



Testimony



STATEMENT OF
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DEPUTY INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
BEFORE THE
SUBCOMMITTEE ON
READINESS AND MANAGEMENT SUPPORT
OF THE
SENATE COMMITTEE ON THE ARMED SERVICES
ON
DEFENSE ACQUISITION

Report No. D-2000-118

DELIVERED: April 26, 2000

Office of the Inspector General
Department of Defense

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to testify before you today on current issues regarding Defense acquisition management. Although the Department has been continuously improving the acquisition process for at least 20 years, there has been intensified interest and effort during the past several years. The demands of post-Cold War Defense downsizing and the dramatic revolution in business affairs created urgent need for acquisition reform.

The Defense Reform Initiatives are the Department's corporate strategy to adapt better business processes, pursue commercial alternatives and eliminate redundancy through consolidation and streamlining. The Department has also adopted a vision of becoming a world-class buyer of best value goods and services from a globally competitive industrial base. In this regard the DoD hopes to achieve this transformation through rapid insertion of commercial technology, basic business process improvements, creating a workforce that is continuously educated and retrained to operate in new environments and institutionalizing improvements through change insertion. In order to fulfill these goals, the Department has initiated an unprecedented number of major improvement efforts across the spectrum of DoD activities, including at least 40 significant acquisition reform initiatives. The Department has made notable progress in acquisition reform and has also set several commendable goals. Examples include:

- de-emphasizing overly detailed military specifications and standards;
- using credit cards for nearly 9 million small purchases in FY 1999;
- pushing for public and private sector implementation of public key infrastructure technology to enable secure electronic commerce;
- replacing multiple, inconsistent, government-unique requirements imposed on contractors holding more than one Defense contract with common, best, facility-wide processes; and
- establishing aggressive weapon system unit cost and total ownership cost targets, which are 20 to 50 percent below historical norms.

However, in the midst of this reform, the business of creating and sustaining the world's most powerful military force remains

expensive and vulnerable to fraud, waste and mismanagement. In FY 1999, the DoD bought about \$140 billion in goods and services, in 14.8 million purchasing actions, which means 57,000 purchasing actions on an average working day. The scope, complexity, variety and frequent instability of Defense acquisition programs pose particularly daunting management challenges. In the rush to streamline and incorporate commercial practices and products, the Department cannot compromise its insistence on quality products and services at fair and reasonable prices. An inherent challenge throughout the Department's acquisition reform effort is ensuring that critically needed controls remain in place and that we have proper oversight and feedback on new processes.

Inspector General Role in Acquisition Reform

Since its establishment in 1982, the Office of the Inspector General, DoD, has issued hundreds of audit reports identifying problems in Defense acquisition programs and opportunities for improving efficiency and effectiveness. In addition, the principal focus of the Defense Criminal Investigative Service, the criminal investigative arm of the Office of the Inspector General, DoD, has always been procurement fraud, in its various forms. For instance, we currently have over 660 open cases involving procurement fraud, which include allegations of product substitution, cost mischarging, defective pricing, kickbacks and Buy America Act violations, as well as false claims. Based on the many risks, vulnerabilities and problems identified by our audit and investigative effort, the Office of the Inspector General, DoD, has been in the forefront of those calling for improved management across the spectrum of Defense acquisition activities, from initial requirements determination to the purchase and delivery of goods and services.

Acquisition audits and investigations provide insight into how well individual programs and contracts are managed. Many of them also provide independent feedback as to how well the Department's overall acquisition policies and applicable laws or regulations are being implemented, and whether they are having their intended effect. Audits are particularly useful for verifying that reported performance information is accurate and whether previously identified problems have been corrected.

Unfortunately, in recent years our oversight of Defense acquisition has been severely constrained by resource shortfalls and conflicting priorities. I am concerned that audit and investigative coverage has been inadequate in nearly all Defense

management sectors that we and the General Accounting Office have identified as high risk areas. Given the Department's aggressive transformation efforts, an appropriate level of oversight is now more critical than ever.

The DoD lacks a broad, systematic program of comprehensive independent audit of acquisition programs. Currently, less than ten of the several hundred weapon system projects are being comprehensively reviewed by DoD internal auditors each year. The same holds true for the 79 major information system development and modification projects and hundreds of smaller information technology projects. Whereas the Department spent \$51.8 billion for consultants and other support services in FY 1999, there have been only a few recent audits on management controls with respect to contracting for services. Finally, there is limited independent information available on the progress of the 40 acquisition reform initiatives and the need for other initiatives.

In addition to audit and investigative efforts, the IG role in acquisition management improvement includes reviewing all proposed legislative and regulatory changes. The Department has been generally responsive to our advice on such matters and congressional committees also request our views on acquisition legislation issues on a routine basis. Similarly, we support various cross-functional teams and task forces established by the Department to study acquisition issues, identify opportunities for reform, develop implementation strategies or monitor progress. Assisting in those efforts is a high priority for us and we currently have senior audit personnel participating as team members or advisors for 16 acquisition or logistics reform teams, such as the Acquisition Reform Senior Steering Group, Acquisition Deskbook Working Group, Joint Contracting Pilot Program, and a team working on long term pricing arrangements for spare parts.

While my office does play a vital role in the Department's ongoing improvement activities and reform efforts, our coverage is sorely inadequate. The heavy workload of the last two years created by the successful DoD Year 2000 conversion effort, which my office supported with over 180 audits, is now behind us and we are trying to redress the imbalances in coverage caused by that extraordinary effort. We continue to weigh the need to improve coverage in the acquisition area against other urgent oversight priorities in such critical areas as information security, readiness and financial reporting. In 1999 alone, DCIS opened 235 procurement fraud related investigations.

Our resources are simply inadequate to provide the kind of comprehensive oversight needed to successfully navigate this era of sweeping reform. Last year, the Department recognized this shortfall and decided not to proceed with most of a previously planned IG budget reduction. The number of IG employees had already been reduced by 26 percent since 1995. Despite Departmental efforts, however, the appropriations committees opted to cut our FY 2000 request, hampering our ability to provide an appropriate level of oversight of vital areas such as acquisition. We hope to better articulate our resource situation this year and to achieve congressional support of our FY 2001 budget request. In the interim, let me assure you that we do work closely with other oversight organizations such as GAO, DCAA and the Service audit and investigative agencies to ensure we are optimizing available resources.

Special Emphasis Areas

Let me amplify on some of our recent audit work in Defense acquisition. This Subcommittee has a clear understanding of the myriad of challenges inherent in determining what forces, capabilities and underpinning support infrastructure are needed to implement the national security strategy. To assure success across the spectrum of conflict, Defense managers must decide what information systems, supplies and other logistical support are needed; what these required goods and services should cost; what is affordable; what acquisition strategy would achieve the best results; and so forth. Today I would like to focus on four aspects of these major issues, highlighting results from our recent audit reports that are listed in the attachment to this statement. Specifically, I will discuss contracting for services, spare parts pricing, acquisition workforce reductions and other transactions.

Contracting for Services

Issues related to Defense weaponry and other equipment attract the most oversight emphasis and publicity, yet the annual DoD expenditures for contractor services (rather than goods) constitute a huge acquisition program in their own right. From FY 1992 through FY 1999, DoD procurement of services increased from \$39.9 billion to \$51.8 billion annually. The largest sub-category of contracts for services was for professional, administrative, and management support services, valued at \$10.3 billion. Spending in this sub-category increased by

54 percent between 1992 and 1999 and will probably continue to grow as outsourcing initiatives expand.

Deliverables from contracts for services often are not as tangible as hardware, such as a missile or even a set of tires. Quantifiable information on requirements, performance and costs is frequently harder to develop, and overworked contracting personnel are more likely to give priority attention to equipment procurements than to mundane contracting actions for consulting services or information systems support. Also, except for travel and transportation services, the increased efficiencies derived from e-commerce pertain much more to goods than to services. We believe that, because of these factors, DoD managers and contracting personnel were not putting sufficient priority during the 1990's on this sector of Defense acquisition. Likewise, this area was virtually ignored for the first few years of acquisition reform efforts. Consequently, we believe the risk of waste in this area is higher than has been commonly realized.

The awareness of the need for more emphasis on services contracts has been growing over the past year, in part because of two major audits, whose results I would like to summarize for you.

Multiple Award Task Order Contracts. The Federal Acquisition Streamlining Act authorized agency heads to enter into multiple award delivery and task order contracts for procuring goods and services. Multiple award contracts occur when two or more contracts are awarded from one solicitation. Generally these contracts have broad scopes and dozens of subsequent task orders are awarded by the Government over the life of the contract. The Act established a general preference for using multiple awards and mandates their use for advisory and assistance services contracts exceeding \$10 million and 3 years duration. The Act also stipulates that contractors on a multiple award arrangement are to be provided a "fair opportunity to be considered" for individual task and delivery orders over \$2,500.

Multiple award contracts are excellent tools for avoiding duplicative solicitations and accelerating the contracting process. Their advantages are degraded, however, if the individual task and delivery orders are inappropriately sole-sourced or poorly priced.

In April 1999, we reported the results of an audit of 156 orders, valued at \$143.7 million and placed on 12 multiple award

contracts between 1995 and 1998. Whereas we found few problems with the 32 delivery orders for goods, there were significant problems with the 124 task orders for services. Specifically:

- Contracting officers awarded task orders without regard to price. Price was also not a substantial factor in the selection of vendors for the initial multiple award contract. As a result, higher-priced contractors were awarded 36 of the 58 task orders competed. We identified \$3 million in additional costs resulting from awarding orders to contractors with higher-priced bids.
- Contracting officers directed work and issued orders on a sole-source basis for 66 task orders, valued at \$47.2 million, without providing the other contractors a fair opportunity to be considered. Only 8 of the 66 orders had valid justification for sole-source award. Eleven of the 66 had no justification at all. As a result, DoD almost certainly paid higher prices than would have been the case if competition had been sought.

These problems were caused by a variety of factors, including difficulty in establishing pricing on the multiple award contracts at the time of award, because requirements for the number and scope of subsequent task orders were not well understood. Contractors also were not sure of the amount of work they would receive, making it hard to forecast costs. Regarding the failure to compete task orders, I believe the root causes were lack of clear guidance, pressure to make task order awards rapidly, and excessive workload in some contracting offices, which deterred contracting personnel from questioning sole-source preference input from program managers.

In response to the audit findings, the Director for Defense Procurement has been gathering information from the Military Departments on the need to establish a competition goal for task orders on multiple award contracts--we had suggested that a goal of 90 percent would be advisable. The Director also issued a memorandum in April 1999 calling the audit results to the attention of senior acquisition officials and emphasizing the need to consider price. The Congress took action by mandating in Section 804 of the National Defense Authorization Act for FY 2000 that the Federal Acquisition Regulations be revised by April 2000 to improve guidance on the appropriate use of task order and delivery order contracts. We have seen the draft changes proposed for the Federal Acquisition Regulation and agree they will help correct the reported problems. We have

been gratified by the interest shown in our report and the action by the Congress and Executive Branch.

Other Problem Indicators. In light of the problems found during our work on multiple award task order contracts and various other, more narrowly scoped audits, we undertook a comprehensive effort last year to look at services contracts. We reviewed 105 Army, Navy and Air Force contracting actions, valued at \$6.7 billion, for a wide range of professional, administrative and management support services amounting to about 104 million labor hours, or 50,230 staff years. We were startled by the audit results, because we found problems with every one of the 105 actions. The specific problems included:

- Failure to use prior history to define requirements, which must be done before a clear statement of work can be written and the appropriate contract type can be chosen (58 actions);
- Poor Government cost estimates (81 actions);
- Cursory technical reviews (60 actions);
- Inadequate competition (63 actions);
- Failure to award multiple award contracts where required by law (7 actions);
- Incomplete price negotiation memorandums (71 actions);
- Inadequate contract surveillance (56 actions);
- Lack of cost controls (21 actions);

The following examples illustrate some of these problems:

- On a sole source Navy cost contract for \$73 million that was renewed annually with the same contractor for 25 years, the contract file stated that cost of performing the work could not be forecasted to make the contract fixed-price. This rationale was not convincing.
- A contracting officer identified \$5.7 million in requirements for a fixed-price contract for the Air Force. The Air Force told the contracting officer to add \$2.2 million to a time and materials line item to use up available funding. There was nothing in the file to show rates, hours or labor categories to support the "plug in" figure.
- One sole-source task order contract for professional services awarded for \$19,871 was increased to \$642,199 to add requirements for the contractor to buy things such as

furniture and computers. The Army was entitled to four free laptop computers from a quantity discount for the computer purchase. The Army gave the computers to the contractor, asking no consideration in return. Because of the added costs, furniture and computers should never be purchased on an unrelated contract for professional services.

- One contracting officer arbitrarily determined which contractors would get 12 task orders on a sole-source basis. Another contracting officer followed the request of the program office to award 30 task orders sole-source with appropriate justification.

Lack of adequate staff and training for service contracting were also evident by the following examples:

- One person who was responsible for contract administration of 43 contracts valued at \$621 million told us that he actually spent most of his time working on the upcoming award of 13 contracts valued at \$115 million. Another contract had no contracting officer assigned for 6 months prior to the audit.
- None of the 25 contracting personnel interviewed had received training in service contracts. Further, one contracting officer did not understand how to correctly apply the Truth in Negotiations Act to a \$1.3 million sole-source cost type task order.
- Because of constant personnel turnover and inexperienced staff on one \$6 million sole-source contract, the DoD had to rely on the contractor data to tell them if the fee and hours were fair and reasonable.

It was impossible to quantify the monetary impact of these deficiencies, but clearly waste was occurring. Further complicating the problem, there were no performance measures in use to judge the efficiency and effectiveness of the services rendered.

We made numerous recommendations to management to address these problems, stressing the paramount need for more effective training. Many cost reimbursable contracts for repetitive tasks should be converted to more economical fixed price contracts. We also endorsed establishing centers of excellence, which in this case would be specialized contracting organizations or

cadre, as a means of developing in-depth expertise on services markets and on services contracting techniques. We understand that this concept has proven highly beneficial for private sector businesses that purchase large volumes and varieties of contractor services. The Department agreed with our recommendations.

Recently we have noted a welcome upswing in interest and activity regarding contracting for services and we assisted in efforts such as developing a Performance Based Service Acquisition Training Class. We agree with the Federal Procurement Executives Council and DoD that performance based acquisition strategies should be heavily emphasized when contracting for services and we support the goal of making half of services contracts performance based by 2005. We welcome recent DoD initiatives for putting information such as a guide for performance based service acquisitions on the web and establishing a baseline and measures for tracking progress on expanding the performance based approach.

Continuing Spare Parts Pricing Issues. In early 1998, we began issuing a series of audit reports on prices paid for aviation spare parts and equipment. As you may recall from your hearings at the time and intermittent publicity since, we found that prices paid under new, commercial type contracting arrangements were considerably higher than was the case when the same items were procured previously under "traditional" Defense contracts or ordering agreements. In one case, DoD paid modestly discounted, but still excessive, contractor catalog prices that were \$4.5 million (280 percent) higher than fair and reasonable prices for \$6.1 million of commercial items from one supplier.

Although the Department has been generally responsive to the problems that we have identified on individual contracts, new examples continue to surface as we do additional audits. We have issued 5 more reports on spare parts in the last two years. One report provided good news and the other four described problems. Most recently, in a pair of reports issued last month, we discussed pricing in a prototype contract for supply support from what the DoD refers to as a virtual prime vendor. Under this concept, one vendor anticipates DoD needs for a specified list of commodities and assumes responsibility for having inventory on hand to meet those needs, using a range of modern commercial business practices and techniques. Theoretically, considerable savings should result from shifting the burden of carrying inventory to the vendor.

As with many prototypes, some of the terms of this particular contract proved to be flawed. The audit indicated that DoD was paying on average 38 percent more than necessary for a variety of aviation components and spares. The most egregious example was propeller blade heaters for C-130 and P-3 aircraft. We calculated that the \$1.4 million paid in 1998 for blade heaters ranged from 124 to 148 percent more than fair and reasonable prices.

Although some DoD officials insist that we underestimated the value of services being provided by prime vendors, this is not the case and our followup efforts have confirmed that claims related to improved parts availability because of the virtual prime vendor contract are unsupported. I am somewhat constrained in my ability to discuss the details further because we have not completed the process of identifying contractor proprietary data in the two reports so that sanitized versions can be released outside the Government. I can say, however, that we are pleased that the Department agreed with our recommendations to seek voluntary refunds; develop alternative sources, where prudent; resolve technical data rights ownership questions; cease paying prices that included contractor royalties; and transition to an entirely different contracting approach, namely, a long-term strategic supplier alliance based on more sophisticated analysis of logistics support requirements. In fact, initial meetings with the contractor to explore that approach were held during the audit. We are assisting the Department in moving forward into a new generation of corporate contracts that should provide better value for the taxpayer and fair profits for the suppliers.

There are a variety of problems to be addressed in spare parts procurement. First, the Government must learn to be a smarter buyer in terms of pooling its purchases to maximize its market leverage, enable in-depth market research by specialists and use economic order quantity approaches where feasible. Everything possible must be done to maximize competition and avoid sole-source situations. Virtually all of the pricing problems identified by our audits arose on sole-source contracts. Further, the Government should consider root causes of poor purchasing decisions: under-staffing in DoD procurement offices, unreliable inventory data, inadequate training and incomplete guidance. Long term pricing arrangements should be pursued with key suppliers, with mutual incentives for price reduction. Lastly, contracting officers should use the tools already made available by the Congress--including the ability under the Truth in Negotiations Act to obtain certified

contractor cost data--to ensure fair pricing in sole-source procurements. For commercial items, to which the Truth in Negotiations Act does not apply, contracting officers can still negotiate good prices on the basis of uncertified cost data. Some DoD acquisition officials discourage them from doing so, but offer no practical alternatives for situations where no competitive market forces exist to drive down prices.

Response to Audits and Congressional Direction for Spare Parts

The Department has initiated a concerted training effort to help in buying commercial items, which will be useful where a competitive commercial market exists.

In a report issued in July 1999, we recommended the Department issue guidance for negotiating fair and reasonable prices for sole-source spare parts called commercial items. To date, we have not received an adequate response from the Department. We were told the Department's Price-Based Acquisition Study Report would contain the requested guidance, but that did not occur. We are also waiting for the Department to issue a Commercial Item Handbook and hold a workshop on parametric cost estimating. These actions are needed to address findings in an audit report issued in February 1998.

Sections 803(a) and 808 of the Fiscal Year 1999 Authorization Act required changes to the Federal Acquisition Regulation to address problems we reported on overpriced spare parts in March 1998. The changes are not yet published. We have seen the draft changes and, although we agree with many of them, we do not believe they will fully address the problems of overpriced commercial spare parts. The draft guidance does not adequately address the statutory requirement to provide information other than certified cost or pricing data. Our audits found that doing price analysis, market research and reviewing contractor sales data were ineffective tools to determine price reasonableness for sole-source commercial spare parts.

Section 803(b) of the FY 1999 Authorization Act required the Under Secretary of Defense for Acquisition, Technology and Logistics to develop and implement procedures on unified management of commercial items so that more efficient DoD purchasing strategies would be possible. No procedures have been developed or implemented to date. The Department is working on unified management of sole-source spare parts with one contractor and we strongly support that initiative; however, the overall guidance gap remains.

The Department has performed the commercial price trend analysis required by Section 803(c) of the FY 1999 Authorization Act. The first annual report on the price trend analysis for the Defense Logistics Agency showed that commercial item prices, especially those that are sole-source, increased at a much greater rate than prices for noncommercial items. The Services' price trend analyses were not as rigorous. Additional, more detailed work is needed by the Department to improve the scope, depth and consistency of those analyses. Nevertheless, we believe these price trend reports can be developed into very useful tools for both the DoD and Congress.

Acquisition Workforce Issues

Having made previous references to problems caused by the lack of contracting workforce capacity and training, I would like to call your attention to our recent report on the DoD Acquisition Workforce Reduction Trends and Impacts.

The DoD reduced its acquisition workforce from 460,516 people in September 1991 to 230,556 in September 1999, a reduction of 50 percent. Further cuts are likely and, in fact, one of this year's Defense acquisition goals is to achieve another 15 percent reduction in the DoD acquisition related workforce. If workload had been reduced proportionally, eliminating half of the acquisition positions could be regarded as a positive achievement. Unfortunately, this has not been the case. From FY 1990 through FY 1999, the value of DoD procurement actions decreased about 3 percent, from \$144.7 billion to \$139.8 billion. However, the number of procurement actions increased about 12 percent, from 13.2 million to 14.8 million. The greatest amount of work for acquisition personnel occurs on contracting actions over \$100,000, and the annual number of those actions increased about 28 percent from FY 1990 to FY 1999, from 97,948 to 125,692.

We surveyed 14 of the 21 major acquisition organizations and found this growing imbalance between resources and workload to be a major concern. Acquisition personnel advised us that the adverse consequences include:

- skill imbalances (9 organizations), and
- insufficient staff to manage requirements efficiently (9 organizations),

- increased program costs resulting from contracting for technical support versus using in-house technical support (7 organizations),
- difficulty retaining personnel (6 organizations),
- reduced scrutiny and timeliness in reviewing acquisition actions (4 organizations),
- increased backlog in closing out completed contracts (3 organizations),
- lost opportunities to develop cost savings initiatives (2 organizations).

Our audit report contains various examples of problems related to the reduced workforce. The following are illustrative of those examples:

- The Defense Contract Management Command's lack of engineering and quality assurance presence in plants producing space launch vehicles caused the Command to express concern in its annual statement of assurance on management controls. The Command stated that, when it stopped inspections of all procedures in some plants, so did the contractor. Recent failures with hardware in the Space Program caused concern that the Command may have reduced the quality assurance program too much.
- The Defense Logistics Agency stated that complaints about the quality of material received have increased; however, it has placed less emphasis on responding to customer complaints because of workforce reductions.
- Reduced staffing in an Army organization caused the organization to give little attention to reducing backlogs in processing quality deficiency reports and equipment improvement reports.
- An Army organization said loss of expertise impacted efforts to develop price analysis in a timely manner and reduced oversight increased the risk that contracting actions were not properly executed.
- Lack of in-house engineering staff at an Army acquisition organization caused an increase in customer costs of \$20,000 to \$50,000 per each work year of support services for weapons programs because of the need to hire contractors to perform the work.

- Another organization stated it was missing opportunities for savings of \$20 to \$30 million annually because value-engineering workshops were drastically reduced by staffing reductions.

This appears to be a conservative summary of the overall impact of this problem and, if further downsizing occurs, these staffing management problems and performance shortfalls can only get worse.

Likewise, there is cause for serious concern in the likelihood of the DoD acquisition workforce losing about 55,000, or 42 percent, of its 129,000 personnel in key job series through attrition by FY 2005. Also, there are overall disconnects between workload forecasts, performance measures, productivity indicators, and plans for workforce sizing and training.

In a general sense, DoD acquisition workforce reductions are part of the overall downsizing of the Federal and Defense workforce. However, Congress has singled out the DoD acquisition population for separate downsizing emphasis, while allowing the Secretary of Defense considerable latitude in implementing reductions. We hope that our report will encourage both the Congress and the Department to take stock of the long-term human capital requirements in this crucial area. The Department's response to the report was positive and there appears to be growing awareness of the serious risks related to the Defense acquisition staffing outlook.

A reasonably sized, well-trained and highly motivated workforce is by far our best safeguard against inefficiency, waste and fraud.

Other Transactions

The last area that I would like to discuss today involves special purchasing arrangements known as other transactions. Other transactions were authorized to encourage commercial firm, who otherwise might not contract with the Government, to join with the Department on research and development efforts. Other transactions are exempt from the usual controls and oversight mechanisms set forth in acquisition statutes and the Federal Acquisition Regulation.

There are two types of other transactions authorized by law. The first, used for basic, applied and advanced research, are called research other transactions. These arrangements pair DoD

with a single company or a consortium of companies and require the companies to contribute at least 50 percent of the costs. The Department, however, can waive the 50 percent cost share. The second type are called prototype other transactions. These do not require cost sharing and may be used to develop prototypes for weapons, information systems, major end items such as ships and miscellaneous equipment like helicopter blades.

The intent of using other transactions is to attract new contractors to DoD. The results are mixed with respect to the Department's success in attracting new contractors through the use of other transactions. Through FY 1999 there were 265 research other transactions valued at \$3 billion. The research other transactions included 653 traditional DoD contractors and 225 new contractors. Traditional DoD contractors received 72 percent of the funding for research other transactions. There were 143 prototype other transactions valued at \$4.8 billion and they included 301 traditional DoD contractors and 98 new contractors. In comparison, the normal DoD contracting process attracted 1,972 firms new to the Defense business sector in the past two years, so other transactions are not the only way to attract more suppliers.

The majority of new contractors in other transactions is at the second and third tier subcontractor level. For example, food service contractors were brought in to help design new processes for preparation and delivery of meals on new ships to reduce military staffing. About 97 percent of the funding for prototype other transactions went to traditional DoD contractors. The three largest DoD contractors received 77 percent of the funding for prototype other transactions.

We recently completed two audits on other transactions, whose results I will summarize below:

Evolved Expendable Launch Vehicle. The Evolved Expendable Launch Vehicle program consisted of two other transactions with \$1 billion of DoD funding and an estimated \$2 billion of company funding. The EELV other transaction arrangements included technical safeguards but provided limited insight into the financial aspects of the program. Further, EELV program costs will exceed the \$1 billion of DoD costs reported to Congress because one contractor was receiving a large DoD reimbursement for its cost share for independent research and development. We were also concerned about the use of inappropriate procedures for protecting unclassified and contractor proprietary data.

For example, the Evolved Expendable Launch Vehicle Program Office denied the Air Force Operational Test and Evaluation Center access to data needed to accomplish its job. Since the audit, the Air Force program office has started getting briefings on the contractor's financial investment in the program, and the contractor has provided the needed access to data. However, we still disagree with the Air Force on the use of inappropriate protective measures that limit visibility into this project.

Costs Charged to Other Transactions. In this audit we assessed whether the contractors were putting up their cost share for research other transactions. We found problems with \$83 million of the \$304 million of the contractors' cost share for five research other transactions. Contractors were counting as their cost share other government contracts, duplicate equipment costs, and prior research paid for by the Government. This allowed contractors to reduce their actual cost share and risk on the other transactions. We also noted that required reports to Congress did not reflect the actual DoD cost of the other transactions because traditional DoD contractors can get separately reimbursed from DoD for their cost share allocated to independent research and development. In this regard, the congressional reporting requirements did not require the DoD to report the details on reimbursements. We also found inconsistent accounting treatment for overhead rates, and insufficient planning for any potential audit requirement.

Regulations. Although the statute authorizing other transactions has required issuance of regulations since 1994, none have been issued. The Department has been operating the program based on interim guidance memorandums and non-mandatory deskbook procedures. The lack of regulations causes repetitive relearning of the problems and solutions for managing other transactions. The Department started an effort last fall to develop a "guide" for use of other transactions; however, compliance with the "guide" would not be mandatory. Although issues that we or others identify would be addressed in the "guide," they would not have to be considered. In addition to the statutorily required regulations, we also believe the Department needs to develop performance measures for assessing the benefits and costs of other transactions. Although DoD agreed in 1998 with our recommendation to develop such measures, this was never done.

Congress may consider legislative proposals for other transactions this year. Given the inapplicability of

traditional controls to other transactions, any expansion of the authority for other transactions should provide the needed protections both for the Department and the American taxpayers.

Conclusion

The Office of the Inspector General, DoD, continues to be a strong supporter of acquisition reform. I appreciate your interest in our reports and views on these challenging matters. This concludes my statement.

Acquisition Audit Reports
By Inspector General, DoD
Mentioned in this Testimony

98-064, Commercial and Noncommercial Sole-Source Items Procured on Contract N000383-93-G-M111, February 6, 1998. The DoD purchasing strategies were seriously flawed.

98-088, Sole-Source Prices for Commercial Catalog and Noncommercial Spare Parts, March 11, 1998. The audited contract was another example of poor acquisition planning.

99-026, Commercial Spare Parts Purchased on a Corporate Contract, October 30, 1998. The DoD paid a 54.5 percent premium, \$3.2 million, on the audited contract for aviation spares in fiscal years 1996 and 1997, but did not use the services offered at the higher prices.

99-116, DoD Use of Multiple Award Task Order Contracts (4/2/99). The audit was requested by Senator Carl Levin. Task orders were awarded without sufficient consideration to price on 36 of 58 audited task orders. Only 8 of 66 audited sole-source task orders had valid sole-source justifications.

99-217, Sole-Source Commercial Spare Parts Procured on a Requirements Type Contract (7/21/99). A cost-based requirements contract for aviation spares was appropriately priced.

99-218, Sole-Source Noncommercial Spare Parts Orders on a Basic Ordering Agreement (7/21/99). The DoD paid \$4.9 million (18 percent) more than fair and reasonable prices for \$32.2 million of aviation spares on a basic ordering agreement during fiscal years 1996 through 1998.

00-065, Costs Charged to Other Transactions (12/27/99). Report discusses issues identified with \$83 million of \$304 million of contractor cost share for research other transactions and other accounting and management issues requiring guidance.

00-070, Evolved Expendable Launch Vehicle Program Other Transactions (12/30/99). The other transactions did not provide adequate insight into financial aspects of the program, did not fully disclose all Government costs for the program, and required inappropriate protective measures for unclassified data. (Report currently available only in a For Official Use Only Version.)

00-088, DoD Acquisition Workforce Reduction Trends and Impacts (2/29/00). The Department needs to reconsider the appropriate size and skills mix of the acquisition workforce, which has been

cut in half without significant workload reduction and faces future skills shortages.

00-098, Spare Parts and Logistics Support Procured on a Virtual Prime Vendor Contract (3/8/00). A long term alliance arrangement would be preferable to the contractual terms under which overpriced aviation spares were purchased in 1997 and 1998. (Report currently available only in a For Official Use Only version.)

00-099, Procurement of the Blade Heaters for the C-130 and P-3 Aircraft (3/8/00). This report discusses one of the overpriced spare parts procured under the contract that is evaluated in Report No. 00-098. (Report currently available only in a For Official Use Only version.)

00-100, Award and Administration of Contracts for Professional, Administrative and Management Support Services (3/10/00). The Military Departments needed to put more emphasis on all aspects of procurement planning, contracting and contract administration for services.