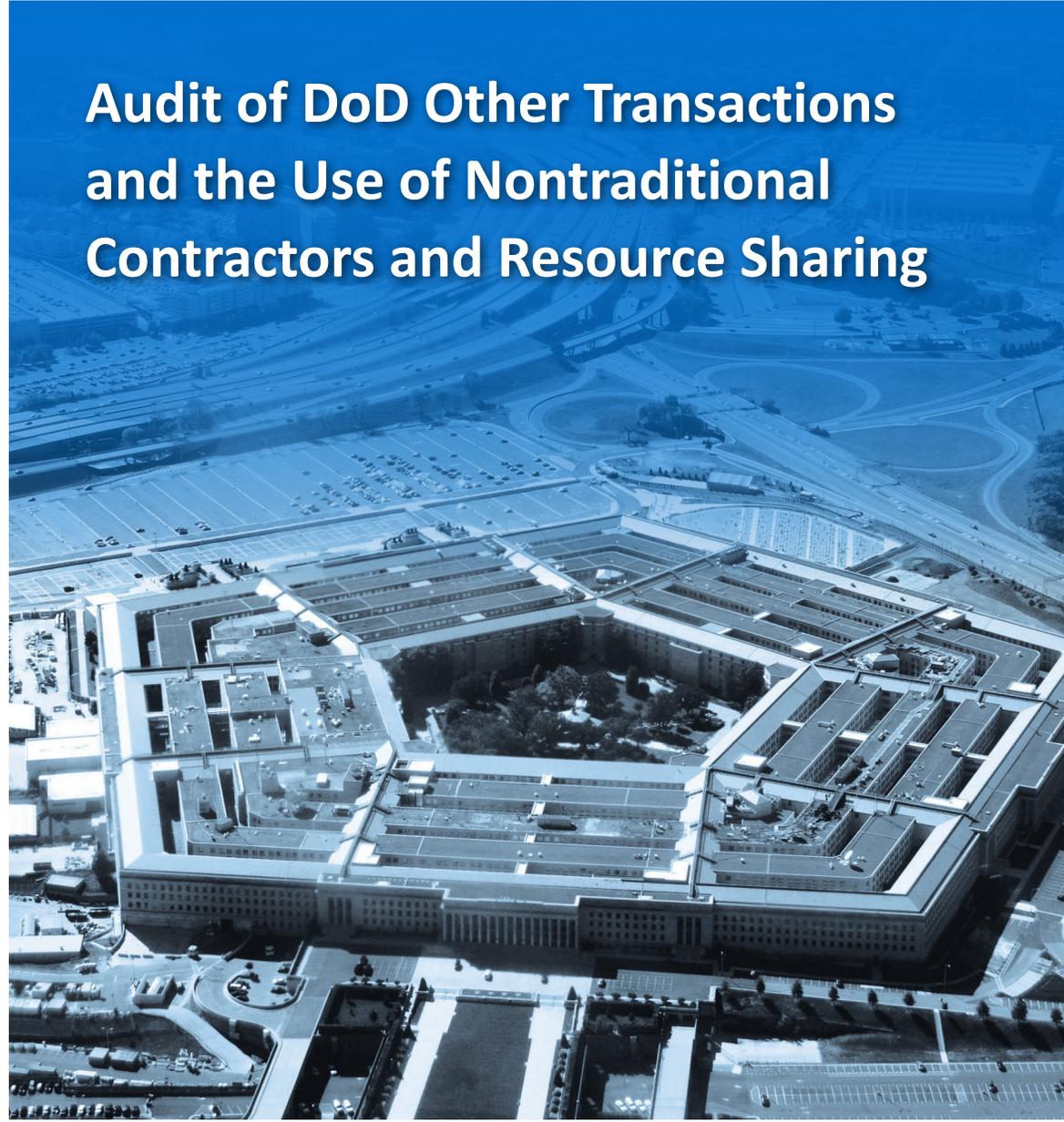


INSPECTOR GENERAL

U.S. Department of Defense

SEPTEMBER 8, 2022



Audit of DoD Other Transactions and the Use of Nontraditional Contractors and Resource Sharing

INTEGRITY ★ INDEPENDENCE ★ EXCELLENCE





Results in Brief

Audit of DoD Other Transactions and the Use of Nontraditional Contractors and Resource Sharing

September 8, 2022

Objective

The objective of this audit was to determine whether the DoD awarded Other Transactions (OT) for prototypes in accordance with applicable Federal laws and DoD policies.

Background

According to the United States Code (U.S.C.), the DoD can enter into transactions other than procurement contracts, grants, or cooperative agreements for basic, applied, or advanced research, through potential teaming arrangements tailored to a particular project. OTs are generally not subject to Federal regulations governing procurement contracts. The U.S.C. expanded this authority to include prototype OTs. The U.S.C. requires the DoD to meet one of the following conditions to carry out prototype projects:

- At least one nontraditional defense contractor (NDC) or nonprofit research institution participates to a significant extent.
- All significant participants are small businesses or NDCs.
- Non-Government sources pay at least one-third of the total cost of the prototype project (resource share).
- The agency senior procurement executive determines in writing that exceptional circumstances justify the use of an OT.

The U.S.C. defines NDCs as entities that are not currently performing and have not

Background (cont'd)

performed any DoD contract or subcontract subject to full cost accounting standards for at least 1 year before the OT solicitation. According to the OT Guide, a large number of contractors qualify as NDCs due to the exemptions related to full cost accounting standards.

The Office of the Under Secretary of Defense for Acquisition and Sustainment issued an OT Guide, which provides guidance and lessons learned on planning, publicizing, soliciting, evaluating, negotiating, awarding, and administering OT agreements. While the OT Guide includes references to the controlling statutory and policy provisions for DoD OT authority, the guide is not a formal policy document.

Finding

Although DoD agreement officers awarded OTs for prototypes in accordance with the U.S.C., additional OT policies are needed.¹ Specifically, we reviewed 34 prototype OT awards, valued at \$5.0 billion, and found agreement officers did not always:

- verify the status of NDCs because there is no requirement for agreement officers to do so;
- validate NDCs participating in prototype awards to a significant extent actually completed the significant work because there is no requirement for the agreement officers to validate the work performed by the NDC throughout the project; or
- approve costs incurred prior to award or appropriately award resource share OTs because the agreement officers did not comply with the U.S.C. and compliance with the OT Guide is not a requirement.

The DoD takes on more risk when it uses OTs to get participation from NDCs. However, without validating NDC status, conducting appropriate oversight to ensure

¹ Agreement officers are warranted individuals with the authority to enter into, administer, or terminate OTs.



Results in Brief

Audit of DoD Other Transactions and the Use of Nontraditional Contractors and Resource Sharing

Finding (cont'd)

the NDC performs the requirements of the OT agreement as proposed, or validating resource share contributions, agreement personnel may not meet the conditions of the U.S.C., the Government may be paying more than the amount required in the resource share agreement, and traditional contractors may obtain an OT for which they were ineligible. Because of agreement personnel's noncompliance with U.S.C. and failure to approve costs incurred before award, the Department of the Navy incurred \$800,000 in questioned costs associated with an Armored Reconnaissance Vehicle Research Area 2 Full-System Technology Demonstrator.

Recommendations

We recommend that the Principal Director, Defense Pricing and Contracting:

- Require agreement officers to validate the NDC status prior to award and include documentation of the verification in the OT file.
- Implement guidance or best practices for agreement personnel to consider when validating NDC significant participation throughout the duration of the project.
- Reinforce the requirements in the U.S.C. and require agreements officers to ensure the OT files for resource sharing clearly document contractor contribution, approval of costs incurred before the effective date, and contractor contribution-verification procedures.

We also recommend that the Chief, Office of Naval Research, review the \$800,000 in questioned costs to determine whether the agreement officer properly approved it in writing and if the costs were appropriate. If the costs were not properly approved or appropriate, then take action to recover the funds.

Management Comments and Our Response

The Defense Pricing and Contracting Principal Director agreed with the recommendations, stating that Defense Pricing and Contracting will develop and implement additional guidance to address the recommendations in the OT Guide update. Therefore, the recommendations are resolved but open. We will close the recommendations once the Principal Director provides a copy of the additional guidance and we verify that the guidance fully addresses the recommendations.

The Deputy Assistant Secretary of the Navy (Procurement) Senior Procurement Analyst, responding for the Office of Naval Research Chief, did not agree with the recommendation to review the \$800,000 in questioned costs, stating that subsequent to the issuance of the draft report, the Department of the Navy was able to locate a letter documenting that the agreement officer approved the questioned costs and that the costs were appropriate. Although the Senior Procurement Analyst disagreed with the recommendation, actions taken were sufficient to close the recommendation and the \$800,000 is no longer a questioned cost.

Please see the Recommendations Table on the next page for the status of recommendations.

Recommendations Table

Management	Recommendations Unresolved	Recommendations Resolved	Recommendations Closed
Principal Director, Defense Pricing and Contracting	None	1.a, 1.b, 1.c, 1.d, 1.e	None
Chief, Office of Naval Research	None	None	2

Please provide Management Comments by December 7, 2022.

Note: The following categories are used to describe agency management’s comments to individual recommendations.

- **Unresolved** – Management has not agreed to implement the recommendation or has not proposed actions that will address the recommendation.
- **Resolved** – Management agreed to implement the recommendation or has proposed actions that will address the underlying finding that generated the recommendation.
- **Closed** – DoD OIG verified that the agreed upon corrective actions were implemented.





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

September 8, 2022

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION AND SUSTAINMENT
UNDER SECRETARY OF DEFENSE FOR POLICY
AUDITOR GENERAL, DEPARTMENT OF THE NAVY

SUBJECT: Audit of DoD Other Transactions and the Use of Nontraditional Contractors and Resource Sharing (Report No. DODIG-2022-127)

This final report provides the results of the DoD Office of Inspector General's audit. We previously provided copies of the draft report and requested written comments on the recommendations. We considered management's comments on the draft report when preparing the final report. These comments are included in the report.

This report contains five recommendations that are considered resolved. Therefore, as discussed in the Recommendations, Management Comments, and Our Response section of this report, the recommendations will remain open until documentation is submitted showing that the agreed-upon actions are complete. Once we verify that the actions are complete, the recommendations will be closed.

This report contains one recommendation that is considered closed as discussed in the Recommendations, Management Comments, and Our Response section of this report. This recommendation does not require further comments.

DoD Instruction 7650.03 requires that recommendations be resolved promptly. For the resolved recommendations, within 90 days please provide us documentation showing that the agreed-upon action has been completed. Your response should be sent as a PDF file to aud-colu@dodig.mil. Responses must have the actual signature of the authorizing official for your organization.

We appreciate the cooperation and assistance received during the audit. If you have any questions please contact me at [REDACTED]).

A handwritten signature in cursive script, reading "Carol N. Gorman", is positioned above the typed name.

Carol N. Gorman
Assistant Inspector General for Audit
Cyberspace Operations & Acquisition,
Contracting, and Sustainment

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Introduction

Objective

The objective of this audit was to determine whether the DoD awarded Other Transactions (OT) for prototypes in accordance with applicable Federal laws and DoD policies.

We reviewed a nonstatistical sample of 34 standalone, prototype OTs, valued at \$5.0 billion that were active in FYs 2019 and 2020.² See Appendix A for our scope, methodology, and a list of prior audit reports.

Background

Other Transactions

In accordance with section 2371, title 10, United States Code (10 U.S.C. § 2371 [2020]), the DoD can enter into transactions other than procurement contracts, grants, or cooperative agreements for basic, applied, or advanced research.³ OT authorities are designed to give the DoD the flexibility necessary to adopt and incorporate commercial industry standards and best practices into its awards. OTs are intended to provide the Government with access to state-of-the-art technology solutions from traditional and nontraditional defense contractors (NDCs), that may use teaming arrangements tailored to the particular project and needs. OTs are generally not subject to Federal regulations governing procurement contracts, such as the Federal Acquisition Regulation (FAR). Therefore, OTs can help foster new relationships and practices involving traditional defense contractors and NDCs, especially those NDCs that may not be interested in entering into FAR based contracts with the Government. There are three types of OTs: research, prototype, and production. The focus of this review is prototype OTs.

Other Transactions for Prototypes

Under section 2371b, title 10, U.S.C., 2020, the DoD has the authority to carry out prototype projects that are directly relevant to enhancing the mission effectiveness of military personnel and the supporting platforms, systems, components, or

² Our original sample includes 36 standalone, prototype OTs, valued at \$5.4 billion; however, after our review, we found that two sample items were not within our scope.

³ Section 2371, title 10, U.S.C., 2019, "Research projects: transactions other than contracts and grants." Public Law 117-81, National Defense Authorization Act for FY 2022, issued December 27, 2021, renumbered 10 U.S.C. § 2371 to 10 U.S.C. § 4021. We kept the original U.S.C. numbering since it coincided with the fieldwork of our audit and the documentation referencing throughout the report.

materials proposed to be acquired or developed by the DoD.⁴ In addition, the DoD can use prototype OTs to improve platforms, systems, components, or materials in use by the Armed Forces. To use this authority, the project must meet one of the following conditions.

- There is at least one NDC or nonprofit research institution participating to a significant extent.
- All significant participants in the transaction other than the Government are small businesses or NDCs.
- At least one-third of the total cost of the prototype project is to be paid out of funds provided by sources other than the Government.
- The senior procurement executive for the agency determines in writing that exceptional circumstances justify the use of a transaction that provides for innovative business arrangements or structures that would not be feasible or appropriate under a contract, or would provide an opportunity to expand the defense supply base in a manner that would not be practical or feasible under a contract.⁵

Nontraditional Defense Contractors

Section 2302, title 10, U.S.C., 2020, defines an NDC as an entity that is not currently performing and has not performed, for at least the 1-year period preceding the solicitation of sources, any contract or subcontract for the DoD that is subject to full coverage under the cost accounting standards (CAS).⁶ CAS are a set of 19 Government-issued standards and rules for use in establishing costs on negotiated procurements for larger contracts. According to the OT Guide issued by the Under Secretary of Defense for Acquisition and Sustainment (OUSD[A&S]), per the statutory definition, NDCs are all entities that have not performed a DoD contract or subcontract subject to full coverage under CAS within 1 year of the solicitation of the prototype OT opportunity. The OT Guide states that the effect of this narrow definition is that a large number of entities will fall into the nontraditional category, including nearly all small business concerns, and even

⁴ Public Law 117-81, National Defense Authorization Act for FY 2022, issued December 27, 2021, renumbered 10 U.S.C. § 2371b to 10 U.S.C. § 4022. We kept the original U.S.C. numbering since it coincided with the fieldwork of our audit and the documentation referencing throughout the report.

⁵ Our universe and sample did not include any OTs justified by the senior procurement executive of the agency; therefore, our report only addresses OTs to an NDC, to a traditional contractor with significant NDC participation, or using resource sharing. Section 2371b, title 10, U.S.C., 2020, “Authority of the Department of Defense to carry out certain prototype projects.”

⁶ Section 2302, title 10, U.S.C., 2020, “Definitions.”

CAS are designed to achieve uniformity and consistency in the cost accounting principles followed by defense contractors and subcontractors under Federal contracts. Full coverage requires that the entity must comply with all of the CAS. “Full” coverage applies when a company receives either one CAS-covered contract of \$50 million or more in the current accounting period, or, in the preceding cost accounting period, multiple CAS-covered contracts cumulatively totaling \$50 million.

those firms that work exclusively with DoD. This is, in part, due to the exemptions to CAS coverage, which exempt commercial contracts, firm-fixed-price contracts based on adequate price competition, and any contract or subcontract with a small business concern, among other exemptions. Further, even where an entity is not outright exempt from CAS coverage, the entity may not have been subject to full CAS coverage.⁷ See Appendix B for other matters of interest on large contractors qualifying as NDCs.

Nontraditional Defense Contractor Participating to a Significant Extent

The DoD can award an OT to a traditional DoD contractor if an NDC or a small business participates to a significant extent; however, there is no definition for significant extent. The OT Guide states it is the agreement officer's (AO) responsibility to make a reasoned, prudent, and independent determination of significance for each individual prototype project. According to the guide, the AO should consider the following instances, by way of illustration and not limitation, whether the NDC will:

- supply a new key technology, product, or process;
- supply a novel application or approach to an existing technology, product, or process;
- provide a material increase in the performance, efficiency, quality or versatility of a key technology, product, or process;
- accomplish a significant amount of the prototype project;
- cause a material reduction in the cost or schedule of the prototype project; or,
- provide for a material increase in performance of the prototype project.

The OT Guide states that AOs should not establish blanket rules or thresholds for significance, and agencies must not establish local policies that infringe on the AO's judgement in making such determinations.

Resource Sharing

The OT Guide states resource sharing in a transaction occurs when a portion of the total cost of the project is paid out of funds provided by sources other than the U.S. Government. Contributions can be in cash or non-cash form, and costs can be either direct or indirect, so long as contributions are allowable, allocable, reasonable, and consistently accounted for by the awardee. Contributions may

⁷ OUSD(A&S) OT Guide, November 2018.

include labor, materials, equipment, usage rights in Intellectual Property, facilities costs, as well as independent research and development costs that the DoD may reimburse later through overhead rates on other awarded efforts.⁸

DoD Guide for Other Transactions

OUSD(A&S) issued an OT Guide that provides advice and lessons learned on the planning, publicizing, soliciting, evaluating, negotiating, awarding, and administering of OT agreements. While the OT Guide includes references to the controlling statutory and policy provisions for DoD OT authority, the guide itself is not a formal policy document. The guide is intended for DoD contracting personnel and Government partners, including industry, academia, other Federal agencies, and state and local authorities seeking information on OT best practices and the DoD's objectives in leveraging OT authority.

Agreement Personnel

The OT Guide states that a small, dedicated team of experienced personnel works best when planning for the award of an OT agreement. Agreement personnel can include Project Managers, AOs, agreement specialists, agreement officer representatives, systems engineers, small business representatives, and legal counsel. AOs are warranted individuals with the authority to enter into, administer, or terminate OTs. According to the OT Guide, AOs must possess a level of responsibility, business acumen, and judgement that enables them to operate in the relatively unstructured environment of OTs. AOs do not need to be contracting officers, unless required by the Component's appointment process.

Guidance and Annual Reporting for Prototype Other Transactions

Public Law 115-232, "John S. McCain National Defense Authorization Act for Fiscal Year 2019," requires the Service Acquisition Executives of the Military Departments to collect data on the use of other transactions by their respective departments. According to this public law, the data is required to be stored in a manner that allows the Assistant Secretary of Defense for Acquisition and other appropriate officials access at any time to update policy and guidance related to the use of other transactions.⁹ The Office of the Secretary of Defense requires contracting personnel to track OTs in the Federal Procurement Data System-Next Generation (FPDS-NG).¹⁰

⁸ OUSD(A&S) OT Guide, November 2018.

⁹ Public Law 115-232, "John S. McCain National Defense Authorization Act for Fiscal Year 2019."

¹⁰ OUSD(A&S) Memorandum, "Reporting Other Transactions to the Federal Procurement Data System," September 7, 2018.

Senior procurement executives, directors, and relevant commanding officers are responsible for ensuring data required under Public Law 115-232 is accurate. Public Law 115-232 requires the Secretary of Defense to submit a report to the congressional committees on the DoD's use of the OT authority no later than December 31, 2018, and each December 31 thereafter. Within the OUSD(A&S), Defense Pricing and Contracting (DPC) is responsible for preparing the report and promulgating policy and guidance on OTs for prototype projects awarded under title 10 U.S.C. § 2371b authority.

Review of Internal Controls

DoD Instruction 5010.40 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.¹¹ We identified internal control weaknesses related to awarding and administering OTs. Specifically, related to verifying the NDC status, conducting oversight to ensure the NDC performed the significant work proposed, and awarding OTs using resource sharing. We will provide a copy of the final report to the senior official responsible for internal controls in the OUSD(A&S).

¹¹ DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013, (Incorporating Change 1, June 30, 2020).

Finding

OTs Awarded in Accordance with Laws and Regulations but Additional Controls Needed

Although DoD AOs awarded prototype OTs in accordance with 10 U.S.C. § 2371b, additional OT policies are needed. Specifically, we reviewed 34 standalone OT awards, valued at \$5.0 billion, and found agreement personnel did not always:

- verify NDC status prior to awarding OTs because there is no requirement for the AOs to do so,
- validate that NDCs participating in prototype awards to a significant extent actually conducted or completed the significant work because there is no requirement for the AOs to validate the work performed by the NDC throughout the project, or
- approve costs incurred prior to award or appropriately award resource share OTs because the AO did not comply with the U.S.C. and compliance with the OT Guide is not a requirement.

The DoD is taking on more risk when it uses OTs to get participation from NDCs that typically do not conduct business with the DoD. Without validating NDC status or conducting appropriate oversight to ensure the NDC performs the requirements of the OT agreement as proposed, agreement personnel may not meet the conditions of 10 U.S.C. § 2371b. Further, by not validating resource share contributions to ensure the contractor actually provided the required amount, the Government may be paying more than the amount required in the resource share agreement, or contractors may obtain an OT for which they were ineligible. Because of agreement personnel's noncompliance with U.S.C. and failure to approve costs incurred prior to award, the Department of Navy incurred \$800,000 in questioned costs associated with an Armored Reconnaissance Vehicle Research Area 2 Full-System Technology Demonstrator.

Nontraditional Defense Contractor Status Not Always Verified

Agreement personnel did not always verify NDC status prior to awarding an OT. Section 2371b, title 10, U.S.C., states that one of four conditions must be met to award a prototype OT, including that there is at least one NDC or nonprofit research institute participating to a significant extent.¹² According to

¹² Section 2371b, Title 10, U.S.C., 2020, "Authority of the Department of Defense to carry out certain prototype projects."

10 U.S.C. § 2302, an NDC is an entity that is not currently performing and has not performed, for at least the 1-year period preceding the solicitation of sources by the DoD for the procurement or transaction, any contract or subcontract for the DoD that is subject to full coverage under the cost accounting standard.¹³ However, there was no guidance regarding if or how agreement personnel should verify NDC status. Agreement personnel used inconsistent methods to determine the NDC's status. Some agreement personnel relied on the contractor to self-certify NDC status and did not validate the self-certification. Other agreement personnel attempted to verify the NDC status, but used the wrong North American Industry Classification System (NAICS) codes or did not look into parent-subsidary relationships.¹⁴ The U.S.C. requires the use of an NDC when agreement personnel award an OT to a traditional contractor teaming to a significant extent with an NDC; therefore, the AO should verify whether the contractor qualifies as an NDC before awarding an OT.

Some agreement personnel relied on the contractor to self-certify NDC status and did not validate the self-certification.

Agreement Personnel relied on Contractor Statements for Nontraditional Contractor Status

Agreement personnel relied on statements by the contractor for NDC status or stated that they validated NDC status, but did not include any documentation to support those claims in the OT file. For example, agreement personnel awarded one Air Force OT for \$5 million to a traditional contractor, who qualified for an OT by teaming with an NDC participating to a significant extent. The traditional contractor submitted a whitepaper that stated its partner was an NDC.¹⁵ The AO Determination and Findings Memorandum in the OT file stated that the NDC met the definition in the U.S.C. because it did not perform a contract or subcontract subject to full CAS coverage. Further, the AO stated that the company was a small business. However, the OT file did not include any documentation to indicate what, if anything, the AO did to validate the contractor size status or that the contractor had not performed a contract subject to CAS. The OT file included the System for Award Management (SAM) profile for the NDC; however, the SAM profile did not contain information necessary to verify the NDC's status or that the company was a small business. Agreement personnel stated they relied heavily on the contractor to provide accurate information to support the NDC status.

¹³ Section 2303, Title 10, U.S.C., 2020, "Definitions."

¹⁴ NAICS is an industry classification system that groups establishments and industries based on the similarity of their product processes.

¹⁵ White papers are documents used to propose solutions to solicited DoD OT requirements.

For an Army OT in our sample, valued at \$5.6 million, agreement personnel stated that the AO verified the NDC's status, but could not provide any documentation showing how or what the AO verified. Army agreement personnel awarded an OT to a traditional contractor, which qualified for the OT under the U.S.C. by teaming with an NDC participating to a significant extent. The AO Determinations and Findings memorandum stated that the NDC certified in writing that it was not currently performing and had not performed, for at least 1 year preceding the issue date of the solicitation, any contract or subcontract for the DoD that was subject to full coverage under CAS, and that the certification would be confirmed prior to award. However, the OT file did not contain documentation to support that the AO confirmed the NDC's status. The AO stated that the awarding AO requested the affirmation of business status form, a self-certified form, to verify the status of the NDC. However, the OT file did not contain the affirmation of business status form and the AO could not provide the documentation. Further, the AO stated that agreement personnel checked SAM and the Federal Awardee Performance and Integrity Information System (FAPIS).¹⁶ However, the reports in the OT file were only for the traditional contractor and did not include information regarding the NDC's status.

Agreement Personnel Did Not Take Sufficient Steps to Validate Nontraditional Defense Contractor Status

Agreement personnel took steps to validate NDC status for some OTs in our sample; however, those steps were not sufficient to validate that the contractor was an NDC. Specifically, USMC personnel awarded an OT to a traditional contractor that teamed with an NDC participating to a significant extent, for approximately \$440,000. According to the OT Guide, nearly all small business concerns qualify as an NDC.¹⁷ According to the OT file, the NDC in this example qualified because it was a small business. Therefore, agreement personnel used the FAR and Defense Federal Acquisition Regulation Supplement report from the NDC's SAM profile to verify the NDC's status. The SAM profile showed the NDC to be a small business under one NAICS code for photographic and photocopying equipment manufacturing. However, agreement personnel awarded the project using a different NAICS code for search, detection, navigation, guidance, aeronautical, nautical system, and instrument manufacturing. The NAICS code the OT was awarded under was not listed in the NDC's SAM profile. Therefore, the NDC was not listed as a small business under the NAICS code for the project. Agreement

¹⁶ FAPIS is a database that contains information to support award decisions. FAPIS includes government entered records, suspension/debarment information, if any, and administrative proceedings information. FAPIS also identifies an affiliate that is an immediate owner or subsidiary of the offeror, if any, and all predecessors of the offeror that held a Federal contract or grant within the last 3 years.

¹⁷ OUSD(A&S) OT Guide, November 2018.

personnel stated that if the NDC was considered a small business under one NAICS code, the contractor would be considered a small business under the NAICS code the work was being performed under. However, the two NAICS codes appear to be unrelated and are from different NAICS categories. The size standards are developed for each NAICS category to determine whether a business is small, so if a business is small under one category that does not mean it is small under another. While the NAICS codes checked in the SAM profile had a lower size standard than the NAICS code used to perform the work, a Small Business Administration official stated that the AO is responsible for verifying the size standard under the NAICS code that is on the contract. The official said that responsibility exists regardless of the size standards established under other NAICS codes, and added that verifying status on a different NAICS codes could create additional risk. The SAM profile also showed that the NDC had a parent company as the immediate owner and controller of the NDC. Depending on the NDCs relationship with the parent company, it could affect the NDC status if the parent company performed work for the DoD under a CAS compliant contract in the last year. The audit team also identified two additional parent companies to the NDC's immediate owner. The agreement personnel could not provide any information regarding the parent subsidiary relationship and were unaware of the parent companies.

Traditional Defense Contractors Teamed with their Own Subsidiaries as the NDC

For this report, our sample items only included standalone OTs. However, based on work for a prior DoD OIG report, Report No. DODIG-2021-077, "Audit of Other Transactions Awarded Through Consortiums," there may be questionable teaming arrangements in consortiums as well.¹⁸ In an OT awarded through a consortium, it is harder to track the contractors participating in the OT since the award is to the consortium management organization. Specifically, in a prior audit, the DoD OIG identified examples of traditional contractors who teamed with their own entity or subsidiary as the NDC.

For example, the Navy made an award through a consortium to a traditional contractor that qualified for the OT award

The proposal stated that the NDC was a wholly owned subsidiary of the traditional contractor.

by teaming with an NDC to a significant extent. The proposal stated that the NDC was a wholly owned subsidiary of the traditional contractor. The agreement officer completed a SAM and Federal Awardee Performance and Integrity Information System check for the traditional contractor, but the OT file did not contain that

¹⁸ Report No. DODIG-2021-077, "Audit of Other Transactions Awarded Through Consortiums," April 21, 2021.

information for the NDC. Based on the information in the OT files, the AO did not conduct any additional work to look into the relationship of the two companies and whether that would affect the NDC status.

In another example, Air Force agreement personnel awarded an OT through a consortium to a traditional defense contractor that qualified for the OT award by teaming with an NDC. The NDC was a part of the traditional contractor company; however, agreement personnel stated that the entity was a separate business entity from the traditional contractor. The audit team did not independently review the parent-subsidary relationships in the prior audit since it was not in the scope; however, these types of teaming arrangements are occurring and the AO should complete additional reviews when a relationship is identified to ensure the relationship does not affect the NDC's status.

In addition, a former DoD AO stated that agreement personnel are aware of traditional contractors creating separate legal business entities, with a separate

Agreement personnel are aware of traditional contractors creating separate legal business entities to use as an NDC to team with for OT awards.

Commercial and Government Entity code to use as an NDC to team with for OT awards.¹⁹ The AO stated that if the traditional contractor is able to make the argument that the newly created NDC is participating to a significant extent, traditional contractors will continue to

receive the OT awards using a portion of their own companies. The AO told us that he believed that this is a clear loophole in the statute. See Appendix B for Other Matters of Interest on large contractors that conduct millions of dollars in business with the DoD that qualified as NDCs.

No Guidance for Verifying Nontraditional Contractor Status

Agreement personnel did not always verify NDC status because there is no requirement or guidance for the AOs to do so. Some AOs did take extra steps to verify NDC status and found that a contractor that claimed to be an NDC was not. In one example, USMC agreement personnel awarded an OT to a traditional contractor who qualified for the OT award using resource sharing. However, the contractor originally proposed using two traditional defense contractors with one NDC participating to a significant extent. The AO took steps to validate the status of the NDC, and found that the NDC did not qualify because of its relationship to one of the traditional contractors. Specifically, agreement personnel stated

¹⁹ A Commercial and Government Entity code is a five-character identification number assigned by the Defense Logistics Agency that is used to support a variety of systems throughout the government and provide a standard method of identifying a given legal entity at a specific location.

the Commercial and Government Entity code was the same for both companies and the NDC was not a separate revenue-generating organization from the traditional contractor. The AO determined that the NDC did not qualify as an NDC for this agreement. The traditional contractor disagreed with the AOs decision, but did agree to enter into a resource share agreement to comply with 10 U.S.C. § 2371b. In this example, the AO incorporated additional controls to ensure the requirements of the law were met; however, this was not standard practice for AOs based on our review.

If agreement personnel do not validate NDC status, the AO may award an OT that does not meet the conditions of 10 U.S.C. § 2371b. One of the intents of OTs is to foster new relationships and practices involving NDCs or to broaden the industrial base available to the Government. Agreement personnel should validate that the NDC participating to a significant extent actually meets the definition of an NDC before making the award to ensure compliance with the U.S.C. Therefore, the Principal Director, DPC, should require AOs to validate NDC status prior to awarding an OT and to document the verification in the OT file. In addition, the DPC should implement guidance or best practices for validating NDC status to ensure that the conditions of 10 U.S.C. § 2371b are met, including steps to review the relationship between companies claiming to be an NDC, when necessary.

Significant Participation by the Nontraditional Contractor Not Always Validated

Agreement personnel did not always validate that the NDC participating to a significant extent performed significant work. One condition under 10 U.S.C § 2371b is that there is at least one NDC or nonprofit research institution participating to a significant extent.²⁰ The awarding AO makes the determination as to whether the proposed work is significant to the project. The OUSD(A&S) OT Guide states that AOs should not establish blanket rules or thresholds for determining significance, and agencies must not establish local policies that infringe on the AO's judgement in making such determinations.²¹ The OT Guide further states that AOs consider input from relevant technical advisors in assessing the totality of the circumstances for each proposed prototype project before making an independent judgement as to the significance of the NDC. While the OT Guide explains how to determine significance, there is nothing in the guide regarding oversight or validation that the NDC actually conducted the significant work agreed to in the OT.

²⁰ 10 U.S.C. §2371b (2020).

²¹ OUSD(A&S) OT Guide, November 2018.

For example, Army personnel made an award for \$5.6 million to a traditional contractor that teamed with an NDC participating to a significant extent. The AO determined that the participation by the NDC was significant to the project and documented the decision in the OT file. The AO initially stated that there are monthly and quarterly reports that show progress toward the final deliverable. The AO then stated that agreement personnel track NDC participation on a case-by-case basis depending on the involvement of the agreement officer representative, but for this project there was no official report or oversight specific to the work of the NDC.

In another example, the USMC awarded an OT for approximately \$440,000 to a traditional contractor that qualified for the OT by teaming with an NDC participating to a significant extent. The traditional contractors' proposal included how the NDC would participate in the project. Further, the AO signed a memorandum for record in the OT file, which included a statement by the technical evaluator that the NDC would participate to a significant extent. The AO stated that the final deliverable would show whether the NDC participated; however, agreement personnel did not track the work completed throughout the project to validate whether the NDC completed its portion of the project.

There is no guidance for the AO to validate that the NDC completes the significant work.

The OT Guide states that the AO should verify that an NDC will participate to a significant extent at the time of award. However, there is no guidance for the

AO to validate that the NDC completes the significant work throughout the period of performance. An NDC participating to a significant extent is a requirement for agreement personnel to be able to award an OT to a traditional contractor. Without validating that the NDC actually completed the significant work proposed, agreement personnel cannot be sure that the NDC completed the significant work to meet the requirement of 10 U.S.C. § 2371b. Therefore, to ensure compliance with the U.S.C., the DPC should develop and implement guidance or best practices for agreement personnel to validate whether the NDC participated to a significant extent throughout the duration of the prototype project.

Resource Share Agreements Did Not Always Comply With Requirements and Guidelines

DoD agreement personnel did not always approve costs incurred prior to award or award resource sharing OTs in accordance with U.S.C. or the OT Guide. Section 2371b, title 10, U.S.C. contains requirements that agreement personnel must follow when costs are incurred prior to a prototype project award in resource share OT agreements. The OT Guide includes guidelines for agreement personnel to use

when preparing resource share OTs, including guidelines for what non-government contributions can include, guidance on costs incurred before the OT becomes effective, and procedures for ensuring the OT complies with 10 U.S.C. § 2371b. For one Navy agreement in our sample for an Armored Reconnaissance Vehicle Research Area 2 Full System Technology Demonstrator, valued at \$24 million, agreement personnel did not follow these requirements or guidelines.

Cost Incurred Before Award

Agreement personnel did not approve, in writing, costs incurred before the OT effective date. Section 2371b, title 10, U.S.C. and the OT Guide state that contractor contributions may not include costs incurred before the OT effective date unless the AO determines in writing that the contractor incurred the costs in anticipation of the OT agreement, and it was appropriate for the contractor to incur the costs before the effective date to ensure the successful implementation of the OT agreement. In one Navy example, the government agreed to pay \$800,000 in contractor costs before the effective date of the OT. The OT file did not contain documentation approving the costs incurred before the award and the AO was not able to provide the written determination. Since the AO did not include written approval of pre-agreement costs, the AO did not comply with the statute and did not show whether the costs incurred were in preparation for or appropriate for the OT agreement. We consider these unapproved pre-agreement costs to be questioned costs. Questioned costs are incurred costs that auditors question for a variety of reasons, including alleged violation of a law, or inability to support the cost with adequate documentation at the time of the audit. The Chief, Office of Naval Research, should review the \$800,000 in questioned costs to determine whether the AO properly approved it in writing and whether the costs were appropriate. If the costs were not properly approved or appropriate, then the Chief should take action to recover the funds.

Contractor Contributions

DoD Agreement personnel did not always follow guidance for contractor contributions when approving resource-sharing OTs. The OT Guide includes guidance on items the AO may consider as non-government resource sharing contributions such as labor, materials, equipment, intellectual property rights, facilities costs, and independent research and development costs.²² For one Navy OT, the OT file did not include any documentation showing what the contractor contribution included. The AO stated that the contractor took an overall approach for this OT and she could not provide a breakout of what made up the contractor

²² OUSD(A&S) OT Guide, November 2018.

portion of the costs. If the AO does not know what elements are included in the contractor portion of the resource share, the AO cannot ensure the OT complied with the OT Guide for non-government contributions.

Validation of Contractor Contributions

DoD Agreement personnel did not conduct oversight or have necessary documentation to verify contractor contributions. According to the OT Guide, OTs requiring resource sharing should generally provide for adjustment if the Government or contractor is not able to make the required contribution. The OT Guide further states that such OTs should address the procedures for verifying resource share contributions, the conditions that will trigger an adjustment, and the procedures for making the adjustment. Multiple AOs stated that they verify contractor contributions using various reports required throughout the OT; however, the reports did not always show the contractor contribution and only included the Government contributions. In one Navy OT, the AO provided an example of a monthly progress report used to ensure deliverables

The Air Force OT file did not contain any details or procedures for tracking and verifying the contractor contribution and the AO was unable to provide any information.

include the contractor contribution but the report only showed the government contribution. In another example, valued at \$9 million, the Air Force OT file for the Light Attack Experimentation Phase II prototype did not contain any details or procedures for tracking and verifying

the contractor contribution and the AO was unable to provide any information about how the AO verified that the contractor made its required contribution. If agreement personnel do not verify that the contractor is making its required contribution, they would not know if the contractor is violating the terms of the OT agreement and requirements of 10 U.S.C. § 2371b.²³

DoD Agreement Personnel Did Not Comply with Laws and Were Not Required to Follow the OT Guide

DoD agreement personnel did not always approve costs incurred prior to award or appropriately award resource sharing OTs because agreement personnel did not comply with U.S.C. and the OT Guide is not a requirement. While agreement personnel have flexibility awarding OTs, the OT Guide includes clear procedures tied to resource share agreements to ensure that contractor contributions are appropriate. Specifically, 10 U.S.C. § 2371b and the OT Guide state that the AO

²³ 10 U.S.C. § 2371b (2020).

must approve pre-award costs in writing. The guidance also describes contractor contributions for AOs to consider and states there should be procedures for verifying resource share contributions. If AOs do not confirm that OTs follow the OT Guide for resource share contributions, the AO cannot ensure the OT contributions were appropriate to be considered as part of a resource share agreement or costs incurred were in preparation for or appropriate to the OT. In addition, the AO cannot verify that the contractor provided its required contribution to make up the resource share required portion for compliance with 10 U.S.C. § 2371b. Since a traditional contractor must provide a specific portion of the costs to enter into an OT through resource sharing, agreement personnel should be required to validate those costs or contributions. The Principal Director, DPC, should reinforce the requirements in 10 U.S.C. § 2371b for approving costs prior to awarding an OT. In addition, the Principal Director should require AOs to follow resource-sharing procedures like those in the OT Guide to ensure resource sharing OT files clearly document elements of the contractor contribution, AO approval of costs incurred before the effective date of the OT, and steps taken to verify contractor contributions.

Conclusion

The DoD has the authority to carry out prototype projects as long as the OT meets one of the conditions outlined in the U.S.C. DoD agreement personnel awarded prototype OTs as required by 10 U.S.C. § 2371b; however, additional policies are necessary. While OTs are intended to be flexible, they are also intended to provide the Government with state-of-the-art technology and opportunities to do business with companies that normally do not do business with the DoD and may be challenged by the requirements of traditional FAR-based contracts. However, AOs do not always validate NDC status, NDC significant participation, and properly support resource share agreements. The DoD can implement additional controls to ensure the Government achieves the conditions required for an OT, while still giving the AOs flexibility. The additional controls would ensure that the OT meets the U.S.C. requirements. Without additional controls to validate NDC status and resource share contributions, the DoD may not meet the requirements of the statute or maximize its relationships with NDCs. Further, the Government may be paying more than the amount required in the resource share agreement, or contractors may obtain an OT for which they were ineligible.

Recommendations, Management Comments, and Our Response

Recommendation 1

We recommend that the Principal Director, Defense Pricing and Contracting:

- a. **Require agreement personnel to validate the nontraditional defense contractor status prior to awarding an other transaction, when necessary, and to include documentation of the verification in the other transaction file.**
- b. **Implement guidance or best practices for agreement personnel to consider when validating nontraditional defense contractor status to ensure that the conditions of section 2371b, title 10, United States Code are met, including steps to review the relationship between companies claiming to be a nontraditional defense contractor, when necessary.**
- c. **Develop and implement guidance or best practices for agreement personnel to validate that the nontraditional defense contractor participated to a significant extent, as proposed, throughout the duration of the prototype project.**
- d. **Reinforce the requirements in Section 2371b, Title 10, United States Code for approving costs prior to awarding an other transaction.**
- e. **Require agreement officers to follow resource-sharing procedures in the Other Transaction Guide or implement other requirements to ensure resource sharing other transaction files clearly document elements of the contractor contribution, agreement officer approval of costs incurred before the effective date, and verification procedures for contractor contributions.**

Defense Pricing and Contracting Comments

The DPC Principal Director agreed, stating that the DPC will develop and implement additional guidance addressing the elements of the recommendations in the OT Guide update planned for this calendar year.

Our Response

Comments from the Principal Director addressed the specifics of the recommendations; therefore, the recommendations are resolved but open. We will close the recommendations once we verify that the updated OT Guide requires AOs to validate and document NDC status prior to awarding an OT; review the relationships between companies claiming to be an NDC; validate that the NDC participated to a significant extent throughout the duration of the prototype project; reinforce the requirements for approving costs before awarding an OT;

and ensure resource sharing OT files clearly document elements of the contractor contribution, approval of costs incurred before the effective date, and verification procedures for contractor contributions.

Recommendation 2

We recommend that the Chief, Office of Naval Research review the \$800,000 in questioned costs to determine if the agreement officer properly approved it in writing and if the costs were appropriate. If the costs were not properly approved or appropriate, then take action to recover the funds.

Deputy Assistant Secretary of the Navy (Procurement) Comments

The Deputy Assistant Secretary of the Navy (Procurement) Senior Procurement Analyst, responding for the Office of Naval Research Chief, stated that the Department of the Navy disagreed with the recommendation. The Senior Procurement Analyst stated that after the draft report was issued, personnel located the AO letter approving the costs incurred before the agreement award for the Armored Reconnaissance Vehicle Research Area 2 Full-System Technology Demonstrator. The Senior Procurement Analyst stated that, based on the letter, the Department of the Navy complied with 10 U.S.C. § 2371b and the OT Guide and requested closure of the recommendation.

Our Response

Although the Senior Procurement Analyst disagreed with the recommendation, actions taken met the intent of the recommendation. We validated that the AO approved the \$800,000 in costs incurred before the OT was awarded in the AO letter; therefore, the recommendation is closed and the \$800,000 is no longer considered a questioned cost. No additional comments are required for this recommendation.

Appendix A

Scope and Methodology

We conducted this performance audit from March 2021 through June 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To complete this audit, we obtained our universe using the OUSD(A&S), “Report to Congress On the Use of Other Transaction Authority for Prototype Projects,” Appendix A, for FY 2019 and 2020. We removed OTs that were awarded through a consortium and selected to review only standalone prototype OTs. Working with the Service points of contact we requested additional information to determine whether an award was to a traditional contractor with a NDC participating to a significant extent, or the award was to a NDC. Further, for those awards with a NDC participating to a significant extent, we requested a list of the NDCs. The total universe of standalone OTs for FY19 and FY20 includes 889 OT awards valued at \$23.58 billion.²⁴

There are four conditions from 10 U.S.C. § 2371b, one of which needs to be met to enter into an OT agreement. The conditions include:

- at least one NDC or nonprofit research institute participating to a significant extent,
- all significant participants in the transactions other than Federal Government are small businesses or NDCs,
- at least one third of the total cost is to be paid out of funds provided by sources other than the Federal Government, or
- the senior procurement executive for the agency determines that exceptional circumstances justify the use of a transaction.

²⁴ We combined the numbers from FYs 2019 and 2020 to get our universe. However, the actual number of standalone OTs for the 2 years is likely lower than our universe total since each FY universe is based on active OT actions for that FY. Therefore, some OTs may show up in both the FYs 2019 and FY 2020 universe.

From our universe, we selected a non-statistical sample of 36 awards from the different 10 U.S.C. § 2371b conditions, valued at \$5.4 billion for review.²⁵

The non-statistical sample included 12 awards from each Military Department.

Of the 12 awards from each Department, we selected:

- 4 awards to NDCs;
- 4 awards to a traditional contractor with at least one NDC participating to a significant extent, and;
- 4 awards using resource sharing.²⁶

While we selected a sample of 36 OTs to review, after selecting our sample, we found that 2 OTs were awarded in accordance with 10 U.S.C. § 2373 and not 10 U.S.C. § 2371b.²⁷ Therefore, although a part of our sample, we did not review them in accordance with our objective. From our sample, we reviewed 34 OTs, valued at \$5.0 billion, in accordance with our audit objective.

For each OT in our sample, we performed an in-depth review to determine whether DoD contracting officials used NDCs, traditional contractors teaming with NDCs or resource sharing when awarding OTs in accordance with applicable Federal laws and DoD policies. Specifically, we reviewed Federal criteria and guidance. We conducted interviews with agreement personnel and requested responses to questionnaires. We also reviewed the documentation in the OT file to determine which condition of 10 U.S.C. § 2371b agreement personnel used to award the OT. We also reviewed the documents in the OT file to determine whether agreement personnel documented which condition the OT met and whether the AO documented all the decisions for the award in the OT file.

We reviewed the following Federal and DoD Criteria:

- Section 2371, title 10, U.S.C., “Research projects: transactions other than contracts and grants,” January 14, 2019
- Section 2371b, title 10, U.S.C., “Authority of the Department of Defense to carry out certain prototype projects,” December 31, 2020
- Section 2302, title 10, U.S.C., “Definitions,” July 26, 2020

²⁵ We selected a sample of 36 OTs to review. However, after selecting our sample, we found that 2 OTs were awarded in accordance with 10 U.S.C. § 2373 and not 10 U.S.C. § 2371b. Therefore, although a part of our sample, we did not review them in accordance with our objective. From our sample, we reviewed 34 OTs, valued at \$5.0 billion, in accordance with our audit objective.

²⁶ While there are four conditions under 10 U.S.C. § 2371b, the audit team did not include any OTs awarded under the determination of exceptional circumstances. The universe included 11 awards labeled as the determination of exceptional circumstances; however, those awards were either not in the scope of this audit or incorrectly labeled.

²⁷ Section 2373, title 10, U.S.C. states that the Secretary of Defense and the Secretaries of the Military Departments may each purchase ordnance, signal, chemical activity, transportation, energy, medical, space-flight, and aeronautical supplies, including parts and accessories, and designs thereof, that they consider necessary for experimental or test purposes in the development of the supplies that are needed for the national defense. Purchases under this authority may be made by contract or otherwise.

- Public Law 115-232, “John S. McCain National Defense Authorization Act for Fiscal Year 2019,” August 13, 2018
- OUSD(A&S) Memorandum, “Reporting Other Transactions to the Federal Procurement Data System,” September 7, 2018
- “Other Transactions Guide” issued by the OUSD(A&S), November 2018

Internal Control Assessment and Compliance

We assessed internal controls and compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed compliance with 10 U.S.C. § 2371b (2020) and the DoD-issued OT Guide. Further, we identified several internal control deficiencies related to awarding and administering OTs. However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

Use of Computer-Processed Data

We used computer-processed data to perform this audit, but we did not rely on that data. To obtain our universe, we used the data in Appendix A of the OUSD(A&S) “Report to Congress On the Use of Other Transaction Authority for Prototype Projects” for FY 2019 and 2020. While the data in that report comes from the Federal Procurement Data System-Next Generation (FPDS-NG), we did not rely on this data. We only used the data in the OUSD(A&S) report to obtain our universe and select a sample. The findings in our report were based on a review of the OT files and not the data in the OUSD(A&S) report.

Prior Coverage

During the last 5 years, the Government Accountability Office (GAO), the DoD Office of Inspector General (DoD OIG) and Army Audit Agency issued six reports discussing the use of other transaction authority.

GAO

Report No. GAO-20-84, “DoD’s Use of Other Transactions for Prototype Projects Has Increased,” November 2019.

The GAO found that the DoD significantly increased its use of agreements known as OTs for prototype projects from FYs 2016 through 2018. DoD data shows that companies typically not doing business with the DoD participating

in 88 percent of the other transactions awarded during this time. In nine of the eleven prototype OTs the GAO reviewed, DoD contracting personnel followed their components' established review policies before awarding other OTs.

Report No. GAO-21-8, "Army Should Improve Use of Alternative Agreements and Approaches by Enhancing Oversight and Communication of Lessons Learned," October 1, 2020.

The GAO found that Army organizations lack consistent, coordinated practices to identify and share lessons learned from entering into alternative agreements or executing alternative approaches. OTs for prototype projects have driven the recent expansion in the overall use of alternative agreements to support Army modernization. The use of consistent, coordinated lessons learned practices for alternative agreements can improve the processes leading up to an agreement by including more diverse perspectives and ensuring that lessons learned are not confined to a subset of organizations or officials involved in decision-making. In addition, improvements to the lessons learned practices used for the Army's alternative approaches would provide its personnel with increased access to what has worked well and what has not when interacting with industry and academia. Improved sharing of these lessons learned can help the Army more effectively engage with new partners in support of its modernization goals.

Report No. GAO-21-501, "Actions Needed to Enhance Transparency and Oversight of Selected Awards," July 26, 2021.

The GAO found two challenges with how the agencies tracked these agreements due to limitations with the federal procurement database. First, the three agencies did not properly identify at least \$1.6 billion of the \$12.5 billion as COVID-19-related agreements. Second, the DoD reported that one consortium management firm received \$7.2 billion in agreements. In actuality, the management firm distributed nearly all of the awarded dollars to five pharmaceutical companies, with each receiving \$450 million to \$2 billion. Also, two agencies' policies on OT agreements did not address the requirement for enhanced oversight of certain activities that consortium management firms may perform.

DoD OIG

Report No. DODIG-2021-077, “Audit of Other Transactions Awarded Through Consortiums,” April 21, 2021.

The DoD found that contracting personnel did not properly track OTs awarded through consortiums and did not have an accurate count of OTs and associated dollar values. In addition, contracting personnel did not consistently award OTs in accordance with applicable laws and regulations and did not have a consistent basis to negotiate Consortium Management Organization fees. Furthermore, DoD contracting personnel did not ensure the security of controlled or restricted information being sent to the consortium members and did not require consortium members to register in SAM. DoD personnel were also not performing security review of cumulative technical information provided to consortium members, and instead only performed security reviews on a per-project basis.

Army

Report No. A-2020-0038-BOZ, “Other Transaction Authority Control Environment,” February 27, 2020.

The Army Audit Agency found that OT agreements did not always have appropriate safeguards to protect Government interests. AOs generally used proper designation authorities and addressed intellectual property rights. However, the agreements needed safeguards to ensure AOs or their representatives assessed and mitigated risks to make sure contractors could meet technical, schedule, and cost expectations; made sure contractors met security requirements; and ensured that invoices were supported and properly approved before payment.

Report No. A-2022-0029-BOZ, “Other Transaction Authority Program Goals and Objectives,” February 25, 2022.

The Army Audit Agency found that the Army met the goals and objectives for both standalone and consortium OT agreements outlined in 10 U.S.C. § 2371b. The program has been successful in streamlining processes and engaging with nontraditional companies and small businesses. However, the Army did not have adequate implementing guidance to manage and execute the program. Therefore, it lacked a control environment (including a framework of organizational roles and responsibilities) to protect itself from potential fraud, waste, and abuse. Use of these agreements has tripled over the past 4 years and this trend is likely to continue.

Appendix B

Other Matters of Interest

DoD agreement personnel awarded OTs to large DoD contractors who qualified as an NDC based on section 2302, title 10, U.S.C., which defines an NDC as an entity that is not currently performing and has not performed a DoD contract in the past year subject to full CAS. According to the OT Guide, the effect of this legislated definition is that a large number of entities qualify as NDCs, even those firms that work exclusively with the DoD. As a result, large contractors that have done millions of dollars in business with the DoD can qualify as NDCs. When codifying the definition for an NDC in section 845 of the National Defense Authorization Act for FY 1994, as modified by the FY 2015 National Defense Authorization Act, the House Committee Report stated that the flexibility of the OT authorities of 10 U.S.C. § 2371, would make them attractive to firms and organizations that do not usually participate in government contracting due to the typical overhead burden. The committee report stated that expanded use of OTs would support DoD efforts to access new sources of technical innovation, such as Silicon Valley startup companies and small commercial firms.

During the course of our review, we identified large DoD contractors who received OT awards as NDCs. For example, agreement personnel awarded a prototype OT to Microsoft Corporation, valued at \$15 million for the Program Manager Wargaming Capability Integrated Prototyping. Microsoft is listed in the SAM as one of the top DoD contractors, with \$645 million dollars obligated in FY 2019, and \$702 million dollars obligated in FY 2020. Microsoft self-certified as a large contractor, which qualified as an NDC because the company did not receive a contract award subject to full CAS within the preceding 12 months. The AO checked the FPDS-NG and confirmed that Microsoft did not receive or perform a full CAS contract within the past 12 months. In another example, agreement personnel awarded a prototype OT to Verizon Business Network Services Inc., on behalf of MCI Communication Services, doing business as Verizon Business Services, with a value of \$9.8 million for the Enterprise Information Technology as a Service solution. According to the FPDS-NG, Verizon Business Services had \$406 million obligated for contract actions in the 12 months prior to the OT award. Verizon Business Services self-certified as a large contractor, which qualified as an NDC because the company did not receive or perform a DoD contract award subject to full CAS within the last 12 months. Therefore, both Microsoft and Verizon Business Services qualified as an NDC based on the definition in 10 U.S.C. § 2302.

When leveraged appropriately, OTs provide the Government with state-of-the-art technology solutions from traditional contractors and NDCs, through teaming arrangements or resource sharing. OTs allow DoD agreement personnel more flexibility to seek opportunities with companies that normally do not do business with the DoD or companies that may be challenged by the requirements of traditional FAR based contracts. However, large contractors that already do business with the DoD are also eligible to receive OT awards as NDCs. Therefore, we suggest that the Principal Director, DPC, consider coordinating with the appropriate Congressional office to assess the definition of a NDC and determine whether the language in 10 U.S.C. § 2302 reflects the intent of OTs and which companies should qualify as a NDC. If the language does not reflect the intent, then consider requesting a revision to the statute, as necessary.

Management Comments

Defense Pricing and Contracting



ACQUISITION
AND SUSTAINMENT

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

MEMORANDUM FOR PROGRAM DIRECTOR, ACQUISITION, CONTRACTING, AND
SUSTAINMENT, OFFICE OF THE INSPECTOR GENERAL

SUBJECT: Response to the Department of Defense Inspector General's Draft Audit of
DoD Other Transactions for Prototypes and the Use of Nontraditional
Defense Contractors and Resource Sharing (Project No. D2021-D000AX-
0111.000)

As requested, I am providing a response to Recommendation 1 of the subject report.

Recommendation 1: The Department of Defense Inspector General recommends the Principal
Director, Defense Pricing and Contracting (DPC):

- a. Require agreement personnel to validate the nontraditional defense contractor status prior to awarding an Other Transaction, when necessary, and to include documentation of the verification in the other transaction file.
- b. Implement guidance or best practices for agreement personnel to consider when validating nontraditional defense contractor status to ensure that the conditions of section 2371b, title 10, United States Code [now 10 U.S.C. § 4022] are met, including steps to review the relationship between companies claiming to be a nontraditional defense contractor, when necessary.
- c. Develop and implement guidance or best practices for agreement personnel to validate that the nontraditional defense contractor participated to a significant extent, as proposed, throughout the duration of the prototype project.
- d. Reinforce the requirements in section 2371b, title 10, United States Code for approving costs prior to awarding an other transaction.
- e. Require agreement officers to follow resource-sharing procedures in the Other Transaction Guide or implement other requirements to ensure resource sharing Other Transaction files clearly document elements of the contractor contribution, agreement officer approval of costs incurred before the effective date, and verification procedures for contractor contributions.

Response: Concur. DPC will develop and implement additional guidance for the elements of Recommendation 1 in the update to the OT Guide planned for this calendar year.

My point of contact for this matter is [REDACTED], who may be reached at [REDACTED]
[REDACTED] or [REDACTED].

TENAGLIA.J [REDACTED]

OHN.M. [REDACTED]

[REDACTED]
John M. Tenaglia
Principal Director,
Defense Pricing and Contracting

Department of the Navy



DEPARTMENT OF THE NAVY
OFFICE OF THE ASSISTANT SECRETARY
RESEARCH, DEVELOPMENT AND ACQUISITION
1000 NAVY PENTAGON
WASHINGTON DC 20350-1000

28 July 2022

MEMORANDUM

From: Office of Deputy Assistant Secretary of the Navy (Procurement)

To: Office of the Inspector General, Department of Defense

Subj: DEPARTMENT OF THE NAVY RESPONSE TO THE DRAFT REPORT - AUDIT OF
DOD OTHER TRANSACTIONS FOR PROTOTYPES AND THE USE OF
NONTRADITIONAL DEFENSE CONTRACTORS AND RESOURCE SHARING
(D2021-D000AX-0111.000)

Ref: (a) [REDACTED] email, same subject, dated 16 June 2022 with attachment

Encl: (1) Pre-contract cost approval letter for resultant other transaction agreement N00014-19-9-0005, dated 29 January 2019

The Department of the Navy (DON) appreciates the opportunity to review the draft report, Audit of DOD Other Transactions for Prototypes and the Use of Nontraditional Defense Contractors and Resource Sharing, dated 16 June 2022 (Project No. D2021-D000AX-0111.000), provided by Reference (a). The DON's response to recommendation 2 is provided below, as required by Reference (a).

Recommendation 2:

We recommend that the Chief, Office of Naval Research review the \$800,000 in questioned costs to determine if the agreement officer properly approved it in writing and if the costs were appropriate. If the costs were not properly approved or appropriate, then take action to recover the funds.

DON Response: Nonconcur. Subsequent to the issuance of the subject draft report, the DON has located the letter documenting approval of cost incurred before the award of agreement N00014-19-9-0005 by the Agreements Officer (AO). Enclosure 1 shows that the AO properly approved appropriate costs up to \$2,000,000. During negotiations, a review of incurred costs was performed and a reduced amount of \$800,000 was negotiated and incorporated into the agreement. Based on the aforementioned, the DON complied with 10 U.S.C. 2371b and the DoD OT Guide. As a result, the DON requests closure of this recommendation.

MCMILLAN, SALEEMAH
M [REDACTED]

Saleemah McMillan
Senior Procurement Analyst
Deputy Assistant Secretary of the Navy
(Procurement)

Acronyms and Abbreviations

AO	Agreement Officer
A&S	Acquisition and Sustainment
CAS	Cost Accounting Standards
DPC	Defense Pricing and Contracting
FAR	Federal Acquisition Regulation
FAPIIS	Federal Awardee Performance and Integrity Information System
FPDS-NG	Federal Procurement Data System-Next Generation
GAO	Government Accountability Office
NAICS	North American Industry Classification Code
NDC	Nontraditional Defense Contractor
OT	Other Transaction
OUSD	Office of the Under Secretary of Defense
SAM	System for Award Management
U.S.C.	United States Code



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