Audit Report

OFFICE OF THE INSPECTOR GENERAL

AUDIT OF ECONOMIC DEVELOPMENT STUDY OF THE FORMER SOVIET UNION

Report No. 95-242 June 20, 1995

Department of Defense

Additional Copies

Copies of the report can be obtained from the Secondary Reports Distribution Unit, Audit Planning and Technical Support Directorate, 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 Planning and Coordination Branch, Audit Planning and Technical Support Directorate, at (703) 604-8939 (DSN 664-8939) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

Inspector General, Department of Defense
OAIG-AUD (ATTN: APTS Audit Suggestions)
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@DODIG.OSD.MIL; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

ASD	Assistant Secretary of Defense
FFRDC	Federally Funded Research and Development Center
NDRI	National Defense Research Institute
OSD	Office of the Secretary of Defense

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

Report No. 95-242 June 20, 1995

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND TECHNOLOGY
ASSISTANT SECRETARY OF DEFENSE (POLICY AND PLANS)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit of Economic Development Study of the Former Soviet Union (Project No. 1CH-5012.03)

Introduction

We are providing this report for your information and use. We performed the audit in response to a referral from the Inspector General, Department of State. The referral resulted from an allegation by a State Department employee that a DoD-sponsored study on the economies of the former Soviet republics and overseas travel related to the study were not essential and were a waste of DoD funds.

Audit Results

We did not substantiate the allegation. The study and related overseas travel pertained to the mission of the Assistant Secretary of Defense (ASD) (Policy and Plans) and was a matter of interest to the Under Secretary of Defense for Policy during FY 1994. However, the noncompetitive assignment of the study to the RAND Corporation National Defense Research Institute (NDRI), a DoD-sponsored, federally funded research and development center (FFRDC), was not justified. This report makes no recommendations to improve compliance with Office of Federal Procurement Policy and Federal Acquisition Regulation policies on proper and effective use of FFRDCs because those recommendations were made in Inspector General, DoD, Report No. 95-048, "Contracting Practices for the Use and Operations of DoD-Sponsored Federally Funded Research and Development Centers," December 2, 1994.

Audit Objectives

The primary audit objective was to determine whether a justifiable need existed for an economic development study of the former Soviet Union and for study-related overseas travel. The audit also evaluated the sole-source award of the study to NDRI. In addition, the audit evaluated the effectiveness of management controls applicable to the primary audit objective.

Scope and Methodology

We examined the justification for the study, "The Outlook for a Common Market in the Newly Independent States," sponsored by the ASD (Policy and Plans). We reviewed documentation related to the requirements, review and approval, and sole-source award of the study to NDRI. The documentation, dated from 1989 through 1994, included mission statements, decision memorandums, study justifications, program and contract files, and information on previous studies of economic conditions in the former Soviet Union and Eastern European states. We discussed that information with sponsoring program and procurement officials.

This economy and efficiency audit was made from August through November 1994 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of management controls as were considered necessary. We did not use computer-processed data or statistical sampling procedures to perform the audit. Enclosure 2 lists the organizations visited or contacted during the audit.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to have management controls in place and to periodically evaluate those controls.

Scope of Review of the Management Control Program. We evaluated the effectiveness of the controls established by the ASD (Policy and Plans) for developing the FY 1994 Under Secretary of Defense for Policy studies program. The implementation of the management control program in the Office of the Secretary of Defense is discussed in Report No. 95-048.

Adequacy of Management Controls. Management controls were not adequate to ensure that the ASD (Policy and Plans) used FFRDC resources properly, but the inadequacies are not discussed in this report. The adequacy of management's evaluation of applicable management controls is discussed in Report No. 95-048 and applies to the noncompetitive assignment of the study, "The Outlook for a Common Market in the Newly Independent States," to NDRI.

Prior Audits and Other Reviews

During the last 5 years, the Inspector General, DoD; the Air Force Audit Agency; the Congressional Research Service; and the Senate Committee on Governmental Affairs issued seven reports that discuss requirements and cost-effectiveness issues involving DoD-sponsored FFRDCs. A summary of prior audits and other reviews is in Enclosure 1.

Audit Background

Use of FFRDCs. FFRDCs are intended to assist the Government in accomplishing specialized missions, the effective performance of which requires unique capabilities or specialized skills that cannot be obtained as effectively from in-house or non-FFRDC contractor sources. Policies on the establishment and use of FFRDCs are in Office of Federal Procurement Policy Letter 84-1, "Federally Funded Research and Development Centers," April 4, 1984, as implemented by Federal Acquisition Regulation 35.017, "Federally Funded Research and Development Centers."

Mission of NDRI. The mission of NDRI is to conduct a wide range of research and analyses for the Office of the Secretary of the Defense (OSD), Joint Staff, unified commands, and Defense agencies in the areas of international security and economic policy; threat assessment; Defense strategy and force employment options; applied science and technology; information processing systems; systems acquisition; readiness and support systems; and active-duty and reserve staffing, personnel, and training.

Sponsor of the Study. The Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) was the sponsor for the study on the former Soviet republics. The Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) reports to the ASD (Policy and Plans), who is the principal staff assistant and advisor to the Under Secretary of Defense for Policy and the Secretary of Defense. The ASD (Policy and Plans) advises on mid- to long-range planning on strategic security matters and emerging national security issues, Defense policy priorities, and net assessments. The ASD (Policy and Plans) formulates and coordinates security strategy and policy and political-military policy on issues of DoD interest that relate to foreign governments and their defense establishments in Russia, the Ukraine, and other republics of the former Soviet Union.

Discussion

Allegation on the Need for the Study. We did not substantiate the allegation that the study was not essential and was a waste of funds. The study was within the mission of the ASD (Policy and Plans) and was proposed by NDRI in response to a research need of the Under Secretary of Defense for Policy. Sponsoring officials within the Office of the Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) certified that the research was needed and stated that the study provided useful information.

Justification and Approval of the Study. The following actions were taken before the study began.

o On September 3, 1993, the Under Secretary of Defense for Policy forwarded a memorandum to the Secretary of Defense identifying priority issue areas for research during FY 1994.

o In September 1993, NDRI proposed a research project for sponsorship by the Under Secretary of Defense for Policy on the economies of the former Soviet republics at an estimated cost of $460,000.

o In October 1993, the ASD (Policy and Plans) requested that NDRI revise the scope and estimated cost of the study.

o On November 15, 1993, the Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) agreed to sponsor the NDRI study and recommended its input for the FY 1994 study plan.

o In January 1994, NDRI submitted a revised proposal (project description) for the study.

o On January 27, 1994, the project sponsor for the Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) approved a January 1994 NDRI project description for the study. In an internal memorandum, the project sponsor stated that the study was essential and would:

- address key issues for which the Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia) lacked the resources to assess independently;

- reflect RAND's high-level expertise; and

- provide vital, timely information on the economic integration in the former Soviet Union, a process that could have a major effect on Defense planning and policy.

o On February 7, 1994, the ASD (Policy and Plans) approved the study and funding of $260,000.

Objective and Goal of the Study. The January 1994 project description submitted by NDRI and approved by the ASD (Policy and Plans) identified the following objective and goal for the study.

> The objective of this study is to assess the economic development of the former Soviet Union, and the prospects of its successor economies to form a "Common Market." Of key concern is the ability of the various economies to generate economic growth at home and what those prospects mean for questions related to the allocation of resources toward civilian and military ends. A second concern is the degree to which economic relationships may exacerbate or mitigate political, ethnic, and other tensions in the region . . . . A major goal of the project is to produce both timely analyses that can be used for current policy making needs and more forward looking pieces that will have a longer shelf life.

Overseas Travel Related to the Study. On July 22, 1994, the Director, Policy Research, Office of the Under Secretary of Defense for Policy, requested Department of State clearance for travel by an NDRI employee to perform

foreign affairs research in connection with the study. The itinerary for the overseas travel included participation in a conference at the Central European University, Prague, Czechoslovakia, and a workshop at the International Institute for Applied Systems Analysis, Vienna, Austria. Officials at the Office of the Under Secretary of Defense for Policy requested approval of the travel in accordance with DoD Directive 4500.54, "Official Temporary Duty Travel Abroad," May 1, 1991. An official of the Department of State Research Council initially denied the clearance on grounds that the project was nonessential and was a waste of funds. However, clearance guidelines established by the Department of State Research Council provide that "review is for the sole purpose of avoiding adverse effects on U.S. foreign relations and does not constitute State endorsement of the cost, need, method, or value of the project." Accordingly, the Department of State approved the clearance, and the NDRI employee traveled in August 1994.

Study Results Prove Useful to DoD. The NDRI study was completed in December 1994. The study resulted in two research publications and two briefings for the Office of the Under Secretary of Defense for Policy. The publications were "Kazakhstan and the CIS [Commonwealth of Independent States]," June 1994, and "Russia, Ukraine, and the CIS: An Uneasy Partnership," November 17, 1994. The briefings were "Russia, Kazakhstan, and the CIS," October 1994, and "Outlook for CIS Reintegration," October 1994. According to the project sponsor, the reports and briefings were useful for senior DoD officials who visited the Central Asian republics and who visited high-level Ukranian dignitaries during visits the United States.

Consideration of Non-FFRDC Research Sources. The ASD (Policy and Plans) did not adequately consider the effectiveness of non-FFRDC sources before assigning the study to NDRI. In addition to NDRI, other Government and non-Government organizations have performed substantial research on the economies of the former Soviet republics. Those organizations include the Strategic Studies Institute, Army War College; the Directorate of Intelligence, Economic Division, Central Intelligence Agency; the International Monetary Fund; the Brookings Institution; the Institute for International Economics; and the George Washington University Institute for European, Russian, and Eurasian Studies. ASD (Policy and Plans) personnel could provide no evidence that other Government and non-Government organizations were considered as alternatives to NDRI for the research study or that the ASD (Policy and Plans) requested proposals from other organizations to perform the research. The ASD (Policy and Plans) relied on NDRI to evaluate existing research products before approving the NDRI proposal.

Neither the contracting officer, Defense Supply Service-Washington, nor the Director, OSD Studies and FFRDC Programs, OSD, challenged the ASD (Policy and Plans) decision to have NDRI perform the research study. The contracting officer was not aware of the research tasking to NDRI because the contracting officer relied on the sponsor and the Director, OSD Studies and FFRDC Programs, who was the contracting officer representative for NDRI, to determine that work was appropriate for performance by NDRI. We believe that either the Defense Supply Service-Washington contracting officer or the

Director, OSD Studies and FFRDC Programs, should have questioned the study sponsor about the existence and potential effectiveness of alternatives to NDRI before authorizing the study to be performed under the NDRI contract.

We are making no recommendations to strengthen the controls over the screening and noncompetitive assignment of work to NDRI. A discussion of insufficient justification for assigning projects to DoD-sponsored FFRDCs, including NDRI, and recommendations to correct the problem are in Inspector General, DoD, Report No. 95-048, December 2, 1994.

Management Comments

We provided a draft of this report to you on May 3, 1995. Because the report contained no recommendations, written comments were not required, and none were received. Therefore, we are publishing this memorandum report in final form.

Courtesies extended to the audit staff are appreciated. If you have questions about this audit, please contact Mr. Garold E. Stephenson, Audit Program Director, at (703) 604-9332 (DSN 664-9332) or Mr. John M. Gregor, Audit Project Manager, at (703) 604-9321 (DSN 664-9321). The planned distribution of this report is listed in Enclosure 3. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosures

Summary of Prior Audits and Other Reviews

Inspector General, DoD

Report No. 95-048, "Contracting Practices for the Use and Operations of DoD-Sponsored Federally Funded Research and Development Centers," December 2, 1994. The report states that DoD sponsors did not provide sufficient justification for using FFRDCs to perform 223 of the 229 projects reviewed. The report recommends that DoD strengthen controls over the screening and assignment of work to FFRDCs, to include performing cost comparisons and using broad agency announcements and competitive solicitations to assess alternatives to the use of FFRDCs. The Director, Defense Research and Engineering, generally agreed that improved controls over the noncompetitive assignment of work to FFRDCs were needed, but did not agree to conduct cost comparisons of using FFRDC personnel or using DoD personnel or to use competitive solicitations to evaluate alternatives to the use of FFRDCs.

Report No. 94-012, "Sole-Source Justifications for DoD-Sponsored Federally Funded Research and Development Centers," November 4, 1993. The report states that DoD sponsors did not adequately document the basis for renewing the sole-source contracts with the 10 FFRDCs reviewed. Also, the Navy could reduce costs by $6.2 million over 2 years by replacing personnel at the Center for Naval Analyses with Navy personnel. The report recommends that the Director, Defense Research and Engineering, require FFRDC sponsors to perform new comprehensive reviews of the continued need for FFRDCs and that DoD acquisition officials not award new FFRDC contracts pending completion of acceptable comprehensive reviews and adequate sole-source justifications. The Director and the DoD acquisition officials agreed to perform new comprehensive reviews and to clarify the Director's role in performing the reviews. The Director stated that existing Office of Federal Procurement Policy and Federal Acquisition Regulation guidance on the conduct of comprehensive reviews was adequate, but agreed to further clarify those requirements in a revised FFRDC Management Plan.

Report No. 90-041, "Contracting Practices of the Institute for Defense Analyses," March 1, 1990. The report states that the review process used to select work for the Institute for Defense Analyses (the Institute) was not thorough enough to properly select noncompetitive work suitable for an FFRDC. Also, the Institute did not have a mission statement that clearly differentiated between work suitable for the Institute and work that a non-FFRDC should perform. In addition, contract administration by the Defense Supply Service-Washington was not adequate to ensure that the Institute complied with contract requirements and that contract payment to the Institute was appropriate. The report recommends that the Director, Defense Research and Engineering, establish a mission statement for the Institute in accordance with Office of Federal Procurement Policy Letter 84-1 and procedures to

adequately justify the sole-source assignment of work to the Institute. The Deputy Director, Defense Research and Engineering, and the Army concurred with the recommendations.

Air Force Audit Agency

Report No. 93064014, "Follow-up Audit--Review of Air Force-Managed Federally Funded Research and Development Centers," August 18, 1993. The audit evaluated the effectiveness of management actions implemented in response to selected recommendations in Report No. 0056410, "Review of Air Force-Managed Federally Funded Research and Development Centers," August 6, 1991. The report states that the Air Force Materiel Command Space and Missile Systems Center and Electronic Systems Center were effectively defining FFRDC taskings or using alternative methods to prepare independent estimates of support requirements and were using independent estimates to help negotiate fair and reasonable prices. However, the Space and Missile Systems Center had not fully implemented procedures to review and validate FFRDC billings, and the Electronic Systems Center had not effectively implemented procedures to evaluate FFRDC performance. The report contains no new findings requiring corrective actions.

Report No. 0056410, "Review of Air Force-Managed Federally Funded Research and Development Centers," August 6, 1991. The report states that non-FFRDC contract support was less costly than support provided by the Aerospace and MITRE Corporations. Also, Air Force program managers approved sole-source taskings for the use of FFRDCs without determining whether in-house or non-FFRDC contractors could accomplish the work, did not independently develop an estimate of FFRDC support requirements, and did not adequately or objectively evaluate the FFRDCs' technical performance for any of the performance evaluations reviewed. The report recommends that the Air Force direct:

o program managers to coordinate proposed FFRDC taskings through the appropriate in-house functional experts to determine whether in-house personnel or non-FFRDC contractors could accomplish the taskings, and

o the Electronic Systems Division (now Electronic Systems Center) and the Space Systems Division (now Space and Missile Systems Center) to establish guidance requiring program managers to develop independent estimates of costs for members of technical staff and use the estimates as a basis for verifying that program managers are receiving fair and reasonable prices from the FFRDCs.

Air Force management officials agreed with the conclusions and recommendations in the report.

Congressional Research Service

Report No. 91-378 SPR, "DoD's Federally Funded Research and Development Centers (FFRDCs)," April 29, 1991. The report summarizes congressional concerns related to the DoD-sponsored FFRDCs. Those concerns included:

o the increased funding and growth of the FFRDCs at the same time that funding was decreasing for research, development, test, and evaluation;

o the view that contracting officials increasingly placed sole-source contracts with FFRDCs to bypass requirements of the Competition in Contracting Act and other procurement regulations;

o the extent to which FFRDCs are required because of their ability to maintain objectivity and avoid conflicts of interest;

o the inadequate oversight of the FFRDCs; and

o the diversification of FFRDCs into areas beyond their originally defined missions.

U.S. Senate

Senate Subcommittee on Oversight of Government Management, Committee on Governmental Affairs Report, "Inadequate Federal Oversight of Federally Funded Research and Development Centers," July 8, 1992. The report states that cost, accounting, and auditing controls were inadequate and inconsistent and had contributed to wasteful and inappropriate use of Federal funds by FFRDCs. The report discusses the following at Air Force-sponsored FFRDCs:

o lack of independent cost estimates,

o failure to ensure the validity and reasonableness of costs, and

o inadequate review and monitoring of projects assigned to the FFRDCs.

The report notes that the competitive award of FFRDC operating contracts was generally lacking. Also, the report discusses concerns regarding the operation of "shell corporations," such as the Center for Naval Analyses, the Institute for Defense Analyses, the Aerospace Corporation, and the Logistics Management Institute, whose sole purpose was to operate an FFRDC.

The report recommends that the Office of Federal Procurement Policy and the sponsors of all FFRDCs improve oversight of FFRDC spending, to include improving cost, accounting, and auditing controls and increasing competition for FFRDC contracts.

Organizations Visited or Contacted

Office of the Secretary of Defense

Assistant Secretary of Defense (Policy and Plans), Washington, DC
Deputy Assistant Secretary of Defense (Russia, Ukraine, and Eurasia), Washington, DC
Director, OSD Studies and FFRDC Programs, Washington, DC

Department of the Army

Director, Defense Supply Service-Washington, Washington, DC

Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Under Secretary of Defense (Comptroller/Program/ Budget)
Director, Defense Research and Engineering
Assistant Secretary of Defense (Policy and Plans)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Director, Defense Supply Service-Washington
Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Central Imagery Office

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Inspector General, Department of State
Technical Information Center, National Security and International Affairs Division, General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
House Committee on National Security

Audit Team Members

This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Paul J. Granetto
Garold E. Stephenson
John M. Gregor
Hoa H. Pham
Janice S. Alston