

Subcontract Management From A to Z:

Session 5: Contractor Purchasing Systems

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Overview of the Series

- January 12: Federal Subcontracting 101 (An Overview)
- February 9: Joint Ventures and Teaming Agreements
- March 9: Small Business Programs
- April 13: Small Business Subcontracting
- May 11: Contractor Purchasing Systems
- June 8: Awarding Subcontracts
- September 14: Flow Downs and Terms & Conditions
- October 12: Subcontract Pricing
- November 9: Subcontract Management and Administration

Agenda

- Contractor Purchasing Systems
 - Purchasing System guidelines (generally)
 - DOD Purchasing Systems
- Contractor Purchasing System Reviews (FAR Subpart 44.3)
 - Purpose and scope
 - Government data requests
 - Review of Policies and Procedures
 - Extent of Government review and report
 - Planning for a CPSR

Contractor Purchasing Systems



CONTRACTOR

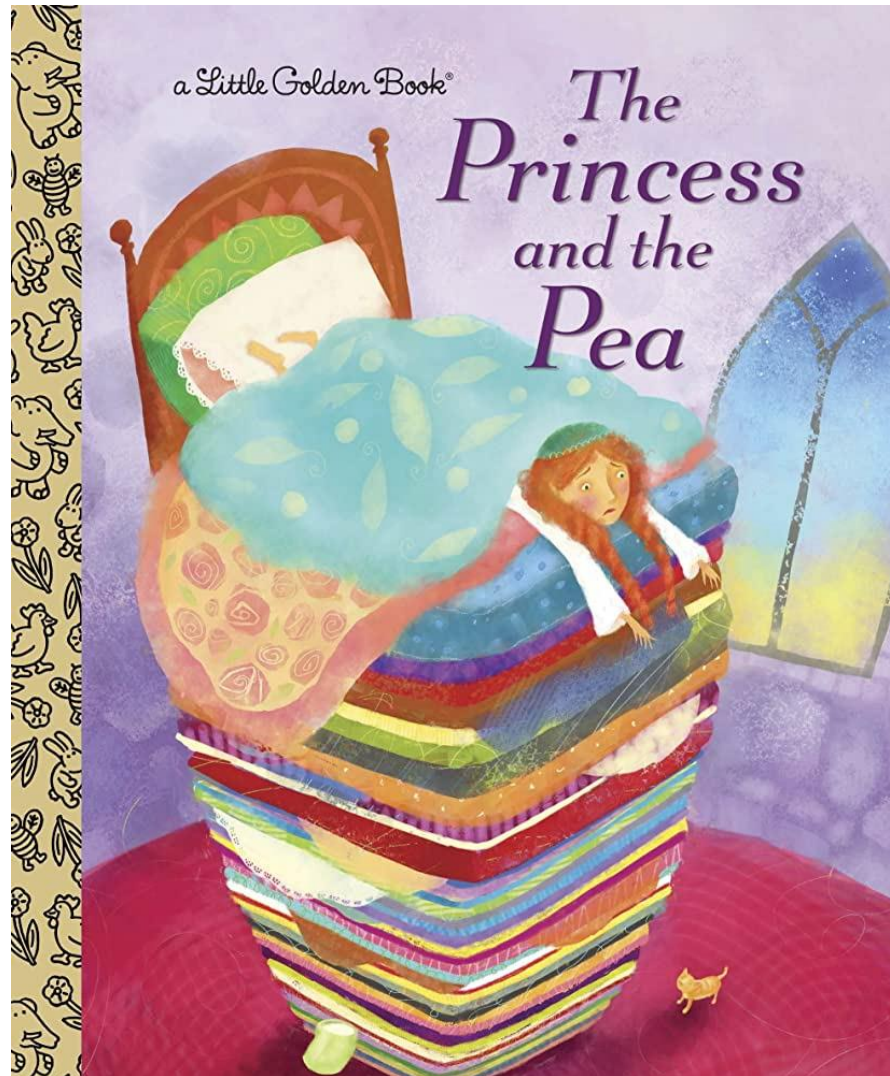


PURCHASING



SYSTEMS

The Princess and the Pea



30
layers
deep
???

1. Contractor Purchasing Systems

Contractor Purchasing Systems



VS



Contractor Purchasing Systems (cont'd)

- As federal **deputies**, the Government wants to ensure that your subcontracting dollars are wisely spent
 - Risks of fraud/waste/abuse
 - Fair and reasonable price
 - Secure supply chain
 - Supporting small businesses
 - Matching federal priorities
- But Purchasing Systems also make good commercial sense, too
 - **Tailored solutions** for your specific business



Contractor Purchasing Systems (cont'd)

- Unless your contract requires differently, there are **no definitive requirements** for a Purchasing System
- But you may consider the following features:
 - ✓ Ability to conduct **market research**
 - ✓ Ability to obtain **competition**, including price competition
 - ✓ **Pricing policies** and techniques, including processes to obtain (where appropriate) accurate and current cost or pricing data
 - ✓ Methods of **evaluating subcontractor responsibility**
 - ✓ Treatment accorded **affiliates**
 - ✓ Policies regarding **small businesses** and other socioeconomic programs
 - ✓ **Managing** subcontractors
 - ✓ Compliance with **Cost Accounting Standards** (if applicable)
 - ✓ Appropriateness of **types of contracts** used
 - ✓ Management **control systems** (including internal audit procedures) for administering progress payments

Contractor Purchasing Systems (cont'd)

- Purchasing system can also be built around a written **Subcontract Management Plan**
 - Industry surveys
 - Market Research (required for non-commercial contracts over \$6M)
 - J&A protocols
 - Creating and distributing RFPs
 - Drafting SOWs
 - Reporting
 - Small business subcontracting (if contracts are > \$750,000)
 - T&Cs (including warranty clauses)
 - Evaluation procedures
 - Protests
 - Administration of Awards
 - Make/Buy protocols
 - Monitoring/Q&A from subs
 - Production
 - Payments

DFARS Business Systems Rule

- Basic clause: DFARS 252.242-7005, “Contractor Business Systems”
- Applies to six contractor business systems, **including** Purchasing (Subcontracting) when prime contract is subject to the Cost Accounting Standards
 - Other systems: MMAS, Accounting, Government Property, EVMS, Estimating



DFARS Business Systems Rule (cont'd)

- Business Systems rule provides, among other things, for **disapproval of purchasing system** and **withholding of payments up to 5%** if “significant deficiency” in one system and **up to 10%** withhold if significant deficiencies in multiple business systems
 - Withholdings may be applied against progress payments and performance-based payments
 - The contractor may also be directed to withhold from its billings on interim cost vouchers on cost-reimbursement, labor-hour, and time and materials contracts
- “Significant deficiency,” in the case of a contractor business system, means a shortcoming in the system that materially affects the ability of officials of the Department of Defense to rely upon information produced by the system that is needed for management purposes
- Imposes lengthy multi-step corrective action process

DFARS Business Systems Rule – Case Study

- In September 2013, DOD assessed a **5% penalty** against engine manufacturer Pratt & Whitney for deficiencies in the Company's **earned value management system**, which is a project management tool that integrates the project scope of work with cost, schedule, and performance elements
- By April 2014, the withholdings reached **\$26 million**
- In June 2014, the penalty was reduced to 2% because P&W was making progress in remedying the deficiencies
- But, by December 2015, the penalty was increased to 5% because of continued deficiencies, and reached **\$40 million**
- P&W acknowledged the deficiencies, and pledged to implement “root-cause corrective action plans”



DFARS 252.244-7001 – Contractor Purchasing System Administration

- Pursuant to DFARS 244.305-71, the clause at 252.244-7001 is **required** when contract contains FAR 52.244-2, Subcontracts

252.244-7001(c) *System criteria*. **The Contractor's purchasing system shall—**

- (1) Have an adequate system description including policies, procedures, and purchasing practices that comply with the Federal Acquisition Regulation (FAR) and the Defense Federal Acquisition Regulation Supplement (DFARS);
- (2) Ensure that all applicable purchase orders and subcontracts contain **all flowdown clauses**, including terms and conditions and any other clauses needed to carry out the requirements of the prime contract;
- (3) Maintain an **organization plan** that establishes clear lines of authority and responsibility;
- (4) Ensure all **purchase orders are based on authorized requisitions** and include a complete and accurate history of purchase transactions to support vendor selected, price paid, and **document** the subcontract/purchase order files which are subject to Government review;
- (5) Establish and maintain **adequate documentation** to provide a complete and accurate history of purchase transactions to support vendors selected and prices paid;

DFARS 252.244-7001 – Contractor Purchasing System Administration (cont'd)

- (6) Apply a **consistent make-or-buy policy** that is in the best interest of the Government;
- (7) Use **competitive sourcing** to the maximum extent practicable, and ensure debarred or suspended contractors are properly excluded from contract award;
- (8) Evaluate price, quality, delivery, technical capabilities, and financial capabilities of competing vendors to ensure **fair and reasonable prices**;
- (9) Require **management level justification and adequate cost or price analysis**, as applicable, for any sole or single source award;
- (10) Perform **timely and adequate cost or price analysis and technical evaluation** for each subcontractor and supplier proposal or quote to ensure fair and reasonable subcontract prices;
- (11) **Document negotiations** in accordance with FAR 15.406-3;
- (12) **Seek, take, and document economically feasible purchase discounts**, including cash discounts, trade discounts, quantity discounts, rebates, freight allowances, and company-wide volume discounts;
- (13) **Ensure proper type of contract selection** and prohibit issuance of cost-plus-a-percentage-of-cost subcontracts;
- (14) Maintain **subcontract surveillance** to ensure timely delivery of an acceptable product and procedures to notify the Government of potential subcontract problems that may impact delivery, quantity, or price;

DFARS 252.244-7001 – Contractor Purchasing System Administration (cont'd)

- (15) Document and justify reasons for subcontract changes that affect cost or price;
- (16) Notify the Government of the award of all subcontracts that contain the FAR and DFARS flowdown clauses that allow for Government audit of those subcontracts, and ensure the performance of audits of those subcontracts;
- (17) Enforce adequate policies on conflict of interest, gifts, and gratuities, including the requirements of [the Anti-Kickback Act];
- (18) Perform internal audits or management reviews, training, and maintain policies and procedures for the purchasing department to ensure the integrity of the purchasing system;
- (19) Establish and maintain policies and procedures to ensure purchase orders and subcontracts contain mandatory and applicable flowdown clauses, as required by the FAR and DFARS, including terms and conditions required by the prime contract and any clauses required to carry out the requirements of the prime contract;
- (20) Provide for an organizational and administrative structure that ensures effective and efficient procurement of required quality materials and parts at the best value from responsible and reliable sources ;

DFARS 252.244-7001 – Contractor Purchasing System Administration (cont'd)

(21) Establish and maintain selection processes to **ensure the most responsive and responsible sources** for furnishing required quality parts and materials and to promote competitive sourcing among dependable suppliers so that purchases are reasonably priced and from sources that meet contractor quality requirements;

(22) Establish and maintain procedures to **ensure performance of adequate price or cost analysis on purchasing actions**;

(23) Establish and maintain procedures to **ensure that proper types of subcontracts are selected, and that there are controls over subcontracting, including oversight and surveillance of subcontracted effort**; and

(24) Establish and maintain procedures to **timely notify the Contracting Officer**, in writing, if:

(i) **The Contractor changes the amount of subcontract effort after award such that it exceeds 70 percent of the total cost of the work to be performed under the contract, task order, or delivery order.** The notification shall identify the revised cost of the subcontract effort and shall include verification that the Contractor will provide added value; or

(ii) **Any subcontractor changes the amount of lower-tier subcontractor effort after award such that it exceeds 70 percent of the total cost of the work to be performed under its subcontract.** The notification shall identify the revised cost of the subcontract effort and shall include verification that the subcontractor will provide added value as related to the work to be performed by the lower-tier subcontractor(s).

Contractor Purchasing System Administration (cont'd)

[25] Compliance with DFARS 252.204-7012, “Safeguarding Covered Defense Information and Cyber Incident Reporting”

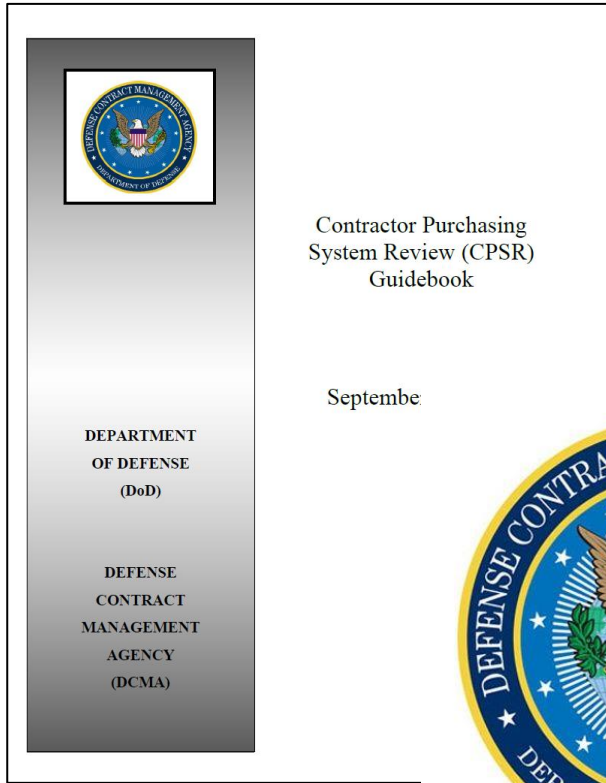
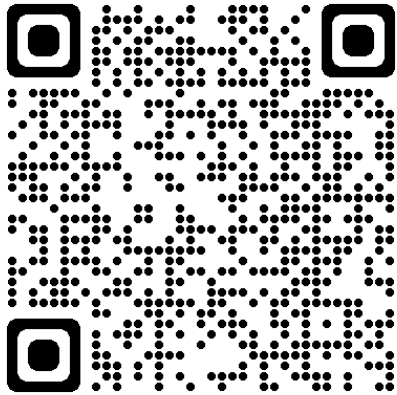
- Is this clause being **flowed down** without alteration to subcontractors?
 - What procedures are in place to ensure that CDI [covered defense information] **and CUI** [controlled unclassified information] are appropriately **marked and/or limit future distribution**?
 - Does the contractor have procedures to **assess subcontractors’ compliance** with DFARS 252.204-7012?
 - **Note: One and a half of these “requirements” are not included in the clause!**
- See DCMA’s CPSR Guidebook (updated September 10, 2021)
 - Section 5.24, “Supply Chain Management Process:”
“Safeguarding DoD covered defense information is a critical aspect” of supply chain management.
 - See Jan. 21, 2019 memorandum from Ellen Lord, Undersecretary of Defense for Acquisition and Sustainment (“Addressing Cybersecurity Oversight as Part of a Contractor’s Purchasing System Review”)



2. Contractor Purchasing System Reviews (CPSR) (FAR Subpart 44.3)

Contractor Purchasing System Reviews (CPSRs)

DCMA Contractor Purchasing System Review (CPSR) Guidebook (September 10, 2021)



September

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Contractor Purchasing System Reviews (cont'd)

- CPSRs look generally to a contractor's **past performance**
 - Focuses on the process, not a single contract
- Also looks to **complexity and dollar value** of subcontracts
- Formal CPSRs are **not always mandatory** but may be advisable when a contractor's total sales to the Government exceed \$25M, per FAR 44.302, "if it is considered to be in the Government's best interest"
 - \$50M threshold for DOD
- CPSRs are administered by the Administrative Contracting Officer (ACO)

Government Data Requests

- Types of DCMA CPSRs
 - Initial / Comprehensive Review
 - Special Review
 - Follow-up Review

Government Data Requests (cont'd)

- **DCMA Risk Assessment Form**
 - Contact information
 - Summary of purchasing over past 12 months
 - Total dollar value of all purchases
 - Subcontractors by dollar value
 - < \$150,000
 - \$150,000 - \$749,999
 - \$750,00 - \$2,000,000
 - > \$2,000,000
 - Small vs. large breakdown
 - Details of sole source purchases
 - Sales volume detail reasonably available
 - Total vs. Commercial vs. Subcontract vs. Prime
 - By Agency: Negotiated vs. Competitive

Government Data Requests (cont'd)

- **DCMA Data Request (selected data)**
 - Copy of Purchasing Manual or Subcontract Management Plan
 - Geographical location of plants and offices
 - Subsidiary and affiliate companies
 - Copies of internal audits related to purchasing
 - Details of active government contracts
 - Subcontract/Purchase Order detail (segregated by value)
 - Types of awards for purchases by number of actions and value

Government Data Requests (cont'd)

- **DCMA Data Request (selected data)**
 - Conflict of interest questions
 - Standards of conduct or ethics policy
 - Management approval prior to purchase of items greater than \$25,000
 - Rotation of buyers
 - Monitoring of buyers by management inquiry to suppliers
 - Hotline

CPSR Policies and Procedures

DCMA Guidebook – Expectations

1. Policy and Procedure Manual
2. Truthful Cost or Pricing Data / Truth in Negotiations Act (TINA)
3. Cost Accounting Standards (CAS)
4. Prior Consent and Advance Notification (FAR Subpart 44.2)
5. Small Business Subcontracting Plans
6. Protecting the Government's Interest when Subcontracting with Contractors Debarred, Suspended, or Proposed for Debarment (subcontracts > \$35,000)
7. Limitation on Use of Appropriated Funds to Influence Certain Federal Transactions Certification (Anti-lobbying)
8. Defense Priorities and Allocation System (DPAS) Rating

CPSR Policies and Procedures (cont'd)

9. Federal Funding Accountability and Transparency Act of 2006
10. Counterfeit Parts Mitigation and Surveillance
11. Price Analysis
12. Source Selection
13. Negotiations
14. Make-or-Buy Program
15. Limitation on Pass-through Charges
16. Documentation
17. Training
18. Internal Review/Self Audit
19. Mandatory FAR and DFARS Flow Down Requirements/Terms and Conditions

CPSR Policies and Procedures (cont'd)

20. Purchase Requisition Process
21. Commercial Item Determination
22. Subcontract Types
23. Procurement Authority
24. Supply Chain Management Process
25. Buy American/Country of Origin requirements
26. Restrictions on the Acquisition of Specialty metals/Articles containing Specialty Metals
27. Subcontractor/Vendor Closeout Process
28. Long-Term Purchasing Arrangements
29. Handling Change Orders and Modifications
30. Intra/Inter-Company, Affiliate, or Subsidiary Transactions

CPSR: Extent of Review

- FAR 44.303
 - Degree of price competition obtained
 - Pricing policies and techniques
 - Methods of evaluating subcontractor responsibility
 - Treatment of affiliates and partners
 - Small business policies and procedures
 - Planning, award, and post-award management
 - CAS compliance requirements
 - Appropriateness of subcontract types
 - Management control systems
- DFARS 252.244-7001 – [24 + 1 criteria, previously discussed]

CPSR: Report

- Auditor makes recommendation to ACO
- Status of prior recommendations
- Statistical data (selected area)
 - Total POs reviewed
 - Percentage of competitively awarded POs to total POs
 - Percentage of single/sole source awarded POs to total POs

CPSR: Report (cont'd)

- Predominant justifications for awards made without adequate price competition

Customer Directed	Engineering Directed
Proprietary Items	Only Supplier Qualified
Economically Justified	Other Justifiable Reasons
No Justification Given	

CPSR: Report (cont'd)

- Effectiveness in major purchasing areas
 - Public Laws and Certification Requirement Areas
 - Cost Accounting Standards (CAS)
 - Certified Cost or Pricing Data (TINA)
 - Advance notification and consent
 - Evaluation of subcontractor responsibility
 - Small business subcontracting plans
 - Certification and representation package

CPSR: Report (cont'd)

- Effectiveness in major purchasing areas (cont'd)
 - Policy and procedures
 - Addresses numerous areas (refer to DCMA data request)
 - Pricing
 - Adequacy of cost/price analysis
 - Documentation of published price lists/catalogs
 - Negotiations
 - Single/sole source justifications
 - Adequacy and degree of price competition obtained
 - Make or Buy program
 - Supply Chain management
 - Vendor rating system

CPSR: Report (cont'd)

- Current recommendation
- Contractor's Corrective Action Plan (CAP)
- Evaluation of CAP

Planning for CPSRs

- Understand the scope and intent of the CPSR
 - Source Selection
 - Price/Cost Analysis and Negotiations
 - Cost Accounting Standards
 - Compliance with Public Law requirements
 - Contractor's Terms and Conditions (review by DCMA Legal Counsel)
 - Contractor Vendor Rating Process
 - Contractor Best Value Process
 - Contractor Make/Buy Process
 - Contractor Internal Purchasing System Audit Process

Planning for CPSRs (cont'd)

- Understand the scope and intent of purchasing system internal controls review
 - Evaluate the adequacy of and the contractor's compliance with the purchasing system internal controls
 - Assess the adequacy of the contractor's policies and procedures, whether they have been implemented, and if they are working and being monitored effectively
 - Assess control risk as a basis to identify factors relevant to the design of substantive tests
 - Report on the understanding of the purchasing system internal controls and assessment of control risk, and the adequacy of the system for Government contracts

Planning for Procurements



- GAO decisions confirm that it is reasonable to include Purchasing System requirements in a solicitation and that offerors are responsible for providing details regarding their system in proposals
 - *Graybar*, B-410886 (Mar. 4, 2015) (denying protest of assignment of weakness for purchasing system because record supported that the offeror’s proposal lacked details regarding “the methods and procedures used for some of the purchasing system elements.”)
 - *Symvionics, Inc.*, B-408505 (Sept. 19, 2013) (denying protest of alleged bias where NASA required offerors, including small businesses, to either have an existing government-approved purchasing system or to propose a system that NASA could approve without DCMA review under FAR authority that allows NASA to approve purchasing systems)
 - *Evolver, Inc.; Armed Forces Services Corp.*, B-413559.2 (Dec. 21, 2016) (denying protest claiming that requiring firms to have government-approved accounting/purchasing systems at time of contract award for the Alliant 2 vehicle was unduly restrictive where agency explained that having approval at time of award “relates to the agency’s need to provide a contract vehicle . . . where DOD and other agencies can find companies qualified to perform cost-reimbursement type contracts.”)

Conclusion

Key Takeaways

- ✓ Your Purchasing System **may require a formal CPSR**
 - \$50M threshold for DOD; \$25M for civilian
 - Having an approved purchasing system may limit the Government's consent to subcontract rights (FAR Subpart 44.2)
- ✓ Even if a CPSR is not required, you should still have an **internal Purchasing System** tailored to your specific business
 - Manage risks
 - Implement federal policies
- ✓ **Written policies and procedures** are critically important
- ✓ **Competition** is (mostly) king
 - ✓ Market research
 - ✓ Price reasonableness
 - ✓ Small business subcontracting opportunities
- ✓ Make sure that you have **policies and approvals** (e.g., J&A) to justify unusual / sole-source purchases
- ✓ **Training, training, and more training!**



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Next Session on June 8, 2023

Session 6: Awarding Subcontracts

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