Office of Inspector General

Audit Report

DOT DOES NOT FULLY COMPLY WITH REVISED FEDERAL ACQUISITION REGULATIONS ON THE USE AND MANAGEMENT OF COST-REIMBURSEMENT AWARDS

Department of Transportation

Report Number: ZA-2013-118
Date Issued: August 5, 2013

Memorandum

U.S. Department of Transportation
Office of the Secretary
of Transportation
Office of Inspector General

Subject: ACTION: DOT Does Not Fully Comply With Revised Federal Acquisition on the Use and Management of Cost-Reimbursement Awards Department of Transportation Report Number ZA-2013-118

Date: August 5, 2013

From: Mary Kay Langan-Feirson
Assistant Inspector General for Acquisition and Procurement Audits

Reply to Attn. of: JA-60

To: DOT Senior Procurement Executive

In an effort to reduce spending, the President, Congress, and the Office of Management and Budget have directed the Federal Government to improve the effectiveness and efficiency of its procurement practices by reducing the use of high-risk contracts, such as cost-reimbursement contracts. Cost-reimbursement contracts pose a high risk for waste or misuse of taxpayer funds because they do not provide a direct incentive for the contractor to control costs. In addition, agency inspectors general, the Government Accountability Office (GAO), and other independent review bodies have identified that agencies sometimes use cost-reimbursement contracts without appropriate justification and do not provide sufficient management and oversight of these contracts.

Despite the emphasis on decreased use of this contract type, the U.S. Department of Transportation (DOT), excluding the Federal Aviation Administration, increased its obligations for cost-reimbursement contracts between fiscal year 2009 and fiscal year 2012—from $322 million to $506 million (from 18 percent to 22 percent of all DOT contract obligations).[1] Since DOT obligates hundreds of millions of dollars in high-risk cost-reimbursement contracts each year, even minimal steps toward improving the use and management of these contracts could yield substantial savings for DOT, the Government, and ultimately the taxpayers.

[1] We did not include the Federal Aviation Administration's (FAA) obligations in these figures or in our audit review because the Agency is not required to comply with the Federal Acquisition Regulation.

The Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (Duncan Hunter Act) required that the Federal Acquisition Regulation (FAR) be revised to provide additional guidance on the use and management of cost-reimbursement contracts. The Act also required that each Office of Inspector General review its agency's compliance with these revisions within 1 year of the published FAR revisions and include the results in its next semiannual report. The FAR was revised in an interim rule effective March 16, 2011, and issued as a final rule on March 2, 2012.[2] Accordingly, our audit objective was to assess whether DOT and its Operating Administrations comply with the revised FAR requirements on the use and management of cost-reimbursement contracts.

We conducted this review between July 2012 and May 2013 in accordance with generally accepted Government auditing standards. To conduct our work, we interviewed DOT and Operating Administration procurement officials and reviewed the Duncan Hunter Act and the revised FAR requirements, including the interim and final rules. To test compliance with the FAR revisions, we reviewed a statistical sample of 31 cost-reimbursement awards selected from a universe of 655 DOT cost-reimbursement awards entered into between July 1, 2011, and May 31, 2012. Six DOT Operating Administrations were represented in this universe: the Federal Highway Administration (FHWA), Federal Railroad Administration (FRA), Federal Transit Administration (FTA), Maritime Administration (MARAD), National Highway Traffic Safety Administration (NHTSA), and Research and Innovative Technology Administration (RITA) John A. Volpe National Transportation Systems Center (Volpe).[3] See exhibit A for more information on our scope and methodology.

RESULTS IN BRIEF

The six DOT Operating Administrations we reviewed do not fully comply with revised FAR requirements on the use and management of cost-reimbursement awards. The Operating Administrations' noncompliance is primarily attributable to the Department's lack of internal guidance for implementing these new requirements and lack of oversight needed to verify departmentwide compliance. We reviewed a random sample of 31 out of 655 cost-reimbursement awards, including 11 contracts and 20 task orders.[4] Our review determined that the

[2] FAR Case 2008-030, "Proper Use and Management of Cost-Reimbursement Contracts"; Interim Rule, 76 Fed. Reg. 14547 (Mar. 16, 2011); Final Rule, 77 Fed. Reg. 12925-01 (Mar. 2, 2012).

[3] We excluded the Federal Aviation Administration from the scope of our review because the Agency is not subject to the FAR or any changes to the FAR resulting from the Duncan Hunter Act.

[4] While not all of the revised FAR requirements explicitly address task orders, decisions about contract type can be made at both the contract and task order level. Since cost-reimbursement task orders and contracts both involve obligations of Government funds, the common application of the revised FAR requirements is to both cost-reimbursement task orders and contracts. For consistency, we refer to both contracts and task orders as "awards" throughout this report.

Operating Administrations' practices for 15 of the 31 awards do not comply with a significant portion, at least 25 percent, of the revised FAR requirements.[5] Specifically, we found that the Operating Administrations do not (1) fully comply with the revised FAR requirements related to acquisition planning and documenting justifications, or (2) consistently assess oversight risks, properly designate oversight personnel, or verify that contractors' accounting systems are adequate to provide valid and reliable cost data.

- The Operating Administrations do not fully comply with the revised FAR requirements related to acquisition planning and documenting justifications for the use of cost-reimbursement awards. For example, in 16 of the 31 awards we reviewed, the awarding Operating Administrations did not document justifications for selecting cost-reimbursement awards. Notably, 14 of these 16 noncompliant awards were task order awards. One reason for the high rate of noncompliance among task orders is that the Operating Administrations only applied the revised FAR requirements for planning and justification to contracts, not task orders.[6] However, use of cost-reimbursement contracts or task orders without proper justification could unnecessarily expose the Federal Government to higher risks.

- The Operating Administrations also do not consistently assess oversight risks, properly designate oversight personnel, or verify contractors' accounting systems. The purpose of the revised FAR requirements is to ensure that agencies have adequate and qualified oversight staff in place to shoulder the increased oversight burden associated with cost-reimbursement awards. For 22 of the 31 awards in our sample, the Operating Administrations designated official oversight personnel in writing; however, only 12 of these were designated prior to award, as required. Moreover, the designated oversight personnel for five of the awards in our sample lack support that they were properly certified to perform oversight.

We are making a series of recommendations to improve DOT's compliance with the revised FAR requirements on the use and management of cost-reimbursement awards.

[5] We identified 39 revised FAR requirements that we used as a basis for computing compliance rates. However, not all of the revised FAR requirements applied to every award in our sample, so the applicable requirements ranged in number from 30-38.

[6] While the FAR revisions do not consistently include the word "order," they require agencies to perform detailed planning and to document justifications for all cost-reimbursement obligations of Government funds.

BACKGROUND

Section 864 of the Duncan Hunter Act required amendments to the FAR to provide further guidance on the use and management of cost-reimbursement contracts in three areas: (1) circumstances when cost-reimbursement contracts are appropriate, (2) acquisition plan findings to support the selection of a cost-reimbursement contract, and (3) acquisition resources necessary to award and manage a cost-reimbursement contract.

Under a firm-fixed-price contract, the contractor accepts all cost risk and is fully responsible for delivery of the goods or services at the agreed-upon price. As a result, firm-fixed-price contracts provide maximum incentive for the contractor to perform efficiently and impose the least administrative burden and risk on the Government. In contrast, cost-reimbursement awards shift cost risk to the Government and require the Government to pay all allowable costs incurred by the contractor, thus providing the contractor with considerably fewer incentives for controlling costs and placing greater administrative burden on the Government to oversee the contractor's progress and costs. In order to mitigate these additional risks, the FAR imposes increased oversight requirements on agencies that choose to use contract types other than firm-fixed-price.

DOT OPERATING ADMINISTRATIONS DO NOT FULLY COMPLY WITH REVISED FAR REQUIREMENTS ON COST-REIMBURSEMENT AWARDS

The six DOT Operating Administrations we reviewed do not fully comply with the revised FAR requirements on use and management of cost-reimbursement awards. The Operating Administrations' noncompliance is primarily attributable to the Department's lack of internal guidance on the implementation of these new requirements and lack of oversight needed to verify departmentwide compliance. Of the 31 cost-reimbursement awards we reviewed, 15 do not comply with a significant portion—from 28 percent to as much as 87 percent—of the revised FAR requirements related to: (1) acquisition planning and justification for selecting cost-reimbursement awards; and (2) assessment of oversight risks, proper designation of oversight personnel, and verification of the adequacy of the contractor's accounting system to provide valid and reliable cost data. The Operating Administrations that do not comply with these revised FAR requirements face increased cost and performance risks associated with this contract type.

Insufficient Departmentwide Guidance and Oversight Resulted in Varying Compliance Throughout the Department

DOT's Office of the Senior Procurement Executive (OSPE) did not issue guidance or oversee the Operating Administrations' implementation of the revised FAR requirements, which resulted in varying compliance across the Department. In the absence of departmentwide guidance, the Operating Administrations applied their own interpretations of the new requirements, including the view that the revised FAR requirements on planning and justifications did not apply to cost-reimbursement task orders. In addition, our review found that the Operating Administrations that took the initiative to communicate the revised FAR requirements and establish procedures for implementation had higher rates of compliance than Operating Administrations that did not take such proactive steps.

OSPE Has Not Provided Sufficient Guidance and Oversight To Facilitate Consistent Implementation of the Revised FAR Requirements

As part of its acquisition policy and oversight role, the Department's OSPE is responsible for ensuring DOT's compliance with Federal and departmental acquisition regulations.[7] However, OSPE has not issued guidance, established internal policy, or updated the Transportation Acquisition Manual (TAM) to reflect the revised FAR requirements on the use and management of cost-reimbursement awards. While the Department did issue a high-level communication in a "DOT DASH" to alert the Operating Administrations' Chiefs of the Contracting Office (COCOs) of the FAR revisions,[8] the communication did not provide additional explanations or guidance on how the FAR revisions should be implemented.

In addition, OSPE does not have procedures to assess whether the Operating Administrations are consistently interpreting and applying the revised FAR requirements, such as requiring contract file reviews to assess compliance. Instead, OSPE relies on the Operating Administrations' COCOs and contracting officers to ensure compliance with these requirements. Our findings are consistent with a January 2013 GAO report, which also noted that DOT lacked departmentwide acquisition management oversight. According to GAO's report, OSPE stated that acquisition management was best left to the individual Operating Administrations, given the decentralized nature of the Department. During our review, OSPE officials informed us that the organization is currently re-evaluating its oversight

[7] The Services Acquisition Reform Act of 2003, Public Law 108-135, Section 1421, identifies the duties of Chief Acquisition Officer (CAO), which includes monitoring the performance of acquisition activities and acquisition programs of the executive agency. The Senior Procurement Executive reports to the CAO and is specifically responsible for management direction of the agency's procurement system, including implementing procurement policies, regulations, and standards of the agency.

[8] DOT issued a "DOT DASH" in April 2011 regarding the interim rule and another in March 2012 regarding the final rule.

role—with a goal to be more proactive than reactive—but has not formalized its plans.

Operating Administrations Did Not Apply the Revised FAR Requirements to Cost-Reimbursement Task Orders

Lacking guidance from the Department, the Operating Administrations developed their own interpretations of the revised FAR requirements. A particular concern is that the Operating Administrations applied the revised FAR requirements on acquisition planning and documented justifications only to cost-reimbursement contracts and not to cost-reimbursement task orders. While the FAR revisions do not include the word "order" in all of the amended sections, the purpose of the revisions is to require agencies to perform detailed planning and to document justifications for all cost-reimbursement obligations of Government funds—which would include both contracts and task orders issued after the March 16, 2011, effective date. Therefore, we applied the revised FAR requirements to all cost-reimbursement contracts and task orders in our sample. Similarly, other Federal Offices of Inspector General—such as those from the Department of Defense and General Services Administration—have also applied the revised FAR requirements to both cost-reimbursement contracts and task orders in their agencies.

The Department's OSPE officials agreed with our view that cost-reimbursement task orders issued after the effective date must comply with the revised FAR requirements, regardless of when the base contracts were awarded. However, OSPE officials noted that the FAR and DOT guidance do not require Operating Administrations to develop separate written acquisition plans for individual cost-reimbursement task orders. Instead, Operating Administrations could comply with the revised FAR requirements for detailed and specific acquisition planning and justifications by preparing documentation at either the base contract level or the task order level. For example, Operating Administrations could update the base contracts' existing acquisition planning documents or develop supplemental planning documentation specific to the task order.[9]

While we agree with OSPE's interpretation of the rule, we did not find evidence that the Operating Administrations fully applied the revised FAR planning and justification requirements at either the base contract level or the task order level for the 20 task orders in our sample of 31 awards. Notably, all task orders in our sample were issued under Indefinite Delivery Indefinite Quantity (IDIQ) base contracts that allowed individual task orders to be issued on either a fixed-price or cost-reimbursement basis. Although the acquisition planning documents for the

[9] It is possible for some base contracts to have sufficient acquisition planning and justification for all task orders, but there were no such cases in our sample. In many cases, it may be difficult to adequately plan for future task orders during the initial acquisition planning stage, especially to the level of detail required by the revised FAR requirements.

base IDIQ contracts were approved before the interim rule, all task orders we reviewed were issued after the interim rule became effective. However, the Operating Administrations did not update the base contracts' acquisition planning documents or prepare supplemental planning documents for these task orders to comply with the revised FAR requirements on planning and justification.

By not applying the revised FAR requirements to these cost-reimbursement task orders, the Operating Administrations are missing opportunities to better manage or reduce high-risk contracting. For example, our sample included a $4.8-million cost-reimbursement task order that Volpe issued in February 2012—during the second year of a 5-year $234-million IDIQ contract. Although the revised FAR requirements were in effect when the task order was issued, Volpe did not update the base contract's acquisition plan to address these new requirements, but did prepare documentation that addressed some of the planning factors described by the FAR change. If the Department does not ensure that Operating Administrations comply with the revised FAR requirements when issuing cost-reimbursement task orders, DOT will continue to be exposed to increased cost and performance risks during the remaining years of the base contracts' performance periods.[10]

Operating Administrations That Took Proactive Steps To Implement the Revised FAR Requirements Had Higher Rates of Compliance

In the absence of departmentwide guidance, some Operating Administrations took the initiative to notify procurement staff of the revised FAR requirements and to implement oversight procedures to facilitate compliance. For example, FHWA provided formal training on the revised FAR requirements. FHWA's COCO also issued internal guidance that created a formal process for implementing the revised FAR requirements. Consequently, FHWA achieved a higher rate of compliance than the other five Operating Administrations we reviewed.

Other Operating Administrations also established procedures that help ensure compliance with the revised FAR requirements. For example, before the revisions became effective, Volpe's COCO established a procedure to standardize the review and approval process for procurement actions, which includes a check for FAR compliance. In addition, FTA's COCO issued a standard Contracting Officer Representative (COR) designation letter that includes all of the FAR revision requirements for documenting COR designations and requires that a COR be designated for every cost-reimbursement award, including individual task orders.

[10] The Duncan Hunter Act, which required the revisions to the FAR, aligns with the President's goal of reducing high-risk contracting as noted in the Presidential Memorandum on Government Contracting, dated March 4, 2009. The Memorandum states that the use of cost-reimbursement type contracts creates the risk that taxpayer funds will be spent on contracts that are wasteful, inefficient, subject to misuse, or otherwise not well designed to serve the needs of the Government or interests of the taxpayers.

In contrast, MARAD did not implement such actions to facilitate compliance with the revised FAR requirements and, consequently, achieved the lowest rate of compliance.

Operating Administrations Do Not Fully Comply With Revised FAR Requirements Regarding Acquisition Planning and Justifications

While some Operating Administrations have higher compliance rates than others, none of the six DOT Operating Administrations fully complies with all revised FAR requirements related to acquisition planning and justifications for use of cost-reimbursement awards. Based on our review of a statistical sample of 31 cost-reimbursement awards, we identified cases of noncompliance with the revised FAR requirements for (1) written acquisition plans, (2) consideration of required planning factors,[11] (3) consideration of transition to firm-fixed-price, and (4) justifications for the use of a cost-reimbursement award.

Written Acquisition Plans Are Not Prepared When Required

According to the revised FAR requirements, agencies should develop written acquisition plans that address specific planning factors to support the use of contract types other than firm-fixed-price (including cost-reimbursement). In accordance with the FAR,[12] DOT's TAM establishes a dollar threshold for written acquisition plans consistent with FAR for acquisitions greater than $20 million.[13] Of the 11 contracts in our sample of 31 cost-reimbursement awards, only 2 exceeded the $20-million threshold requirement. However, neither of these two contracts—which have a combined value of approximately $71 million—have written acquisition plans. In response, a NHTSA official, which awarded both these contracts, stated that NHTSA's procurement staff conduct comprehensive acquisition planning meetings with their program offices six times a year but do not record meeting notes or document these planning efforts.

Most Operating Administrations Consider the Majority of Required Planning Factors

The revised FAR requirements state that a cost-reimbursement award may only be used when planning factors specified in FAR section 16.104—such as competition, price analysis, and urgency—have been considered and

[11] FAR 16.104 *Factors in selecting contract types*. According to the FAR, "planning factors" include: price competition, price analysis, cost analysis, type and complexity of the requirement, combining contract types, urgency of requirement, period of performance or length of production run, contractor's technical capability and financial responsibility, concurrent contracts, extent and nature of proposed subcontracting, and acquisition history.
[12] FAR 7.103(e) *Acquisition Plans: Agency-head responsibilities.*
[13] With certain exceptions. See TAM 1207.103 *Agency-head responsibilities.*

documented.[14] Although only 1 of the 31 awards we reviewed addressed all the planning factors, 22 awards in our sample included documented consideration of at least half of the required planning factors (see table 1).

Table 1. Compliance With FAR Requirement To Consider Planning Factors

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Majority[a] of planning factors considered	23 / 31	0 / 5	5 / 5	4 / 5	5 / 5	6 / 8	3 / 3

[a] In our review, we defined "majority" as 50 percent or more of the planning factors.

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

Operating Administrations Seldom Consider Transition to Firm-Fixed-Price

According to the revised FAR requirements, as part of acquisition planning, agencies should document their consideration of strategies to transition from a cost-reimbursement to firm-fixed-price award type—whether for the current award, future option years, or follow-on contracts. However, only 6 of the 31 awards we reviewed included documentation showing that the agencies considered strategies to transition to a firm-fixed-price award (see table 2).

[14] For our review, we consolidated the 12 planning factors from FAR 16.104 into 10 categories: (1) price competition/price and cost analysis, (2) type and complexity of the requirement, (3) urgency of the requirement, (4) period of performance or length of production run, (5) contractor's technical capability and financial responsibility, (6) concurrent contracts, (7) extent and nature of proposed subcontracting, (8) acquisition history, (9) combining contract types, and (10) adequacy of the contractor's accounting system.

Table 2. Compliance With FAR Requirement To Consider Transition to Firm-Fixed-Price Type

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Consider transition to firm-fixed-price type	6 / 31	0 / 5	2 / 5	0 / 5	3 / 5	0 / 8	1 / 3

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

The revised FAR requirements also require agencies to consider structuring the contract to permit some or all of the work requirements to be awarded on a firm-fixed-price basis. However, only 5 of 11 contracts in our sample of 31 awards included documentation that met this requirement.[15] For example, FHWA did not comply with this requirement when it planned a 5-year $2.7-million contract to provide technical, publication, communication, marketing, and outreach support for its Local and Tribal Technical Assistance Programs. However, this award may have been a good candidate for transitioning to fixed-price type given the 5-year period of performance and because FHWA had contracted for similar services in the past. By not complying with FAR requirements to consider transition to a fixed-price award, FHWA may have missed an opportunity to reduce the Government's risk and to alleviate oversight burdens.

Operating Administrations Do Not Consistently Document Justifications for the Use of Cost-Reimbursement Type

According to the revised FAR requirements, an agency must document why the use of a contract type other than firm-fixed-price is appropriate. The FAR states that a cost-reimbursement award may only be used when (1) circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price award or (2) uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price award. Only 15 of the 31 awards in our sample included documented rationale to justify the selection of cost-reimbursement awards (see table 3).

[15] We applied this requirement only to the 11 contracts in our sample. We did not apply this requirement to the 20 task orders in our sample since their IDIQ base contracts allowed for either fixed-price or cost-reimbursement orders.

Table 3. Compliance With FAR Requirement for Justifying the Use of Cost-Reimbursement Awards

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Justification for use of cost-reimbursement type documented	15 / 31	0 / 5	5 / 5	0 / 5	5 / 5	2 / 8	3 / 3

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

Operating Administrations Do Not Consistently Assess Oversight Risks, Designate Contracting Officers' Representatives, or Verify the Adequacy of the Contractors' Accounting Systems

In our sample of 31 cost-reimbursement awards, we identified noncompliance with the following requirements: (1) assessments of the additional risks, burdens, and resources needed to award and manage cost-reimbursement awards; (2) written designations of CORs prior to the award date; and (3) verification of the adequacy of contractors' accounting systems. Operating Administrations that neglect to follow these FAR's requirements face heavier oversight burdens and, consequently, increased cost and performance risks.

Operating Administrations Do Not Consistently Assess Risks, Burdens, and Resources

According to the revised FAR requirements, an agency that selects other than a fixed-price award should include a documented discussion of the additional risks and administrative burdens of managing the contract type selected. The discussion should describe the nature of the additional risks and establish a plan to mitigate risks. The FAR also requires a documented assessment of the adequacy of Government resources necessary to properly plan for, award, and administer the contract type selected. These requirements are critical because cost-reimbursement awards often cause the Government to shoulder additional cost risks and increased oversight burdens. However, our review determined that only 8 of the 31 awards in our sample included a discussion of the additional risks and burdens of managing a cost-reimbursement award. Additionally, only 14 of the 31 sample awards contained assessments of the adequacy of Government resources to ensure effective management of the risks (see table 4).

Table 4. Compliance With FAR Requirements on Assessing Risks, Burdens, and Resources

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Consider additional risks and burdens	8 / 31	0 / 5	4 / 5	0 / 5	2 / 5	2 / 8	0 / 3
Assess adequacy of acquisition resources	14 / 31	0 / 5	5 / 5	1 / 5	5 / 5	3 / 8	0 / 3

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

Operating Administrations Do Not Properly Designate Contracting Officer's Representatives

According to the revised FAR requirements, a cost-reimbursement award may be used only when, prior to the award of the contract or task order, adequate Government resources are available to provide sufficient surveillance of contractor performance. In addition, a properly trained COR must be designated in writing for all cost-reimbursement contracts and orders before they are awarded. Our review determined that the Operating Administrations designated CORs in writing for 22 of the 31 awards in our sample. However, only 12 of the 22 designations were issued prior to the date of award (see table 5). The remaining 10 COR designations occurred anywhere from the same day as the award up to over 2 months after the date of award.

Table 5. Compliance With FAR Requirements for Designating CORs Prior To Award

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Designated COR in writing	22 / 31	0 / 5	3 / 5	5 / 5	3 / 5	8 / 8	3 / 3
COR designation prior to award date[a]	12 / 22	N/A	1 / 3	2 / 5	0 / 3	7 / 8	2 / 3

[a] We only applied this requirement to the 22 awards that had written designations.

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations.

Further, only 16 of the 22 written COR designations included all specifications in the revised FAR requirements, such as the COR's responsibilities, authorities, limitations, and period of delegation. The Department's formal 2008 COR Program Guidance includes a sample COR designation letter that addresses all of

the revised FAR requirements. However, the Operating Administrations are not required to use the sample letter, and there are no controls to ensure that Operating Administrations' internal COR designations letters are sufficient to address the new requirements.

Notably, MARAD lacks written COR designations for the five cost-reimbursement task orders we reviewed; however, MARAD did designate CORs in writing for the IDIQ base contracts associated with each of these task orders. MARAD officials stated that it would be labor intensive to issue designation letters for every task order under these contracts because they are ship manager contracts that can include over 100 task orders.[16] We agree that a separate COR designation may not be required for each task order if the agency clearly specifies in the original base contract that the same COR will manage every task order under that contract. However, we are concerned with this approach as the COR may not be aware when work on a new task order has begun, especially given the high volume of task orders under ship manager contracts and the fact that some CORs oversee more than one ship manager contract at a time.

The revised FAR requirements also call for CORs to meet training requirements to obtain COR certification, which must be maintained in accordance with Federal policy.[17] Our review determined that four of the six Operating Administrations we reviewed maintained documentation for each designated COR, verifying that the COR was certified (see table 6).[18]

Table 6. Compliance With FAR Requirements on Documentation of COR Certifications

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Documentation of COR certifications	26 / 31	1 / 5	5 / 5	5 / 5	5 / 5	8 / 8	2 / 3

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

The five awards in our sample that were missing documentation on COR certification were from MARAD and NHTSA. For example, although MARAD

[16] Ship manager contracts maintain Ready Reserve Fleet ships in support of national emergencies and defense objectives. Services may include maintenance, repair, logistics support, activation, operation, deactivation, crewing and management for vessels.

[17] OMB, "The Federal Acquisition Certification for Contracting Officer Technical Representatives," Nov. 26, 2007, revised Sept. 6, 2011.

[18] GAO-13-117, *DOT Lacks Data, Oversight, and Strategic Focus Needed to Address Significant Workforce Challenges* (Jan. 2013). In this report, GAO found that 53 percent of the Department's CORs were not certified in 2011.

did not designate a COR for any of the five cost-reimbursement task order awards in our sample, it did designate a COR for each of the associated base IDIQ contracts. However, MARAD did not maintain documentation in either the base contract or the task order files to verify that four of the five CORs were certified. In addition, when we requested the certification support for these four CORs, MARAD provided outdated certification support for two of the CORs and did not furnish any certification support for the other two.

Operating Administrations Usually Ensure Adequate Contractor Accounting Systems

According to the revised FAR requirements, the contracting officer must determine the adequacy of the contractor's accounting system. Our review determined that 24 of the 31 awards in our sample had documentation showing the contracting officer ensured that the contractor's accounting system was adequate (see table 7).

Table 7. Compliance With FAR Requirements on Ensuring Adequate Contractor Accounting Systems

	Sample awards that comply with FAR requirement						
FAR requirement	**Total**	**MARAD**	**FHWA**	**FTA**	**FRA**	**Volpe**	**NHTSA**
Adequate contractor accounting system	24 / 31	5 / 5	3 / 5	5 / 5	1 / 5	7 / 8	3 / 3

Source: OIG analysis of statistical sample of 31 cost-reimbursement awards from 6 DOT Operating Administrations

However, 7 of the 31 awards did not have evidence that the contracting officer verified the contractor's accounting system. For example, FRA awarded a contract to a contractor whose accounting system had never been tested by a Federal agency, and it did not ensure that this system was adequate. Since a contractor's accounting system is used to track the costs incurred on cost-reimbursement awards, it is critical to ensure that the system is reliable.

CONCLUSION

DOT awarded approximately $506 million in cost-reimbursement awards in fiscal year 2012—placing a large administrative burden on its acquisition workforce and accepting greater cost and performance risk for its acquisitions. Given this substantial investment, even minimal steps toward improving the management of these high-risk awards could yield substantial savings for DOT, the Government, and ultimately the taxpayers. Operating Administrations can do a better job of managing their use of cost-reimbursement awards, starting with improved

compliance with the revised FAR requirements, which are designed to assist in this effort.

RECOMMENDATIONS

We recommend that the Office of the Senior Procurement Executive take the following actions:

1. Update the Department's Transportation Acquisition Manual (TAM) to reflect the revised Federal Acquisition Regulation (FAR) requirements for the use of cost-reimbursement awards, including consideration of task orders.

2. Until the TAM is revised, provide guidance such as acquisition policy letters to help acquisition personnel understand and properly implement the revised FAR requirements for the use of cost-reimbursement awards.

3. Require that the Maritime Administration's Chief of the Contracting Office (COCO)

   a. develop guidance to ensure that ship manager contract files identify the assigned COR and specify which task orders the COR is responsible for overseeing (including whether the COR is responsible for all task orders, if applicable),

   b. implement a procedure to notify CORs of each planned task order before it is issued, and

   c. maintain adequate training documentation for members of its acquisition workforce.

4. Update the Department's Contracting Officer's Representative Program Guidance to reflect the revised FAR requirements for the use of cost-reimbursement awards.

5. Require the Operating Administrations to conduct periodic reviews to verify compliance with the revised FAR requirements for the use of cost-reimbursement awards and to report the results to OSPE.

AGENCY COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

We provided OST with our draft report on May 20, 2013, and received its response on July 9, 2013. OST's complete response is included as an appendix to this report. Although OST either concurred or partially concurred with all five of our recommendations, OST raised a number of concerns with our findings. First, OST disagreed that it was necessary to issue guidance to the Operating Administrations regarding the revised FAR requirements. According to OST, our report provided no evidence that guidance would have improved the acquisition workforce's behavior or compliance. However, as we reported, some Operating Administrations, such as FHWA, implemented training or notified staff of the revised FAR requirements resulting in higher rates of compliance than Operating Administrations that did not take similar actions. Therefore, we did observe a direct link between guidance and compliance, and OST subsequently concurred with this recommendation.

Second, according to OST, we incorrectly interpreted best practice guidance as requirements. In its example, OST stated that the OIG "over-interpreted" the requirements in FAR 16.104, "Factors in selecting contract types," which states that "There are many factors that the contracting officer should consider in selecting and negotiating the contracting type." According to OST, the word "should" is permissive and therefore optional. However, FAR 16.3, "Cost Reimbursement Contracts"—as amended by the interim rule, effective March 16, 2011—clearly states that "a cost-reimbursement contract may be used *only when*" (italics added for emphasis) the "factors listed in 16.104 have been considered." In addition, the Supplementary Information section of the interim rule states that "FAR 16.301-3, Limitations, is amended to . . . ensure that all planning factors have been considered per FAR 16.104." Therefore, the revised FAR requirements require the consideration of all planning factors before selecting a cost-reimbursement contract type. Moreover, we were conservative in applying this requirement to the contracts in our sample. We considered contracts compliant if Operating Administrations considered at least 50 percent of the factors before selecting a cost-reimbursable contract type.

Finally, OST's response states that FAA awarded about 75 percent of DOT's $1.9-billion cost-reimbursable contract obligations in fiscal year 2012—a dollar figure we originally cited in the introduction of our report. According to OST, product and service codes indicate that these FAA contracts were all related to complex information technology (IT) development projects, which can be appropriate uses of cost-reimbursable contracts. While we acknowledge that many of FAA's contracts are associated with complex IT projects, we disagree that all of them fall into this category. In fact, some of FAA's IT projects involve hybrid

contracts comprised of several contract types, including fixed price. However, it is important to note that we excluded FAA contracts from our review because FAA maintains its own Acquisition Management System and is not subject to FAR requirements for cost-reimbursement awards. To address OST's concern and to reflect our audit scope, we modified the figures in the introduction of our report to exclude FAA obligations. After excluding FAA obligations, DOT's cost-reimbursable obligations still show an increase between fiscal years 2009 and 2012—from $322 million to $506 million.

Despite these concerns, OST either concurred or partially concurred with all five of our recommendations. For recommendations 1, 2, 4, and 5, OST concurred with our recommendations and provided appropriate planned actions and timeframes that are responsive. Accordingly, we consider these recommendations resolved but open pending completion of the planned corrective actions.

For recommendation 3, OST partially concurred. In its response, OST agreed with the need for the recommendation regarding MARAD's contracting practices, but indicated that the recommendation would be most appropriately made to the Maritime Administrator. However, we addressed recommendation 3 to OSPE because the office has been delegated responsibility for performing both SPE and CAO duties, per Title 49 CFR Section 1.38a. The specific responsibilities of the SPE and CAO, as detailed in Title 41 United States Code Section 1702, include monitoring acquisition activities and programs, developing unique acquisition policies, and ensuring an adequate acquisition workforce—all of which align with our intention for recommendation 3. Accordingly, we request that OSPE reconsider its request that we redirect recommendation 3 to the Maritime Administrator, and provide planned actions and timeframes to address this recommendation. Until we receive this information, we consider recommendation 3 open and unresolved.

ACTIONS REQUIRED

OST's planned actions and timeframes for recommendation 1, 2, 4, and 5 are responsive, and we consider these recommendations resolved but open pending completion of the planned actions. We request that OST reconsider its request that we redirect recommendation 3 to the Maritime Administrator, and provide planned actions and timeframes to address the recommendation. In accordance with Department of Transportation Order 8000.1C, we request that OST provide this information within 30 days of this report. Until we receive this information, we consider recommendation 3 open and unresolved.

We appreciate the courtesies and cooperation of DOT representatives during this audit. If you have any questions concerning this report, please call me at (202) 366-5225 or Terry Letko, Program Director, at (202) 366-1478.

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cc: Maritime Administrator
MARAD Audit Liaison, MAR-392
FHWA Audit Liaison, HAIM-13
FRA Audit Liaison, RAD-41
FTA Audit Liaison, TBP-30
NHTSA Audit Liaison, NPO-310
RITA Audit Liaison, RTC-1
DOT Audit Liaison, M-1

EXHIBIT A. SCOPE AND METHODOLOGY

As required by the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, this report provides the results of our work to determine whether DOT complied with the revisions to the FAR on the use and management of cost-reimbursement contracts, as prescribed in the FAR Case 2008-030. We conducted our work from July 2012 through May 2013 in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To conduct our work, we interviewed officials from the Department's OSPE and the Operating Administrations' COCOs to determine what internal controls were in place to encourage compliance with the revised FAR requirements on the use of cost-reimbursement awards. We reviewed applicable Federal laws and memorandums, the FAR case interim and final rules, and the revised FAR sections. We also created a standardized checklist of these requirements to test the compliance of a statistical sample of 31 cost-reimbursement awards.

To select our sample, we used the Federal Procurement Data System-Next Generation (FPDS-NG) to extract a universe of all potential cost-reimbursement awards[19] that DOT entered into between July 1, 2011, and May 31, 2012. The 655 awards in our universe had a total value of about $3.1 million. The timeframe of our universe allowed DOT over 3 months to start implementing the new requirements. We stratified the universe by the six Operating Administrations that entered into cost-reimbursement awards during this time: (1) the Federal Transit Administration, (2) the Research and Innovative Technology Administration/ Volpe, (3) the National Highway Traffic Safety Administration, (4) the Maritime Administration, (5) the Federal Railroad Administration, and (6) the Federal Highway Administration.[20] We then selected a stratified sample of 31 cost-reimbursement awards with probability proportional to the value of the base award plus all options. These 31 cost-reimbursement awards included 20 task orders and 11 contracts, with a total value of over $1.3 million. According to FPDS-NG, the total value of the base awards plus options was over $643 million.

Although the Department continues to report annually on deficiencies in the reliability of FPDS-NG data, we deemed the data sufficiently reliable for the

[19] We extracted this universe based on the contract type identified in FPDS-NG by selecting awards indicated as cost-type or order dependent. Order dependent types could possibly represent a cost-reimbursement award, depending on the individual task order.

[20] The Federal Aviation Administration was not included in this review because it is exempt from the FAR.

purpose of this audit because we were able to validate the data elements we used for the contracts in our statistical sample.

Exhibit A. Scope and Methodology

EXHIBIT B. MAJOR CONTRIBUTORS TO THIS REPORT

Name	Title
Terrence Letko	Program Director
Ann Wright	Project Manager
Jill Cottonaro	Senior Analyst
Stacie Seaborne	Senior Analyst
Meredith Howell	Analyst
Christina Lee	Writer-Editor
Amy Berks	Senior Legal Counsel
Petra Swartzlander	Senior Statistician
Megha Joshipura	Statistician
William Savage	Information Technology Specialist

APPENDIX. AGENCY RESPONSE

U.S. Department of Transportation

Office of the Secretary of Transportation

1200 New Jersey Ave., SE
Washington, DC 20590

July 9, 2013

MEMORANDUM TO: Mary Kay Langan-Feirson
Assistant Inspector General for
Acquisition and Procurement Audits

FROM: Willie Smith
Senior Procurement Executive

SUBJECT: Management Response to OIG Draft Report on the Use of Cost Reimbursement Contracts

The Office of the Senior Procurement Executive (OSPE) continues its efforts to strengthen procurement practices across the Department and provide up-to-date comprehensive and consistent procurement guidance for all aspects of the acquisition process including the use of cost reimbursement contracts. The OIG report highlights areas that would benefit from further refinement in practice, including accommodating evolving thought on the application of task orders on existing contracts to the revised FAR, and operating administrations'(OA) producing more comprehensive documentation of the decision process. However, the OIG report is lacking in key areas. For example, it asserts a causal linkage between guidance and behavior, but provides no evidence of the linkage. Further, it is an exaggeration to assert that the OAs created a "safe haven for high risk contracting," by using a valid contracting tool.

OSPE Provided Timely Interim Guidance to Operating Administrations

Within 30 days of the release of the interim rule and within 2 weeks of the release of the subsequent final rule, OSPE, using its standard means of communicating with the DOT procurement community highlighted the release of these changes and emphasized the requirements and their importance. However, reiterating the FAR is neither appropriate nor necessary to implement Federal provisions. In accordance with FAR 1.301, the Department maintains the Transportation Acquisition Requirements and Manual in order to enumerate agency policies and interrelationships among OST and the OAs with regard to procurement activities. However, the Department also must abide by the provisions in FAR 1.304, stating that agencies *shall* limit the issuance of agency directives that restrain the flexibilities found in the FAR, and "*shall not* unnecessarily repeat, paraphrase, or otherwise restate material contained in the FAR." As a result, the expeditious reference to the interim and final revisions to the FAR, were both appropriate and sufficient, and in accordance with the express direction of the FAR.

OSPE is Further Strengthening Procurement Structure and Practice

OSPE is updating procurement systems, practices and processes to apply a risk based approach to acquisition oversight. Specifically, OSPE is updating the Department's Acquisition Oversight and Risk Management Policy to provide a more robust departmental role in supporting acquisition oversight and stewardship. The updated policy will recognize the importance and complexities of business decisions associated with various contracting types and apply the resources of a new Acquisition Strategies Review Board towards reviewing certain acquisition strategy documents and will better ensure the rigor in application of FAR requirements across the Department. Further, the OIG is aware of ongoing efforts to update the Transportation Acquisition Requirements and Manual (TAR/TAM), by the end of the calendar year, and the OSPE is intent to keep it up to date on an ongoing basis. Finally, it is important for the OIG to recognize that the statutory structure of the Department places primary responsibility on the OAs for managing the procurement planning and administration of acquisition requirements within the context of Federal Acquisition Regulation and the Department's requirements established in the TAR/TAM. Within this context the Department relies on the OAs to provide primary oversight to ensure compliance with acquisition requirements and guidance, exercising sound business judgment as to the appropriate contract type, and support key decisions as required in the FAR.

Cost Reimbursable Contracting is Used Judiciously

While the Department recognizes the Governmentwide efforts to reduce the use of cost reimbursable contracts, FAR 16.3 recognizes that cost reimbursement contracts are suitable for use when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed price contract. It specifically recognizes that a cost contract may be appropriate for research and development work.

As a practical matter, cost reimbursable contracts are appropriate where

1) The object, scope, and nature of the work required cannot be definitely described,

2) Performance specification represents technical achievement of a performance goal not yet demonstrated, or

3) Products or tasks are technically complex.

Such circumstances are typical during research and development projects and complex services, which might include complex information technology development projects. Under such circumstances, the risk of underutilizing cost type contracts is that the vendor community is forced to price the uncertainty into the contract price, which increases the potential for the Department to pay too much.

Based on our cursory review of the OIG results, about 75 percent of the $1.9 billion total cost reimbursable contracts for the Department in fiscal year 2012 were let from FAA. A summary examination of the product and service codes (PSC) associated with these contracts indicates that they were all related to the development and deployment of complex information technology development projects. For example the $173 million coded under S211 were development contracts for the Automatic Dependent Surveillance – Broadcast (ADS-B) element of FAA's NextGen system that is intended to replace traditional radar surveillance systems.

Also $259 million coded under 5820 was for the development of En Route Automation Modernization (ERAM), one of the cornerstones of NextGen which processes flight radar data, provides communications and generates display data to air traffic controllers. Such types of development activities, as explained above, can make appropriate use of cost reimbursable contracts

OIG Report Over-Interprets Federal Acquisition Regulation

While the OIG report identifies a number of areas where the state of the practice relating to the application of the FAR can be enhanced, the report is diminished by its interpretation of best practice guidance as requirements. For example the OIG report states that "the revised FAR requirements state that a cost reimbursement award may only be used when planning factors specified in FAR section 16.104…have been considered." This over interprets the language in FAR 16.104 that actually states, "there are many factors that the contracting officer should consider in selecting and negotiating the contracting type, including…." This is not an exclusionary statement that precludes the use of cost reimbursable contracts as portrayed in the OIG report, but rather an advisory of some of the areas that should be considered. We agree that these factors should be considered and are working hard to fully implement this guidance in a consistent way across the Department, but it is also well understood that there is a significant different between "*should*," which is permissive, and "*shall*," which is an absolute, unyielding requirement (such as that mentioned earlier for FAR 1.304). The OIG report needs to accommodate recognition of this key distinction, and ensure that throughout its presentation, it accurately represents the FAR.

RECOMMENDATIONS AND RESPONSES

The OIG draft report makes the following recommendations to OSPE:

Recommendation 1: Update the Department's Transportation Manual (TAM) to reflect the revised Federal Acquisition Regulation (FAR) requirements for the use of cost-reimbursement awards, including consideration of task orders.

Response: Concur. As described in response to a previous OIG recommendation, OSPE is engaged in updating the TAR/TAM. This update will include the sections regarding the use of cost-reimbursement contracts. The target date for completing the update is December 31, 2013.

Recommendation 2: Until the TAM is revised, provide guidance such as acquisition policy letters to help acquisition personnel understand and properly implement the revised FAR requirements for the use of cost-reimbursement awards.

Response: Concur. OSPE will provide the DOT acquisition community with supplemental guidance to convey evolving interpretations of the revised FAR. This will include its applicability to Task Orders, FAR requirements for adequate documentation, ensuring the adequacy of a contractor's cost accounting system, and other aspects touched upon in the OIG report, as appropriate. The target date for completing this acquisition policy letter is August 30, 2013.

Recommendation 3: Require that the Maritime Administration's Chief of the Contracting Office (COCO):

a. Develop guidance to ensure that ship manager contractor files identify the assigned Contracting Officer's Representative (COR) and specify which task orders the COR is responsible for overseeing (including whether the COR is responsible for all task orders, if applicable),
b. Implement a procedure to notify CORs of each planned task order before it is issued, and
c. Maintain adequate training documentation for members of its acquisition workforce.

Response: Concur in part. Recommendations relating to the development of procedures specific to contracting in the Maritime Administration would be most appropriately made to the Maritime Administrator. While OSPE agrees with the need for each of the elements of the recommendation, and it is our understanding that MARAD has actions underway or completed in each of the areas described, we suggest the OIG consider issuing the final report with this recommendation directed to the Maritime Administrator.

Recommendation 4: Update the Department's COR Program Guidance to reflect the revised FAR requirements for the use of cost-reimbursement awards.

Response: Concur. OSPE will issue updated COR program guidance that includes updated information on the revised FAR requirements for the use of cost reimbursement contracts. The target date for complete the update is December 31, 2013.

Recommendation 5: Require the OAs to conduct periodic reviews to verify compliance with the revised FAR requirements for the use of cost-reimbursement awards and to report the results to OSPE.

Response: Concur. The TAR/TAM will specify that OAs are expected to conduct periodic reviews to verify FAR compliance for the use of cost-reimbursement awards and report the results to OSPE. This provision will be included in the updated intended for completion by December 31, 2013.