Audit Report

OFFICE OF THE INSPECTOR GENERAL

CERTIFICATION AND MANAGEMENT OF VALUE-ADDED NETWORKS

Report No. 96-172 June 21, 1996

Department of Defense

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Acronyms

DISA	Defense Information Systems Agency
DITCO	Defense Information Technology Contracting Office
EDI	Electronic Data Interchange
FACNET	Federal Acquisition Computer Network
FAR	Federal Acquisition Regulation
JITC	Joint Interoperability Test Command
VAN	Value-Added Network
VAS	Value-Added Service
VLA	VAN License Agreement

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

June 21, 1996

MEMORANDUM FOR DIRECTOR, DEFENSE INFORMATION SYSTEMS AGENCY

SUBJECT: Audit Report on Certification and Management of Value-Added Networks (Report No. 96-172)

We are providing this audit report for your review and comment. Management comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. Management nonconcurred with Recommendation 1. We request that the Defense Information Systems Agency reconsider its position and provide additional comments on Recommendation 1. in response to this final report. Comments must be received by July 22, 1996.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Ms. Kimberley A. Caprio, Audit Program Director, at (703) 604-9248 (DSN 664-9248) or Ms. Carolyn R. Davis, Audit Project Manager, at (703) 604-9217 (DSN 664-9217). See Appendix F for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 96-172 **June 21, 1996**
(Project No. 6CA-0019)

Certification and Management of Value-Added Networks

Executive Summary

Introduction. Value-Added Networks provide communication of electronic data between DoD and its trading partners. Each Value-Added Network must be certified by the Government. Twenty-five Value-Added Networks had been certified and fourteen Value-Added Networks were awaiting certification as of January 1996. The Defense Information Systems Agency is responsible for certifying Value-Added Networks for all Government organizations, including DoD.

Audit Objectives. The overall audit objective was to determine the adequacy of the Value-Added Network certification process and of the management and oversight of Value-Added Networks. We also reviewed the management control programs as they applied to the overall audit objective at the DoD organizations we visited.

Audit Results. The Defense Information Systems Agency did not establish an adequate Government Value-Added Network certification process and did not adequately monitor Value-Added Networks for compliance with the Value-Added Network License Agreement. As a result, 15 of the 25 Value-Added Networks were certified even though the adequacy of their financial resources was questionable, and the Government cannot ensure that control is exercised to prevent, identify, and resolve deficient services by the Value-Added Networks. The Government and its trading partners may be impacted by the potential loss of business. See Part I for a discussion of the finding.

Management controls over Value-Added Network certification, management, and oversight needed improvement. See Appendix A for details on our review of the management control program. Recommendations in this report, if implemented, will bring about improvements in the certification of Value-Added Networks and ensure Value-Added Network compliance with the Value-Added Network License Agreement.

Summary of Recommendations. We recommend that the Director, Defense Information Systems Agency:

o issue policy requiring enforcement of compliance with the Federal Acquisition Regulation 9.104, "Contractor Qualifications," to include establishing a system for evaluating business qualifications such as a weighted procedure or point system;

o issue policy for monitoring Value-Added Networks for compliance with the Value-Added Network License Agreement; and

o expedite the completion and issuance of the new Value-Added Network License Agreement.

Management Comments. The Defense Information Systems Agency partially concurred with the draft report recommendations. The comments stated that the Defense Information Systems Agency either has implemented or plans to implement each of the recommendations. The comments also stated that the Defense Information Systems Agency currently has procedures regarding contractor responsibility that are in accordance with the Federal Acquisition Regulation requirements and, therefore, it does not see a need to revise current procedures to determine contractor responsibility in accordance with the Federal Acquisition Regulation. See Part I for a summary of management comments and Part III for the complete text of management comments.

Audit Response. Management's comments were partially responsive. Although management does not see a need for revising current procedures to determine contractor responsibility, we maintain that there is a need for a more objective evaluation to ensure that each Value-Added Network meets minimum standards and that Value-Added Networks being certified are financially capable and will be in business for the foreseeable future. We request that the Defense Information Systems Agency reconsider its position and provide additional comments on the recommendation by July 22, 1996.

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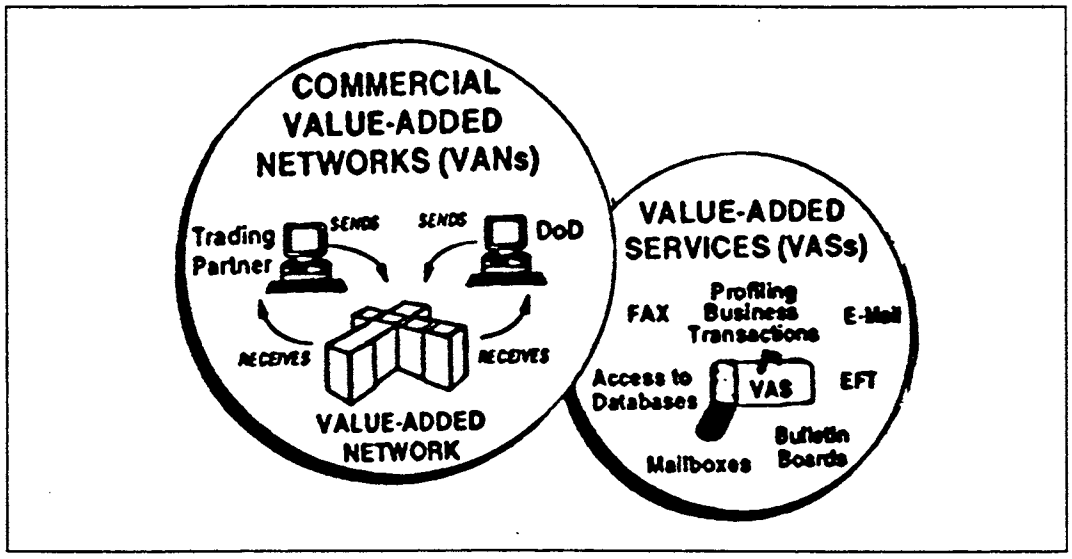
Part I - Audit Results

Audit Background

This audit was conducted as a result of work performed on Inspector General, DoD, Project No. 5CA-3002, "Audit of DoD Implementation of Electronic Commerce in Contracting for Small Purchases." The review identified potential systemic problems with the implementation of the Federal Acquisition Computer Network (FACNET). FACNET is the network through which the Government communicates transactions electronically between its individual procurement offices and its trading partners. The potential systemic problems included concerns about the adequacy of the certification process for Value-Added Networks (VANs).

VANs are an integral part of the current and proposed FACNET. A VAN is a commercial company that provides communication of electronic data interchange (EDI) between DoD and trading partners. A Value-Added Service (VAS) is a commercial company or VAN that provides extra-fee-based services such as "EDI-to-fax" services, complete EDI-integrated business systems, and translation services, in addition to providing communications capabilities.

The figure shows the role of the VAN between DoD and the trading partner and the various services offered by the VAS.



Source: Office of the Deputy Under Secretary of Defense (Acquisition Reform).

Value-Added Networks and Value-Added Services

Each VAN must be certified by the Government. The VAN certification process should include:

o the signing of the VAN License Agreement (VLA) by the prospective VAN;

o a business qualification review in accordance with Federal Acquisition Regulation (FAR) part 9, "Contractor Qualifications;"

o successful completion of communications testing; and

o the signing of the VLA by the Defense Information Technology Contracting Office (DITCO), an office within the Defense Information Systems Agency (DISA), upon completion of the previously mentioned steps.

The VLA is a no-cost agreement between a VAN and the Government allowing the VAN access to electronic commerce data and allowing the Government to use the data interchange capability and VAN services.

DISA is responsible for certifying, managing, and overseeing VANs for all Government organizations, including DoD. As of January 1996, 25 certified VANs existed with 14 awaiting certification. Of the 25 certified VANs, 13 are also VAS companies that translate data.

Audit Objectives

The overall audit objective was to determine the adequacy of the VAN certification process and of the management and oversight of VANs. We also reviewed the management control program at each organization visited as it applied to the overall audit objective. See the finding for a discussion of the management control weaknesses we identified and Appendix A for the audit scope and methodology and details of our review of the management control programs. See Appendix B for a summary of prior coverage related to the overall audit objective.

Value-Added Network Certification, Management, and Oversight

The Defense Information Systems Agency had not established an adequate process for certifying Value-Added Networks. DISA also was not adequately monitoring Value-Added Networks to verify compliance with VAN License Agreement provisions. Those conditions occurred because DISA management wanted to encourage participation in FACNET so they chose to be lenient in certifying VANs and did not always comply with existing guidelines, including the FAR part 9 and the VLA. As a result, the Government, including DoD, cannot ensure that VANs being relied upon to perform VAN services are financially responsible and that adequate and continuous control is being exercised to prevent, identify, and resolve deficient VAN services. Consequently, the Government and trading partners may be impacted by the potential loss of business.

Background

The FAR part 9, "Contractor Qualifications," states that all prospective contractors should be responsible. It further states that to be determined responsible, a prospective contractor must have adequate financial resources to perform the contract or the ability to obtain them. FAR part 9 also states that a prospective contractor must have the necessary organization, experience, accounting and operational controls, and technical skills, or the ability to obtain them, to be determined responsible.

DITCO evaluates a candidate for VAN certification by evaluating criteria such as customer references, financial institution references, its Dun & Bradstreet rating, and its operational business plan. DITCO also makes sure that the prospective VAN is not on the vendor debarment list.

The VAN License Agreement DCA 200-94-H-0015 establishes the terms and conditions for doing business electronically with the Government. The VLA requirements are outlined in Appendix C.

Adequacy of the VAN Certification Process

Application of FAR Part 9. To encourage participation in FACNET, when certifying VANs, DISA chose not to strictly comply with the policies prescribed in FAR part 9 regarding contractor financial qualifications. DITCO chose not to perform further evaluations to identify payment history and current financial

status on prospective VANs, despite recommendations made by Dun & Bradstreet, before certifying those candidates as VANs. Also, DITCO approved organizations with questionable financial resources as VANS.

No Dun & Bradstreet Ratings. DITCO did not perform additional research on prospective VANs that Dun & Bradstreet could not rate--those it identified as having questionable financial capabilities and needing additional support prior to certification. To determine whether a prospective VAN was financially responsible in accordance with FAR part 9, DITCO relied on reports it requested from Dun & Bradstreet. Dun & Bradstreet performs financial risk assessments of companies and generates reports that show the resources of the company. Dun & Bradstreet assessments are based on a review of the payment history and the current financial statements of the company. If Dun & Bradstreet does not have access to a sufficient sample of payment experiences or a current financial statement, Dun & Bradstreet provides no rating, but rather recommends to the Defense Logistics Agency that a more detailed evaluation be done.

Use of Dun & Bradstreet Ratings and Other Financial Data. DITCO personnel responsible for performing evaluations were lenient in approving VANs even when the adequacy of financial resources was questionable. Our review of the evaluations performed on the 25 certified VANs, as of October 10, 1995, determined that DITCO certified 15 of the 25 VANS despite the lack of Dun & Bradstreet ratings or moderate Dun & Bradstreet ratings suggesting close examination of the company. It also approved candidates with bank balances below $10,000.

The table shows the evaluation status of the 15 certified VANs with questionable financial capabilities.

Evaluation Status of VANs With Questionable Financial Capabilities

Evaluation Status	Number of VANs*
Dun & Bradstreet recommended for further evaluation	10
No Dun & Bradstreet ratings	8
Moderate Dun & Bradstreet Rating	5
Bank balance below $10,000	2

*Some VANs were deficient in more than one area. For example, a VAN may have needed further evaluation and also have had a moderate Dun & Bradstreet rating.

Rationale for Limited Evaluations. According to DITCO personnel, further evaluations were not performed and more stringent requirements were not applied because the VLA was considered a "no cost" agreement. According to DISA management, because the contract is a "no cost" agreement, the dollar limitation of the VLA is below the simplified acquisition threshold of $100,000 and, therefore, is not worth the cost/benefit analysis. That is, the VANs

charged only the trading partners for FACNET services performed by the VAN, and the VLA provided for the VANs to make their services available to Government agencies, including DoD, at no cost. However, DITCO should have performed further evaluations as recommended by Dun & Bradstreet to provide assurance of VAN credibility, regardless of the simplified acquisition threshold criteria. However, to encourage VAN participation in FACNET, DISA made the decision to relax the certification requirements.

Certification of Questionable Organizations as VANs. As a result of relaxed certification requirements, DITCO approved organizations with questionable financial resources and work histories to perform as VANs. Two examples follow.

o One company had a moderate Dun & Bradstreet rating suggesting closer examination was appropriate, had no prior EDI experience (it was a manufacturer of navigational equipment), had a negative net worth, and had filed for voluntary bankruptcy within 1 year prior to applying to become a certified VAN.

o Another company had no Dun & Bradstreet rating, provided no client references, changed company names twice, and had filed bankruptcy within 3 years prior to becoming a certified VAN. In addition, the company had filed 47 agency-level protests since February 1990.

Impact of Questionable Financial Resources. Applicants with questionable financial capabilities should not have been certified as VANs. Poor financial data at the start of a contract is often an indicator of future problems, as shown by Inspector General, DoD, Report No. 96-105, "Contract Award Decisions Resulting in Contract Termination for Default." The report states that contracting officers awarded 24 contracts, valued at $34.1 million, to contractors without obtaining adequate information to support determinations of contractor responsibility or without adequately addressing adverse contractor information that was available before contract award. As a result, $13.5 million of unrecoverable unliquidated progress payments was paid to defaulting contractors. Additionally, unquantified administrative costs were incurred and operations were potentially hindered. DISA certification of VANs with questionable financial resources could result in similar problems.

DISA incurred additional costs by certifying 15 VANs with questionable financial resources, despite the perception that the DoD affiliation with VANs was a no-cost relationship. Specifically, DISA incurred administrative and personnel costs to support the process of certifying those VANs that were questionable financially.

Improvements Needed. We acknowledge the desire DISA had to obtain companies to function as VANs and to encourage participation during the initial development and implementation of FACNET. However, in the future, DISA needs to improve the VAN certification process by enforcing compliance by DITCO with FAR 9.104-1. The process could include establishing minimum financial requirements by using, for example, a weighted procedure or point system for evaluating business qualifications. Though the FAR does not

provide specific guidance on establishing minimum financial requirements when determining contractor financial responsibility, a weighted procedure or point system can be useful to conduct an objective and fair evaluation of business qualifications. A weighted procedure or point system could consist of assigning ratings and weights to each category being evaluated. For example, DITCO evaluates a prospective VAN based on its customer references, financial institution references, Dun & Bradstreet rating, operational business plan, and exclusion from the vendor debarment list. Relative weights could be given to each category and an overall score or rating determined for each prospective VAN. DITCO could determine an acceptable overall score or rating for considering a prospective VAN qualified to perform electronic commerce/electronic data interchange business with the Government. That procedure would make the review more objective and ensure that each certified VAN was qualified.

Compliance With the VLA

DISA did not adequately monitor VANs for compliance with the terms and conditions of the VLA. Specifically, DISA did not perform reviews to verify that each VAN:

- o maintained an audit trail of transactions,
- o backed up all data to allow for full data recovery capabilities, and
- o had an internal quality monitoring program to assure the maintenance of reliable communication lines.

The VLA requires that each item listed above exist at the VAN. VANs must also comply with additional requirements of the VLA as, detailed in Appendix C. Although our review did not include checking for compliance with the additional requirements of the VLA, the remaining VLA requirements could be included as part of the audit trail and review of the internal quality monitoring program established by each VAN.

Audit Trails. The VLA requires VANs to provide the Government with an EDI mailbox for Government use in monitoring compliance with the terms and conditions of the VLA and for troubleshooting and testing. The VANs must maintain an audit trail for transactions exchanged through the DoD's EDI mailbox for at least 90 days. The audit trail should include the date and time each message was received or delivered. The mailbox should only be used by the DISA DoD technical representative who is responsible for administering the VLA. Despite the requirement to maintain an audit trail, the DoD technical representative did not use the mailbox to monitor compliance with the VLA and verify that the VANs maintained an audit trail of transactions.

The Office of the Deputy Under Secretary of Defense (Acquisition Reform) was concerned that the monitoring of the mailbox was not being accomplished

and, therefore, hired a contractor in August 1995 to develop a system for performing the monitoring function. However, as of February 1996, the contractor had not completed the development of the system. To help ensure compliance with the VLA, DISA needs to monitor the mailbox and verify that an audit trail of transactions is maintained for at least 90 days.

Without assurance that VANs are monitoring the mailbox and maintaining audit trails, DoD can not be certain that VANs are in compliance with the terms and conditions of the VLA. In addition, the lack of monitoring and audit trails may prevent DISA from identifying and correcting problems occurring with electronic transactions.

Data Backup and Recovery Capabilities. DISA did not monitor compliance with the VLA for backup capabilities. According to the VLA, the VAN must:

o back up all data it processes to allow for full data recovery;

o provide the Government with the capability to restore EDI transactions; and

o provide the Government with access to, and use of, backup capabilities after disaster notification or in the event of an unplanned interruption.

DISA did not review the disaster recovery capabilities of the VANs. However, DISA is considering adding remote testing of VAN backup recovery capabilities as part of the new VLA. Until DISA adds a remote testing feature, DoD can not be certain that VANs are backing up data as required or that DoD will be able to recover transaction information in the event of a disaster. In the interim, DISA needs to perform periodic reviews to ensure that each VAN has a disaster recovery plan.

Internal Quality Monitoring Program. DISA did not verify that the VANs had internal quality monitoring programs as required by the VLA. DISA also did not require the VANs to provide evidence of the results of any internal quality monitoring performed. According to the VLA, the VAN must have an internal quality monitoring program that assures that reliable communication lines are maintained to enable DoD and non-DoD agencies to exchange electronic transactions using the EDI mailbox provided by the VAN. DISA personnel stated that they did not verify whether the VANs had internal quality monitoring programs because the Office of the Deputy Under Secretary of Defense (Acquisition Reform) did not provide guidance on how to perform evaluations of internal quality monitoring programs. However, DISA is responsible for verifying compliance with the VLA, regardless of whether DISA is provided guidance from the Office of the Deputy Under Secretary of Defense (Acquisition Reform).

Need for VLA Compliance. Audit trails, data backup and recovery capabilities, and internal quality monitoring programs are measures that enable DoD and non-DoD organizations to verify when VANs are responsible for errors and omissions. Without use of complete audit trails to identify problems,

DISA must rely on tedious procedures such as researching trouble tickets. Researching trouble tickets involves determining the causes of reported transaction problems. Trouble tickets document problems with FACNET reported by VANs, Network Entry Points, trading partners, and gateways. With audit trails and internal quality monitoring programs, DISA should be able to identify and correct some of the problems occurring with electronic transactions, such as late and lost transactions, that are resulting in trouble tickets. Without assurance of VAN data backup and recovery capabilities, DISA may be unable to pinpoint where problems occurred and may be held liable for errors, omissions, or nonperformance by the VANs.

Leniency of the Current VLA

DISA intended for the current VLA to be lenient. As a result, some controls were not built into the VLA to protect DoD and other FACNET participants. For example, the current VLA does not include detailed communications testing procedures for VANs and does not require compliance testing prior to certification to verify that VANs can send actual transactions that meet the appropriate standards. In addition, the current VLA does not include decertification procedures for VANs not in compliance with the terms and conditions of the VLA. Also, the current VLA requires that DISA annually reevaluate the terms included in the VLA; however, DISA does not enforce the requirement. As of December 1995, no annual review had been performed. According to the DISA DoD technical representative, annual reviews were not performed because DISA weekly meetings and focal point meetings at which VLA issues were discussed satisfied the intent of the annual review requirement in the VLA.

Many of the VANs interviewed voiced concerns that the VANs certification process was too lenient. Specifically, the VANs stated that:

o DISA was not performing sufficiently detailed or stringent communications testing;

o DISA was certifying VANs that could not pass data in the manner specified in the VLA;

o DISA was not testing for compliance with applicable standards; and

o DISA was certifying companies with questionable financial and technical capabilities.

In addition, VANs cited concerns that the current certification process was not adequate to ensure that VANs already certified would be capable of handling the transaction workload that would be required for the full implementation of FACNET.

Corrective Actions Taken and Planned

DISA is taking actions to address some of the issues identified. Specifically, DISA is in the process of revising the VLA and has made some procedural changes that will be reflected in the revised VLA that may improve the VAN certification process. Specifically, DISA transferred the responsibility for communications testing of VANs to the Joint Interoperability Test Command (JITC) in September 1995. Our review of the JITC test plan showed that JITC communications testing requirements should be adequate to verify that VANs could pass data in the manner specified in the VLA. However, as of December 1995, JITC had not begun testing. DISA stated that JITC will not begin communications testing until the revised VLA is completed. Under the revised VLA, DISA will require compliance testing prior to certification, which is not required under the current VLA, and conduct semiannual reevaluations of the VLA. Also, DISA plans to include in the revised VLA circumstances under which VANs can be decertified and the procedures for decertifying VANs that are not meeting the requirements of the VLA.

We acknowledge the improvements that the procedural changes and proposed VLA will bring to the certification process. The new VLA has been in draft since March 1995. The proposed VLA is expected to be implemented by July 1996.

The proposed changes to the VLA, however, do not address the issues we identified regarding improving the process for evaluating financial qualifications of the VANs, monitoring of VANs for compliance with the VLA, and enforcing the VLA.

Conclusion

As DoD continues to implement electronic commerce, DoD must be able to ensure that adequate and continuous control is exercised to prevent deficient services and quality. To encourage VAN participation, DISA relaxed the requirements in the VAN certification process and did not actively monitor and enforce the VLA to ensure compliance with the VLA provisions. Consequently, DoD and its trading partners may be impacted by the potential loss of business. In addition, without audit trails, data backup and recovery capabilities, and internal quality monitoring programs, DoD will continue to incur unnecessary costs to process certifications for questionable VANs and to trace defective transactions. The corrective actions taken or planned will not correct the problems with the business financial review of VANs and with the monitoring and enforcement of the VLA. Therefore, DISA needs to issue policy requiring DITCO to enforce compliance of the VANs with FAR 9.104-1, and to monitor VANs for compliance with the VLA. It should also expedite the completion and issuance of the revised VLA.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Defense Information Systems Agency:

1. Issue policy requiring the Defense Information Technology Contracting Office to enforce compliance with Federal Acquisition Regulation 9.104-1 to include establishing a system for evaluating business qualifications, such as a weighted procedure or point system.

Defense Information Systems Agency Comments. DISA nonconcurred with the recommendation, stating that the DITCO contracting officer exercised judgments in the assessment of Value-Added Networks' qualifications fully in line with the FAR. DISA maintains that the assessment was reasonable and a preaward survey is not justified because the VLA is a no-cost agreement. The contracting officer verified the financial references and the lists of parties excluded from Federal programs and indebted to the Government. DISA further stated that because the capability of a contractor is largely subjective, judgments generally will not be reviewed, lacking a showing of fraud or bad faith.

Audit Response. The DISA comments are not responsive. Relative risk exists in relation to the certification of financially questionable VANs, even though the VLA is a no-cost agreement. The deadline for implementing FACNET is January 1, 2000. To encourage participation in FACNET, vendors need to be certain that VANs being certified are financially capable and will be in business for the foreseeable future.

Though the determination of the capability of contracts is largely subjective, the more objective the evaluation, such as through a weighted procedure or point system, the less likely the Government will be subjected to loss of business and lack of interest by vendors in doing business with the Government through FACNET. For example, for cost-type contracts, the contracting officer evaluates, assign points, and selects the contractors based on their overall score in the cost or price and technical areas. Regardless of whether or not the VLA is a no-cost agreement, the key to implementing the new concept of FACNET is viability of the VANs and the credibility they present on the behalf of the DoD to its trading partners.

Using a weighted procedure or point system would make the review more objective and ensure prospective VANs were considered equally and fairly. It would also eliminate the contracting officer exercising questionable judgment to determine contractor financial responsibility. Therefore, we request that the DISA reconsider its position on this recommendation and provide comments on the final report.

2. Monitor Value-Added Networks for compliance with the Value-Added Network License Agreement to include:

a. Monitoring the test mailbox for audit trail purposes.

Defense Information Systems Agency Comments. DISA concurred with the recommendation, stating that as of March 1996, the Office of the Deputy Under Secretary of Defense (Acquisition Reform/Electronic Commerce) has the capability to monitor all Government transactions being transmitted to the various VANs.

b. Performing periodic audits to ensure that each Value-Added Network has a disaster recovery plan.

Defense Information Systems Agency Comments. DISA concurred with the recommendation, stating that the Disaster Recovery Plan will be recertified annually as part of the implementation of the new VAN licensing agreement scheduled to begin implementation in July 1996.

c. Verifying existence of Value-Added Networks internal quality monitoring programs.

Defense Information Systems Agency Comments. DISA concurred with the recommendation, stating that it currently monitors networks using both internal DISA reporting and the Office of the Deputy Under Secretary of Defense (Acquisition Reform/Electronic Commerce) mailbox system identified above.

3. Expedite the completion and issuance of the revised Value-Added Network License Agreement.

Defense Information Systems Agency Comments. DISA concurred with the recommendation, stating that it received formal comments to the new VLA from the Office of the Deputy Under Secretary of Defense (Acquisition Reform/Electronic Commerce) on April 30, 1996. DISA is working to finalize that document. The estimated implementation date is July 1996.

Part II - Additional Information

Appendix A. Scope and Methodology

Value-Added Network Certification, Management, and Oversight Review

There are currently 25 Government-certified VANs. We reviewed the current and proposed VAN License Agreements (VLA), including the technical scope of work and proposed decertification procedures. We identified responsible personnel and held discussions with DISA and DITCO personnel responsible for VAN certification, management, and oversight. We reviewed documents submitted prior to certification by all 25 VANs for compliance with FAR 9.104-1. We checked for standard operating procedures on certifying and decertifying VANs. We identified personnel responsible for providing detailed written test plans to VANs. We obtained and reviewed written test plans where available for compliance with the VLA. Discussions held with DISA and VAN personnel covered issues pertaining to DoD monitoring of the test mailbox, reviews of VAN audit trails, data backup and recovery, and the existence of a disaster recovery plan. Other issues discussed included the VAN internal quality monitoring program existence, communications and compliance testing, and the VLA annual reviews.

Audit Period, Standards, and Locations

We performed this program audit from October 1995 through February 1996 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. We did not use computer-processed data or statistical sampling procedures for this audit. Appendix E lists the organizations we visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We reviewed the adequacy of management controls over VAN certification, management, and oversight at the sights we visited. We also assessed the adequacy of management's self-evaluation of those controls.

Adequacy of Management Controls. We identified management control weaknesses as defined by DoD Directive 5010.38 relating to VAN certification, management, and oversight. Recommendation 2, if implemented, will establish controls to ensure that the VAN certification process is adequate and that VANs are in compliance with the terms and conditions of the VLA. A copy of the final report will be provided to the senior official in charge of management controls for the electronic commerce/electronic data interchange program.

Adequacy of Management's Self Evaluation. DISA officials identified electronic commerce/electronic data interchange as an assessable unit in a self-evaluation performed in August 1995 and assigned a medium level of risk. Because we did not review the entire electronic commerce/electronic data interchange area, we are unable to determine the appropriate level of risk. However, VAN certification, management, and oversight should be covered under this assessable unit. As part of the review of the electronic commerce/electronic data interchange area, DISA should have conducted an evaluation of the management controls applicable to VAN certification, management, and oversight. Because DISA did not conduct an evaluation of the management controls applicable to VAN certification, management, and oversight, DISA did not identify or report the management control weaknesses identified by the audit.

Appendix B. Summary of Prior Audits and Other Reviews

The Inspector General, DoD, issued three reports related to this audit.

Inspector General, DoD, Report No. 96-129, "DoD Implementation of Electronic Commerce in Contracting for Small Purchases," was issued on May 24, 1996. The report states that the review identified a series of issues involved in the implementation of electronic commerce within DoD. The issues identified include: realization of the "single face to industry" concept; adequacy of the transmission of data by the DoD FACNET infrastructure; implementation of security controls; level of vendor participation; adequacy of management controls for FACNET transactions; and adequate development of FACNET implementation plans. The Deputy Under Secretary of Defense (Acquisition Reform) and DISA are aware of the issues and are implementing corrective actions.

Inspector General, DoD, Report No. 96-105, "Contract Award Decisions Resulting In Contract Termination for Default," was issued on April 29, 1996. The report states that contracting officers at Warner Robins Air Logistics Center awarded 24 contracts, valued at $34.1 million, to contractors without obtaining adequate information to support determinations of contractor responsibility or without adequately addressing adverse contractor information that was available before contract award. The awards resulted in a $13.5 million unrecoverable loss to the Government from unliquidated progress payments owed by the contractors at contract termination. The report recommends that the Commander, Warner Robins Air Logistics Center, establish procedures that contracting officers award contracts only to responsible prospective contractors and that determinations of responsibility are fully supported and documented; establish contractor responsibility determinations as an assessable unit as part of the management control program; and take administrative action against personnel involved in improper contract awards. Management concurred with all of the recommendations.

Inspector General, DoD, Report No. 96-057, "DoD Use of Electronic Bulletin Boards in Contracting," was issued on January 8, 1996. The report states that the use of bulletin boards by DoD procurement offices to conduct small purchase transactions was not a major impediment to FACNET implementation. Bulletin boards served as an interim solution that enabled procurement offices to conduct electronic commerce until FACNET becomes fully operational. Procurement officials were not investing significant resources to establish new bulletin boards or to upgrade existing capabilities, and they were committed to phasing out their use of bulletin boards when FACNET becomes fully operational. The report contained no recommendations.

Appendix C. Value-Added Network License Agreement Requirements

The current VLA requires that the VAN transmit, receive, and store EDI messages for its trading partners. Specifically, the VLA requires that the VAN:

o provide DoD with an EDI mailbox for DoD use in monitoring compliance with the terms and conditions of the VLA;

o maintain an audit trail for transactions exchanged via the DoD mailbox for at least 90 days;

o exchange transactions using American National Standards Institute Accredited Standards Committee X12 Standards;

o enable interested businesses to receive and send Accredited Standards Committee X12 transaction conventions;

o maintain accessibility for exchange of transactions to and from the Government Network Entry Points 24 hours a day, 7 days a week, excluding 8 hours a week for regularly scheduled maintenance;

o report any scheduled and unscheduled breaks in service under the VLA to the Government in a prudent manner;

o back up all data processed in such a way that full data recovery is possible;

o maintain an internal quality monitoring program that ensures that reliable communication lines are maintained to enable the exchange of electronic transactions; and

o provide DoD with the right of access to and use of backup capabilities.

Appendix D. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology, Washington, DC
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence), Washington, DC

Other Defense Organizations

Defense Information Systems Agency, Falls Church, VA
- Defense Information Systems Agency, C4 and Intelligence Programs, Electronic Commerce/Electronic Data Interchange Program Management Office, Falls Church, VA
- Defense Information Systems Agency Western Hemisphere, Fort Richie, MD
- Defense Information Systems Agency MegaCenter, Columbus, OH
- Defense Information Technology Contracting Office, Scott Air Force Base, IL
- Joint Interoperability Test Command, Fort Huachuca, AZ
- Joint Interoperability and Engineering Organization, Reston, VA

Defense Logistics Agency, Alexandria, VA

Non-Government Organizations

Advanced Communication Systems, North Olmsted, OH
American Logistics Information Corporation, Diamond Bar, CA
Advance Logic Resources, Yaphank, NY
AT&T, Philadelphia, PA
Complexity Simplified Incorporated, Denver, CO
Computer Network Corporation, Washington, DC
Datamatix, Plymouth Meeting, PA
Electronic Data Systems, Herndon, VA
ELOCO, New Castle, NH
GAP Instrument Corporation, Long Island, NY
General Electric Information Systems, Rockville, MD
Harbinger EDI Services, Atlanta, GA
Maple Information Systems, Canada
MCI Telecommunications Corporation, Piscataway, NJ
Network Information Services, Newport Beach, CA
Premenos Corporation, Concord, CA
Sidereal Corporation, Springfield, VA
Simplix, Troy, MI

Non-Government Organizations (cont'd)

Softshare Information Services, Santa Barbara, CA
Sprint Government Systems Division, Overland Park, KS
Sterling Software, Dublin, OH
Technology Management Programs, Carlsbad, CA
Total Procurement Services, Novato, CA
TranSettlements, Inc., Atlanta, GA
VAN SAT, Oklahoma City, OK

Appendix E. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
  Deputy Under Secretary of Defense (Acquisition Reform)
  Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
  Deputy Chief Financial Officer
  Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Command, Control, Communications, and Intelligence)
Assistant to the Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

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

Department of the Air Force

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

Other Defense Organizations

Director, Defense Information Systems Agency
  Commander, Defense Information Technology Contracting Office
Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
  Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Non-Defense Federal Organizations

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

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

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

Part III - Management Comments

Defense Information Systems Agency Comments

DEFENSE INFORMATION SYSTEMS AGENCY
701 S. COURTHOUSE ROAD
ARLINGTON, VIRGINIA 22204-2199

IN REPLY REFER TO: Inspector General

23 May 96

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: DIRECTOR, CONTRACT MANAGEMENT DIRECTORATE

SUBJECT: Draft Audit Report on Certification and Management of Value-Added Networks (Project No. 6CA-0019)

Reference: DODIG Draft Audit Report, subject as above, 27 March 95

1. We have reviewed the subject draft report and concur in part with the finding and recommendations. Our management comments are enclosed which discuss corrective actions to be taken or that have already been completed.

2. The point of contact is Ms. Sandra J. Sinkavitch, Audit Liaison. If you have questions on our response, Ms. Sinkavitch can be reached on (703)607-6316.

FOR THE DIRECTOR:

RICHARD T. RACE

Enclosure a/s

MANAGEMENT COMMENTS TO DOD INSPECTOR GENERAL DRAFT REPORT ON CERTIFICATION AND MANAGEMENT OF VALUE-ADDED NETWORKS PROJECT NO. 6CA-0019

Comments in Response to the Finding: DISA concurs in part that the agency had not established an adequate process for certifying Value Added Networks (VANS). The main point of disagreement is the DoDIG assessment in regards to the Business Qualification Review. The DoDIG report cites the Federal Acquisition Regulation (FAR) Part 9 as the criteria for their assessment. We agree that the FAR requires an assessment of contractor qualifications. However, the DoDIG's evaluation does not fully describe the requirements of the FAR, nor does the finding adequately describe the approach taken by management. Defense Information Technical Contracting Office (DITCO) did not choose, "not to strictly comply with the policies prescribed in FAR Part 9" as stated in the draft audit report. Rather, the contracting officers utilized the flexibility and discretion permitted by the FAR language to make a reasonable judgement. The extent of the information necessary to make a responsibility determination and the determination itself are matters within the broad discretion of the contracting officer. Therefore, the issue is not one of compliance with FAR Part 9, as DITCO did perform the assessment required. Rather, the issue is whether the assessment was reasonable under the circumstances. The facts are as follows:

1. Electronic Data Interchange (EDI) VAN License Agreement is a no-cost agreement.

2. In accordance with the FAR 9.104-1, all potential EDI VAN Providers were determined responsible prior to signing the EDI VAN License Agreement. The process for determining contractor responsibility is:

a. EDI VAN Provider must submit client (4) and financial (1) references.

b. All references were verified by the Contracting Officer.

c. The List of Parties Excluded from Federal Procurement or Nonprocurement Programs and the List of Contractors Indebted to the Government are verified.

d. Dun & Bradstreet Report (D&B) was initially requested. DITCO also uses direct contact with references and others as necessary to determine financial responsibility. DITCO did not limit their evaluation to obtaining a D&B report. That statement in the audit is not factual. The assessment was based on relative risk, and the initial information obtained on the vendors responsibility.

A Memo for Record (MFR) determining contractor responsibility is placed in each file prior to certification that the above information is current, accurate, and complete to the best of the Contracting Officer's knowledge. Contracting Officer signs MFR.

The DoD Inspector General report cites FAR 9.106-1 on preaward survey "when information on hand or readily available to the contracting officer is not sufficient to make a determination regarding responsibility." However, FAR 9.106-1 supports DISA's position in that it further states:

"If the contemplated contract will have a fixed price at or below the simplified acquisition threshold, the contracting officer should not request a preaward survey unless circumstances justify its cost."

The dollar limitation of this agreement is below the Simplified Acquisition Threshold (SAT)(Currently $100,000 or less) as the contract is a no-cost agreement. Therefore, a detailed contractor responsibility is not required under the SAT. DITCO cannot justify the cost of conducting a preaward survey for a no-cost agreement.

One of the examples cited in the DoD Inspector General report is not fully explained. The issues regarding the EDI VAN Provider, are as follows: sent information regarding their Chapter 11 bankruptcy (Sep 93). Chapter 11 bankruptcy (reorganization) does not automatically disqualify a company from consideration. The facts

ascertained by the contracting officer were as follows:

1. Reorganization of company to be accomplished NLT Oct 94.
2. Received approval to sign agreement from DISA HQ. Agreement signed Oct 94
3. emerged from Chapter 11 Bankruptcy in Oct 95.

SUMMARY CONCLUSION: DISA's position previously stated by GAO is that "Because the determination that an offeror is capable of performing a contract is largely subjective, such judgments generally will not be reviewed absent a showing of fraud or bad faith" (Reference: Color Dynamics, B-250398, 1993 West law 17602(C.G.)(Jan 22, 1993). The DITCO contracting officer exercised judgements, in the assessment of this agency fully in line with the relative risk these contracts posed to the Government in accordance with the provisions of FAR. Therefore, we cannot agree with the DoD Inspector General's assessment.

VAN Testing: DISA does concur with the DoD Inspector General's assessment regarding VAN testing. Specifics are provided in response to the recommendations.

RECOMMENDATIONS:

We recommend that the Director, Defense Information Systems Agency:

1. Issue policy requiring DITCO to enforce compliance with FAR 9.104-1 to include establishing a system for evaluating business qualifications such as a weighted average procedure or point system.

DISA Response: Non-Concur, DISA's current procedures are in accord with FAR requirements as explained in our response to the finding. Therefore, DISA sees no need to revise current procedures to determine contractor responsibility IAW FAR 9.1 and DFARS Subpart 209.1.

2. Monitor Value-Added Networks for compliance with the Value-Added Network License Agreement to include:

a. monitoring the test mailbox for audit trail purposes,

DISA Response: Concur, as of March 96, the DUSD(AR/EC) has the capability to monitor all Government transactions being transmitted to the various VANs. Additionally, DUSD(AR/EC) also has a mailbox (just like any vendor) with each VAN. This allows the Government to monitor Government transactions being transmitted to the VANs as well as being able to monitor transaction processing compliance from a vendor perspective. This capability allows the Government to verify transaction processing and retain an audit trail.

b. performing periodic audits to ensure that each Value-Added Network has a disaster recovery plan, and

DISA Response: Concur, the Disaster Recovery Plan will be recertified annually as part of the Implementation of the new VAN licencing agreement scheduled to begin implementation July 1996.

c. verifying existence of Value-Added Networks internal quality monitoring programs.

DISA Response: Concur, We currently monitor networks utilizing both internal DISA reporting and the DUSD(AR/EC) mailbox system identified in response to (a) above. These two mechanisms allow us to provide daily management of the supporting communications infrastructure.

3. Expedite the completion and issuance of the revised Value Added Network License Agreement.

DISA Response: Concur, We received formal comments to the new VAN license agreement from DUSD(AR/EC) 30 April 1996. DISA is working to finalize this document. Estimated implementation date is July 1996.

Audit Team Members

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

Paul J. Granetto
Kimberley A. Caprio
Carolyn R. Davis
James A. Wingate
Veronica G. McCain
Dorothy L. Dixon
Adam S. Weissberg
Charlene K. Grondine