Testimony

STATEMENT OF
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UNITED STATES SENATE
ON ACQUISITION REFORM

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Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before you today to discuss acquisition reform. At the outset, I want to emphasize that the Office of the Inspector General (OIG) has been a strong supporter of acquisition reform. We intend to keep working diligently to help the Department and Congress identify barriers to more efficient acquisition practices, design new processes, and evaluate the impact of the changes already in place.

INDICATIONS OF PROGRESS

Considerable progress has been made in streamlining DoD acquisition processes and there are numerous good news stories. For example, we recently reported that program managers for the Landing Transport Dock 17 Ship Class, the Joint Standoff Weapon System, the Air-to-Air Intercept Missile 9X, and an Air Force special access system had successfully implemented various acquisition reform principles such as compressing development schedules, reducing acquisition costs, and making prudent tradeoffs between performance, schedule, and cost. We found many "best practices" in use by program managers who were incorporating nondevelopmental items into their systems. The use of purchase cards to buy goods under the $2,500 micropurchase threshold has grown dramatically and in FY 1997 accounted for 71 percent of all purchases under the threshold. The expanded use of the card has reduced much of the paperwork and costs from using purchase orders and contracts for the small dollar value acquisitions that make up 91 percent of the 7.9 million DoD procurement transactions in FY 1997. We have also noted the excellent leadership provided by the Defense Logistics Agency (DLA) in the Single Process Initiative, an effort to work with industry to adopt commercially-used, contractor facility-wide processes instead of the more costly contract-unique requirements of the past. I am sure that the second panel can cite many more examples.

While all of this is "good news" for DoD, there is still much work to be done in the area of acquisition reform. As a result, much of our effort at the OIG continues to focus on acquisition reform on a variety of fronts.

PARTICIPATION IN ACQUISITION REFORM

Over the last 5 years, we have participated on over 100 management process action teams, integrated process teams, and working groups that have been the Department’s principal means of generating new ideas for reforms and process improvements across the spectrum of DoD business activities,

especially acquisition and logistics. We are very supportive of this approach, which is being applied to a wide range of issues such as contract administration, acquisition benchmarking, pilot programs, Government-property in the hands of contractors, and reducing life cycle costs. At present, we are involved in 57 such groups. The growing level of auditor participation on those teams illustrates the good professional working relationship between the acquisition and audit communities, as well as general acceptance of the need for our advice to be considered during the reengineering of DoD processes, not just after new processes are already put into place.

LESSONS LEARNED FROM OVERSIGHT

Despite budget reductions, the DoD acquisition program continues to be far larger than any other capital investment program in the world. At the end of FY 1997, DoD had 85 major Defense acquisition programs valued at over $725 billion of which over half had yet to be appropriated. In addition, there are many hundred small programs. Likewise, the DoD has the largest information technology budget in the Government and spends more than $9 billion a year acquiring information technology resources. The complexity and scope of these efforts, the potentially catastrophic consequences of any failure to provide reliable and technologically superior weapon systems and information tools to our war fighters, and the poor track record in terms of excessively long lead times, insufficient attention to life cycle cost, schedule slippage, cost growth, and high unit costs combine to make both weapon system acquisition and information technology investment high risk areas.

Because of those risks, the Office of Inspector General has historically given high priority to prudent audit coverage of acquisition programs and functions. Despite downsizing, we issued about 90 audit reports over the past two and a half years that address acquisition of weapons, other materiel and automated information systems. Likewise, procurement fraud remains the principal workload of the Defense Criminal Investigative Service, the criminal investigative arm of this office, which has had between 1,600 and 1,800 open fraud cases throughout that period. Today, let me share with you some of the results of our work that bear on acquisition reform.

SPARE PARTS PRICING

Mr. Chairman, your invitation letter requested that I specifically address the continuing work by my office reviewing commercial spare parts pricing issues, and any agency actions taken to correct deficiencies found during those reviews.

Using commercially available, instead of militarily unique, materiel wherever reasonably possible makes eminent sense. The acquisition reform thrust toward expanding DoD use of private sector business practices such as prime vendor instead of maintaining huge DoD wholesale supply inventories is also wise. During the past few years, the DoD has been transitioning into different business relationships with spare parts vendors and manufacturers. We have issued several reports that address various facets of this transition.

In March 1994, we reported that the Service inventory control points often were not transferring essential logistics management data to the DLA or, conversely, the receiving inventory control points were not always using the data. In retrospect, these indicators were a harbinger of the DLA failure to reimplement an Air Force program to break out certain aircraft spares for procurement, which led to the unnecessary sole-source procurements discussed further on in this statement.

In March 1996, we reported that DoD needed to address a variety of issues to successfully implement its initiatives to increase the use of local purchase authority and focus the role of the central supply system on managing items where value is added. The audit was unable to determine the overall extent of local procurement of centrally managed items. However, procurement data provided by 13 organizations visited during the audit showed that only $7.2 million of $744 million (less than 1 percent) of the local procurements were for centrally managed items.

The report recommended that the Deputy Under Secretary of Defense (Logistics) develop procedures to have requisitioning organizations make greater use of local purchase authority for centrally managed items when local procurement is in the best interests of the Government; direct that requisitioning organizations develop procedures to determine the total cost of a local procurement; develop a detailed strategy to address the impact of the local purchase initiatives on centralized material management; and develop procedures addressing local procurement when inventory control points have excess stocks, reporting and recording of demand data for local procurements, and feedback on the progress and economies of local purchase initiatives. Management indicated that the audit results were already being put to use, concurred with the intent of all recommendations, and proposed alternate methods to encourage greater use of local procurement authority instead of requisitioning items from central inventory stock. Changing the mindset of personnel in the field so that they fully utilize their expanded authority and capability to make their own buying decisions has proven to be an evolutionary process, not an instant fix.

HOTLINE COMPLAINTS ON SPARE PARTS PRICING

In mid-1996, we received a complaint that the DLA was paying a major aerospace contractor's catalog prices, which were far higher than prices paid by the DoD for the same aircraft spare parts before DLA began procuring the parts in a commercial pricing environment. Shortly thereafter, the Hotline also received similar allegations concerning DLA procurements from a second contractor's parts catalog. We initiated audits to determine the validity of the allegations. I emphasize that, having been closely involved in DoD acquisition reform and infrastructure streamlining efforts, we went into both audits with the full realization that some price increases were to be expected in cases where the DoD was shifting certain costs to the contractors in order to obtain such benefits as direct vendor delivery and reduced Government inventory management burdens.

We issued two final audit reports, both currently releasable only inside the Government because they contain contractor confidential or proprietary data, on February 6 and March 11, 1998. In brief, both audits substantiated the Hotline allegations. We found a range of weaknesses in the DoD approach to purchasing both commercial and non-commercial spare parts, although the specific problems were somewhat different in the two cases. It is especially important to emphasize that all of the audited transactions involved were sole-source procurements.

Specifically, we audited the following:

- 278 of 300 delivery orders over $25,000 from three DLA centers on one contract during calendar years 1994 through 1996. Documentation on the remaining 22 orders could not be found for various reasons. The orders reviewed constituted $22.7 million of the $24.4 million in orders placed with that contractor for aircraft spares like pistons, gearshifts, gears, bearings, bolts, and springs. About $6.1 million was for commercial catalog items and the balance for non-commercial items.

- 179 delivery orders totaling $12 million from DLA to another contractor on three contracts during the same period. Of the 179 orders reviewed, 124 orders were purchased from the contractor's commercial catalog, and 86 orders were for items with previous DoD competitive price history. The purchased items included structural panels, fittings, supports, washers, bolts, and nuts for a wide variety of aircraft.

AUDIT RESULTS

The audits indicated that the contractors involved were not violating any laws or regulations. However, the DoD procurement approaches were poorly conceived, badly coordinated and did not result in the Government getting good value for the prices paid for both commercial and non-commercial items. Based on our analysis of previous DoD purchases of the same aircraft spares, DLA paid prices that were considerably higher than a prudent buyer would consider fair and reasonable. Specifically:

- On one contract, DLA paid modestly discounted catalog prices that were $4.5 million, an average of 280 percent per item, more than fair and reasonable prices for $6.1 million of commercial items.

- On the same contract, DLA paid $1 million (FY 1997 dollars), an average of 30 percent, more than fair and reasonable prices for non-commercial items.

- On three contracts with another supplier, DLA paid $3.2 million, an average of 171 percent, more than fair and reasonable prices for $5.0 million (FY 1997 dollars) of mixed commercial and non-commercial parts with previous DoD price history.

Examples of particularly high price increases include the following:

- DLA paid $714.00 each for 108 electrical bells, a 1,430 percent increase over the previous price of $46.68.
- DLA paid $1.24 each for 31,108 springs, a 2,380 percent increase over the previous price of $.05.
- DLA paid $403.49 each for 246 actuator sleeves, a 1,532 percent increase over the previous price of $24.72.

- DLA paid $75.60 each for 187 setscrews, a 13,163 percent increase over the previous price of $.57.

FLAWS IN DoD PROCUREMENT APPROACH

We found considerable evidence that the DoD had not yet learned how to be an astute buyer in the commercial market place. Probably the most fundamental problem, however, was that the Government should not have been procuring many of these parts on a sole-source basis in the first place, whether they were commercial or non-commercial items. In the case of the one contractor, a Military Department had negotiated an agreement over 20 years ago that allowed DoD access to the contractor's technical data for the competitive procurement of replenishment spare parts. When management of those parts was transferred to DLA as part of the mass transfer of consumable items over the past few years, DLA failed to continue the breakout program. All 179 of the orders that we reviewed for one contractor were either covered by a previous access to technical data agreement (159 items) or eligible for competitive procurements because the Government owned the technical data (20 items). Similarly, there was little effort until our audit to screen the items being bought sole-source from the other contractor to determine whether alternatives like reverse engineering would be cost-effective to enable competitive buys.

Even in a sole-source situation, it is accepted commercial practice for major customers to seek, and often obtain, significant discounts off suppliers' catalog prices. The DLA failed to maximize its negotiating leverage in any meaningful fashion and therefore received only modest discounts from one contractor and none from the other. Both of our reports contain data illustrating that the DoD was by far the largest customer for most of the parts in question. In some cases, DoD was the only purchaser of the part even if it was a commercial item. (Under FAR 2.101, any item "offered for sale, lease or license to the general public" is termed a commercial item.) The potential DoD influence as a major customer was diminished, however, by a combination of an extremely disjointed procurement approach and a widespread misimpression that aggressively pursuing discounts was either unnecessary or not in consonance with commercial practices.

It is telling, we believe, that DLA used at least 75 different contracting officers to negotiate and award about 1,800 individual orders with one of these contractors.

These contracting officers operated in isolation, as reflected in their completely different perceptions of the reasonableness of the contractor's prices. While some accepted any "commercial price" as a good price, others unsuccessfully sought uncertified cost or pricing data.

Another problem involved the misperception that DoD was

somehow getting good value despite the drastic per unit price markup. For example, buying from a commercial parts catalog generally enables the buyer to eliminate in-house inventory storage and distribution operations. The commercial supplier offers timely direct vendor delivery and the commercial price structure reflects that the supplier is carrying that burden.

In the case of the orders that we audited, DLA was generally buying for inventory and therefore the "direct delivery" was to a Government warehouse, not a user of the parts. Therefore, there was no apparent discomfort with the fact that neither contractor's delivery response time was particularly good.

Other problems included using a basic ordering agreement instead of a better contract vehicle, not grouping purchases for inventory into economic order quantities, negotiating prices based on small quantity purchases despite the fact that overall requirements were rather large and inadequate requirements forecasting. We also found little justification for having DLA be the purchasing agent for many of the small orders, which resulted in DoD customers having to pay a large DLA surcharge with minimal value added. Local procurement is a viable option when buying small quantities for immediate use, since commercial parts catalogs are readily accessible through electronic media.

A final problem, which surfaced in the management comments on the draft version of our February 1998 report, is the lack of good management information on the overall experience to date in buying commercial items. DLA estimated that prices for commercial items, on contracts over $25,000 awarded under FAR Part 12, had modestly decreased. Unfortunately, their study was completely unsupportable. The DLA and we agree that the database used for the study is badly flawed with numerous coding errors. Moreover, we found major problems with the methodology. Although we share the frustration caused by not having the full picture on the impact of buying commercial items, so far we have not been shown or found data from which overall conclusions can be reliably developed.

DoD CORRECTIVE ACTIONS

I am pleased to be able to report to you that DoD senior managers in both DLA and the Office of the Under Secretary of Defense for Acquisition and Technology recognized the importance of our findings right away and took appropriate actions. There had been some disagreement with our position that contracting officers should be aware of and empowered to obtain uncertified cost or pricing data, if in their best judgment, it is necessary to understand the basis of a commercial price. We remain convinced that

access to such data often is particularly important in determining price reasonableness of sole-source items where, as in this case, there is no competitive commercial market to ensure the integrity of prices. We have not yet received final comments on our February 6 and March 11 reports, so I do not know if this or any other substantive issues remain unresolved at this point.

In December 1997, a new indefinite-delivery corporate contract was awarded to one contractor for 216 sole-source commercial items which will save, according to DLA, about $83.8 million over a 6-year period. The negotiations which began in October 1997, were difficult and were conducted in an environment where obtaining even uncertified cost or pricing data is strongly discouraged.

On November 5, 1997, we sent a memorandum to DLA expressing concern that the negotiating team had not requested uncertified cost or pricing data from the contractor. On November 7, 1997, the contracting officer wrote the contractor requesting uncertified cost or pricing data for 73 items where the negotiating team had been unable to support the prices as fair and reasonable.

Only three days later the contractor accepted the Government's last (and fourth) offer instead of providing the cost data. Prior to the request for cost data, the contractor's last offer was still 21.4% higher than the final Government offer. While the final negotiated price was clearly more reasonable than the last contractor offer, it is still higher than the Government's prenegotiation maximum position. We can only speculate as to the impact, if any, of the request for cost data on the contractor's decision to accept a price that had clearly been unacceptable up to that point. In any event, DoD understanding of the basis for the contractor's pricing remains incomplete and any analysis of the reasonableness of the agreement must necessarily be somewhat subjective.

Generally, however, we agree with the Department’s overall approach of using the lessons learned from our work and possibly other sources to develop more effective training for DoD personnel on being smart buyers in the new acquisition environment. We also welcome the offer by industry associations to help arrange more dialogue between Government and industry procurement experts to help facilitate new business relationships in which both sides’ interests are protected. This cooperation will be helpful to DoD in terms of both training and policy initiatives.

The agreed-upon DoD actions also include:

- Negotiating and awarding a new indefinite-delivery contract with one contractor that provides more substantial discounts off catalog prices;

- Seeking a similar up-front pricing arrangement for non-commercial items;

- Requesting voluntary refunds where appropriate;

- Rectifying the problems found with sole-source procurements in the situation where drawings were available, but not being used to solicit items competitively;

- Considering alternatives to the other sole-source situations addressed by the auditors;

- Reviewing whether the audited corporate contract is now being used properly;

- Using the DLA Method of Support Model or other business case analysis model suitable for planning major changes from stock management, before shifting to commercial business practices, such as a corporate contract;

- Training DLA managers and operations personnel in the proper use of corporate contracts, items and requirements that should be excluded, data requests and evaluations of prices. DLA issued specific guidance in a policy letter, "Determinations of Commerciality and Price Reasonableness," dated June 10, 1997;

- Developing automated system changes to preclude automatic order placement for:

    (a) first time buys, to assure items are procured competitively; (This will establish a substantiated cost baseline for subsequent comparisons, e.g., comparing competitive prices to corporate contract price lists.)

    (b) subsequent requisitions for stock-numbered items for which the buy history indicates continued use of a corporate contract would likely result in a

substantially higher material cost and/or an unacceptable delivery timeframe;

- Continuing to make a concerted effort to develop long-term stable partnerships with competitive, as well as sole-source suppliers available on DLA's electronic shipping mall to enable their customers to select the most advantageous source to meet their needs.

While we consider DoD actions to be responsive to the concerns raised in our report, additional measures may be needed as more is learned about both pitfalls and best practices related to buying commercial products. We are currently auditing a third DLA corporate contract arrangement and the General Accounting Office has been conducting reviews that will provide more data. Finally, while we hope our audit work will continue to be helpful in this area, we encourage more self-evaluation by the DoD acquisition community.

FUNDING INSTABILITY

Despite the important issues at hand regarding DoD buying practices for supplies and spare parts, a strong case can be made that pervasive funding instability is the Department's single most challenging acquisition reform issue. Instability in the execution of acquisition programs is the leading cause of cost growth and schedule slips in major weapon systems. In order not to degrade readiness, the DoD has often used weapon system acquisition programs as bill payers for unbudgeted operational and contingency costs. Moreover, neither acquisition planning nor support program budgets always conform to fiscal reality. The impression of too many programs chasing too few dollars has been a DoD acquisition issue for many years, and it is difficult to make a convincing case that the tendency to over-program has been overcome. Affordability-induced program changes and production rate cut backs in mid-stream result in a vicious cycle of increased costs that can cause further reductions in quantities, additional stretch-outs, and even greater per unit costs. The DoD estimates that every dollar removed from a program in the near years requires three dollars in later years to make up the reduction.

This is definitely an area where dialogue and partnership between the DoD and Congress are needed. There can never be enough emphasis on improving weapon system acquisition and life cycle cost estimating, as well as on realistic programming and budgeting in all DoD accounts. We also need to respond more effectively to program managers'

assertions (as expressed in numerous process action teams and other forums) that funds are constantly siphoned off even during budget execution. We recently initiated an audit to shed more light on to what extent this is occurring and why.

Program management flexibility is also severely constrained by the way in which funds are appropriated and allocated in a myriad of separate accounts. The DoD accounting systems were designed to meet the need to maintain the integrity of each of the tens of thousands of accounts maintained by the DoD in what is undoubtedly the most complicated chart of accounts in the world. This multiplicity of "colors of money" is a root cause of the formidable DoD problems with the accuracy of accounting data, the complexity of our contracts, the difficulty of properly managing disbursements and progress payments, the high overhead costs of DoD budget and accounting operations, and the considerable restrictions on the flexibility of managers to shift funds quickly to meet contingencies. Each contractor voucher must contain at least one, and in some cases, many accounting classification codes that typically have from 46 to 55 characters a piece. This is in contrast, of course, to the 16 characters used for a commercial credit card account.

We believe that the DoD and Congress ought to reconsider the need for so many discrete appropriations and subaccounts, as well as the adequacy of the currently authorized periods of obligational availability of appropriations. These kinds of issues are seldom considered in the context of acquisition reform, but we believe that any streamlining of DoD financial management requirements would considerably assist acquisition managers.

JOINT CONTRACTING FOR DEPOT MAINTENANCE OF SECONDARY ITEMS

Based on audits conducted recently, we are confident that there are numerous additional opportunities for acquisition reform.

For example, we recently reported that the Military Departments are not identifying opportunities and initiating actions for joint contracts for repair of secondary items. Taking a snapshot at a point in time in FY 1997, we identified over 3,000 open contracts, valued at over $1 billion, that involved multiple inventory control points of the Military Departments using the same repair facility or supplier, which were candidates for joint contracting. We noted that individual contractor repair facilities had 10, 50, or even as many as 110 different open repair contracts from the various DoD inventory control points.

There are significant opportunities for administrative

efficiencies and economies-of-scale cost savings from joint contracting. At a facility with multiple open contracts, the contractor and DoD would both benefit from having one omnibus type of contract covering all REPAIR actions for a given period of time. The inventory control points of each of the Military Departments are focusing on their own requirements, but do not have the criteria or processes in place for combining DoD-wide requirements on a single contract for depot maintenance of repairable items. Because this issue cuts across the logistics and acquisition bureaucracies of the Military Departments, there may be institutional resistance. However, this is another instance where we think the DoD must reorganize its acquisition approach, simply to be a smarter buyer of services.

DUAL MANAGEMENT OF COMMERCIALLY-AVAILABLE COMMODITIES

We are reviewing the issue of dual management of commercially available commodities. The General Services Administration (GSA) has expanded the range of commercial products available through its Federal Supply Schedule. With the expansion of GSA products that were offered to Government organizations, there is justifiable concern that DoD is operating central procurement programs for the same products as GSA, tying up scarce DoD acquisition workforce resources that are needed elsewhere.

We are now performing an audit addressing the DLA initiatives to procure commercial brand name items and the DLA management of selected commodities. Our work to date suggests that the DLA has duplicated and competed with procurement and supply programs of other Government organizations in procuring commercial brand name items. It is our belief that, in this era of dwindling DoD resources, the DLA should concentrate on its role as a combat support agency and direct its efforts toward procuring replenishment parts for essential weapon systems, or personnel items that are in support of military operations. By competing with other Government organizations for commercial products, the DLA and its DoD customers are missing opportunities to consolidate purchases under a single source of supply. In consolidating purchases, DoD increases its potential for significant savings due to volume buying discounts while cutting administrative costs.

In a report on the DLA Electronic Catalog Pilot Program, we commended DLA for starting an electronic catalog to reduce reliance on DoD inventories. However, we noted that many products in the catalog duplicated products offered by GSA programs, particularly the GSA Advantage system. The Advantage system is a shopping service on the Internet that gives customers access to approximately 310,000 items, and when it is completed in July 1998, the Advantage system is expected to contain approximately

4 million items. Of the seven vendors in the DLA pilot program, five vendors, or companies supplying items to the vendors, had contracts with the GSA for the same or similar items. The types of items that the vendors supplied included cleaning supplies, office equipment and supplies, packaging materiel, and storage cabinets. We also found that the DLA electronic catalog prices were higher than GSA prices. The higher prices were partly caused by the difference in the cost recovery factors used by both organizations to recoup costs for administering their programs. The DLA cost recovery factor was 7.6 percent of the cost of the products while the GSA factor for Federal Supply Schedule contracts was 1 percent. We are working with DLA to resolve our concerns over the duplication in commercial products offered by DLA and GSA in the electronic catalog by surveying the preferences of the potential DoD customers, principally in the Military Departments.

We also recently reported that the DLA managed battery, food service, and photographic national stock numbered items in 17 Federal supply classes that were centrally procured by the GSA. The items included commercial products such as a deep fat fryer, dishwasher, film, and an ice cream cabinet. Our random statistical sample indicated that 27,958 (61 percent) of 45,936 national stock numbered items were either procured by the GSA, or the DLA and the GSA contracted with the same vendors. Additionally, our analysis of the 17 Federal supply classes showed that approximately 92 percent of the items managed in these classes were classified as nonessential to the operations of military weapon systems.

We also found that in some instances DLA customers paid higher prices than if the same item were procured through the GSA. For example, The Defense Supply Center Richmond, Virginia, using a GSA Federal Supply Schedule, placed a delivery order with a vendor for color print film. The vendor shipped the film directly to the DoD customer and the supply center was billed $34,842 for the film. The Supply Center added a 45-percent cost recovery factor to the Supply Schedule contract price and billed the customer $50,572, which was $15,730 more than the GSA price. While attempting to resolve this issue with DLA, we learned that the DLA was planning to expand its procurement of commercial items by establishing a prime vendor program for food service equipment which will further duplicate items GSA sells.

We are also auditing apparent DLA duplication with the Department of Veterans Affairs in the purchase of commercially available medical items for medical treatment facilities. DLA spent about $46 million during FY 1997 to establish prices and engage medical contractors primarily to fill customer orders, valued at about $1 billion, from DoD medical treatment facilities. Likewise, we are auditing a

similar situation involving DLA, GSA, and the National Industries of the Blind regarding office supplies.

In general, we believe that the DoD should stop competing with other Government Agencies that have the mission to buy and supply commercial items, both to conserve DoD acquisition resources and to avoid reducing overall Government negotiating leverage with suppliers. We have brought our audit results in this area to the attention of senior managers and are continuing to work this issue within the Department.

ADVANCED CONCEPT TECHNOLOGY DEMONSTRATION PROGRAM

The Advanced Concept Technology Demonstration (ACTD) Program is an important acquisition reform initiative to get emerging new technologies to meet critical military needs to the war fighters in a much shorter time than the "normal" acquisition development cycle. The Department used 10 selection criteria established in November 1995 to choose programs for inclusion in the ACTD initiative. Those criteria included requirements that the technology should be sufficiently mature and the proposed program should provide significantly increased military capability. DoD acquisition regulations also stated that ACTD projects should meet urgent military needs. When we reviewed the program, the DoD had approved 22 projects, valued at $4 billion, in FYs 1995 and 1996. We found that support for the program was hampered because there was no clear understanding among the technologists and the war fighters of what is a critical military need and what is a mature technology. We reported that, based on the then current selection criteria, five projects, valued at $2.3 billion, appeared to be questionable selections for this program. As a result, the Joint Staff and the Office of the Under Secretary of Defense for Acquisition and Technology agreed to clarify the criteria used to select projects for this program. Draft revised criteria now have been circulated within the Department for comment. When they are finalized, those criteria will be included in the Acquisition Deskbook.

OTHER TRANSACTIONS

The use of "other transactions" is authorized under 10 U.S.C. 2371 as a way to encourage commercial firms to join with the Department in the advancement of dual-use technology, contribute to a broadening of the technology and industrial base available to the Department, and foster within the technology and industrial base new relations and practices that support national security. An "other transaction" is not a contract, grant or cooperative agreement. "Other transactions" are considered exempt from the Competition in Contracting Act, Truth-in-Negotiations Act, Contract Disputes Act, Antikickback Act of 1986,

Procurement Integrity Act, Service Contract Act, Buy American Act, the intellectual property clauses of the Bayh-Dole Act, the Title 10 sections relating to procurement contracts and the Federal Acquisition Regulation. "Other transactions" are also exempt from audit access for examination of contractor records by the General Accounting Office and Defense Contract Audit Agency.

There are two types of "other transactions" authorized by law. The first type of "other transaction" was authorized in 1989 to enable the Defense Advanced Research Projects Agency, and the rest of DoD in 1991, to access commercial technology for research and development purposes. I will refer to these as research "other transactions." Research "other transactions" usually consist of a consortium of companies and requires the companies to contribute at least 50 percent of the costs, to the extent practicable. The Department can waive the 50 percent cost share. There is also a requirement that there be a determination that a contract, grant or cooperative agreement would not be feasible or appropriate. The second type of "other transaction" was authorized in Section 845 of Public Law 103-160 and authorized the Defense Advance Research Projects Agency in 1994, and the rest of the Department in 1996, to enter into "other transactions" for prototype projects related to weapons or weapon systems. I will refer to these as prototype "other transactions." Prototype "other transactions" do not require cost sharing or the determination that a contract, grant or cooperative agreement would not be feasible or appropriate.

The basic authority for "other transactions in 10 U.S.C. 2371 requires the Secretary of Defense to issue regulations but none have been published. Although there have been reviews by the Department and the American Bar Association on what statutes are not applicable to "other transactions," there is no definitive list published.

For FY 1990 through FY 1997, we believe the Department issued 171 research "other transactions," valued at $3 billion, and 59 prototypes "other transactions", valued at $837 million. We have had continuing concerns about a lack of controls over the "other transactions" process since none of the normal rules and procedures apparently apply. In our 1997 report on 28 "other transactions" awarded by the Defense Advanced Research Projects Agency, we outlined the need to put funds advanced to consortiums into an interest bearing account until used; to monitor the actual cost of the work against the funds paid; to ensure that cost sharing arrangements were honored; and to standardize the audit clause.

We are currently looking at how 78 "other transactions" are being managed by the Army Communications and Electronics

Command, Air Force Wright Laboratory, Defense Advanced Research Project Agency, and Defense Contract Management Command. The current review found problems similar to those in our 1997 report about the Defense Advanced Research Projects Agency. We have been cooperatively working with the Department to make improvements in issuing and administering the "other transactions" and correcting problems identified. It is still too early to report on the results from our other major initiative in this area, a joint review with the Defense Contract Audit Agency on how the contractors are charging costs to "other transactions."

The Department is operating and expanding this $3.8 billion program based on interim guidance memorandums issued in 1994 by the Director, Defense Research and Engineering and 1996 by the Under Secretary of Defense for Acquisition and Technology. The Department needs to issue long overdue official guidance on both the research and prototype "other transactions." In the early 1990s, the use of "other transactions" was restricted to the Defense Advanced Research Projects Agency and the lack of guidance was not a critical problem since only eight contracting officers at the Agency were involved. The small scope of the program permitted easy sharing of knowledge and lessons learned. Since expansion of the use of the "other transactions," we now have many personnel at multiple locations trying to award and manage "other transactions." The lack of good guidance causes repetitive relearning of problems and solutions for managing "other transactions." The Director, Defense Procurement, recently promised to issue guidance and lessons learned within 120 days on use of prototype "other transactions." The Director of Defense Research and Engineering has had draft guidance in process on research "other transactions" since 1994, but expects to issue it shortly.

The incentive for "other transactions" was to attract new companies into doing research and development for the Department, yet the DoD collected no data on the program's success or lack of it in that area. We collected data for the period 1990 through 1997 showing that 85 percent of the funds for "other transactions" go to traditional DoD contractors (81 percent) and nonprofit institutions like universities, States and Federally Funded Research and Development Centers (4 percent).

We noted that from FY 1990 through FY 1997, 170 new contractors did business with DoD and this was only 20 percent of the participants in consortiums working on "other transactions." The traditional DoD contractors and nonprofit institutions accounted for 669 of the participants or 80 percent of the total. Some of the traditional DoD contractors participated in as many as 20 "other transactions."

Program advocates may propose expansion of the "other transactions" authority into production. We have expressed concerns within the Department that, without performance metrics on "other transactions," DoD and Congress cannot determine the benefits now and in the future of "other transactions."

We are also concerned that if "other transactions" authority is extended to production runs of equipment, there will be a need for additional scrutiny of pricing for sole-source items. In these cases, the Department will require access to cost or pricing data, plus audit access for DCAA, in order to ensure fair prices. The Cost Accounting Standards should also apply, except perhaps in cases with a new commercial contractor that has no DoD contracts. For new contractors, the Department should have the authority to waive the Standards.

TESTING AND RISK MANAGEMENT

Adequate testing before buying or installing new systems and adequate risk management have been basic tenets of the DoD acquisition process for many years. We continue to believe that congressional insistence on independent test and evaluation was very prudent.

We recently reported that the Air Force planned to install Precision Landing System Receivers in 120 C-17 aircraft with an estimated cost of up to $105 million. However, the Air Force was going to do so without sufficient testing to determine if the system would work. Having seen the inability to operationally deploy the existing Mobile Microwave Landing System on C-130 aircraft for the last decade, after spending $98 million, we had grave concerns about the viability of this "streamlining" action. The Air Force also had not complied with several critical acquisition management requirements, specifically, developing life-cycle cost estimates and assessing potential alternatives to meet the requirement. In addition, the Air Force system was a command unique, service unique system even though the DoD objective is to develop a joint precision approach and landing system for all Services. In the case of the C-17 Precision Landing System Receiver, we questioned the risk assessment done by the Air Force. The Air Force is now doing additional testing on the landing system before it installs the system on additional aircraft.

In implementing acquisition reform initiatives, the Department moves from a risk avoidance to a risk management environment and the program managers are being asked to accept bigger risks. However, in order to function in this environment, the program managers and other acquisition managers must make reasonable assessments of what the risk

is and what actions can be taken to manage and mitigate the risk. We reported that risk management plans for the Combat Service Support Control System, Minuteman III Guidance Replacement Program, Fixed Distributed System, Single Channel Anti-Jam Man-Portable Terminal, and the Hunter Unmanned Aerial Vehicle were not adequate to identify, manage and reduce program cost, schedule, and performance risks. A working group subsequently developed much improved guidance on risk management. However, the Department needs to continuously assess and improve its risk identification and management methodologies, techniques, and tools.

FOREIGN COMPARATIVE TESTING PROGRAM

We strongly support the expanded emphasis on using off the shelf, nondevelopmental items. Similarly, cooperative research and development with our allies often makes far more sense than duplication, especially as many Defense budgets shrink. We are issuing a series of audit reports on the Foreign Comparative Testing Program, which provides for testing foreign technologies and equipment that have the potential to satisfy U.S. military requirements.

In one report, we recommended resubmission and reconsideration of testing the foreign-made nickel cadmium battery as a substitute for a silver zinc battery in the Navy SEAL Delivery System. By using the nickel cadmium battery for training and low-power mission requirements, the Navy can avoid costs of over $7 million annually and reduce the 30-year life cycle cost of the system by $166 million. The Navy agreed in principle and we are working with them to resolve details. In another report, we recommended stopping funding for an expendable countermeasures dispenser for the F-15, until the program manager could provide an executable plan to procure the dispenser if testing was successful. The testing of the dispenser was 20 percent of the $7.4 million available for funding the testing program in FY 1998. We are working with the program manager of the Foreign Comparative Testing Program to further improve the processes used for planning and selecting projects for testing. With improvements in the processes, the Department can reap additional benefits from this program.

INTERNATIONAL COOPERATIVE RESEARCH AND DEVELOPMENT PROGRAMS

The Department has taken actions to improve the use of International Cooperative Research and Development Programs since our 1992 report pointed out numerous weaknesses in that effort, but a recent review showed that additional actions were needed. The International Cooperative Research and Development Programs are a family of programs in which DoD and a foreign ally share in the cost and technology advances of research and development efforts. However, acquisition program managers are still not adequately

considering international cooperative opportunities early in the acquisition cycle. Out of 37 responses to a questionnaire to 86 Acquisition Category I programs, over 70 percent indicated little consideration given to cooperative opportunities. We will work with the Department on revising training and guidance to improve the use of international cooperative research and development.

REQUIREMENTS DETERMINATION

While acquisition reform tends to focus on the mechanics of development and procurement, significant savings in those areas could be wasted if requirements are overstated or misstated. In our audits, we have questioned the reasonableness of the numbers of some weapon systems to be procured and how the Military Departments determine those numbers. In many instances, the requirements estimating process was little more than a multiplier of the number of platforms that can conceivably carry a particular system.

In a series of recently completed and on-going audits, we are assessing DoD theater models used in generating quantitative requirements. Improvements have been made as a result of the Capabilities-Based Munitions Requirements process, which is intended to ensure that military planners base munitions requirements on the estimated number of munitions needed to defeat specified threats within a given force structure. The DoD has made considerable progress in getting the Joint Staff and the Combatant Commands more involved in these kinds of calculations. However, we are identifying problems with the models used in the process. We are working with the multiple organizations responsible for the models to correct the problems. The Department must make hard assessments of what is really needed in light of constrained funding. Without a rigorous and realistic requirements determination process, which recognizes that each Military Department or each platform does not have to "kill" all the threats, the DoD will not be able to effectively integrate the requirements estimating process with the acquisition programs and budget.

ACQUIRING AUTOMATED INFORMATION SYSTEMS

The rapid advance of information technologies underlies the ongoing revolution in both military arts and modern business practices. For example, the use of modeling and simulation is growing and will be used more and more in areas like training, testing and acquisition management.

The Congress addressed the compelling need to improve the Government’s performance in managing information technology programs by enacting the Clinger/Cohen Act. We are attempting to provide thorough audit coverage of the key issues confronting information systems acquisition managers.

Those include: addressing the serious challenges posed by the Year 2000 conversion program; improving the Department's perilous computer security posture; moving away from decades of disjointed information systems management to fully integrated systems; and effectively implementing the disciplined investment decision making processes mandated by the Clinger/Cohen Act. We have issued 43 reports on these matters over the past 2 years.

We have found that, for major automated information systems, the DoD has not fully implemented the management structure and reform concepts envisioned by the DoD acquisition reform initiatives. In March 1996, DoD reissued its "5000 series" of documents that address defense acquisition policies and procedures. As part of the acquisition reform efforts, DoD integrated, for the first time, the acquisition policies and procedures for weapon systems and information systems. However, we continue to have concerns about the management controls for information systems. Recent audits have identified instances where the management controls for vital system development projects did not ensure adequate program definition, structure, design, contracting, assessment, decision reviews, and periodic reporting. For example, we found that the acquisition of the Defense Civilian Personnel Data System needed stronger acquisition management controls to include clearly defined lines of responsibility, authority, and accountability for the acquisition of the system; assignment of a program manager with the requisite acquisition training; and a comprehensive in-process review of the system to include the program acquisition strategy, acquisition program baseline, test and evaluation master plan, life-cycle cost estimates, and information assurance plan. The multi-component Defense Civilian Personnel Data System program life-cycle cost is about $10 billion, which includes $795 million for the regionalization/modernization investment portion.

The DoD acquisition cost of automated training simulator systems now exceeds $1.5 billion annually. We performed an audit that indicated the Department was developing and procuring large-scale (involving interoperable simulators, war games, and live ranges) information system training simulations without assigning a single manager the responsibility and authority for oversight and coordination for these large-scale training simulations. The programs lacked the visibility and acquisition oversight that are essential for investments of this magnitude and importance. The Department agreed and instituted corrective actions.

In different reports, we have identified at least eight information systems, estimated to cost $2.7 billion, which should be subjected to Major Automated Information System

Review Council milestone reviews. Information systems that cost more than $30 million per year or $120 million in total development costs or $360 million in life-cycle costs are subject to review and oversight by the Council. The Military Departments and Defense agencies do not always identify information systems as major and requiring milestone reviews by the Council. The DoD relies heavily on audits to identify issues like these; however, the decline in audit resources and hence, audit coverage, raises serious concerns regarding the adequacy of controls in this vital area. We understand that the Department will soon merge the Defense Acquisition Board and Major Automated Information System Review Council processes. Because the Defense Acquisition Board is generally considered a more rigorous oversight mechanism, we hope that such a realignment will move the Department closer to full implementation of the Clinger/Cohen Act and increased emphasis on automated system investments. Time will tell.

SERVICE CONTRACTS

DoD service contracting is another high risk area for waste and mismanagement. Service contracts is a growth area in DoD, and may continue to grow because of the expanded emphasis on outsourcing. About $93 billion was spent on service contracts during FYs 1996 and 1997. The amounts for service contracts annually exceed the amounts spent on procurement contracts for weapon systems. For weapon system contracts, the senior leadership in the Department provides oversight through Selected Acquisition Reports, Defense Acquisition Board reviews, and numerous briefings. There are almost no oversight mechanisms and the Office of the Secretary of Defense receives basically no information on how the Department is doing in managing service contracts. We see no comprehensive efforts by the Department to oversee or manage the growth, costs, profits or fees for service contracts.

Since FY 1996, we have issued 44 reports covering service contracts. The majority of these audits resulted from Hotline allegations and congressional requests, rather than DoD management requests. The following sections highlight some of the service contract problems we found on competition, task order contracting, intra- and inter-agency procurements, and advisory and assistance services.

COMPETITION

Competition has long been the cornerstone for effective Government contracting. Competition has been an important tool in ensuring fair prices and eliminating price scandals caused by overpriced goods and services. Typically, competition results in price reductions of 5 to 30 percent. Competition works, but the process is dependent on the

diligence of program and contracting officials to develop good acquisition planning, to publicize requirements, and to select contractors who offer the best value and performance to the Government. For service contracts in FYs 1996 and 1997, about 72 percent ($66 billion) were awarded competitively and 28 percent ($26.4 billion) were awarded on a sole-source basis. For the 23 different categories of service contracts, the percent of competitive contracts range from a high 92 percent for construction related services ($12.1 billion) to only 48 percent for technical services ($2.6 billion).

I previously discussed specific problems with the two sole-source contracts for spare parts. DoD organizations also continue to miss opportunities to reap savings from competition for services. Some contracting officers are willing to accept faulty justifications for using other than full and open competition and work statements that give the incumbent contractor or a particular contractor a competitive advantage, and ignore or circumvent thresholds or procedural requirements. We continue to see instances where contracting officers used incorrect justifications of uniqueness or urgency when in fact, the real reasons were inadequate planning or a desire by program offices to continue work with the same contractor or subcontractor. For example, in a recent audit of contract reconciliation services performed by a major accounting firm, the contractor was originally selected noncompetitively as a subcontractor to a disadvantaged small business firm. Subsequent awards were made to the accounting firm as a prime contractor, first as a lone competitor, then using sole-source justifications of uniqueness of service and urgency. The award has stayed with the same contractor since 1989, covering four time and materials contracts and three contracting activities at a cost that has reached almost $80 million. In another instance, the Defense Supply Service-Washington planned to award a $45 million sole-source business process reengineering contract because program officials wanted to continue obtaining services from the particular contractor.

Contracting officers also avoided competition on contracts set aside for small business by arbitrarily keeping award amounts below thresholds at which competition is required or using unrealistic minimum contract values to determine whether threshold limitations were met. An audit showed that Navy contracting officials inappropriately awarded 6 small business contracts noncompetitively because they used minimum contract values to avoid the thresholds for competing the contracts. Competition would have saved $45 million over 6 years on the contracts.

TASK ORDER CONTRACTING

The Federal Acquisition Streamlining Act (FASA)

authorized the use of task order contracts where the specific content of the work to be performed is determined after the original contract is signed through individual task or delivery orders for specific work to be performed. For contracts for advisory and assistance services where the contract period exceeds 3 years and the contract amount is estimated to exceed $10 million, the Act requires, whenever practical, the use of multiple award task order contracts to allow quick, commercial-style competitions among the awardees when specific requirements are needed. We have identified use of large single-award omnibus contracts with broad statements of work and no competition for individual task orders. In these cases, the task order contracts were awarded prior to FASA and work requirements have not been recompeted. For example, one Defense agency allowed customers to pick the desired contractor among the multiple award contracts and direct work to that contractor without competing the requirement. On another multiple award task order contract, contracting officials competed the orders, but manipulated evaluations to select the preferred source, which was often the incumbent contractor on prior contracts for similar work. The problems cited at the Defense agency have been resolved. At the request of Senator Carl Levin, we will be doing additional work this year on reviewing the use of multiple award task order contracts.

INTRA-AGENCY AND INTER-AGENCY PROCUREMENTS

We have issued seven audit reports that have highlighted persistent problems with use of inter-agency and intra-agency transactions. Although none of these reports identify widespread abuse like that found in the early 1990's involving Economy Act orders, the reports indicate that some organizations continue either to use Economy Act orders to direct work to preferred sources or to avoid competition.

One report discusses a Navy program office that wanted to award a sole source $30 million small business contract through the use of an intra-agency order. Another audit indicated that the Defense Finance and Accounting Service directed work to a preferred contractor by adding the requirement to another Defense agency's contract. In this instance, other contracts were available that could have saved money from competition and lower management fees, but the Defense Finance and Accounting Service would not have been able to ensure selection of the preferred source. Another audit identified the misuse of Economy Act orders by the DoD Electronic Commerce Office, which was at the time part of the Office of the Under Secretary of Defense for Acquisition and Technology. In that case, about $300,000 was placed on an order to another activity solely to prevent it from expiring.

This area is difficult to control because there is no reporting system that provides visibility on which activities are ordering and accepting work or the magnitude of Economy Act orders.

CONTRACTS FOR ADVISORY AND ASSISTANCE SERVICES

Contracts for advisory and assistance services, which include most of the professional, administrative, and management support services contracts and contracts for special studies and analyses, are an area where we continue to find problems. During fiscal years 1996 and 1997, there were $18 billion of these contracts. Contracting officers are responsible for ensuring that contracts for these services are properly planned and administered. Agencies are required to establish controls regarding the reporting of these contracts. In a recent audit, we determined that the Office of the Assistant Secretary of Defense (Nuclear, Chemical and Biological Defense Programs) provided Government facilities and equipment to a prime contractor and subcontractor without contracting officer approval or offsets to reflect reduced costs in contract performance. DoD personnel also directed contractor employees and consultants to perform unauthorized services valued at $15.7 million, included tasks on one contract that involved potential conflicts of interest, and used contractor employees on a prohibited personal services basis without the contracting officer's knowledge to compensate for staffing reductions.

In summary, we recommend increased acquisition reform focus on the services contracting area.

CONTRACTOR PENSION PLANS

Another facet of DoD acquisition that generally receives only limited attention is the overhead burden associated with contractor pension and insurance plans. In 1997, we did a review to see if all recommendations in a 1993 report on oversight of contractor insurance and pension plans were implemented. Because of the significance of pension-related issues in business combinations, the review focused on contractors known to have acquired or sold business segments. Billions of dollars of contractor pension fund assets accumulated from charges to Government contracts continue to be exposed to undue risks. Specifically, Government-funded pension assets must be properly allocated during restructuring to ensure future contracts do not bear a disproportionate share of pension costs. Based on estimated average pension costs of $216,000 per employee, the pension fund assets, for the 15 largest contractors, were estimated to be $100 billion. We identified six conditions that result in unacceptable review coverage and substantial risk to the Government and found

that incurred costs are improperly allocated to existing contracts and forward pricing estimates for future contracts are inaccurate. The Director, Defense Procurement, and the Defense Logistics Agency agreed to take corrective action, which we will closely monitor.

DOWNSIZING OF ACQUISITION WORKFORCE

The acquisition workforce at DoD is undergoing a 47-percent reduction from 617,000 personnel in 1989 to 329,000 personnel in 2000. The Department is currently considering further revisions to the number and the definition of the acquisition workforce. Assuring the success of acquisition reform efforts demands a leaner, more professional, highly experienced, and trained acquisition workforce. Unfortunately, there has been no risk assessment or systematic determination on whether needed process improvement, such as electronic contracting, will occur before the personnel reductions are made. The General Accounting Office has repeatedly reported that Defense contract management is a high risk area. Nevertheless, both contracting staffs and audit resources have been drastically reduced, and further reductions are planned. At the same time, DoD plans to increase the contracting out of numerous functions, thus creating more contract administration workload. The DoD also plans to increase its procurement budgets significantly in the coming years, spending over $350 billion for fighter and attack aircraft alone. Both trends will increase the need for effective contract award, administration, and audit.

As DoD seeks to reengineer and streamline its contracting processes, new business process techniques will be key to accomplishing effective and efficient oversight in the future. As we stated in a recent Semiannual Report to Congress, however, "Instead of workforce adjustments being a logical consequence of business process reengineering, the personnel reductions appear to have become a reform goal in and of themselves." Reductions to the acquisition workforce need careful management instead of arbitrary acceleration based on projected business process reengineering that is only partially defined and may not occur.

Maintaining public support for Defense programs requires good contract management and prompt identification of any potential fraud. As personnel reductions in the acquisition workforce have occurred, we have also seen reductions in programs for fraud prevention, detection, and reporting. For example, I am very concerned about the decrease in the number of fraud referrals that we receive from the Defense Logistics Agency. Since 1995, the number of referrals for procurement cases has dropped by 47 percent. This decrease is partly because the number of personnel in the Office of General Counsel involved in fraud

detection and referral at the Defense Logistics Agency has been cut from 15 to 3. As reform efforts continue to emphasize partnering with industry, there also seems to be less emphasis at the working level on reporting potential fraud. While we understand the many benefits of the new emphasis on Government/industry teamwork, the Department should not assume that procurement fraud no longer occurs. To the contrary, our criminal investigators report that their proactive undercover efforts regularly reveal significant fraudulent activity. Unfortunately, due to ongoing downsizing, those proactive efforts are likely to be curtailed in the future and we are concerned that DoD fraud awareness and detection programs will be unable to adequately protect the many taxpayer dollars that fund DoD procurement efforts.

PROCUREMENT FRAUD THREAT

A major focus of the Defense Criminal Investigative Service (DCIS), the criminal investigative arm of the Office of Inspector General, is procurement fraud. For FYs 1996 and 1997, procurement fraud investigations led to 472 criminal charges, 403 criminal convictions, 25 civil charges, 22 civil judgments, 263 suspensions, 321 debarments, and monetary outcomes of $465.7 million.

The following two product substitution cases illustrate the types of procurement fraud DCIS investigates.

Just last month, a company was indicted for allegedly falsifying quality assurance testing of high-reliability semiconductors used in military and space applications. The company allegedly falsified quality assurance testing and data supplied to customers. The semiconductors are used in the Army Commanche helicopter, the Navy F/A-18 fighter aircraft, A/V-8B Harrier aircraft, the space shuttle, space station Freedom and several military and commercial satellites. The cost for rescreening, removing, and replacing these semiconductors is $30 million for the Air Force, $10 million for the Navy, and $20 million for the National Aeronautics and Space Administration.

In another case, the contractor under four separate contracts delivered defective lifeboats to the Navy. Not only did the lifeboats fail to meet contractual specifications, but tests performed by the Federal Bureau of Investigations laboratory determined that the nonconforming lifeboats were dangerously unsafe when used for their intended purpose. The loss to the Navy was $20.9 million, including $4 million to remove the unsafe lifeboats from service. The contractor pled guilty to one count of conspiracy to defraud the United States and one count of obstruction of justice and was sentenced to 5 years probation. A civil settlement of $21.2 million was reached

on charges of violations of the False Claims Act, breach of contract and unjust enrichment.

Many advocates of drastic changes in Government acquisition practices are unaware of, or choose to ignore, the fact that procurement fraud remains a threat to the DoD and the U.S. taxpayer. We must never convey the impression that we are becoming in any way tolerant of criminal activity.

LEGISLATIVE PROPOSALS

My office has also sought to provide constructive advice in reviewing, commenting on and helping the Department draft hundreds of legislative proposals related to acquisition, logistics, and financial reform issues. The other DoD components and we have not always agreed, but our views are always considered.

Today, I wanted to comment on two legislative issues that the Senate may consider this year or in the future: repeal of certain contract fee limitations and amendments to the False Claims Act.

REPEAL OF FEE LIMITATIONS

The Department has proposed the Defense Reform Act of 1998 to implement some of the recommendations in the Defense Reform Initiative Report. We are not opposed to most of the proposed Act; however, we disagree with a section that proposes repeal of the fee limits on cost contracts. Specifically, the proposal would eliminate the 15-percent fee limit on cost-plus-fixed-fee (CPFF) contracts for experimental, developmental, or research work, the 6-percent fee on CPFF contracts for architectural or engineering (A&E) services, and the 10-percent fee limit on any other types of CPFF contracts.

We have disagreed with similar proposals over the last 7 years. In FYs 1996 and 1997, there were about $4.1 billion worth of A&E contracts. The fee limitations on A&E contracts should be retained because the statute reasonably limits how much the DoD can spend to design projects and prevents overspending on design efforts to the detriment of actual construction. Critics claim that the low fees result in A&E work that causes multiple design changes and contract modifications during construction. We looked at 35 completed military construction projects valued at $282 million to see whether changes to contracts were needed because of inadequate A&E design work. We did not identify such problems. Critics also claim that fee limits discourage competition, yet 84 percent of A&E contract awards had multiple bidders and we simply saw no proof of this contention.

The fee limitations on CPFF contracts provide a reasonable framework for the contracting officer to use in negotiating CPFF contracts and still allow flexibility to reward contractors according to different risk situations. Contractors have less financial risk on level-of-effort and completion type CPFF contracts than any of the other contract types. Eliminating the statutory limitations on fees for CPFF contracts would likely result in varying interpretations by contracting officers and higher fees on some CPFF contracts. In FYs 1996 and 1997, the DoD awarded about $57 billion of cost-type contracts, of which about $29 billion were CPFF contracts. Also, contracting officers often apply the 10 and 15 percent limitations as maximum fees on CPIF contracts (about $5.7 billion in FYs 1996 and 1997) and cost-plus-award-fee contracts (about $25.7 billion in FYs 1996 and 1997). Thus, a lot of contracts will be affected. For example, if the fee limit had been removed and contract fees had been increased by 1 percent, the DoD costs for fee type contracts would have increased by about $570 million in 1996 and 1997.

FALSE CLAIMS ACT

Members of industry have recently suggested changes to the False Claims Act, Section 3729-3733 of Title 31 United States Code. The Act has been an invaluable tool in the fight against fraud in government contracting and I vigorously oppose proposals which would significantly raise the required standard of proof and decrease the amount of applicable penalties involved in False Claims Act cases.

Some of those who have called for changes in the Act claim that commercial contractors will not do business with the Government because they fear that if they make a simple mistake and submit incorrect or erroneous documentation to the Government they will be treated like criminals and accused of defrauding the Government. They argue that innocent mistakes will unfairly subject them to the penalties and treble damages available under the False Claims Act.

I note that we have seen no evidence of such misuse of the statute from those making these arguments. Secondly, their argument ignores the clear reading of the statute. A simple mistake does not amount to a false claim subject to the False Claims Act. The Act requires a knowing submission of a false or fraudulent claim; the knowing use of a false record or statement to get a false or fraudulent claim paid; or a conspiracy to defraud the Government by knowingly getting a false or fraudulent claim paid. Knowing and knowingly are specifically defined in the statute to require that a person, with respect to the information, (1) has actual knowledge of the information, (2) acts in deliberate

ignorance of the truth or falsity of the information, or (3) acts in reckless disregard of the truth or falsity of the information.

Proof of either deliberate ignorance or reckless disregard of the truth requires far more than evidence of a simple mistake. In fact, such conduct is considered so serious and so difficult to prove that the courts have found it sufficient when proven beyond a reasonable doubt, to establish the "knowledge" required for criminal convictions under the felony provisions of the false statement statute even without proof of actual knowledge of the falsity of the statement. Given that fact, Congress was clearly more than justified in providing lesser, civil penalties under the False Claims Act for similar conduct when proven by "a preponderance of the evidence," the normal standard of proof in civil cases.

Again, the False Claims Act has been essential to our efforts to combat procurement fraud at DoD. According to the Civil Division of the Department of Justice, $844,714,737 was collected during the last 5 years (FY93-97) as a result of DoD investigations of False Claims Act violations.

BENEFITS OF DEFENSE CONTRACT AUDIT AGENCY

Along those same lines, I want to touch on several other topics that relate to the future of government oversight efforts. I am concerned by the perceptions still held by some regarding the contributions of Government auditing of contracts in the new reform environment.

The Defense Contract Audit Agency (DCAA) is often unfairly criticized, especially by contractors, for not being in step with acquisition reform. In fact, they have been one of the leaders in reform in the Department, despite the fact that they are being drastically downsized (44 percent and 3,150 positions between FY 1990 and FY 2002). To accommodate those cuts, DCAA has reduced the size of Headquarters and regional offices, consolidated field audit offices, reduced the number of middle management positions, doubled the supervisory span-of-control, and significantly improved productivity. DCAA has supported numerous acquisition reform initiatives and undertaken significant business process reengineering in order to achieve this downsizing without negatively impacting its mission. Notable efforts included significant improvements in risk management, supporting Integrated Product Teams and the Single Process Initiative, and leading reinvention laboratories on oversight reduction and parametric cost estimating.

Audits by the DCAA are one very important means of

making sure we do not overpay for weapon systems. Over the last three fiscal years, DCAA audits produced savings of over $9 billion dollars. Last year alone, DCAA efforts produced documented savings of $3.7 billion. In addition, each year contractors subject to DCAA audit do not claim reimbursement for over $2 billion in unallowable costs. We believe there is a clear correlation between contractors not claiming things like "three martini lunches", "golden parachute" payments, and tickets to sporting events or rock concerts and the knowledge that claimed costs will be audited.

There is some talk today about not obtaining cost information under any circumstances; eliminating cost principles, cost accounting standards, and contract audits; and even returning to the simple--but disastrous--1980's practice of fixed price contracts for research and development. I support adopting reasonable commercial approaches when there is a healthy competitive marketplace. However, when we are buying unique military weapons from a few dominant suppliers, we must recognize that we cannot naively rely on competitive market forces that do not exist. In the absence of market forces, any prudent buyer, public or private, would want objective verification that what is paid is reasonable. In those circumstances, the Department, entrusted with billions in taxpayer dollars, has a clear obligation to act as an "informed consumer" to the greatest degree possible. Blind faith reliance on a non-existent market would not likely produce the over $5 billion in annual benefits we now get because of DCAA audit work.

There are unique risks to both contractors and the Government when designing and producing complex and high-cost military weapon systems. This has been recognized for decades. These risks necessitate certain safeguards. Recognition of those risks led Congress and policy makers to enact the Truth in Negotiations Act, to adopt flexibly-priced contracts, to promulgate cost principles, and to develop cost accounting standards. In each instance, Congress required that auditing steps be employed in support of these safeguard approaches. Auditing is, after all, simply verification. Prudent expenditure of public funds requires that where competitive forces can't be trusted to yield a fair price, alternative protections must be employed and the results verified.

If anything, the risks may be greater today because there is such market dominance by a few very large suppliers. In this environment, getting cost information and maintaining audit rights is a prudent business practice. Failure to do so will be very costly for the Department and ultimately the taxpayer.

BENEFITS OF THE TRUTH IN NEGOTIATIONS ACT

The Truth in Negotiations Act, first tested in concept during World War II and then enacted into law in 1962, has long proven to be a highly effective tool for assuring the reasonableness of weapon systems prices. I want to say a few positive words about the Act because it is often criticized, unfairly in my mind, by contractors and some other observers of Government acquisition practices. During considerations of the 1994 and 1996 acquisition law changes, the Truth in Negotiations Act was oftentimes used as an example of outdated and unnecessary procedures. There was a consensus that the Act needed some changes and it was modified and updated by the Congress in 1994 and 1996. The Act is still serving the Department well, despite its critics.

The Act's cost and pricing data requirements only apply to high dollar value, negotiated procurements where the normal pricing constraints of the competitive marketing place do not produce adequate price competition. In FY 1997, about 53,000 contractual actions, valued at about $46.3 billion, were subject to the Truth in Negotiations Act. The Act simply requires contractors to provide to the government current, accurate, and complete cost and pricing data - the same type of data that any efficient contractor is already generating for its internal price negotiations purposes. It permits both the contractor and the government negotiators to be in a position to negotiate fair and reasonable prices based on the same truthful pricing data.

We believe the Act has significantly reduced contract prices over the years, freeing up funds to help meet other critical DoD readiness and weapon system procurement needs. The FY 1995 TASC/Coopers and Lybrand Study of Procurement Oversight Costs stated that the Truth in Negotiations Act increases contract prices by 1.3 percent. The study only included ten contractors and can not be extrapolated reasonably to all contracts. In response to the study, the Department looked at how the Act was being applied in regulations and actual processes, and subsequently initiated procedural changes and education to make its application less onerous and more efficient. A DoD process action team also did a review of the cost and benefits of the Act and reached quite different conclusions. They determined that, in FY 1994 alone, the Act provided $2 billion in benefits and the benefits exceeded the costs by 267 percent.

Prior to this hearing, we updated the cost and benefit analysis of the Act for FY 1997. We estimate that the Act contributed to the identification of about $2.1 billion in benefits, which exceeded both Government and contractor costs by 310 percent. This is just the tip of the iceberg. Most cost savings from the Truth in Negotiations Act are

achieved from the deterrent effect that encourages most sole-source contractors to be open and fair. Because most contractors are complying with the Act and are providing the Government with current, accurate, and complete certified cost or pricing data, overall contract prices are being held down to a lower level than they would be if the Act did not exist or were weakened.

We should not forget that commercial items have always been effectively exempted from the Truth in Negotiations Act. Fixed-price purchases of commercial items at market prices do not carry the risks that the Act protects against. The recent statutory revisions to the Act ensure that the Act is employed only when the business risk justifies it. Further prohibitions could actually place the government buyer at a disadvantage to the private sector in obtaining fair and reasonable prices. Many private sector companies recognize the importance of obtaining cost data and audit rights when confronted with sufficient pricing risk.

The push to eliminate the requirement for cost or pricing data by contractors is generally based on the purported cost of preparing such data. It has been our long held view that contractors do not have a legitimate argument that developing such data is too costly. All well managed companies employ cost accounting practices sufficient to determine the cost of goods or services sold. Rather, contractors object to sharing that data with Government negotiators since this deprives them of the advantage of exclusive knowledge.

Making sure that contractors do not use superior knowledge to make excessive profits is precisely why Congress passed the Truth in Negotiations Act. The Act ensures a "level playing field." Clearly, contractors have a responsibility to shareholders to make a profit, and the Act is not a law to prevent this. The Act helps ensure the contractor makes a reasonable profit, not a windfall profit at taxpayers' expense. The recent experience on spares procurements, discussed earlier in this statement, has demonstrated that some contractors that have recently converted from cost-based pricing to commercial pricing have significantly raised prices. While market-based pricing is still justified in many of the cases, these experiences point out the need to move cautiously, especially in sole-source situations. This is particularly true today when we find ourselves increasingly dependent on a few dominant suppliers.

REDUCTIONS IN THE OFFICE OF THE INSPECTOR GENERAL

Acquisition reform will not reach its full potential if essential management controls are weakened to the point where risk becomes unmanageable. As I have reported to the DoD and Congress on several occasions, including the last three IG semiannual reports to the Congress, I am very concerned that ongoing budget cuts are compromising the adequacy of audit and investigative coverage of DoD high risk areas.

The Office of the Inspector General is being reduced from 1,620 workyears in FY 1995 to 1,059 workyears in FY 2001. The number of auditors is expected to be cut from 619 in FY 1995 to 393 in FY 2001, and the number of investigators is expected to decrease from 373 to 277. To accommodate that downsizing, the OIG has already undergone two reorganizations since 1995, eliminating administrative inefficiencies and efforts in areas that while valuable, are not essential to our statutory mission. We have been also attempting to offset those cuts through productivity improvement. For example, our average time to perform audits decreased by 47 percent, the average cost per audit decreased by 46 percent and the average time to prepare our draft reports decreased by 53 percent. We have also created joint planning teams with the Service Audit agencies in areas such as acquisition, logistics, and finance to improve planning and eliminate any possible duplication and overlap in work.

Our audit workload is growing from required work driven by the Chief Financial Officers Act, congressional requests, management requests, the Government Performance and Results Act, the Clinger/Cohen Act, Year 2000 Conversion, required audits in the annual Authorization and Appropriation Acts, and reviews required under Office and Management Budget Circular No. A-76 on contracting out Government functions. As mentioned earlier, we have also been working on numerous process action teams with Department managers and this is a new workload. We can no longer overcome increasing workload with productivity increases while continuing to downsize. If in 2001 you invite the Office of the Inspector General to a hearing such as the one today, we may not have much to contribute, because audit teams covering acquisition matters will likely be cut by up to 58 percent and procurement fraud investigators by up to a third.

Also, given the extent of the planned downsizing, we will not be able to provide the prompt attention to congressional requests we currently do. For investigations, we will be forced to focus resources on safety and readiness investigations and decrease attention to areas of high dollar crime such as procurement and health care fraud.

Also, new but extremely critical areas such as computer incursion will not be adequately addressed. Given the vulnerability of DoD information systems, I believe it is essential to maintain a robust audit and investigative capability in this area, but am concerned about our continuing ability to do so. Resource cuts will require the realignment or closure of an additional one-fourth of our investigations field offices, which will have a major negative impact in some judicial districts. Our proactive effort on fraud prevention has already been curtailed and will be eliminated if the cuts continue. Finally, investigative backlogs will grow.

Maintaining public support for Defense programs requires good contract management and prompt identification of potential fraud, waste or mismanagement in the process. Just the presence of auditors and investigators provides a deterrent to fraud, waste or mismanagement of contracts. In my opinion, inadequate investment in a sound audit and investigative effort compounds the problem and the dangers already facing the DoD. This is an era of turbulence and considerable risk for the Department as it struggles with the introduction of radically new processes, increased stress on the workforce, reorganization, downsizing, increased reliance on automated systems, and conflicting priorities. Despite the progress made by reform initiatives, there are still many problems in the acquisition area and much work to be done. We believe sound and realistic management efforts constructively coupled with effective and efficient oversight are essential to the Department’s ultimate success in this critical but very difficult area.

Mr. Chairman, that concludes my prepared remarks. I would be happy to take any questions.