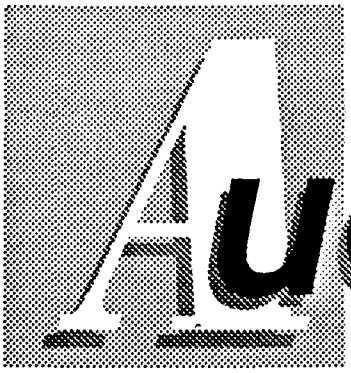

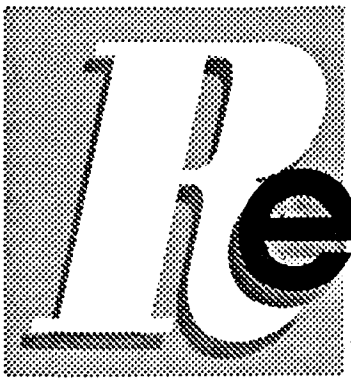

OFFICE OF THE INSPECTOR GENERAL

TITAN IV PROGRAM

Report Number 92-064

March 31, 1992

Department of Defense

The following acronyms are used in this report.

ACO.....Administrative Contracting Officer
ACRN.....Accounting Classification Reference Number
CLIN.....Contract Line Item Number
DCAA.....Defense Contract Audit Agency
DPRO.....Defense Plant Representative Office
FAR.....Federal Acquisition Regulation
O&M.....Operation and Maintenance
PPR.....Progress Payment Request
RDT&E.....Research, Development, Test and Evaluation
SUBCLIN.....Subsidiary Contract Line Item Number

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

March 31, 1992

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
COMPTROLLER OF THE DEPARTMENT OF DEFENSE
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
COMMANDER, DEFENSE CONTRACT MANAGEMENT COMMAND

SUBJECT: Audit Report on the Titan IV Program (Report No. 92-064)

We are providing this report for your information and use. Comments on a draft of this report were not received from the Comptroller of the Department of Defense by March 24, 1992. DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. Therefore, the Director of Defense Procurement; the Comptroller of the Department of Defense; the Commander, Defense Contract Management Command; and the Air Force Program Executive Officer for Space Programs must provide comments on the final report by June 1, 1992. See the "Status of Recommendations" section at the end of the finding for the specific requirements for your comments.

We appreciate the courtesies extended to the audit staff. If you have any questions on this report, please contact Mr. Russell A. Rau, Program Director, at (703) 693-0186 (DSN 223-0186) or Ms. Patricia A. Brannin, Project Manager, at (703) 693-0392 (DSN 223-0392). The distribution of this report is listed at Appendix D.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Enclosure

cc:
Secretary of the Air Force

OFFICE OF THE INSPECTOR GENERAL

AUDIT REPORT NO. 92-064 March 31, 1992
(Project No. 1AE-5006.05)

TITAN IV PROGRAM

EXECUTIVE SUMMARY

Introduction. The Titan IV is an unmanned, expendable launch vehicle that complements the space shuttle and ensures access to space for national security payloads. The target and ceiling prices for the single ceiling fixed-price-incentive contract for development, production, and launch services for the Titan IV were $7.7 billion and $8.9 billion, respectively. The contract was funded from at least four different appropriations.

Objective. The Titan IV was one of nine programs included in the "Audit of DoD Use of Contractor Cost and Schedule Control System Data on Major Defense Acquisition Programs." The audit objective was to evaluate the implementation and oversight of cost and schedule control systems and the use of data reported by contractors complying with cost and schedule control system criteria. We also evaluated applicable internal controls.

Audit Results. Progress payments for the Titan IV contract were made from a predetermined sequence of appropriations, rather than from the appropriations that reflected the type of work done. As a result, the Air Force did not have adequate internal controls over appropriated funds. Also, U.S.C., title 31, section 1301, and potentially U.S.C., title 31, section 1341, which govern use of appropriated funds, were violated.

Internal Controls. The audit identified material internal control weaknesses in that controls were not in place to ensure the control of appropriations, as required by U.S.C., title 31, sections 1301 and 1341, and DoD Directive 7200.1. These internal control weaknesses are further described in Part I of the report.

Potential Benefits of Audit. Implementation of the recommendations in this report will ensure controls exist for all DoD contracts funded with multiple appropriations and will implement controls over the future progress payments on the Titan IV (Appendix B).

Summary of Recommendations. We recommended implementation of procedures within DoD to ensure adequate internal controls over appropriations and implementation of controls on the Titan IV contract to properly categorize costs to ensure proper use of appropriated funds.

Management Comments. The Director of Defense Procurement; the Commander, Defense Contract Management Command; and the Titan IV Program Executive Officer nonconcurred with Recommendations 1., 3., and 4., respectively, because the recommendations were premature until the Comptroller of the Department of Defense reviews existing policies for systemic deficiencies that could result in violations of statutes. However, the Comptroller did not respond to Recommendation 2. by March 24, 1992. Our recommendations are to ensure compliance with public laws concerning expenditures of appropriated funds. Comments on this final report must be received by June 1, 1992.

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This report was prepared by the Acquisition Management Directorate, Office of the Assistant Inspector General for Auditing, DoD. Copies of the report can be obtained from the Information Officer, Audit Planning and Technical Support Directorate, (703) 614-6303.

PART I - INTRODUCTION

Background

The Titan IV is an unmanned, expendable launch vehicle that complements the space shuttle and ensures access to space for certain national security payloads. In February 1985, the Air Force awarded contract F04701-85-C-0019 to Martin Marietta for the development of the Titan IV and production of 10 Titan IV launch vehicles, as well as launch services for the vehicles. The contract also included the activation and operation of a single launch facility at the Cape Canaveral Air Force Station, Florida. As a result of the January 28, 1986, Space Shuttle Challenger accident, the Air Force added 13 Titan IV launch vehicles to the original contract, for a total of 23 vehicles. The Air Force also added two launch facilities at Vandenberg Air Force Base and another facility at Cape Canaveral, bringing the total number of launch facilities to four. In December 1989, the Air Force added another 18 vehicles with options for 8 more to the contract. As of May 26, 1991, the target and ceiling prices for the Titan IV were $7.7 billion and $8.3 billion, respectively. During our audit, the Air Force was developing an upgraded solid rocket motor to provide increased reliability, producibility, and performance. The Titan IV Program is managed by the Titan IV System Program Office at Air Force Space Systems Division. On June 14, 1989, the Air Force successfully launched the first Titan IV, and three others have since been launched.

Objective

Our overall audit objective was to evaluate the effectiveness of the implementation and oversight of contractor cost and schedule control systems and the use of data reported by contractors complying with cost and schedule control system criteria. The Titan IV Program was one of nine major Defense acquisition programs included in the overall audit. While conducting the audit, we determined that oversight of, and control over, the expenditure of Titan IV appropriations were inadequate. We are reporting this issue separately because it will not directly relate to issues identified in our overall report.

Scope

We performed this program audit of the Titan IV between January and November 1991. We reviewed documentation dated from 1981 to 1991 and discussed issues related to the Titan IV Program and to progress payments and the use of appropriations with personnel involved in the approval and payment of progress payments for the Titan IV. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly included such tests of internal controls as were deemed necessary. A list of the activities visited or contacted is in Appendix C.

Internal Controls

We evaluated the implementation of policies and procedures for the control of appropriations that fund the Titan IV contract. The audit identified material internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Progress payments were made from appropriated funds without regard to the type of work that had been performed. Therefore, the Air Force could not ensure that the funds were being used for the purposes for which they were appropriated, as required by U.S.C., title 31, sec. 1301, and DoD Directive 7200.1. This lack of control could result in violations of U.S.C, title 31, sec. 1341. Implementation of the recommendations in this report will correct those weaknesses. A copy of the report is being provided to the senior officials responsible for internal controls within the Offices of the Secretary of Defense and the Secretary of the Air Force.

Prior Audits and Other Reviews

Since 1986, the General Accounting Office has issued four reports and the Air Force Audit Agency has issued three reports addressing the Titan IV. We did not follow up on the prior audits because none of the previous reports contained issues or recommendations related to the issues addressed in this report.

PART II - FINDING AND RECOMMENDATIONS

CONTROL OF APPROPRIATED FUNDS

The Air Force did not have adequate oversight of, and control over, the expenditure of multiple appropriations on the Titan IV contract. This occurred because the contractor's requests for progress payment did not specify how much of the progress payment was for work funded from each appropriation on the contract. Without specific payment instructions, the Paying Office paid the progress payments in a predetermined sequence in accordance with Air Force Regulation 177-120. Although adjustments were made to account for applicable appropriations when contract items were delivered, the established operating procedures did not adequately protect appropriation integrity. Consequently, payments were made to the contractor without regard for whether the payment was made from an appropriation that reflected the type of work done. Therefore, we believe the Air Force violated U.S.C., title 31, sec. 1301, which requires that appropriations be applied only for the purposes for which the appropriations were made and could potentially violate U.S.C., title 31, sec. 1341, when final adjustments are made at contract closeout.

DISCUSSION OF DETAILS

Background

The Titan IV contract provides for development, production, launch services, and launch site activation for the Titan IV. The contract period of performance is from 1985 to 1995, and the contract contains 81 funded contract line items (CLINs) with 212 subsidiary contract line items (SUBCLINs).

As of June 30, 1991, the contract was funded with $7.0 billion from four different Air Force appropriations:

- o $1.9 billion from Research, Development, Test and Evaluation (RDT&E), appropriation 3600;
- o $4.3 billion from Missile Procurement, appropriation 3020;
- o $0.4 billion from Other Procurement, appropriation 3080; and
- o $0.4 billion from Operation and Maintenance (O&M), appropriation 3400.

In addition to the four primary appropriations, the contract included 5-year RDT&E funds, appropriation 3601; 3-year RDT&E funds, appropriation 3602; and 5-year Missile Procurement funds, appropriation 3021.

As prescribed in Federal Acquisition Regulation (FAR) 32.5, "Progress Payments Based on Costs," Martin Marietta received progress payments for work on the Titan IV contract. Progress payments are a method of providing contract financing and are

made based on eligible costs incurred by the contractor as work progresses under the contract. The Titan IV contract used three cash models to determine the amount of flexible progress payments. Flexible progress payments are based on the contractor's cash needs projected over the life of the contract, rather than using the standard progress payment rate specified in the FAR. As the contract was modified to add additional Titan IV vehicles, updated cash models were incorporated for the additions to the contract. During our audit, the Air Force and the contractor were discussing modifying the contract to provide for a single cash model.

U.S.C., title 31, sec. 1301 (sec. 3678 revised statutes), requires that appropriations be used only for the programs and purposes for which the appropriations were made. U.S.C., title 31, sec. 1341, states that expenditures or obligations exceeding the available appropriation cannot be made. Also, U.S.C., title 31, sec. 1514(a), requires that each agency have a control system to restrict obligations or expenditures to the amounts appropriated. The U.S.C.'s are implemented by DoD Directive 7200.1, "Administrative Control of Appropriations," May 7, 1984.

"A Glossary of Terms Used in the Federal Budget Process," March 1981, defines an expenditure as an outlay which, in turn, is defined as liquidation of obligations when checks are issued or cash disbursed. Many definitions of expenditure are used interchangeably with issuing checks or disbursing cash. For example, "Principles of Federal Appropriations Law," GAO, First Edition, 1982, states that an expenditure is the actual disbursement of funds. Air Force Regulation 177-120, "Central Procurement Transactions," February 15, 1988, defines expenditure as the disbursement of funds in payment for supplies and services received and defines disbursement as payments by check, cash, or other such transactions. Approval of a progress payment results in the issuing of a check to the contractor. Although the actual obligation is not liquidated until the eventual delivery of the contracted for goods or services, we believe that a progress payment meets the definition of an expenditure as used in the appropriation laws. If DoD does not ensure that the expenditures are made from the proper appropriation, it has inadequate control over appropriations and thus, violates appropriation law.

Appropriation Control

Organizations responsible for preparing, reviewing, approving, and paying the Titan IV Request for Progress Payments (PRR), Standard Form 1443, did not determine whether the contractor was being paid from appropriated funds that corresponded to the work actually performed.

Progress payments. Our review of the progress payments for the Titan IV showed that DoD did not have adequate controls over appropriated funds when it made progress payments. As of October 10, 1991, the Titan IV contractor had received

$4.4 billion in progress payments. The contractor's PPR did not specify which appropriations or the amounts of the appropriations that should be credited when making the progress payments. The Titan IV contract did not require that the contractor provide the type of funds incurred as part of the contractor's PPR, although the contract did require that the contractor segregate the costs incurred by appropriation.

The Administrative Contracting Officer (ACO) for the Titan IV received the PPR from the contractor and reviewed and approved the request for payment. Although the ACO reviewed the progress payment, he did not evaluate the progress payment's impact on individual appropriations or determine which appropriations should be credited when making the payment. Once the PPR was approved, the ACO forwarded it to the Defense Contract Management Operations Office (the Paying Office) for payment. The Paying Office processed the approved PPR in accordance with Operating Instruction 7000.1-1, October 1, 1990, which required that when a multifunded contract contains no payment instructions, appropriations must be used in the following predetermined sequence: RDT&E, O&M, Aircraft Procurement, Missile Procurement, and Other Procurement. Within this sequence, the oldest funds are to be used first. The Operating Instruction reflects the special procedures outlined in Air Force Regulation 177-120, "Central Procurement Transactions," February 15, 1988. The Regulation states that the special procedures are authorized when multifunded citations are involved and payments cannot be distributed in accordance with the funds cited on the contractual document or other more accurate procedures are not practicable. DoD 7220.9-M, "Department of Defense Accounting Manual," states that it is desirable that the contractor's request for progress payment identify the distribution of appropriations against which payment is being requested. The Manual further states that, if it is not practicable to obtain the contractor's distribution of the payment by appropriation, program management may make such distribution based on knowledge of contractor performance. We believe that more accurate procedures were available for making progress payments on the Titan IV.

This predetermined sequence did not ensure that the payments were made from the correct appropriation. For example, the contractor submitted, and the ACO approved, $272.7 million of PPRs for costs incurred through October 28, November 25, and December 31, 1990. The PPRs did not indicate what type of work had been performed, that is research and development or production, or specify any paying instructions. When the Paying Office received the PPRs, it paid the $272.7 million from the Missile Procurement appropriation. However, based on contractor provided Contract Funds Status Reports, the contractor incurred about $10.0 million in RDT&E, $29.3 million in Other Procurement, and $26.7 million in O&M costs during the period covered by the progress payments. Also, none of the $275.5 million payments made for costs incurred through July 28, August 25, and September 29, 1991, were paid from Other Procurement funds even though about

17 percent of the total accrued expenditures for the period were associated with Other Procurement. About 71 percent of the $275.5 million was paid from the Missile Procurement appropriation, but only about 37 percent of the accrued expenditures was for Missile Procurement effort during the quarter. Appendix A summarizes the payments made from October 1990 through September 1991. Thus, we believe that funds were expended for purposes other than those appropriated, which violated U.S.C., title 31, sec. 1301.

The Missile Procurement appropriation was used next in the sequence because the RDT&E and O&M funds were not available on the contract. Thus, to the extent that RDT&E and O&M funds were not available to fund the contract, a violation of U.S.C., title 31, sec. 1341, could also have occurred.

We believe that the contractor could have provided a supplement to the PPRs that would segregate the payment request by appropriation because the contractor was required to segregrate the costs by appropriation. Part I of the Titan IV contract included the requirement that "The costs associated with specific types of appropriations shall be segregated from other types of appropriations." Also, the contract data requirement for the Contract Funds Status Report required that the Report provide funds status information by appropriation. Thus, the data needed to provide proper paying instructions were available and should have been used according to DoD 7220.9-M.

In addition, there is precedent for requiring that the contractor provide a supplement to the PPR giving appropriation information. The ACO for the C-17 Aircraft Program obtained a supplement to Douglas Aircraft Company's PPRs that segregated the requested progress payments by contract line item. Like the Titan IV Program, the C-17 Program had a single ceiling contract with both RDT&E and procurement funds. However, the CLINs on the C-17 contract were more readily identified to an appropriation, unlike the multifunded CLINs on the Titan IV contract. The supplement to the PPR became the paying instruction, and the Paying Office credited the appropriations accordingly.

Our review of the FAR and the Defense Contract Administration Manual did not find requirements or guidance regarding the need to consider the type of appropriation in approving progress payments.

Multifunded contract line items. Individual CLINs were funded with multiple appropriations, which further complicated the control of appropriations. Of the 81 CLINs and 212 SUBCLINs, 24 CLINs and 26 SUBCLINs were funded from multiple appropriations. For example, CLIN 0001, "Initial Study and Development," was valued at about $5.0 million, of which about $2.8 million was funded from the RDT&E appropriation and about $2.2 million was funded from the Missile Procurement appropriation. Similarly, CLIN 0014, "Special Studies/Payload

Integration Task," was funded with $0.9 million from RDT&E appropriations and $0.5 million from both Missile and Other Procurement appropriations.

Also, some CLINs appeared to be funded with an incorrect appropriation. For example, four CLINs were funded with multiple appropriations: $463.6 million of RDT&E funds, $121.9 million of Missile Procurement funds, and $2.2 million of Other Procurement funds. However, as shown below, all four CLINs appeared to be for RDT&E work.

- o CLIN 0027, RDT&E/Nonrecurring Engineering--Titan IV/ Centaur Configuration;
- o CLIN 0028, RDT&E Titan IV Engineering--Titan IV/No Upper Stage Configuration;
- o CLIN 0048, RDT&E/Nonrecurring Engineering--Titan IV Solid Rocket Motor Upgrade; and
- o CLIN 0063, Hercules RDT&E Nonrecurring Engineering--Solid Rocket Motor Upgrade.

Only at the time of a delivery, and the resulting invoice, were adjustments made to charge the correct appropriation obligated for the deliverable. With the delivery of a CLIN or SUBCLIN, the contractor prepared an invoice that identified the item delivered and the price of the item. The accounting classification reference numbers (ACRN), which are associated with the CLIN, identified the appropriation(s) and fiscal year(s) obligated for the CLIN(s) or SUBCLIN(s) delivered. With the approved invoice, the progress payments were liquidated.* When the progress payments were liquidated, the Paying Office adjusted the accounting ledgers to reflect the actual appropriation(s) that funded the delivered items.

The Paying Office's Operating Instruction states that the progress payments are to be liquidated in reverse order of the payment sequence, that is, newest funds are liquidated first. To the extent that funds are not available in the proper appropriation to cover the liquidation, this sequence of

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* Progress payments are made to contractors before goods or services are received. Therefore, the contractor incurs a debt to the Government in the amount of the progress payments. This debt is liquidated as the goods and services are received. The value of each good and service is predetermined in the contract with a price for the CLIN or SUBCLIN.

liquidation may result in using procurement funds to pay for research and development costs or later year funds to pay prior year costs.

In addition, when a partial delivery of a CLIN or SUBCLIN that has multiple deliverables, as well as multiple appropriations, is to be made, adjustments to appropriations associated with the CLIN or SUBCLIN are to be made based on the alphabetical order of the associated ACRNs. This procedure is unlikely to match expenditures with the work performed, resulting in funds being used for other than appropriated purposes. Again, not until delivery and final billing of the complete CLIN are appropriations to be properly charged, and then only to the extent funds are available.

Defense Contract Audit Agency. The Defense Contract Audit Agency (DCAA) also did not consider funding related issues in its audits and reviews of contractor costs and systems or the impact of funding on contractor actions. FAR 32.503-5, "Administration of Progress Payments," requires periodic reviews or audits of approved progress payments to determine the validity of progress payments already made. DCAA audited progress payments if the ACO requested an audit or if DCAA had a valid reason to believe that an audit was necessary. Depending on the circumstances, the DCAA progress payment audit could consist of verification of costs to amounts recorded on the contractor's books and records or detailed audits of the contractor's accounting and billing systems. DCAA's Contract Audit Manual did not include guidance to consider the type of appropriations, or funding, associated with the contractor's cost incurred or the impact of funding in its progress payment audits.

The Titan IV contract required that costs be segregated by appropriation and that the contractor report costs by appropriation in the Contract Funds Status Report. However, DCAA did not review the adequacy of the segregation or test the segregated data in the Contract Funds Status Report to determine whether the data were properly segregated.

DCAA should consider in its audits and resulting findings and recommendations the impact of funding considerations and should review contractor data to ensure that the segregation of costs required by multifunded contracts is reliable and accurate. We believe that such a determination is essential to adequate internal controls over appropriations because the expenditure of appropriated funds, especially in the RDT&E and Procurement appropriations, will likely be made to a contractor. Therefore,

without the determination of the reliability and accuracy of the contractor's segregated data or the ability of the contractor's systems to adequately segregate the data, DoD cannot ensure that it is using funds only for the purposes appropriated. We did not make recommendations to DCAA in this report because implementation of the recommendations made in Report No. 92-046, "Audit of Contractor Accounting Practice Changes for C-17 Engineering Costs," February 13, 1992, should provide the guidance necessary to ensure that funding issues are adequately considered in DCAA audits and reviews. In Report No. 92-046, we similarly observed that DCAA had not adequately considered the impact of funding on contractor accounting practice changes. In that report, we recommended that the Director, DCAA, establish policy and procedures to review funding implications of contractor activities, including guidance on how to incorporate the requirements of appropriation law into the audit scope and related findings. We also recommended that DCAA ensure that contractors are properly segregating costs if required in the contracts. DCAA nonconcurred with the recommendations. However, we continue to believe that DCAA should implement the recommendations.

Conclusion

While our observation of this problem was limited to the Titan IV, we were informed that progress payments for other multifunded contracts within DoD are paid in the same manner, that is, without regard to how the costs were incurred relative to the type of funds. Also, the existence of an operating instruction giving the predetermined sequences indicates that there are other contracts paid in the same manner. By not specifying paying instructions for the Titan IV progress payments, the Air Force has lost control over the expenditure of appropriated funds and has no way of knowing whether the funds paid were for the purposes appropriated.

Although we found no indication that the total funds obligated on the contract had been exceeded, the lack of appropriation control when making progress payments could result in a violation of U.S.C., title 31, sections 1301 and 1341. The data we reviewed indicated that payments of the October through December 1990 progress payment requests resulted in $66.0 million of RDT&E, Other Procurement, and O&M effort paid for with Missile Procurement funds. Also, the extensive adjustments to the appropriation accounts that have to be made over the life of the contract as described in this report and the extensive manual ledgers required to maintain the paying records could lead to an

Appropriation Act violation when the contract is ultimately closed out because of the possibilities of errors and proper funds not being available to make the final adjustments. By having the contractor segregate the progress payment request by appropriation, the likelihood of such errors is greatly reduced, better control over appropriations is maintained, and more reliable information is available to DoD managers in the execution of budgets. Also, Program Managers cannot be assured of the reliability of the contractors' data on appropriated funds if DCAA's audits and reviews, including reconciliation audits of the Contract Funds Status Reports, do not include the reliability of the segregated data.

To comply with the statutory requirement to expend funds only for the purposes appropriated, we believe that contracts containing multiple appropriations must be structured so that the costs incurred are directly associated to appropriation type. Further, audits of contractor systems and documentation must include an assessment of the impact on the type of funds appropriated.

RECOMMENDATIONS FOR CORRECTIVE ACTION

1. We recommend that the Director of Defense Procurement issue policy requiring that multifunded contracts include provisions to segregate progress payment requests by appropriation.

2. We recommend that the Comptroller of the Department of Defense:

a. Review the accounting policies and procedures for all Military Departments and the Defense Finance and Accounting Centers to ensure that adequate oversight and control of expenditures related to progress payments are implemented and maintained and that costs incurred are properly charged to corresponding appropriations, as required by DoD 7220.9-M, "Department of Defense Accounting Manual."

b. Direct disbursing officers not to make progress payments unless the payments are segregated by appropriation.

c. Identify the extent of violations of United States Code, title 31, sections 1301 and 1341, for the Titan IV program and report the violations as required by the United States Code, title 31, section 1351.

3. We recommend that the Commander, Defense Contract Management Command, issue policy and procedures requiring that Administrative Contracting Officers ensure that requests for progress payment categorize the costs incurred by each appropriation on the contract and that the oversight of, and control over, appropriations are established.

4. We recommend that the Program Executive Officer for Space Programs:

a. Direct the Titan IV Procurement Contracting Officer to request that the contractor provide backup to requests for progress payment that categorizes costs incurred by the type of appropriation.

b. If the contractor will not provide the requested backup, direct the Program Manager for the Titan IV to establish a Memorandum of Understanding with the Paying Office and the Contract Administration Office to ensure that expenditures are properly controlled by appropriation.

MANAGEMENT COMMENTS

Comments were received from the Offices of the Director of Defense Procurement; the Director, Defense Logistics Agency; and the Air Force Program Executive Office for Space (Part IV), but comments on Recommendation 2. were not received from the Comptroller of the Department of Defense by March 24, 1992.

The Director of Defense Procurement nonconcurred with Recommendation 1. stating that current policies were sufficient and issuance of guidance would be premature until the Comptroller of the Department of Defense determined that deficiencies existed. The Director, Defense Logistics Agency, and the Program Executive Officer nonconcurred with Recommendations 3. and 4., respectively, stating that implementation of the recommendations was premature until actions by the Offices of the Comptroller of the Department of Defense and the Director of Defense Procurement were taken.

The Director of Defense Procurement and the Director, Defense Logistics Agency, disagreed that the issues presented were material internal control weaknesses.

AUDIT RESPONSE TO MANAGEMENT COMMENTS

The nonconcurrences to our recommendations should be reconsidered. The intent of Recommendations 1. and 3. is to ensure that future contracts funded with multiple appropriations include clauses or requirements to provide appropriation distribution on progress payments. Where it is not practicable for the contractor to provide the information, the recommendations are to ensure that program offices and contracting officers are aware of the requirements and take appropriate actions to provide paying instructions based on program management information. Although the Accounting Manual provides this guidance, we found no policy and guidance to ensure that the Accounting Manual guidance was implemented by contracting and program management offices. Without such policy and guidance, the payments will be made using a predetermined sequence by default. For example, although the Air Force included the requirement to segregate the cost by type of appropriation in the Titan IV contract, there was no guidance to specifically require that the information be used to provide progress payment information.

The fact that the paying office is responsible for controlling expenditures of appropriated funds and that the FAR does not specifically address progress payments for multifunded contracts does not preclude the program management and contract administrative offices from exercising responsibilities for ensuring that appropriations are controlled in accordance with public law. Program management and contract administration offices are in unique positions to assess contract performance information that can be used to provide appropriation distribution data. According to the Accounting Manual, this method of distributing the progress payment is preferred over the predetermined sequence. Establishing the appropriation distribution for paying office use based on information available on the contractor's performance provides better distribution than paying in the predetermined sequence.

We recognize that in all cases it may not be practicable to have the contractor provide the appropriation distribution data or even have program management data that could be used to provide paying instructions. However, to distribute the payments in a predetermined sequence without otherwise attempting to properly distribute the payment is not appropriate, does not provide for effective control over appropriations, and can result in violations of public law.

We believe that the intent of Recommendations 4.a. and 4.b. was misinterpreted. We do not believe that any polices or procedures exist that prevent the Titan IV program manager from getting the Titan IV contractor to provide a supplement to its progress payment (Recommendation 4.a.). We did not intend that consideration be given to the contractor to provide these data. The contractor is contractually required to segregate the information by appropriation type and to provide the Contract Funds Status Report, which additionally requires that the funds be reported by fiscal year and appropriation accounting reference. Therefore, we know of no reason why the contractor cannot provide the information or, for that matter, why an appropriation distribution could not be constructed by the Government from available data. This latter method would, however, potentially delay progress payments. Thus, it is in the contractor's interest to properly segregate cost by appropriation to provide more timely payment. Recommendation 4.b. was intended to provide proper appropriation distribution information to the paying office if the contractor legitimately refused to provide a progress payment supplement without significant disruption to the existing contract. We believe that the Program Manager, in conjunction with the contract administration office, can provide the paying office with a distribution for progress payments based on existing program management information, such as the Contract Funds Status Report. The Memorandum of Understanding would ensure that all parties are aware of the means used to derive the appropriation distribution and what was to be provided to the paying office for use. We have modified Recommendation 4.b. to recognize that if the contractor provide the supplemental information based on existing contract requirements, that Recommendation 4.b. would no longer be necessary.

We continue to believe that the lack of control over the expenditure of appropriated funds when making progress payments is a material internal control weakness, particularily because it resulted in violations of public law. Policy and guidance do not exist to ensure that program management and contracting offices ensure that proper controls over expenditures are exercised when progress payments are made. As a result, the progress payments are not properly classified by appropriation. The weakness is material because action is required by multiple, high level organizations within DoD. In addition, the lack of control results in noncompliance with U.S.C., title 31, sec. 1301, as well as potential noncompliance with U.S.C., title 31, sec. 1341. In the case of the Titan IV, the control over the expenditure of billions of dollars is large enough to warrant reporting the internal control weakness and immediately taking

corrective action. To the extent that similar conditions exist on other multifunded contracts, the significance of the weakness is worsened. Although the finding is a material internal control weakness, we deleted draft report Recommendation 2.c. to report the weakness because the recommendation was redundant in view of other Inspector General, DoD, reporting on material internal control weaknesses. Draft report Recommendation 2.d. was renumbered 2.c.

STATUS OF RECOMMENDATIONS

		Response Should Cover:			
Number	Addressee	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
1.	Director, Defense Procurement	X	X	X	IC
2.	Comptroller, DoD	X	X	X	IC
3.	Commander, Defense Contract Management Command	X	X	X	IC
4.	Program Executive Officer for Space Programs	X	X	X	

*IC = internal control

PART III - ADDITIONAL INFORMATION

APPENDIX A: COMPARISON OF PROGRESS PAYMENTS MADE WITH EXPENDITURES ACCRUED

(dollars in millions)

Appropriation	Progress Payments Made [1]	Expenditures Accrued [2]
	Oct.-Dec. 1990	Oct.-Dec. 1990
3600	$ 0	$ 10.0 (2.5 percent)
3020	272.7 (100.0 percent)	330.9 (83.4 percent)
3080	0	29.3 (7.4 percent)
3400	0	26.7 (6.7 percent)
Total	$272.7 (100.0 percent)	$396.9 (100.0 percent)
	Jan.-Mar. 1991	Jan.-Mar. 1991
3600	$ 47.2 (19.2 percent)	$ 96.0 (30.7 percent)
3020	198.2 (80.8 percent)	166.4 (53.3 percent)
3080	0	17.3 (5.6 percent)
3400	0	32.5 (10.4 percent)
Total	$245.4 (100.0 percent)	$312.2 (100.0 percent)
	Apr.-Jun. 1991	Apr.-Jun. 1991
3600	$69.8 (25.8 percent)	$133.3 (32.7 percent)
3020	200.6 (74.2 percent)	200.6 (49.2 percent)
3080	0	21.6 (5.3 percent)
3400	0	52.1 (12.8 percent)
Total	$270.4 (100.0 percent)	$407.6 (100.0 percent)
	Jul.-Sep. 1991	Jul.-Sep. 1991
3600	$ 51.6 (18.7 percent)	$143.0 (36.1 percent)
3020	195.9 (71.1 percent)	146.7 (37.0 percent)
3080	0	68.7 (17.3 percent)
3400	28.0 (10.2 percent)	38.2 (9.6 percent)
Total	$275.5 (100.0 percent)	$396.6 (100.0 percent)

APPENDIX A: COMPARISON OF PROGRESS PAYMENTS MADE WITH EXPENDITURES ACCRUED (cont'd)

(dollars in millions)

1/ Progress Payments made for cost incurred through:

October 28, 1990	$ 84.66
November 25, 1990	101.50
December 31, 1990	86.51
Total	$272.67
January 27, 1991	$ 76.15
February 24, 1991	85.02
March 31, 1991	84.21
Total	$245.38
April 28, 1991	$ 86.80
May 26, 1991	103.47
June 30, 1991	80.16
Total	$270.43
July 28, 1991	$ 66.73
August 25, 1991	92.06
September 29, 1991	116.75
Total	$275.54

2/ Expenditures accrued are calculated from the Contract Funds Status Report provided quarterly by the contractor.

APPENDIX B: SUMMARY OF POTENTIAL BENEFITS RESULTING FROM AUDIT

Recommendation Reference	Description of Benefit	Type of Benefit
1., 2.	Compliance with Public Law and Internal Controls. Reviewing and modifying as required the policies and procedures to ensure that payments made to contractors through progress payments are controlled in compliance with Public Law.	Nonmonetary.
3.	Compliance with Public Law and Internal Controls. Providing guidance to offices that review and approve progress payments will improve controls over appropriated funds.	Nonmonetary.
4.	Compliance with Public Law and Internal Controls. Obtaining instructions for which appropriations to credit for progress payments will provide control over future Titan IV expenditures.	Nonmonetary.

APPENDIX C: ACTIVITIES VISITED OR CONTACTED

Office of the Secretary of Defense

Office of the Comptroller of the Department of Defense, Washington, DC
Office of the Director of Defense Procurement, Washington, DC

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller), Washington, DC
Air Force Program Executive Office, Space Programs, Washington, DC
Titan Systems Program Office, Space Systems Division, Los Angeles, CA

Defense Agencies

Defense Contract Audit Agency, Martin Marietta Astronautics Group, Denver, CO
Defense Contract Management Operations Office, Kirtland AFB, NM
Defense Plant Representative Office, Martin Marietta Astronautics Group, Denver, CO

Non-Government Activity

Martin Marietta Astronautics Group, Denver, CO

APPENDIX D: REPORT DISTRIBUTION

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition
Comptroller of the Department of Defense
Assistant Secretary of Defense (Production and Logistics)
General Counsel

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Acquisition)
Assistant Secretary of the Air Force (Financial Management and Comptroller)
General Counsel, Air Force
Commander, Air Force Systems Command
Commander, Space Systems Division
Program Executive Office, Space Programs
Titan IV System Program Office

Other Government Agencies

Director, Defense Logistics Agency
Director, Defense Contract Audit Agency
Commander, Defense Contract Management Command

Non-DoD

Office of Management and Budget
U.S. General Accounting Office, NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Ranking Minority Member, Senate Committee on Armed Services
House Committee on Appropriations
House Subcommittee on Defense, Committee on Appropriations
Ranking Minority Member, House Committee on Appropriations
House Committee on Armed Forces
House Committee on Government Operations
House Subcommittee on Legislation and National Security, Committee on Government Operations

PART IV - MANAGEMENT COMMENTS

Director of Defense Procurement

Defense Logistics Agency

Program Executive Office for Space, U.S. Air Force

Comments from the Director of Defense Procurement

OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON, DC 20301-3000

MAR 0 3 1992

ACQUISITION
DP/CPF

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report on the Titan IV Program
(Project No. 1AE-5006.05)

This is in response to the memorandum of December 30, 1991, from the Director, Acquisition Management Directorate, Inspector General, Department of Defense, which requested our comments on the subject draft audit report. Our detailed responses to the report findings and recommendations are attached.

The subject report contains a single finding that addresses the use of appropriated funds in the administration and payment of progress payments on the Air Force Titan IV contract. That contract is a fixed-price-incentive (FPI) contract for development, production, and launch services for the Titan IV launch vehicle. It is funded with at least four different appropriations. The subject report asserts that, since progress payments were not paid from appropriations that reflected the type of work done, there was a violation of section 1301 (and potentially section 1341) of title 31 of the United States Code (U.S.C.). These sections require that monies be spent for the purpose for which they were appropriated by Congress. The report concludes with a series of four recommendations which arise from the central assertion that contracts with multiple sources of funds must be structured to require segregation of costs reported on progress payment requests by type of appropriation.

We believe current accounting policy already addresses the need for progress payment requests to identify, to the extent practicable, the appropriations against which payment is requested. Consequently, we do not agree with the recommendation that new policy guidance is needed in this area. We would, however, welcome a review of existing policies by the DoD Comptroller in this area to ensure there are no systemic deficiencies resulting in violation of statutes. We believe further action by the Director, Defense Procurement should await the outcome of that review.

Thank you for the opportunity to comment on the subject draft report.

Eleanor Spector

Eleanor R. Spector
Director, Defense Procurement

Attachment

IG DRAFT REPORT - AUDIT REPORT ON THE TITAN IV PROGRAM
DATED DECEMBER 30, 1991 (PROJECT NO. 1AE-5006.05)

DDP RESPONSE TO THE DRAFT REPORT

FINDING: Progress payments for the Titan IV contract were made from a predetermined sequence of appropriations, rather than from the appropriations that reflected the type of work done. As a result, the Air Force did not have adequate internal controls over appropriated funds. Also, U.S.C., title 31, section 1301, and potentially U.S.C., title 31, section 1341, which govern use of appropriated funds, were violated.

DDP RESPONSE: We agree that progress payments on the Titan IV contract were made from a predetermined sequence of appropriations. We do not agree that this necessarily reflects an internal control weakness, as characterized by the subject report. The Department of Defense Accounting Manual (DoD 7220.9-M) allows the use of this technique when it is impractical to obtain a contractor distribution to the various accounting classifications in the contract. As noted in the subject report, the Titan IV contract contains 212 subsidiary contract line items. To make payment in the manner envisioned by the subject report, progress payment requests would require a break down by appropriation for each affected subsidiary contract line item. This may well have been deemed impracticable at time of contract issuance. We defer to the judgment of the DoD Comptroller as to whether or not progress payments made on the Titan IV contract violate accounting policies designed to prevent the improper disbursement of appropriations.

RECOMMENDATION 1. We recommend that the Director of Defense Procurement issue policy requiring that multifunded contracts include provisions to segregate progress payment requests by appropriation.

DDP RESPONSE: Nonconcur. We believe it would be premature to issue the recommended guidance at this time. Even if deficiencies exist in the way progress payments are made on the Titan IV contract, we do not know that similar deficiencies have occurred on other DoD contracts with multiple accounting citations.

The Department of Defense Accounting Manual (DoD 7220.9-M) contains guidance that addresses the concerns of the subject report. It indicates a preference for identification of the appropriation against which a progress payment is being requested. Use of a

predetermined sequence of appropriations is relied upon when it is impractical to obtain either a contractor-provided distribution to the various accounting classifications in the contract, or a distribution provided by the program manager, based on knowledge of contractor performance or historical spending patterns.

The Titan IV contract contains 212 subsidiary contract line items to accommodate the various sources of funds for the contract effort. Consequently, if a predetermined sequence were not utilized, it would be necessary to obtain not just a simple segregation by appropriation type for the contract as a whole, but rather, a breakout of costs by appropriation type and by subcontract line item, in order to make payments.

Moreover, contracts do not routinely require the kind of cost segregation called for in the subject report. Contract Funds Status Reports (CFSRs) are not ordinarily obtained on firm-fixed price contracts, including those with multiple fund citations. CFSRs are obtained on incentive and cost-type contracts in order to anticipate funding actions required as a result of overruns or underruns. We object to any requirement that CFSRs be obtained purely for management of progress payments.

It is neither feasible nor desirable to mandate that segregation of costs by appropriation be required on every contract containing multiple fund cites. Sometimes contract line items with multiple sources of funds are established because it is not possible to segregate the effort by type of appropriation. An example of this might be a multiple source funded service or development effort under which costs are prorated. Segregation would not only be unnecessary, but would be administratively burdensome and would generate an increase in costs that would ultimately be passed on to the Department of Defense.

We believe that the payment practices set forth in the Military Standard Contract Administration Procedures (MOCAS) address the need to ensure that appropriations cited as financing the contracts are not overdisbursed. It is our understanding that, prior to the creation of the Defense Contract Management Command, contracts administered by the individual Services were not usually administered using the MOCAS. However, with the advent of the Defense Contract Management Command, and the creation of the Defense Finance and Accounting Service, MOCAS will be used to administer the payment process for the vast majority of DoD contracts.

RECOMMENDATION 2: We recommend that the Comptroller of the Department of Defense:

a. Review the accounting policies and procedures for all Military Departments and the Defense Finance and Accounting Centers to ensure that adequate oversight and control of expenditures related to progress payments are implemented and maintained and that costs incurred are properly charged to corresponding appropriations, as required by DoD 7220.9M, "Department of Defense Accounting Manual."

DDP RESPONSE: Concur. We have no objection to the DoD Comptroller taking action to ensure compliance with existing accounting policy, including proper oversight of expenditures related to progress payments.

As we stated above, we believe that issuance of new procurement policy by the Director of Defense Procurement is unnecessary, or at least premature, pending the outcome of compliance reviews indicating the existence of a systemic problem requiring action by the DDP.

b. Direct disbursing officers not to make progress payments unless the payments are segregated by appropriation.

DDP RESPONSE: Nonconcur. Progress payments must be made in accordance with the terms of the contracts in question. However, we do agree that disbursing officers must ensure that payments do not result in overdisbursements of appropriations.

c. Report and track the material internal control weakness identified in this report, as required by DoD Directive 5010.38.

DDP RESPONSE: Nonconcur. We do not believe that the subject report establishes that a systemic material control weakness exists.

d. Identify the extent of violations of United States Code, title 31, sections 1301 and 1341, for the Titan IV program and report the violations as required by the United States Code, title 31, section 1351.

DDP RESPONSE: Concur. We agree that the laws and regulations cited must be complied with, but we defer to the review of the Comptroller as to whether violations occurred on the Titan IV contract.

RECOMMENDATION 3: We recommend that the Commander, Defense Contract Management Command, issue policy and procedures requiring that Administrative Contracting Officers ensure that requests for progress payments categorize the costs incurred by each appropriation on the

contract and that the oversight of, and control over, appropriations are established.

DDP RESPONSE: Nonconcur. The ability of the Defense Contract Management Command to comply with this recommendation is premised upon DDP implementation of RECOMMENDATION 1. Since we nonconcur with RECOMMENDATION 1, compliance with this recommendation is a moot point.

RECOMMENDATION 4: We recommend that the Program Executive Officer for Space Programs:

a. Direct the Titan IV Procuring Contracting Officer to request that the contractor provide backup to requests for progress payments that categorizes costs incurred by the type of appropriation.

b. Direct the Program Manager for the Titan IV to establish a Memorandum of Understanding with the Paying Office and the Contract Administration Office to ensure that expenditures are properly controlled by appropriation.

DDP RESPONSE: Nonconcur. Compliance with this recommendation is premised upon the agreement of the DoD Comptroller that the Titan IV contract is in fact in violation of the statutes cited in the subject report. If so, we agree that necessary steps must be taken to ensure that statutes are not violated, and we await the comments of the Comptroller as to what, if any, steps are necessary.

Finally, as a general comment, we do not consider a Memorandum of Understanding (MOU) to be an appropriate vehicle to ensure compliance with contractual terms and conditions that are otherwise valid and enforceable.

Comments from Director of Defense Logistics Agency

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DLA-CI

28 FEB 1992

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Titan IV Program, Project No. 1AE-5006.05, 30 Dec 91

This is in response to your 30 Dec 91 memorandum requesting our comments pertaining to the draft audit report of Titan IV Program (Project No. 1AE-5006.05). The attached position has been approved by Ms. Helen T. McCoy, Deputy Comptroller, Defense Logistics Agency.

1 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Division
Defense Logistics Agency

TYPE OF REPORT: AUDIT DATE OF POSITION: 27 Feb 92

PURPOSE OF POSITION: INITIAL POSITION

AUDIT TITLE & NO.: Titan IV Program (Project No. 1AE-5006.05)

RECOMMENDATION 3: We recommend that the Commander, Defense Contract Management Command, issue policy and procedures requiring that Administrative Contracting Officers ensure that requests for progress payment categorize the costs incurred by each appropriation on the contract and that the oversight of, and control over, appropriations are established.

DLA COMMENTS: Nonconcur. The current Federal Acquisition Regulation (FAR) does not require contractors to accumulate and bill costs at the appropriation level. Additionally, the DCMC does not determine which appropriations are charged for an expenditure. Expenditures are the responsibility of the Defense Finance and Accounting Service (DFAS). In the absence of a valid contractual requirement to collect and bill by appropriation, the DCMC cannot unilaterally implement this policy.

In order for this policy to be implemented, the FAR must be modified to dictate that DoD contracts include requirements for contractors to collect costs, and bill progress payments, by appropriation. Furthermore, contractor accounting system standards would need to be modified to require that systems support billing at the appropriation level. If these regulatory changes were made, then the DCMC would issue policy to ensure that the required data was being collected (via the Defense Contract Audit Agency) and reflected on the payment request. The DFAS would make the actual appropriation debits.

It is important to note that in the specific example of the Titan IV, the contract requires collection and reporting of costs by appropriation "type", e.g. research and development versus production. There is no requirement to track costs to a "specific" appropriation. In order to collect costs by "appropriation", the contractor would be required to collect data, and maintain records, trackable to each and every fund cite identified on a contract funding document.

The literal interpretation of the report recommendations are not only inordinately expensive for the Government and the contractor, they serve no useful purpose. The vast majority of DoD contracts are firm-fixed -price type, under which the contractor will be entitled to all of the funds obligated, upon successful completion of the effort.

DISPOSITION:
( ) Action is Ongoing. Estimated Completion Date:
(X) Action is considered complete.

INTERNAL MANAGEMENT CONTROL WEAKNESSES
(X) Nonconcur (Rationale must be documented and maintained with your copy of the response)
( ) Concur; however, weakness is not considered material (Rationale must be documented and maintained with your copy of the response)
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Stephen J. Herlihy, DCMC-ACA, 47726
PSE REVIEW/APPROVAL: W. V. Gordon, Executive Director, DCMC-A, 2/25/92

DLA APPROVAL: Helen T. McCoy, Deputy Comptroller

Comment from the Program Executive Office for Space, U.S. Air Force

DEPARTMENT OF THE AIR FORCE
AIR FORCE PROGRAM EXECUTIVE OFFICE
WASHINGTON, DC 20330 1000

MAR 3 1992

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: Draft Audit Report, Titan IV Program
Project No. 1AE5006.05 - INFORMATION MEMORANDUM

This memorandum responds to your 30 December 1991 memorandum from the Director, Acquisition Management Directorate, Inspector General, Department of Defense which requested our comments on the subject report.

We believe the recommendations for the Air Force Program Executive Officer for Space Programs contained in the **RECOMMENDATIONS FOR CORRECTIVE ACTIONS** Item 4a. and b., page 22, are premature. Our direction to the field must be based on Air Force policy which is in turn based on the policies of the Director for Defense Procurement and the Comptroller of the Department of Defense.

Until appropriate policy adjustments are made as a result of DOD's assessment of Recommendations 1 and 2, page 20 and 21, it would be inappropriate for the Air Force to take unilateral action.

GARRY A. SCHNELZER, Brig Gen, USAF
Program Executive Officer for Space

This is an important area and I will be responsive. However, OSD and Air Force direction is needed.

AUDIT TEAM MEMBERS

Donald E. Reed, Director, Acquisition Management Directorate
Russell A. Rau, Program Director
Patricia A. Brannin, Project Manager
Jack Snider, Team Leader
Richard L. Collier, Auditor
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Kimberly Willis, Editor
Denise J. Elmendorf, Secretary