



INSPECTOR GENERAL

U.S. Department of Defense

NOVEMBER 7, 2014



DoD Needs to Improve Processes for Issuing and Managing Cost-Reimbursement Contracts

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

INTEGRITY ★ EFFICIENCY ★ ACCOUNTABILITY ★ EXCELLENCE

Mission

Our mission is to provide independent, relevant, and timely oversight of the Department of Defense that supports the warfighter; promotes accountability, integrity, and efficiency; advises the Secretary of Defense and Congress; and informs the public.

Vision

Our vision is to be a model oversight organization in the Federal Government by leading change, speaking truth, and promoting excellence—a diverse organization, working together as one professional team, recognized as leaders in our field.



For more information about whistleblower protection, please see the inside back cover.



Results in Brief

DoD Needs to Improve Processes for Issuing and Managing Cost-Reimbursement Contracts

November 7, 2014

Objective

Our objective was to determine whether DoD complied with interim Federal Acquisition Regulation (FAR) revisions on the use of cost-reimbursement contracts. We performed this audit in accordance with the FY 2009 National Defense Authorization Act, section 864, "Regulations on the Use of Cost Reimbursement Contracts." This summary report is the fifth and final in a series of reports on DoD compliance with the interim rule for the use of cost-reimbursement contracts.

Finding

Of the 604 contracts reviewed, valued at about \$82.7 billion, contracting personnel did not consistently implement the FAR revisions, (the interim rule), for 411 contracts, valued at about \$31.7 billion. Contracting personnel issued contracts that did not follow the interim rule because they were not clear about interim rule requirements or were unaware of the interim rule. As a result, contracting personnel continue to issue cost-reimbursement contracts that may increase DoD's contracting risks because cost-reimbursement contracts provide less incentive for contractors to control costs.

Recommendations

We recommend that the Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, issue memorandums or other guidance specifically to:

- reinforce current guidance or clarify when cost-reimbursement contracts should be approved one level above the contracting officer,
- reinforce current regulations regarding the requirement to consider how a cost-reimbursement contract could transition to a firm-fixed-price contract in the future,
- identify best practices to assess a contractor's accounting system and codify the efforts that should be taken by contracting personnel to assess the adequacy of the contractor's accounting system,
- clarify whether FAR revisions are applicable to task and delivery orders issued on previously issued basic contracts,
- discuss whether broader contracting policies are sufficient support to meet the increased criteria before issuing a cost-reimbursement contract, and
- clarify to what extent initial decisions for a basic contract can be relied on for analysis on the subsequent orders and options pertaining to the contract.

Management Comments

We did not receive comments from the Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, in response to the draft report. We request that the Deputy Director comment on the final report. Please see the Recommendations Table on the next page.

Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy	1, 2, 3, 4, 5, and 6	

Please provide comments by December 8, 2014.



**INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
4800 MARK CENTER DRIVE
ALEXANDRIA, VIRGINIA 22350-1500**

November 7, 2014

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,
TECHNOLOGY, AND LOGISTICS
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, MISSILE DEFENSE AGENCY
NAVAL INSPECTOR GENERAL
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: DoD Needs to Improve Processes for Issuing and Managing Cost-Reimbursement
Contracts (DODIG-2015-029)

We are providing this report for review and comment. DoD issued 411 contracts, valued at about \$31.7 billion, of 604 contracts, valued at about \$82.8 billion, that were not fully compliant with the increased oversight required by the interim rule. We performed this audit in accordance with the FY 2009 National Defense Authorization Act, Section 864, "Regulation on the Use of Cost Reimbursement Contracts." This is the fifth and final in a series of audit reports on DoD Compliance with the interim rule for the use of cost-reimbursement contracts. The final rule was published in the Federal Register on March 2, 2012, without significant changes that would affect our audit objective.

DoD Directive 7650.3 requires that recommendations be resolved promptly. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, did not provide comments on the draft report. Please provide comments that state whether you agree or disagree with the finding and recommendations. If you agree with our recommendations, describe what actions you have taken or plan to take to accomplish the recommendations and include the completion dates of your actions. If you disagree with the recommendations or any part of them, please give specific reasons why you disagree and propose alternative action if that is appropriate. You should also comment on the internal control weaknesses discussed in this report. We request comments from the Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, by December 8, 2014.

Please send a PDF file containing your comments to cmp@dodig.mil. Copies of your comments must have the actual signature of the authorizing official for your organization. We cannot accept the /Signed/ symbol in place of the actual signature. If you arrange to send classified comments electronically, you must send them over the SECRET Internet Protocol Router Network (SIPRNET).

We appreciate the courtesies extended to the staff. Please direct questions to Deborah L. Culp at (703) 604-9335 (DSN 664-9335).

A handwritten signature in cursive script that reads "Amy J. Frontz". The signature is written in black ink and is centered on the page.

Amy J. Frontz
Principal Assistant Inspector General
for Auditing

Contents

Introduction

Objective	1
Background	2
Interim Rule Requirements and Our Interpretation	2
Contracts Reviewed	5
Small Business Innovation Research Program	6
Review of Internal Controls	7

Finding. Sites Visited Inconsistently Implemented the Interim Rule

More Guidance Needed to Better Implement Federal Acquisition Regulation Revisions	9
Approval at Least One Level Above the Contracting Officer for a Cost-Reimbursement Contract Varied by Site	9
Justification Documenting the Use of a Cost Reimbursement Contract Type Was Consistently Completed	11
Identifying Opportunities for Transition to Firm-Fixed-Price Contracts Was Inconsistent	12
Documentation That Government Resources Were Available to Monitor Contract Was Inconsistent	13
Verification That an Adequate Accounting System Was in Place at Award Was Inconsistent	14
General Areas of Concern Regarding the Interim Rule	15
Firm-Fixed-Price Contracts Properly Classified	17
Conclusion	18
Recommendations	18
Management Comments Required	19

Contents (cont'd)

Appendixes

Appendix A. Scope and Methodology _____	20
Universe and Sample Information _____	21
Review of Documentation and Interviews _____	22
Use of Computer-Processed Data _____	23
Use of Technical Assistance _____	23
Prior Coverage _____	24
Appendix B. Federal Acquisition Circular 2005-50 Issued March 16, 2011 _____	26
Appendix C. Sites Visited and Summary Contract Information _____	31

Acronyms and Abbreviations _____	32
---	-----------

Introduction

Objective

Our objective was to determine whether DoD contracting personnel complied with interim Federal Acquisition Regulation (FAR) revisions regarding the use of cost-reimbursement¹ contracts. Specifically, we determined whether contracting personnel implemented the interim rule by documenting:

- approval for the cost-reimbursement contract was at least one level above the contracting officer;
- the use of cost-reimbursement contracts was justified;
- the requirements under the contract could transition to firm-fixed price in the future;
- Government resources were available to monitor the cost-reimbursement contract; and
- contractors had an adequate accounting system in place at contract award.

We also determined whether contracting personnel intentionally misclassified contracts as firm-fixed price to avoid the increased cost-reimbursement contract documentation requirements.

We issued three separate reports for each of the Services and one report to include the Missile Defense Agency and the Defense Microelectronics Activity.

- Report No. DODIG-2013-059, “Air Force Needs Better Processes to Appropriately Justify and Manage Cost-Reimbursable Contracts,” March 21, 2013
- Report No. DODIG-2013-120, “Army Needs Better Processes to Appropriately Justify and Manage Cost-Reimbursement Contracts,” August 20, 2013
- Report No. DODIG-2014-011, “Missile Defense Agency (MDA) and Defense Microelectronics Activity (DMEA) Use of Cost-Reimbursement Contracts,” November 22, 2013
- Report No. DODIG-2014-092, “Navy and Marine Corps Have Weak Procurement Processes for Cost-Reimbursement Contract Issue and Management,” July 11, 2014

¹ We use “cost-reimbursement” to describe any type of contract other than firm-fixed-price contracts throughout the report, such as labor hour and time and materials contracts.

This summary is the fifth and final report in the series of reports and includes contracts issued by DoD at 14 sites visited. Throughout this summary report we make additional recommendations that require implementation on a DoD-wide level. See Appendix A for the scope and methodology and prior coverage related to the objectives.

Background

Section 864 of the FY 2009 National Defense Authorization Act, Public Law 110-417, requires FAR revisions to document decisions and approvals that are necessary before issuing cost-reimbursement contracts. It also requires that the DoD Inspector General audit DoD's compliance with the changes within 1 year of policy issuance. Federal Acquisition Circular (FAC) 2005-50, issued March 16, 2011, implemented the required revisions on an interim basis. See Appendix B for a copy of the interim rule. This interim rule² was effective immediately and was not subject to public comment before issuance. The final rule was published in the Federal Register on March 2, 2012, without significant changes that would affect our audit objective.

Interim Rule Requirements and Our Interpretation

We divided our objective into five areas based on the interim rule. We interpreted parts of the interim rule for each of these areas to determine what we would accept as adequate documentation in the contract file. These five areas included: 1.) approval level; 2.) justification; 3.) transition strategy; 4.) adequate resources; and 5.) adequate accounting system. Contracting personnel were required by the interim rule to include the justification, approval, and transition areas of our objective in the acquisition planning documentation. For each of these areas, we accepted documentation anywhere in the contract file because some of the acquisition plans were completed before the interim rule. Acquisition planning is the coordinated, combined, and integrated efforts of all personnel affected by the acquisition into a plan that timely fulfills the need at a fair and reasonable cost to the Government. Contracting personnel were not required by the interim rule to document whether adequate resources or an accounting system was available specifically within the acquisition planning documentation.

² FAC 2005-50 amended FAR Part 7, "Acquisition Planning;" FAR Part 16, "Types of Contracts;" and FAR Part 42, "Contract Administration and Audit Services."

Approval

Contracting personnel were required by the interim rule to obtain approval of a cost-reimbursement contract at least one level above the contracting officer. FAC 2005-50 states “the contracting officer shall document the rationale for selecting the contract type in the written acquisition plan and ensure that the plan is approved and signed at least one level above the contracting officer.” Contracting personnel were required by the interim rule to document this approval in the acquisition plan. We accepted any documentation in the contracting files that stated the contract type was cost reimbursement and was reviewed and signed by an official above the contracting officer as evidence of having met the interim rule requirement.

Justification

Contracting personnel were required by the interim rule to justify the use of a cost-reimbursement contract. FAC 2005-50 states:

[a]cquisition personnel shall document the acquisition plan with findings that detail the particular facts and circumstances, [[for example], complexity of the requirements, uncertain duration of the work, contractor’s technical capability and financial responsibility, or adequacy of the contractor’s accounting system), and associated reasoning essential to support the contract type selection. . .

Contracting personnel were required by the interim rule to document the justification in the acquisition plan. We determined that contracting personnel followed the interim rule by completing a determination and finding memorandum on contract type for inclusion in the contract file or included a discussion of research and development efforts with results that could not be precisely described in advance. A determination and finding memorandum is a form of written approval by an authorized official that is required by law or regulation as a prerequisite to taking certain contract actions.

Transition Strategy

Contracting personnel were required by the interim rule to document the potential of cost-reimbursement contracts to transition to firm-fixed-price contracts. FAC 2005-50 states:

For each contract (and order) contemplated, discuss the strategy to transition to firm-fixed-price contracts to the maximum extent practicable. During the requirements development stage, consider structuring the contract requirements, [for example], contract line items (CLINS), in a manner that will permit some, if not all, of the requirements to be awarded on a firm-fixed-price basis, either in the current contract, future option years, or follow-on contracts.

We interpreted this section of the interim rule to require an explanation of the potential to transition to a firm-fixed-price contract or a justification as to why the contract could not be transitioned. Contracting personnel were required by the interim rule to document this strategy in the acquisition plan. In addition to their documentation, we determined that the interim rule was followed if they issued contracts that had both firm-fixed price and cost-reimbursement contract line-item numbers including a statement in the contract file that allowed either a firm-fixed price or cost contract line-item number to be used, when appropriate. We also determined a contract met the intent of the interim rule if the award could not be transitioned, for various reasons, to a firm-fixed-price contract.

Adequate Resources

Contracting personnel were required by the interim rule to document that adequate resources were available to manage a cost-reimbursement contract. FAC 2005-50 states:

A cost-reimbursement contract may be used only when—Adequate Government resources are available to award and manage a contract other than firm-fixed-priced (see 7.104(e)) including—
(i) Designation of at least one contracting officer’s representative (COR) qualified in accordance with 1.602-2 has been made prior to award of the contract or order.

We interpreted this section of the interim rule to require evidence of a contracting officer’s representative (COR) or similarly qualified individual assigned to the contract. A COR is nominated in writing and authorized by the contracting officer to perform specific administrative and technical elements on the contract. We reviewed the COR nomination letter, signed acceptances by the CORs, and COR training documents. Contracting personnel were not required by the interim rule to document this evidence in any specific location of the contract file. Although assigning a COR to the contract identifies an individual to oversee a contract, it does not always indicate that adequate Government resources are available to monitor the contract as required by the interim rule. We identified the assignment of a COR on the contracts rather than testing the adequacy of the CORs assigned.

Adequate Accounting System

Contracting personnel were required by the interim rule to determine the adequacy of the contractor’s accounting system during the entire period of performance for cost-reimbursement contracts. FAC 2005-50 states that the contractor’s accounting system should be adequate during the entire period of contract performance. Based on this guidance, we required documentation from

the contracting officer that concluded the accounting system was adequate. At a minimum, we required a statement in the file that the accounting system was adequate based on information from the Defense Contract Audit Agency or Defense Contract Management Agency officials responsible for monitoring the contractor. We also accepted the contracting officer's conclusion or other documents, such as rate verifications and e-mails, from the Defense Contract Audit Agency and Defense Contract Management Agency as adequate documentation. We focused our audit on identifying whether the contracting officer determined if the accounting system was adequate at contract award, rather than during the entire period of performance, as required by the interim rule.

Contracts Reviewed

Our data queries in the Federal Procurement Data System–Next Generation identified 17,677 cost-reimbursement, labor-hour, or time-and-materials contract actions, valued at about \$147 billion, on 5,552 contracts, issued by DoD from March 17, 2011, through February 29, 2012. These figures included the value of all options and any firm-fixed-price portions of the contracts. To perform the review, we selected 14 sites based on a combination of cost-reimbursement award amounts and number of cost-reimbursement contracts issued. At the sites we reviewed a nonstatistical sample of 604 contracts, with cost-reimbursement portions, valued at about \$82.7 billion. See Appendix C for the sites we visited and summary contract information. Table 1 shows the number of contracts and potential cost-reimbursement contract values by DoD Component.

Table 1. Contracts Reviewed

DoD Component	Total	Contract Value (Billions) ²
Army	161	\$ 53.3
Navy and Marine Corps ¹	199	17.3
Air Force	156	10.5
MDA	39	1.3
DMEA	49	.4
Total	604	\$ 82.7

¹ Table includes information regarding 29 contracts reviewed during subsequent site visits to Quantico Marine Corps Base and Naval Sea Systems Command Headquarters.

² Contract value includes total of all cost-reimbursement elements. Totals do not equal the actual sum because of rounding.

Small Business Innovation Research Program

The implementation of the interim rule is affected by other Federal and DoD contracting initiatives, such as the Small Business Innovation Research (SBIR) program. The SBIR program was established under the Small Business Innovation Development Act of 1982—the U.S. Small Business Administration serves as the coordinating agency. The program was developed to increase small business opportunity in Federally-funded research and development, stimulate high-tech innovation, and increase private-sector commercialization. It is a three-phase program that encourages domestic small businesses to engage in Federal research and development that has the potential for commercialization.

Phase I is designed for exploration of the technical merit or feasibility of an idea or technology. A firm-fixed-price contract is almost always used for this phase.

Phase II, typically a cost-plus-fixed-fee contract, consists of the research and development work in which the developer also evaluates commercialization potential.

Phase III, the developer moves toward commercialization of the innovation. SBIR program funds cannot be used for Phase III.

We did not target or avoid SBIR contracts as part of our nonstatistical sample because the interim rule does not include an exception for SBIR contracts. The SBIR Desk Reference for Contracting and Payment states that according to FAR Subpart 16.3, “Cost-Reimbursement Contracts,” a cost-reimbursement contract may be used only when the contractor’s accounting system is adequate for determining costs applicable to the contract and requires Government surveillance during the performance of the contract.

Review of Internal Controls

DoD Instruction 5010.40, “Managers’ Internal Control Program Procedures,” May 30, 2013, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses for implementing the changes required by the interim rule regarding the use of cost-reimbursement contracts. The sites visited did not consistently update local procedures or other guidance for issuing and administering cost-reimbursement contracts. We have addressed areas for improvement at sites during the prior reports in this series. This report focuses on contracting procedures applicable to the entire DoD. Specifically, we discuss several areas where DoD contracting policies need to be clarified or strengthened to more consistently implement the revised regulations. We will provide a copy of the final report to the senior official in charge of internal controls in DoD.

Finding

Sites Visited Inconsistently Implemented the Interim Rule

Of the 604 contracts reviewed, valued at about \$82.7 billion, DoD contracting personnel did not consistently implement the interim rule for 411 contracts, valued at about \$31.7 billion. DoD contracting personnel fully met the interim rule on 193 contracts, valued at about \$50.9 billion, of the 604 contracts reviewed.

Specifically, of the 604 contracts reviewed, contracting personnel did not:

- Obtain approval for the use of a cost-reimbursement contract for 202 contracts valued at about \$907 million.
- Justify the use of a cost-reimbursement contract for 121 contracts, valued at about \$1.1 billion.
- Document the possibility of a transition to a firm-fixed-price contract for 227 contracts, valued at about \$11.3 billion.
- Ensure adequate Government resources were available for 138 contracts, valued at about \$18.4 billion.
- Verify the adequacy of the contractor's accounting system for 167 contracts, valued at about \$15.5 billion.

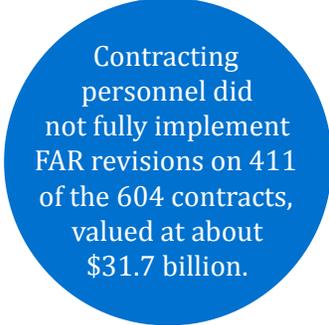
Contracting personnel stated various reasons why they issued contracts that did not meet the interim rule. Generally, these reasons included that they were unaware of the interim rule requirements, their actions were based on sections of the interim rule that had unclear requirements, or that they completed the increased requirements, but did not document them in the contract files. Contracting personnel also stated that they believed the interim rule did not apply to certain types of contracts.

As a result, contracting personnel continue to issue cost-reimbursement contracts that may inappropriately increase DoD's contracting risks because cost-reimbursement contracts provide less incentive for contractors to control costs.

More Guidance Needed to Better Implement Federal Acquisition Regulation Revisions

Contracting personnel did not fully implement FAR revisions on 411 of the 604 contracts, valued at about \$31.7 billion.

Contracting personnel implemented portions of the interim rule for the 411 contracts, but they did not consistently include documentation in the contract files to meet the interim rule. Contracting personnel documented elements of the interim rule in the acquisition plan, business clearance memorandum, COR acceptance letters, or in the determination and findings of contract type. We interpreted the interim rule to apply to task or delivery orders issued after the effective date of the interim rule (March 16, 2011), regardless of the timing of the basic contract award.



Contracting personnel did not fully implement FAR revisions on 411 of the 604 contracts, valued at about \$31.7 billion.

Four contracting offices issued 122 of the 193 contracts that fully met the increased requirements: 1.) Offutt Air Force Base, Nebraska; 2.) Rome–Air Force Research Lab, New York; 3.) Fort Belvoir, Virginia; and 4.) Space and Naval Warfare Systems Command–Charleston, South Carolina.

Approval at Least One Level Above the Contracting Officer for a Cost-Reimbursement Contract Varied by Site

Contracting personnel inconsistently met the interim rule requirement to approve the use of a cost-reimbursement contract one level above the contracting officer. Contracting personnel obtained proper approval for the use of a cost-reimbursement contract for 402 contracts valued at about \$81.8 billion, of the 604 contracts reviewed. However, contracting personnel issued 202 of the 604 contracts reviewed without approval one level above the contracting officer, valued at about \$907 million. Table 2 shows the total contracts reviewed and the number of contracts that did not meet this section of the interim rule by DoD Component.

Table 2. Approval at Least One Level Above the Contracting Officer

DoD Component	Total Contracts	Did Not Meet Interim Rule
Army	161	61
Navy and Marine Corps	199	52
Air Force	156	39
MDA	39	19
DMEA	49	31
Total	604	202

Contracting personnel stated that they did not believe low-dollar awards required approval and, in some cases, the awards were already signed by the highest ranking person within the contracting office. We made recommendations to the specific DoD Components in the previous reports of this series to address this area; however, further guidance is needed regarding the applicability of this requirement for certain types and values of contracts and whether senior contracting personnel in an office can issue cost-reimbursement awards without higher level approval.

We also identified conflicts in acquisition regulations that need clarification regarding whether awards need approval when an acquisition plan is not required. The interim rule amended FAR section 16.301-3 “Limitations” to state that a cost-reimbursement contract could only be used when a written acquisition plan has been approved and signed at least one level above the contracting officer. However, Defense Federal Acquisition Regulations Supplement Section 207.103 “Agency-head responsibilities” states that unless otherwise directed by the department or agency head, written acquisition plans are only required on acquisitions for development when the total estimated contract costs are greater than \$10,000,000. The thresholds are higher on acquisitions for production or services. Additionally, the interim rule stated that when written acquisition plans are not required, the rationale for selecting a cost-reimbursement contract should be documented elsewhere in the contract file.

However, the language in the interim rule was unclear. We determined that the interim rule did not explicitly state that approval one level above the contracting officer was to be documented in the contract file if a written acquisition plan was not required. A contracting officer stated that they issued cost-reimbursement contracts without higher level approval based on their interpretation of the interim rule. They noted that the interim rule only specifically requires higher level approval on a written acquisition plan even though FAR section 16.301-3

forbids issuing cost-reimbursement contracts without an acquisition plan signed and approved at least one level above the contracting officer. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, should issue a memorandum or other guidance to reinforce the applicability of the current guidance or clarify when cost-reimbursement awards should be approved one level above the contracting officer. The Director should include specific guidance on approval requirements on contracts issued by senior officials and whether approval is required if a written acquisition plan is not also required for the contract.

Justification Documenting the Use of a Cost-Reimbursement Contract Type Was Consistently Completed

Contracting personnel generally satisfied the interim rule requirement to justify a cost-reimbursement contract type. Contracting personnel met the interim rule requirement to justify a cost-reimbursement contract type for 483 contracts, valued at about \$81.6 billion, of the 604 contracts reviewed. However, contracting personnel did not satisfy the interim rule's requirement to justify a cost-reimbursement contract type for 121 contracts, valued at about \$1.1 billion because contracting personnel stated they were not aware of the interim rule or they believed that the cost-reimbursement type for the contract was authorized by other programs and guidance. We made specific recommendations to DoD Components in the previous reports of this series to address this area and do not have any further recommendations in this area. Table 3 shows the total contracts reviewed and the number of contracts that did not meet this section of the interim rule by DoD Component.

Table 3. Justified the Use of A Cost-Reimbursement Contract Type

DoD Component	Total Contracts	Did Not Meet Interim Rule
Army	161	34
Navy and Marine Corps	199	52
Air Force	156	25
MDA	39	0
DMEA	49	10
Total	604	121

Identifying Opportunities for Transition to Firm-Fixed-Price Contracts Was Inconsistent

Contracting personnel inconsistently met the interim rule requirement to determine the possibility of transitioning from a cost-reimbursement contract type to a firm-fixed-price contract. Contracting personnel met the interim rule requirement to show transition to firm-fixed-price contract for 377 contracts, valued at about \$71.4 billion, of the 604 contracts reviewed. Of the 227 contracts that did not identify opportunities to transition to firm-fixed-price contracts, valued at about \$11.3 billion, contracting personnel stated in many cases they did not document the opportunities because:

- they were unaware of the requirement to document the potential transition to firm-fixed price;
- no opportunities to transition existed; or
- the contract was a one-time requirement.

Table 4 shows the total contracts reviewed and the number of contracts that did not meet this section of the interim rule by DoD Component.

Table 4. Efforts to Transition Subsequent Contracts to Firm-Fixed Price

DoD Component	Total Contracts	Did Not Meet Interim Rule
Army	161	57
Navy and Marine Corps	199	78
Air Force	156	42
MDA	39	2
DMEA	49	48
Total	604	227

During this series of reports, we identified best practices that should be implemented across DoD. Contracting offices that routinely issued hybrid contracts were most compliant in this area. A hybrid contract contains multiple contract line items with different pricing structures that allows the contracting officer to choose whether cost reimbursement or firm-fixed price is most appropriate at the time the order is awarded. Additionally, we noted that better communication between the program managers, contracting officers, and personnel responsible for contract oversight resulted in more opportunities to identify areas of the contracts that could transition to a firm-fixed-price contract. We made recommendations to the specific DoD Components in the previous reports of this series to address contracts that did not meet this area of the interim rule; however because of

the high number of contracts not meeting this area, we recommend further reinforcement of the requirements by DoD officials. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, should issue a memorandum or other guidance reinforcing the current regulations. Additionally the memorandum should promote the issuance of hybrid contracts and better communication between the requiring components, contracting personnel, and contract monitors allowing contracting personnel increased opportunities to identify ways to transition to firm-fixed-price contracts.

Documentation That Government Resources Were Available to Monitor Contract Was Inconsistent

Contracting personnel did not consistently meet the interim rule requirement to make adequate Government resources available to monitor a cost-reimbursement contract. Contracting personnel met the interim rule requirement to make adequate Government resources available to monitor a cost-reimbursement contract for 466 contracts, valued at about \$64.3 billion, of the 604 contracts reviewed. In the 138 cases of noncompliance, valued at about \$18.4 billion, contracting personnel stated they were unaware of the interim rule requirements, did not receive an acknowledgement from the COR, or assigned a COR after the contract was awarded. We made specific recommendations in the previous reports of this series to address this area at sites visited and do not have any further recommendations in this area. Table 5 shows the total contracts reviewed and the number of contracts that did not meet this section of the interim rule by DoD Component.



Contracting personnel stated they were unaware of the interim rule requirements.

Table 5. Documented that Government Resources Were Available to Monitor the Contract

DoD Component	Total Contracts	Did Not Meet Interim Rule
Army	161	17
Navy and Marine Corps	199	97
Air Force	156	23
MDA	39	0
DMEA	49	1
Total	604	138

Verification That an Adequate Accounting System Was in Place at Award Was Inconsistent

Contracting personnel inconsistently verified that an adequate accounting system was in place before issuing a cost-reimbursement contract. Contracting personnel met the interim rule requirement for 437 contracts, valued at about \$67.2 billion, of the 604 contracts reviewed. Of the 167 cases of noncompliance, valued at about \$15.5 billion, contracting personnel stated they were unaware of the interim rule requirements, did not adequately document their assessment of the accounting system in the contract file, or they did not receive timely support from auditors. We made recommendations in the previous reports of this series to address contracts that did not meet the interim rule requirements. Table 6 shows the total contracts reviewed and the number of contracts that did not meet this section of the interim rule by DoD Component.

Table 6. Documented that an Adequate Accounting System Was in Place

DoD Component	Total Contracts	Did Not Meet Interim Rule
Army	161	33
Navy and Marine Corps	199	65
Air Force	156	42
MDA	39	7
DMEA	49	20
Total	604	167

More guidance is required so that contracting officers can consistently assess contractors' accounting systems. The interim rule does not identify what steps contracting officers should take to assess a contractor's accounting system. Some contracting officers issued contracts without this assessment stating that the Defense Contract Audit Agency could not assess the system in a timely manner. However, other contracting officers completed an assessment of the contractor's accounting system without specifically requesting outside assistance. These contracting officers assessed the contractor's accounting systems by obtaining statements and certifications from the contractor about the capabilities of their accounting system or used other similar methods that gave them an understanding of the capabilities of the contractor's accounting system. Additionally, contracting officers may have used outdated

The interim rule does not identify what steps contracting officers should take to assess a contractor's accounting system.

audit reports to assess contractor accounting systems. However, these contracting officers met the interim rule criteria because the rule did not stipulate a time period that accounting system audits can be used as a basis to determine the adequacy of a contractor's accounting system. We determined the contract files that documented an adequate accounting system existed in the opinion of the contracting officer and how the accounting system was assessed met the interim rule because the rule does not identify criteria for assessing a contractor's accounting system.

We determined the interim rule requirement that the contracting officer assess the adequacy of the contractor's accounting system after the contract is awarded also needs further clarification. The interim rule added a new paragraph to FAR section 42.302, "Contract administration functions" that states the contractor's accounting system must be adequate "during the entire period of contract performance." We did not review this area for compliance as part of our work because the contracts were still ongoing when we conducted our site visits and the FAR changes were unclear regarding what would be required to meet the increased regulations. If DoD contracting policymakers establish acceptable methods for contracting personnel to meet the criteria for continual assessments of the contractor's accounting system, then the methods should establish whether a system needs reassessed when certain events occur, such as exercising an option, or based on a time period, such as a reassessment on a quarterly basis.

Further guidance regarding details required for the contractor's accounting system initial assessment and how contracting personnel should assess a contractor's accounting system "during the entire period of contract performance" as required by the interim rule. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, should issue a memorandum or other guidance to identify best practices to assess a contractor's accounting system and codify the efforts that should be taken by contracting personnel to ensure that a contractor's accounting system is adequate during the entire period of contract performance.

General Areas of Concern Regarding the Interim Rule

In addition to the five areas that we audited, we also identified areas where contracting personnel required further guidance regarding the overall implementation of interim guidance and whether interim guidance applied to the contracts they were issuing. These areas contributed to the contracting personnel issuing contracts that did not meet the increased oversight for issuing

cost-reimbursement contracts required by the interim rule. If DoD contracting policymakers provide guidance to contracting personnel on the following areas, then contracting personnel can more consistently implement FAR revisions across the Department.

Confusion Regarding Applicability to Task and Delivery Orders

DoD Components were confused regarding whether task and delivery orders issued after the interim rule on basic contracts issued before the interim rule would be subject to the increased oversight. We conducted our audit using the assumption that new orders would be subject to the interim rule requirements. The contracting personnel we interviewed stated they issued some contracts that did not meet interim requirements because they assumed the interim rule only applied when the basic contract was issued after the interim rule because the basic contract was the foundation for the order. The interim rule includes no guidance as to whether these orders were subject to the interim rule. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy should issue a memorandum or other guidance clarifying whether FAR revisions are applicable to task and delivery orders issued on previously issued basic contracts.

Exceptions for Certain Contracts

Contracting personnel identified certain contracts (for example, contracts under the SBIR Program) that have policies in place outlining specific contracting procedures and requirements to participate in the program. Additionally, contracts for specific services (for example, utilities, travel, or shipping) have additional restrictions and alternative contracting procedures that may make the interim rule requirements an additional burden on contracting personnel resulting in little benefit in managing the risks of cost-reimbursement contracts. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, should issue a memorandum or other guidance discussing whether broader contracting policies are sufficient support to meet the requirements for issuing a cost-reimbursement contract or reinforce that there are no exceptions to documenting the requirements within each contract file regardless of the nature of the contract.

Assessing Prior Decisions before Issuing Orders or Exercising Options

During our review, we considered documentation adequate to support the interim rule criteria regardless of whether decisions were made specific to that contracting action, or whether the decisions were made previously during the issuance of the basic contract. The interim rule did not specify whether decisions and approvals made during the acquisition planning on a basic contract would apply to all orders issued on the contract. In some cases, changing conditions may eliminate the need for the Government to issue a cost-reimbursement contract and sustain the associated risk. For example, a contracting officer justifying a cost-reimbursement contract for unknown circumstances may not make the same determination years after the initial decision to issue a cost-reimbursement contract because the Government and contractor could adapt and eliminate risks as the contract matured. Alternatively, contracting officers documenting that adequate resources are available for initial contract oversight may not make the same determination as the Government issues numerous orders on the contract. The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, should issue a memorandum or other guidance clarifying to what extent initial decisions for a basic contract, such as justification to issue a cost-reimbursement award, approval by higher authority, and the assessment of the contractor's accounting system can be relied on for analysis on the subsequent orders and options pertaining to the contract.

Firm-Fixed-Price Contracts Properly Classified

Contracting officials generally classified firm-fixed-price contracts correctly and did not avoid the increased cost-reimbursement contract documentation requirements by purposely miscoding contracts. We reviewed 566 contracts identified as firm-fixed-price contracts in the Electronic Document Access system that were issued by contracting personnel at the 14 sites. We reviewed some contracts that contained a small cost-reimbursement portion within the contract, but if the contract was mainly firm-fixed price, we considered the award classified correctly. We determined that 4 of the 566 contracts may have been improperly classified as firm-fixed price and should have been treated as cost-reimbursement contracts. However, we concluded that contracting personnel were properly classifying contracts because of the small number of contracts we questioned.

Conclusion

DoD contracting personnel issued 411 contracts, valued at \$31.7 billion, of 604 contracts, valued at \$82.7 billion, which did not fully comply with the interim rule requirements for issuing cost-reimbursement contracts. Contracting personnel continue to issue cost-reimbursement contracts that may inappropriately increase the contracting risks because cost-reimbursement contracts provide less incentive for contractors to control costs. Contracting personnel will plan, issue, and oversee cost-reimbursement contracts more effectively by fully implementing the FAR revisions. DoD policymakers can also increase compliance with FAR revisions by clarifying the applicability of the FAR revisions to task and delivery orders, determining whether broader contracting policies are sufficient support to meet the requirements for issuing a cost-reimbursement contract, and whether decisions made for the basic contract can be used as a basis for the subsequent task and delivery orders issued.

Recommendations

We recommend that the Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, issue a memorandum or other guidance to:

1. Reinforce the applicability of the current guidance or clarifying when cost-reimbursement contracts should be approved one level above the contracting officer. They should include specific guidance on approval requirements on contracts issued by senior officials and whether approval is required if a written acquisition plan is not also required for the contract.
2. Reinforce the current regulations regarding the requirement to consider how a cost-reimbursement contract could transition to a firm-fixed-price contract in the future. Additionally the memorandum should promote the issuance of hybrid contracts and better communication between the requiring components, contracting personnel, and contract monitors allowing contracting personnel increased opportunities to identify ways to transition to firm-fixed price contracts.
3. Identify best practices to assess a contractor's accounting system and codify the efforts that should be taken by contracting personnel to ensure that a contractor's accounting system is adequate during the entire period of contract performance.

4. Clarify whether Federal Acquisition Regulation revisions are applicable to task and delivery orders issued on previously issued basic contracts.
5. Discuss whether broader contracting policies are sufficient support to meet the requirements for issuing a cost-reimbursement contract or reinforce that there are no exceptions to documenting the requirements within each contract file regardless of the nature of the contract.
6. Clarify to what extent initial decisions for a basic contract, such as justification to issue a cost-reimbursement award, approval by higher authority, and the assessment of the contractor's accounting system can be relied on for analysis on the subsequent orders and options pertaining to the contract.

Management Comments Required

The Deputy Director, Contract Policy and International Contracting, Defense Procurement and Acquisition Policy, did not respond to the recommendations on the draft report. We request that the Deputy Director provide comments on the final report.

Appendix A

Scope and Methodology

We conducted this audit from February 2012 through August 2012 under DoD IG Project No. D2012-D000CG-0121.000. In August 2012, we decided to issue multiple reports as a result of those efforts. From August 2012 through April 2014, we primarily performed work on other reports in this series. In April 2014, we announced this audit, DoD IG Project No. D2014-D000CG-0175.000, as a summary project for this series of reports auditing DoD's Use of Cost-Reimbursement Contracts. We completed all projects of this series in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The criteria we applied to this audit included Federal Acquisition Regulation (FAR) revisions required by section 864 of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 and implemented by the FAR interim rule, FAC 2005-50, 76 Federal Register 14542, "Proper Use and Management of Cost Reimbursement Contracts" (2011). We also reviewed the Small Business Innovation Research policy directive. The FAR sections updated by the interim rule include FAR 1.602-2, "Responsibilities;" FAR 1.604, "Contracting Officers Representative;" FAR 2.101, "Definitions;" FAR 7.103, "Agency-Head Responsibilities;" FAR 7.104, "General Procedures;" FAR 7.105, "Contents of Written Acquisition Plans;" FAR 16.103, "Negotiating Contract Types;" FAR 16.104, "Factors in Selecting Contract Types;" FAR 16.301-2, "Application;" FAR 16.301-3, "Limitations;" FAR 42.302, "Contract Administration Functions;" and FAR subpart 50.1, "Extraordinary Contractual Actions." We also reviewed Defense Federal Acquisition Regulation Supplement Subpart 207.1 "Acquisition Plans."

In addition to this report, we issued separate reports for the Army, Navy, and Air Force as well as a report regarding the Missile Defense Agency and Defense Microelectronics Activity's implementation of the interim rule. This is the fifth and final in a series of audit reports. This audit was required by the FY 2009 National Defense Authorization Act, section 864, "Regulation on the Use of Cost Reimbursement Contracts." Our objective was to determine whether DoD complied with interim Federal Acquisition Regulation revisions on the use of cost-reimbursement contracts.

To determine compliance with the interim rule, our methodology included reviewing basic contract and task and delivery order files that varied slightly from the specific interim rule requirements. In cases where the interim rule required areas to be documented in the acquisition plan, we expanded our review to the entire contract file because, in many cases, the acquisition plan was written and approved before the interim rule was issued. Additionally, we focused our audit to assess how contracting personnel determined that adequate resources were available to monitor the award by determining whether a contracting officer's representative (COR) or similar person was assigned to the contract at issuance. We did not determine whether the person assigned had an appropriate workload or was properly geographically located to monitor the award. We identified the assignment of a COR on the contracts rather than testing the adequacy of the COR assigned to the contract reviewed. Additionally, we determined whether the contracting officer documented that the contractor's accounting system was adequate at contract award and not during the entire period of contract performance as required by the interim rule.

Universe and Sample Information

We used Federal Procurement Data System–Next Generation data to identify a universe of cost-reimbursement, labor-hour, and time-and-materials contracts issued by contracting personnel from March 17, 2011, through February 29, 2012. We included task and delivery orders issued after March 17, 2011, in our universe even if the basic contract was issued before the interim ruling. We limited the review to contracts valued at \$150,000 or above. We removed contract modifications from our universe because they were not new contract awards. We eliminated contracts that were issued on General Service Administration contracts. We queried all cost-reimbursement contracts from March 17, 2011, through February 29, 2012. Our universe consisted of 17,677 contract actions, valued at over \$147 billion—this included the value of all potential options and any firm-fixed-price portions of the contracts. To meet the DoD Inspector General's audit requirement in Section 864 of the FY 2009 National Defense Authorization Act, we determined that we would review each Service, one Defense agency, and one Defense activity. We selected the 14 visited sites based on a combination of cost-reimbursement award amounts and number of cost-reimbursement contracts and task or delivery orders issued. The Army sites visited were Ft. Huachuca Army Contracting Command-Aberdeen Proving Ground (APG), Sierra Vista, Arizona; Durham-APG, North Carolina; Intelligence and Security Command-Ft. Belvoir, Virginia; and Army Contracting Command-Redstone Arsenal, Huntsville, Alabama. The Air Force sites visited were Hanscom Air Force Base (AFB), Massachusetts; Offutt AFB, Nebraska; Air Force Research Laboratory, Rome, New York; and

Warner Robbins AFB, Georgia. The Navy and Marine Corps sites visited were Space and Naval Warfare Systems Command, Charleston, South Carolina; Naval Sea Systems Command Headquarters, Washington, District of Columbia; Naval Supply Systems Command, San Diego, California; and Quantico Marine Corps Base, Virginia. We also visited Missile Defense Agency, Huntsville, Alabama and Defense Microelectronics Activity, McClellan, California. The sites visited are identified in Appendix C.

Our nonstatistical sample consisted of about 50 contracts from each of the 14 sites, except Fort Huachuca, which only had 18 contracts in the universe. Our total sample size was 667 contracts. We removed 92 contracts from our combined sample because:

- time constraints limited our review;
- contracts were misclassified and were actually firm-fixed-price contracts;
- contracts were not located at the site; or
- contracts were actually issued on General Service Administration contracts and not identified as such in the Federal Procurement Data System–Next Generation.

We also reviewed a separate nonstatistical sample of 29 contracts issued by Naval Sea Systems Command Headquarters and Quantico Marine Corps Base from February 1, 2013, through July 31, 2013, with a total value of about \$9.58 billion as part of a subsequent review of contracts. These 29 contracts are included in the summary information presented throughout the report, but are not identified as part of the universe and sample discussed above.

Review of Documentation and Interviews

We reviewed documentation maintained by the contracting offices. The documents reviewed included acquisition plans; business clearance memorandums; determination and finding for contract type; COR designation letters; COR training certificates; Defense Contract Audit Agency audit reports; and other documentation included in the contract file to comply with the interim rule. We reviewed contract award documentation including basic contract files from FY 2000 through FY 2013. We interviewed personnel responsible for awarding contracts, as well as quality assurance personnel, such as CORs, who were responsible for monitoring the contracts.

At each site visited, we determined whether contracting personnel implemented the interim rule by documenting:

- approval for the cost-reimbursement contract was at least one level above the contracting officer;
- justification for the use of cost-reimbursement, time-and-materials, or labor-hour contracts;
- how the requirements under contract could transition to firm-fixed price in the future;
- Government resources were available to monitor the cost-reimbursement contract; and
- whether the contractor had an adequate accounting system in place at contract award.

We tested contracts to determine whether contracting personnel were misclassifying cost-reimbursement contracts as firm-fixed-price contracts. We used the Federal Procurement Data System–Next Generation and Electronic Document Access to review the firm-fixed-price contracts. We reviewed 566 firm-fixed-price contracts issued by the sites visited to determine whether contracts contained cost-reimbursement line items. Although we used these systems during our audit, we did not use them as a material basis for our findings, recommendations, or conclusions.

Use of Computer-Processed Data

We did not rely on computer-processed data to perform this audit.

Use of Technical Assistance

The DoD Office of Inspector General Quantitative Methods Division assisted with the audit. We worked with the Quantitative Methods Division during our planning phase of DoDIG Project No. D2012-D000CG-0121.000 to determine the number of sites per Service to visit and the number of contracts that should be reviewed at each site. The Quantitative Methods Division suggested that we should visit three to five sites per Service and have a nonstatistical sample of at least 30 contracts per site.

Prior Coverage

During the last 6 years, the Government Accountability Office, the Department of Defense Inspector General, the Department of Transportation Inspector General, the Department of Homeland Security Inspector General, the General Services Administration Inspector General, and the National Aeronautics and Space Administration Inspector General have issued nine reports discussing oversight of the use of cost-reimbursement contracts. Government Accountability Office reports can be accessed at www.gao.gov. Department of Defense Inspector General reports can be accessed at www.dodig.mil. Department of Transportation Inspector General Reports can be accessed at www.oig.dot.gov. Department of Homeland Defense Inspector General reports can be accessed at www.oig.dhs.gov. General Services Administration Inspector General reports can be accessed at www.gsaig.gov. National Aeronautics and Space Administration Inspector General reports can be accessed at <http://oig.nasa.gov>.

GAO

Report No. GAO-09-921, “Contract Management: Extent of Federal Spending Under Cost-Reimbursement Contracts Unclear and Key Controls Not Always Used,” September 30, 2009

DoD IG

Report No. DODIG-2014-092, “Navy and Marine Corps Have Weak Procurement Processes for Cost-Reimbursement Contract Issuance and Management,” July 11, 2014

Report No. DODIG-2014-011, “Missile Defense Agency and Defense Microelectronics Activity Use of Cost-Reimbursement Contracts,” November 22, 2013

Report No. DODIG-2013-120, “Army Needs Better Processes to Appropriately Justify and Manage Cost-Reimbursement Contracts,” August 23, 2013

Report No. DODIG-2013-059, “Air Force Needs Better Processes to Appropriately Justify and Manage Cost-Reimbursable Contracts,” March 21, 2013

DOT IG

Report No. ZA-2013-118, “DOT Does Not Fully Comply With Revised Federal Acquisition Regulations on the Use and Management of Cost-Reimbursement Awards,” August 5, 2013

DHS IG

Report No. OIG-12-133, "Department of Homeland Security Compliance with the Federal Acquisition Regulation Revisions on Proper Use and Management of Cost-Reimbursement Contracts," September 28, 2012

GSA IG

Report No. A120052/Q/A/P12004, "Audit of GSA's Cost-Reimbursement Contracts," March 30, 2012

NASA IG

Report No. IG-12-014, "Final Memorandum on NASA's Compliance with Provisions of the Duncan Hunter National Defense Authorization Act 2009—Management of Cost Reimbursement Contracts," March 14, 2012

Appendix B

Federal Acquisition Circular 2005-50 Issued March 16, 2011

Federal Register / Vol. 76, No. 51 / Wednesday, March 16, 2011 / Rules and Regulations **14543**

THIS SECTION INTENTIONALLY LEFT BLANK

DEPARTMENT OF DEFENSE

**GENERAL SERVICES
ADMINISTRATION**

**NATIONAL AERONAUTICS AND
SPACE ADMINISTRATION**

48 CFR Parts 1, 2, 7, 16, 32, 42, and 50

[FAC 2005-50; FAR Case 2008-030; Item
I; Docket 2011-0082, Sequence 1]

RIN 9000-AL78

**Federal Acquisition Regulation; Proper
Use and Management of Cost-
Reimbursement Contracts**

AGENCIES: Department of Defense (DoD),
General Services Administration (GSA),
and National Aeronautics and Space
Administration (NASA).

ACTION: Interim rule with request for
comments.

SUMMARY: DoD, GSA, and NASA are
issuing an interim rule amending the
Federal Acquisition Regulation (FAR) to
implement section 864 of the Duncan
Hunter National Defense Authorization
Act for Fiscal Year 2009. This law aligns

Federal Acquisition Circular 2005-50 Issued March 16, 2011 (cont'd)

14544 Federal Register / Vol. 76, No. 51 / Wednesday, March 16, 2011 / Rules and Regulations

with the Presidential Memorandum on Government Contracting, issued on March 4, 2009, which directed agencies to save \$40 billion in contracting annually by Fiscal Year (FY) 2011 and to reduce the use of high-risk contracts. This rule provides regulatory guidance on the proper use and management of other than firm-fixed-price contracts (e.g., cost-reimbursement, time-and-material, and labor-hour).

DATES: *Effective Date:* March 16, 2011.

Comment Date: Interested parties should submit written comments to the Regulatory Secretariat on or before May 16, 2011 to be considered in the formulation of a final rule.

ADDRESSES: Submit comments identified by FAC 2005-50, FAR Case 2008-030, by any of the following methods:

- *Regulations.gov:* <http://www.regulations.gov>. Submit comments via the Federal eRulemaking portal by inputting "FAR Case 2008-030" under the heading "Enter Keyword or ID" and selecting "Search." Select the link "Submit a Comment" that corresponds with "FAR Case 2008-030." Follow the instructions provided at the "Submit a Comment" screen. Please include your name, company name (if any), and "FAR Case 2008-030" on your attached document.

- *Fax:* (202) 501-4067.
- *Mail:* General Services

Administration, Regulatory Secretariat (MVCB), ATTN: Hada Flowers, 1275 First Street, NE., 7th Floor, Washington, DC 20417.

Instructions: Please submit comments only and cite FAC 2005-50, FAR Case 2008-030, in all correspondence related to this case. All comments received will be posted without change to <http://www.regulations.gov>, including any personal and/or business confidential information provided.

FOR FURTHER INFORMATION CONTACT: For clarification of content, contact Lori Sakalos, Procurement Analyst, at (202) 208-0498. For information pertaining to status or publication schedules, contact the Regulatory Secretariat at (202) 501-4755. Please cite FAC 2005-50, FAR Case 2008-030.

SUPPLEMENTARY INFORMATION:

I. Background

This case implements section 864 of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (Pub. L. 110-417), enacted October 14, 2008. This law aligns with the President's goal of reducing high-risk contracting as denoted in the March 4, 2009, Presidential Memorandum on Government Contracting.

Section 864 requires the FAR to be revised to address the use and management of cost-reimbursement contracts and identifies the following three areas that the Defense Acquisition Regulation Council and the Civilian Agency Acquisition Council (Councils) should consider in amending the FAR—

(a) Circumstances when cost-reimbursement contracts are appropriate;

(b) Acquisition plan findings to support the selection of a cost-reimbursement contract; and

(c) Acquisition resources necessary to award and manage a cost-reimbursement contract.

1. *Guidance on Cost-reimbursement contracts.*

As required, the Councils included additional coverage at FAR subpart 16.1, Selecting Contract Types, and at subpart 16.3, Cost-Reimbursement Contracts, to provide further guidance as to when, and under what circumstances, cost-reimbursement contracts are appropriate. Therefore, this rule makes the following changes:

- FAR 16.103, Negotiating contract type, is amended to revise paragraph (d) to reflect additional documentation when other than a firm-fixed-price contract type is selected.

- FAR 16.104, Factors in selecting contract types, is amended to add a new paragraph (e) to provide guidance to the contracting officer to consider combining contract types if the entire contract cannot be firm fixed-price.

- FAR 16.301-2, Application, is amended to provide guidance to the contracting officer as to the circumstances in which to use cost-reimbursement contracts as well as outlining the rationale for documentation for selecting this contract type.

- FAR 16.301-3, Limitations, is amended to (1) provide additional guidance to the contracting officer as to when a cost-reimbursement contract may be used, (2) ensure that all factors have been considered per FAR 16.104, and (3) ensure that adequate Government resources are available to award and manage this type of contract.

- FAR 7.104(e) also requires the designation of a properly trained contracting officer's representative (COR) (or contracting officer's technical representative (COTR)) prior to award of the contract or order.

2. *Identification of acquisition plan findings.* FAR 7.103, Agency-head responsibilities, is amended and renumbered to add new paragraphs 7.103(d), 7.103(f), and 7.103(j) to ensure that acquisition planners document the file to support the selection of the

contract type in accordance with FAR subpart 16.1; ensure that the statement of work is closely aligned with the performance outcomes and cost estimates; and obtain an approval and signature from the appropriate acquisition official at least one level above the contracting officer. FAR 7.105(b)(5)(iv) was added to discuss the strategy to transition from cost-reimbursement contracts to firm-fixed-price contracts. Although FAR 7.105(b)(5), Acquisition considerations, requires the acquisition plans to include a discussion of contract type selection and rationale, the Councils believe that a greater emphasis on the use of cost-reimbursement contracts should be added and included a new paragraph at FAR 7.105(b)(3), Contract type selection. Additionally, FAR 16.301-3(a) has been amended and renumbered.

3. *Acquisition workforce resources.*

The Councils recognize that assigning adequate and proper resources to support the solicitation, award, and administration of other than firm-fixed-price contracts (cost-reimbursement, time-and-material, and labor-hour) contract is challenging. There is also great concern that a lack of involvement in contract oversight by program offices is primarily present in other than firm-fixed-price contracts. Therefore, from the outset, contracting officers should be assured, to the greatest extent practicable, that the right resources in number, kind, and availability be assigned to support other than firm-fixed-price contracts. The Councils consider that greater accountability for the management and oversight of all contracts, especially other than firm-fixed-price contracts, can be gained and improved by requiring that properly trained CORs or COTRs (see FAR 2.101(b)(2), Definitions) be appointed before award. Therefore, FAR 7.104, General Procedures, and FAR 16.301-3(a)(4)(i) are amended to reflect that prior to award of a contract, especially on other than firm-fixed price contracts, at least one COR or COTR qualified in accordance with FAR 1.602-2 is designated. FAR 1.602-2, Responsibilities, is amended to add a new paragraph (d) outlining the requirement for the contracting officer to designate and authorize, in writing, a COR on contracts and orders, as appropriate. Additionally, a new section was added at FAR 1.604, Contracting officer's representative, outlining the COR's duties.

4. *Contract administration functions.*

A new paragraph was added at FAR 42.302(a)(12) to require that the contracting officer determine the continuing adequacy of the contractor's

Federal Acquisition Circular 2005-50 Issued March 16, 2011 (cont'd)

Federal Register / Vol. 76, No. 51 / Wednesday, March 16, 2011 / Rules and Regulations 14545

accounting system during the entire period of contract performance. Also, paragraph (a)(12) was added to the list of functions at FAR 42.302(a) that cannot be retained and that must be delegated by the contracting officer when delegating contract administration functions to a contract administration office in accordance with FAR 42.202(a).

II. Executive Order 12866

This is a significant regulatory action and, therefore, was subject to review under Section 6(b) of Executive Order 12866, Regulatory Planning and Review, dated September 30, 1993. This rule is not a major rule under 5 U.S.C. 804.

III. Regulatory Flexibility Act

DoD, GSA, and NASA do not expect this interim rule to have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, because section 864 affects only internal Government operations and requires the Government to establish internal guidance on the proper use and management of all contracts especially other than firm-fixed-price contracts (*e.g.*, cost-reimbursement, time-and-material, and labor-hour) and does not impose any additional requirements on small businesses.

Therefore, an Initial Regulatory Flexibility Analysis has not been performed. DoD, GSA, and NASA invite comments from small business entities and other interested parties on the expected impact of this rule on small entities.

DoD, GSA, and NASA will also consider comments from small entities concerning the existing regulations in subparts affected by the rule in accordance with 5 U.S.C. 610. Interested parties must submit such comments separately and should cite 5 U.S.C. 610 (FAC 2005-50, FAR Case 2008-030) in correspondence.

IV. Paperwork Reduction Act

The changes to the FAR do not impose information collection requirements that require the approval of the Office of Management and Budget under the Paperwork Reduction Act (44 U.S.C. chapter 35).

V. Determination To Issue an Interim Rule

A determination has been made under the authority of the Secretary of Defense (DoD), the Administrator of General Services (GSA), and the Administrator of the National Aeronautics and Space Administration (NASA) that urgent and

compelling reasons exist to promulgate this interim rule without prior opportunity for public comment. This action is necessary because section 864 of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, enacted October 14, 2008, directs that it must be implemented within 270 days from enactment. This rule is also urgent because this law requires the Inspector General to conduct a compliance review for each executive agency, one year after the regulations have been promulgated, on the use of cost-reimbursement contracts and include the results of their findings in the IG's next semiannual report. However, pursuant to 41 U.S.C. 1707 and FAR 1.501-3(b), DoD, GSA, and NASA will consider public comments received in response to this interim rule in the formation of the final rule.

List of Subjects in 48 CFR Parts 1, 2, 7, 16, 32, 42, and 50

Government procurement.

Dated: March 4, 2011.

Millisa Gary,
Acting Director, Office of Governmentwide Acquisition Policy Division.

Therefore, DoD, GSA, and NASA amend 48 CFR parts 1, 2, 7, 16, 32, 42, and 50 as set forth below:

■ 1. The authority citation for 48 CFR parts 1, 2, 7, 16, 32, 42, and 50 continues to read as follows:

Authority: 40 U.S.C. 121(c); 10 U.S.C. chapter 137; and 42 U.S.C. 2473(c).

PART 1—FEDERAL ACQUISITION REGULATIONS SYSTEM

■ 2. Amend section 1.602-2 by adding paragraph (d) to read as follows:

1.602-2 Responsibilities.
* * * * *

(d) Designate and authorize, in writing, a contracting officer's representative (COR) on all contracts and orders other than those that are firm-fixed price, and for firm-fixed-price contracts and orders as appropriate. However, the contracting officer is not precluded from retaining and executing the COR duties as appropriate. *See* 7.104(e). A COR—

(1) Must be a Government employee, unless otherwise authorized in agency regulations;

(2) Shall be certified and maintain certification in accordance with the Office of Management and Budget memorandum entitled "The Federal Acquisition Certification for Contracting Officer Technical Representatives" dated November 26, 2007, or for DoD, DoD Regulations, as applicable;

(3) Must be qualified by training and experience commensurate with the responsibilities to be delegated in accordance with department/agency guidelines;

(4) May not be delegated responsibility to perform functions that have been delegated under 42.202 to a contract administration office, but may be assigned some duties at 42.302 by the contracting officer;

(5) Has no authority to make any commitments or changes that affect price, quality, quantity, delivery, or other terms and conditions of the contract; and

(6) Must be designated in writing, with copies furnished to the contractor and the contract administration office—

(i) Specifying the extent of the COR's authority to act on behalf of the contracting officer;

(ii) Identifying the limitations on the COR's authority;

(iii) Specifying the period covered by the designation;

(iv) Stating the authority is not redelegable; and

(v) Stating that the COR may be personally liable for unauthorized acts.

■ 3. Amend section 1.603 by revising the section heading to read as follows:

1.603 Selection, appointment, and termination of appointment for contracting officers.
* * * * *

■ 4. Add section 1.604 to read as follows:

1.604 Contracting Officer's Representative (COR).

A contracting officer's representative (COR) assists in the technical monitoring or administration of a contract (*see* 1.602-2(d)). The COR shall maintain a file for each assigned contract. The file must include, at a minimum—

(a) A copy of the contracting officer's letter of designation and other documents describing the COR's duties and responsibilities;

(b) A copy of the contract administration functions delegated to a contract administration office which may not be delegated to the COR (*see* 1.602-2(d)(4)); and

(c) Documentation of COR actions taken in accordance with the delegation of authority.

PART 2—DEFINITIONS OF WORDS AND TERMS

■ 5. Amend section 2.101 in paragraph (b)(2) by adding, in alphabetical order, the definition "Contracting officer's representative (COR)" to read as follows:

Federal Acquisition Circular 2005-50 Issued March 16, 2011 (cont'd)

14546 Federal Register / Vol. 76, No. 51 / Wednesday, March 16, 2011 / Rules and Regulations

2.101 Definitions.

* * * * *

(b) * * *

(2) * * *

Contracting officer's representative (COR) means an individual, including a contracting officer's technical representative (COTR), designated and authorized in writing by the contracting officer to perform specific technical or administrative functions.

* * * * *

PART 7—ACQUISITION PLANNING

■ 6. Amend section 7.102 by adding paragraph (a)(3) to read as follows:

7.102 Policy.

(a) * * *

(3) Selection of appropriate contract type in accordance with part 16.

* * * * *

■ 7. Amend section 7.103 by—

■ a. Redesignating paragraphs (e) through (w) as paragraphs (g) through (y);

■ b. Redesignating paragraph (d) as paragraph (e);

■ c. Adding a new paragraph (d);

■ d. Revising newly redesignated paragraph (e);

■ e. Adding a new paragraph (f); and

■ f. Revising newly redesignated paragraph (j).

The added and revised text reads as follows:

7.103 Agency-head responsibilities.

* * * * *

(d) Ensuring that acquisition planners document the file to support the selection of the contract type in accordance with subpart 16.1.

(e) Establishing criteria and thresholds at which increasingly greater detail and formality in the planning process is required as the acquisition becomes more complex and costly, including for cost-reimbursement and other high-risk contracts (*e.g.*, other than firm-fixed-price contracts) requiring a written acquisition plan. A written plan shall be prepared for cost reimbursement and other high-risk contracts other than firm-fixed-price contracts, although written plans may be required for firm-fixed-price contracts as appropriate.

(f) Ensuring that the statement of work is closely aligned with performance outcomes and cost estimates.

* * * * *

(j) Reviewing and approving acquisition plans and revisions to these plans to ensure compliance with FAR requirements including 7.104 and part 16. For other than firm-fixed-price contracts, ensuring that the plan is

approved and signed at least one level above the contracting officer.

* * * * *

■ 8. Amend section 7.104 by adding paragraph (e) to read as follows:

7.104 General procedures.

* * * * *

(e) The planner shall ensure that a COR is nominated by the requirements official, and designated and authorized by the contracting officer, as early as practicable in the acquisition process. The contracting officer shall designate and authorize a COR as early as practicable after the nomination. *See* 1.602–2(d).

■ 9. Amend section 7.105 by—

■ a. Removing from the first sentence of the introductory text the words “*see* paragraph (b)(19)” and adding the words “*see* paragraph (b)(21)” in their place;

■ b. Redesignating paragraphs (b)(3) through (b)(21) as paragraphs (b)(4) through (b)(22), respectively;

■ c. Adding a new paragraph (b)(3);

■ d. Removing from newly redesignated paragraph (b)(5)(i) the words “contract type selection (*see* part 16);”;

■ e. Removing from newly redesignated paragraph (b)(5)(ii)(A) the words “*see* 7.103(t)” and adding the words “*see* 7.103(v)” in its place; and

■ f. Adding paragraph (b)(5)(iv).

The added text reads as follows:

7.105 Contents of written acquisition plans.

* * * * *

(b) * * *

(3) *Contract type selection.* Discuss the rationale for the selection of contract type. For other than firm-fixed-price contracts, *see* 16.103(d) for additional documentation guidance. Acquisition personnel shall document the acquisition plan with findings that detail the particular facts and circumstances, (*e.g.*, complexity of the requirements, uncertain duration of the work, contractor's technical capability and financial responsibility, or adequacy of the contractor's accounting system), and associated reasoning essential to support the contract type selection. The contracting officer shall ensure that requirements and technical personnel provide the necessary documentation to support the contract type selection.

* * * * *

(5) * * *
(iv) For each contract (and order) contemplated, discuss the strategy to transition to firm-fixed-price contracts to the maximum extent practicable. During the requirements development stage, consider structuring the contract

requirements, *e.g.*, contract line items (CLINS), in a manner that will permit some, if not all, of the requirements to be awarded on a firm-fixed-price basis, either in the current contract, future option years, or follow-on contracts. This will facilitate an easier transition to a firm-fixed-price contract because a cost history will be developed for a recurring definitive requirement.

* * * * *

PART 16—TYPES OF CONTRACTS

■ 10. Amend section 16.103 by revising paragraphs (d)(1) and (2) to read as follows:

16.103 Negotiating contract type.

* * * * *

(d) * * *

(1) Each contract file shall include documentation to show why the particular contract type was selected. This shall be documented in the acquisition plan, or if a written acquisition plan is not required, in the contract file.

(i) Explain why the contract type selected must be used to meet the agency need.

(ii) Discuss the Government's additional risks and the burden to manage the contract type selected (*e.g.*, when a cost-reimbursement contract is selected, the Government incurs additional cost risks, and the Government has the additional burden of managing the contractor's costs). For such instances, acquisition personnel shall discuss—

(A) How the Government identified the additional risks (*e.g.*, pre-award survey, or past performance information);

(B) The nature of the additional risks (*e.g.*, inadequate contractor's accounting system, weaknesses in contractor's internal control, non-compliance with Cost Accounting Standards, or lack of or inadequate earned value management system); and

(C) How the Government will manage and mitigate the risks.

(iii) Discuss the Government resources necessary to properly plan for, award, and administer the contract type selected (*e.g.*, resources needed and the additional risks to the Government if adequate resources are not provided).

(iv) For other than a firm-fixed price contract, at a minimum the documentation should include—

(A) An analysis of why the use of other than a firm-fixed-price contract (*e.g.*, cost reimbursement, time and materials, labor hour) is appropriate;

(B) Rationale that detail the particular facts and circumstances (*e.g.*,

Federal Acquisition Circular 2005-50 Issued March 16, 2011 (cont'd)

Federal Register / Vol. 76, No. 51 / Wednesday, March 16, 2011 / Rules and Regulations 14547

complexity of the requirements, uncertain duration of the work, contractor's technical capability and financial responsibility, or adequacy of the contractor's accounting system), and associated reasoning essential to support the contract type selection;

(C) An assessment regarding the adequacy of Government resources that are necessary to properly plan for, award, and administer other than firm-fixed-price contracts; and

(D) A discussion of the actions planned to minimize the use of other than firm-fixed-price contracts on future acquisitions for the same requirement and to transition to firm-fixed-price contracts to the maximum extent practicable.

(v) A discussion of why a level-of-effort, price redetermination, or fee provision was included.

(2) Exceptions to the requirements at (d)(1) of this section are—

(i) Fixed-price acquisitions made under simplified acquisition procedures;

(ii) Contracts on a firm-fixed-price basis other than those for major systems or research and development; and

(iii) Awards on the set-aside portion of sealed bid partial set-asides for small business.

* * * * *

■ 11. Amend section 16.104 by—

■ a. Redesignating paragraphs (e) through (k) as paragraphs (f) through (l), respectively;

■ b. Adding a new paragraph (e);

■ c. Removing from newly redesignated paragraph (f) the words “incentives to ensure” and adding the words

“incentives tailored to performance outcomes to ensure” in their place;

■ d. Removing from newly redesignated paragraph (g) the words “price adjustment terms” and adding the words “price adjustment or price redetermination clauses” in their place; and

■ e. Revising newly redesignated paragraph (i).

The added and revised text reads as follows:

16.104 Factors in selecting contract types.

* * * * *

(e) *Combining contract types.* If the entire contract cannot be firm-fixed-price, the contracting officer shall consider whether or not a portion of the contract can be established on a firm-fixed-price basis.

* * * * *

(i) *Adequacy of the contractor's accounting system.* Before agreeing on a contract type other than firm-fixed-price, the contracting officer shall

ensure that the contractor's accounting system will permit timely development of all necessary cost data in the form required by the proposed contract type. This factor may be critical—

(1) When the contract type requires price revision while performance is in progress; or

(2) When a cost-reimbursement contract is being considered and all current or past experience with the contractor has been on a fixed-price basis. *See* 42.302(a)(12).

* * * * *

■ 12. Revise section 16.301–2 to read as follows:

16.301–2 Application.

(a) The contracting officer shall use cost-reimbursement contracts only when—

(1) Circumstances do not allow the agency to define its requirements sufficiently to allow for a fixed-price type contract (*see* 7.105); or

(2) Uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.

(b) The contracting officer shall document the rationale for selecting the contract type in the written acquisition plan and ensure that the plan is approved and signed at least one level above the contracting officer (*see* 7.103(j) and 7.105). If a written acquisition plan is not required, the contracting officer shall document the rationale in the contract file. *See also* 16.103(d).

■ 13. Amend section 16.301–3 by revising paragraph (a) to read as follows:

16.301–3 Limitations.

(a) A cost-reimbursement contract may be used only when—

(1) The factors in 16.104 have been considered;

(2) A written acquisition plan has been approved and signed at least one level above the contracting officer;

(3) The contractor's accounting system is adequate for determining costs applicable to the contract; and

(4) Adequate Government resources are available to award and manage a contract other than firm-fixed-priced (*see* 7.104(e)) including—

(i) Designation of at least one contracting officer's representative (COR) qualified in accordance with 1.602–2 has been made prior to award of the contract or order; and

(ii) Appropriate Government surveillance during performance to provide reasonable assurance that efficient methods and effective cost controls are used.

* * * * *

PART 32—CONTRACT FINANCING

32.1007 [Amended]

■ 14. Amend section 32.1007 by removing from paragraph (a) “(*see* 42.302(a)(12))” and adding “(*see* 42.302(a)(13))” in its place.

PART 42—CONTRACT ADMINISTRATION AND AUDIT SERVICES

■ 15. Amend section 42.302 by—

■ a. Removing from the introductory text of paragraph (a) the words “paragraphs (a)(5), (a)(9), and (a)(11)” and adding the words “paragraphs (a)(5), (a)(9), (a)(11), and (a)(12)” in their place;

■ b. Redesignating paragraphs (a)(12) through (a)(26) as paragraphs (a)(13) through (a)(27); and

■ c. Adding a new paragraph (a)(12) to read as follows:

42.302 Contract administration functions.

(a) * * *

(12) Determine the adequacy of the contractor's accounting system. The contractor's accounting system should be adequate during the entire period of contract performance. The adequacy of the contractor's accounting system and its associated internal control system, as well as contractor compliance with the Cost Accounting Standards (CAS), affect the quality and validity of the contractor data upon which the Government must rely for its management oversight of the contractor and contract performance.

* * * * *

PART 50—EXTRAORDINARY CONTRACTUAL ACTIONS AND THE SAFETY ACT

50.205–1 [Amended]

■ 16. Amend section 50.205–1 by removing from the first sentence in paragraph (b) the words “(*see* FAR 7.105(b)(19)(v))” and adding the words “(*see* 7.105(b)(20)(v))” in their place.

[FR Doc. 2011–5552 Filed 3–15–11; 8:45 am]

BILLING CODE 6820–EP–P

Appendix C

Sites Visited and Summary Contract Information

Site Visited	Number of Contracts Reviewed	Total CR Value of Contracts Reviewed	Approval Adequately Documented	Justification Adequately Documented	Transition Adequately Documented	Monitoring Adequately Documented	Accounting System Adequately Documented	Number of Contracts Fully Documented
Durham – APG	49	\$ 318,794,688	10	48	43	42	39	7
Fort Belvoir	46	49,316,715,710	44	42	39	46	43	38
Fort Huachuca	18	3,098,278,147	16	17	10	15	10	5
Redstone Arsenal	48	542,280,160	30	20	12	41	36	4
Army Subtotal	161	\$ 53,276,068,705	100	127	104	144	128	54
NAVSEA-Headquarters*	53	13,327,645,753	30	29	20	16	33	6
NAVSUP-San Diego	50	3,547,042,544	49	39	37	25	34	7
QMCB*	54	74,718,246	28	39	27	27	35	3
SPAWAR-Charleston	42	338,420,574	40	40	37	34	32	26
Navy Subtotal	199	\$ 17,287,827,118	147	147	121	102	134	42
Hanscom AFB	28	8,185,091,164	25	27	21	23	18	14
Offutt AFB	50	801,224,266	37	33	25	49	45	25
Rome AFRL	34	199,509,819	34	34	33	34	33	33
Warner Robins AFB	44	1,276,160,393	21	37	35	27	17	9
Air Force Subtotal	156	\$ 10,461,985,642	117	131	114	133	114	81
Missile Defense Agency	39	1,256,385,631	20	39	37	39	32	15
DMEA	49	407,901,590	18	39	1	48	29	1
Components Subtotal	88	\$ 1,664,287,221	38	78	38	87	61	16
DoD Total	604	\$ 82,689,027,685	402	483	377	466	437	193

* Includes combined total of initial and subsequent site visits

Legend

AFB	Air Force Base	NAVSEA	Naval Sea Systems Command Headquarters, Washington, D.C.
AFRL	Air Force Research Lab	NAVSUP	Naval Supply Fleet Systems Center–San Diego
APG	Aberdeen Proving Ground	QMCB	Quantico Marine Corps Base, Virginia
CR	Cost Reimbursement	SPAWAR	Space and Naval Warfare Systems Command–Charleston
DMEA	Defense Microelectronics Agency		

Acronyms and Abbreviations

- COR** Contracting Officer's Representative
- DMEA** Defense Microelectronics Activity
- FAC** Federal Acquisition Circular
- FAR** Federal Acquisition Regulation
- MDA** Missile Defense Agency
- SBIR** Small Business Innovation Research

Whistleblower Protection

U.S. DEPARTMENT OF DEFENSE

The Whistleblower Protection Enhancement Act of 2012 requires the Inspector General to designate a Whistleblower Protection Ombudsman to educate agency employees about prohibitions on retaliation, and rights and remedies against retaliation for protected disclosures. The designated ombudsman is the DoD Hotline Director. For more information on your rights and remedies against retaliation, visit www.dodig.mil/programs/whistleblower.

For more information about DoD IG reports or activities, please contact us:

Congressional Liaison

congressional@dodig.mil; 703.604.8324

Media Contact

public.affairs@dodig.mil; 703.604.8324

Monthly Update

dodigconnect-request@listserve.com

Reports Mailing List

dodig_report@listserve.com

Twitter

twitter.com/DoD_IG

DoD Hotline

dodig.mil/hotline



DEPARTMENT OF DEFENSE | INSPECTOR GENERAL

4800 Mark Center Drive
Alexandria, VA 22350-1500
www.dodig.mil
Defense Hotline 1.800.424.9098

