

GAO

Report to the Chairman, Subcommittee
on Military Procurement, Committee on
National Security, House of
Representatives

November 1998

DEFENSE TRADE

Weaknesses Exist in DOD Foreign Subcontract Data





**United States
General Accounting Office
Washington, D.C. 20548**

**National Security and
International Affairs Division**

B-279237

November 13, 1998

The Honorable Duncan Hunter
Chairman, Subcommittee on Military Procurement
Committee on National Security
House of Representatives

Dear Mr. Chairman:

The Department of Defense (DOD) uses contracting data in part to make decisions on matters relating to defense procurement and defense industrial base issues. To ensure that DOD has sufficient contract data available, Congress enacted legislation in fiscal year 1993 requiring advance notification of contract performance outside the United States. Since 1982, DOD has required prime contractors and first-tier subcontractors to report subcontracts placed overseas that meet certain thresholds. In response to your concern about trends in foreign sourcing and whether contractors are reporting their foreign subcontracts, we examined DOD's foreign procurement data.¹ Specifically, we reviewed DOD's reported trends on contracts performed outside the United States. We also evaluated DOD's use of foreign subcontract information and the completeness and accuracy of how DOD collects and manages its data. Details on our scope and methodology are provided in appendix I.

Results in Brief

For prime contracts, DOD purchases the majority of its defense equipment and services from contractors operating in the United States. Though subject to annual fluctuations, DOD's prime contract awards outside the United States remained about 5.5 percent of total DOD contract awards from fiscal year 1987 to 1997. Over this period, the value of DOD prime contracts performed both in and out of the United States declined. Prime contracts performed outside the United States tended to be concentrated in certain countries such as Germany, Italy, Japan, South Korea, and the United Kingdom and in certain sectors such as services, fuel, and construction. At the subcontract level, the value of DOD's reported foreign subcontract awards ranged from almost \$2 billion in fiscal year 1990 to almost \$1.1 billion in fiscal year 1997, but this data has its limitations.²

¹For report purposes, we defined foreign subcontracts as contracts for materials manufactured or services performed outside the United States in support of DOD contracts.

²The value of DOD's foreign subcontract awards is calculated using the Office of Foreign Contracting's DD 2139 database on foreign subcontracts.

The Office of Foreign Contracting does not consider the data needs of industrial base specialists in its efforts to collect foreign subcontract data. Industrial base specialists are often unaware that data of this nature are available. Furthermore, weaknesses in the Office of Foreign Contracting's data collection and management processes undermine DOD's ability to use the foreign subcontract data for defense trade and industrial base decision-making. The Office has no mechanism for ensuring that contractors provide required foreign subcontract information, which contributes to the underrepresentation of foreign subcontract activity. Our review of selected subcontracts disclosed instances in which foreign subcontracts were not reported to the Office because contractors were unaware of the reporting requirement or misunderstood the criteria for reporting a foreign subcontract. The Office's poor database management also compromises the credibility and usefulness of its foreign subcontract data.

Background

DOD collects information on the extent of foreign participation in its contracts to assess matters related to defense trade balances and domestic industrial base capabilities. Toward this end, DOD uses different sources of information. For defense trade information, DOD has one database for prime contract awards (DD 350 Individual Contracting Action Report) and a second database for foreign subcontract awards (DD 2139 Report of Contract Performance Outside the United States). For industrial base information, DOD periodically conducts studies of specific industry sectors using industrial base questionnaires. These studies sometimes address the level of foreign participation in a particular industry sector.

The United States currently conducts defense trade with 21 countries under the terms of reciprocal defense procurement memoranda of understanding (MOU).³ These agreements were designed in the late 1970s to promote rationalization, standardization, and interoperability of defense equipment within the North Atlantic Treaty Organization (NATO).⁴ Consistent with relevant laws and regulations, these MOUs seek to eliminate the application of nations' buy-national laws and tariffs relating to defense procurements. DOD's Office of Defense Procurement (Foreign Contracting) monitors the level of two-way defense procurement activity under MOUs by preparing summaries on the annual defense trade

³The 21 countries are Australia, Austria, Belgium, Canada, Denmark, Egypt, Finland, France, Germany, Greece, Israel, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, and the United Kingdom.

⁴The United States also has some reciprocal procurement MOUs with countries outside NATO.

procurement balances between the United States and the 21 countries. The Office uses these summaries internally and exchanges the data with MOU countries that give the United States their defense procurement statistics. DOD has exchanged data with six MOU countries: Finland, Germany, Israel, Norway, Spain, and the United Kingdom. DOD does not compare the other countries' defense trade information with its own because it does not know how the other countries define and collect their defense trade information.⁵

As part of its efforts to monitor foreign procurements, DOD established in 1982 a reporting requirement to identify certain subcontracts performed outside the United States. In the fiscal year 1993 defense authorization legislation, Congress required any firm performing a DOD contract exceeding \$10 million, or submitting a bid or proposal for such a contract, to notify DOD in advance if (1) the firm or any of its first-tier subcontractors intends to perform work exceeding \$500,000 on that contract outside the United States and Canada and (2) such work could be performed inside the United States or Canada.⁶ This information must be made available for preparing required national defense technology and industrial base assessments.⁷ DOD regulations also require prime contractors to submit notification of contracts exceeding \$500,000 when any part of the contract that exceeds \$25,000 will be performed outside the United States, unless a foreign place of performance (1) is the principal place of performance and (2) is in the firm's offer.⁸ Contracts for commercial items or identified exceptions need not be reported.⁹ First-tier subcontractors awarded subcontracts in excess of \$100,000 are also subject to the reporting requirement.

Prime contractors and first-tier subcontractors are required on a quarterly basis to submit information such as the type of supply or service provided, the principal place of subcontract performance, and the dollar value of the

⁵In June 1998, DOD initiated a dialogue with the other MOU signatories to improve the quality of defense procurement data by developing a joint approach for gathering and analyzing the data. According to a DOD official, this initiative may be a long-term effort.

⁶The National Defense Authorization Act for Fiscal Year 1993 (sec. 840 of P.L. 102-484, 10 U.S.C. 2410g) required advance notification of contract performance outside the United States and Canada.

⁷Periodic national technology and industrial base assessments are required by 10 U.S.C. sec. 2505.

⁸DOD raised the required threshold to \$100,000 in the Defense Federal Acquisition Regulation Supplement effective March 1998.

⁹Exceptions are contracts for military construction, ores, natural gas, utilities, petroleum products and crudes, timber, and subsistence.

transaction.¹⁰ The regulation states that reports should be submitted to the Office of Foreign Contracting on the standard form DD 2139 (Report of Contract Performance Outside the United States) or in computer-generated reports. The Office enters the information into its DD 2139 database on foreign subcontracting.

DOD Prime and Subcontract Awards Performed Outside the United States

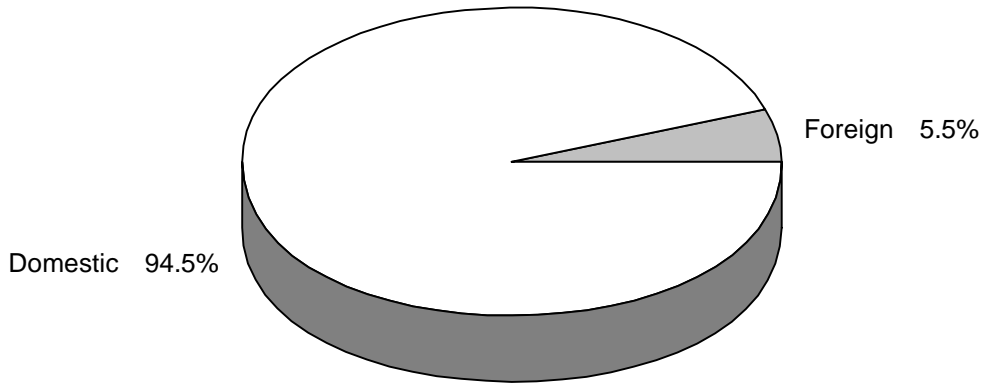
Although DOD purchases the majority of its defense equipment and services from contractors performing in the United States, it does purchase some from firms performing outside the United States.¹¹ While subject to annual fluctuations, the value of DOD's prime contract awards performed outside the United States remained about 5.5 percent of total DOD procurement awards from fiscal year 1987 to 1997 (see fig. 1).¹² These awards, as a percentage of total DOD prime contract awards, ranged from a high of approximately 6.8 percent in 1991 to a low of 4.6 percent in 1995. Though the value of awards outside the United States increased during the last 2 fiscal years, it represented only 5.8 percent of total DOD prime contract award values by the end of 1997.

¹⁰The regulation governing the reporting of contract performance outside the United States further requires that for contracts exceeding \$10 million, contractors are to report such information at least 30 days prior to the award of a first-tier subcontract valued at more than \$500,000 that is to be performed outside the United States or Canada.

¹¹For the purposes of this report, we did not consider issues of ownership or control when determining whether a firm was performing outside the United States.

¹²To analyze DOD's prime contract awards, we used the DD 350 database, which includes information on contracting procedures, competition, financing, statutory requirements, socioeconomic programs, and other data relating to DOD acquisitions greater than \$25,000.

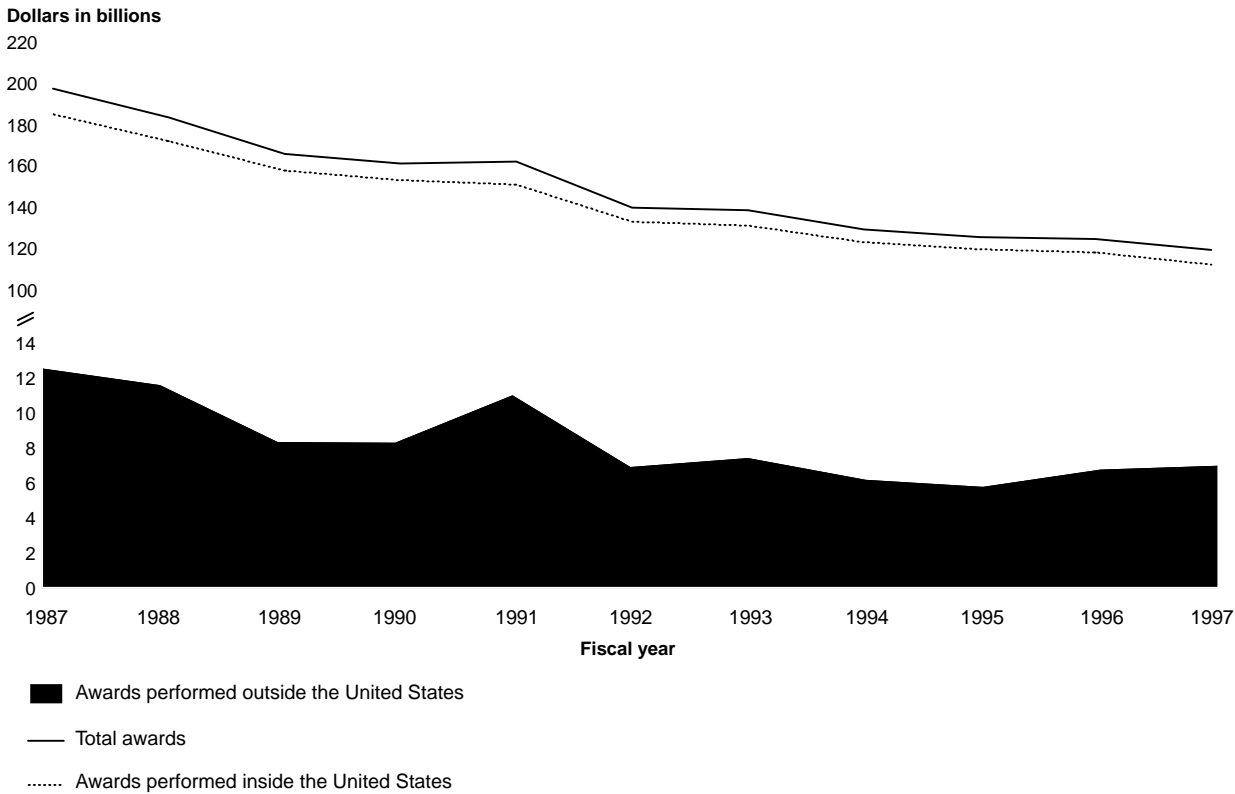
Figure 1: DOD Prime Contract Awards by Place of Contract Performance For Fiscal Years 1987-97



Source: GAO analysis of DOD's DD 350 data.

From fiscal year 1987 through 1997, the value of DOD prime contracts performed outside the United States declined, which was consistent with the overall decline in the value of total DOD prime contract awards. As shown in figure 2, the value of DOD prime contracts performed outside the United States declined from about \$12.5 billion to about \$6.9 billion, while the total value of DOD prime contract awards also declined from about \$197 billion to \$119 billion. Data were adjusted and shown in constant fiscal year 1998 dollars.

Figure 2: Trends in DOD Prime Contract Award Values in Fiscal Years 1987-97 (in constant fiscal year 1998 dollars)



Source: GAO analysis of DOD's DD 350 data.

Prime contracts performed outside the United States tended to be concentrated in certain countries and products. Although DOD's prime contracts were performed in more than 100 different countries between fiscal year 1987 and 1997, 5 countries—Germany, Italy, Japan, South Korea, and the United Kingdom—accounted for about 61 percent of total prime contract values performed outside the United States when countries were identified. While DOD awarded prime contracts outside the United States for a wide variety of items, many of the awards were concentrated in three sectors: services, fuel, and construction. Services accounted for about 41 percent of all prime contracts performed outside the United States in fiscal year 1997, while petroleum and other fuel-related products

accounted for about 19 percent and construction accounted for another 17 percent.

DOD also tracks the award of subcontracts performed outside the United States, but the subcontract data are limited. According to DOD's DD 2139 data, the value of annual foreign subcontract awards ranged from a high of almost \$2 billion in fiscal year 1990 to a low of almost \$1.1 billion in fiscal year 1997, averaging about \$1.4 billion over this period. As with prime contracts, DOD's foreign subcontracts tended to be concentrated in only a few countries. From 1990 to 1997, Canada, Israel, and the United Kingdom accounted for about 65 percent of the subcontracts that appeared in DOD's foreign subcontract database.¹³ The foreign subcontracts that appear in DOD's database cover a variety of equipment such as computers, circuitry, and components for engines; aircraft; lenses; and optics as well as services such as assembly, maintenance, and testing.

Weaknesses Exist in DOD's Use, Collection, and Management of Foreign Subcontract Data

DOD's Office of Foreign Contracting and DOD industrial base offices both collect and use foreign subcontract data, but they do not exchange their data with one another. In addition, the Office of Foreign Contracting has no safeguards for ensuring the accuracy and completeness of its foreign subcontract award (DD 2139) database. In our review of selected subcontracts, we found instances in which foreign subcontracts were not reported to DOD in accordance with the reporting requirement, resulting in the underreporting of foreign subcontract values. Also, the Office lacks standards and procedures for managing its database, which compromises the database's usefulness. An Office of Foreign Contracting official said the Office does not have sufficient resources to validate the collection and management of data but reviews the reported data for inconsistencies.

DOD's Use of Foreign Subcontract Data Is Limited

DOD's Office of Foreign Contracting collects foreign subcontract information from prime contractors and first-tier subcontractors as required by law and regulation. The Office uses the data to prepare defense procurement trade balance reports on offshore activity with the 21 countries with which the United States has reciprocal procurement MOUs. While the Office's foreign subcontract data are used for a single, narrow purpose, similar data are sometimes collected by other DOD offices and are used to prepare industrial base assessments. DOD's periodic industrial base assessments sometimes entail evaluating reliance on foreign suppliers for

¹³According to the law governing the reporting of foreign subcontracts, contractors are not required to report subcontract performance in Canada. However, DOD's regulation requires that subcontract performance in Canada be reported if it meets the identified thresholds.

specific products. DOD and military industrial base specialists rely on their own industrial base questionnaires to obtain relevant information to respond to specific requests from the military services. We spoke with numerous specialists who were not aware that data collected by the Office of Foreign Contracting existed. In addition, officials from the Office of Foreign Contracting said they have not been requested to furnish the foreign subcontract data for industrial base assessments.

Data Collection Does Not Capture Complete Foreign Subcontract Activity

DOD has no process or procedures to systematically ensure that contractors are complying with the foreign subcontract reporting requirement. Furthermore, neither the law nor the regulation provides penalties for noncompliance. DOD officials said they performed a limited follow-up with contractors and are certain that contractors are reporting as required. However, responsibility for determining whether a foreign subcontract is to be reported lies with the contractor. We found that in several instances contractors had not reported their foreign subcontracts.

Among the 42 foreign subcontracts we examined, 11 subcontracts totaling about \$124 million did not have DD 2139 forms filed with the Office of Foreign Contracting. Contractors gave various reasons for not filing the DD 2139 forms. Some said they were unaware of the requirement to report foreign subcontract awards; others had apparently misinterpreted the law and regulation. A few of them said that the regulation was not clear and that a better understanding of the intent of the law and regulation would help them determine if they needed to report. Examples of their rationale for not filing included the following:

- Two contractors stated that Defense Acquisition Circular 91-5 rescinded the DD 2139 form. However, the circular deleted only the form and not the reporting requirement. Also, a subsequent circular reinstated the DD 2139 form.
- One contractor interpreted the dollar thresholds in the reporting requirement as applying only to the foreign subcontracts, not to the value of the prime contract. This contractor did not file a DD 2139 form, even though the value of the prime contract was above the \$500,000 threshold, because the foreign subcontract was below this amount. The regulation required a contractor to report foreign subcontracts greater than \$25,000 for prime contracts exceeding \$500,000.
- One contractor awarded a foreign subcontract as part of a co-production program with Germany. The contractor cited the existence of an MOU between the United States and Germany for a specific program as the

justification for not filing a DD 2139 form. We found no support for the contractor's position in the MOU, which aims "to use industrial capabilities in both countries by providing both industries a fair chance to compete on a dual-source basis and by initiating co-production of components." The MOU is also subject to the respective countries' national laws, regulations, and policies.

- One contractor said its foreign subcontract was for a component that had to be produced outside the United States because its design was solely owned by a foreign firm. According to the contractor, no U.S. or Canadian firm was licensed to produce it, although the U.S. company had the manufacturing capability to produce this item. Given this circumstance, a company official said that he believed that the company did not have to report this subcontract. The official, however, expressed uncertainty about the reporting requirement and later indicated that the company would report this subcontract to the Office of Foreign Contracting.

We also identified 12 subcontracts, which were valued at almost \$67 million, that were not reported to the Office because of possible weaknesses in the procedures used to collect foreign subcontract data. First, contracts should include the foreign subcontract reporting requirement to ensure that contractors report their foreign subcontracts to the Office. We found one contractor that did not file the DD 2139 forms for four subcontracts because the reporting requirement was erroneously omitted from the prime contract. Second, we found three companies that did not file DD 2139 forms for eight subcontracts because, consistent with the reporting requirement, this information was reported in their initial offers and was submitted either to the contracting officer or to the prime contractor. However, the information was not forwarded to the Office by the contracting officers as stipulated by the regulation. The contracting officers we spoke with were not aware they were required to send this information to the Office of Foreign Contracting for inclusion in the DD 2139 database.

Although the law requires advance notification of contract performance outside the United States, we spoke with several contractors that regularly submitted DD 2139 information but used different criteria for identifying a foreign subcontractor. The various criteria included (1) no U.S. taxpayer identification number, (2) incorporation outside the United States, (3) foreign ownership, (4) place of contract performance, and (5) requirement of an export license. Sometimes this caused contractors to report transactions differently, which would create inconsistent data. For example, one contractor said it would report subcontracts awarded to a

foreign subsidiary of a U.S. company because the subsidiary would be manufacturing overseas. However, another contractor said it would not report a subcontract awarded to a foreign subsidiary of a U.S. company because the subsidiary is domestically owned. Contractors also lack clear guidance about whether deobligations of foreign subcontracts should be reported.¹⁴ Currently, the Office of Foreign Contracting enters any subcontract deobligations voluntarily reported by contractors into its database, but there is no requirement that contractors report these deobligations. As such, deobligations are being reported inconsistently.

Weaknesses in Database Management Minimize Usefulness of the Foreign Subcontract Data

The DD 2139 database lacks documentation defining the database's structure, critical data fields, and procedures for data entry, all of which makes the data highly questionable. For example, no written procedures exist for querying the database for the total dollar value of foreign subcontracts awarded. As a result, determining the dollar value of these subcontracts can lead to varying values, depending on the method used to query the database. We queried the database using two different methods and obtained a difference of \$15.3 million in the total dollar value of foreign subcontracts in fiscal year 1997 and a difference of \$2.8 billion for fiscal year 1990 to 1997.

The current DD 2139 database structure of 30 data fields is based on a November 1985 version of the DD 2139 form (Subcontract Report of Foreign Purchases). However, some of the data no longer need to be reported. For example, the database contains six data fields of dollar values, but only two of the six fields are needed to calculate the value of foreign subcontracts awarded. According to an agency official, the remaining four data fields are irrelevant. The DD 2139 database also contains two fields related to offsets, but contractors are no longer required to submit this information.¹⁵ The Office of Foreign Contracting, however, continues to enter into its database offset information when it is voluntarily provided by contractors.

The lack of standards and procedures for data entry has caused numerous data entry errors that compromise the database's usefulness. Data entry errors included blank critical fields; keypunch errors; duplicate entries; contract values for U.S. subcontractors; and inconsistent entries of prime

¹⁴Deobligation refers to the cancellation or downward adjustment of previously reported subcontract award data.

¹⁵Offsets are all the industrial and commercial compensations provided to foreign governments and firms as inducements or conditions for the purchase of military goods and services. The Department of Commerce tracks offset activity.

contract numbers, prime contractor names, and weapon systems names. In fiscal year 1997, we found that 2 prime contractors' names had been entered with 10 or more different variations. Inconsistent data entry makes it difficult to query the DD 2139 database or use another database to validate its completeness.

Programming errors in the DD 2139 database resulted in some underreporting of foreign source procurements. We examined the database structure for fiscal year 1997 and found some incorrectly coded database records. The miscoding of data for 1 year caused 13 out of 1,412 data records to be omitted from the total value of foreign subcontracts. As a result, the total value of foreign subcontracts for fiscal year 1997 was understated by \$1.15 million, of which \$802,249 was related to MOU countries.

No error detection and correction procedures have been established to ensure the integrity of the DD 2139 database. As a result, the database contained information that was inconsistent with the reporting criteria specified in the statutory requirement. For example, the database should contain subcontracts awarded to foreign sources only for DOD prime contracts. For fiscal year 1997, the database included 25 out of 1,412 subcontracts totaling \$2.8 million for the National Aeronautics and Space Administration, an independent civilian agency. We also found that one U.S. defense contractor reported its foreign subcontracts for sales to both DOD and foreign governments (the latter sales are known as direct commercial sales). Although the contractor's submittal clearly distinguished between DOD and direct commercial sale subcontracts, the Office included the data on subcontract awards for direct commercial sales in the database.

Conclusions

Data on DOD subcontracts performed outside the United States could provide important information for making decisions on foreign sourcing and industrial base issues. The Office of Foreign Contracting collects information on contracts performed outside the United States to prepare defense trade reports. DOD industrial base specialists collect similar information for periodic industrial base assessments but are unaware of the data the Office has collected. In addition, weaknesses in the Office's data collection process significantly limit DOD's ability to use consistent data on foreign subcontract-level procurements. The Office has made no effort to improve contractor compliance with the foreign subcontract reporting requirement, resulting in underrepresentation of the level of

foreign subcontracting activity. Poor database management also undermines the credibility and usefulness of the Office's foreign subcontract data.

Recommendations

We recommend that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to review the existing subcontract reporting requirement and amend it, as needed, to ensure that data collected satisfy the common information needs of the offices working on defense trade and industrial base issues, thus also avoiding duplicative data collection efforts within DOD. As part of this effort, DOD should provide additional guidance containing clear criteria and definitions for reporting foreign subcontracts. We also recommend that the Under Secretary of Defense for Acquisition and Technology direct the Director of the Office of Defense Procurement to

- develop and implement controls and procedures for periodically verifying compliance with the foreign subcontract reporting requirement and specify how to transmit the information to the Office of Foreign Contracting as a means of improving the completeness and consistency of its data and
- develop and implement procedures for entering data, verifying critical fields, documenting database programs, and querying the database to improve the Office's database management practices.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DOD did not agree with the need for our first recommendation to ensure that data being collected satisfy common user needs. DOD stated that existing regulations and procedures governing the generation of data needed to address defense trade and industrial base issues are sufficient as it provides the data it collects to other groups within DOD. Our review, however, demonstrated that similar data are being collected by other offices. Further, our recommendation is in accordance with DOD's policy that states the Department will regularly review and evaluate opportunities for improvements to increase the usefulness of information and reduce the cost of information collection activities for both DOD and contractors. We have modified our recommendation to clarify that we are referring to the existing data collection requirement.

DOD also stated that the reporting requirement is clear from the language in the relevant Defense Federal Acquisition Regulation Supplement clause.

However, the reporting requirement has been interpreted differently by contractor and government officials. The varying interpretations indicate a lack of understanding about what subcontracts should be reported, which detracts from the consistency of information actually contained in the database.

DOD did not fully concur with our second recommendation to improve the collection and management of foreign subcontract data. Our findings relating to poor database management arose from our attempts to use the database to determine the total value of DOD's foreign subcontract awards. We could not determine the total value from the database. First, some entries were coded so as not to be counted in the totals. Second, subcontracts for National Aeronautics and Space Administration procurements and for direct commercial sales, which should not be included in this database, were. Third, subcontracts performed in the United States, which should not be included in this database, were. Finally, in our attempt to match entries from the DD 2139 database with the subset of information on foreign subcontracts found in the Defense Contract Management District International database, we found subcontracts that should have been in the DD 2139 database but were not. Taken together, these findings represent a significant degradation of the value of the information. If DOD plans to use the data, and a recent directive by the Under Secretary suggests that it will become more important, the integrity of the data needs to be enhanced.

Our analysis showed that these problems are directly attributable to the lack of controls and procedures for periodically verifying compliance with the reporting requirement and the lack of procedures for managing and using the database. DOD stated that it already maintains the most complete database on foreign subcontracting and that periodically verifying compliance would be too costly. Having the most complete database does not address the value of the data contained in it. In addition, periodically verifying compliance with the reporting requirement could be accomplished as part of contracting officers' routine oversight responsibilities.

DOD agreed that there are no written procedures for managing and using the DD 2139 database, but stated that none are needed. DOD guidance, however, states that database managers must have written documentation to maintain their systems. Having written procedures for managing and using the database, such as controls for data entry and verification, are

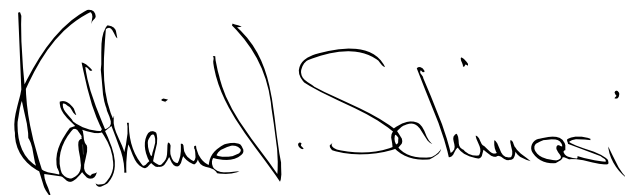
important to ensuring the reliability, accuracy, and usefulness of the information contained in the DD 2139 database.

DOD's written comments and our evaluation of them are discussed in appendix II.

We are sending copies of this report to the Chairmen and Ranking Minority Members of the Senate Committee on Armed Services and the House Committee on National Security; the Secretary of Defense; and the Director, Office of Management and Budget. We will also make copies available to others upon request.

Please contact me at (202) 512-4841 if you have any questions concerning this report. Major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink that reads "Katherine V. Schinasi". The signature is written in a cursive style with a large initial "K" and a distinct "V" for the middle name.

Katherine V. Schinasi
Associate Director
Defense Acquisitions Issues

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Abbreviations

DCMC	Defense Contract Management Command
DCMDI	Defense Contract Management District International
DOD	Department of Defense
MOU	memorandum of understanding
NATO	North Atlantic Treaty Organization

Scope and Methodology

To determine trends in the Department of Defense's (DOD) foreign sourcing, we analyzed DOD's DD 350 data on prime contract awards, which were adjusted to reflect constant 1998 dollars, from fiscal year 1987 to 1997. We examined the amounts DOD purchased at the prime contractor level by country and by item. We performed a similar assessment of DOD's data on foreign subcontract awards. However, we did not include a trend analysis of DOD's foreign subcontract procurements because of the data weaknesses described in this report. In addition, we reviewed DOD's annual reports to Congress on purchases from foreign entities for fiscal year 1995 to 1997 and the laws and regulations requiring advance notification of contract performance outside the United States. We discussed the law and regulations with DOD and industry officials. We also examined DOD's policy and the chronology of changes to regulations regarding this reporting requirement.

To determine the completeness of DOD data collection efforts, we tried to compare the DD 2139 database to other government and commercial databases. We were unable to use many of the sources we identified because they did not contain fields that could be readily compared to the DD 2139 database. We obtained foreign subcontract data from the Defense Contract Management District International (DCMDI) and the Defense Contract Management Command's (DCMC) customs team. Each of these data sources contained similar information to the DD 2139 database, including prime and subcontract numbers, transaction values, and subcontractor names. However, the DCMC import data were based on actual deliveries and not contract awards, unlike the DD 2139 and DCMDI data. Given the time difference between contract award and delivery data, we concentrated on matching the DD 2139 database with the DCMDI database.

DCMDI's database is used internally to track foreign subcontracts administered by the district's field offices and is not representative of the universe of foreign subcontracts. We did not perform a reliability assessment of the DCMDI database because we only used it to identify possible unreported foreign subcontracts that we could trace back to original source documentation.

To compare the two databases, we performed an automated and manual match of fiscal year 1997 DCMDI data with multiple years of the DD 2139 data to verify data entries. We sampled data records from the DCMDI database, which led us to examine 49 foreign subcontracts. We then eliminated all National Aeronautics and Space Administration and fuel and

subsistence contracts because these types of subcontracts are excluded from the foreign subcontract reporting requirement. By comparing the two data sets, we found 7 subcontracts that matched and 42 subcontracts that did not appear in the DD 2139 database. For the 42 subcontracts, we obtained contractual documentation from the DCMC field offices and contractors to verify information about the prime contracts and subcontracts and to ensure that the contracts contained the foreign subcontract reporting requirement clause. We interviewed the contractors to determine whether they reported the foreign subcontracts to the Office of Foreign Contracting and discussed reasons for not reporting.

We also interviewed officials from several defense companies, DCMC representative offices, and program offices. We discussed with company officials their processes for tracking foreign subcontracts and compliance with the DD 2139 reporting requirement. We obtained supplier lists for two defense programs and surveyed several subcontractors about the DD 2139 reporting requirements and corresponding regulations. With DOD officials, we discussed their procedures for monitoring subcontracts, including subcontractor performance, and for reviewing and approving requests for duty-free entry of foreign imports.

To assess DOD's management of data on foreign subcontract procurements, we reviewed DOD's DD 2139 database for fiscal years 1990 through 1997, which was the only automated data available during our review. We performed various programming queries to examine the database structure and critical fields. We discussed with Office of Foreign Contracting officials the process for ensuring proper data entry, including error detection and correction procedures, reconciliation of output reports with input entries, and verification of contractor compliance with the reporting requirement. We requested documentation describing or evaluating the data system, but none was available. We did not compare the DD 2139 data with original source documents because no criteria, such as written standards for data entry and management, exist.

We performed our review between January and September 1998 in accordance with generally accepted government auditing standards. Limitations of the DD 2139 database have been identified and discussed in earlier sections of the report. Where possible, corroborating evidence was obtained from other databases and original source documentation. The DD 350 database provides the most commonly used information on DOD procurements. However, we did not assure the reliability of the DD 350 data.

Comments From the Department of Defense

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



ACQUISITION AND
TECHNOLOGY

OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

October 29, 1998

DP/FC

Mr. Louis Rodrigues, Director
Defense Acquisitions Issues
National Security and International
Affairs Division
General Accounting Office
Washington, DC 20548

Dear Mr. Rodrigues:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) draft report, "DEFENSE TRADE: Weaknesses Exist in DoD Foreign Subcontract Data", dated September 30, 1998 (GAO Code 707325/OSD Case 1700). The recommendations contained in the report raise concern.

The GAO report recommends that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to establish requirements for collecting data to meet the information needs of the offices working on defense trade and industrial base issues, and to provide guidance containing criteria and definitions for reporting foreign subcontracts. DoD does not concur. DoD already has regulations and procedures to generate the data needed to address defense trade and industrial base issues. There is no need for establishment of new data collection requirements. The pertinent clause of the Defense Federal Acquisition Regulation Supplement (DFARS) is clear as to what subcontracts are to be reported. The meaning of the term "foreign subcontracts" is evident from the language of the clause.

GAO recommends that DoD develop and implement controls and procedures for verifying periodically compliance with the foreign subcontract report requirement. The Office of Foreign Contracting already maintains the most complete foreign subcontractor database within DoD or other agencies. Verification of contractor compliance with the DFARS clause would necessitate periodic auditing of defense contractors' subcontract management. The cost to verify contractor compliance with the DFARS clause would likely outweigh any benefit of such verification.



Appendix II
Comments From the Department of Defense

DoD agrees that there are no written procedures dealing with the entering of data, verifying critical fields, and querying the database. Written procedures were not deemed necessary because the database program was developed by DoD technical support staff and on the job training is provided to individuals entering data. The error rate noted by GAO for the 1997 data entries was less than 1 percent.

DoD appreciates the opportunity to comment on the draft GAO report. Detailed comments on each of the GAO recommendation are enclosed.

Sincerely,



Eleanor R. Spector
Director, Defense Procurement

Enclosure:
As stated

General Accounting Office Draft Report

"DEFENSE TRADE: Weaknesses Exist in DoD
Foreign Subcontract Data," September 30, 1998
(GAO Code 707325/OSD Case 1700):

DEPARTMENT OF DEFENSE COMMENTS
TO THE GAO RECOMMENDATIONS

RECOMMENDATION #1: The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense for Acquisition and Technology to establish requirements for collecting data to meet the information needs of the offices working on defense trade and industrial base issues and to provide guidance containing clear criteria and definitions for reporting foreign subcontracts. (p. 16/Draft Report)

DOD RESPONSE: Do not concur

DoD does not concur that the Secretary of Defense should direct the Under Secretary of Defense for Acquisition and Technology to establish new requirements for collecting data to meet the information needs of the offices working on defense trade and industrial base issues. In implementing 10 U.S.C. 2410g and 10 U.S.C. 2505, DoD has already instituted regulations and procedures that govern the collection of data needed to address defense trade and industrial base issues. There is no need for establishment of new data collection requirements. The clause at section 252.225-7026 of the Defense Federal Acquisition Regulation Supplement (DFARS) is clear as to which overseas subcontracts are to be reported.

10 U.S.C. 2410g requires, on contracts exceeding \$10 million, advance notification of subcontracts exceeding \$500,000 to be awarded outside the United States and Canada. In order to evaluate bi-lateral defense trade with our allies, the Office of Foreign Contracting expanded the reporting requirements of the law to include lower dollar contracts. DFARS Subpart 225.72 and the clause at 252.225-7026 provide instructions to defense contractors for reporting foreign subcontracts in compliance with the law and DoD's requirements. Part 53 of the DFARS contains a form (DD 2139) that enables defense contractors to respond to all the requirements specified in the law and DoD regulations. The defense trade collection needs of the Office of Foreign Contracting are limited in scope, and the current collection procedures respond to the law and DoD regulations. The Office provides the data it collects to other

Now on p. 12.

See comment 1.

See comment 2.

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groups within DoD who have an interest in foreign trade but has no need to expand or redefine its data collection requirements.

10 U.S.C. 2505 requires that DoD perform selected defense capability assessments of the National Defense Technology and Industrial Base as necessary to determine if the base can meet stated national security objectives. DoD Directive 5000.60, "Defense Industrial Capabilities Assessments" and accompanying handbook DoD 5000.60-H, "Assessing Defense Industrial Capabilities" describe the policies and procedures necessary to make appropriate judgments. The Department prepares industry sector and product area analyses necessary to support the Department's key budget, acquisition, and logistics processes. The Department also addresses any instances of foreign dependency that constitutes a vulnerability. Prior to issuance of the draft GAO report and this recommendation, the Director, Industrial Capabilities and Assessments, had begun steps to improve DoD's access to relevant industrial capabilities information, including capturing the contents of the DD2139 database. No additional guidance is required for collecting the necessary data to fulfill DoD's industrial base assessment needs.

See comment 2.

RECOMMENDATION #2: The GAO recommended that the Under Secretary of Defense for Acquisition and Technology direct the Director of the Office of Foreign Contracting to:

- develop and implement controls and procedures for periodically verifying compliance with the foreign subcontract reporting requirement and specify how to transmit the information to the Office of Foreign Contracting as a means of improving the completeness and consistency of its data; and
- develop and implement procedures for entering data, verifying critical fields, documenting database programs, and querying the database to improve the Office's database management practices. (pp. 16-17/Draft Report)

Now on p. 12.

DOD RESPONSE: Partially concur.

The cost to implement the GAO recommendation to develop and implement controls and procedures for periodically verifying compliance with the DFARS foreign subcontract reporting requirement may outweigh any benefit from such verification. The Office of Foreign Contracting has the most complete and comprehensive database on foreign subcontracts. There is no independent database against which the Office can perform a verification of contractor compliance with subcontract reporting

See comment 3.

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requirements. In the past, the Office has sent letters to the top 100 defense contractors reminding them of their subcontract reporting obligations.

See comment 4.

With regard to the transmission of information, the clause at DFARS 252.225-7026 contains clear instructions for submission of reports to contracting officers and the Office of Foreign Contracting.

See comment 5.

We do not concur with the GAO recommendation to implement written procedures for entering data, verifying critical fields, documenting database programs and data base queries. There are no written procedures because DoD technical support staff developed the current database structure. On-the-job training is provided to clerical personnel as needed. The GAO report found only 13 programming errors out of 1,412 data entries in 1997 or less than 1 percent, certainly falling within the bounds of normal data entry errors. Certain fields within the database are no longer used in the calculations of total subcontract dollars by country or by overall total. The Office will review the database to determine whether some fields should be eliminated.

The following are GAO's comments to DOD's letter dated October 29, 1998.

GAO Comments

1. We are not proposing the establishment of a new data collection requirement. Instead, we are recommending that the current data collection efforts be enhanced to satisfy the information needs of the offices working on defense trade and industrial base issues. Such action would be in compliance with DOD policy to regularly review and evaluate opportunities for improvements to increase the usefulness of information and reduce the cost of information collection activities for both DOD and contractors. If the collection of foreign subcontracting award data (DD 2139) were improved, the data could meet multiple information needs. To avoid further misunderstanding, we have clarified the wording of our recommendation.
2. Prior to our review, the Office of Industrial Capabilities and Assessments was unaware of the data collection efforts of the Office of Foreign Contracting. The Office of Industrial Capabilities and Assessments has an industrial base questionnaire that, in part, collects information on subcontractors similar to the information collected by the Office of Foreign Contracting. The two offices would benefit from coordinating with each other to avoid some duplication of effort and alleviate burdening industry for similar information. According to DOD policy, information should be collected in a nonduplicative and cost-effective manner. Moreover, the Under Secretary of Defense for Acquisition and Technology recently initiated reviews of the globalization of the defense industrial base and its effects on national security. Information on suppliers located outside the United States, particularly those at lower tiers, such as that collected by the Office of Foreign Contracting, or owned by foreign entities, will be instrumental in evaluating the extent and effects of this globalization.
3. The Office of Foreign Contracting has no mechanism for systematically verifying contractor compliance with the foreign subcontract reporting requirement. Unless some verification is performed, DOD has no assurance of the accuracy of the total value of foreign subcontracts awards. We recognize that the Office of Foreign Contracting has limited resources for performing an extensive verification of contractor compliance. To assist in the verification process, some follow-up could be performed by contracting officers because defense companies are required to submit certain DD 2139 information to them. However, the contracting officers that we spoke with were often unaware of this reporting requirement and,

therefore, would need to be educated about the requirement so that they could periodically check contractor compliance when performing routine oversight functions such as certifying duty-free entry of imported items.

In 1989 we reported that the Office of Foreign Contracting sent a letter to the top 100 prime contractors informing them of the foreign subcontract reporting requirement and found that about one-third had reported.¹ The Office of Foreign Contracting has not performed another survey of defense companies since then. Furthermore, officials from defense companies told us that the Office of Foreign Contracting had not contacted them to verify the data they had submitted. Periodic follow-up with the defense companies would help ensure that erroneous information, such as subcontract awards for nondefense contracts, would not be submitted.

4. For awarded contracts, the reporting requirement provides instructions on when and how contractors are to report subcontract performance outside the United States to the Office of Foreign Contracting. However, for offers exceeding \$10 million, if the company is aware at the time its offer is submitted that it or its first-tier subcontractor intends to perform any part of the contract that exceeds \$500,000 outside the United States and Canada, and if that part could be performed inside the United States or Canada, DD 2139 information must be submitted with the offer to the contracting officer. The regulation (Defense Federal Acquisition Regulation Supplement 225.7202) then stipulates that contracting officers are to forward a copy of reports submitted by successful offerors to the Office of Foreign Contracting. However, the contracting officers we spoke with were not aware that the regulation instructed them to forward any information to the Office of Foreign Contracting and had never provided the Office with such information. Consequently, information provided in firms' offers is not being fully captured by the Office's database.

5. Poor database management practices undermine the reliability of DOD's foreign subcontract data. The Office of Foreign Contracting lacks appropriate written standards for entering and verifying data. Such standards are necessary to ensure the reliability and integrity of the data. Our example of a programming error that resulted in 13 miscoded data entries merely illustrates the problems that can arise when no system controls are in place. DOD's calculation of an error rate based on these 13 entries is erroneous and misleading. It is erroneous because statistical inferences such as error rates must be based on a random statistical

¹See *Industrial Base: Adequacy of Information on the U.S. Defense Industrial Base* (GAO/NSIAD-90-48, Nov. 15, 1989).

sample assessed against defined parameters such as written procedures for data entry, verification, or database queries. Without such documentation, we were unable to assess data reliability fully. It is also misleading because, as detailed in our report, we found numerous other examples of problems with the DD 2139 database that undermine its credibility. Besides the programming errors, we found data entry errors such as the inclusion of National Aeronautics and Space Administration subcontracts, direct commercial sales subcontracts, and U.S. subcontract awards. Other problems included evidence of noncompliance with the reporting requirement and inconsistent treatment of data. These problems support the need for written standards explaining the DD 2139 database's structure, data fields, and procedures for data entry and verification.

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