HBCT office representatives could not provide any correspondence from either the Army Budget Office or the Assistant Secretary of the Army (Acquisition, Logistics, and Technology) directing Army commands to obligate funding within 30 days. PM-HBCT personnel stated that their guidance from the Army Budget Office was verbal. An Office of the Assistant Secretary of the Army, Financial Management and Comptroller memorandum, dated May 10, 2005, required Army Major Commands to report the planned execution of supplemental funding within 30 days of receipt. Assistant Secretary of the Army, Financial Management and Comptroller office representatives confirmed the requirement to report the planned execution of supplemental funding and stated that no requirement existed to obligate the supplemental funding within 30 days of receipt.

Results of BOM Review. On Monday, June 6, 2005, DCAA personnel e-mailed the results of the BOM review to the PCO, stating that they could not obtain sufficient evidence to base an opinion on the FY 2005 Bradley direct material costs, subcontractor costs, and other material costs due to PCO-imposed time constraints. According to the e-mail, the amount of time provided for performance of the audit did not allow DCAA auditors to apply auditing procedures to verify the acceptability of BAE's direct material costs, subcontract costs, and other material costs. DCAA officials stated that an audit of this size and scope might typically take three weeks. The DCAA CAM states that a DCAA auditor should use previous purchase order prices adjusted for quantity differences in evaluating a contractor's BOM pricing. According to the DCAA CAM, the auditor should compare the prices on the BOM with prices quoted by competing suppliers for comparable quantities, recent quotations for the same or similar items, and costs incurred by the contractor for the same or similar items. Additionally, the DCAA CAM states that the auditor should consider patterns of reductions from quotes to actual prices paid by the contractor for prior procurements.

DCAA auditors did not have time to gather historical data and compare the material prices listed by BAE to previous vendor quotations and purchase orders. Therefore, DCAA personnel relied on the BAE analysis of historical data. For 26 of the 37 subcontractors, DCAA personnel reviewed BAE's cost and price analyses and determined the analyses to be incomplete because the analyses did not include historical procurement information from the subcontractors. DCAA personnel did not have time to review the BAE files to obtain and analyze the incomplete data, nor did DCAA personnel have time to contact the cognizant DCAA offices to obtain more information. DCAA personnel provided decrement factors to the PCO for 22 subcontractors based on previous DCAA audit assignments and limited data that the contractor provided. DCAA disclaimed an opinion for 15 subcontractors.

Agency Compliance With Alpha Guidance. TACOM LCMC and DCMA personnel failed to comply with their respective agency Alpha contracting policies and procedures for the FY 2005 Bradley procurement.

TACOM LCMC. TACOM LCMC personnel did not follow internal Alpha contracting policies and procedures, which state that the Alpha team should usually include a DCAA auditor, as determined by the complexity and the dollar amount of the acquisition. The PCO did not communicate with DCAA regarding the FY 2005 Bradley procurement until May 2, 2005, and never requested DCAA participation on the Alpha team. Based on TACOM LCMC guidance, a \$1.1 billion procurement involving in excess of 500 vehicles warrants DCAA involvement in the Alpha contracting process.

The TACOM LCMC personnel did follow their internal procedures for the Alpha contracting process for the FY 2005 HERCULES procurement. The PCO requested DCAA assistance on March 16, 2005, for a \$143 million contract modification also awarded to BAE on June 23, 2005, for HERCULES vehicles. The PCO involved DCAA personnel in the Alpha process as early as April 26, 2005.

DCMA. The DCMA Guidebook includes DCAA as a participant in the Alpha contracting process; however, the DCMA ACO never informed DCAA personnel of the Alpha meetings for the FY 2005 Bradley procurement nor invited DCAA personnel to participate in the Alpha meetings. DCMA personnel participated in most of the Alpha meetings from December 2004 through May 2005. Meeting notes from the December 2, 2004, Alpha meeting stated that the DCMA ACO will decide whether to include DCAA personnel in the Alpha process.

If DCAA personnel had participated in the Alpha meetings DCAA auditors might have been able to examine subcontractor proposals and quotations as subcontractors provided the information to BAE. With more time to gather and analyze data, DCAA auditors might have been able to provide more meaningful audit results to the PCO for this procurement. Meeting notes prepared by BAE personnel from a February 24, 2005, Alpha meeting state that the proposals from suppliers and subcontractors were to be submitted by March 16, 2005, which would have given DCAA auditors time to review the proposals and gather the data necessary to evaluate the proposals in preparation for negotiations. Additionally, the TACOM LCMC contract specialist indicated that BAE provided vendor quotations to the Alpha team as BAE received the quotations.

Forward Pricing Rate Agreements

For contractors with significant sales to the Government, an ACO may establish forward pricing rates to facilitate the estimating and negotiating of proposals by making the process less time-consuming and costly for both the Government and contractors. A Forward Pricing Rate Agreement (FPRA) is a written agreement that a contractor and the Government negotiate to generate rates to be used in pricing contracts or modifications during a specified period of time. The rates represent projections of specific costs that are not easily estimated for, identified with, or generated by a specific contract.

FPRA Criteria. The FAR provides instruction for establishing FPRAs and details the requirements for adequately documenting the basis for established forward pricing rates included in an FPRA. DCMA guidance provides instruction on the use of the Alpha contracting process for FPRAs. DCAA guidance instructs DCAA auditors on what information must be considered when auditing an FPRA.

FAR Requirements. FAR 42.1701, “Forward Pricing Rate Agreement Procedures,” provides instruction for establishing FPRAs, stating that the ACO will obtain the contractor’s proposal and require that it include cost or pricing data that are accurate, complete, and current as of the date of submission. In addition, the ACO will invite the cognizant contract auditor and contracting offices to participate in developing a Government objective and in the negotiations. After completing negotiations with the contractor, the ACO must prepare a price negotiation memorandum (PNM), along with the FPRA. The FPRA provides specific terms and conditions covering expiration, application, and data requirements for systematic monitoring to ensure the accuracy of the rates. The agreement should also provide for cancellation at the option of either party and require the contractor to submit any changes in cost or pricing data to the ACO and to the cognizant contract auditor. When an FPRA becomes inaccurate, the contractor should submit and negotiate a new proposal to reflect the changed conditions.

FAR 15.406-3, “Contract Pricing Documenting the Negotiation,” details the requirements for adequately documenting the basis for established forward pricing rates included in an FPRA. In the PNM, the ACO should document the principal elements of the negotiated agreement, including the:

- purpose of the negotiation;
- description of the contractor’s proposal;
- name, position, and organization of each person representing the contractor or the Government in the negotiation;
- current status of any relevant contractor systems (for example, estimating, accounting, etc.);
- field pricing assistance recommendations, if any, including the reasons for any pertinent variances from them;
- Government’s negotiation objective;
- negotiated position; and
- negotiated agreement, including an explanation of any significant differences between the objective and negotiated positions.

DCMA Guidance. According to the DCMA Guidebook, the ACO should request an FPRA proposal from the contractor when establishing an FPRA. The ACO may choose to use the Alpha contracting process to create an FPRA. When Alpha contracting is used to create an FPRA, the Alpha team should be involved in the development of the FPRA proposal. Although the Alpha team will review

the contractor's proposal data as it is developed, the contractor must still provide a final proposal to be used for achieving an FPRA.

DCAA Guidance. The DCAA CAM Chapter 9 states that while auditing an FPRA, a DCAA auditor must consider: the materiality of bases, pools, and rates; the results of prior DCAA audits and the adequacy of contractor internal controls; the historical differences between the contractor's forecasted and actual rates; and changes in the contractor's organization, operations, manufacturing processes and practices, business volume, and allocation bases. Additionally, the auditor should determine that the contractor's projected business volume, allocation bases, and indirect costs are reasonable; the contractor's rate data are valid and correct; and that the contractor's rate computations are mathematically correct.

The DCAA CAM requires that, at a minimum, a DCAA auditor should verify that the forecasted allocation bases and estimated pool costs are compatible with the contractor's current business volume estimates and developed in accordance with the latest management plan when performing FPRA audits. Additionally, the auditor should consider the procurement requirements and limitations of the individual buying offices.

BAE FPRAs. DCMA contracting officials did not require BAE forward pricing rate agreement proposals to be current, accurate, and complete, as required by the FAR. Additionally, the first FPRA Alpha team discussion minutes from September 20, 2000, stated that, ideally, the FPRA Alpha team will not require an FPRA proposal submission, an audit, an evaluation, or any negotiations.

Prior to 2000, DCMA and BAE personnel did not negotiate formal FPRAs at BAE because BAE's business base was very volatile, causing fluctuations in indirect rates. DCMA and BAE personnel established an FPRA Alpha team in October 2000 to create an FPRA and eliminate the need to negotiate indirect rates for each contract awarded to BAE. The FPRA Alpha team continuously monitored and updated the BAE FPRA after the first FPRA was established in March 2001, resulting in 21 subsequent FPRAs as of June 2007.

BAE FPRA Alpha Team. The BAE FPRA Alpha team consisted of a base team and a pool team. The base team identified the business base by reviewing BAE's projected business for all of the years included in an FPRA. Generally, an FPRA at BAE encompassed four or five years of business. Base team members discussed BAE's projected production of vehicles with Government program managers to verify the probability that BAE would produce the given number of vehicles. The base team then analyzed the BAE conversion of the projected number of vehicles to projected labor hours and compared the number of projected labor hours with Government negotiation memorandums documenting the number of labor hours the Government and BAE agreed to in previous contracts. Finally, the base team agreed to a business base, which included the number of vehicles and labor hour quantities to be incorporated into the FPRA. The pool team identified pool costs by examining the BAE budgeted costs for each department (that is, contract support, manufacturing) for the current calendar year.

After the base and pool teams developed their figures, BAE personnel entered the data into the automated forward pricing rate model that BAE

developed. The model then calculated the forward pricing rates for out years based on budgeted costs developed by the pool team and the projected business base developed by the base team. After the model calculated forward pricing rates, the ACO, along with BAE personnel, reviewed the rates and signed an FPRA.

According to DCAA documentation, BAE challenged DCAA requests for supporting data during the FPRA Alpha meetings in FY 2001 by stating that DCAA was not permitted to audit the data, making it difficult for DCAA to provide quantitative input. DCAA personnel felt their attendance at FPRA Alpha meetings gave the appearance that DCAA personnel audited and supported the FPRAs. DCAA auditors were concerned that by reviewing data entered into the FPRA model, yet not reviewing the output of the FPRA model, BAE could claim that DCAA took no exception and, therefore, DCAA could not question any of the pool costs. In March 2003, a DCAA auditor requested to be removed from the FPRA Alpha team, citing concerns about auditor independence. The FPRAs no longer listed DCAA personnel as members of the FPRA Alpha team; however, DCAA personnel still attended FPRA Alpha meetings, acting mainly as observers.

DCAA Audits. DCAA audits performed throughout the FPRA Alpha process did not provide effective and meaningful results because BAE FPRA data provided to DCAA was not current, accurate, and complete. In addition, the ACO did not always consider DCAA audit results when negotiating FPRAs. Since 2001, DCAA performed 5 audits on BAE budget data and 4 audits on BAE FPRAs.

DCAA Budget Audits. The BAE Calendar Year (CY) budgets provided the basis for the pool costs that were entered into the automated forward pricing rate model to calculate forward pricing rates. Since 2001, DCAA performed 5 audits on BAE budget data that were used as the basis for FPRA pool costs; however, DCAA auditors did not examine the corresponding business bases used to allocate the costs because the ACO requested that DCAA look only at the pool costs. As a result, DCAA did not look at all of the data critical for determining whether the forward pricing rates were accurate. Additionally, BAE did not always use the same business bases to formulate the CY budget that the FPRA Alpha team used in the forward pricing rate model. As a result, the budgeted costs that DCAA reviewed in its audits of budget data may have differed from the budget costs used to develop the FPRA. Furthermore, the ACO requested DCAA to audit the budgeted costs for only 1 year and did not request that DCAA review any of the projected costs applicable to the additional years covered in the FPRA.

DCAA Audit on CY 2002 BAE Budget Data. DCMA personnel requested that DCAA personnel audit the BAE CY 2002 budget on January 11, 2002. According to DCAA documentation, DCMA personnel directed DCAA personnel not to examine the BAE allocation business base during this budget audit. In addition, DCAA documentation indicated that DCMA personnel informed DCAA personnel that DCMA personnel “may not even use” the audit results during the FPRA Alpha process.

DCAA Audit on CY 2003 BAE Budget Data. DCMA personnel requested DCAA to audit the BAE CY 2003 budget on January 17,

2003. However, the ACO and BAE personnel signed an FPRA on February 24, 2003, using the BAE CY 2002 budget data, which violated the FAR requirement that an FPRA be based on cost or pricing data that are accurate, complete, and current as of the date of submission. The ACO should have used the CY 2003 budget data because it was more current. However, the DCAA audit report issued on April 18, 2003, stated that the BAE CY 2003 budget did not form an acceptable basis for negotiation of fair and reasonable indirect forward pricing rates because the BAE CY 2003 budget was not prepared in accordance with applicable cost accounting standards. According to the audit report, DCAA personnel informed the ACO of this finding on April 10, 2003. However, the ACO and BAE personnel signed an FPRA developed using the BAE CY 2003 budget on May 20, 2003. We could not determine whether the ACO considered the DCAA audit report when negotiating this FPRA because the ACO did not prepare a PNM for this FPRA.

DCAA Audit on CY 2004 BAE Budget Data. On February 2, 2004, DCMA personnel requested DCAA to audit the indirect cost pools contained in the BAE CY 2004 budget, which the FPRA Alpha team would use as a basis for the pool costs in the next FPRA. DCAA questioned \$2.9 million in indirect costs. The ACO used the DCAA audit report to negotiate cost reductions totaling \$2 million. However, the DCAA audit report stated that the business base assumptions BAE used to create the CY 2004 budget may have differed from the base agreement used by the FPRA Alpha team to create the FPRA. Since the base cost used may have differed from the budget, the pool costs used may have been different than the costs DCAA audited. Therefore, the DCAA results may not be applicable to the pool costs actually used to create the FPRA.

DCAA Audit on CY 2005 BAE Budget Data. On February 4, 2005, DCMA personnel requested DCAA to audit the indirect cost pools contained in the BAE CY 2005 budget, which the FPRA Alpha team would use as a basis for the pool costs in the next FPRA. Again, DCAA questioned \$2.9 million in indirect costs. The ACO used the DCAA audit report to negotiate cost reductions totaling \$1.6 million. However, the DCAA audit report stated that the business base assumptions BAE used to create the CY 2005 budget may have differed from the base agreement used by the FPRA Alpha team to create the FPRA. Therefore, the DCAA results may not be applicable to the pool costs actually used to create the FPRA.

The DCAA CAM requires that, at a minimum, a DCAA auditor should verify that the forecasted allocation bases and estimated pool costs are compatible with the contractor's current business volume estimates and developed in accordance with the latest management plan when performing FPRA audits. Additionally, the DCAA CAM states that the auditor should consider the procurement requirements and limitations of the individual buying offices. However, DCAA auditors reviewed only individual CY budget costs and did not review a complete FPRA proposal because the ACO requested that DCAA review only pool costs.

DCAA FPRA Audits. Since 2001, DCAA has audited 4 BAE FPRAs; however, DCMA and BAE personnel signed the FPRAs before DCAA issued the audit reports. Although in all four cases DCAA provided preliminary results to DCMA, two of the four PNMs did not address whether the ACO considered

DCAA audit results when negotiating FPRAs. DCAA canceled a fifth audit of an FPRA due to lack of adequate cost and pricing data to support the FPRA. DCAA may have been able to provide more meaningful information for the ACO to use in negotiating the FPRAs with BAE if the ACO had required BAE to submit current, accurate, and complete proposals for the FPRAs, as required by the FAR.

The ACO prepared PNMs that did not properly document how the ACO used DCAA audit results in negotiating the FPRAs, as required by the FAR. For example, in April and May 2005, DCAA performed an audit of the BAE indirect pools, bases, and rates while an FPRA was being developed, and determined BAE's projected FY 2007 Division-Wide Material Handling and Division-Wide General and Administrative rates were unacceptable. DCAA issued this audit report on June 22, 2005; the audit report stated that DCAA provided verbal results to the ACO on May 3, 2005. However, DCMA and BAE personnel negotiated the FPRA on May 4, 2005. The FPRA dated May 4, 2005, properly included the rates DCAA recommended for BAE's FY 2007 Division-Wide Material Handling and Division-Wide General and Administrative costs; however, the ACO did not document in the PNM how the ACO used the audit results in negotiating the FPRA, as required by the FAR.

On October 23, 2006, the ACO requested that DCAA examine base and pool information for an in-process FPRA. The ACO and BAE personnel signed the FPRA on November 1, 2006. On January 16, 2007, DCAA canceled the examination requested by the ACO because DCAA could not obtain adequate cost and pricing data to review.

Compliance With FAR Guidance. DCMA officials had not established procedures to implement internal guidance and FAR requirements on forward pricing rate agreements. BAE provided supporting documentation during the FPRA Alpha process for the business base and pool expenses separately. However, the ACO stated that he did not require BAE to submit a complete FPRA proposal with supporting documentation detailing the allocation business bases, pool expenses, and rates for each FPRA. FAR 42.1701(b) requires that the ACO obtain the contractor's FPRA proposal, to include cost or pricing data that are accurate, complete, and current as of the date of submission. According to numerous PNMs, BAE personnel entered the business base and pool expense figures developed by the respective Alpha teams into the FPRA proposal model; the model then calculated the rates, and after little or no negotiation, the ACO used the rates for the FPRAs.

In addition, the ACO was unable to provide PNMs for 8 of the 22 BAE FPRAs; FAR 42.1701(b) requires that the ACO prepare a PNM after reaching agreement with the contractor on an FPRA. The ACO provided PNMs for 14 BAE FPRAs, and the PNMs did not properly document information required by the FAR. The PNMs did not comply with FAR 15.406-3 because the ACO failed to:

- include a description of the contractor's proposal;
- detail the Government objective;
- highlight significant variances between the negotiated rates and the Government objective;

-
- detail DCAA recommendations, if any; and
 - include the reasons for any pertinent variances from DCAA recommendations.

Due to the lack of adequate documentation, we could not determine whether the ACO used DCAA audit results when negotiating FPRAs with BAE.

Rate Overstatements. The majority of the indirect rates negotiated in BAE FPRAs from 2001 through 2006 were overstated when compared with the actual indirect rates incurred by BAE. For example, TACOM LCMC contracting officials used the May 4, 2005, FPRA to award the FY 2005 Bradley procurement, valued at \$1.1 billion, and the contract included at least \$138 million of estimated indirect costs derived from the FPRA rates. The FPRA included rates for CYs 2005, 2006, 2007, and 2008, and the FPRA overstated 25 of the 34 indirect rates for 2005 and 2006, when compared with the actual rates incurred by BAE for those years. As a result, the \$138 million of estimated indirect costs negotiated in the contract price included costs that BAE did not actually incur. We were unable to determine the specific estimated costs associated with 2005 and 2006 because TACOM LCMC contracting officials could not provide cost estimate summaries by calendar year for the negotiated contract price; as a result, we could not determine how much of the \$138 million in indirect costs were not incurred. DCAA should perform a post award audit of the Alpha contracting process for forward pricing rate agreements to determine whether defective pricing occurred and make any necessary recommendations to adjust affected contracts.

Other Matters of Interest

During our review of the contracts identified in the allegations, it became clear that communication and coordination among TACOM LCMC, DCMA, DCAA, and BAE personnel were ineffective and often nonexistent. The Alpha contracting process cannot succeed without a simultaneous exchange of information among representatives for the Government and the contractor; communication and coordination are critical elements to a successful Alpha contracting negotiation.

During the Alpha contracting process for the FY 2005 Bradley procurement, DCMA and DCAA personnel lacked basic and fundamental communication on most issues. DCAA auditors were not included in the Alpha contracting process until late May 2005, when TACOM LCMC contracting officials requested the BOM review. DCAA personnel were aware of the Bradley procurement, however, as early as January 2005. Although the onus is clearly on TACOM LCMC and DCMA contracting personnel to invite DCAA to participate in the Alpha contracting process, DCAA auditors could have been more proactive in determining their involvement in the process and what services they might be required to perform. During the audit, DCAA officials agreed that they could have been more proactive and would ensure a more assertive approach, if necessary, in the future.

Additionally, DCAA continues to have difficulty obtaining necessary information in a timely manner. Since June 2007, DCAA has issued 5 memorandums to BAE regarding Government requests for information that have not been satisfactorily answered by BAE. DCMA should provide DCAA assistance in obtaining information from the contractor to satisfy DCMA audit requests in a timely manner and so that DCAA can provide more meaningful audit results.

DCMA and DCAA management officials must establish an environment that ensures effective, simultaneous, and sufficient communication among personnel executing the Alpha contracting process. DCMA personnel stated that they chair executive management meetings to provide a forum for DCMA, DCAA, and BAE to maintain communication and elevate concerns. However, the communication and coordination issues discussed in our report were not raised at the executive management meetings. If the personnel responsible for Alpha contracting do not or cannot communicate or coordinate as necessary to accomplish their requirements, senior managers must identify and address the problem.

Conclusion

TACOM LCMC contracting officials may have overpriced the FY 2005 Bradley procurement awarded to BAE because contracting officials did not ensure DCAA participation in the Alpha contracting process and BAE FPRA negotiations. TACOM LCMC contracting officials acknowledged that they requested results from a DCAA review within 2 non-working days, stating that they were under strict time constraints from the PM-HBCT to obligate funds. PM-HBCT officials stated that the Army Budget Office guidance was verbal and very clear that the expectation was to obligate the funds within 30 days. According to the Office of the Assistant Secretary of the Army, Financial Management and Comptroller, however, the time constraint requirement did not exist. Although the time constraint may have resulted from misinterpreted guidance, TACOM LCMC personnel continued to execute contract actions with BAE and without critical assistance from DCAA. Because of the unnecessary time constraints imposed by TACOM LCMC contracting officials, DCAA disclaimed an opinion on the FY 2005 Bradley procurement BOM review. If TACOM LCMC and DCMA contracting officials had followed existing agency Alpha contracting policies and procedures and included DCAA in Alpha meetings as early as December 2004, DCAA may have been able to provide more meaningful results to contracting officials in order to negotiate lower material prices to be paid by the Government for this firm-fixed-price procurement. Additionally, if DCAA personnel had coordinated with the PCO on the services DCAA might be asked to provide, DCAA may have been able to provide a more useful review of material costs.

TACOM LCMC contracting officials may have overpriced firm-fixed-price contracts with BAE, because a majority of the indirect rates negotiated in FPRAs were higher than the actual rates incurred by BAE. As a result, the Government negotiated firm-fixed price contracts awarded to BAE based on estimated costs that BAE did not actually incur. If DCMA personnel had properly required BAE to submit accurate, current, and complete FPRA proposals for DCAA to audit, DCAA may have been able to provide meaningful audit results for the ACO's use in negotiating FPRAs.

Management Comments on Finding and Audit Response

The Deputy Chief of Staff for the Commander, TACOM Life Cycle Management Command and the Program Executive Officer, Ground Combat Systems, TACOM Life Cycle Management Command made comments to the finding discussion of the draft report.

Commander Comments. The Deputy Chief of Staff for the Commander agreed that TACOM requested an unrealistic response time from DCAA for the FY 2005 Bradley procurement. The Deputy Chief of Staff for the Commander also stated that TACOM Acquisition Center Bradley team invited DCAA to participate in the Alpha process on many occasions. The Deputy Chief of Staff for the Commander stated that DCAA attended most of the weekly FPRA IPT meetings and were invited to the Alpha meetings, which they attended on occasion.

We determined that DCAA personnel did not attend any Alpha meetings for the FY 2005 Bradley procurement. DCAA auditors stated that they were unaware that BAE and DCMA personnel conducted Alpha meetings for the FY 2005 Bradley procurement. In response to DCAA auditor inquiries on why DCAA personnel were not notified of the Alpha meetings, BAE personnel responded that because DCAA is a Government agency, it is more appropriate for the PCO or the ACO to invite DCAA to participate. However, BAE personnel invited DCAA to participate in the Alpha meetings for the previous Bradley vehicle procurement in FY 2004.

In addition, during the audit the PCO stated that he did not invite DCAA to participate in the IPT process because DCAA already knew they needed to attend the meetings and that a request letter was only a formality. However, a request letter was sent to DCAA to participate in the IPT process for the FY 2005 HERCULES procurement, which occurred concurrently with the FY 2005 Bradley procurement. TACOM LCMC procurement procedures state that the Alpha team should include the contractor, a contract specialist and/or contracting officer, a legal representative, the customer, and applicable Government personnel. TACOM LCMC procurement procedures state that applicable Government personnel will usually include a pricing specialist, a DCAA auditor, a DCMA representative, and technical representatives as needed based on the level of complexity and the dollar amount of the acquisition. TACOM LCMC invited DCAA to participate in the IPT process for the \$143 million FY 2005 HERCULES procurement; therefore, TACOM LCMC personnel should have invited DCAA to participate in the \$1.1 billion FY 2005 Bradley procurement.

Additionally, the Deputy Chief of Staff for the Commander commented on the report statement that, "... the Government negotiated firm-fixed price contracts awarded to BAE based on estimated costs that BAE did not actually incur," and stated that the Government negotiation team relied on BAE's proposal data, which was certified by BAE as current, accurate, and complete. The Deputy Chief of Staff for the Commander stated the team could not have anticipated that BAE would not actually incur the costs related to the higher rates compared to subsequent actual rates. The actual rates came in lower due to the unanticipated surge in war-related business volume.

We determined, however, that BAE provided supporting documentation during the FPRA Alpha process for the business base and pool expenses separately. The ACO stated that he did not require BAE to submit a complete FPRA proposal with

supporting documentation detailing the allocation business bases, pool expenses, and rates for each FPRA. FAR 42.1701(b) requires that the ACO obtain the contractor's FPRA proposal, to include costs or pricing data that are accurate, complete, and current as of the date of submission.

Program Executive Officer Comments. The Program Executive Officer, Ground Combat Systems TACOM Life Cycle Management Command, acknowledged that a number of the indirect rates negotiated in BAE FPRAs from 2001 through 2006 were overstated compared with actuals incurred. However, the Program Executive Officer, Ground Combat Systems TACOM LCMC, stated that the conclusion that the \$138 million in indirect costs in the contract included costs that BAE did not actually incur is misleading. The Program Executive Officer also stated that the auditors did not request the breakdown for the amount of work performed under this contract by calendar year and that the auditors did not provide any specific data or even any anecdotal evidence to support the allegation made that the overstating of FPRA rates at BAE is due to defective pricing.

Based on the comments from the Program Executive Officer, the team changed the text within the paragraph titled, "Rate Overstatements," by inserting the word "estimated" in front of any mention of costs or indirect rates to make the paragraph read more clearly. Additionally, the report now states, "As a result, the \$138 million of estimated indirect costs negotiated in the contract price included costs that BAE did not actually incur." The team changed the last sentence of the "Rate Overstatements" paragraph to state "determine whether defective pricing occurred" instead of "identify defective pricing."

The audit team did not specifically ask for the amount of work performed on the contract per year because we did not require that information. We specifically asked PM HBCT personnel for the cost estimate summaries by calendar year for the contract, and PM HBCT personnel could not provide this information by calendar year.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Commander, TACOM Life Cycle Management Command direct the Director, Acquisition Center to follow TACOM Life Cycle Management Command policies and procedures to include Defense Contract Audit Agency auditors during the Alpha contracting process.

Management Comments. The Deputy Chief of Staff for the Commander, TACOM Life Cycle Management Command concurred, stating that the Director, Acquisition Center will issue a memorandum to all procurement contracting officers reminding them of the responsibility to include Defense Contract Audit Agency auditors during the Alpha contracting process as outlined in TACOM LCMC policy. The Deputy Chief of Staff for the Commander stated that the target date of completion of this action is June 30, 2008.

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

2. We recommend that the Program Executive Officer, Ground Combat Systems, TACOM Life Cycle Management Command issue guidance to project managers that clearly establishes time frames for obligating supplemental funding.

Management Comments. The Program Executive Officer, Ground Combat Systems, TACOM Life Cycle Management Command concurred, stating that guidance will be issued to project managers and their acquisition staff that strengthens current processes and procedures with timeframes for awarding appropriated funds. The Program Executive Officer stated that the target date of completion of this action is June 30, 2008.

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

3. We recommend that the Director, Defense Contract Management Agency direct the Commander, Defense Contract Management Agency, BAE Systems Ground Systems Division to:

a. Obtain current, accurate, and complete forward pricing rate agreement proposals from BAE Systems Land and Armaments Ground Systems Division in accordance with Federal Acquisition Regulation Part 42, "Contract Administration and Audit Services," and properly document the negotiation of forward pricing rate agreements in accordance with Federal Acquisition Regulation Part 15, "Contracting by Negotiation."

Management Comments. The Director, Defense Contract Management Agency concurred and stated that Defense Contract Management Agency agrees that all contractors are required to provide current, accurate and complete forward pricing rate agreement proposals. The Director also stated that DCMA Combat Vehicles-BAE York required current, accurate, and complete data from the contractor to be input into a computer program to produce a proposal. The Director stated that the Divisional Administrative Contracting Officer (DACO) will continue to require BAE to furnish such data and certification of the FPRA proposal information will continue to be required when it is used to price a contract action that requires a certificate. In addition, the identification of the supporting information and the results of the negotiation will be documented in the negotiation memorandum in accordance with the Federal Acquisition Regulation. DCMA's comments on page 6 state that the ACO does not require a complete proposal submission in a continuous FPRA environment; it is not always necessary.

Audit Response. The comments are not responsive, and additional comments are required. The comments do not address the recommendation. The ACO did not require a complete forward pricing rate agreement proposal submission as required by the FAR, and the Director's comments on page 6 acknowledge that they did not require this data. The statements made by the Director in response to recommendation 3.a. and DCMA comments on page 6 are contradictory. In addition, the ACO was unable to provide price negotiation memorandums for 8 of 22 BAE FPRAs, and 14 price negotiation memorandums did not properly document information required by FAR 15.406-3. We request that DCMA provide additional comments that address the recommendation and provide a target completion date for corrective actions to be taken.

b. Submit accurate, current, and complete forward pricing rate agreement proposals to the Defense Contract Audit Agency for audit.

Management Comments. The Director, DCMA concurred and stated that DCMA will continue to request DCAA involvement in the FPRA process. DCMA's comments on page 6 state that the ACO does not require a complete proposal submission or request a DCAA review of a complete proposal in a continuous FPRA environment; it is not always necessary. In addition, the Director stated that in order to assist DCMA contracting officers in coordinating DCAA audit support, DCMA has implemented and is conducting training on the 2.0 version of the E-tools based Pricing and Negotiation application. This application will provide the ACO with the ability to create and track pricing support requests.

Audit Response. The comments are not responsive, and additional comments are required. The comments do not address the recommendation. The statements made by the Director in response to recommendation 3.b. and DCMA comments on page 6 are contradictory. We request that DCMA provide additional comments that address the recommendation and provide a target completion date for corrective actions to be taken.

c. Establish procedures to implement Defense Contract Management Agency guidance to include Defense Contract Audit Agency auditors during the Alpha contracting process.

Management Comments. The Director, DCMA concurred and stated that the PCO normally leads the Alpha process; however, to ensure DCAA participation in the Alpha process, DCMA Combat Vehicles leadership will meet with DCAA upper management to facilitate common understanding and establish mutual agreement on roles and responsibility in the Alpha process. The estimated completion date for this action is May 15, 2008.

Audit Response. The comments are partially responsive, and additional comments are required. The DoD IG recommends that the procedures implemented or agreed upon as a result of the meeting with DCAA upper management be documented.

4. We recommend that the Commander, Defense Contract Management Agency, BAE Systems Ground Systems Division request the Defense Contract Audit Agency to perform an audit of forward pricing rate agreement proposals in accordance with Federal Acquisition Regulation Part 42 requirements.

Management Comments. The Director, DCMA partially concurred with the recommendation and stated that the DCMA guidebook on forward pricing rates includes extensive guidance on the process to be followed for the development of FPRAs. Section 3 of the Guidebook provides for the inclusion of DCAA in the process. The Director also stated that the ACO does not require a complete proposal submission or request a DCAA review of a complete proposal in a continuous FPRA environment; it is not always necessary.

In addition, the Director stated that an opportunity for improvement may exist; the DACO had initiated discussions between BAE, TACOM, and DCAA. The intent is to evaluate the impact on the Alpha Proposal Development Process as

compared to the process in which a complete proposal is audited after submittal. The evaluation is estimated to be completed by July 30, 2008.

Audit Response. The comments are partially responsive, and additional comments are required. We acknowledge that the DACO has initiated discussions to evaluate the proposal process; however, DCMA should already be requesting audits of forward pricing rate agreement proposals in accordance with Federal Acquisition Regulation Part 42 requirements. We request that DCMA provide additional comments that document the agreed-to procedures after the evaluation including TACOM LCMC and DCAA and provide a target completion date for corrective actions to be taken.

5. We recommend that the Branch Manager, Germantown Branch Office, Defense Contract Audit Agency, perform a post award audit of contracts awarded using forward pricing rate agreements for which certified cost and pricing data was obtained. The auditors should identify whether defective pricing occurred and make any necessary recommendations to adjust affected contracts.

Management Comments. The Regional Director, Mid-Atlantic Region, Defense Contract Audit Agency concurred, stating that DCAA will commence post award audit(s) of applicable pricing actions subject to the CY 2001 through current forward pricing rate agreements. DCAA will select applicable pricing actions for post award audits based on a risk assessment considering the potential for these actions to be overpriced. In addition, DCAA would welcome any customer-requested post award audits of specific contracts based on customer concerns or risk assessment.

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

Appendix A. Scope and Methodology

We conducted this performance audit from August 2007 through March 2008 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 evaluated whether TACOM LCMC and DCMA contracting officials constrained DCAA's ability to perform effective and meaningful audits in support of contracts awarded to BAE. We performed the audit in response to allegations to the Defense Hotline. Based on the information provided in the anonymous complaint, we reviewed contract W56HZV-05-G-0005, delivery orders 0001, 0002, 0003, 0004; contract DAAE07-01-C-N030, modifications P00102 and P00133; and contract DAAE07-01-C-M016, modification P00123.

Our audit included four major areas of review. Our review focused on FPRAs, estimating system reviews, the FY 2005 Bradley vehicle procurement, and the FY 2007 HERCULES vehicle procurement. We collected, reviewed, and analyzed documents from TACOM LCMC, DCMA BAE, and DCAA BAE dated from July 2000 through February 2008. Specifically, we evaluated: FPRA documentation; DCAA estimating system deficiency reports and estimating system determination letters issued by the DACO; one basic contract; four delivery orders; three modifications; price negotiation memoranda; Alpha negotiations documentation; and other miscellaneous correspondence to determine contracting officials' inclusion of DCAA in awarding contracts to BAE.

We interviewed contracting officials at TACOM LCMC and DCMA and supervisory and staff auditors at the DCAA Germantown Branch Office and the BAE office.

We reviewed applicable contracting regulations, including the FAR, the Defense Federal Acquisition Regulation Supplement, DoD Directives, United States Code, and Agency guidance from TACOM LCMC, DCMA, and DCAA.

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

No prior coverage has been conducted on contracts awarded by TACOM LCMC to BAE during the last 5 years.

Appendix B. Allegations

The following section summarizes the 11 Defense Hotline allegations concerning TACOM LCMC and DCMA contracting officials' actions. We substantiated 3 and partially substantiated 3 of the 11 allegations.

Allegation 1. TACOM LCMC personnel typically request DCAA to perform BOM reviews in unreasonably short time frames rather than requesting audits of procurements on sole-source fixed-price contracts.

Audit Results. We partially substantiated this allegation. We reviewed contract DAAE07-01-C-M016 and determined that DCAA conducted an audit of the sole-source fixed-price contract proposal.

We also reviewed the FY 2005 Bradley vehicle procurement under contract W56HZV-05-G-0005 and determined that TACOM LCMC personnel requested DCAA to perform a BOM review within 2 non-working days. Please see the Finding discussion for details.

In addition, we reviewed the FY 2005 and FY 2007 HERCULES vehicle procurements under contract DAAE07-01-C-N030. We determined that TACOM LCMC personnel requested DCAA to perform a review of the BOM in less than 1 month for the FY 2005 HERCULES procurement. DCAA did not perform a review for the FY 2007 HERCULES procurement because TACOM LCMC personnel granted a waiver for the submission of certified cost or pricing data. Although two of the four procurements reviewed had requests for audits of part of a proposal in a short time frame, we could not determine whether TACOM LCMC contracting officials' requests for DCAA to perform a BOM review in unreasonably short time frames were typical.

Allegation 2. DCAA was not included during the Alpha contracting process for Bradley vehicles, which began 6 months prior to award of a \$1.2 billion contract.

Audit Results. We substantiated this allegation. Please see the Finding discussion for details.

Allegation 3. The PNM for the \$1.2 billion Bradley contract falsely referred to an "audit" by DCAA when no actual audit was performed; the PNM also falsely stated that DCAA participated in the Alpha negotiations.

Audit Results. We partially substantiated this allegation. The PNM issued by TACOM LCMC personnel for the \$1.2 billion Bradley contract accurately conveyed the results of the DCAA review performed in support of this procurement. The PNM uses the word, "audit," and DCAA did not perform an actual audit; however, "audit" was not used to intentionally mislead. The PNM clearly stated that DCAA disclaimed an opinion on the review due to time constraints, and the PNM accurately lists the limited DCAA results.

The award abstract for the contract incorrectly stated that DCAA personnel participated in Alpha negotiations and concurred with the negotiated settlement. DCAA personnel did not participate in the Alpha negotiations. See the Finding discussion for details.

Allegation 4. DCMA and the DACO, in particular, ignored numerous inadequate estimating system reports and estimating deficiency flash reports that DCAA issued, and subsequently issued letters to BAE stating that their estimating system was adequate.

Audit Results. We did not substantiate this allegation. Since 2001, DCAA has issued 7 audit reports citing a total of 28 deficiencies on BAE's estimating system. The DACO issued four letters, in response to four audit reports, notifying BAE of deficiencies identified by DCAA on their estimating system. However, the DACO determined BAE's estimating system to be approved, in accordance with DoD guidance. Specifically, the Defense Federal Acquisition Regulation Supplement 215.4 states that the ACO must determine the acceptability of a contractor's estimating disclosure and system and pursue corrective actions of any deficiencies.

On February 20, 2008, DCAA issued an estimating system report citing six estimating system deficiencies, two of which were previously identified as outstanding deficiencies. The DACO has not yet made a determination on the adequacy of BAE's estimating system, based on the results of the most recent estimating system report.

Allegation 5. The DACO does not permit DCAA to perform FPRAs reviews, even though DCAA has expressed concern over substantial differences between the proposed rates in BAE's FPRAs and the eventual actual rates.

Audit Results. We substantiated this allegation. Please see the Finding discussion for details.

Allegation 6. TACOM LCMC did not require cost or pricing data on the sole-source contract to BAE for 113 HERCULES vehicles and did not ask DCAA to review past cost data as a basis for pricing the contract, allowing BAE to potentially overprice the contract by a substantial amount.

Audit Results. We did not substantiate this allegation. TACOM LCMC contracting officials acted in accordance with FAR 15.403-1(c)(4) when they granted a waiver of certified cost or pricing data for the FY 2007 HERCULES procurement. On November 8, 2006, the Commander TACOM LCMC determined that the Government had sufficient cost or pricing data information that could be used to determine a fair and reasonable price for the procurement. On March 23, 2007, the Director, Defense Procurement and Acquisition Policy issued a memorandum with the subject line, "Waivers Under the Truth in Negotiations Act," which mandated stricter guidance for issuing waivers of cost or pricing data. TACOM LCMC provided the guidance to BAE on June 22, 2007, and stated that very few waivers for certified cost or pricing data would be granted in the future, and the contractor should not expect future waivers on the basis of a previous one.

Allegation 7. Increasingly, TACOM LCMC procurements fail to require cost or pricing data, and TACOM LCMC does not request DCAA to evaluate cost data on some past fixed-price procurements.

Audit Results. We did not substantiate this allegation. We reviewed four procurements and found one instance in which TACOM LCMC did not require cost or pricing data. See the Audit Results for Allegation 6.

Allegation 8. TACOM LCMC consistently required BAE to provide pricing on a quick turn-around basis, many times within 5 days; as a result, BAE priced subcontracts 20 to 30 percent higher than reasonable in order to lower the financial risks related to providing pricing on short notice.

Audit Results. We did not substantiate this allegation. TACOM LCMC uses Alpha contracting to negotiate BAE contracts. TACOM LCMC and BAE use an integrated product team to develop the contract requirements and proposal through a simultaneous exchange of information.

We reviewed four procurements, three of which used Alpha contracting. We determined that DCAA reviewed the BAE proposal for contract DAAE07-01-C-M016, which included a review of direct material costs. During Alpha negotiations, DCAA discussed differences between proposed direct material and vendor quotes and historical data. DCAA ensured that the contractor incorporated the negotiated material costs into the final proposal. For the FY 2005 Bradley procurement, DCAA reviewed the major subcontracts not included in the BOM and six subcontracts to be awarded at not-to-exceed prices with a downward adjustable clause. TACOM LCMC applied a 4-percent decrement to all subcontractors because the Government believed an upfront 4-percent decrement would result in more cost savings than a downward adjustment to be made at a later date. For the FY 2005 HERCULES procurement, DCAA reviewed major subcontract costs included in the BOM and recommended decrement factors. TACOM LCMC negotiated with BAE to incorporate DCAA's recommendations.

With the exception of the FY 2007 HERCULES procurement, TACOM LCMC and BAE personnel worked together to develop the proposal prior to final negotiations, and DCAA auditors reviewed the major subcontract costs and recommended decrement factors to be applied during final negotiations. TACOM then negotiated with BAE to incorporate DCAA's recommendations. Based on the procurements we reviewed, we cannot substantiate that TACOM LCMC consistently requires BAE to provide pricing on a short turn-around that resulted in BAE overpricing contracts by 20 to 30 percent.

Allegation 9. TACOM LCMC does not request that DCAA review labor costs in proposals or perform audits of labor for estimating purposes.

Audit Results. We substantiated the statement in the allegation, but TACOM LCMC had a logical basis for not requesting DCAA reviews. TACOM LCMC contracting personnel stated that they did not ask DCAA to review labor costs for any of the procurements we reviewed because they do not believe DCAA personnel had the expertise to review labor costs. TACOM LCMC used alternate methods to review labor costs. For example, DCMA personnel review labor hours during contract negotiation by comparing proposed hours with actual hours incurred on prior procurements.

Allegation 10. The ACO at BAE is extremely unprofessional to DCAA auditors.

Audit Results. We did not substantiate this allegation. Although we did find instances of unprofessional language used by the ACO, we consider this to be an administrative matter that is not under the purview of our audit.

Allegation 11. BAE's profits across all contracts are as high as 25 percent; the concerns raised in the allegations have contributed to the Government paying substantially higher prices for fixed-price contracts than the Government would pay if DCMA and TACOM LCMC provided DCAA with reasonable support.

Audit Results. We partially substantiated this allegation. We reviewed a limited number of contracts based on the information in the anonymous Defense Hotline allegations. The Government may have paid substantially higher prices for the fixed-price contracts we reviewed. Please see the Finding discussion for details.

Appendix C. Management Comments on Allegations and Audit Response

DCAA Management Comments to Allegation 9. The Regional Director, Mid-Atlantic Region, Defense Contract Audit Agency, provided comments in response to Allegation 9 (See Appendix B). The Regional Director stated that DCAA will work with TACOM LCMC's contracting personnel and provide the necessary audit support in reviewing labor costs. DCAA has access to contractor records, as well as an in-plant presence. DCAA uses learning curve applications for production operations and utilizes regression analysis to evaluate categories of labor that are dependent on other labor elements.

Audit Response. We agree with this action.

DCMA Management Comments to Allegation 2. The Director, Defense Contract Management Agency, stated that contract negotiations are led by the PCO unless delegated to the ACO. The Director stated that the ACO is not responsible for determining whether to include DCAA personnel in the Alpha contracting process, as was stated in the December 2004 BAE meeting minutes.

Audit Response. We agree that the PCO has the ultimate responsibility for the Alpha negotiations; however, the DCMA guidebook defines Alpha contracting as the process by which DCMA, DCAA, and the buying command remain in constant communication with the contractor while the proposal is developed. The Alpha team concurrently evaluates, analyzes, fact-finds, and resolves disagreements as the contractor develops the proposal. Therefore, if DCAA was absent from the meetings, the ACO should have been proactive in informing DCAA of the Alpha meetings, as both DCAA and DCMA are colocated at BAE, in order to comply with DCMA guidance and to assist the Government in obtaining the best price.

DCMA Management Comments to Allegation 5. The Director, Defense Contract Management Agency, stated that the ACO does not request or require a complete proposal submission or request a DCAA review of a complete proposal in a continuous FPRA environment; it is not always necessary, and it allows for having a continuous FPRA in place for pricing contract actions.

In addition, the Director stated that BAE submits a proposal for all FPRAs with all current or projected business, broken down by overhead burden center, by year, with dollars and hours for each contract. The Director stated that DCAA issued post award audit reports for contracts negotiated from 2001 through 2008 which required cost and pricing certification, and none of these reports addressed defective pricing for rates.

Audit Response. BAE provided supporting documentation during the FPRA Alpha process for the business base and pool expenses separately. However, the ACO stated that he did not require BAE to submit a complete FPRA proposal with supporting documentation detailing the allocation business bases, pool expenses, and rates for each FPRA. FAR Part 42.1701 stated the ACO will obtain the contractor's proposal and require that it include cost or pricing data that are accurate, complete, and current as of the date of submission. In addition, the DCMA guidebook stated the ACO should request an FPRA proposal from the contractor when establishing an FPRA. When Alpha

contracting is used to create an FPRA, the Alpha team should be involved in the development of the FPRA proposal. Although the Alpha team will review the contractor's proposal data as it is developed, the contractor must still provide a final proposal. The ACO needs to comply with the FAR and DCMA guidance.

DCMA Management Comments to Allegation 11. The Director, Defense Contract Management Agency stated that the use of forward pricing rates in negotiating contract for future periods of time inherently contains risk. All FPRAs are estimated and will vary from final rates.

Audit Response. We agree that all forward pricing rate agreements inherently contain risk and the estimates will vary from final rates; however, the rates at BAE were consistently overstated for the contracts we reviewed. If DCAA had been more effectively utilized, the ACO may have been better able to negotiate rates.

Appendix D. Report Distribution

Office of the Secretary of Defense

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

Department of the Army

Assistant Secretary of the Army (Financial Management and Comptroller)
Auditor General, Department of the Army
Commander, Army Materiel Command
Commander, TACOM Life Cycle Management Command

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

Congressional Committees and Subcommittees, Chairman and Ranking Minority Member (cont'd)

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

Defense Contract Audit Agency Comments



MID-ATLANTIC REGION
DEFENSE CONTRACT AUDIT AGENCY
ONE INDEPENDENCE MALL
615 CHESTNUT STREET, SUITE 1000
PHILADELPHIA, PA 19106-4498

IN REPLY REFER TO

APR 21 2008

RQA-6 720.7 (D2007-D000CK-0256)

L:\RD\RD-DRD\Admin Stuff\Draft DoD IG Rpt on Hotline TACOM BAE RD revised.doc

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR ACQUISITION AND
CONTRACT MANAGEMENT, OFFICE OF THE INSPECTOR
GENERAL, DEPARTMENT OF DEFENSE

SUBJECT: Response to the Draft DoD IG Report of Defense Hotline Allegations Concerning
Contracts Issued by U.S. Army TACOM Life Cycle Management Command to
BAE Systems Land and Armaments, Ground Systems Division (Project No.
D2007-D000CK-0256.000)

Thank you for the opportunity to respond to the draft report. Our comments/clarifications
and response to Recommendation 5 follows:

Allegation 9

TACOM LCMC does not request DCAA to review labor costs in proposals or perform
audits of labor for estimating purposes.

DoD IG Finding

We did not substantiate this allegation. TACOM LCMC contracting personnel stated that
they did not request DCAA to review labor costs for any of the procurements we reviewed
because they do not believe DCAA personnel had the expertise to review labor costs. TACOM
LCMC used alternate methods to review labor costs. For example, DCMA personnel review
labor hours during contract negotiation by comparing proposed hours with actual hours incurred
on prior procurements.

DCAA Response

DCAA will work with TACOM LCMC's contracting personnel and provide the necessary
audit support in reviewing labor costs. DCAA has access to contractor records (including labor
hours) as well as an in-plant presence and has been very successful in evaluating labor hours
using learning curve applications for production operations such as BAE Systems Land and
Armaments, Ground Systems Division. We also utilize regression/correlation analysis to
evaluate categories of labor that are dependent on other labor elements. We believe DCAA can
be very useful to TACOM LCMC's contracting personnel in their negotiation of labor and related
costs.

~~FOR OFFICIAL USE ONLY~~

SUBJECT: DCAA Response to the Draft DoD IG Report of Defense Hotline Allegations
Concerning Contracts Issued by U.S. Army TACOM Life Cycle Management
Command to BAE Systems Land and Armaments, Ground Systems Division
(Project No. D2007-D000CK-0256.000)


DoD IG Recommendation 5

We recommend that the Branch Manager, Germantown Branch Office, Defense Contract Audit Agency, perform a postaward audit of contracts awarded using forward pricing rate agreements for which certified cost and pricing data was obtained. The auditors should identify defective pricing and make the necessary recommendations to adjust affected contracts.

DCAA Response

Concur. DCAA will commence postaward audit(s) of applicable pricing actions subject to the CY 2001 through current forward pricing rate agreements. DCAA will select for postaward audits applicable pricing actions based on a risk assessment considering the potential for these actions to be overpriced. We would also welcome any customer requested postaward audits of specific contracts based on their own concerns or risk assessment.

If you have any questions concerning this memorandum, please contact me at (215) 597-7451 or Mr. Arthur Ruggia, Chief, Quality Assurance Division, at (856) 727-5795.


Francis P. Summers, Jr.
Regional Director

Copy furnished:
FAO 6221
RAMD-6
DCAA HQ, PQA

Defense Contract Management Agency Comments



DEFENSE CONTRACT MANAGEMENT AGENCY
6350 WALKER LANE, SUITE 300
ALEXANDRIA, VIRGINIA 22310-3226

IN REPLY
REFER TO DCMA-DMI

APR 22 2008


MEMORANDUM FOR PROGRAM DIRECTOR, ACQUISITION AND CONTRACT
MANAGEMENT, INSPECTOR GENERAL, DEPARTMENT
OF DEFENSE

SUBJECT: Response to DoD Inspector General (IG) Draft Report, Defense Hotline
Allegations Concerning Contracts Issued by U.S. Army TACOM Life Cycle
Management Command to BAE Systems Land and Armaments, Ground
Systems Division

Reference: DoD IG Project Number D2007-D000CK-0256.000, March 21,
2008

We have attached the Headquarters, Defense Contract Management Agency
response to recommendations 3 and 4 cited in the subject audit report.

Point of contact is Ms. Dorotheine Eaddy at 703-428-1446 or
Dorotheine.Eaddy@dcma.mil.


KEITH D. ERNST
Director

DCMA Comments in Response to DoD IG Draft Report, Project No. D2007-D000CK-0256.000, March 21, 2008

FINDINGS

The findings that relate to the Recommendations for DCMA are stated in each of the following subject areas and we either concur or partially concur with these findings below under the Recommendations:

BAE FPRAs. DCMA contracting officials did not require BAE forward pricing rate agreement proposals to be current, accurate, and complete, as required by FAR. Additionally, the first FPRA Alpha team discussion minutes from September 20, 2000, stated that, ideally, the FPRA Alpha team will not require an FPRA proposal submission, an audit, an evaluation, or any negotiations.

Compliance With FAR Guidance. DCMA officials had not established procedures to implement internal guidance and FAR requirements on forward pricing rate agreements. BAE provided supporting documentation during the FPRA Alpha process for the business base and pool expenses separately. However, the ACO stated that he did not require BAE to submit a complete FPRA proposal with supporting documentation detailing the allocation business bases, pool expenses, and rates for each FPRA. FAR 42.1701(b) requires that the ACO obtain the contractor's FPRA proposal, to include cost or pricing data that are accurate, complete, and current as of the date of submission. According to numerous PNMs, BAE personnel entered the business base and pool expense figures developed by the respective Alpha teams into the FPRA proposal model. The model then calculated the rates, and after little or no negotiation, the ACO used the rates for the FPRAs figures developed by the respective Alpha teams into the FPRA proposal model. In addition, the ACO was unable to provide PNMs for eight of the 22 BAE FPRAs. FAR 42.1701(b) requires that the ACO prepare a PNM after reaching agreement with the contractor on an FPRA. The ACO provided PNMs for 14 BAE FPRAs, and the PNMs did not properly document information required by the FAR. The PNMs did not comply with FAR 15.406-3 because the ACO failed to:

- include a description of the contractor's proposal;
- detail the Government objective;
- highlight significant variances between the negotiated rates and the Government objective;
- detail DCAA recommendations, if any; and
- include the reasons for any pertinent variances from DCAA recommendations

Due to the lack of adequate documentation, we could not determine whether the ACO used DCAA audit results when negotiating FPRAs with BAE.

DCAA FPRA Audits. Since 2001, DCAA has audited four BAE FPRAs; however, DCMA and BAE personnel signed the FPRAs before DCAA issued the audit reports. Although in all four cases DCAA provided preliminary results to DCMA, two of the four

PNMs did not address whether the ACO considered DCAA audit results when negotiating FPRAs. DCAA cancelled a fifth audit of an FPRA due to lack of adequate cost and pricing data to support the FPRA. DCAA may have been able to provide more meaningful information for the ACO to use in negotiating the FPRAs with BAE if the ACO had required BAE to submit current, accurate, and complete proposals for the FPRAs, as required by the FAR.

The ACO prepared PNMs that did not properly document how the ACO used DCAA audit results in negotiating the FPRAs, as required by the FAR.

Responses to Recommendations

Recommendation 3: We recommend that the Director, Defense Contract Management Agency direct the Commander, Defense Contract Management Agency, BAE Systems Ground Systems Division to:

a. Obtain current, accurate, and complete forward pricing rate agreement proposals from BAE Systems Land and Armaments Ground Systems Division in accordance with Federal Acquisition Regulation Part 42, Contract Administration and Audit Services, and properly document the negotiation of forward pricing rate agreements in accordance with Federal Acquisition Regulation Part 15, Contracting by Negotiation.

DCMA comments: Concur. DCMA agrees that all contractors are required to provide current, accurate and complete FPRA proposals. As stated in our comments in Attachment #1 for allegation #11, DCMA Combat Vehicles - BAE York did require it for the FPRA proposals. Throughout the Alpha process the three parties reviewed the financial data that was provided by the contractor's estimating and subcontracting systems (which are audited by DCAA and DCMA under other contract requirements). The data is collected and input into a computer program that produces the proposal. This methodology produces a proposal that is considered by all parties to be current, accurate and complete.

The DCMA CV-BAE York DACO will continue to require BAE Systems to furnish such data. Certification of the FPRA proposal information will continue to be required when it is used to price a contract action that requires a certificate. The certificate supporting that contract action shall cover the data supplied to support the FPRA or other advance agreement, and all other data supporting the action IAW Federal Acquisition Regulation 15.407-3(c).

The identification of the supporting information and the results of the negotiation will to be documented in the negotiation memorandum IAW Federal Acquisition Regulation 42.1701(b). The requirement for a documented negotiation memorandum is further detailed in paragraph 6.8.3 of the DCMA Guidebook chapter on Forward Pricing Rates.

b. Submit accurate, current, and complete forward pricing rate agreement proposals to the Defense Contract Audit Agency for audit.

DCMA Comments: Concur. DCMA will continue to request DCAA involvement in the FPRA process. The role of DCAA is crucial for the analysis and review of BAE's financial and accounting records as well as the contractor's cost control systems. To assist DCMA contracting officers in coordinating DCAA audit support requests, DCMA has implemented and is conducting training on the 2.0 version of the E-tools based Pricing and Negotiation application. Training was actually completed by the DACO on April 10, 2008. This web-based application will provide the ACO/CA with the ability to create and track pricing support requests. This system will provide standardization of support requests being provided to DCAA and will allow increased traceability by management.

c. Establish procedures to implement Defense Contract Management Agency guidance to include Defense Contract Audit Agency auditors during the Alpha contracting process.

DCMA Comments: Concur. Corrective action: As previously stated in DCMA attachment #1 comments, at allegation #2, normally the PCO ascertains membership to the Alpha process; however, to ensure DCAA participation to the fullest extent possible, DCMA Combat Vehicles leadership will meet with DCAA upper management to facilitate common understanding and establish mutual agreement on roles and responsibility in the Alpha (IPT) process. Estimated date: May 15, 2008.

Recommendation 4: We recommend that the Commander, Defense Contract Management Agency, BAE Systems Ground Systems Division request the Defense Contract Audit Agency to perform an audit of forward pricing rate agreement proposals in accordance with Federal Acquisition Regulation Part 42 requirements.

DCMA Comments: Partially Concur The DCMA Guidebook on Forward Pricing rates includes extensive guidance on the process to be followed for the development of FPRAs. While DCAA has declined to be identified as a member of the FPRA team at the York, Pennsylvania facility, Section 3 of the Guidebook chapter provides for the inclusion of DCAA in the process. The Alpha (IPT) process identified in paragraph 3.1 provides for the evaluation of the elements of the rate proposal as they are ready for evaluation, instead of waiting for the contractor to submit a complete proposal. This has proven to be a successful approach at many contractor facilities. DCAA's involvement at the York facility, through participation on the base and pool teams has allowed the IPT to immediately evaluate the impact of the changes and update the FPRA agreement, with no break in "agreed to" rates. An opportunity for improvement may exist: the DACO has initiated discussions between BAE, TACOM and DCAA. The intent is to evaluate the impact of the Alpha Proposal Development Process as compared to the process in which a complete proposal is audited after submittal. The evaluation is estimated to be completed by July 30, 2008.

COMMENTS ON MATERIAL INTERNAL CONTROL WEAKNESS

IG Finding: DCMA personnel did not follow the Federal Acquisition Regulation (FAR) and internal agency guidance for Alpha contracting.

DCMA Comments: DCMA Combat Vehicles – Detroit completed a Management Internal Control Review (MICR) of the FPRA processes utilized at all its offices, including BAE York, on March 31, 2008. This review examined the BAE FY07-FY10 FPRA process and found no material weakness. However, the MICR will be specifically supplemented to insure the improvements to the Alpha (IPT) process pertaining to DCAA involvement in FPRA development have been implemented. Target date: July 31, 2008.

Attachment #1

Subject: DCMA Combat Vehicles – DCMA Response to DoD IG Draft Report, Project No. D2007-D000CK-0256.000, March 21, 2008

Summary of Findings on Allegations:

The DoD IG report details the DoDIG investigation of eleven anonymous allegations made against DCMA and TACOM LCMC for constraining Defense Contract Audit Agency audit efforts during award and administration of contracts to BAE Systems Land and Armaments, Ground Systems Division. Of the eleven allegations listed, six were attributed to TACOM and will not be addressed herein. Five allegations were attributed to DCMA, in full or in part, of which two were substantiated and one was partially substantiated.

#	Who	Substantiated?	
1	TACOM	PARTIAL	
2	DCMA & TACOM	YES	See comments
3	TACOM	PARTIAL	
4	DCMA	NO	
5	DCMA	YES	See comments
6	TACOM	NO	
7	TACOM	NO	
8	TACOM	NO	
9	TACOM	NO	
10	DCMA	NO	
11	DCMA & TACOM	PARTIAL	See comments

The report provides five recommendations, two of them (#3 and #4) to DCMA regarding interactions with DCAA.

The two substantiated allegations (#2 and #5) involve the same issue: that DCAA was not part of the ALPHA contracting process for the FY05 Bradley vehicle procurement. The partially substantiated allegation (#11) alleges that DCAA's absence from the negotiation process resulted in higher prices for the Army and higher profits for BAE.

DCMA Comments on Substantiated Allegations:

Allegation #2 – DCAA was not included during the Alpha contracting process for Bradley vehicles which began 6 months prior to award of a \$1.2 billion contract.

IG Audit Results: Substantiated.

DCMA Comments: Partially concur. This finding pertains to the FY2005 Bradley procurement which was awarded in June 2005. Contract negotiations are led by the PCO

(TACOM LCMC) unless delegated to the ACO (DCMA). The IG cites December 2004 BAE meeting minutes that stated that BAE personnel noted that the ACO must decide whether to include DCAA personnel in the Alpha process. This is not the decision of the ACO.

It is noted that prior to the FY05 Bradley procurement, DCAA attended Alpha meetings. They are held at the same time (1000 Thursday) and location (BAE proposal center, or phone in option) for all Bradley procurements. DCAA attended these meetings on prior buys, and all subsequent Bradley procurements. Based on meeting minutes from FPRA team meetings as early as January 2005, DCMA and DCAA were aware of the pending procurement of the FY05 Bradley REMAN. It is clear that DCAA participated in meetings with BAE, TACOM and DCMA on procurements prior to and subsequent to this one. The IG report, page 15, states: “. . . DCAA auditors could have been more proactive in determining their involvement in the process and what services they might be required to perform.”

Although the Alpha process is normally led by the PCO for contract negotiations, DCMA will work with both the PCO and DCAA to ensure DCAA involvement in all Alpha contracting meetings and negotiations.

Allegation #5 – The DACO does not permit DCAA to perform FPRA reviews even though DCAA has expressed concern over substantial differences between the proposed rates in BAE’s FPRAs and the eventual actual rates.

IG Audit Results: Substantiated.

DCMA Comments: Partially concur. The ACO does not request, require a complete proposal submission or request a DCAA review of a complete proposal in a continuous FPRA environment; it is not always necessary and it allows for having a continuous FPRA in place for pricing contract actions.

DCAA has been a participant in FPRA reviews in the past and has performed audits of BAE FPRA data. Examples of DCAA involvement:

- IG report, page 11, states: “In March 2003, a DCAA auditor requested to be removed from the FPRA Alpha team, citing the above concerns. The FPRAs no longer listed DCAA personnel as members of the FPRA Alpha team; however, DCAA personnel still attended FPRA Alpha meetings, acting mainly as observers.”
- IG report, page 11: “DCAA audits performed throughout the FPRA Alpha process did not provide effective and meaningful results because BAE FPRA data provided to DCAA was not current, accurate, and complete. In addition, the ACO did not always consider DCAA audit results when negotiating FPRAs. Since 2001, DCAA performed five audits on BAE budget data and four audits on BAE FPRAs.”

- IG report, page 12 , DCAA was requested by DCMA to review BAE Budget Data for years CY 2002, CY 2003, CY 2004, CY 2005

DCMA disagrees with the reference to the BAE FPRA data not being current, accurate and complete. For all FPRAs, other than addendum/updates, BAE submits a proposal with all current or projected business, broken down by overhead burden center, by year, with dollars and hours for each contract. These books were presented to the IG team during their visits to York. This is the most current information at the time of the agreement. DCAA has issued post award audit reports for contracts negotiated in the 2001-2008 time period requiring cost and pricing certification and none of these reports address defective pricing for rates. The certification for those contracts covered rate data.

DCMA agrees that communication needs to be improved with DCAA as the DoD IG has pointed out/recommended. DCMA has already met with DCAA and TACOM on April 10, 2008 to improve the process. Discussed at this meeting was what needs to be done to develop a true team approach to FPRAs at BAE York.

Allegation #11 – BAE's profits across all contracts are as high as 25 percent; the concerns raised in the allegations have contributed to the Government paying substantially higher prices for fixed-price contracts than the Government would pay if DCMA and TACOM LCMC provided DCAA with reasonable support.

IG Audit Results: The IG partially substantiated this allegation by finding that indirect rates negotiated in BAE FPRAs from 2000 through 2006 were overstated when compared to actual indirect rates incurred (page 14, Rate Overstatements). The report found that the FY2005 Bradley procurement, valued at \$1.1 billion, included at least \$138 million of indirect costs derived from FPRA rates, 25 of 34 of which were overstated.

DCMA Comments: Partially concur. The use of Forward Pricing Rates in negotiating contracts for future periods of time inherently contains risk. All FPRAs are estimated and will vary from final rates. However, the benefits to the Government in establishing FPRAs is to facilitate timely and less costly estimating and negotiating of proposals. The use of estimated FPRAs contains the risk of overstated and understated rates.

Rates fluctuate for a number of reasons. Some background information regarding the company and their business base in recent years is important to note. In calendar year 2004 the contractor's business base was \$580 million. The final G&A rate for 2004 was 11.41%. Out year rates at the time, negotiated in the FPRAs in the 2003 – 2004 timeframe reflected a declining business base. The company was in the process of laying-off employees and in fact was closing down certain sections in York. The FCS program, still a Research and Development (R&D) program in Santa Clara, was the company's main program. Vehicle production in York was declining with no long term prospects for Bradley, HERCULES or any other vehicle line. In 2005 we began to hear talk of a supplemental defense budget which could result in increased vehicle production.

The May 4, 2005 FPRA was the first FPRA that included any consideration for the Supplemental Defense budget. As a result, G&A for the years 2006 and 2007 was reduced 40% in each year from the prior FPRA (December 2004) as a result of the new information regarding the Supplemental. Over the next two years the FPRA team attempted to quantify the Supplemental budget impact, however, in a two year time period the company's business nearly tripled. Beginning in 2005 the contractor's business base was \$755 million (additional work in 2005 for Bradley Reset, a totally new program for BAE that had previously been done at the Depots) and their year end G&A rate was 7.42%; in 2006 their base was \$1.4 billion (first significant impact of increased work due to a Supplemental) and year end G&A was 5.31%. The 2007 business base was \$2 billion and the year end G&A rate was 6.26%. From 2005 - 2007 we constantly and consistently lowered rates in the FPRAs. In a firm fixed price environment with the uncertain conditions of the Supplemental Defense budgets, out-year projection became increasingly more challenging. Our current FPRA (November 20, 2007) shows a G&A rate of 4.98% for 2008, and 2009 and 2010 rates of 5.30% and 5.60% respectively. We have not been notified by DCAA of any defective pricing due to rates in this time period.

TACOM Life Cycle Management Command Comments



DEPARTMENT OF THE ARMY
UNITED STATES ARMY TACOM LIFE CYCLE MANAGEMENT COMMAND
6501 EAST 11 MILE ROAD
WARREN, MICHIGAN 48397-5000

REPLY TO
ATTENTION OF:

AMSTA-CS-CJ

15 April 2008

MEMORANDUM FOR Principal Director for Acquisition, Acquisition and Contract Management, Inspector General, Department of Defense, 400 Army Navy Drive, Arlington, Virginia 22202-4704

SUBJECT: DODIG Draft Report on Audit of the Defense Hotline Allegations Concerning Contracts Issued by US Army TACOM Life Cycle Management Command to BAE Systems Land and Armaments, Ground Systems Division (Project No. D2007-D000CK-0256.000)

1. Reference e-mail, Department of Defense Office of the Inspector General, 21 March 2008, subject: Official Draft Report.
2. We have reviewed subject DODIG Draft Report and are enclosing the TACOM LCMC position to the report and report Recommendation 1 addressed to the Commander, TACOM LCMC. We generally agree with the report and concur with Recommendation 1. We have provided additional facts to the report and our planned corrective action to the recommendation in the enclosed reply.
3. The TACOM LCMC Internal Review and Audit Compliance Office will track the status of the corrective action to the recommendation and perform a follow-up review to verify that the action has been completed.
4. Point of contact for this memorandum is Mr. Jerry Bartus, AMSTA-CS-CJ, commercial: 586-574-7773, DSN 786-7773 or e-mail: jerry.bartus@us.army.mil.


WM W. Pickenheim
Deputy Chief of Staff

Enclosure

**TACOM Life Cycle Management Command (LCMC) Reply
to DoD Inspector General Draft Report,
Defense Hotline Allegations Concerning Contracts Issued by US Army TACOM
Life Cycle Management Command to BAE Systems Land and Armaments, Ground
Systems Division (Project No. D2006-D000AE-0154.000)**

Objective: DoDIG's overall objective was to evaluate whether the allegations to the Defense Hotline concerning contracts issued by the U.S. Army TACOM LCMC to BAE Systems Land and Armaments, Ground Systems Division were substantiated. Specifically, they determined whether contract award and administrative procedures were in compliance with Federal and DoD policy.

DoDIG Conclusion: TACOM LCMC contracting officials may have overpriced the FY 2005 Bradley procurement awarded to BAE because contracting officials did not ensure DCAA participation in the Alpha contracting process and BAE FPRA negotiations. TACOM LCMC contracting officials acknowledged that they requested results from a DCAA review within 2 non-working days, stating that they were under strict time constraints from the PM-HBCT to obligate funds. PM-HBCT officials stated that the Army Budget Office guidance was verbal and very clear that the expectation was to obligate the funds within 30 days. According to the Office of the Assistant Secretary of the Army, Financial Management and Comptroller, however, the time constraint requirement did not exist. Although the time constraint may have resulted from misinterpreted guidance, TACOM LCMC personnel continued to execute contract actions with BAE and without critical assistance from DCAA. Because of the unnecessary time constraints imposed by TACOM LCMC contracting officials, DCAA disclaimed an opinion on the FY 2005 Bradley procurement BOM review. If TACOM LCMC and DCMA contracting officials had followed existing agency Alpha contracting policies and procedures and included DCAA in Alpha meetings as early as December 2004, DCAA may have been able to provide more meaningful results to contracting officials in order to negotiate lower material prices to be paid by the government for this firm-fixed-price procurement. Additionally, if DCAA personnel had coordinated with the PCO on the services DCAA might be asked to provide, DCAA may have been able to provide a more useful review of material costs.

TACOM LCMC contracting officials may have overpriced firm-fixed-price contracts with BAE because a majority of the indirect rates negotiated in FPRAs were higher than the actual rates incurred by BAE. As a result, the Government negotiated firm-fixed price contracts awarded to BAE based on estimated costs that BAE did not actually incur. If DCMA personnel had properly required BAE to submit accurate, current, and complete FPRA proposals for DCAA to audit, DCAA may have been able to provide meaningful audit results for the ACO's use in negotiating FPRAs.

Additional facts: It is agreed that TACOM requested an unrealistic response time from DCAA. However, the TACOM Acquisition Center Bradley team did invite the DCAA to participate in the Alpha process on many occasions. In fact, DCAA was in attendance at

most of the weekly FPRA IPT meetings and were also invited to the Alpha meetings (which they attended on occasion).

With regard to the statement in the report that "... the Government negotiated firm-fixed price contracts awarded to BAE based on estimated costs that BAE did not actually incur." The Government negotiation team relied on BAE's proposal data. This data was certified by BAE as to being "current, accurate, and complete". The team used the alpha process to evaluate material costs, the FPRA, labor hours, and other cost elements to the best of their ability under the imposed time constraints. The team could not have anticipated that BAE would not actually incur the costs related to the higher rates compared to the subsequent actual rates. The actual rates came in lower mainly due to the unanticipated surge in war-related business volume that could not have been anticipated at the time. It is speculation whether the team would have been able to negotiate lower prices had they taken more time. Any fixed price contract is based on the best estimate at the time of the negotiation.

Recommendation 1: We recommend that the Commander, TACOM Life Cycle Management Command direct the Director, Acquisition Center to follow TACOM Life Cycle Management Command policies and procedures to include Defense Contracting Audit Agency auditors during the Alpha contracting process.

Commander, TACOM LCMC Comments: Concur. The Director, Acquisition Center will issue a memorandum to all procurement contracting officers reminding them of the responsibility to include Defense Contract Audit Agency auditors during the Alpha contracting process as outlined in our policy. Target completion, 30 June 2008.

TACOM Life Cycle Management Command Comments



DEPARTMENT OF THE ARMY
PROGRAM EXECUTIVE OFFICE
GROUND COMBAT SYSTEMS
6501 E. ELEVEN MILE ROAD
WARREN, MICHIGAN 48397-5000

REPLY TO

SFAE-GCS-RM

21 April 2008

MEMORANDUM FOR Program Director for Acquisition and Contract Management, Inspector General, Department of Defense, 400 Army Navy Drive, Arlington Virginia 22202-4704

SUBJECT: Draft Report, Defense Hotline Allegations Concerning Contracts Issued by U.S. Army TACOM Life Cycle Management Command to BAE Systems Land and Armaments, Ground Systems Division (Project Code D2007-D000CK-0256.000)

1. Reference memorandum, Department of Defense Inspector General, 21 March 2008, subject as above.
2. We have reviewed subject report and have provided comments to your conclusions. We concur with report recommendation 2. Our response is contained in the attachment.
3. The TACOM LCMC Internal Review and Audit Compliance Office will track our planned corrective action through completion and perform a follow-up review to verify the action was completed.
4. Point of contact for this action is Ms. Kathleen Allen, SFAE-GCS, DSN 786-6284.

Encl

Kevin M. Fahey
FOR
KEVIN M. FAHEY
Program Executive Officer
Ground Combat Systems

**Program Executive Officer, Ground Combat Systems Reply
to DoD Inspector General Draft Report,
Defense Hotline Allegations Concerning Contracts Issued by U.S. Army TACOM
Life Cycle Management Command to BAE Systems Land and Armaments, Ground
Systems Division (Project No. D2006-D000AE-0154.000)**

Objective: DoDIG's overall objective was to evaluate whether the allegations to the Defense Hotline concerning contracts issued by the U.S. Army TACOM LCMC to BAE Systems Land and Armaments, Ground Systems Division were substantiated. Specifically, they determined whether contract award and administrative procedures were in compliance with Federal and DoD policy.

DoDIG Conclusion: TACOM LCMC contracting officials may have overpriced the FY 2005 Bradley procurement awarded to BAE because contracting officials did not ensure DCAA participation in the Alpha contracting process and BAE FPRA negotiations. TACOM LCMC contracting officials acknowledged that they requested results from a DCAA review within 2 non-working days, stating that they were under strict time constraints from the PM-HBCT to obligate funds. PM-HBCT officials stated that the Army Budget Office guidance was verbal and very clear that the expectation was to obligate the funds within 30 days. According to the Office of the Assistant Secretary of the Army, Financial Management and Comptroller, however, the time constraint requirement did not exist. Although the time constraint may have resulted from misinterpreted guidance, TACOM LCMC personnel continued to execute contract actions with BAE and without critical assistance from DCAA. Because of the unnecessary time constraints imposed by TACOM LCMC contracting officials, DCAA disclaimed an opinion on the FY 2005 Bradley procurement BOM review. If TACOM LCMC and DCMA contracting officials had followed existing agency Alpha contracting policies and procedures and included DCAA in Alpha meetings as early as December 2004, DCAA may have been able to provide more meaningful results to contracting officials in order to negotiate lower material prices to be paid by the government for this firm-fixed-price procurement. Additionally, if DCAA personnel had coordinated with the PCO on the services DCAA might be asked to provide, DCAA may have been able to provide a more useful review of material costs.

TACOM LCMC contracting officials may have overpriced firm-fixed-price contracts with BAE because a majority of the indirect rates negotiated in FPRAs were higher than the actual rates incurred by BAE. As a result, the Government negotiated firm-fixed price contracts awarded to BAE based on estimated costs that BAE did not actually incur. If DCMA personnel had properly required BAE to submit accurate, current, and complete FPRA proposals for DCAA to audit, DCAA may have been able to provide meaningful audit results for the ACO's use in negotiating FPRAs.

Additional PM HBCT facts:

The PMO HBCT takes exception to the paragraph entitled "Rate Overstatements" on page 14 of the DOD IG Draft Report.

While we acknowledge that a number of the indirect rates negotiated in BAE FPRA's from 2001 through 2006 may have been overstated when compared with actuals incurred, and that the difference may have been more pronounced in 2005 and 2006, the specific contract that was audited in this case was the FY05 Bradley Reman Contract W56HZV-05-G-0005, D.O. 0009, and for that contract the bulk of the work was performed in 2007, not in '05 and '06.

The report contains the statement that the FPRA overstated 25 of the 34 indirect rates for 2005 and 2006, and therefore concludes that the \$138M in indirect costs in this contract included costs that BAE did not actually incur. We maintain that this conclusion is misleading since only about 2.5% of the work on the contract was actually performed in 2005, 45% was performed in 2006, and the remaining 52% of the work was performed in 2007, a year for which the final actual rates are not even yet available. Preliminary 2007 rate data is available, but per DCAA the final 2007 indirect rates have not yet been determined.

As for the statement that the auditors could not determine the amount of work performed under this contract by calendar year, PM HBCT was not asked for such a breakdown but could have provided this data if asked.

Finally, the auditors have not provided any specific data or even any anecdotal evidence to support the allegation made in the last sentence of this paragraph that the overstating of FPRA rates at BAE is due to defective pricing. We agree that DCAA should perform post-award audits to verify actual rates incurred, and acknowledge that clearly some of the negotiated FPRA rates were overstated compared to BAE's actual costs incurred. However, this report does not contain any evidence that these differences are due to defective pricing or to BAE misconduct, and fails to mention other factors such as major changes in BAE's business base due to the large number of Bradley vehicles that have been remanufactured or repaired for use in Iraq over the last several years.

Given the incorrect assumptions about the year that work was performed on the FY05 contract, and the non-availability of the data on actual indirect costs incurred by BAE in 2007, we recommend that the \$138M dollar figure, the statement that links the overstating of the rates for 2005 and 2006 to the performance of the FY05 Bradley Reman contract, and the statement in the last sentence that mentions defective pricing be deleted from the report.

Recommendation 2: We recommend that the Program Executive Officer, Ground Combat Systems, TACOM Life Cycle Management Command issue guidance to project managers that clearly establishes time frames for obligating supplemental funding.

Program Executive Officer, Ground Combat Systems Comments:
Concur. The PEO will issue guidance to the Project Managers and their Acquisition staff that strengthens current process and procedures with timeframes for awarding appropriated funds. Target date of completion, 30 June 2008.

U.S. Army Materiel Command Comments



REPLY TO
ATTENTION OF:

DEPARTMENT OF THE ARMY
HEADQUARTERS, U.S. ARMY MATERIEL COMMAND
9301 CHAPEK ROAD
FORT BELVOIR, VA 22060-5527

AMCIR

2 May 2008

MEMORANDUM FOR The Army Audit Liaison Office (ATTN: Mr. David Lawson), U.S. Army Audit Agency, 3101 Park Center Drive, Alexandria, VA 22302-1596

SUBJECT: DODIG Draft Report, Defense Hotline Allegations Concerning Contracts Issued by U.S. Army TACOM Life Cycle Management Command to BAE Systems Land and Armaments, Ground Systems Division (Project Number D-2007-D000CK-0256.000) (AMC No. D0730)

Headquarters, U.S. Army Materiel Command (HQ AMC) has reviewed the subject draft report and TACOM's comments and endorses TACOM's response. HQ AMC point of contact for this action is Mr. Gary Irving, 703-806-9844.

FOR THE COMMANDER:

Encl

Susan C. McCoy
SUSAN C. McCOY
Director, Internal Review and
Audit Compliance Office

Printed on  Recycled Paper

Team Members

The Department of Defense Office of the Deputy Inspector General for Auditing, Acquisition and Contract Management Directorate prepared this report. Personnel of the Department of Defense Office of Inspector General who contributed to the report are listed below.

Richard B. Jolliffe
Bruce A. Burton
Deborah L. Carros
Sarah A. Davis
Erin M. Grates
Jessica M. Smith
Paula Gonzalez-Tosado
Jillisa H. Milner
Meredith Johnson
Ellen Kleiman-Redden



Inspector General Department of Defense

