



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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INTERNATIONAL DIVISION

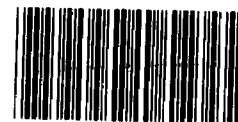
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RELEASED

January 21, 1983

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives



120641

Subject: Defense Department Subcontract-Level
Reporting System (GAO/ID-83-30)

Dear Mr. Chairman:

In your January 10, 1983, letter to the Comptroller General, you requested information on Defense Department attempts to obtain foreign-source procurement data at the subcontract level and a status report on Defense's implementation of a subcontract-level reporting system. You also asked for our views on Defense's efforts to establish such a reporting system. This letter responds to your request.

The Defense Department is in the process of implementing a reporting system to identify foreign-source procurement at the subcontract level. A quarterly reporting requirement has been established for certain Defense contractors, and some of them have begun to provide information on their foreign subcontracts. It will be at least 6 months, however, before Defense has received a full year's data from those required to report. At this time, it is questionable whether the system as planned and implemented will receive sufficient data to fully disclose foreign-source procurement at the subcontract level.

HISTORY AND STATUS OF
REPORTING SYSTEM

Prior to December 29, 1973, the Defense Department kept records on the dollar value of prime contractor and subcontractor production for the top 700 firms it did business with. The information was published yearly and apparently was helpful in tracking a significant portion of Defense expenditures to the States and countries that benefitted. Defense abandoned the practice in December 1973, believing it no longer necessary to develop the information on subcontractor awards. It did, however, continue to record an array of data relating to prime contractor awards.

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Congressional concern regarding the void of statistical and geographical information below the prime contract level was manifest in the Department of Defense Appropriations Act, 1978, enacted September 21, 1977. Section 836 of the Act directed the Secretary of Defense to:

- (1) Require prime contractors receiving Defense awards of \$500,000 or more to file a yearly report with the Secretary showing the dollar value of Defense work each such contractor had performed by subcontractors during the year and to identify the State or States in which each subcontractor performed the work subcontracted to it.
- (2) Submit an annual report to the Congress showing on a State-by-State basis the total amount of Defense funds paid to subcontractors during the year for which the report was submitted by the prime contractors.

Defense established a reporting requirement to implement Section 836 in September 1978. Defense Acquisition Regulations were changed to require the following clause in new contracts expected to exceed \$500,000 or contract modifications which increased the amount of a contract to \$500,000 or more.

GEOGRAPHIC DISTRIBUTION OF DEFENSE SUBCONTRACT DOLLARS (1978 SEP)

[a] For each subcontract or modification thereof exceeding \$10,000, the contractor agrees to prepare and submit the report on DOD subcontracts in accordance with DD Form 2139.

[b] Negative reports will be submitted annually to the addressee contained on the DD Form 2139, when applicable. Negative reports will be submitted not later than October 31 for the 12-month period ending September 30 of each year. Negative reporting will be continued until the contract or subcontract has been completed and the addressee contained in DD Form 2139 notified of its completion.

(c) The Contractor further agrees to insert the provisions of paragraphs (a) and (b) above in each subcontract in excess of \$100,000 except subcontracts for ores, natural gas, utilities, petroleum products and crudes, timber (logs), and subsistence.

(End of clause)

The Department of Defense Appropriations Act, 1979, enacted October 13, 1978, deleted the requirement to collect and report to the Congress on the distribution of Defense subcontract work. Defense had requested deletion of section 836 on the premise that it was too costly for the prime contractor and the Government to collect, process, evaluate, and disseminate subcontractor information.

Despite deletion of the legislative requirement, Defense officials prepared a preliminary report using the geographic subcontract data supplied by prime contractors and first-tier subcontractors for fiscal year 1979. There was, however, little confidence in the validity of the data due to estimates which indicated less than 50-percent compliance with the reporting requirement.

Defense, for reasons not clear considering its contention that collecting the data was too costly, continued to require the subcontract information from contractors until the requirement was formally cancelled on September 30, 1981.

Cancellation of the reporting requirement had an unintended side effect which Defense officials quickly recognized. It greatly impaired Defense's ability to monitor the value of subcontracts placed overseas. The need for this information was clear to Defense officials and others, including many congressional members, concerned with the growing amount of Defense trade between the United States and its allies. The Defense Acquisition Regulations (DAR) Council, on December 17, 1981, approved continued reporting of subcontracts placed with foreign vendors.

Defense officials then turned their attention toward fully implementing a new subcontract-level reporting system, geared exclusively to identifying foreign subcontract awards. In April 1982, Defense received Office of Management and Budget approval for the revised reporting system. And, in late June, it established a reporting requirement for all prime contractors awarded contracts or contract modifications exceeding \$500,000 for other than commercial items¹ or identified exceptions² (DAR 1-340, 7-104.78). First-tier subcontractors awarded subcontracts in excess of \$100,000 were also to be made subject to the reporting requirement by the prime contractor.

¹Defined as "an item, including both supplies and services, of a class or kind which is used regularly for other than government purposes, and is sold or traded in the course of conducting normal business operations."

²Exceptions are contracts for ores, natural gas, utilities, petroleum products and crudes, timber (logs), and subsistence.

Those required to report to Defense must identify each subcontract or modification which exceeds \$10,000 where the principal place of performance is outside the United States or its territories and possessions. The contractor is required to identify, among other things, the (1) type of supply or service provided, (2) principal place of subcontract performance, and (3) dollar value of the transaction. New or updated information is to be reported quarterly to Defense.

Only those contractors receiving new awards or modifications are subject to the reporting requirement. It will therefore be about 6 months before Defense has received data for a representative period (1 year) from the targeted group of contractors.

Another factor complicating full implementation of the reporting system is that Defense has only recently approved a standardized form for collecting the data. Since July, when the reporting requirement went into effect, contractors have been reporting in a non-standardized way, thus making it difficult to store, aggregate, or manipulate the data for statistical purposes. We were told that the new form (DD Form 2139--see copy in enc. I) has been sent to the military departments for distribution to the contractors.

OBSERVATIONS ON REPORTING SYSTEM

From our limited examination of plans, regulations, and procedures for implementing Defense's new subcontract-level reporting system, we have reservations whether the system as planned and presently implemented will provide the information necessary to fully (1) monitor arms cooperation agreements with friendly governments or (2) identify foreign source procurement at the subcontract level. Defense's new reporting system is designed simply to identify the value and type of defense subcontracts placed overseas. Such subcontracts will be recorded in their entirety as foreign procurement and subcontracts placed domestically will be considered totally of U.S. origin. Moreover, the new system will not be able to answer the question of how much materials and services foreign vendors provide to defense subcontractors each year.

While some may argue that it is precisely this question that Defense should be addressing, we, quite frankly, are unsure whether such information is readily available or whether it could be developed at reasonable cost. However, based on prior

indications of strong congressional interest in reliable data in this area, we developed the following observations on Defense's planned system.

We believe that the planned reporting system contains a number of definitional and procedural weaknesses which will affect the quality of information developed. By excluding prime contractors and first-tier subcontractors receiving major contracts for commercial items from reporting requirements, Defense discarded an area where foreign source procurement is known to be significant and growing. Under Defense's criteria, for example, an automobile manufacturer receiving a major contract from Defense for civilian automobiles, buses, or trucks would not have to report its subcontracts with foreign vendors. The broad definition of a "commercial item" contained in Defense Acquisition Regulations also creates a loophole through which otherwise reluctant contractors can avoid reporting.

Another problem with Defense's reporting criteria is that no attempt is made to net out the value of domestic goods and services included in subcontracts with foreign vendors. Contractors are simply asked to report the dollar value of foreign subcontracts. This obviously results in an overstatement of foreign procurement. A related but potentially more important issue, however, is that the reporting system does not attempt to capture any information on foreign source procurement in those subcontracts below the first tier having a place of performance within the United States. This omission may result in a significant understatement of foreign procurement.

Establishing procedural controls to assure contractor compliance with the reporting requirement is another potential weakness. Considering the less than 50 percent response rate Defense experienced when it last tried to collect subcontract-level information and the adverse effect this had on the ability to publish usable data, it is surprising to find that the new system has a lesser degree of control than the old system. The old system required negative reports from the contractor. The new system does not. Negative reporting is generally conceded to be a useful tool in improving reporting compliance and the quality of analysis that can be carried out with the data. In this case, when the universe of those with positive data to report is unknown, negative reporting would help to better distinguish a good response rate from a low one and to better identify the universe of firms with foreign procurement.

Negative reporting alone, of course, is no panacea for assuring compliance. Overcoming general resistance to any new reporting requirement requires a strong demonstration of the need

for the data, periodic reinforcement of this need, and an organized program of followup by those units responsible for monitoring contract performance. No such effort was made to improve compliance under the old subcontract-level reporting requirement. And, there is little evidence to suggest that Defense plans anything different this time around. The result may well be exactly what happened last time--a failure to provide usable data on subcontract-level procurement.

We performed our review generally in accordance with our "Standards for Audit of Government Organizations, Programs, Activities and Functions." Our review included discussions with Defense officials responsible for planning and implementing the subcontract-level reporting system. We researched legislation, studies, and Defense Acquisition Regulations and procedures to identify past reporting requirements. We also examined internal correspondence, planning and decision documents, and current reporting procedures related to implementation of the revised subcontract-level reporting system. Your urgent need for the information did not permit us to obtain official Defense comments on this letter.

As arranged with your office, we plan no further distribution of this report until 30 days from the date it is issued. At that time, we will send copies to interested parties and make copies available to others upon request.

Sincerely yours,


Frank C. Conahan
Director

Enclosure

SECTION I	1. PRIME CONTRACT NUMBER	7a. NAME OF PRIME CONTRACTOR	b. DIVISION	FIRM APPROVAL UMS NO. 0704-0082
	3. ADDRESS (Include ZIP Code)			FOR OOD USE ONLY
II. 1ST-TIER SUBCONTRACT	4. SUBCONTRACT NUMBER	8a. NAME OF SUBCONTRACTOR	b. DIVISION	A.
	5. ADDRESS (Include ZIP Code)		7. OFFSET PROGRAM	C.
	8. SUBCONTRACT AMOUNT (Dollars)	9. PRINCIPAL PLACE OF PERFORMANCE		E.
	a. PRIOR _____ b. THIS ACTION _____ c. NEW TOTAL \$ _____	10. SUPPLIES OR SERVICE PURCHASED		F.
III. 2D-TIER SUBCONTRACT	11. SUBCONTRACT NUMBER	12a. NAME OF SUBCONTRACTOR	b. DIVISION	J.
	13. ADDRESS (Include ZIP Code)		14. OFFSET PROGRAM	K.
	15. SUBCONTRACT AMOUNT (Dollars)	16. PRINCIPAL PLACE OF PERFORMANCE		L.
	a. PRIOR _____ b. THIS ACTION _____ c. NEW TOTAL _____	17. SUPPLIES OR SERVICE PURCHASED		
18. NAME OF COMPANY SUBMITTING REPORT	19a. NAME OF SUBMITTER (Last, First, MI)	b. SIGNATURE	20. DATE (YYMMDD)	
		a. TELEPHONE NUMBER		

DD FORM 2139 22 JUN 66 FEB EDITION IS OBSOLETE

SUBCONTRACT REPORT OF FOREIGN PURCHASES

INSTRUCTIONS - GENERAL AND SPECIFIC

A. This report form is for use by DoD prime contractors and their first-tier subcontractors participating in the DoD subcontracting reporting program.

B. DoD prime contractors will complete and submit Sections I and II of the form.

C. First-tier subcontractors in receipt of subcontracts from the prime contractor which exceed \$100,000 will complete: Items 1, 2 and 3 of Section I; Items 5, 8, and 9 of Section II; and all items of Section III as well as items 18-20 for each subcontract (as defined in Para D below) placed by them which is estimated will exceed \$10,000 and for each action (modification) in excess of \$10,000 on such subcontract.

D. The term subcontract as used herein means any procurement including purchase orders in excess of \$10,000 written by the prime contractor or the first-tier subcontractor necessary in the performance of this contract and for any action (modification) in excess of \$10,000 on such procurements.

E. DoD prime contractors will provide the number of the DoD prime contract to their first-tier subcontractors for entry on the reports.

F. The report is to be submitted within 5 working days after placement of the subcontract or on a quarterly basis to:

Director for Information Operations
and Report
Washington Headquarters Services
Department of Defense
Washington, D.C. 20301

G. Prime contractors will obtain a supply of the forms from their DoD Contract Officer. Subcontractors will obtain the forms from the prime contractor.

Item 1 - Enter the DoD prime contract number. If the material and services being procured cannot be identified to a single prime contract, enter the contract number which would account for the majority of the costs. If that is not possible, enter the letters "NSI" (Not Separately Identifiable). This must be kept to a minimum.

Item 2 - Enter name, and division if applicable, of the prime contractor.

Item 3 - Enter address (City, State and zip code only, or Country if foreign sources) of the prime contractor.

Item 4 - Enter subcontract number.

Item 5 - Enter name, and division if applicable, of the subcontractor.

Item 6 - Enter address (City, Country and zip code) of the subcontractor.

Item 7 - If the subcontract is part of an offset or coproduction program identify the weapon system by name against which this subcontract will apply.

Item 8 - Enter the dollar amount of the subcontract commitment or modification thereto, rounded to the nearest dollar. Modifications resulting in decommitments are to be enclosed in parentheses to indicate that they are negative or subtractions. On line 8a, enter the cumulative amount of the subcontract prior to the action being reported. If the reported action is a new subcontract, enter the word "New." On line 8b, enter the amount of the action being reported. On line 8c, enter the new cumulative amount (total of lines 8a and 8b).

Item 9 - Enter the location (City and Country) of the principal plant or place of business where the items will be produced, or supplied from stock, or where the work will be performed.

Item 10 - Supplies or Service Purchased. Enter brief description of the work being furnished including weapon or subsystem identification number. For example: (Vertical stabilizer F-15; Bomb Nav System FB-111).

Item 11 thru 17 - See Items 4 thru 10.

Item 18 - Enter the name of the company submitting the report. This should be the name of the prime contractor for reports on first-tier subcontracts; it should be the name of the first-tier subcontractor for reports on second-tier subcontracts.

Item 19a - Enter name of company individual submitting the report.

Item 19b - Enter signature of individual submitting report.

Item 19c - Phone number of individual signing report.

Item 20 - Enter date of signature.