

Testimony

of

Patrick J. Fitzgerald  
Director, Defense Contract Audit Agency

before the

Commission on Wartime Contracting

March 29, 2010

Chairman Thibault, Chairman Shays, and members of the Commission; thank you for the opportunity to appear before you today. I am pleased to provide you with an overview of DCAA's role in supporting overseas contingency operations and appreciate the opportunity to highlight some of our actions in support of the contingency contracting community as they negotiate, administer and close out contracts. As requested, I will also discuss DCAA's efforts related to the contractor drawdown in Iraq and provide an update to our October 26, 2009 report recommendations related to Kellogg Brown & Root Services, Inc's. (KBR's) staffing levels under the LOGCAP contract which we shared with you during your November 2, 2009 hearing.

### **Background**

I have been with the Department of Defense (DoD) for 30 years, holding positions at almost all levels with the Army Audit Agency. In March of 2006, I became the Auditor General of the Army where I was responsible for the worldwide operations of the Army Audit Agency. I held that position until November 2009 when I was appointed the Director of the Defense Contract Audit Agency (DCAA).

DCAA is a distinct agency of the Department of Defense (DoD) that reports to the Under Secretary of Defense (Comptroller). The DCAA mission is to perform all necessary audits of contractors for DoD components responsible for the negotiation, administration, and settlement of contracts and subcontracts. DCAA's mission supports DoD's efforts to obtain maximum value for the dollars spent in defense contracting, thereby protecting the taxpayer's interest. In total, DCAA has about 4,400 employees and 105 field audit offices around the world.

In FY 2009, DCAA performed 21,276 audits covering \$330 billion in proposed or claimed contractor costs. These audits recommended reductions in proposed or billed costs of

\$20.4 billion or roughly 6.2 percent (referred to as questioned costs), and \$12.1 billion or roughly 3.7 percent in estimated costs where the contractor did not provide sufficient information to explain the basis of the estimated amounts (referred to as unsupported costs).

### **DCAA Contingency Contracting Audit Effort Update**

DCAA is responsible for providing Iraq/Afghanistan related contract audit services to both DoD and other Government organizations for about 114 contractors. These contractors hold more than 271 prime contracts with contract ceiling amounts of \$81.7 billion and funding to date of about \$65.9 billion. Under LOGCAP III and IV alone, over \$34 billion has been awarded through December 2009 including \$4.8 billion in 2009.

DCAA has supported Contingency Operations in Iraq, Kuwait, and Afghanistan since May of 2003. Since that time approximately 240 auditors have served overseas in various theatres of operations in support of Operation Iraqi Freedom and Operation Enduring Freedom, and this is in addition to the audit support provided by multiple DCAA Field Audit Offices located at contingency contractor locations in the United States. Through February 2010, DCAA has issued 3,157 reports in support of in-theatre contracts and we are expecting to issue over 200 more during the remainder of FY 2010.

As reported to you in May and August 2009, DCAA oversight of in-theatre contracts has led to our finding a number of problems. Our resulting action has ranged from recommending changes in processes, to collection of overcharges, to referral of our findings to the Inspector

General for possible legal action. Through February 2010, DCAA has reported total exceptions of \$17.5 billion related to our oversight efforts of in theatre contracts.

When auditing a contractor's records, auditors may receive information constituting evidence or causing suspicion of fraud or other suspected irregular conduct. It is DCAA policy that these suspected irregularities shall be referred to the appropriate investigative organization. Referrals may be made using the DCAA Suspected Irregularity Referral Form 2000 (DCAA Form 2000) or by using the DoD Hotline. When the referral comes from an audit finding or when the auditor has information to supplement that obtained from an external source, the DCAA Form 2000 is preferred because it specifies information needed by investigators and provides for appropriate consideration of the audit impact. We have issued an additional 23 suspected irregularity referrals (DCAA Forms 2000) subsequent to our May 4, 2009 testimony before the Commission which are identified at Appendix 1.

I would now like to take the opportunity to provide an update on several initiatives we have taken to ensure responsive support to overseas contingency operations: increasing DCAA resources to support overseas contingency operations; ensuring adequate oversight; our way forward on business systems audits; and increasing the number of operations audits in theatre.

### **Increasing Resources Allocated to Contingency Operations**

In the Commission's June 2009 Interim Report you observed that the lack of DCAA resources is a significant factor contributing to ineffective audit coverage of contingency contracts. While DCAA's 2010 risk based requirements plan revealed that we do not have sufficient resources to perform all our FY 2010 Agency-wide audit requirements, we continue to

view the contingency operations as our highest priority with the greatest risk. As a result we have committed to fully staffing our contingency contracting audit oversight positions.

As we have previously shared with the Commission, we continue to assess and increase our presence in the theater of operations as needed. Since opening the Iraq Branch Office (IBO) in May of 2003 we have covered the work in Iraq, Afghanistan and Kuwait with roughly 17 to 23 auditors all reporting through the IBO. In response to the troop buildup, along with the associated increase in contracting and contractor personnel in Afghanistan, we increased our presence from 4 auditors in the spring of 2009 to a staff of 17 today while also opening a separate Afghanistan Branch Office (ABO) in October 2009 which assumed responsibility for Afghanistan from the IBO. The ABO staff of 17 in Afghanistan is in addition to the 17 working in Iraq and Kuwait for the IBO which results in a near doubling of our presence to conduct the Agency important mission in theatre. Based on our current workload, we anticipate increasing our presence to approximately 40 auditors in the area of operations (IBO and ABO) by the end of FY 2010.

DCAA has implemented planning and coordination procedures to effectively integrate audit work between the Iraq and Afghanistan Branch Offices and the DCAA CONUS Audit Offices with cognizance of companies performing contracts in-theatre. In addition, we continue to assess the resources required to support the CONUS audit support at the three LOGCAP IV contractors. In December 2009, we made a decision to increase our FY 2010 work years of effort from 24 to 42 at KBR, from 16 to 41 at DynCorp, and from 15 to 30 at Fluor. Overall, we have increased our work year commitment at the three performing LOGCAP contractors by 105 percent from 55 to 113 staff years.

## **Ensuring Adequate Oversight**

Given our mission to provide contract audit and financial advisory services to those responsible for negotiating, administering and closing contracts, we recognize that it is imperative that we understand the needs of the users of our services and do our best to meet those needs while ensuring that we conform to the highest standards of quality and integrity. To ensure that we continue to provide the appropriate services, I have tasked my Regional Directors to reassess contracting operations in theatre to determine if we are providing the appropriate oversight. Our re-assessment will be based on feedback that we receive from DCMA theater commands, the Corp of Engineers, Joint Contracting Command Iraq/Afghanistan (JCC I/A), and Multi-National Security Transition Command – Iraq and our independent risk assessment of their contracting workload. As part of this process my key executives and I met with Brigadier General Nichols prior to her deployment to become Commander of Joint Contracting Command Iraq/Afghanistan (JCC I/A). We met so that we could brief her on DCAA's presence in theater while offering our services and support to her organization as they award and administer contracts in the area of operations.

In my few short months as the Director of DCAA, my key executives and I have personally reached out and met with Major General Yves Fontaine, Commanding General, Army Sustainment Command, Mr. Edward Harrington, Deputy Assistant Secretary of the Army (Procurement), and Mr. Jeffrey Parsons, Executive Director of the Army Contracting Command, along with other executives from the Army Material Command and the Army Contracting Command to specifically discuss DCAA's audit and financial advisory role in support of the LOGCAP contract. In addition, I appointed a LOGCAP Audit Liaison/Coordinator who will

facilitate communications between the Army Sustainment Command (ASC), Defense Contract Management Agency (DCMA), LOGCAP contractors, and the respective field audit offices. We view the position as a key component in supporting ASC as they negotiate future awards while also resolving current and future audit issues.

We are seeing some positive effects of our efforts to engage our stakeholders. Recently, our level of involvement associated with awards under LOGCAP IV has increased dramatically. We recently performed audits of the three LOGCAP IV performance contractor proposals for Corps Logistics Support Services (CLSS), Transportation Mission, and Postal Operations (CTP) in Iraq and will perform audits of the performance contractors' proposals for Base Life Support (BLS) services in the Iraq North and South area of responsibility as well. In addition, the Army solicited, and we provided financial advice related to its Business Case Analysis as it considers the effects of transitioning from LOGCAP III to LOGCAP IV for the Iraq (BLS). Also, we have had a seat at the table when the LOGCAP program plans were briefed to the Chairman of the Joint Chiefs of Staff, the Secretary of the Army, and Chief of Staff of the Army.

In addition to meeting with those noted above, I also meet periodically with Mr. Charlie Williams, Director, DCMA to address and resolve issues common to our organizations. As you know, DCMA, under the direction of Mr. Williams is responsible for administering many of the contingency contracts, and it is his organization which has the responsibility for addressing many of DCAA's audit findings. We are committed to working with Mr. Williams and his organization as they tackle the difficult task of rendering final decisions related to our audit findings while they administer and close out contracts.

In summary, I have instructed my staff to coordinate their audit efforts with the appropriate level of any DoD or US Government organization that is a stakeholder in Overseas Contingency Contracting Operations so that we are instrumental in supporting the procurement needs of our war fighters and representing the US taxpayers' interests.

### **Contractor Business System Audits**

As shared with the Commission in our November 2, 2009 hearing testimony, in response to concerns raised by the GAO we recognized the need to reassess our processes for auditing contractor business systems and established a project for that purpose. This project included assessing the DCAA process for evaluating and reporting on contractor internal controls considering the requirements of the Generally Accepted Government Auditing Standards and the need to provide contracting officials with the necessary information to meet their responsibilities related to contractor systems under the Federal Acquisition Regulations. We believe that the real time reporting of significant deficiencies/material weaknesses of a particular system as opposed to an overall audit opinion on the adequacy of each of those systems is a better approach. Historically, contracting officers who are charged with resolving DCAA reported deficiencies with the contractor have generally considered a business system to be adequate when the contractor submits an acceptable corrective action plan. Often, we have found that once the system has been deemed adequate, contractors have lost the incentive to devote the resources necessary to implement corrective actions to address reported deficiencies.

On January 15, 2010, a proposed contractor business system Defense Federal Acquisition Regulations Supplement (DFARS) rule was published. The proposed rule is the result of Mr. Shay Assad's commitment as the Director, Defense Procurement and Acquisition Policy, to improve DoD oversight over contractor business systems. Consistent with our views above, the



proposed rules define and establish criteria for each contractor business system and implement compliance mechanisms (i.e., percentage withholds) when deficiencies are discovered. We are encouraged that the proposed rule will allow for the Government to take a consistent approach to ensure that contractors implement the appropriate corrective actions in a timely manner, shifting the focus away from an adequacy/inadequacy determination.

In January, I directed my staff to commence the necessary business system audits at Overseas Contingency Operations (OCO) contractor locations that we believe are necessary to protect the Government's interests. We completed our preliminary assessment of the revised process for evaluating contractor billings and are currently evaluating revised processes for the accounting system. We have commenced pilot testing of the revised approach with emphasis on the accounting system and related billing procedures. We expect to commence these reviews at all significant OCO contractor locations within the next six months. The revised approach will be consistent with the proposed DFARS rule and will no longer require an opinion on the overall adequacy of the system of internal controls. Instead, the opinion will be limited to determining compliance with the applicable DFARS criteria. Our approach will result in increased transaction testing while ensuring that deficiencies are reported on a real time basis.

As we implement our new processes on contractor business systems I have asked our Regional Directors to assess the status of any in-process business system audits to ensure that deficiencies discovered as a result of our prior work are reported where appropriate. As important, where contractors assert that they have addressed reported deficiencies we will commit the resources necessary to assess whether those deficiencies have been corrected. As previously shared with the Commission, there are a number of outstanding DCAA reported business system deficiencies at the performing LOGCAP contractors. In many cases, the

LOGCAP contractors have asserted that those deficiencies have been corrected. As such, we are currently performing a number of follow-up audits to determine whether the corrective actions taken by the contractor are sufficient to resolve the reported deficiencies.

### **Economy and Efficiency Audits**

In addition to our October 26, 2009 audit of KBR's staffing levels under LOGCAP, which will be discussed later, in FY 2010 we have increased our efforts to perform economy and efficiency audits over the last several months. We anticipate expending roughly 12,000 hours in Iraq and Afghanistan during FY 2010 to perform these operations audits, as they are commonly referred. This is a significant commitment when compared to 2008 and 2009 when we expended roughly 900 and 3,500 hours respectively. The objective of operations audits is to assess whether the contractor's practices are inefficient and/or ineffective ultimately resulting in unreasonable costs.

In addition to our October 26, 2009 report, we have recently completed other audits which noted that the contractor's practices were inefficient or ineffective. The following are specific examples of those audits which are focused on KBR and the Iraq drawdown:

- **Corps Logistics Support Services (CLSS) Labor Management**. Our audit revealed that approximately \$21 million in cost savings can be realized on the LOGCAP contract in Iraq between May and December 2010 by de-scoping excess labor and capacity within the CLSS function (i.e., organizational and direct support maintenance).

From January 2009 through July 2009, the contractor's labor utilization rate across all sites in Iraq was less than 11 percent as determined by dividing the actual number of hours performing maintenance functions by the total available hours charged. Army Regulation 750-1 provides that "for civilian manpower, the standard utilization rate is 85 percent; the goal is 90 percent." During the same period, over 1.1 million hours (including overtime) had been charged to the Government, yet only 116,000 hours of documented repair work had been conducted.

At the Government's request, KBR submitted a de-scope proposal that took effect August 3, 2009. Our evaluation revealed that the implementation of the de-scope proposal had little effect. For the subsequent three month period (August – October 2009), KBR achieved a 16 percent utilization rate which continued to be well short of the 85 percent required by Army regulation.

In the case of the CLSS function, there is already a contractually mandated system to collect and report utilization rates to help the contractor and the Government more effectively manage staffing. This system clearly highlights the excess labor. Using the three month data subsequent to the implementation of KBR's August 3, 2009 de-scope proposal as a baseline, we determined that if the CLSS function was de-scoped to bring utilization rates in line with Army Regulation 750-1 cost savings of approximately \$21 million could be achieved during the period from May 2010 through December 2010.

- **DFAC Staffing - Inefficient Response to ACO Change Letter**. On August 10, 2009, KBR received an ACO change letter which required them to immediately reduce headcounts and related costs at 17 DFAC locations in Iraq. Our audit revealed that KBR was slow to react to the direction from the contracting officer at the majority of the DFAC locations. The failure to react in a timely manner resulted in unreasonable costs of roughly \$987,000. We recently issued a DCAA Form 1 to suspend these costs from current billings.

In addition to those discussed above, a number of other audits have been established as a result of our coordination efforts with our DCMA counterparts located in theater to also address specific concerns that they may have. For example, we have established audits to evaluate the following operational areas:

- Non-tactical vehicle utilization (Follow-up Iraq) which will evaluate whether KBR has implemented recommendations from a prior operations audit which concluded that KBR should reduce the number of low usage non-tactical vehicles and the personnel related to those vehicles.
- Third Country Nationals/Host Country Nationals/ExPat Labor Mix (Follow-up Iraq) which will evaluate whether KBR implemented prior recommendations that KBR could reduce labor costs by increasing the percentage of local and foreign nationals as compared to expatriates.
- Chartered Aircraft Utilization (Iraq/Afghanistan) which will evaluate KBR's efficient and effective use of its chartered aircraft for employees who travel within the theatre of operations. Preliminary results indicate that the actual average aircraft utilization is below KBR's own benchmark for such travel.

- Afghanistan DFAC Operations which will evaluate the overall reasonableness of the DFAC pricing structure based on current and expected utilization.

### **October 26, 2009 Report on Ineffective Drawdown by KBR in Iraq**

As mentioned during the Commission hearing in November 2009, DCAA had initiated several audits of KBR's labor operations in Iraq in light of the military drawdown there. Observations from our in country audit staff as well as a preliminary review of KBR staffing levels compared with military troop levels, suggests that KBR was slow in responding to the military troop drawdown. On October 26, 2009, we issued a report concluding that KBR was ineffective at managing their staffing levels during the planned military troop drawdown due to the lack of an advanced contingency plan which would have allowed them to respond more effectively to the changing environment. Our report concluded that KBR could save the Government approximately \$193 million over the 8-month period from January 2010 through August 2010 by improving the staff management and aligning their labor drawdown with the military drawdown. When the military reduced its troop levels from 160,000 in January 2008 to 130,000 in September 2009, a 19 percent reduction, KBR's staffing levels remained constant. At the time of our audit and as noted above, KBR did not have a detailed, written plan to reduce staffing levels in consonance with the military drawdown.

In addition, KBR's system and procedures for staff management were not sufficiently detailed to identify and prevent overstaffing even though KBR had projected a quarterly 5 percent staffing reduction. Even if KBR achieves its projected quarterly 5 percent staffing reduction, we estimated that KBR would be overstaffed by an average of 2,857 employees from January 2010 to August 2010. The payroll attributed to the overstaffing for this 8-month period for these employees is approximately \$193 million.

## **Current Status of the Drawdown Audit**

On November 5, 2009, the contracting officer for the Army requested that KBR prepare a formal plan for the reduction of personnel in Iraq in direct response to our October 26, 2009 audit report by November 27, 2009. In addition, KBR was requested to provide a detailed briefing to Major General Fontaine, including key executives for the Army and their staffs, to illustrate KBR's assessment of the required manning levels in support of the declining population.

On November 30, 2009, KBR responded with a "draft" support plan noting that the plan is still contingent upon feedback from Multi Force National – Iraq (MNF-I). DCAA was not on distribution of the "draft" plan and did not receive a copy until it was provided by representatives from Rock Island on January 22, 2010. However, DCAA was invited to participate in a February 23, 2010 meeting at Rock Island at which time KBR was to submit their latest draft drawdown plan to the Government.

On February 23, 2010, KBR submitted and briefed the Army and ASC on its revised drawdown plan. KBR still considers the plan to be draft, or pre-decisional, as they believe that additional input from the Army is necessary. DCAA was invited, and participated in the briefing. KBR's briefing consisted of 37 slides summarizing the facts and assumptions inherent in their drawdown plan. KBR's plan primarily focuses on their drawdown efforts under Task Orders (TO) 151 and 159 of LOGCAP III. TO 151 period of performance ends April 30, 2010 and is currently in negotiation for an extension and TO 159 period of performance ends August 31, 2010. Since these TOs represent the bulk of KBR's efforts in theatre, their drawdown plan includes the timeframe up through August 2010. According to their plan, KBR is proposing

overall staff reductions of 38% (direct and non-direct hires) between November of 2009 and August of 2010.

As soon as we received the plan, we initiated our follow-up audit to assess KBR's proposed plan; however; our timely follow-up results will be contingent upon confirmation from the Army regarding major assumptions used in KBR's analysis and KBR's timeliness in responding to our requests for information. Although our review is in process and we have not drawn any conclusions, we share the following initial observations of the plan:

- KBR's proposed supported headcount of 188,933 in August 2010 is significantly higher than other Government estimates of 105,000 (50,000 military and 55,000 civilians/contractors).
- KBR's proposed 15% staff reduction from November 2009 through July 2010 does not appear in consonance with anticipated troop reductions,
- Over 60% of KBR's planned staff reductions occur within the final month of the current period of performance (i.e., from July 2010 to August 2010).
- Using a similar methodology that we used in our October 26, 2009 report, KBR's projected labor drawdown plan will achieve a reduction in labor costs of approximately \$27 million over the same period (January 2010 through August 2010) as compared to the \$193 million as noted in our report.

These are just a few observations that we have made based on our initial review.

Additional audit work will be required to verify key facts and assumptions of the company's

plan. DCAA will continue to work hard in reviewing KBR's plan and we will issue our follow-up report as soon as we complete our audit.

### **Closing**

In closing, I would like to say that I am very proud of DCAA's highly skilled, hard working and dedicated auditors supporting DCAA's important mission. In particular, I would like to personally acknowledge the dedication of those auditors on the ground with our soldiers in Iraq, Afghanistan, and Kuwait, who are supporting the overseas contingency contracting oversight in austere environments and conditions. I would also like to acknowledge those at our CONUS field audit office locations who are also supporting this important work that continues to provide real value to the Department. USD/AT&L Ash Carter recently testified that: "I support, as does the Secretary, the initiatives the Congress directed when it unanimously passed the Weapon Systems Acquisition Reform Act (WSARA). Acquisition Reform is one of DoD's High Priority Performance Goals presented in the Analytic Perspectives volume of the President's FY 2011 Budget. The Department is moving out to implement these initiatives." DCAA's efforts discussed above are consistent with WSARA implementation and DoD's Acquisition Reform goal. I appreciate the opportunity to testify before you today and I will be glad to respond to your questions.



**DCAA Form 2000 Referrals  
Suspected Irregular Conduct**

**Issued Since April 2009**

<b>Case No</b>	<b>Description</b>	<b>Date</b>	<b>Ref Org</b>
09-051	Labor/Timekeeping Irregularities	4/8/2009	USAIDIG
09-052	Billing Irregularities – billed retainage from subcontractors	4/8/2009	DCIS
09-070	Subcontract Irregularities – charging contingency costs	4/28/2009	DCIS
09-075	Subcontract Irregularities – failure to eliminate subcontractor errors	4/29/2009	DCIS
09-106	Subcontract Irregularities – invoiced labor costs are overstated	7/17/2009	DCIS
09-107	Accounting Mischarging – travel invoices appear fraudulent	7/23/2009	DCIS
09-108	Ethical Violations - possible bid rigging of insurance coverage	7/23/2009	DCIS
09-114	Subcontract Irregularities – collusion, unreasonable pricing, false claims	7/31/2009	DCIS
09-126	Billing Irregularities – public vouchers	9/2/2009	DCIS
10-006	Subcontract Irregularities - termination settlements	10/16/2009	DCIS
10-010	False Claim/Certification	12/4/2009	DCIS
10-034	Billing & Material Irregularities	12/14/2009	DCIS
10-038	Human Trafficking and Withholding of Employee Passports	1/7/2010	DCIS
10-049	Labor/Timekeeping Irregularities – inconsistent signatures	1/27/2010	USAIDIG
10-050	Labor/Accounting Mischarging	1/27/2010	DCIS
10-054	Violation of FAR 31.205-47 Cost Related to Legal & Other Proceedings	1/27/2010	DCIS
10-055	Violation of FAR 31.205-47 Cost Related to Legal & Other Proceedings	1/27/2010	DCIS
10-056	Violation of FAR 31.205-47 Cost Related to Legal & Other Proceedings	1/27/2010	DCIS
10-060	Human Trafficking	1/26/2010	DCIS
10-061	Miscellaneous Fraudulent Activities Reported	3/10/2010	DCIS
10-069	Billing Irregularities – public vouchers	3/10/2010	DOSIG
10-070	Other Irregular Activity – avoidance of paying payroll taxes	3/10/2010	DCIS
10-073	Labor/Timekeeping Irregularities – inconsistent signatures	3/10/2010	USAIDIG