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

REPORT
NO. 91-095 June 14, 1991

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION

SUBJECT: Report on the Survey of Contracting Operations at the Defense Evaluation Support Activity (Project No. 0AD-0074)

We are providing this final report for your review and additional comment. The May 23, 1991, comments from the Director, Special Programs, Office of the Under Secretary of Defense for Acquisition, were considered in preparing the final report. The report resulted from our survey of Contracting Operations at the Defense Evaluation Support Activity (DESA), formerly known as the Defense Test and Evaluation Support Agency (DTESA).

The survey objective was to determine whether DESA was effectively managing its contracting operations. We evaluated acquisition planning, the solicitation process, contract evaluation and award, contract administration, and internal controls applicable to contracting procedures and operations. We had planned to follow up on a 1989 Air Force Audit Agency Advisory Report that covered DESA's contracting activities. However, after the start of the survey, we found that the Air Force Audit Agency had conducted its own followup and issued an advisory report in May 1990. Finally, since DESA is an organization within the Office of the Secretary of Defense, we reviewed its implementation of the Federal Managers' Financial Integrity Act.

Since the Air Force Audit Agency's initial review, DESA's contracting operations have improved for the contracts awarded during FY 1990. DESA has also established a quality assurance group that monitors the contracting officers' compliance with the Federal Acquisition Regulation. Overall, we found that DESA was adequately managing its contracting operations, with some compliance problems in contract administration.

BACKGROUND

DTESA was chartered in 1986 to consolidate all DoD activities engaged in the acquisition of foreign military material for test purposes. Under the classified identity of National Resource Center, DTESA managed, developed, acquired, and maintained threat systems. These assets consisted largely of Eastern Bloc radars and communication equipment that DTESA acquired on the open foreign market. This aspect of DTESA's

operations constituted a large part of its special access program. DoD envisioned that a mobile threat capability would be developed that would result in the realistic testing of U.S. countermeasure capabilities against enemy systems.

DTESA also provided test and evaluation support to DoD and other Government agency programs and projects. This support was a cover for the sensitive functions discussed above, and it provided DTESA with the opportunity to expand its customer base. Furthermore, it provided the DoD test and evaluation community an opportunity to observe DTESA's capabilities. DTESA's ultimate goal was to become a focal point for test and evaluation support within DoD, thereby providing a coordinated national test capability.

DTESA was initially under the oversight of the Deputy Director, Defense Research and Engineering (Test and Evaluation). In 1988, DTESA also reported to, and provided support to, the Director, Operational Test and Evaluation. The Air Force was the lead Military Department for administrative support.

Although DTESA was created to act as a support activity for the test and evaluation community and to acquire and manage foreign material, it made its procurement warrant readily available throughout DoD. DTESA became an organization that provided a means for expedient contracting through extensive use of sole source letter contracts with minimal customer justification. All of the Military Departments used DTESA for this purpose, and many of their requirements were not related to test and evaluation support.

In July 1990, the Deputy Secretary of Defense reorganized DTESA to refocus the organization on providing test and evaluation support to Defense-wide activities of the Under Secretary of Defense for Acquisition. DTESA's name was changed to the DESA. DESA is under the authority of the Deputy Director, Defense Research and Engineering (Test and Evaluation). The foreign commercial purchases of threat equipment were transferred to the Intelligence System Support Office under the Assistant Secretary of Defense (Command, Control, Communications and Intelligence). The Deputy Assistant Secretary of Defense (Intelligence) was authorized to maintain operational control over this activity. On a reimbursable basis, DESA will provide contracting support to this office.

DESA's funding for FY 1991 totaled $114 million. DESA received $100 million from other agencies primarily for contract support. As of July 1990, DESA had awarded 85 contracts totaling $665 million. DESA employed about 132 personnel, of whom 14 were contracting officers.

SCOPE

We selected and reviewed nine contracts and two delivery orders under a Basic Ordering Agreement. The 11 contract actions, totaling $145 million, were awarded from FY 1987 through FY 1990. This sample included four contracts awarded in FY 1990. We also reviewed the contracts that DESA had administered. Since 1986, DESA retained contract administration responsiblity on 33 of the 85 contracts awarded. We reviewed 29 of these contracts to evaluate DESA's administration of Government property furnished to contractors and its contract close-out procedures.

After our review of the two orders under the Basic Ordering Agreement, we found that neither order had been definitized within 180 days, and DESA had authorized payments up to the not-to-exceed price established when the orders were awarded. The Air Force Audit Agency had not identified this problem in its initial review but had identified the problem in the follow-up review. To determine if DESA was correcting the deficiency, we reviewed all payments made after May 1990 on undefinitized orders placed under the Basic Ordering Agreement MDA970-87-G-0013. We found that DESA had implemented a procedure that mandated a reduced time frame to definitize orders and a review process that would ensure that payments against undefinitized orders would comply with the Federal Acquisition Regulation (FAR).

This economy and efficiency survey was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were considered necessary. An issue related to several DESA contracts was referred to the Defense Criminal Investigative Service. The survey was conducted from June through December 1990. Activities visited or contacted are included in Enclosure 2.

INTERNAL CONTROLS

We evaluated the internal controls applicable to DESA's contracting operations. In assessing internal controls, we evaluated written policies and procedures, as well as mechanisms for internal review of contracting operations. Specifically, we reviewed the documented procedures prepared by DESA to ensure that they were consistent with the FAR. We also assessed DESA's compliance with regulations in awarding and administering contracts. We reviewed internal controls for DESA's Property Administration Division, since this Division was responsible for maintaining records on Government property furnished to contractors on DESA administered contracts. Finally, since DESA was an activity of the Office of the Secretary of Defense, we reviewed its implementation of the Federal Managers' Financial Integrity Act.

We found deficiencies in internal controls in the area of contract administration. Completed DESA administered contracts were not being closed in a timely manner, and Government furnished property was not properly controlled. We also found that DESA had not fully implemented the Federal Managers' Financial Integrity Act, as set out in DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987.

PRIOR COVERAGE

The Air Force Audit Agency issued Audit Advice 89-15, "Review of Financial and Procurement Operations, Defense Test and Evaluation Support Agency," June 29, 1989. The Advice covered concerns with DTESA's assigned mission, activities performed in support of the mission, and various aspects of the financial and contracting operations. The audit was conducted from January through March 1989. The Air Force Audit Agency recommended a reevaluation of DTESA's charter and scope of activities because the audit concluded that DTESA had overextended its capabilities by contracting for the nontest and evaluation needs of customers. The Air Force Audit Agency found problems with DTESA's routine use of sole source justification based on national security when the essential procurement documents were unclassified. The report also noted that DTESA had awarded contracts to unqualified contractors as well as making extensive use of unpriced contractual actions for expediency. To correct the deficiencies, the Air Force Audit Agency recommended that each procurement have a valid sole source justification; preaward evaluation of contractors' ability be performed; and letter contracts, if not eliminated, be definitized in a timely manner.

The Air Force Audit Agency conducted a follow-up review and issued Audit Advice 90-08, "Follow-up Review of Financial and Procurement Operations, Defense Test and Evaluation Support Agency," May 1990. The report concluded that management actions taken or planned were responsive to the main issues and recommendations of the 1989 Advice. Supplemental Report No. 90-09, "Authority for Sole Source Contracting, Defense Test and Evaluation Support Agency," recommended a legal review of the Director's authority to approve sole source contracts. A legal review, completed in September 1990, concluded that the Director, as the head of the contracting activity, had the authority to approve the issuance of sole source contracts.

Following the initial Air Force audit, the Office of the Assistant Secretary of Defense (Command, Control, Communications and Intelligence) reviewed DTESA and issued a report in August 1989. The report identifed problems concerning DTESA's internal management structure and oversight, which led to DTESA's reorganization.

FINDINGS AND RECOMMENDATIONS

A. Government Furnished Property. DESA had not adequately controlled and accounted for Government property furnished to contractors. We reviewed 29 of the contracts that DESA administered from FY 1986 through FY 1990 and found 14 contracts had Government property furnished to the contractor. In providing property, DESA had not complied with the FAR. For example, DESA did not insert appropriate clauses and property listings in the contracts. In addition, instead of requiring the contractor to maintain auditable property records, DESA maintained property records that did not provide an auditable trail of property transactions.

The FAR provides several contract clauses that can be placed in contracts where Government property is furnished to the contractor. These clauses protect the Government's interest by providing that the property be identified, controlled, and properly used for work performed under the contract. Four contracts that had property provided did not contain the appropriate property clause, and six contracts did not identify the property that had been provided under the contract.

Generally, the contractor is expected to maintain the official Government property records, with the contract administration office reviewing these records to ensure proper accounting of Government property. However, if the Government chooses to retain the responsiblity for maintaining the property records, it inserts the clause identified in FAR, 52.245-1. This clause modifies the principal Government property clause by deleting the requirement for the contractor to maintain the records. We discovered that six contracts, where DESA maintained the official Government property record, did not contain this clause.

FAR, 45.105(b), provides exceptions to the general provision that the contractor maintain the Government property records. When the contracting office retains administration, the contract may provide for the contracting office to maintain the Government records when the property is furnished for repair or servicing and return to the shipping organization, for use on Government installations, or under a local support service contract. Additional exceptions include contracts involving property having an acquisition cost of less than $50,000 or contracts of short duration. Most of the contracts that contained property and that DESA administered met the specific exceptions. However, we found that DESA was maintaining the official property records for a contract (MDA970-89-C-0012) that provided $311,000 in Government property. Although FAR, 45.105(b)(5), provides that the contracting officers can choose to maintain the Government property records if they decide it is in the Government's best interest, we could not find any reason why the exceptions under 45.105(b) would apply to this contract.

FAR, 45.505(c), states that official Government property records must identify all Government property and provide a complete, current, auditable record of all transactions. DESA's records did not provide for an auditable trail of property transactions. Property records were maintained by the DESA Property Manager, who was responsible for maintaining property records for all Government property under DESA's control, regardless of whether it was provided to a contractor. This individual did not change his recordkeeping practices to account for property in the hands of contractors. For example, according to the DESA Property Manager, after a new inventory was completed, the prior year's inventory sheet was destroyed. This precluded a continuous and auditable year-to-year trail for the Government property provided to contractors.

Since DESA had not used the proper Government property clauses in contracts, recorded Government property furnished to contractors in the contracts, maintained property records that contractors should have maintained, and maintained auditable property control records, Government property valued at about $406,000 is subject to loss or misuse.

Recommendations

We recommend that the DESA Director:

1. Review all contracts to determine if Government furnished property is involved, and after the review, ensure that the correct property management clauses and property lists are contained in the contract.

2. Require contractors to maintain the official Government property records in accordance with Federal Acquisition Regulation, 45.105 (a). Document exemptions to the policy, allowed in Federal Acquisition Regulation, 45.105 (b), in the contract administration file.

3. Maintain past years' inventory listings and reconcile contractor's Government furnished property inventory yearly.

B. Contract Close-Out. DESA had not closed completed contracts within the time frames established by the FAR. The primary reason for the delay in closing contracts was that the process had not been assigned a high priority in the contracting officers' schedules. Delays in closing contracts may cause the Government to forfeit its ability to recapture prior overpayments and increase the risk of loss or misuse of Government furnished property. In addition, with the loss of "M" account funding options, future delays could result in unbudgeted final payments being made from current year funds.

FAR, 4.804-5, specifies that the administrative contracting officer is responsible for contract closeout. FAR, 4.804-1(2), provides for closing fixed-price contracts within 6 months of the contracting officer receiving evidence of physical completion. We found that 12 firm-fixed-price contracts, valued at $4.1 million, were physically complete but not closed. Six of these open contracts had been physically complete since 1988.

FAR, 4.804-1(3), provides for closing cost type contracts within 36 months of their completion. We found 6 completed cost contracts, valued at $15.9 million, for which DESA retained contract administration responsiblities. In order to close out a cost type contract, the administrative contracting officer must request that the Defense Contract Audit Agency (DCAA) audit the costs incurred. Although none of the 6 cost contracts had been completed for more than 36 months, 2 contracts had been completed for more than 2 years. Of the six contracts requiring a DCAA audit, only one had evidence in the contract file that an audit had been requested.

Lengthy delays in closing contracts can result in losing excess funds that are not deobligated in time to be reprogrammed; risking that overpayments will not be recovered; increasing the risk of loss or misuse of Government furnished property; and risking the need to have to pay old obligations from current year appropriations, thereby impacting current procurements. Since the consequences of failing to promptly close contracts are significant, the President's Council on Integrity and Efficiency is assessing the current status of contract closeouts throughout the Government to identify means of expediting the process. Preliminary indications are that contract closeout is a systemic Government-wide problem requiring immediate attention, particularly in light of the new fiscal realities.

Recommendations

We recommend that the DESA Director:

1. Close the backlog of completed firm-fixed-price contracts by fiscal year 1992.

2. Request audits and develop a plan to close the backlog of completed cost contracts.

3. Develop and monitor a system to track the contracting officer's success in closing fixed-priced contracts within 6 months and cost contracts within 36 months of completion.

4. Reflect accomplishment of contract closeouts in contracting officer's performance appraisal.

C. Federal Managers' Financial Integrity Act. DESA had not implemented an internal control program, as required by the Federal Managers' Financial Integrity Act. This occurred because the Deputy Director, Defense Research and Engineering (Test and Evaluation), did not include DESA in its own internal control program. The omission occurred because of a lack of understanding on the part of the Deputy Director on how the Federal Managers' Financial Integrity Act should be implemented. As a result, management might have detected and corrected many of the problems experienced by DESA earlier if they had taken responsibility for the internal control of their organization.

The Federal Managers' Financial Integrity Act of 1982, as implemented by Office Of Management and Budget Circular A-123 and DoD Directive 5010.38, requires DoD Component heads to establish an internal management control program, prepare guidance for assessing internal controls, and report annually to the Secretary of Defense in a statement of assurance. Guidance on the program for the Office of the Secretary of Defense Component is contained within OSD Administrative Instruction No. 90.

The responsiblity for ensuring that DESA was included in the Internal Management Control Program rested with the Deputy Director, Defense Research and Engineering (Test and Evaluation). The Internal Management Control Program flows down through an organization. The Office of the Director of Administration and Management administers the Internal Management Control Program for the Office of the Secretary of Defense. The Director has identified the principals within the Office of the Secretary of Defense responsible for the Program, one of which is the Under Secretary of Defense for Acquisition. The principal is responsible for carrying out the requirements of the Internal Management Control Program within his or her organization to include subordinate DoD field activities. Within the Office of the Under Secretary of Defense for Acquisition, the program requirements flow down to the Deputy Director, Defense Research and Engineering (Test and Evaluation), through the Director, Defense Research and Engineering. The Deputy Director had management and oversight responsibility for DESA since its creation in 1986. The Deputy Director did not communicate the requirements of the Internal Management Control Program to DESA.

Although DESA had not been formally tasked by the Deputy Director, Defense Research and Engineering (Test and Evaluation), to implement an Internal Management Control Program, DESA developed and issued guidance in November 1, 1990, to implement a program and plans to submit its first statement of assurance in October 1991. Had the program been previously implemented, DESA might not have experienced the problems in its contracting operations that have been reported in the past 2 years.

Recommendations

We recommend that the Deputy Director, Defense Research and Engineering (Test and Evaluation):

1. Include the Defense Evaluation Support Activity in its Internal Management Control Program.

2. Train managers designated as responsible for the implementation of the Federal Managers' Financial Integrity Act on the Act's requirements and responsiblities.

MANAGEMENT COMMENTS AND AUDIT REPONSE

The Director, Special Programs, Office of the Under Secretary of Defense for Acquisition, provided comments on May 23, 1991, that stated concurrence with all the report's recommendations. The comments are contained in Enclosure 1. The Director provided dates when actions were taken or planned to be taken that would correct reported deficiencies. This information will faciliate followup by the Office of the Inspector General. However, the Director's comments on Recommendation A.3. showed that there was a misunderstanding on the intent of the recommendation. We recommended that DESA maintain past year inventory listings and reconcile the inventory yearly. The Director responded that DESA's destruction of the inventory records was in accordance with Air Force Regulation 12-50, volume II, table 67-11, rule 40, which allows for the destruction of superceded material unpon receipt of updated listings. We reviewed the cited Regulation and found that it applies to records of property being transferred within the Air Force; however, it does not apply to records controlling property furnished to contractors. Air Force Regulation 12-50, volume II, table 70-5, rule 26, applies to records of Government property furnished to contractors. This guidance requires that reports be destroyed 1 year after the property is returned to the Government or disposed of by other means.

The intent of the recommendation was to bring DESA into compliance with the FAR assuming DESA still chose to maintain the official Government property records. The FAR requires that the official Government property records be complete and provide an auditable trail. DESA's annual destruction of the inventory listing and its current recordkeeping system do not provide an auditable trail. Maintaining the annual inventory list, with a reconciliation, would be the minimum requirement for auditable Government property records. The DESA Director should implement a procedure to maintain the inventory records of Government property furnished to contractors, and these records should be reconciled annually to ensure that they are accurate.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Office of the Under Secretary of Defense for Acquisition must provide final comments

on the unresolved recommendation. As required by DoD Directive 7650.3, the comments must indicate concurrence or nonconcurrence in the finding and each recommendation addressed to you. If you concur, describe the corrective actions taken or planned, the completion dates for actions already taken, and the estimated dates for completion of planned actions. If you nonconcur, state your specific reasons for each nonconcurrence. If appropriate, you may propose alternative methods for accomplishing desired improvements. Since you did not specifically comment on the internal control weaknessess identified in the draft report, we ask that your comments on the final report indicate concurrence or nonconcurrence with the internal control weaknesses identified in Recommendations A.3. and B.3.

Recommendations are subject to resolution in accordance with DoD Directive 7650.3, in the event of nonconcurrence or failure to commment. Your comments must be received by August 16, 1991. This report does not claim any monetary benefits.

The courtesies extended to the audit staff (identified in Enclosure 3) are appreciated. If you have any questions on this audit, please contract Ms. Kathleen M. Stanley at (703) 693-0551 (DSN 223-0551). The planned distribution of this report is contained in Enclosure 4.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosures

OFFICE OF THE UNDER SECRETARY OF DEFENSE
WASHINGTON, DC 20301

23 MAY 1991

ACQUISITION

MEMORANDUM FOR DEPARTMENT OF DEFENSE INSPECTOR GENERAL

SUBJECT: Response to Draft Report of the Survey of Contracting Operations at the Defense Evaluation Support Activity (Project No. OAD-0074, dated March 18, 1991

The Draft Report was reviewed by the USD(A) staff and the Defense Evaluation Support Activity (DESA). The following comments are provided:

a. Government Furnished Property: We concur with these recommendations.

Response: (1) By 15 April 1991, a review of all active contracts had been completed. The review of each contract was conducted by the Procuring Contracting Officer (PCO), the responsible program representative and the DESA property accountable officer.

(2) As a result of that review, all contracts now formally reflect what government property, if any, is accountable under it; however, the Government Property may change because this is an on-going process. Contracts were modified where necessary, and each now contains the correct property management clause.

(3) Any exceptions to FAR 45.105(a) have been and will be in the future documented with a memo from the PCO and filed in the official contract file.

(4) Inventory of all custodial accounts are conducted yearly. The Custody Receipt Inventory List is signed by the appointment property custodian and placed in DESA's custodian file. At the same time a copy is placed in the appropriate contract file. Also at this time, the custody receipt listing in file from the past year's inventory is pulled and destroyed. This procedure is in accordance with AFT 12-50, Vol II, Table 67-11, Rule 40. (Destroy superseded material upon receipt of updated listing.)

b. Contract Close-Out: We concur with these recommendations.

Response: (1) As of this date, 30 April 1991, all physically complete firm fixed price contracts have been closed and have the appropriate close-out forms (DD 1594/DD 1597) in the contract file.

(2) As of this date, 30 April 1991, all physically complete cost reimbursement contracts have letters to the appropriate DCAA office requesting final close-out audits be conducted. We can do nothing more pending receipt of these audit reports. Upon receipt, we will expeditiously negotiate a final settlement and formally retire the contract.

(3) Under the reorganized DESA contracting function, the Contracting Policy and Support Division will establish and monitor a suspense system to help ensure the timely close-out of all DESA contracts.

(4) While contract close-out activities are important they are only one of a large number of equally important Contracting Officer's responsibilities that are evaluated for performance purposes. Timely close-out action within the control of the PCO will be duly considered as part of that overall responsibility.

c. Federal Manager's Financial Integrity Act: We concur with these recommendations.

Response: (1) DESA will be included in the Deputy Director of Research and Engineering (Test & Evaluation) Management Control Program.

(2) DESA's IMCP Manager has been scheduled to attend the training required for the program. LTC Montoya is scheduled to attend the Internal Control Systems Training at the Washington, D.C., Thomas Circle Training Facility, 6-9 May 1991. In addition, personnel from our Management Control Committee are being scheduled for attendance at future courses.

d. Classification:

(1) In the Background Section, on page 2, the 4th full paragraph, delete the 3rd sentence in its entirety.

(2) Once the sentence discussed above is deleted the rest of the report should be unclassified since the program which you reviewed was declassified as of 5 July 1990.

Dennis. A. Jones
Rear Admiral, U. S. Navy
Director of Special Programs

ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Washington, DC
Assistant Secretary of Defense (Command, Control, Communications and Intelligence), Washington, DC
Director, Operational Test and Evaluation, Washington, DC
Director, Defense Research and Engineering, Washington, DC
Deputy Director, Research and Engineering (Test and Evaluation), Washington, DC

Department of the Army

Army Missile, Space, and Intelligence Command, Huntsville, AL

Department of the Air Force

Office of the Administrative Assistant, Washington, DC
Air Force Audit Agency, Washington, DC
Defense Evaluation Support Activity, Kirtland Air Force Base, Albuquerque, NM

Defense Agencies

Defense Test and Evaluation Support Agency, Albuquerque, NM
Headquarters, Defense Logistics Agency, Alexandria, VA
Defense Logistics Agency, Defense Contract Administrative Services Region, Atlanta, GA
Defense Logistics Agency, Defense Contract Administrative Services Region, Huntsville, Al

Contractors

The BDM Corporation, Washington, DC
Verac, Inc., Ball Systems Engineering Division, Albuquerque, NM

AUDIT TEAM MEMBERS

Donald E. Reed, Director, Acquisition Management Directorate
Kathleen M. Stanley, Program Director
William R. Harshman, Team Leader
Alma J. Wolfe, Team Leader
William Scott Harris, Auditor
Jean C. Hill, Auditor
Joyce S. McCutcheon, Auditor

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House Subcommittee on Defense, Committee on Appropriations
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House Committee on Armed Services
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations