

controllability of the airplane, accomplish the following:

Service Information

(a) The following information pertains to the service bulletin referenced in this AD:

(1) The term "service bulletin," as used in this AD, means the Accomplishment Instructions of Dassault Service Bulletin F50-A370, dated May 6, 2003.

(2) Although the service bulletin referenced in this AD specifies to submit inspection results to the manufacturer, this AD does not include such a requirement.

Inspection

(b) Within 7 days after the effective date of this AD, do a detailed inspection of the entire length of the hydraulic lines located within the No. 1 and No. 3 engine pylons for clearance, per paragraph 2.C.(2)(b) of the service bulletin.

Note 1: For the purposes of this AD, a detailed inspection is defined as: "An intensive visual examination of a specific structural area, system, installation, or assembly to detect damage, failure, or irregularity. Available lighting is normally supplemented with a direct source of good lighting at intensity deemed appropriate by the inspector. Inspection aids such as mirror, magnifying lenses, etc., may be used. Surface cleaning and elaborate access procedures may be required."

Proper Clearance

(c) If the clearance of both hydraulic lines is found within the limits specified in the service bulletin during the inspection required by paragraph (b) of this AD, do the actions specified in paragraph (e) of this AD.

Incorrect Clearance

(d) If the clearance of any hydraulic line is found outside the limits specified in the service bulletin during the inspection required by paragraph (b) of this AD, before further flight, do a detailed inspection for discrepancies (*i.e.*, evidence of contact, chafing, or abrasion) between the hydraulic lines, per the service bulletin.

(1) If no discrepancy is detected, do the actions specified in paragraph (e) of this AD.

(2) If any discrepancy is detected, before further flight, measure the wear depth per the service bulletin.

(i) If the measurement is less than 0.004-inch (0.10 millimeter (mm)), no further action is required by this paragraph.

(ii) If the measurement is greater than or equal to 0.004-inch (0.10 mm), at the applicable time specified in Figure 1, 2, or 3 of the service bulletin following the inspection required by paragraph (d) of this AD, replace the hydraulic line with a new hydraulic line per the service bulletin. The term "flights," as used in Figures 1, 2, and 3 of the service bulletin, means "flight cycles" for this AD.

Fastening Lines, Ensuring Proper Clearance, and Marking Location of Clamps

(e) Before further flight following any inspection or replacement required by this AD, do the actions specified in paragraphs (e)(1), (e)(2), and (e)(3) of this AD per the service bulletin.

(1) Using clamps, screws, and nuts, fasten the hydraulic line(s) as indicated in Figure 4 of the service bulletin.

(2) Ensure proper clearance between the hydraulic line(s) and adjacent structure as indicated in paragraph 2.C.(2)(b) of the service bulletin.

(3) Using yellow paint, mark the location of the clamps installed on the hydraulic line(s).

Revision to Maintenance Manual

(f) Within 7 days after the effective date of this AD, revise the Dassault Falcon 50 Maintenance Manual by inserting a copy of Dassault Falcon 50 Maintenance Manual Temporary Revision 37, dated May 2003.

Alternative Methods of Compliance

(g) In accordance with 14 CFR 39.19, the Manager, International Branch, ANM-116, Transport Airplane Directorate, FAA, is authorized to approve alternative methods of compliance for this AD.

Incorporation by Reference

(h) The actions shall be done per Dassault Service Bulletin F50-A370, dated May 6, 2003; and Dassault Falcon 50 Maintenance Manual Temporary Revision 37, dated May 2003; as applicable. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from Dassault Falcon Jet, PO Box 2000, South Hackensack, New Jersey 07606. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

Note 2: The subject of this AD is addressed in French telegraphic airworthiness directive T2003-190(B), dated May 6, 2003.

Effective Date

(i) This amendment becomes effective on June 4, 2003.

Issued in Renton, Washington, on May 9, 2003.

Vi L. Lipski,

Manager, Transport Airplane Directorate, Aircraft Certification Service.

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DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 3

RIN 0790-AH01

Transactions Other Than Contracts, Grants, or Cooperative Agreements for Prototype Projects

AGENCY: Office of the Secretary, DoD.

ACTION: Final rule.

SUMMARY: This final rule establishes the Department's audit policy for prototype

projects that use "other transaction" authority. Representatives of the military departments, Defense agencies and other DoD activities, have agreed on a final rule that amends the proposed rule as a result of comments received.

EFFECTIVE DATES: This final rule will become effective on June 19, 2003. This final rule will become effective for new solicitations issued on June 19, 2003, and for any issued thereafter. This final rule may be used for new prototype awards that result from solicitations issued prior to June 19, 2003.

FOR FURTHER INFORMATION CONTACT:

David Capitano, (703) 847-7486.

SUPPLEMENTARY INFORMATION:

Background and Purpose

Section 845 of the National Defense Authorization Act for Fiscal Year 1994, Public Law 103-160, 107 Stat. 1547, as amended, authorizes the Secretary of a Military Department, the Director of Defense Advanced Research Projects Agency and any other official designated by the Secretary of Defense, to enter into transactions other than contracts, grants or cooperative agreements in certain situations for prototype projects that are directly relevant to weapons or weapon systems proposed to be acquired or developed by the Department of Defense. Such transactions are commonly referred to as "other transaction" agreements for prototype projects. To the extent that a particular statute or regulation is limited in its applicability to the use of a procurement contract, it would generally not apply to "other transactions" for prototype projects.

Part 3 to 32 CFR was established to codify policy pertaining to prototype "other transactions" that have a significant impact on the public and are subject to rulemaking. Additional guidance on prototype "other transactions" directed at Government officials can be found at the Defense Procurement Web site at: <http://www.osd.dp.mil>.

A proposed rule was published in the **Federal Register** (66 FR 58422-58425) for public comment on November 21, 2001. A notice of public meeting was published in the **Federal Register** on March 4, 2002 (67 FR 9632), and held on March 27, 2002. The proposed rule addressed conditions on use of "other transactions" for prototype projects, the nontraditional Defense contractor definition and audit policy. Comments on the proposed rule were received from five respondents and approximately 50 representatives of Government and industry attended the public meeting. The majority of the written comments

and discussion at the public meeting focused on the audit policy and are addressed in this final rule. The following summarizes the comments regarding audit policy and the disposition.

The following is a summary of the public input and the DoD response thereto (the source of the input is annotated after each comment):

A. General

1. *Public Comment:* The policy will discourage nontraditional Defense contractors from doing business with DoD (written public comments—five commenters).

DoD Response: A key concept of our form of government is accountability for its resources. DoD recognizes the balance that must be achieved between encouraging nontraditional contractors to do business with the DoD and the key concept of accountability for public funds. DoD believes there are certain instances when the government, either through use of an Independent Public Accountant (IPA) or a government employee, must have access to the awardee's books and records. However, in response to this and other comments, a number of revisions have been made to the proposed rule to reduce the potential for discouraging nontraditional Defense contractors. These revisions include raising the mandatory applicability requirements to \$5 million per cost-type agreement, providing for a deviation from the mandatory applicability requirements for agreements in excess of \$5 million, specifying instances in which the government could have no direct access to the contractor's books and records, and specifying that the government will make copies of IPA work papers when there is evidence that the audit has not been properly performed.

2. *Public Comment:* The value of the expanded policy and oversight is questionable (written public comment—one commenter).

DoD Response: DoD believes there is value in having an access to records policy that properly balances the need to encourage contractor participation with the need to obtain access to records necessary to ensure compliance with the terms of the agreement. However, DoD recognizes that the proposed rule needed to be revised to provide more flexibility towards achieving this balance.

3. *Public Comment:* Balance the need for audit access with the possible loss of access to technology (public meeting).

DoD Response: DoD agrees there must be an appropriate balance between the need to access new technologies and the

level of access required to assure compliance with the terms of the agreement. DoD believes the final rule achieves this appropriate balance.

4. *Public Comment:* Review the language throughout the rule to ensure consistency of terms (public meeting).

DoD Response: DoD has reviewed the terms in the final rule to ensure consistency.

5. *Public Comment:* Revise the tone and verbiage of the proposed rule to reduce the perception of intrusion (public meeting).

DoD Response: DoD believes the final rule reduces the perception of intrusion noted at the public meeting. For example, the final rule states that the purpose of the government's review of an IPA's work papers is to verify compliance with Generally Accepted Government Auditing Standards (GAGAS). The rule also states that the government has no direct access to awardee records for nontraditional Defense contractors that refuse to accept government access. Another example is the language that provides for the government to make copies of audit work papers only if the audit has not been performed in accordance with GAGAS. Finally, the length and extent of audit access language specifies that access should be provided only to the extent needed to verify the actual costs or statutory cost share.

B. Definitions

1. *Public Comment:* Definition of "Key Participant" should be clarified for applicability to subawardees and their segments (written public comments—two commenters).

DoD Response: Revisions to the proposed rule have eliminated the need for the term "key participant" in the final rule.

2. *Public Comment:* Delete or define terms "subordinate element" and "awardee" (written public comments—two commenters).

DoD Response: Revisions to the proposed rule have eliminated the need for the term "subordinate" in the final rule. The term "awardee" was defined in the final rule issued on August 27, 2002 (67 FR 54955), regarding conditions for use.

3. *Public Comment:* Define "Qualified Independent Public Accountant" (written public comment—one commenter).

DoD Response: The final rule provides a definition of a "Qualified Independent Public Accountant."

C. Statutory Basis

Public Comment: Withdraw audit policy and clauses in their entirety

because they are not required or implied by statute, rule, or regulation. The audit policy is not supported by legislative direction and not tailored to implement changes in 2000 or 2001 DoD Authorization Acts. The audit policy should incorporate only those provisions in section 803 of the FY 2000 DoD Authorization Act (written public comments—two commenters).

DoD Response: DoD does not believe the policy should be withdrawn. DoD believes that issuance of this final rule is consistent with the statutory requirements for the use of other transactions. The statutory authority for other transactions specifically requires, at 10 U.S.C. 2371, that the Secretary of Defense " * * * shall prescribe regulations to carry out this section." DoD believes that this access to records policy is consistent with that statutory requirement.

D. Flexibility

1. *Public Comment:* Replace audit policy with a general statement such as "If the Agreements Officer determines that an audit right is required, the coverage, length and extent shall be mutually agreed to by the parties. The audit shall be performed by an independent auditor that is mutually acceptable to the parties, and all audit expenses shall be reimbursed by the government" (written public comment—one commenter).

DoD Response: For agreements that are less than \$5 million, DoD agrees that general language providing the Contracting Officer with flexibility in negotiating the coverage, length, and extent of access is appropriate. DoD believes that, for cost-type agreements in excess of \$5 million, more specific policy is necessary. However, the final rule provides flexibility to deviate from the specific policy when supported by the particular facts and circumstances.

2. *Public Comment:* Rely on awardee's internal auditors, certification of accounting procedures and documentation, and if necessary a tailored audit clause providing limited access for independent auditor (written public comment—one commenter).

DoD Response: DoD does not believe it is sufficient to rely on an awardee's internal auditors when cost-type agreements provide for government payments that exceed \$5 million. DoD agrees that access is limited to those records that are needed to verify the established cost-share, actual costs or reporting used as the basis for payments.

3. *Public Comment:* Limit audits to post-verification of cost sharing only. Costs incurred should not be subject to

audit other than GAO (written public comments—three commenters).

DoD Response: DoD believes the government should not preclude reviews when payments are based on amounts generated from awardee's financial or cost records. The government needs to have some reasonable assurance regarding the appropriateness of those amounts. DoD believes the final rule provides such reasonable assurance while also providing appropriate flexibility in its application.

4. *Public Comment:* Audits for other than cost sharing should apply only if there is reason to believe an impropriety has occurred (written public comment—one commenter).

DoD Response: DoD believes the government should not limit reviews of actual costs incurred to cases where there is a reason to believe an impropriety has occurred. When cost-type agreements provide for government payments that exceed \$5 million, the government needs to have some reasonable assurance regarding the appropriateness of those amounts. DoD believes the final rule provides such reasonable assurance while also providing appropriate flexibility in its application.

E. Applicability

1. *Public Comment:* Need to establish a threshold for applicability to prime recipients (written public comment—one commenter).

DoD Response: DoD agrees that a threshold for mandatory application of the policy is needed. The final rule establishes that threshold at \$5 million per cost-type agreement. DoD believes this is an appropriate threshold because it will cover a majority of the dollars while exempting a majority of the agreements from mandatory application of the policy. Using data from the past eight years, it is anticipated that this threshold will provide the government with access to records for 89% of all government dollar under cost-type agreements, while also exempting 78% of those agreements from mandatory application of the policy.

2. *Public Comment:* Consider whether the language regarding "payments generated from financial records" could be misconstrued and applied too broadly. Examples of when the language would and would not apply should be considered (public meeting).

DoD Response: The language "payments generated from financial records" has been included in the final rule within the definition of a cost-type other transaction. To reduce potential misunderstanding or inappropriate

application, the final rule includes examples of what constitutes a cost-type agreement.

3. *Public Comment:* Consider providing the Agreements Officer more flexibility in the application of the audit access clause (public meeting).

DoD Response: The final rule provides the Agreements Officer with the flexibility to negotiate the length and extent of access for any agreements that are less than \$5 million. It also provides for the ability to deviate from some or all of the specific access requirements for cost-type agreements in excess of \$5 million when such deviation is adequately supported by the particular facts and circumstances. The Agreements Officer should consult with the cognizant auditor to ensure that the benefits of such a deviation outweigh any increased risks to the Government.

4. *Public Comment:* Consider addressing the circumstances where a single agreement has both cost-based and fixed-price portions (public meeting).

DoD Response: DoD believes the examples of a cost-type agreement included in the proposed rule provides sufficient guidance for use by Agreements Officers in determining proper application of the policy to those unique circumstances in which an agreement has both cost-type and fixed-price portions.

5. *Public Comment:* Consider using different thresholds for nontraditional vs. traditional contractors (public meeting).

DoD Response: DoD considered using different thresholds for nontraditional and traditional contractors, but believes such an application would result in unnecessary complexity. DoD believes requiring application of the policy to all cost-type agreements in excess of \$5 million is a more desirable approach because (1) it is anticipated to include a majority of the Government dollars on cost-type agreements while also exempting most of the agreements from mandatory application, and (2) it provides for the same threshold as the Comptroller General access, thereby providing a simple unified threshold for applying the two requirements.

6. *Public Comment:* Make the application of the audit policy at the discretion of the Agreements Officer regardless of the dollar amount of the agreement (public meeting).

DoD Response: DoD believes it is desirable to provide some specific policy for access to records when agreements exceed \$5 million. However, DoD recognizes the need for an Agreements Officer to be able to

exercise good business judgment. Under the final rule, for agreements that are less than \$5 million, application of the audit policy is solely at the discretion of the Agreements Officer. In addition, for cost-type agreements in excess of \$5 million, the final rule provides for a deviation from application of the policy if supported by the particular facts and circumstances.

7. *Public Comment:* Make the application of the audit policy mandatory regardless of the dollar amount of the agreement (public meeting).

DoD Response: DoD established a threshold that minimizes its risk. We did so to encourage participation by non traditional contractors. DoD believes that, for agreements that are less than \$5 million, the Agreements Officer should have the flexibility to negotiate audit access to records based on their assessment of risk of the particular agreement.

8. *Public Comment:* Apply the audit threshold requirements at \$5 million per agreement. This is the same as the GAO access requirements and the trigger for Earned Value Management (public meeting).

DoD Response: DoD agrees that this threshold is appropriate for mandatory application of the policy. In addition to being the same as the GAO access requirements (which simplifies application), DoD also believes that threshold, with its accompanying provisions for deviation, properly balances the need for access to records with the need to encourage contractor participation.

9. *Public Comment:* Consider using a trigger threshold requirement such as that used in applying the Cost Accounting Standards (public meeting).

DoD Response: DoD considered using a trigger concept, but believes such a concept would be unnecessarily complex. The \$5 million threshold per cost-type agreement is a simplified approach that achieves the proper balance between the need for access to records and the need to encourage contractor participation.

10. *Public Comment:* The rule should not apply to nontraditional contractors (written public comment—one commenter).

DoD Response: DoD believes the final rule properly balances the need to access records with the concerns of nontraditional Defense contractors. The final rule provides for application of the policy for cost-type agreements in excess of \$5 million. It is anticipated, based on past history, that this will exempt about 78% of the agreements. For the remaining 22%, the final rule

provides for a deviation when supported by the particular facts and circumstances. In those remaining instances where the access requirements are applied to nontraditional Defense contractors, the rule provides for use of an Independent Public Accountant if the nontraditional Defense contractor refuses Government access to its records.

11. *Public Comment:* The rule should state that it does not apply to existing agreements (written public comment—one commenter).

DoD Response: The final rule specifies the Other Transactions to which the policy applies, which does not include existing agreements.

F. Use of an Independent Public Accountant (IPA)

1. *Public Comment:* Use of an IPA will discourage nontraditional contractors because of the need for accounting systems to fully document costs and government access to IPA work papers that include company proprietary information (written public comments—two commenters).

DoD Response: DoD believes an awardee should maintain an accounting system that adequately supports the amounts used as the basis for payment regardless of whether the Government has access to the awardee's records. An awardee that enters into a cost-type agreement should have some sort of accounting system that adequately supports those amounts. In regard to company proprietary information, the final rule addresses this concern by limiting the government's right to make copies of the IPA's work papers to instances where there is evidence the audit has not been performed in accordance with GAGAS.

2. *Public Comment:* Delete government access to IPA work papers to protect propriety information of awardees/participants (written public comments—two commenters).

DoD Response: DoD believes it is important for the government to have access to IPA work papers to assure the audit has been performed in accordance with GAGAS. However, in recognition of the concern expressed by the commenter, the final rule limits the government's right to make copies of the IPA's work papers to instances where there is evidence the audit has not been performed in accordance with those standards.

3. *Public Comment:* The statements "Use amounts generated from the awardee's financial or cost records as the basis for payment" and "direct access to sufficient records to ensure full accountability for all government

funding" are too broad and too vague. Audit access should be for very limited with focused purposes (written public comment—one commenter).

DoD Response: The final rule includes specific examples of a cost-type agreements which is defined as agreements where payments are based on amounts generated from the awardee's financial or cost records or that require at least one third of the total costs to be provided by non-Federal parties pursuant to statute. The statement "direct access to sufficient records to ensure full accountability for all government funding" has been replaced by a more focused requirement that the government have access to directly pertinent records "needed to verify the actual costs or reporting used as the basis of payment or to verify statutorily required cost share under the agreement."

4. *Public Comment:* Define GAGAS (written public comment—one commenter).

DoD Response: The final rule includes a description of Generally Accepted Government Auditing Standards and where those standards can be found.

5. *Public Comment:* The rule should require the agreement to specify the percentage of payments that may be withheld when an audit by an IPA is not adequately performed (written public comment—one commenter).

DoD Response: The final rule states that the Agreements Officer has the right to "withhold or disallow a specified percentage of costs until the audit is completed satisfactorily. The specified percentage should be sufficient to enhance performance or corrective action while also not being unfairly punitive."

6. *Public Comment:* Change "should" to "shall" in statement that "Agreement Officer should grant approval to use an IPA when participant is not performing contract subject to Cost Principles/CAS and refuses to accept award if government has access" (written public comment—one commenter).

DoD Response: The final rule states that the access to records clause for business units not performing contracts subject to the Cost Principles/CAS "must provide for the use of a qualified IPA if such a business unit will not accept the agreement if the government has access to the business unit's records."

7. *Public Comment:* Sample audit clause should revise "The audit will be conducted by an IPA" to "The audit will be conducted by a mutually acceptable IPA at government expense" (written public comment—one commenter).

DoD Response: To reduce the complexity of the rule and assure maximum flexibility for the Agreements Officer, the final rule deletes all of the sample audit clauses. Sample audit clauses intended to serve as a guide can be found at <http://www.osd.mil/dp> (under the "Other Transactions" Special Interest Item in "Questions and Answers"). These samples may be modified as necessary to address the particular facts and circumstances of each agreement.

8. *Public Comment:* Add language stating that the purpose of the audit of an IPA's work papers is to verify compliance with GAGAS (public meeting).

DoD Response: The final rule states that the government will have access to the IPA's audit reports and working papers to ensure that the IPA has performed the audit in accordance with GAGAS.

9. *Public Comment:* Eliminate the need to access an IPA's work papers and rely on AICPA standards and public accounting peer reviews (public meeting).

DoD Response: DoD does not believe the AICPA standards and peer reviews provide adequate assurance that the audit of the other transaction has been performed in accordance with GAGAS because (a) GAGAS has some requirements that are not included in the AICPA standards, and (b) public accounting peer reviews focus on financial statement reviews and compliance with GAAS (as opposed to government financial payment reviews and compliance with GAGAS).

10. *Public Comment:* Require that IPA's comply with Generally Accepted Auditing Standards (GAAS) instead of GAGAS (public meeting).

DoD Response: The requirement to comply with GAGAS is a statutory requirement that cannot be waived by DoD. The Inspector General Act of 1978 (as amended) requires that audit work of Federal organizations, programs, activities, and functions comply with GAGAS.

11. *Public Comment:* Add language stating that, when an IPA's report is not adequate, an Agreements Officer should consider terminating an agreement only if it is impractical to withhold monies or suspend performance until the audit is satisfactorily performed (public meeting).

DoD Response: The final rule states that the Agreements Officer may terminate the agreement only if it is not practical to either (a) withhold monies, or (b) suspend performance until the audit is completed satisfactorily.

G. DoDIG Access

Public Comment: Delete 3.7(f)(2) that states if Agreements Officer gets access, DoDIG also gets access. This is not supported by statute. The only audit access in section 804 of Public Law 106–398 is for GAO, not DoDIG (written public comment—two commenters).

DoD Response: While section 804 of Public Law 106–398 does not provide for DoDIG access, such access is provided for in the Inspector General Act (Public Law 95–452). Public Law 95–452 provides that the Inspector General shall have access to the same records as the agency (DoD) and its employees (e.g., the Agreements Officer). Thus, in accordance with this statute, if an agreement gives the Agreements Officer or another DoD component official access to a business unit's records, the DoDIG is granted the same access to those records.

H. Audit Performance

1. *Public Comment:* Delete the word “normally” from “Audits normally will be performed only when Agreements Officer determines it is necessary to verify the awardee's compliance with the terms of the agreement” (written public comment—one commenter).

DoD Response: The final rule deletes the word “normally.” The final rule states that “Audits will be performed when the Agreements Officer determines it is necessary to verify statutory cost share or to verify amounts generated from financial or cost records that will be used as the basis for payment or adjustment of payment.”

2. *Public Comment:* Consider adding a “problem statement” describing what the policy is intending to correct (public meeting).

DoD Response: DoD does not believe it adds value to include a “problem statement” in the final rule. However, in response to the public comment, DoD notes that in developing the proposed and final rule, DoD has considered the “problem” to be the extent of access to records required by the government on cost-type agreements. The goal is to achieve an appropriate balance between the need to access new technologies and the level of access required to assure compliance with the terms of the agreement.

3. *Public Comment:* Consider permitting reviews of records at the awardee facility only, i.e., the government would be precluded from removing records from the contractor's facility (public meeting).

DoD Response: DoD does not believe it is necessary to limit access to records at the awardee facility. However, DoD

recognizes the concern expressed at the public meeting. For traditional contractors, the final rule does not provide any more access than the government currently has under procurement contracts with those contractors. For nontraditional Defense contractors, the rule provides for the use of an IPA if the nontraditional Defense contractor refuses to grant access to the government. In those instances, the government has no direct access to the nontraditional Defense contractors' books and records, and can only make copies of the IPA's work papers if there is evidence the audit was not performed in accordance with GAGAS.

I. Flowdown to Subawardees/ Subagreements

1. *Public Comment:* Revise flow down requirements because they appear to be nonnegotiable (written public comment—one commenter).

DoD Response: The final rule provides for flexibility in negotiating flow down requirements for subagreements that are less than \$5 million. For cost-type subagreements that are in excess of \$5 million, a deviation from the flow down requirements is permitted when supported by the particular facts and circumstances. Note, that Single Audit Act requirements apply to subawardees/ subagreements where appropriate.

2. *Public Comment:* The threshold of \$300,000 for flow down to key participants is unusually low. Recommend using the \$500,000 in legislation for traditional contractors or the \$5 million used for GAO access (written public comments—two commenters).

DoD Response: DoD agrees that the \$300,000 threshold in the proposed rule was too low. The final rule establishes a subagreement threshold of \$5 million.

3. *Public Comment:* Delete the mandatory clauses for subagreements and instead make the awardee responsible for providing sufficient support for subawardee costs (public meeting).

DoD Response: The final rule deletes the requirement to apply the policy for subagreements that are less than \$5 million. For cost-type subagreements that are in excess of \$5 million, deviation from application of the policy is permitted when supported by the particular facts and circumstances.

4. *Public Comment:* The flow down requirements will discourage technology rich subcontractors from participating in other transactions (written public comment—one commenter).

DoD Response: DoD has strived to balance the potential discouragement of technology rich subcontractors from the need to assure compliance with the terms of the agreement. DoD believes this balance has been achieved in the final rule because (a) application of the policy is not required for subagreements that are \$5 million or less, and (b) deviation from the policy is permitted for subagreements that are in excess of \$5 million if warranted by the particular facts and circumstances.

J. Sample Audit Clauses

1. *Public Comment:* Sample audit clauses should revise “awardee” to “business unit of the awardee”, and “awardee's records” to “directly pertinent records of those business units of the awardee performing the work under the OT agreement” (written public comment—one commenter).

DoD Response: DoD has deleted the sample clauses from the final rule because they add unnecessary complexity and could serve to reduce the flexibility of the Agreements Officer by becoming quasi-standard and/or quasi-required clauses. Sample clauses maintained at <http://www.osd.mil/dp> (under the “Other Transactions” Special Interest Item in “Questions and Answers”) that are intended to serve as a guide do clarify access is to the specified business unit.

2. *Public Comment:* Consider adding language to the audit access clause that states when it applies (public meeting).

DoD Response: The final rule does provide specific language as to when a DoD access to records clause is applicable.

K. Traditional vs. Non-Traditional Contractor

1. *Public Comment:* Distinguish between nontraditional and traditional contractors based on the agreement value using TINA threshold of \$550,000, or based on the CAS threshold for full (\$50 million) or modified (\$7.5 million) coverage (public meeting).

DoD Response: The final rule distinguishes between traditional and nontraditional Defense contractors for purposes of determining the level of approval for (a) the use of an IPA and (b) deviating from application of the policy. DoD believes that, when used for these purposes, the statutory definitions are adequate. In addition, the use of definitions that are consistent with those in statute reduces complexity, thereby simplifying implementation of the rule.

2. *Public Comment:* Consider whether using the cost principles as a criteria for use of an Independent Public

Accountant is overly broad (public meeting).

DoD Response: DoD does not believe using the cost principles is overly broad for purposes of the final rule, which uses cost principles for determining the level of approval to (a) use an IPA and (b) deviate from application of the policy. When a contractor is performing on a contract subject to the cost principles, a government representative (e.g., Defense Contract Audit Agency (DCAA)) has access to that contractor's books and records. Therefore, DoD believes that cost principles are an appropriate for determining when an IPA may be used.

Regulatory Evaluation

Executive Order 12866, "Regulatory Planning and Review"

It has been determined that this rule is not a significant rule as defined under section 3(f)(1) through 3(f)(4) of Executive Order 12866.

Unfunded Mandates Reform Act (Section 202 of Public Law 104-4)

It has been certified that this rule does not contain a Federal mandate that may result in the expenditure by State, local and tribal governments, in aggregate, or by the private sector, of \$100 million or more in any one year.

Public Law 96-354, "Regulatory Flexibility Act" (5 U.S.C. 601)

It has been certified that this part is not subject to the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) because it would not, if promulgated, have a significant economic impact on a substantial number of small entities. The rule does not require additional record keeping or other significant expense by project participants.

*Public Law 96-511, "Paperwork Reduction Act of 1995" (44 U.S.C. 3501 *et seq.*)*

It has been certified that this rule does not impose any reporting or record keeping requirements under the Paperwork Reduction Act of 1995.

Executive Order 13132, "Federalism"

It has been certified that this rule does not have federalism implications, as set forth in Executive Order 13132.

List of Subjects in 32 CFR Part 3

Government procurement,
Transactions for prototype projects.

■ Accordingly, 32 CFR part 3 is amended to read as follows:

PART 3—TRANSACTIONS OTHER THAN CONTRACTS, GRANTS, OR COOPERATIVE AGREEMENTS FOR PROTOTYPE PROJECTS

■ 1. The authority citation for 32 CFR part 3 continues to read as follows:

Authority: Section 845 of Public Law 103-160, 107 STAT. 1547, as amended.

■ 2. Section 3.4 is revised to read as follows:

§ 3.4 Definitions.

Agency point of contact (POC). The individual identified by the military department or defense agency as its POC for prototype OTs.

Agreements Officer. An individual with the authority to enter into, administer, or terminate OTs for prototype projects and make related determinations and findings.

Approving Official. The official responsible for approving the OTs acquisition strategy and resulting OT agreement. This official must be at least one level above the Agreements Officer and at no lower level than existing agency thresholds associated with procurement contracts.

Awardee. Any business unit that is the direct recipient of an OT agreement.

Business unit. Any segment of an organization, or an entire business organization which is not divided into segments.

Contracting activity. An element of an agency designated by the agency head and delegated broad authority regarding acquisition functions. It includes elements designated by the Director of a Defense Agency which has been delegated contracting authority through its agency charter.

Cost-type OT. Agreements where payments are based on amounts generated from the awardee's financial or cost records or that require at least one third of the total costs to be provided by non-Federal parties pursuant to statute or require submittal of financial or cost records/reports to determine whether additional effort can be accomplished for the fixed amount.

Fixed-price type OT. Agreements where payments are not based on amounts generated from the awardee's financial or cost records.

Head of the contracting activity (HCA). The official who has overall responsibility for managing the contracting activity.

Nontraditional Defense contractor. A business unit that has not, for a period of at least one year prior to the date of the OT agreement, entered into or performed on (1) any contract that is subject to full coverage under the cost

accounting standards prescribed pursuant to section 26 of the Office of Federal Procurement Policy Act (41 U.S.C. 422) and the regulations implementing such section; or (2) any other contract in excess of \$500,000 to carry out prototype projects or to perform basic, applied, or advanced research projects for a Federal agency, that is subject to the Federal Acquisition Regulation.

Procurement contract. A contract awarded pursuant to the Federal Acquisition Regulation.

Qualified Independent Public

Accountant. An accountant that is licensed or works for a firm that is licensed in the state or other political jurisdiction where they operate their professional practice and comply with the applicable provisions of the public accountancy law and rules of the jurisdiction where the audit is being conducted.

Segment. One of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service.

Senior Procurement Executive. The following individuals:

(1) Department of the Army—Assistant Secretary of the Army (Acquisition, Logistics and Technology);

(2) Department of the Navy—Assistant Secretary of the Navy (Research, Development and Acquisition);

(3) Department of the Air Force—Assistant Secretary of the Air Force (Acquisition).

(4) The Directors of Defense Agencies who have been delegated authority to act as Senior Procurement Executive for their respective agencies.

Single Audit Act. Establishes uniform audit requirements for audits of state and local government, universities, and non-profit organizations that expend Federal awards.

Subawardee. Any business unit of a party, entity or subordinate element performing effort under the OT agreement, other than the awardee.

Traditional Defense contractor. Any business unit that does not meet the definition of a nontraditional Defense contractor.

■ 3. New § 3.8 is added to read as follows:

§ 3.8 DoD access to records policy.

(a) *Applicability.* This section provides policy concerning DoD access to awardee and subawardee records on OT agreements for prototype projects. This access is separate and distinct from Comptroller General access.

(1) *Fixed-price type OT agreements.*

(i) *General*—DoD access to records is not generally required for fixed-price type OT agreements. In order for an agreement to be considered a fixed-price type OT agreement, it must adequately specify the effort to be accomplished for a fixed amount and provide for defined payable milestones, with no provision for financial or cost reporting that would be a basis for making adjustment in either the work scope or price of the effort.

(ii) *Termination considerations.* The need to provide for DoD access to records in the case of termination of a fixed-price type OT can be avoided by limiting potential termination settlements to an amount specified in the original agreement or to payment for the last completed milestone. However, if a fixed-price agreement provides that potential termination settlement amounts may be based on amounts generated from cost or financial records and the agreement exceeds the specified threshold, the OT should provide that DoD will have access to records in the event of termination.

(2) *Cost-type OT agreements.* (i) *Single Audit Act*—In accordance with the requirements of Public Law 98–502, as amended by Public Law 104–156, 110 STAT. 1396–1404, when a business unit that will perform the OT agreement, or a subawardee, meets the criteria for an audit pursuant to the Single Audit Act, the DoD must have sufficient access to the entity's records to assure compliance with the provisions of the Act.

(ii) *Traditional Defense contractors.* The DoD shall have access to records on cost-type OT agreements with traditional Defense contractors that provide for total Government payments in excess of \$5,000,000. The content of the access to records clause shall be in accordance with paragraph (c) of this section. The value establishing the threshold is the total value of the agreement including all options.

(iii) *Nontraditional Defense contractors.* The DoD should have access to records on cost-type OT agreements with nontraditional Defense contractors that provide for total Government payments in excess of \$5,000,000. The content of the access to records clause should be in accordance with paragraph (c) of this section. The value establishing the threshold is the total value of the agreement including all options.

(iv) *DoD access below threshold.* The Agreements Officer has the discretion to determine whether to include DoD access to records when the OT does not meet any of the requirements in (a)(2)(i)

through (a)(2)(iii) of this section. The content of that access to records clause should be tailored to meet the particular circumstances of the agreement.

(v) *Examples of cost-type OT agreements.* (A) An agreement that requires at least one-third cost share pursuant to statute.

(B) An agreement that includes payable milestones, but provides for adjustment of the milestone amounts based on actual costs or reports generated from the awardee's financial or cost records.

(C) An agreement that is for a fixed-Government amount, but the agreement provides for submittal of financial or cost records/reports to determine whether additional effort can be accomplished for the fixed amount.

(3) *Subawardees.* When a DoD access to records provision is included in the OT agreement, the awardee shall use the criteria established in paragraphs (a)(2)(i) through (a)(2)(iii) of this section to determine whether DoD access to records clauses should be included in subawards.

(b) *Exceptions.* (1) *Nontraditional Defense contractors*—(i) The Agreements Officers may deviate, in part or in whole, from the application of this access to records policy for a nontraditional Defense contractor when application of the policy would adversely impact the government's ability to incorporate commercial technology or execute the prototype project.

(ii) The Agreements Officer will document:

(A) What aspect of the audit policy was not applied;

(B) Why it was problematic;

(C) What means will be used to protect the Government's interest; and
(D) Why the benefits of deviating from the policy outweigh the potential risks.

(iii) This determination will be reviewed by the approving official as part of the pre-award approval of the agreement and submitted to the agency POC within 10 days of award.

(iv) The agency POC will forward all such documentation received in any given fiscal year, to the Director, Defense Procurement by 15 October of each year.

(2) *Traditional Defense contractor.* (i) Any departure from this policy for other than nontraditional Defense contractors must be approved by the Head of the Contracting Activity prior to award and set forth the exceptional circumstances justifying deviation.

(ii) Additionally, the justification will document:

(A) What aspect of the policy was not applied;

(B) Why it was problematic;

(C) What means will be used to protect the Government's interest; and
(D) Why the benefits of deviating from the policy outweigh the potential risks.

(iii) The HCA will forward documentation associated with such waivers in any given fiscal year, to the Director, Defense Procurement by 15 October of each year.

(3) *DoD access below the threshold.* When the Agreements Officer determines that access to records is appropriate for an agreement below the \$5,000,000 threshold, the content, length and extent of access may be mutually agreed to by the parties, without documenting reasons for departing from the policy of this section.

(4) *Flow down provisions.* The awardee shall submit justification for any exception to the DoD access to records policy to the Agreements Officer for subawardees. The Agreements Officer will review and obtain appropriate approval, as set forth in paragraphs (b)(1) and (b)(2) of this section.

(c) *Content of DoD access to records clause.* When a DoD access to records clause is included as part of the OT agreement, address the following areas during the negotiation of the clause:

(1) *Frequency of audits.* Audits will be performed when the Agreements Officer determines it is necessary to verify statutory cost share or to verify amounts generated from financial or cost records that will be used as the basis for payment or adjustment of payment.

(2) *Means of accomplishing audits.* (i) *Business units subject to the Single Audit Act*—When the awardee or subawardee is a state government, local government, or nonprofit organization whose Federal cost reimbursement contracts and financial assistance agreements are subject to the Single Audit Act (Public Law 98–502, as amended by Public Law 104–156, 110 STAT. 1396–1404), the clause must apply the provisions of that Act for purposes of performing audits of the awardee or subawardee under the agreement.

(ii) *Business units not subject to the Single Audit Act currently performing on procurement contracts.* The clause must provide that DCAA will perform any necessary audits if, at the time of agreement award, the awardee or subawardee is not subject to the Single Audit Act and is performing a procurement contract that is subject to the Cost Principles Applicable to Commercial Organizations (48 CFR part

31.2) and/or the Cost Accounting Standards (48 CFR part 99).

(iii) *Other business units.* DCAA or a qualified IPA may perform any necessary audit of a business unit of the awardee or subawardee if, at the time of agreement award, the business unit does not meet the criteria in (c)(2)(i) or (c)(2)(ii) of this section. The clause must provide for the use of a qualified IPA if such a business unit will not accept the agreement if the Government has access to the business unit's records. The Agreements Officer will include a statement in the file that the business unit is not performing on a procurement contract subject to the Cost Principles or Cost Accounting Standards at the time of agreement award, and will not accept the agreement if the government has access to the business unit's records. The Agreements Officer will also prepare a report (Part III to the annual report submission) for the Director, Defense Procurement that identifies, for each business unit that is permitted to use an IPA: the business unit's name, address and the expected value of its award. When the clause provides for use of an IPA to perform any necessary audits, the clause must state that:

(A) The IPA will perform the audit in accordance with Generally Accepted Government Auditing Standards (GAGAS). Electronic copies of the standards may be accessed at www.gao.gov. Printed copies may be purchased from the U.S. Government Printing Office (for ordering information, call (202) 512-1800 or access the Internet Site at www.gpo.gov).

(B) The Agreements Officers' authorized representative has the right to examine the IPA's audit report and working papers for 3 years after final payment or three years after issuance of the audit report, whichever is later, unless notified otherwise by the Agreements Officer.

(C) The IPA will send copies of the audit report to the Agreements Officer and the Assistant Inspector General (Audit Policy and Oversight) [AIG(APO)], 400 Army Navy Drive, Suite 737, Arlington, VA 22202.

(D) The IPA will report instances of suspected fraud directly to the DoDIG.

(E) The Government has the right to require corrective action by the awardee or subawardee if the Agreements Officer determines (subject to appeal under the disputes clause of the agreement) that the audit has not been performed or has not been performed in accordance with GAGAS. The Agreements Officer should take action promptly once the Agreements Officer determines that the audit is not being accomplished in a timely manner or the audit is not

performed in accordance with GAGAS but generally no later than twelve (12) months of the date requested by the Agreements Officer. The awardee or subawardee may take corrective action by having the IPA correct any deficiencies identified by the Agreements Officer, having another IPA perform the audit, or electing to have the Government perform the audit. If corrective action is not taken, the Agreements Officer has the right to take one or more of the following actions:

(1) Withhold or disallow a specified percentage of costs until the audit is completed satisfactorily. The agreement should include a specified percentage that is sufficient to enhance performance of corrective action while also not being unfairly punitive.

(2) Suspend performance until the audit is completed satisfactorily; and/or

(3) Terminate the agreement if the agreements officer determines that imposition of either (c)(2)(iii)(E)(1) or (c)(2)(iii)(e)(2) of this section is not practical.

(F) If it is found that the awardee or subawardee was performing a procurement contract subject to Cost Principles Applicable to Commercial Organizations (48 CFR part 31.2) and/or Cost Accounting Standards (48 CFR part 99) at the time of agreement award, the Agreements Officer, or an authorized representative, has the right to audit records of the awardee or subawardee to verify the actual costs or reporting information used as the basis for payment or to verify statutorily required cost share under the agreement, and the IPA is to be paid by the awardee or subawardee. The cost of an audit performed in accordance with this policy is reimbursable based on the business unit's established accounting practices and subject to any limitations in the agreement.

(3) *Scope of audit.* The Agreements Officer should coordinate with the auditor regarding the nature of any audit envisioned.

(4) *Length and extent of access.* (i) *Clauses that do not provide for use of an IPA*—The clause must provide for the Agreements Officer's authorized representative to have access to directly pertinent records of those business units of the awardee or subawardee's performing effort under the OT agreement, when needed to verify the actual costs or reporting used as the basis for payment or to verify statutorily required cost share under the agreement.

(ii) *Clauses that provide for use of an IPA to perform the audits.* The clause must:

(A) Provide the Agreements Officer's authorized representative access to the IPA's audit reports and working papers to ensure that the IPA has performed the audit in accordance with GAGAS.

(B) State that the Government will make copies of contractor records contained in the IPA's work papers if needed to demonstrate that the audit was not performed in accordance with GAGAS.

(C) State that the Government has no direct access to any awardee or subawardee records unless it is found that the awardee or subawardee was performing a procurement contract subject to Cost Principles (48 CFR part 31) and/or Cost Accounting Standards (48 CFR part 99) at the time of agreement award.

(iii) *Business Units subject to the Single Audit Act.* The clause must provide access to the extent authorized by the Single Audit Act.

(iv) *Record Retention/Period of Access.* The clause must require that the awardee and subawardee retain, and provide access to, the records referred to in (c)(4)(i) and (c)(4)(ii) of this section for three years after final payment, unless notified of a shorter or longer period by the Agreements Officer.

(5) *Awardee flow down responsibilities.* Agreements must require awardees to include the necessary provisions in subawards that meet the conditions set forth in this DoD access to records policy.

(d) *DoDIG and GAO access.* In accordance with statute, if an agreement gives the Agreements Officer or another DoD component official access to a business unit's records, the DoDIG or GAO are granted the same access to those records.

Dated: May 12, 2003.

Patricia L. Toppings,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 100

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Special Local Regulations for Marine Events; Chesapeake Bay Bridges Swim Races, Chesapeake Bay, MD

AGENCY: Coast Guard, DHS.