



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
(RESEARCH, DEVELOPMENT AND ACQUISITION)
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

SEP 25 2009

MEMORANDUM FOR DISTRIBUTION

SUBJECT: Follow-on Actions in Response to OIG Report Notification: "Effect of Payments into Boeing Pension Funds on Economic Price Adjustment Clauses in DoD Contracts" (Project No. D2006-D000CH-0226.000)

By attached memorandum dated September 9, 2009, the Director of Defense Procurement and Acquisition Policy (DPAP) reiterated the policies contained in DFARS PGI 216.203-4. In addition, the DPAP memorandum highlighted the finding in the subject Department of Defense Inspector General (DoDIG) audit report that the actions of a single contractor significantly affected the Bureau of Labor Statistics (BLS) employment cost index for total compensation, aircraft manufacturing (NAICS Product Code 336411, formerly Standard Industrial Classification Code 3721, Aircraft). The recommendations contained in the subject DoDIG audit report resulted in the current policy in DFARS PGI 216.203-4 (3), which expressly prohibits use of the aforementioned BLS index in any EPA clause in DoD contracts.

DPAP has established a DoD-wide policy that Multi-Year contracts with EPA clauses will be monitored to ensure that economic price adjustments are the result of normal economic behavior. In addition, DPAP has instituted an annual reporting requirement for Multi-Year contracts with EPA clauses. The format for the required report is attached to the DPAP memorandum. The initial report is due to this office no later than October 26, 2009.

It is requested that the attached memorandum be forwarded to all appropriate contracting personnel. My point of contact for this matter is Mr. Clarence Belton, clarence.belton@navy.mil, (703) 693-4006.

Elliott B. Branch

Elliott B. Branch
Executive Director
DASN (A&LM)

Attachment:
As stated

Distribution:
See next page

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ACQUISITION,
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
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WASHINGTON, DC 20301-3000

SEP -9 2009

MEMORANDUM FOR COMMANDER, UNITED STATES SOUTHERN COMMAND
(ATTN: ACQUISITION EXECUTIVE)
COMMANDER, UNITED STATES TRANSPORTATION
COMMAND (ATTN: ACQUISITION EXECUTIVE)
DEPUTY ASSISTANT SECRETARY OF THE ARMY
(PROCUREMENT), ASA (ALT)
DEPUTY ASSISTANT SECRETARY OF THE NAVY
(ACQUISITION & LOGISTICS MANAGEMENT),
ASN (RDA)
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE
(CONTRACTING), SAF/AQC
DIRECTORS, DEFENSE AGENCIES
DIRECTORS, DOD FIELD ACTIVITIES

SUBJECT: Follow-on Actions in Response to OIG Report Notification: 'Effect of Payments into Boeing Pension Funds on Economic Price Adjustment Clauses in DoD Contracts' (Project No. D2006-D000CH-0226.000)

The purpose of this memorandum is to reiterate the need to use caution when incorporating Economic Price Adjustment (EPA) provisions in contracts. As stated in PGI 216.203-4, EPA provisions can result in significant and unanticipated price increases which can have major adverse impacts to a program.

The situation described in the subject audit underscores the importance of ensuring EPA clauses are properly structured and carefully monitored after contract award. The Department of Defense Inspector General (DoDIG) found that Boeing's pension contributions between 2003 and 2005 disproportionately influenced the Bureau of Labor Statistics (BLS) index (ECI 3721) used in the EPA clauses of the Air Force C-17 Globemaster III, the Navy F/A-18 E/F Super Hornet, and the Army AH-64D Apache Longbow contracts. This situation only became apparent after contract award.

The basis of a BLS index, per DFARS PGI 216.203-4(6), should not be so large and diverse that it is significantly affected by fluctuations not relevant to contract performance, but it must be broad enough to minimize the effect of any single contractor. In addition, care should be exercised in those cases that deal with volatile commodities that have only a limited number of sources of supply. In these cases it may be appropriate to consider an alternative methodology, such as one based on published

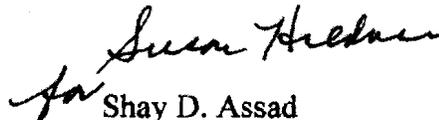
market prices. DoD contracting officers shall use caution when incorporating economic price adjustment provisions in contracts.

Since the ECI 3721 index failed both of the PGI tests, the DoDIG determined that use of this BLS index constituted a material internal control weakness (as defined by DoD Instruction 5010.40, "Managers Internal Control (MIC) Program Procedures," January 4, 2006). As a result of the audit recommendations, PGI 216.203-4 was revised to prohibit the BLS employment cost index for total compensation, aircraft manufacturing (NAICS Product Code 336411, formerly Standard Industrial Classification Code 3721, Aircraft) in any EPA clause in DoD contracts.

It is the policy of the Department that Multi-Year (MY) contracts with EPA clauses will be monitored to ensure that economic price adjustments are the result of normal economic behavior as intended by the clause. Accordingly, the Components are responsible for establishing local policies and procedures for reviewing and monitoring MY contracts with EPA clauses.

To ensure continued visibility, Components must also submit an annual report of Contract Data for MY contracts with EPA clauses in the attached format. The initial report of FY 2009 data is due October 30, 2009.

My point of contact for this memorandum is Mr. David Mabee and he can be reached at 703-602-0326 or via e-mail at Dave.Mabee@osd.mil.



Shay D. Assad
Director, Defense Procurement
and Acquisition Policy

Attachment:
As stated

cc:
DCAA

DPAP Multiyear Contract Data Submission (revised FY2009)

| | 1 | 2 | 3 |
|---|-------|-------|-------|
| Contract Number | _____ | _____ | _____ |
| Organization | _____ | _____ | _____ |
| POC Name | _____ | _____ | _____ |
| POC Number | _____ | _____ | _____ |
| Program | _____ | _____ | _____ |
| Contractor | _____ | _____ | _____ |
| Contract Type | _____ | _____ | _____ |
| Performance Period (Mo/Yr to Mo/Yr) | _____ | _____ | _____ |
| Total Contract Price at Award | _____ | _____ | _____ |
| Quantity at Time of Award | _____ | _____ | _____ |
| “Current” as of date for below | _____ | _____ | _____ |
| Current Total Contract Price | _____ | _____ | _____ |
| Current (Revised) Quantity | _____ | _____ | _____ |
| Current Incurred Costs | _____ | _____ | _____ |
| Initial Projected Savings Amount to justify multiyear | _____ | _____ | _____ |
| Initial Projected Savings Percentage to justify multiyear | _____ | _____ | _____ |
| Negotiated Profit Rate | _____ | _____ | _____ |
| Has EPA Index? (Note 1) | _____ | _____ | _____ |
| EPA Index used (Note 2) | _____ | _____ | _____ |
| Source of EPA Index (Note 3) | _____ | _____ | _____ |
| EPA Adjustment Year 1 | _____ | _____ | _____ |
| EPA Adjustment Year 2 | _____ | _____ | _____ |
| EPA Adjustment Year 3 | _____ | _____ | _____ |
| EPA Adjustment Year 4 | _____ | _____ | _____ |
| EPA Adjustment Year 5 | _____ | _____ | _____ |
| Comments (if any) | _____ | _____ | _____ |

Please do not insert additional rows above the comment line

Notes:

- (1) Answer Y or N
- (2) If there is an index, state title, otherwise leave blank
- (3) State the source or publisher of the index, e.g., BLS, EIA, Global Insights, etc.