

CONTRACTOR BUSINESS SYSTEMS

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TUESDAY, AUGUST, 11, 2009

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Commission on Wartime Contracting in Iraq and Afghanistan,
Washington, D.C.

The Commission met, pursuant to notice, at 9:31 a.m., in Room SD-342, Dirksen Senate Office Building, Christopher Shays, Co-Chair of the Commission, presiding.

Present: Commissioners Shays, Thibault, Tiefer, Henke, Gustitus, Zakheim, Ervin, and Green.

OPENING STATEMENT OF CHAIRMAN SHAYS

Chairman Shays. I would like to call this hearing to order. Good morning. I am Christopher Shays, Co-Chair of the Commission on Wartime Contracting in Iraq and Afghanistan. Thank you for attending this hearing on contractor business systems.

I will make an opening statement on behalf of Co-Chairman Michael Thibault and my six fellow Commission members. Mr. Thibault will provide the joint opening statement at tomorrow's hearing in this room on Linguistic Support Services in Theater.

The other Commissioners at the dais today are Clark Kent Ervin, Grant Green, Linda Gustitus, Robert Henke, Charles Tiefer, and Dov Zakheim. Congress established this Commission by statute in 2008 as an independent bipartisan body to examine a wide range of issues relating to wartime contracting, to extract lessons learned, and to make specific recommendations to improve structures and practices, to promote achievement of national objectives, and to reduce waste, abuse, and fraud in contracting.

We are hard at work to fulfill that mandate. Commissioners and our professional staff are conducting hundreds of interviews, carrying out intensive research, making numerous trips to the Southwest Asia theater, and holding hearings with Government and contractor witnesses. On June 10th of this year, we issued, "At What Cost? Contingency Contracting in Iraq and Afghanistan," our interim report to Congress. A detailed final report will follow after we complete our full work plan to cover issues ranging from organizational structures and personnel issues to practices for defining contract requirements and monitoring performance.

Earlier hearings have highlighted the roles and findings of special and departmental Inspector Generals, and the operation of a multi-billion-dollar LOGCAP contract that provides logistic support to U.S. operations in Iraq and Afghanistan.

Today, we focus on another vital aspect of the contracting world: the vast and complex business systems intended to support and document contractors' billing, labor hours estimates, purchases, subcontractor management, and other activities.

Ebenezer Scrooge's business system consisted of a shivering Bob Cratchit making quill pen entries in a ledger. Today's business systems comprise policies, practices, internal controls, and intricate software with millions of lines of computer code, often customized to accommodate legacy systems, differing regulatory or accounting requirements, and multiple lines of businesses.

There are literally millions of accounting transactions that need to be recorded, properly billed to the Government, and used to support estimates for future contracts. Over \$100 billion -- and I did not say "\$100 million." Over \$100 billion of contract costs have been estimated, recorded, billed, and controlled using these business systems.

The complexity of these systems gives them incredible power for documenting and managing business operations, but also the potential to create formidable obstacles to transparency for oversight and audit when poorly designed, incorrectly used, or not updated. Those weaknesses and obstacles are at center stage in this hearing.

We will swear in two panels of witnesses today. The first panel will represent Federal agencies whose work involves dealing with or auditing contractor business systems. Those witnesses are: Jeff Parsons, Executive Director of the Army Contracting Command; April Stephenson, Director of the Defense Contract Audit Agency; David Ricci, Director of Contract Business Operations at the Defense Contracting Management Agency, DCMA.

Our second panel will consist of witnesses from the contracting industry. The three companies represented are the three primary contractors for LOGCAP IV logistics contracts. The witnesses are: William Ballhaus, President and CEO of DynCorp; William Walter, Senior Vice President and Director of Government Compliance at KBR; David Methot, Chief Compliance Officer with Fluor Government Group.

Before we hear our witnesses' testimony and their responses to questions from the Commissioners, we want to offer some basic remarks on the purpose of today's hearing.

From 2001 through mid-2009, Congress has appropriated about \$880 billion to fund U.S. overseas contingency operations, with the great majority of that funding devoted to Iraq and Afghanistan. Over that period, America's reliance on contractors has grown to unprecedented proportions to support logistics security and reconstruction efforts related to those operations. More than 240,000 contract employees, about 80 percent of them foreign nationals, work in Iraq and Afghanistan at one time to support the Department of Defense. Additional contractor employees support the Department of State and the U.S. Agency for International Development.

Contractor employees outnumber U.S. military personnel in both theaters. They have a critical mission, and according to reports from the military in theater, they are doing an exceptionally good job providing security, transportation, meals, laundry, and other services.

The questions raised today in no way detract from the overwhelming good opinions of contractors' support for U.S. missions or obscure the fact that nearly 1,400 contract employees have died on duty in Southwest Asia. The questions do, however, reflect serious concerns about the Government's ability to evaluate the costs of contractor services and provide good stewardship of taxpayers' dollars.

Are we spending too much for services for which we could and should be paying much less? Are we overpaying and wasting precious resources?

The Commission's internal report "At What Cost?" called policymakers' and lawmakers' attention to eight issues of immediate concern that we felt should not languish unaddressed until completion of our final report. One of the eight was contractor business systems, about which we simply said too many contractor business systems are inadequate and must be fixed.

Commission staff examined a selection of reports on 100 business systems used by 15 contractors who had raised \$43 billion in contracts for work in Iraq and Afghanistan. We learned that 30 of those 100 systems had been judged inadequate or inadequate in part by the Defense Contract Audit Agency. Fully half of the billing and compensation systems were considered inadequate. Every other category of applicable business systems -- accounting, budget, electronic data processing, indirect and other direct costs, labor and purchasing -- also showed inadequacies, although to a lesser extent.

As we issued the interim report, DCAA identified three more contract business systems as inadequate, including the labor, billing, and compensation systems that are essential parts of a contractor's overall management control structure. This issue of inadequate business systems in the contingency contracting environment is growing. But after more than 6 years, the opposite should be expected. This is a serious problem that should concern the President, every Member of Congress, and every taxpayer.

As the Commission said in its interim report, "Significant deficiencies in contractor systems increased the likelihood that contractors will provide proposal estimates that include unallowable costs or that they will request reimbursement of contract costs to which they are not entitled or which they cannot support."

The Commission's May 2009 hearing heard that although through fiscal year 2008 DCAA had taken exception to over \$13 billion in questioned and unsupported costs associated with the efforts in theater, some of those shortcomings reflect inconsistencies or ineffective operations of contractor business systems. And even if further inquiries provide documentation for questioned costs, the shortcomings demanded extra time and effort from Federal oversight personnel that should not have been needed and has resulted in higher costs for taxpayers.

DCAA has also testified that inadequate business systems may prevent the Government from closing out some Iraq and Afghanistan contracts for years because of missing or incorrect data.

U.S. Army Contracting Command previously testified before this Commission about "over-taxed business systems under LOGCAP III that created problems with management subcontractors making accurate estimates, reporting costs and purchases, and other issues."

Army Contracting Command has adopted a policy under the new three-vendor task order competition LOGCAP IV contract that segregates 15 percent of the award pool to provide incentives for good management of business systems and small business subcontractor performance. This is a welcome reform, but the test will be in its consistent and strict application.

The harsh fact we still face is that some contractor business system deficiencies have remained uncorrected, without consequences, for months or even years. Federal regulations require contractors to maintain adequate business systems. Regulations also permit, but do not require, contracting officers to withhold payment when a contractor fails to correct significant deficiencies. But previous DCAA testimony indicates that many contractors continue to operate inadequate business systems with little fear of effective discipline.

Further, there appears to be disagreement at times between DCMA and DCAA on whether withholds should be imposed after a DCAA determination of inadequacy. We will explore these disagreements at today's hearing in some length.

This state of affairs is both alarming and puzzling. Why can't private corporations, who do not face the bureaucratic obstacles to change of a Federal department, find ways to make prompt corrections to systems that log vital data? How can large corporations manage their affairs effectively and provide accurate information to shareholders let alone meet their regulatory obligations to the Federal Government with business systems that are truly inadequate?

Are Federal definitions of "adequacy" irrelevant to real-world operations? Or are contractors using some parallel system of enterprise management that remains invisible to Federal oversight?

With whatever concerns we have with the private sector, we do not intend to give the Government a free pass on this issue. Contractors are not the only ones with business systems issues. For example, the business systems modernization program at the Department of Defense has been on the Government Accountability Office's high-risk list since 1995 -- not 2005, 1995. Tackling that issue is outside the Commission's mandate, but we can still ask: Is Government doing its job to ensure that contractors comply with Federal requirements? If the procuring contracting officer, the administrative contracting officer, and the auditor cannot ensure that needed improvements are timely made, who can? And who is accountable on the Federal side of contracting?

These are just a few of the questions that my colleagues and I hope to learn more about in today's hearing.

(The prepared statement of Chairman Shays and Chairman Thibault follows:)

Chairman Shays. Again, we thank our witnesses for their cooperation.

As is customary, a question-and-answer period will follow the testimony. After we adjourn, the hearing record will remain open for 10 business days to allow responses to questions for the record.

And, with that, we welcome our witnesses, our first panel. I would invite you to stand. I would like to swear you in, as is the custom of this Commission. Raising your right hand, do you solemnly swear or affirm that the testimony you will give before this Commission is the truth, the whole truth, and nothing but the truth?

Mr. Parsons. Yes.

Ms. Stephenson. Yes.

Mr. Ricci. I do.

Chairman Shays. Thank you. Your statements are long in some instances, so we will, as you know, ask you to summarize your statements. We would like you to keep your statements between 5 and 7 minutes. That would be our preference. And we will be sure to make sure that anything that you need to say you will be allowed to say, even if we have not asked the question. We will give you that opportunity at the end.

So we are going to go in order with you, Mr. Parsons, then you, Ms. Stephenson, and then Mr. Ricci.

TESTIMONY OF JEFFREY PARSONS, EXECUTIVE DIRECTOR, U.S. ARMY CONTRACTING COMMAND

Mr. Parsons. Thank you. Chairmen Thibault and Shays and distinguished Commissioners of the Commission on Wartime Contracting, thank you for this opportunity to discuss the importance of contractor business systems in contractor business systems in army contracting.

Effective business systems are central to the conduct of sound business operations. Contractors must have systems in place such as accounting, payroll, and billing at the time of contract award that are in compliance with Government cost accounting standards, Federal Acquisition Regulations, and Defense Federal Acquisition Regulations. The systems must reasonably forecast labor and material requirements, ensure the costs of labor, subcontracts, and purchase of fabricated material charged or allocated to a contract are based on valid requirements, and maintain a consistent, equitable, and unbiased logic for costing of material transactions and labor. Contractors must maintain the systems throughout the life of the contract.

The army considers the relative condition of a contractor's management systems, including business systems, during the source selection process. Generally, this is included as part of the management area of contractor proposals and related evaluation criteria. Under the LOGCAP IV source selection, the evaluation criteria established that management, of which business systems was a sub-factor, took precedence over all other factors. This area was given a higher-than-usual weight because of the difficulties

of managing a quick response program in an austere environment and the need for robust systems to respond as contract requirements change and to keep up with wartime threats in evaluating the relative strengths of business systems as part of the source selection process, the contracting officer and source selection authority, relying on the input of experts from the Defense Contract Audit Agency and the Defense Contract Management Agency.

After the business systems are considered under the source selection process, they are reviewed again before award is made. The contracting officer may not award a contract unless he or she has made an affirmative determination of the contractor's responsibility. In making this determination, the contracting officer must consider whether the contractor has the necessary accounting and operational controls in place, such as accounting, payroll, and invoicing systems, applicable to the services being performed by the contractor and subcontractors. On cost-type contracts, the contracting officer must determine that the contractor's accounting system and related internal controls provide reasonable assurance that the accounting system and cost data are reliable, risk of misallocations or mischarges are minimized, and contract allocations and charges are consistent with invoice procedures.

During contract performance, the contractor must maintain its systems to support billing and payment under its contract and must be able to accurately track the costs associated with the contract baseline and any changes made to the contract. The cost allocation amongst various work packages must be verifiable and must track back to the discrete contract change.

This is the method the Government uses to validate the costs charged under the contract are fair, reasonable, and allocable. If a problem with any of the contractor's business systems is noted during a DCAA incurred cost audit or during DCMA surveillance, the contracting officer is notified, DCAA and DCMA work together to resolve what adjustments will be made to the billing rates of invoice, and the contracting officer supports that process by taking appropriate contract action, if necessary.

In the case of an award-fee contract, pressure can be brought to bear through the award-fee criteria. That is one of the levers used under the LOGCAP award-fee process, which has criteria directly associated with corporate management and business systems. Should the contractor not react in a timely manner, the army will dialogue with senior management in the corporate chain. Depending on the severity of the problem, senior army or defense officials may engage with the contractor's most senior managers to ensure that the army's mission needs are met at a reasonable price.

Let me assure you that the Army Contracting Command is committed to excellence in all contracting, including these very complex and critical LOGCAP contracts. We continue to collect lessons learned and make improvements in adjustments along the way to ensure mission success and protection of the interests of the U.S. Government and taxpayer. As stewards of the taxpayers' dollars, the army is committed to excellence in managing and documenting contractor performance and the overall discipline

of contract administrative services. It is my honor to lead the Army Contracting Command team as we persevere to achieve those goals.

Thank you for inviting me today to speak with you. This concludes my statement.

[The prepared statement of Mr. Parsons follows:]

Chairman Shays. Thank you.

Ms. Stephenson?

TESTIMONY OF APRIL STEPHENSON, DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

Ms. Stephenson. Chairman Thibault, Chairman Shays, and members of the Commission, thank you for the opportunity to be before you today. I am pleased to be here. As requested, I will describe the audit effort performed by DCAA on business systems for contractors' performing effort in theater. A more detailed account is provided in the statement that I ask be submitted for the record.

DCAA has implemented planning and coordination procedures to effectively integrate audit work between the Iraq branch office, opened in May 2003, and more than 60 DCAA offices stateside. Just recently, I approved the opening of a second audit office in theater in Afghanistan. Through June 2009, DCAA has completed over 200 business system audits and has cited deficiencies in more than half of these audits.

When a contractor's business system is inadequate, the data generated by the contractor is unreliable, which in turn results in the risk of noncompliances with Government laws and regulations, mischarging, fraudulent acts, and contract overpayments.

The requirement for adequate business systems dates back to 1977 to the Foreign Corrupt Practices Act, the results of which were further refined in 1985 by the National Commission on Fraudulent Financial Reports, known as the Treadway Commission. The Commission developed a framework that defined internal control as a process designed to provide reasonable assurance about the reliability of financial reporting, efficiency and effectiveness of operations, and compliance with applicable laws and regulations. Currently, public laws, acquisition regulations, and contract terms require Government contractors to maintain adequate business systems. Using these previous bodies of work on internal controls, DCAA established audit procedures for the ten contractor business systems listed in my written testimony.

DCAA's opinion on contractor business systems is advisory, and the contracting officer, usually DCMA -- the Defense Contract Management Agency -- has the ultimate decision to approve or disapprove the contractor's systems.

Since an inadequate business system is considered a critical breakdown in the contractor's processes, the acquisition regulations require contracting officers take certain actions when deficiencies are found,

such as considering whether it is appropriate to suspend a portion of interim payment.

Even when the contractor has proposed an apparently adequate corrective action plan, until that plan is effectively implemented the contractor is still processing transactions with an inadequate system of internal controls. As a result, there is a greater risk of overpayment.

During our audits of contracts and contractor business systems in theater, we have reported a number of system deficiencies. For example, since March 2009, we have reported three business systems at DynCorp to be inadequate. In the last few months, 50 percent of sampled billings at DynCorp have been rejected for exceeding allowable amounts.

Shortly after DynCorp was awarded the task orders for Kuwait, it submitted change order proposals requesting an increase in price at about 51 percent, or a \$50 million increase. The increase is primarily due to increased labor costs DynCorp stated it incurred to hire employees in theater. We identified a number of other billing deficiencies through our audits of the Department of State contracts at DynCorp, resulting in \$13 million of overpayments being refunded.

As stated in our testimony to the company on May 4th, we have reported a number of issues related to system deficiencies at KBR. Rather than repeating the extensive list of issues in this testimony, we refer the Commission to our prior testimony. However, it is worth noting the effects of these inadequacies in KBR's purchasing system resulted in significant unreasonable subcontract prices on the LOGCAP III contract.

We have issued in excess of 100 suspensions, known as a DCAA Form 1, suspending hundreds of millions of dollars due to unreasonable and unsupported costs, many of which stem from deficient systems.

In April 2009, DCAA issued an audit report on KBR's purchasing system with an opinion of inadequate, primarily due to KBR's failure to perform adequate price analysis of subcontractor proposals as required by the regulations.

For example, KBR purchased about 4,100 living units at an average unit price of \$38,000. When a lower-priced vendor proposed \$18,000 for containers having similar amenities, the \$20,000 unit price difference equates to \$82 million.

DCAA has found that contractors do not always follow through to correct deficiencies in internal controls. In June 2006, DCAA reported significant deficiencies with KBR's purchasing system, and in that same year KBR stated it initiated a corrective action plan. But in our follow-up audit, issued 3 years later in April 2009, we identified similar deficiencies as well as two new deficiencies that led to issuing an overall opinion of inadequate.

Based on these events, it is clear that KBR did not take the correction of the reported deficiencies seriously. We believe a contributing factor is

DCMA's practice of recognizing the existence of a contractor's corrective action plan as the basis to render a system adequate.

Auditing contracts for contractors performing effort in theater has been very challenging in many areas. These challenges are discussed in greater detail in my written testimony.

For example, it appears that DCAA and contracting officers apply different criteria when assessing the adequacy of systems. DCAA must follow the Government auditing standard, which encompasses months of testing contractor internal controls before rendering an opinion.

In contrast, just recently DCMA performed its review of KBR's purchasing system in about a week -

Chairman Shays. Would try to finish up in the next minute?

Ms. Stephenson. Yes, I am almost done, sir. Thank you

-- and determined that the system was adequate. Clearly, we have different criteria in the opinions of an adequate system.

In closing, the challenges in applying sound and reliable business practices have been daunting and have required our auditors to be flexible. I would be pleased to take your questions.

[The prepared statement of Ms. Stephenson follows:]

Chairman Shays. Thank you.

Mr. Ricci?

TESTIMONY OF DAVID RICCI, DIRECTOR OF CONTRACT BUSINESS OPERATIONS,
DEFENSE CONTRACT MANAGEMENT AGENCY

Mr. Ricci. Good morning, Chairman Thibault, Chairman Shays, and Commissioners. On behalf of the Defense Contract Management Agency, I thank you for the opportunity to speak today on contractor business systems.

DCMA is responsible for the administration of about 325,000 contracts with unliquidated obligations of over \$220 billion awarded to over 19,000 contractors. DCMA accepts approximately three-quarters of a million shipments of supplies and 1,150 aircraft each year. We also manage over \$136 billion of Government property and administer about \$36 billion worth of contract financing payments each year. That workload, coupled with a significant reduction in personnel over the years, has posed a tremendous challenge to the agency.

Contractor maintenance of reliable business systems would help address that challenge. Simply put, robust planning and control systems increase the likelihood that conforming supplies and services are delivered on time and at a fair price. They also reduce the Government's cost of processing individual transactions.

Unfortunately, contractor business systems are not maintained at the level we would expect. Today I will provide some insight into our assessment of contract business systems and efforts to resolve deficiencies in those systems.'

The acquisition regulation gives our administrative contracting officers, or ACOs, wide latitude to exercise business judgment when determining the application of regulations and policies. While the authority and responsibility for determining system status clearly rests with the ACOs, they must consider the input provided by functional specialists. The Defense Contract Audit Agency is the Department's expert in contract auditing. As such, their advice is integral to the process.

To ensure DCAA recommendations are appropriately considered, last November we revised our internal policies to mandate that any ACO determination inconsistent with DCAA recommendations is subject to higher-level review that may include review by the DCMA head of contracting activity, a Senior Executive Service position within DCMA.

There are seven major contractor business systems prescribed by regulation. These systems are: accounting, estimating, purchasing, material management and accounting, property, earned value, and cost accounting standards disclosure statements. There is no consolidated list of these systems in the FAR or DFARS.

Many contractors maintain adequate systems, but there is room for improvement. Even the largest defense contractors with years of experience in Government contracting have sufficient deficiencies in their system. Only two of the ten largest business units have adequate systems across the board. Four of those ten business units are considered inadequate in three or more of the seven systems evaluated.

Taking a broader view, of the 435 contractor purchasing systems that have been reviewed, 19 -- about 5 percent -- have had their approvals withheld. Of the 2,479 contractor property systems that have been reviewed, 80 -- about 3 percent -- have been found inadequate. Of the 66 earned value management compliance reviews conducted since April 2006, only four suppliers have been found fully compliant with those guidelines.

However, focusing on whether a system is rated acceptable does not paint the whole picture. That is because an acceptable system may contain some deficiencies. Longstanding practice and regulatory guidance allows contractors in many cases to avoid having systems disapproved if they submit adequate corrective action plans and make timely progress against those plans.

The system rating is important as it may result in specific consequences. For example, a disapproved purchasing system automatically leads to increased subcontract consent requirements. But knowledge of the individual deficiencies is no less important.

The impact of a deficiency on the instant contracting action can often be mitigated through Government action, albeit typically through the expenditure of additional Government resources.

To illustrate this point, consider that the regulatory guidance for contractor cost estimating systems lists a number of potential risk mitigation strategies. These include use of a different contract type, performing additional cost analyses, or inclusion of a contract reopener clause. For that reason, we are working to improve the quality of our communications with contracting officers relative to system deficiencies.

The consequences of failing to maintain acceptable systems vary by system. I have mentioned the consent requirements of disapproved purchasing systems. Here are a few other examples: an inadequate accounting system may preclude the award of cost-type contracts or limit financing options; an unacceptable estimating system may result in increased post-award reviewed for defective pricing; an inadequate property system may lead the Government to revoke its assumption of risk and hold contractors liable for loss, damage, destruction, or theft of Government property. But with the exception of an MMAS, none of the consequences expressly and, importantly, contractually include reductions in contract price, payments, or financing.

Certain clauses allow the Government to impact cash flow when contractors fail to maintain acceptable systems or correct deficiencies in a timely manner. Both the progress payment and performance-based payments clauses allow for reduction or suspension of those financing payments for any material noncompliance with contract terms. The incentive-fee and fixed-fee clauses allow the contracting officer to withhold payment of fee after 85 percent has been paid, up to a total of \$100,000, although this has generally been done to ensure submission of final rate proposals, not to encourage improvements in business systems.

Finally, the allowable cost and payment clause gives the contracting officer the authority to suspend or disallow reimbursement of costs found to be unallowable. However, unless a system deficiency can be found to directly impact a specific cost allowability, use of this clause is generally not appropriate. Before it can be used to suspend costs, under our current contractual authority we need to demonstrate through substantial evidence a reasonable nexus or causality between the specific system deficiency and the cost to be suspended.

I know I am over. I will finish up quickly.

We recently offered some ideas to the Director of Defense Procurement Acquisition Policy on additional incentives to obtain greater compliance with regulatory business system requirements. We are also considering submitting a specific regulatory change to address suspension of cost for EVMS deficiencies. We will work this with the Director of Defense Procurement Acquisition Policy through the formal rulemaking process, including the opportunity for public comment.

In closing, we share the concerns you have with the adequacy of contractor business systems and appreciate Congressional support of our efforts to obtain improvements in them.

Again, thank you for the opportunity to appear before the Commission. This concludes my statement. I would be pleased to answer any questions.

[The prepared statement of Mr. Ricci follows:]

Chairman Shays. Thank you very much.

We are going to go in this order: Commissioner Thibault, then Commissioner Tiefer, Commissioner Henke, Commissioner Gustitus, Commissioner Zakheim, Commissioner Ervin, Commissioner Green, and then myself. We are going to go for 8 minutes, and then we will have a follow-up question of five.

Mr. Thibault?

Chairman Thibault. Thank you, Commissioner Shays. Thank you to each of you for taking the time to come up and prepare for this.

I have several areas of interest. This is a really important area. I do not see any difference of a view that it is a really important area, and I am going to talk about the, although I see differences, treatment of the outcomes. But before I go into that, Ms. Stephenson, Director Stephenson, you indicated to us last May, 4 months ago, you acknowledged the uptick or the significant increase in Afghanistan for workload, and a big part of this commission's effort is to try to take lessons learned from Iraq and the importance. And I know that DCAA was one of, if not the first, non-combat agency to go into Iraq in 2003, the summer of 2003, and the event started in early spring of 2003.

In May, we kind of highlighted that when we went out, we did not see as much of DCAA as we might have expected given the uptick. Can you talk a little bit about actions you might have taken?

Then the other thing we talked about was: Is DCAA going to get out into the outlying areas where so much of the costs are incurred and look at operations? Can you update this Commission on what, if any, actions you have taken as the Director?

Ms. Stephenson. Yes. We took your recommendations very seriously, and we do appreciate the Commission's support on these. Shortly after that hearing, we did assess what the staffing needs were, both in Iraq, Kuwait, and Afghanistan. I call that the "in-theater effort." And just recently we have opened an office in Afghanistan, so we now have two offices. We will have the Iraq branch office until the drawdown is complete and audits are no longer necessary in that area. And we now have the office that will be opening in Afghanistan, and we are coordinating with CENTCOM on the logistics that is necessary for that.

We have also approved and have a manager in Afghanistan right now along with an audit team, although it is not -- as the office is set up, it is on a temporary travel basis. We are shifting as need be.

On your question regarding the operations audits, we have initiated 15 operations audits, split between Iraq, Kuwait, Afghanistan. In Iraq, it is mostly focused on the drawdown and do we have too many people doing too little work. In Afghanistan, it is the control of various things such as the transition of equipment and property. We anticipate we will be spending in 2010 over 12,000 hours on operations audits.

Chairman Thibault. Thank you. One of the things -- and then I will move it around, but one of the areas that we were also interested in -- and I think I would like to start with you, Mr. Parsons -- at the last hearing was the business system evaluations in terms of coordination between the three organizations -- the three organizations that are here now -- in terms of, you know, is there a need -- we felt, and we got an agreement from every agency, that there was a need for improved or more directed or more focused. There were various coordination activities, but we had these differences that we are going to talk about and update in a bit. But I guess I am interested in, following that hearing, what kind of actions were you involved in that were trying to address these differences where you might have DCAA saying it is 50 percent or we have a very significant issue, and you might have DCMA with a different view.

So can you talk a little bit about what actions -- you know, in the army it is so critical, because you are the ones spending the dollars on the contracting effort.

Mr. Parsons?

Mr. Parsons. As I mentioned in my statement, you know, obviously these business systems are very important to us as far as our contracts go under LOGCAP, and as such, we put a lot of focus on that in the source selection for the basic LOGCAP contract and at the task order level. But, obviously, as the charts up here show, there are some differences of opinion between DCAA and DCMA, and that is one of the things the contracting officer has to wrestle with.

The contracting officer is informed by DCAA of audits where they find inadequacies. They are in communication with DCMA as well, and then they have got to understand the positions of both of those organizations.

I think it was last month that we actually held a meeting out at Rock Island where DCMA and DCAA participated. All the regional directors, in fact, were in from DCAA and gave a very thorough review of all the issues that they have identified with the different contractor business systems, and there was quite a bit of discussion about those. And as recently as a couple weeks ago, DCAA gave a follow-up update to the Rock Island Contracting Center on the concerns that they have with many of these business systems.

So the contracting officer needs to address those when they make the responsibility determination. They make trade-offs between the

information provided by DCAA and then DCMA and come to a conclusion on whether they believe or not the risk is so high that it cannot be mitigated or whether it can be, and then take appropriate action.

Chairman Thibault. Okay. Well, let me say thank you for that, but let me share that it seems that we are doing a lot of talking, but it seems, based on some of the testimony, that we have not done a lot of resolving. And I realize that DCAA answers through the Comptroller and DCMA comes up through the acquisition side and in my observation, it seems like something is not getting done in terms of addressing these important issues and trying to figure it out. And Director Stephenson has really focused as much with you, Mr. Ricci, because you shared in your testimony that 2,400-some -- or, excuse me, 475 contractor purchasing systems reviews performed by your CPSR team with -- I think the number was 19 exceptions. That is a pretty small percentage, just as an observation.

You just shared that typically your systems are running greater than 50 percent. So you have got whatever 19 out of 45 is, which is maybe 4 or 5 percent, and you have got 50 percent. So you have got one advisory organization saying to contractors and saying to your customers, the army, hey, we got a 50-percent hit rate problem. We got another one saying we got a 5-percent hit rate problem. And I am just talking about purchasing.

Now, I am sensitized because when you briefed us, Mr. Ricci and we appreciated it -- in advance of the hearing, you outlined, there it is, the staffing reductions that your CPSR teams have encountered. And I think it is important to share that in 1994, your CPSR team seems pretty important activity, your thresholds fairly low, important that you take a look at it, you had 102 individuals performing these reviews. You went down, by 2002 to 32, and in the present you have 14 that you shared with us. You also said, I believe, that you thought it was reasonable.

Well, I am here to tell you, intuitively and logically, it really does not seem reasonable, and then I feel like we kind of got a Hatfields and McCoys situation going on because in Director Stephenson's testimony, she stated that the CPSR team conducted its review in less than a week. So she did not put that in there because -- as a compliment, quite frankly, and she said there were 200 or 300 separate procurements, and by week's end they said it was adequate, and DCAA for a long standing had said it was inadequate. So using that as an example, and using the significant number, it is really troubling that we have these differences and that the two agencies have not been able to resolve it.

The last point is that you end up with companies, you know, there are great companies out there, and maybe they do not know how to assess this, much rather the army. There are companies out there that have had continuing problems, and maybe they are using it as excuses. Well, DCMA is telling me one thing -- if you look at that chart up there, DCMA is telling me one thing, and the others are telling me another.

So when I get to my questions at the end in the next round, I am going to be focused just on that and what is going on here. What is it going to take to get these two agencies together to figure out a good course of

action and to speak as one since you have a mutual customer, the United States military in this case?

Chairman Shays. Thank you. That is a nice introduction, but it may get answered before you get your second round.

Chairman Thibault. Well, that is just perfect.

Chairman Shays. Okay. Mr. Tiefer?

Commissioner Tiefer. Thank you, Mr. Chairman.

My respect to Ms. Stephenson of the DCAA for the professional diligence of your two lieutenants, Ron Meldonian and David Eck. Always a resource for me. And my Chairman, Mr. Thibault, I respect and draw on his deep insight into these systems. I could not look into them without him.

Okay. At the May 4th hearing, we expressed our concern that the Army Contracting Command might not take DCAA's offer to audit contractor proposals on the LOGCAP IV task orders. To put it in context for people, we are still trying to stand up LOGCAP IV. Proposals come in from the contractors through LOGCAP IV, the new iteration. The first was in Kuwait, a small system. The second was in Afghanistan, obviously of high importance. You were willing to audit it. Mr. Parsons pledged to us at that hearing a lot of cooperation with you. What happened?

Ms. Stephenson. I have to admit I tried every angle possible to get involved with the pre-award audits of the task orders for Afghanistan. I have met with Mr. Parsons. He did follow through on his effort to meet. I met with Charlie Williams, Lee a . I even went within AT&L and met with Shay Assad and expressed concerns and the risks associated with the pre-award.

As Mr. Parsons mentioned, we all had a meeting where I brought in every one of my executives involved with the three contractors, and we had a meeting with the individuals responsible for awarding the task orders for Afghanistan, an entire-day meeting, and went through each and every one of the issues and what it meant in LOGCAP.

Unfortunately, the train left the station without us, and we were not engaged in auditing the proposals for LOGCAP IV for Afghanistan.

Commissioner Tiefer. You are being diplomatic, Ms. Stephenson. The train did not sort of have no engineer on board. Mr. Parsons opposed you and won as he went up the ladder with you.

Is such auditing crucial for the drawdown? Remember, our top -- I am sorry. I want to follow up about the auditing. Our highest strategic imperative in Iraq is the drawdown. There is nothing more important. My Commission sent me 2 weeks ago to Baghdad to talk to -- I ended up talking to General Odierno. He sat down with me. I will say more about that later.

For the drawdown, is such auditing of proposals crucial for the new task order in Iraq which is coming -- has not been competed yet, is coming?

Ms. Stephenson. Yes, I would say the audits are almost more critical with the drawdown, and the reason being prior to awarding the task orders for the drawdown, we have to have a good understanding of the prices at a low enough level that when the drawdown occurs we can assess cost containment and cost growth. And given the inadequacies with the business systems with these three contractors, if these internal controls are not improved, coupled with a poorly priced drawdown, the drawdown in Iraq -- and these Iraq task orders are going to become a deep pocket for these contractors.

Commissioner Tiefer. A what?

Ms. Stephenson. A deep pocket. It is going to be critical that we have an adequately priced drawdown.

Now, in this effort, as Mr. Parsons said, we have had at least two meetings since June to talk about DCAA's involvement. I have Mr. Parsons' commitment that we will be involved with auditing the task orders on the pre-award basis for Iraq.

Commissioner Tiefer. Well, we have heard promises of cooperation before. I am glad this is a little more than in the past. What objections are you meeting, and how do you answer them, about why they did not last time and they would not this time let you audit the proposals which, as you say, could become a deep pocket, the drawdown could become a deep pocket for contractors? Go ahead.

Ms. Stephenson. I will talk in generalities as to what we have heard, whether it has been for Afghanistan or Kuwait, for the task orders in general. I hear such things as: DCAA takes too long; we need an audit quickly. I have heard that you ask for too much data, you want the contractors to submit more data than what perhaps is needed, and you have too many issues that get raised that delay an awarding of the contract.

And we recognize, we sincerely recognize that delays in contract audits do no one any good. And to mitigate this, we have set up a central person that will be the point of contact on all the Iraq -- on all the LOGCAP task orders to help facilitate. If we have enough time -- and I am not talking months. We can do this in weeks.

Commissioner Tiefer. Weeks.

Ms. Stephenson. Weeks. We can do this in weeks. If we have enough time, we certainly can do this, and generally it can even be in 4 weeks or less, depending on the amount of data. If contractor estimating systems provide adequate data that is easily supported when we go in and we assess it, we can get in and out quite quickly.

However, if the contractor data is deficient -- and in some instances, it has been severely deficient -- that will indeed hamper our audits getting done quickly.

Commissioner Tiefer. Okay. Let me go on to another topic, which is key for questioning of the second panel today, the contractor panel, including KBR. When I asked them about their labor system and whether that poses risks to the contractor drawdown in Iraq, risks to it, you have some familiarity with KBR's labor system on Task Order 159, the last big task order. I look on page 11, and it says, "We questioned \$368 million" -- and change -- "of direct labor costs as summarized by schedule."

What is the problem with KBR's labor system? Is it too high a level generality and that you could not -- you do not have internal controls within KBR to tap into to keep them from becoming, as you said, a deep pocket in situations like this?

Ms. Stephenson. First, our internal controls audit over labor is in process, so I want to be careful in that I do not get into issues that might be premature. However, there are a couple of issues I can talk about.

We have recently provided KBR -- recently, as in last month -- what we call a Statement of Condition for their assessment regarding the level of data that is gathered within their labor system, meaning at too high of a level to be able to assess whether the tasks are being accomplished or, even better yet, when there are change order proposals.

And there are a lot of change order proposals -

Commissioner Tiefer. Can I just cache that, because that is technical talk. Is a Statement of Conditions and Recommendations, or SOCAR in short terms, is that in effect? Could we lay people consider that a criticism of the KBR system?

Ms. Stephenson. Yes. I call it a Statement of Condition because it is in the process of the contractor having an opportunity to respond to it. We want to ensure that we have not missed something. But this is very similar to what was in the Task Order 159 report, which is the level of detail. We need to ensure labor as at a low enough detail that when a change order proposal or the drawdown proposals or other things come in place -- and there are a lot of those that come in place -- that there is not a duplication of the reimbursement of labor costs, where you are not paying the same person doing the same effort more than once.

Commissioner Tiefer. My time is almost over. I want a short answer to this. Is there a danger that KBR will, in effect, bill double fee on its labor being used in change order situations in the drawdown? Double fee, you know, once on the basic contract, once on -

Ms. Stephenson. Absent improvement in their internal controls, there is a risk of a payment of inappropriate or double fees, as you are saying. There is a risk.

Commissioner Tiefer. Thank you. My time has expired.

Chairman Shays. Before going to Mr. Henke, let me just say to the other witnesses, take notes on anything you want. Mr. Parsons, you will be

given an opportunity to respond to anything you have heard. We will leave it open. I will use my time, if I have to, but you will all be able to respond to everything that has been asked.

Mr. Henke, Commissioner Henke?

Commissioner Henke. A question for Mr. Parsons. Your statement, page 2 and page 3, twice says, "The army considers the relative condition of contractors' management systems." Relative to what? You have gone out of the way there to say the army considers the relative strength of systems in -- most importantly, during the source selection process.

Mr. Parsons. Correct. During the source selection, we put a lot of increased emphasis on management proposals submitted by the contractors with an emphasis on the contractor business systems because of the importance, as Ms. Stephenson has said, with these costs that are being incurred and costs that are being estimated.

Commissioner Henke. So if you have three proposals, three vendors, you are comparing those three relative to each other or to a standard?

Mr. Parsons. To both. To both. So, first of all, you have to determine whether or not these systems are approved, identify if there are deficiencies in there, the risks associated with those deficiencies, whether there are opinions by the DCMA on corrective action plans that have been submitted, or other mitigating actions. So you compare them to the standards and whether the systems are approved, and then to one another. Is one contractor's business system in better state of health than the others?

Commissioner Henke. But how do you make a judgment about systems' relative strength to a standard, to an independent, objective, assessable standard, other than relying on your experts, DCAA and DCMA?

Mr. Parsons. We do rely upon those experts, but we do have people that are familiar with, you know, price analysts and cost analysts that understand a lot of these aspects. So they do evaluate what the conditions of the systems are based on what DCAA has found, and then make some kind of a judgment on how much risk we may be assuming with going with a contractor that may have those deficiencies.

So, you know, I think we do have the expertise, but ultimately we do have to rely upon our subject matter experts out at DCAA and DCMA.

Commissioner Henke. You have had some vendors with longstanding systems problems, deficiencies, correct?

Mr. Parsons. Correct.

Commissioner Henke. And some of those deficiencies date back to 2004, 2005, 2006, have not gotten better, in fact, have gotten worse, if I understand the estimating system at KBR. Is that correct, Ms. Stephenson?

Ms. Stephenson. It is the purchasing system.

Commissioner Henke. Purchasing system, thank you. But it has gotten worse over time. Okay.

In that context, your statement, Mr. Parsons, you said, "Contractors must have systems in place such as accounting, payroll, and billing at the time of contract award that are in compliance with cost accounting, the FAR, and the DFAR."

To me, that statement has no wiggle room. They must have in place at the time of award systems that are compliant.

Mr. Parsons. Right, and -

Commissioner Henke. So how did you do what you did, which was award contracts to vendors who do not have compliance systems?

Mr. Parsons. Well, again, this gets back to DCMA's role versus DCAA's role, and at the time we made those awards, all the systems were either in -- were in an approved status by DCMA. So while DCAA identified issues and found those systems to be inadequate or inadequate in part from way back, DCMA ultimately is the one that makes the call on whether those systems are approved, and the contracting officer has to rely upon that judgment.

Commissioner Henke. We will get into this a lot more, I am sure, with the other questions, but it seems to me something as simple as this is going on: If my kid asks Mom to do something and she says no, he goes and gets a different answer. He goes and asks me for something that he may get a different answer about, and he finds the answer he wants.

Ms. Stephenson, I want to talk about your grading scale, and as I understand it, in December of last year, you changed how you assess systems from a three-grade system to a two-grade system. And I would like you, in the time remaining, to just walk us through your thought process and your rationale for making that change.

It used to be you would have an inadequate, inadequate in part, or an adequate judgment, and now you have effectively pass/fail, adequate or inadequate. That strikes me as interesting because the language of accounting is not always just binary. As you know and can instruct me on, you have material weaknesses and significant deficiencies and less important reportable conditions. So you make judgments about relative risks.

It seems if you have a pass/fail system you are removing that judgment, you are supplying less information to your DCMA and your buying command partners, and if I am looking at a report card and it is A, B, C, F, I know where to focus first. If I am looking at a report card that is pass/fail and it is mostly passes or it is mostly fails, I do not know where my most risk is.

So just walk us through why you made that change and how it has been implemented.

Ms. Stephenson. Sure, I would be happy to.

Prior to December, you are right, we had three opinions that we provided: adequate, inadequate in part, inadequate. Through time we have assessed that the inadequate in part opinion was not getting the attention it needed by either the contracting community or what I will call "contracting officer community," whether that is with the service or DCMA.

Case in point: KBR's purchasing system was inadequate in part in 2006. As part of our process of reassessing our systems and our audits of internal controls, as we have done in the past year, through various things that have come to our attention through oversight organizations, we have gone back to the basics of the auditing standards and the acquisition regulations to determine if an inadequate in part opinion is required, and it is not. In fact, under the auditing standards, it is either adequate or inadequate.

Commissioner Henke. Are those the yellow book standards?

Ms. Stephenson. Yes, those are the yellow book the District.

Commissioner Henke. Okay. So you did not have any real -- you do not have any discretion. The auditing standards applied to the Federal Government are adequate or inadequate.

Ms. Stephenson. Right. When we assessed it, we saw that there really was not a requirement for inadequate in part. There was not a requirement in the acquisition regulations, and given that inadequate in part was not getting the attention it needed and many times was seen as a caution as opposed to an issue, we realized we needed to change something.

Commissioner Henke. Do the accounting standards prevent you from having anything other than adequate/inadequate?

Ms. Stephenson. I would not say it prevents, but I would not say that it is required. So because it is not required, we assess what we could do better in this process.

Now, keep in mind, we only perform internal control audits at very large companies that have internal controls. These are the very, very large companies. In order to report a deficiency, it is a breakdown in what is called a control objective. I am sorry to get into the accounting terminology, but it is a control objective. That control objective, if it fails, is critical to the system. So even though one of many may fail, in the past that may have been inadequate in part because they all did not fail.

Case in point: In 2006, KBR, the subcontract piece failed. However, that piece resulted in hundreds of millions of dollars of overcharges to the Government. We realized we had to do something different. We were at risk, and we were perhaps with our inadequate in part exacerbating that risk. So we eliminated the opinion to where it is now inadequate. That

is where KBR's purchasing system became inadequate in April of 2009. The controls over subcontracts is inadequate.

Commissioner Henke. Okay. I am out of time, but I will come back in the second round. Thanks.

Chairman Shays. I would just make the point. I am not sure you are getting any more attention by doing pass/fail, and you are disguising the degrees of challenges. So I think you may want to revisit this.

We now go to Commissioner Gustitus.

Commissioner Gustitus. Thank you. I am struck by the way that the term is "adequate." We are not really asking these systems to be stellar or role models. We are asking them just to be adequate. We basically want them to be a C.

So it is pretty depressing to think that some of our major companies cannot meet a C standard for getting their business systems in -- now, I know it is a technical term that they use in auditing, but the impression you get is it just has to be adequate.

But we also know -- you said this, all three of you -- that it is -- I think, April Stephenson, you used the term "critical." It is crucial. The DOD IG has said that the business systems are crucial to protecting taxpayers.

So it is of great concern when I think, Mr. Ricci, you said in your testimony that only two of them major defense contractors out of ten have adequate business systems.

Now, both of you, DCMA and DCAA, have a regulatory responsibility to review these business systems. DCAA does it from the auditing perspective, trying to meet the generally accepted Government auditing standards to ensure the adequacy of internal controls. And, DCMA, you do it from a contract management perspective to improve a contractor's system and to reduce the risk to government. Is that right? So you come at this from different perspectives?

Ms. Stephenson. Slightly.

Commissioner Gustitus. Both of you. Mr. Ricci, is that right?

Mr. Ricci. I would say we kind of look for compliance with the acquisition regulation, again, in order to reduce the risk, and also to save us time and money by being able to rely upon the systems.

Commissioner Gustitus. Okay.

Mr. Ricci. So if I could just -- one point that was made before about inadequate in part, the acquisition regulations recognize disapproval of selected part of the systems, so since, again, that is what is in our regulation, we would continue to make such recommendations; whereas, DCAA, it is black or white, I guess.

Commissioner Gustitus. Well, with KBR, you have never found an inadequate in part system.

Ms. Stephenson. No.

Commissioner Gustitus. Mr. Ricci, have you?

Mr. Ricci. The purchasing -

Commissioner Gustitus. Your view, the DCMA's view, is the green line for those top four systems that you are particularly involved in, in that first chart. And you have never found an inadequate in part system for KBR. In fact, you have never found an inadequate system for KBR, have you?

Mr. Ricci. I do not believe that the formal status that we assign to any of them have been unacceptable or disapproved.

Commissioner Gustitus. Right, and that is even though -- Director Stephenson is saying that the purchasing system in KBR has gotten worse over the years, not better. It is not it has not even improved. It has gotten worse. And yet DCMA is still assessing that purchasing system as adequate.

Mr. Ricci. You know, one thing to understand is that DCAA has responsibility for some of these systems. DCMA has authority for performing the review for others.

Purchasing, for example, by regulation DCMA, with our purchasing specialists, conduct the reviews and provide recommendations to the ACOs. We actually do our reviews in accordance with what was once part of the regulation, Appendix C, that we actually provided to this Commission.

Again, DCAA's audit, they are doing it, I guess, for internal control purposes for that 242.75 subsection of the FAR; whereas, again, it is our statutory responsibility.

To talk about the purchasing, if I may --

Commissioner Henke. Statutory or regulatory?

Mr. Ricci. Regulatory. Okay. DCMA issued a report on June 10th that basically looked at the purchase orders awarded basically during calendar year 2007. In that report, we had 13 recommendations. Those recommendations essentially mirrored those in the 2009 DCAA audit report that has been referred to. Now, DCAA has them grouped into three, but when you go through specifically what they are, they are essentially the same.

The thing is that the 2009 DCAA audit was based upon data for calendar year 2007; whereas, our 2009 CPSR that we recently completed -- I believe that is July, July 10th -- we looked at 200 purchase orders from July 2008

to April 2009, a time period that afforded KBR the opportunity to make the corrective actions.

So, again, DCAA, I know they are currently always doing audits of subcontracts on all the task orders, so that may be coloring their opinion. But the 2009 audit, again, was simply an audit that was delayed for release. So I do not think that it is reasonable to compare it again.

You talked about the fact that we did it in a week. Actually, I believe it was like 3-1/2 or 4 days. We sent four people in. That means they looked at a purchase order, probably one every 30 to 45 minutes. Since it was a follow-up on those 13 deficiencies that we found a year before, I do not know that it is unreasonable. Again, these folks do this full-time.

So, again, until DCAA issues an audit -- I know they are working on one now, and we will be happy to see it; we will definitely consider any findings -- I must go with the recommendations from the CPSR group that is given that authority in the regulations.

Commissioner Gustitus. Director Stephenson, do you want to respond to that?

Ms. Stephenson. Where to begin? First of all, I want to say the proof of the inadequate purchasing system is in the proposal. Task Order 159, October 2008, \$1 billion unsupported because of the inadequacies with KBR's purchasing system. I think that alone, regardless of the other testing that we have done, has shown that there are systemic deficiencies in this system that need to be addressed.

I do not want to pass judgment on how another organization reviews invoices, but I know with my expertise, I have looked at a number of invoices over the years, been involved with a number of reviews I could not quite possibly determine the adequacy of an invoice, 200 to 300 invoices in a week, I could not do that. I am not sure how others do that. It takes a lot of peeling back the layers to determine whether something is adequate.

We obviously have a disconnect between our two organizations, and I do invite Mr. Ricci and our organization to work to together to try to address this. The disconnect is just too large.

Commissioner Gustitus. Mr. Parsons, did you have anything to add to that?

Mr. Parsons. Well, I think just this exchange demonstrates the complexity and difficulty of these issues. And I agree with Mr. Ricci. I think that, you know, the regulations do need to be examined in this area to be more specific and what are those standards. I think even the standards that we are going to hold contractors accountable for in all the different systems need to be very specific and very clear. And my opinion, I do not think they always are that clear, and there is a lot of room there for judgment, differing opinions, and I think that is part of the difficulty and that needs to be resolved.

I can tell you personally I am upset, after what we did with LOGCAP IV, that so many of these business systems still have some deficiencies, and I think these contractors are going to get a wake-up call when we start doing the award-fee determinations where we have set aside award fee for management and for the business systems to see if it gets their attention, because I do not disagree with Ms. Stephenson that I think in many cases we are not getting their attention.

Commissioner Gustitus. Have you sought to make this regulatory change, or is this something you want to do going forward? I mean, this is an issue, I take it that has been around for some time and there was a 2002 DOD IG report that said there was miscommunicating between DCMA and DCAA, lack of cooperation; then there was a 2009 DOD IG report. I mean, it seems to me this has been a very pressing issue for some time. Has your office taken any responsibility to try to move the ball forward?

Mr. Parsons. No, ma'am, we have not.

Commissioner Gustitus. Do you wish you had?

Mr. Parsons. Well, I do believe that this is an issue that needs to be addressed at the OSD level. You know, certainly the army could initiate some type of regulatory proposed change, but I really think that the issue, like you said, has been around and needs to be addressed by OSD.

Commissioner Gustitus. Okay. I want to move on to one other issue, another issue here, and that is -

Chairman Shays. Let me just say your time has expired, but if this issue -

Commissioner Gustitus. Oh, it has? I thought I had a minute left. It is a long question. It is about withholds, so I will do it in the second round. Thanks.

Chairman Shays. Let me just say, Mr. Ricci, you have left the impression that basically DCAA's inadequacies in every case, you have either ignored them or overruled them. That is the impression that is left so far with this -

Commissioner Henke. For KBR.

Chairman Shays. For KBR. And so I would just like to ask this question: Have you ever accepted DCAA's...

Mr. Ricci. Like I said, DCAA is integral to DCMA's mission.

Chairman Shays. I did not ask that. Have you ever accepted them? Have you ever said they said they are inadequate and so you agreed they are inadequate? Or have you overruled them every time.

Mr. Ricci. No. I can provide data on the suspension rate for the other contractors. We are looking at really -

Chairman Shays. You know what? That is not an answer to my question. It will be a question I will get into.

Mr. Zakheim.

Commissioner Zakheim. Thank you.

Mr. Ricci, first of all, I want to point something out to everybody here. This is not just about the details of green eyeshades. We are talking about operations and maintenance budgets. Every dollar that gets wasted, every dollar that gets lost, is money that could have gone to training, could have gone to the maintenance of our equipment, and it, therefore, goes to the protection of our soldiers' lives. It is not just the taxpayers. It is the kids that are being shot at. And I do not want us to lose sight of that. Number one.

Mr. Ricci, I would like you to define "adequate" for me, and let me tell you why. On page 7, you make the remarks, "The LOGCAP contractors each have only one 'inadequate' system." As I understand it -- and I just want a yes or no answer -- if a contractor has a corrective action plan, you rule the contractor adequate in that business system? Yes or no.

Mr. Ricci. Generally, yes.

Commissioner Zakheim. Generally, yes? Give me an example where you did not.

Mr. Ricci. On these three contractors?

Commissioner Zakheim. No. Where somebody has a corrective action plan, sometimes you say that is not enough. I would like an example, please.

Mr. Ricci. I will have to get you one. Not with these three contractors.

Commissioner Zakheim. Not with those contractors.

Mr. Ricci. Correct.

Commissioner Zakheim. Okay. So somebody says, "I am going to fix something, I promise I am going to be a good boy." They tell you that in 2003. Do you give them 6 months before you come back to it to see if they corrected it.

Mr. Ricci. Generally, 6 months to a year, yes.

Commissioner Zakheim. Okay. So as my colleague here pointed out, in some of these systems things have actually gotten worse. It is now 6 years since 2003. What have you done about that?

Mr. Ricci. If you are referring to the KBR purchasing system -

Commissioner Zakheim. I am referring to anything.

Mr. Ricci. Well, that is what the focus appears to be on, and as I said -

Commissioner Zakheim. No, no, no, Mr. Ricci. I am referring to any system. You have ruled a ton of systems as adequate. We heard that from Mr. Parsons. So our poor contracting officers out there are confused because they see things going to hell in a hand basket while you are ruling them adequate, while you rule them adequate because there is a corrective action plan. Tell me at what point you invoke DFARS 242.7502 and withhold the money. Is it a year? Six months? Two years? Three years? Five years? We are in a war 7 years. When?

Mr. Ricci. It would depend upon the severity and their lack of progress. I mean

Commissioner Zakheim. Okay. So give me a case where you did that.

Mr. Ricci. We have numerous systems that are that we are responsible for.

Commissioner Zakheim. So give me an -

Mr. Ricci. On these three contractors here, we have not yet done so.

Commissioner Zakheim. Not once since 2003, correct?

Mr. Ricci. Correct.

Commissioner Zakheim. Okay, fine. Next question. Page 10, you make a whole play here of why actions that involve withholding funds, quote-unquote, do not represent the hammer some folks seem to believe the Government possesses. I do not know who some folks are, but I want to quote you the DFARS 242.7502(a)(4). "The ACO," which is the administrative contracting officer -- "will consider whether it is appropriate to suspend a percentage of progress payments or reimbursements of costs proportionate to the estimated cost risk to the Government, considering audit reports a relevant input, until the contractor submits a corrective action plan acceptable to the ACO and corrects the deficiencies."

Now, it seems to me that if you withhold 15 percent of somebody's money, you are going to get their attention. Why is that not a hammer?

Mr. Ricci. Okay. This regulatory guidance has no contractual authority behind it. When you look at the acquisition regulation, this subsection of the DFARS 242.75, accounting and I guess related internal controls, generally what -- how the subsection ends is with a prescription for a clause? That is what gives us the authority. And, again, as you look through the regulation, you will find that in almost every section, this is guidance to the contracting officer, and then the contracting officer needs to find an appropriate clause under which to do it.

Commissioner Zakheim. Yes, but that is not the point. The point is you make an assertion -

Mr. Ricci. Yes.

Commissioner Zakheim. -- that this is not a hammer. Now, if you are going to wait and you are going to withhold 15 percent because the deficiencies have not been corrected, that is a sledgehammer. Why do you think this is not effective? That is what I want to know.

Mr. Ricci. Again, that is guidance. It gives us no authority to -

Commissioner Zakheim. No. I am not interested in the guidance. Tell me why it is not effective, why if the person chooses to do that, why it will not make a difference.

Mr. Ricci. Because I have other contract clauses that provide other direction.

Commissioner Zakheim. And 15 percent -

Mr. Ricci. Can I read you -

Commissioner Zakheim. -- withhold is not effective? I know you have other clauses. I am asking you about this clause. Why is it -

Mr. Ricci. That is not a clause. That is regulatory guidance, and we -

Commissioner Zakheim. Good. This regulatory guidance, why is it not effective? I just want to know why it is not effective.

Mr. Ricci. That gives the ACO no contractual authority. It tells us to consider doing this, okay? And then we need to find a clause like the progress payments, performance-based payments clause, allowable cost and payment, and the remedy comes through those clauses. Again, the authority is provided -

Commissioner Zakheim. So there are remedies elsewhere. Fine. When was the last time that you withheld payments from these three contractors?

Mr. Ricci. There is lots of suspension of cost, but I do not believe that we have actually withheld funds. Again, the withholding of funds is not really a term of art. I mean, there is suspension or reduction of financing payments. But there, again, given regulatory guidance, for example, if I could read you what it says for estimating systems, which DCAA finds to be inadequate, here is the guidance: "If the contractor has neither submitted an acceptable corrective action plan nor corrected significant deficiencies within 45 days, the ACL shall disapprove all or selected portions of the system."

Again, the regulation says there that if they submit the corrective action plan, they make timely progress, we do not disapprove the system.

In my opinion, we are making a little too much of the overall status of the system when what we need to focus on are the questions that were directed to Mr. Parsons of the significant deficiencies themselves.

Again, purchasing for KBR, I guess every Commissioner will ask me about it, but even if we disapprove of the system, Commissioner, all we are

going to do is they are going to be subject to additional consent requirements. The army has already made KBR subject to them. So, in effect, whether the system is inadequate, inadequate in part, or adequate does not so much change what the Government actions would be to protect its interests.

Commissioner Gustitus. Can I just a question?

Commissioner Zakheim. No, hang on a second.

Commissioner Gustitus. Okay.

Commissioner Zakheim. What I would simply remark is this: To my simple mind, if somebody withholds money from a contract, you are going to get their attention, and they are not just going to give you a plan. They are actually going to act on it. And since we have seen over the last 7 years that people have given you plans but have not acted on it, and you keep saying they are adequate, you are not helping them, the taxpayer, or the soldier, sailor, marine, or airman who desperately needs that O&M money.

Commissioner Gustitus. I just want to ask, if you find a purchasing system inadequate, does that mean that your CO then has to review each purchasing invoice before it is approved? Is there work that becomes incumbent upon your DCMA employee if you were to find that purchasing system inadequate?

Mr. Ricci. Yes, either us or the contracting officers. It is often delegated, but at times withheld, as you are going to hear tomorrow on the GLS.

Commissioner Gustitus. So to some extent it is an advantage for you to find a purchasing system adequate because you do not have to impose -

Mr. Ricci. It would be different folks. I do not believe that enters into our decision. Again, our purchasing system analysts are in a separate group, like a center, if you will.

Commissioner Gustitus. Thank you.

Chairman Shays. Mr. Ervin.

Commissioner Ervin. Thank you.

Let me, in my preparatory remarks, build on those of Commissioner Zakheim. They key issue for me -- and I think the key issue, as you have seen, from all the Commissioners -- is that of accountability. And unless and until we hold these contractors responsible for continually having inadequate business systems, we will continue to see waste, fraud, and abuse, and the very same mistakes that we made in Iraq at the beginning of that war in 2003 are going to be repeated and continued as we draw down there and are going to be continued in Afghanistan as we ramp up there. And as Commissioner Zakheim said, this is not just a waste, fraud, and abuse issue, but it has real consequences on the battlefield for the lives of our men and women there.

So there is no more important issue, it seems to me, for us to be focusing on today than business systems. It is anything but dry and anodyne.

Now, with that by way of preface, I want to get into this whole issue of coordination. To me it is not an issue of coordination between DCMA and DCAA. It sounds like you have lots of meetings. It is that at the end of the day -- and you have all acknowledged this, but we have not really talked about it explicitly. At the end of the day, DCMA calls the tune, and all too often, as we have demonstrated here in the hearing so far, DCMA deems these systems to be adequate, and this allows contractors to play DCMA and DCAA against each other.

Now, we are going to get into this with Mr. Walter from KBR in his testimony, but he says on page 2, "Our systems are regularly reviewed and approved by the Government. Just last month, the Government's most recent review resulted in approval."

And then at the end, he makes this plaintive plea: "If the Commission can identify the means that will allow the Government to speak with one voice in instructing its contractors in future contingencies, this would be a significant improvement to the current expeditionary contracting system." And I say to that, "Amen."

So, with that, my question is this: Isn't the fundamental problem that DCAA's audit recommendations ought to be mandatory rather than advisory? I mean, you essentially say that in your recommendations, Ms. Stephenson. Can you elaborate on your view of that matter? Then I want to hear from Mr. Parsons and Mr. Ricci.

Ms. Stephenson. I have to say that over the years my frustration has probably led me to say I would like them to be mandatory. However, I do recognize that not all systems, it is just DCAA. I would turn that and say instead of mandatory, I would like there to be an accountability when DCAA's findings are ignored or appear to be ignored. And I think the purchasing system is that example. And it certainly knocks the wind out of you when you hear a week is spent, when your own people have spent thousands of hours reviewing a system, testing transactions, and found over time there to be a significant amount of costs that were overcharged to the Government. That is my concern at the end of the day. I, along with Commissioner Zakheim, this is for the soldiers that we are protecting, money that can be better spent for the soldiers. So I would like there to be a better accountability.

Commissioner Ervin. All right. Mr. Chairman, I want to give Mr. Ricci and Mr. Parsons an opportunity to comment on that. I think that is only fair. Mr. Ricci?

Mr. Ricci. Again, we are responsible for dispositioning all audit findings from reportable audits in the Contract Audit Follow-up System. And, again, we definitely value DCAA's input, and to ensure that the recommendations are fully considered, again, we established this board of review process that, if the contracting officer seeks to make a decision

that is contrary to a DCAA recommendation, it will be elevated and in many cases, again, will rest with the senior contracting personnel. You

Commissioner Ervin. But it sounds like, as you just demonstrated, that while it is considered, it is never ultimately used to hold contractors accountable, right?

Mr. Ricci. I mean, it has not been -- we have not disapproved any of the systems for the three contractors, correct. Again, we are looking at three out of, again, 19,000 contractors that we administer and understood that most of these rules do not apply to small business. But I am just saying the universe is much larger than these three, Commissioner.

Commissioner Ervin. Mr. Parsons.

Mr. Parsons. Sir, I will just repeat. I do not disagree that we need to hold contractors accountable, but I think the real question is: What are we holding them accountable for? What are the standards that are expected? And then giving to some other points, what do we mean by "adequate"?

To be quite honest with you, I do not think that those standards and the definition of what is adequate have been vetted through the regulatory system for all these systems, and I think that is where some of the frustration I know on the contracting officer part gets, is that you read the DCAA opinion, you get the DCMA opinion, you take a look at what is in the regulations, there is a lot of room for interpretation, and it is not real clear in many cases, and it gives that -- so I think something needs to be done.

Commissioner Ervin. Well, I think that is a fair point, and let us delve into that. In your testimony, Ms. Stephenson, you point out that there are objective standards, the yellow book standards, that DCAA uses to reach its audit opinions, its audit conclusions, and its recommendations.

By way of contrast, as I understand it from your testimony, the ACO has considerable discretion, as you just acknowledged, it sounds like, Mr. Parsons, in coming to a conclusion. And yet at the end of the day, it is the entity ACO, DCMA ACO that has the final decision with regard to the matter. And yet that entity does not have any objective standards that they are forced to rely on by virtue of contrast to DCAA.

Well, let me ask about the withhold issue, which a number of us wanted to get into. Isn't the answer to that that this language that was just on the screen, DFARS 242.7502, the ACO will consider whether it is appropriate that the ACO shall suspend a percentage until a corrective action plan is not just submitted but corrected and audited by DCAA to confirm that the plan has been implemented and corrected deficiencies? Isn't that the answer to that in this particular instance?

Ms. Stephenson. Can I address this, Commissioner? I have seen the withhold being very powerful over time, and I will give a case in point. Titan Corporation, which is now L-3, used to be the incumbent to the linguist contract we will be discussing tomorrow, in 2004 had almost a

non-existent internal control system in theater on labor. We issued an inadequate opinion and recommended a withhold. Within 30 days of our recommendation, the DCMA, they implemented a 10-percent withhold on all labor. That went on for 2 years, and it went up to \$40 million. And I will tell you, that withhold was the greatest carrot that contractor had to correct those deficiencies to where they adequately staffed their billing and accounting department, they adequately -- they put adequate staff not only in the Reston area where their corporate headquarters was for this segment, but also in theater. They met weekly with our people and went through everything that they were trying to do. This got action.

I have seen it with Fluor. Although there has not been an actual percentage withheld, just recently, in July, the contracting officer, based on our advice on some issues that we have reported, has not permitted Fluor to bill certain indirect costs. That got Fluor's instant attention, and they are working hard to improve those systems. I feel it is effective.

Commissioner Ervin. Thank you. Is my time expired? It appears to have expired.

Chairman Shays. You have a few more seconds.

Commissioner Ervin. All right. Let me ask this, then, to both DCMA and you, Mr. Parsons. What kind of inadequacy, what failure on the part of a contractor would be sufficient, in your judgment, to preclude a LOGCAP IV contractor from being awarded a task order under LOGCAP IV? What do they have to do?

Mr. Parsons. Well, certainly because the nature of the contract is cost type, I think, you know, their accounting systems are very critical. You know, we could not find the contractor to be responsible if the accounting systems were not in place and were found to be totally inadequate.

Commissioner Ervin. Totally inadequate?

Mr. Parsons. Yes.

Commissioner Ervin. Mr. Ricci?

Mr. Ricci. Again, the source selection decision is up to the army, but, again, to the extent that they make that part of the plan, they can base their decision on that to some degree, I mean, also considering, you know, other factors -- ability to perform.

Commissioner Ervin. Mr. Parsons and Mr. Ricci, would you be for or against the idea of a mandatory suspension of financing?

Chairman Shays. And that will have to be the last question.

Commissioner Ervin. For an inadequate system.

Mr. Ricci. We actually proposed clauses that would essentially give us that ability to defense procurement recently. I think it would be very

helpful, as well as revisions to the regulatory language, which I read the estimating one, also for property it applies, that do direct the contracting officer not to disapprove a system if there is an adequate corrective action plan in place. So I would welcome that.

Commissioner Ervin. Mr. Parsons?

Mr. Parsons. And I support that as well. I do not disagree with Ms. Stephenson. I think that suspensions and withholds do get the attention of the contractors, and I think we just need to be very specific, again, about what those standards are, very specific in the contract that we will withhold in the event that there are deficiencies found.

Commissioner Ervin. Thank you.

Chairman Shays. Commissioner Green?

Commissioner Green. Thank you, and I thank the three of you for your frankness today.

At the risk of beating a dead horse, Mr. Ricci, in your statement you indicated, "In order to ensure DCAA recommendations are appropriately considered, we mandate in our internal policies that any determination inconsistent with DCAA recommendations is subject to higher-level review that may include review by the DCMA head of contracting activity, a Senior Executive Service position within DCMA."

Mr. Ricci. Yes, sir.

Commissioner Green. You made a big deal about this. How many -- and maybe you have answered this, but in how many cases was a review reverse the position of the ACO?

Mr. Ricci. Okay, I need to make the point that for 15 years, DCMA had no internal control review such as this. This was really put in place in March of this year, okay? So it is relatively new.

Commissioner Green. And how many times has it -

Mr. Ricci. I can think of one time, but we are talking probably -- I do not know, seven to ten boards of review that actually got raised to my level because of dollar value or other issues. So one time.

Commissioner Green. And how many times -- was the one time when you did not support the ACO or DCAA recommendation?

Mr. Ricci. We actually supported neither the ACO nor DCAA but instead decided that we need to find a certain -- this was a cost accounting standards noncompliance. We decided that it needed to be found to be noncompliant, and we were going to pursue recovery of over \$45 million.

Commissioner Green. Okay. In continuing a line of questioning that we have heard from others here, I fully recognize today the different missions of your two organizations. But I also remain concerned -- and

Ms. Stephenson called it a "disconnect," others -- Commissioner Tiefer referred to it as, you know, "promises of cooperation." And I think those are nice words, but I do not see evidence of a lot happening in that area other than we are going to get together and talk about it.

Let me say that, you know, I come from an operational background, so my tendency is to support the force in the field. And I gather that in many cases that is the tendency of the contracting officer, and I can understand the pressures that a contracting officer comes under from the field.

But I also have to believe that there are occasions when DCAA has made a recommendation for a business system when the outcome of that can be so onerous, so costly, that they should prevail. So my question to the two of you -- to the three of you is: How would you react to an independent, more senior forum to resolve the differences, not the day-to-day differences but the ones that DCAA, for example, can show as hugely significant? April?

Ms. Stephenson. I am all for trying anything different that will help resolve these major issues. The KBR purchasing system, I realize we have used that a lot today, but, by golly, that has resulted in us overpaying hundreds of millions of dollars. When we are in that situation, when this is money that is going in a contractor's pocket than to the soldier, we need to find a better way.

So, Commissioner Green, I am open to anything that can be suggested to try to resolve these issues to where we can get these systems improved. That is ultimately what we need, the systems improved so we do not have these overcharges.

Commissioner Green. Where today is the court of last resort to resolve the differences between the two?

Ms. Stephenson. When I have differences, I take them to Charlie Williams, the Director of DCMA, or to Shay Assad, DPAP within AT&L.

Commissioner Green. To me that is on the DCMA side. You know, you kind of run out of altitude and airspeed after that.

Ms. Stephenson. That is correct

Commissioner Green. Mr. Ricci?

Mr. Ricci. I would say what April said is correct, that Mr. Assad would probably deal with any serious issues, although I do not recall ever being over there for a meeting on a specific contractor system status. But, actually, I believe it should rest within the contracting authority, so I believe it should be within DCMA.

Commissioner Green. You do not support then a separate independent board, if you will, or individual who would mediate these differences.

Mr. Ricci. I am a believer in the contractual authority of, in this case, the ACO. So, again, anything, I think, needs to be considered given the differences of opinion, but I would not be inclined to do that.

Commissioner Green. Mr. Parsons, do you have an opinion on this?

Mr. Parsons. Well, sir, I think it goes back to a point I have been making before. I think the underlying issue is why are there differences of opinion, and, you know, putting another board above two bodies to resolve, quote, differences to me is not the long-term solution. To me it is let us go find out why there is this ability to have diverging opinions on what ought to be in my mind some reasonable standards to put in place and let us clear that up so that there is not this kind of disagreement or lots of room for interpretation rather than putting another board in. But I agree with Mr. Ricci. I think it still needs to be in the contracting authority chain.

Commissioner Green. Okay. For you, Mr. Parsons, one hopefully quick question. In February of this year, the LOGCAP PCO directed that KBR freeze its hiring and staffing. This was based on a \$50 million labor cost overrun. In the recent trip to Iraq, the Commission was told by senior military folks that they were reiterating to KBR the necessity to draw down the workforce. What is the interaction between Army Contracting Command, KBR, and the field in ensuring that this happens?

Mr. Parsons. Well, Mr. Lee Thompson, who is the Executive Program Director for LOGCAP, has the responsibility to ensure that that is happening, and he is tracking that on a weekly basis with reports coming out of KBR. He has been making frequent trips over to Iraq and Afghanistan, especially Iraq, to verify that.

Commissioner Green. Is the size of that contracting force coming down?

Mr. Parsons. The size of KBR's organic force is coming down, yes.

Commissioner Green. Okay. Thank you.

Chairman Shays. I give myself 8 minutes. We are in one fight. We are all on the same team. Those of you up there, you are on the same team. But it does not sound like it, and it does not look like it. And what we need to do is go where the truth takes us, wherever that takes us.

What comes across to me is, Ms. Stephenson, that you have been ignored, so you have changed the system, and you have made the system worse, because you are basically saying adequate or inadequate, and there are too many inadequates with huge varying degrees. Where do you put your attention? Some are inadequate, and some are really inadequate.

Mr. Ricci, you come across like you will tolerate DCAA, but you are going to ignore it. That is the way you come across.

Mr. Parsons, you come across as saying, "You know what? These systems are bad, and we are going to check it out." But they have been bad for a long time, and you have not been, you know, in China. You have been around.

And it just strikes me as pathetic, because it is not a hard thing to resolve. You need to pay more attention, Mr. Ricci, to what DCAA does, DCAA is suggesting. You give the impression that everything is advisory. Her opinion is advisory. You have advisories on whether you can withhold money or not. We could write the system, we could recommend as a commission that we force you to do what you have to do, take away all good judgment, take away all flexibility, and then we will have other problems that come from that. That is what we will have.

So, Mr. Ricci, you have basically given me the impression that all of the inadequates you have overruled, particularly as it relates to these three contracts, and that is stunning. You have got to explain to me if it is advisory, you have the authority, it does not say you have to use it, why the hell don't you use it once in a while?

Explain to me just because if it is advisory does not mean you cannot do it. So why haven't you done it? Why haven't you withheld money, kept it back? Tell me why.

Mr. Ricci. Okay.

Chairman Shays. A short answer would be preferred.

Mr. Ricci. Okay. That contract provision that we keep seeing does not in and of itself have any teeth. I must go to the financing clauses or the allowable cost and payment clause.

We do, not with these contractors, these are cost-type contracts. But we do do a lot -

Chairman Shays. You are saying it is advisory, but you do not have the authority. Do you have the authority to withhold money?

Mr. Ricci. I have the authority to reduce or suspend progress payments on fixed-price contracts -

Chairman Shays. That is basically withholding money, isn't it?

Mr. Ricci. Okay. I was trying to stick to the -

Chairman Shays. But you do have the authority.

Mr. Ricci. In certain cases, depending upon what clauses are in the contract and contract

Chairman Shays. You do have the authority.

Mr. Ricci. Yes, sir, and we do. We do suspend progress payments quite often because the threshold contained in that clause is any material noncompliance with the contract. It is, in fact, easier -- and you will see we have far more withholds, if you will -- on fixed-priced contracts directed at the financing than we normally do on cost-type contracts.

Commissioner Gustitus. Withhold on cost contracts -

Chairman Shays. Commissioner Gustitus?

Commissioner Gustitus. I am sorry. You can also withhold from cost-type contracts as well, and these are cost-type contracts.

Mr. Ricci. These are all cost-type.

Commissioner Gustitus. But you can withhold from cost-type contracts as well.

Mr. Ricci. Again, and these are all award fee. For the fixed-fee and incentive-fee, there are fee withholds that we can do, again, up to \$100,000, so not too significant. Our withholds of the reimbursement of costs on these contracts that we are talking about comes from the allowable cost and payment clause. And again, there we believe we need to show a logical nexus or causality between the specific system deficiency and the cost, meaning that the specific deficiency is likely to lead to unallowable costs.

Chairman Shays. You know what I am struck with? I am struck with the fact that there is a little bit of a gray area, and so you are going to make sure that you are going to be totally on the contractor's side.

It would be rather refreshing for you to test it, to have them complain about it, but it strikes me you might get some action before then.

Ms. Stephenson, how do you respond to what Mr. Ricci has said?

Ms. Stephenson. I know that the DCMA has done withholds on cost-type contracts due to inadequate systems, and I have seen that they worked, and I saw that they got action. I feel it can be done. I am not an attorney. I do not know about the clauses and all that, but I know it has been done, it has been effective, and it has gotten action, and it has resulted in appropriate costs being charged to contracts.

Chairman Shays. Since I have joined this Commission, the one thing that I am struck with is the people on the inside are not outraged the way they should be outraged. We have contractors who go overseas, and their folks -- and there may be, you know, six electricians on a base when you only need two, and they are only working two hours a day in terms of a job, but they are on duty for 12 and they charge 12. We have civil servants who go and charge 12 hours a day and get double their salary in half a year. And there is no outrage because people say, well, that is just the way the system works.

It would be refreshing to see some outrage with this, to see -- Mr. Ricci, for you to just be so outraged at some of this to say, "No, it ain't going to happen." And then see what it gets you. I think it would get you a lot.

This Commission has talked about the fact that if this hearing ended up the kind of way it has, we are going to ask you to come back in 60 days,

and we are going to ask you to show us that you have resolved these differences, because it is just wrong.

I hope, Ms. Stephenson, that you reevaluate this pass/fail.

Ms. Stephenson. And, sir, if I can build just for one second, when you say "outrage," we are outraged. We are absolutely outraged at this. We have been inside and seen this go on for too long. Consequently, we did change. And as you say, you would like us to reassess, and I certainly will.

Chairman Shays. Well, let me just tell you why, and I do feel your outrage, and you are a very credible witness, and I want to say that. It is a little easier to be on the side of just reviewing. It is easy for us to criticize, easy for you to criticize. I give them a little slack that they have to make the system ultimately work, and they have got lots of other pressures. But it seems basic to me that if Mr. Ricci is going to ignore or overrule that he should have to come in and explain point by point why he disagrees.

And it does seem -- 3 days to a week seems a little absurd to me as well.

So, I mean, I have my own opinions about this, but the bottom line is this has got to stop.

Ms. Stephenson. I agree.

Chairman Shays. So we are going to start again. Mr. Thibault?

Chairman Thibault. Thank you.

Mr. Parsons I want to explore a bit what Professor Tiefer, Commissioner Tiefer brought up. A simple question. On LOGCAP IV Afghanistan, you told us -- first of all, Director Stephenson expressed absolute support to involve herself in that pricing action. That was in May. She said she has been communicating for an extended period. You were supportive, and then yet, when we were briefed by DCAA about a month ago, they indicated the army's present position is that they hope to involve DCAA more in Iraq but that they did not involve DCAA in LOGCAP IV in Afghanistan, billions and billions of dollars with issues that everybody knows about and we have talked about. Why didn't you use DCAA's support earlier? Or in May, in whatever format, whether Director Stephenson says I can do something in a very few weeks, I can tailor it, why didn't you?

Mr. Parsons. The acquisition strategy for LOGCAP IV was assuming that the competition would drive the reasonable price -

Chairman Thibault. But don't we know that you can still use audit services for cost realism to ensure -

Mr. Parsons. Sure.

Chairman Thibault. -- they are properly putting the packages together for a variety of other means? So I do not want to hear about acquisition strategy. I really want to hear why didn't you use DCAA.

Mr. Parsons. Because in the opinion of the contracting officer, based on the information that they were provided in the proposals, at the cost detail level that they had, they felt that they had sufficient competition and had enough information to do that analysis to assure themselves that the cost was realistic.

Chairman Thibault. So the short version would be, as I listened to you, they did not feel they needed DCAA input regardless of DCAA's offers to tailor that input in any way, shape, or form. They felt in their opinion they did not need it.

Mr. Parsons. Correct.

Chairman Thibault. Is that the simple short version without a long explanation?

Mr. Parsons. Correct, along with the other thing you understand from operational needs we needed to get those task orders awarded to support the war-fighter.

Chairman Thibault. So in terms of that, you are talking about the timeliness of DCAA's Director Stephenson said, "I will tailor it," but you said, regardless, you had concerns about timeliness.

Mr. Parsons. Right.

Chairman Thibault. Okay.

Mr. Parsons. So we -

Chairman Thibault. Let me go on. That is fine -

Mr. Parsons. Can I follow up though? Because we -

Chairman Thibault. You will get a chance at the end, Jeff, because I am -
- I do not want my Chairperson to jump me again.

[Laughter.]

Chairman Thibault. I want to go back. We are trying to help you, David, Mr. Ricci, in the sense of trying to bring issues out and focus on them and support you. And so I want to go back. And 1994, you are right, we are using contractor purchasing system reviews, subcontracting, as sort of a featured area for discussion. Your teams -- and I have worked with your teams. There are some pretty sharp people. I have worked with them extensively in my time, and I am pretty impressed by what they do. They had 102 people in 1994. They have 14 now. You would have to grow at 800 percent to be back where you were, and we have seen study after study -- we could have charts -- that the workload is more demanding right now for DCMA, more demanding, than it was back then. But we all got caught with

this peace dividend where they slashed you. And we absolutely support the Secretary's initiative to hire, absolutely support that.

I am just at a loss how -- and I think you clarified -- and my question is going to be focused. You clarified that the team that went in to do the review in KBR, where we have the differences of opinion that we are getting animated on, is that there were 13 follow-up items, and they looked at the 13 follow-up items, they were satisfied.

DCAA has come in and said we brought all sorts of new items to the table in a detailed brief, and they expressed concern they were not addressed. What is up?

Mr. Ricci. I do not believe that is correct, sir. When I sent the CPSR team in -- and, you know, I made it clear to them that this was going to be reviewed at a high level, which this Commission is. So they tried to put their best people on it, and they tried to do the best job that they can. I am sure they did. I mean, they do not want to be here talking to you next.

DCAA identified 20 to 30 purchase orders that they thought the team should look at and ensured those were included in the sample. They said they did. So, again, I have the review results from the CPSR team. DCAA is working on an audit, and, again, the clause provides that we can revoke our acceptance at any time. If I get contrary evidence from DCAA, we are going to look at it, and we are going to do what we think is right. But right now all I am saying is that I sent in dedicated specialists, and they reported that the deficiencies were corrected.

Chairman Thibault. So we have this difference of opinion. I have one last, and it is in support of, I think, comments by Commissioner Zakheim and comments by Commissioner Co-Chair Shays. That is this pass/fail or -- I like the analogy, except I would not say A, B, C, F. I would say A or F -- April, report card on system adequacy.

I would just propose that you look seriously at it. You are trying to get their attention. I think we are trying to let you get their attention. But I have gone -- we sat with your regional executives, the two regional directors, and they said -- for example, in DynCorp they are doing a whole series of reviews. They said, frankly, with the new policy every one of them is going to show as inadequate. It will be surprising if it is not. Then they said the same thing about KBR.

Well, if I am a contracting officer -- I get back to the point they raised -- tell me which ones -- and we get into suspensions. I want them to withhold costs consistent with the guidance. But I would say tell me which ones and how it is impacted that I need to focus on. Do not just go across them all. That is what I might do as a contracting officer, and I think it would be a whole lot more helpful to them if you would be willing to stand back and say a material internal control weakness, you have got to move out, internal control weakness, you know, maybe we accept the corrective action plan. You know, it is can the parties get together and find something where it is not -- I am sorry, the Hatfields and the McCoys, because I have talked to enough people on the side that I propose

to you it is not just a disconnect. It is the Hatfields and the McCoys. And that is not the Government that I knew. And it is disappointing.

So I go back and I encourage you to go back and look at what you can do in terms of holding your independent reporting, aggressive reporting. I commend you for that. You are kind of out on a plateau that is very narrow on all sides, and you are standing there. And I commend you for that, but sometimes I think -- you know, I am not even going to ask for a response. I would ask you to consider what my Co-Chair, my partner, and the other Commissioners have said. Thank you.

Chairman Shays. Thank you. Mr. Tiefer?

Commissioner Tiefer. Thank you, Mr. Chairman, and I identify myself completely with the remarks of Chairman Thibault on this subject. We were left with an impression at the beginning of May by you, Mr. Parsons, which was not carried out, that you were going to work real hard to get an audit from Ms. Stephenson.

Ms. Stephenson, I am going to revisit some of the key systems, especially first the labor system and the subcontract system, the purchasing system that handles the contracts. But I want to set a context.

The Commission sent me to Baghdad, and I realized I did not fully explain what I was talking about. General Odierno sat with me in his Baghdad office Tuesday -- July 28th I believe it was -- and he shared his challenges and perspectives about the drawdown in general, but about what I call the contractor drawdown in particular. And this afternoon I am going to refer to a Washington Post article because it is on the public record, and it says, "In a command-wide directive issued January 31, General Ray Odierno" et cetera, et cetera -- "ordered all military units to start cutting U.S. contractors at a target rate of 5 percent each quarter and to hire more Iraqis to do their jobs. As we transition more responsibility to the Government of Iraq, it is time to make this change." He means reducing the footprint of U.S. contractors. He wants to bring the numbers down.

He shared his vision with me. A central pillar was this real reduction of contractors, not playing games, not just eliminating vacancies but real.

How would you describe that you just issued a Statement of Conditions, a form of criticism of the KBR labor system, how is it going - - how might it get in the way of oversight in Baghdad of whether KBR does a real reduction and thereby saves the costs you would expect?

Ms. Stephenson. I tell you, the labor system when it comes to the drawdown is going to play a critical role, and that is one of the reasons we got out ahead and tried to identify the weaknesses as this drawdown is beginning to start. It will be critical that these internal control weaknesses within that labor system be addressed promptly, because without the lack -- with this lack of visibility that we are in right now, we do not know, and the risk -- I should say the risk is significantly higher that we will not know if the cost containment is indeed happening or if what we have is cost growth.

It will be critical to get this corrected quickly. I am in hope that KBR has taken our Statement of Condition and Recommendations seriously and is right now putting improvements in place to improve that system.

Commissioner Tiefer. Thank you. I have a very quick question on a different system, and I do not want us to dwell on it. It is the allowability system and its component, the unallowable excess executive compensation. You had an audit report in 2006. You had one audit report on the compensation system that said that their compensation system was not adequate. On this particular element their accounting system, the inallowability, you ticked off that KBR had deleted in fiscal year 2003 \$547,000 excess exec. compensation; in 2004, \$719,000; in 2005, KBR deleted \$4.1 million. What you are talking about when you say they deleted these?

Ms. Stephenson. There is a statutory requirement that has been implemented in the regulations that places a ceiling or a cap or a limit that the Government will pay on the top five executives within a company.

Commissioner Tiefer. That is from the CEO down?

Ms. Stephenson. That is right. And it is the top five. And when we talk about that KBR removed X amount, that means the amount that was above that cap they have removed from their submissions.

Commissioner Tiefer. Because they originally had it in their submissions, and they only later realized it, something like that.

Ms. Stephenson. Sometimes it is that way. In the particular instance of KBR, I am not sure if it got in and came out later or if they took it out before they submitted it.

Commissioner Tiefer. Good. Let us go back to labor. We found that General Warner was the logistics person who has been closest to watching the drawdown, showed us charts, but that -- handled contractors as a whole, but this is what General Odierno said specifically when I asked him specifically. He said, "We have looked at LOGCAP. As we closed these bases, I was not seeing a reduction of contractors. We had to make LOGCAP accounts."

Now LOGCAP means KBR, because as a monopoly of LOGCAP in Iraq, and KBR's subcontractors, what does -- is there a problem with the purchasing system with KBR watching its subcontractors? And do you have even less visibility into the subcontractor labor than you have into KBR's own labor?

Ms. Stephenson. Yes, we have less visibility into subcontract labor than we do KBR employee labor. And, yes, the risk is greater because of the weaknesses with KBR's purchasing system as related to subcontracts. And, yes, it is a great risk with the drawdown that if those weaknesses are not improved, we will not know what the appropriate amount of the subcontract costs could be, and we will not know if there has been "cost containment" that everyone has been speaking of.

Commissioner Tiefer. Thank you, Madam Director.

Chairman Shays. Thank you. Commissioner Henke.

Commissioner Henke. Mr. Parsons, you give a lot of credibility to, I am going to look at this in the award fee process and I am going to hold contractors accountable for systems in the incentive or award fees, right? And -- but it struck me that the maximum -- what is the maximum dollar value in an award fee scenario that you can withhold from the contractor? I heard \$100,000.

Mr. Parsons. Well, sir, for the -

Commissioner Henke. Is that the maximum hammer you have?

Mr. Parsons. Not for award fee. I mean, the award fee is just that. It is fee that is earned by the contractor over and above what is expected -

Commissioner Henke. Right.

Mr. Parsons. -- so in case of cap, 15 percent of the award fee pool -

Commissioner Henke. Yes -

Mr. Parsons. -- has been set aside for corporate management.

Commissioner Henke. Right.

Mr. Parsons. Part of that assessment -

Commissioner Henke. But you can withhold, I heard and read in one of the statements, up to 85 percent -

Mr. Parsons. No, 15 percent of the award fee pool -

Commissioner Henke. Up to -

Mr. Parsons. --so if the award fee pool is \$100 million, it will be \$15 million will be set aside for the corporate management.

Commissioner Henke. Okay, so it is not capped at \$100,000.

Mr. Parsons. No.

Commissioner Henke. I was crossing apples and oranges -

Commissioner Henke. Mr. Ricci?

Mr. Ricci. I didn't mean to mislead you, Commissioner. There are three different types of fee, if you will. There is fixed fee -

Commissioner Henke. Yes.

Mr. Ricci. -- incentive fee, and award fee.

Commissioner Henke. Right.

Mr. Ricci. Since the award fee -- the PCOs have a lot of authority to craft their own solution to it, I only referred to the incentive fee -

Commissioner Henke. Got it, not an award fee.

Mr. Ricci. Right.

Commissioner Henke. Okay. LOGCAP IV and the transition from III to IV, we commended you in May for having a competitive basis for awarding LOGCAP IV and particularly LOGCAP IV task orders. In our interim report, we lauded the Army for apparently finding the savings that one would expect to come from competition. We cited your Kuwait task order -- I think that was your first substantive LOGCAP IV task order -- that used to cost about \$125 million. I think you would call it, Jeff, the Kuwait AOR work, right? Performed by the old contractor, \$125 million. You awarded it to one of the new contractors for 44 percent less, \$75, \$74 million. We were thrilled. We thought the benefits of competition are coming to pass. Did you ask DCAA to do a proposal audit on that work?

Mr. Parsons. For the pre-award?

Commissioner Henke. Yes.

Mr. Parsons. No, we did not.

Commissioner Henke. Did you, April Stephenson? Did your organization do an audit on that?

Ms. Stephenson. The pre-award, no, sir.

Commissioner Henke. The pre-award.

Ms. Stephenson. No, sir.

Commissioner Henke. Okay. Jeff, I am going to ask you what is going on here, because we have read in the statements that now that shortly after award, and I want to know exactly when after award -- tell me, when was it awarded to DynCorp?

Mr. Parsons. When was the award made?

Commissioner Henke. Yes.

Mr. Parsons. Sir, I will have to get back. I don't remember the -

Commissioner Henke. Okay. Would you ask one of the staff in the audience?

Mr. Parsons. I think it was five or six months ago.

Commissioner Henke. Okay. When after that award did the contractor come in and tell you, whoops, I have got a new number for you?

Mr. Parsons. I think it was several months after the initial award news, request for adjustments are being evaluated by the contracting officer. I believe we getting DCAA assistance on those, so -

Commissioner Henke. What happened?

Mr. Parsons. Sir, I really don't know. I will have to get back to you with what the details are.

Commissioner Henke. You don't know?

Mr. Parsons. No, I don't.

Ms. Stephenson. Can I -

Commissioner Henke. Yes.

Ms. Stephenson. Commissioner, do you mind if I shed some light?

Commissioner Henke. That would be great.

Ms. Stephenson. What we were informed as to why they came in for the price increase is they needed to hire employees in theater.

Commissioner Henke. Right.

Ms. Stephenson. The employees in theater were KBR and the employees wanted more money, and DynCorp -

Commissioner Henke. Or at least the same.

Ms. Stephenson. They wanted more money.

Commissioner Henke. Okay.

Ms. Stephenson. And that was part of the increase.

Commissioner Henke. What is the connection with that scenario, which is set beyond unfortunate, with their labor system or their estimating system? What is the connection that you would make?

Ms. Stephenson. The connection I would make is more with the estimating system in this particular case.

Commissioner Henke. Okay.

Ms. Stephenson. But I don't know the amount or the level of data that was submitted with the proposal, whether it was at a low enough level that the Army could assess whether DynCorp had actually had employee agreements or actually had gone out to determine what the cost of that labor would be, having to hire KBR employees on the market or whoever else they hired,

what that cost would be prior to putting that bid in. That is something a pre-award audit would have looked into. Did they actually go out and determine what that labor would be, or did they put a number into a proposal in the hopes that that is what people could be hired for.

Commissioner Henke. So you, with the right level of detail in the work, you could have found something -

Ms. Stephenson. We could have found something like that -

Commissioner Henke. And could have alerted -

Ms. Stephenson. I am optimistic we could have found something. Now, we miss things, too, but I am optimistic we could have found that they had indeed not actually checked what the labor would be on the market.

Commissioner Henke. Okay. As much as we were thrilled to see that first result, and the Army was thrilled to see it, too, I am sure, with a 44 percent reduction over an old price, then to have within months of an award a contractor come in and say the old price is not good, I am going to give you change proposals and give you an REA, or Request for Equitable Adjustment, and come in and say, I can't do the work for what I bid, you are going to have to pay me this price, that is -- where did -- this is a rhetorical question. Where did the savings from competition go?

Mr. Parsons. That is a good rhetorical question. Again, it is the reason why the contracting officer with the DCAA assistance is trying to figure that out. What has changed that has caused the labor rates or the labor to go up as much as what DynCorp is claiming it to go up. You know, Ms. Stephenson and I have had this conversation before and it may be somewhat true. Do we really have an environment in those deployed theaters that allowed you to have competition?

Commissioner Henke. Right.

Mr. Parsons. And as a result, we are definitely getting DCAA involved with the Iraq task orders as a result of what we have learned.

Chairman Shays. Just a quick question, Mr. Parsons. Can you withdraw the contract? I mean, if they ended up getting the contract but then they come back with a much higher number, once they have the contract, do they have the contract?

Mr. Parsons. Sir, when you say withdraw the contract, we have the -- always have the option not to exercise options, so that is something the contracting officer is going to have to wrestle with. Okay, with these increased -

Chairman Shays. Okay. I got the answer.

Mr. Parsons. -- do we exercise the option.

Chairman Shays. Ms. Gustitus, Commissioner Gustitus?

Commissioner Gustitus. Thank you. Are we able to say what that number is, by the way, what the proposed cost increase is, or is that confidential?

Commissioner Henke. [Off microphone.]

Commissioner Gustitus. Oh, okay. So we know it is about \$50 million, then.

Commissioner Henke. Fifty million, 50 percent.

Commissioner Gustitus. So it is a 50 percent cost increase. Okay.

Mr. Ricci, you were saying that this DFARS clause isn't embodied in a contract clause and therefore you can't use it to do a withhold. It is kind of unenforceable, is that right? You have to look at for other clauses -

Mr. Ricci. That is our -

Commissioner Gustitus. -- in a contract. So my -

Mr. Ricci. -- position. That is not a clause. That is regulatory -

Commissioner Gustitus. Right. So my question to you is, do you need more authority regulatory for withholds? Do you want more authority, and do you need more authority?

Mr. Ricci. If this is unacceptable, and I think that we all agree it is -

Commissioner Gustitus. You agree?

Mr. Ricci. -- I would need more authority, maybe a contract clause that implements that, some changes to existing clauses. But what I would also like -- or what we need, I need the regulatory guidance, not -- I know nobody here accepts that the mere submission of an acceptable corrective action plan, that that should affect the status, but that is the regulatory direction, so I would need that direction changed. The contracting officers, they go by the contract. They go by the clause.

Commissioner Gustitus. Where is the regulatory direction that the submission of a corrective action plan is adequate to make a business system adequate?

Mr. Ricci. It varies by system. Another thing -

Commissioner Gustitus. Because the implication of this statement -

Mr. Ricci. Right.

Commissioner Gustitus. -- is the absolute opposite philosophy, that you have to have a corrective action plan and it has to be -- and the deficiencies have to be corrected in order to meet -

Mr. Ricci. I understand that. Again, that is what you would assume that that says, that right there. But again, if you remember, going through the FAR, looking at what clauses are in there that mandate certain systems, there are seven. As a matter of fact, they are actually different from the internal controls the DCAA looks at. The FAR doesn't even mention the terms, much less provide any coverage.

Commissioner Gustitus. Okay. Is there a regulation that says the submission of a corrective action plan is sufficient?

Mr. Ricci. Within the clauses of regulatory -- yes. Do you want me to read it for you?

Commissioner Gustitus. No, but would you -

Mr. Ricci. Okay. For estimating and for property, it is very explicit.

Commissioner Gustitus. It says, if they submit a corrective action plan, then the system can be approved, is that -

Mr. Ricci. If they submit it. If they submit it and make adequate progress, the system won't be disapproved.

Commissioner Gustitus. Oh, so -

Mr. Ricci. Right.

Commissioner Gustitus. Okay. But there is a requirement for adequate progress? A corrective action plan alone is not sufficient.

Mr. Ricci. Well, for estimating systems, it says if the contractor -- an acceptable corrective action plan would be sufficient for estimating systems. Again, if they didn't make progress against it, then we are going to take the stronger action -

Chairman Shays. Would the gentle lady yield for a second, and I will give her time.

Commissioner Gustitus. Mm-hmm.

Chairman Shays. The challenge is, you don't sound like you want that authority. It does say, and corrects the deficiencies, and the deficiencies aren't being corrected. You haven't asked for that authority. So I don't have a warm and fuzzy feeling like you would really like to use this. It is like you are finding every reason to avoid withholding. Are you on record at any time in saying, I don't have the authority, I want the authority, please give it to me?

Mr. Ricci. I hope so.

Chairman Shays. No, it is not -

Mr. Ricci. If not, I will say it now. Yes, I would like to have the authority, Commissioner.

Chairman Shays. No, Mr. Ricci. You are under oath, and I only say that by saying I asked a simple question. Have you ever asked for this authority in any official way other than saying, boy, I don't have it?

Mr. Ricci. Again, we did a presentation for the Director of Defense Procurement Acquisition Policy on July 1st, mainly focused on Earned Value Management Systems, because the performance is so awful there. But we did identify the other systems. So yes, I have, sir.

Chairman Shays. You are under oath saying you have asked for the authority to withhold money from contractors?

Mr. Ricci. I provided -

Chairman Shays. I want you to be real careful now.

Mr. Ricci. Okay. I am going to -

Chairman Shays. I am going to tell you -

Mr. Ricci. I am going to be real careful.

Chairman Shays. Okay, and this is not coming off your time.

Mr. Ricci. We provided a presentation and we identified enhancements, or we called it greater incentives, that we would like to see so that we could have, we will say, more of a hammer with contractors -

Chairman Shays. That is not what I asked -

Mr. Ricci. -- deficiencies.

Chairman Shays. That is not what I asked. Have you ever asked for the authority to withhold money from contractors?

Mr. Ricci. I mean, I did a presentation where I suggested these are changes that would be beneficial for us to have that authority. I have never submitted a statutory proposal -

Chairman Shays. Mr. Ricci, I am going to just end there.

Commissioner Tiefer. Will the gentleman yield?

Chairman Shays. It is Ms. Gustitus' time, and she has -

Commissioner Gustitus. Yes, I will yield to you. Yes.

Chairman Shays. And you will get the time. Go on.

Commissioner Tiefer. You said that the presentation was primarily in connection with Earned Value Management Systems, EVMS, right?

Mr. Ricci. Yes, sir.

Commissioner Tiefer. EVMS is not on the table today, is it? We are talking about a set of business systems that are not EVMS, are we?

Mr. Ricci. I don't know why estimating systems -- the EVMS -

Commissioner Tiefer. It would not be -

Mr. Ricci. I don't know why it would not be on it. Again -

Commissioner Tiefer. I will tell you. Let me state, we have had a system -- we have a list of the ten business systems. EVMS is mostly about making progress, right, progress, not about these ten business systems. As to these ten business systems, not your EVMS presentation, would you answer the Chairman's questions as to the business systems we are talking about today? The Chairman's question was, have you asked in so many words for the authority he is talking about?

Commissioner Zakheim. And could I just ask, all we need is a yes or a no.

Mr. Ricci. I don't believe that I have specifically requested additional authority for the accounting systems.

Commissioner Tiefer. Thank you.

Mr. Ricci. And related internal controls.

Chairman Shays. Ms. Gustitus, you have three minutes. We will give you an extra minute.

Commissioner Gustitus. Okay. Let me ask, do you think that the fact that these three companies in these contracts are involved in contingency contracting make it more likely for DCMA to want to approve the business systems than not? I mean, is there an element of the fact that we are in a contingency system and we have got to make sure we deliver to the troops and this is about logistics? Does it color the decision that your people would make in terms of approving a business system?

Mr. Ricci. I would believe that the standards we would have would consider the environment that they are operating in. The fact that a lot of the prime contractors that have the deficient systems that I mentioned during my testimony, they are making subcontract awards to Raytheon, Northrop Grumman, companies here with established suppliers, whereas KBR and the other LOGCAP contractors, they are dealing with subcontractors that really can't be expected to have the same level of sophistication. So the short answer is, yes, I believe that is considered.

Commissioner Gustitus. Actually, doesn't that make the requirement for a solid business system even more important, if KBR is dealing with subcontractors that are not known?

Mr. Ricci. It would make it more important that you have one, yes.

Commissioner Gustitus. Yes. Okay. Let me just ask about how we determine whether a corrective action plan is complete. I think this is a pretty fuzzy area, as to where the responsibility lies if a correction plan is offered and accepted, how do we determine and who determines, who has the responsibility to determine the progress on a corrective action plan and when it is complete, when there has been sufficient progress made on it? Ms. Stephenson?

Ms. Stephenson. Can I start?

Commissioner Gustitus. Yes, please.

Ms. Stephenson. Certainly with the corrective action plan, when a contractor informs us that the corrective action plan has been implemented and the system is ready to test, meaning that they have, indeed, implemented it, we generally will permit a cycle of costs, whatever that may be -- it is usually three months to get a complete cycle of costs in the system -- and then perform a follow-up audit to determine whether the system has, indeed, improved.

Sometimes there is a length of time that it takes for the contractor to implement it, and we don't go in while they are implementing it, knowing that the deficiencies are still going to exist. We do give them an opportunity to fix it. The question is, who monitors what that length of time is? I have to say, for most contracting instances, that is the contracting officer who is going to monitor that.

However, I will say, in some instances, we could have done a better job in monitoring that and saying something sooner and asking for a withhold sooner. I do say we could have done that, especially with KBR's purchasing system.

However, we did take that into effect when we did the number of suspensions that we have done, the over 100 or 500-and-some suspensions were what we did while they were implementing those corrections to ensure the government's interests were protected.

Ultimately, the audit of that corrective system, I believe, says whether that action plan has been effective or not.

Commissioner Gustitus. Okay. So that usually takes how long, then?

Ms. Stephenson. It usually is anywhere from six months to a year.

Commissioner Gustitus. So it is reasonable to have a withhold go for that length of time?

Ms. Stephenson. I have seen it in the past and it has been useful. We have done pieces of the system, and as that piece was audited and determined to be adequate, a portion of the withhold was returned. It was not all or nothing.

Commissioner Gustitus. So there is a way you could work it out -

Ms. Stephenson. There is a way we can do it.

Commissioner Gustitus. Okay. Thank you.

Chairman Shays. Thank you.

Commissioner Zakheim?

Commissioner Zakheim. Okay. I would like to follow up on that, but first, Mr. Ricci, from what I heard from Commissioner Thibault, you are 800 percent down in terms of the number of people you have doing this kind of checking, down to 14 people, I understand, is that correct?

Mr. Ricci. That is correct.

Commissioner Zakheim. So how many people have you asked for in the current new Defense budget? Have many people have you asked for, have you programmed for?

Mr. Ricci. You mean under the Defense Acquisition Workforce Development -

Commissioner Zakheim. Well, you know, you put together a budget. I happen to know a little bit about budgets.

Mr. Ricci. Yes, sir.

Commissioner Zakheim. You are going to come in with a request. Have you requested 100 people? Have you requested 50? Two hundred? What have you requested for this year?

Mr. Ricci. I believe we are looking at 2,500 over the next five years.

Commissioner Zakheim. And for this coming year?

Mr. Ricci. Umm -

Commissioner Zakheim. You are going to go from -

Mr. Ricci. I can give you an exact number. This is the first year we have asked for a lot more than what we had. Over the past, we hoped to just stay flat -

Commissioner Zakheim. Okay.

Mr. Ricci. -- which was a problem -

Commissioner Zakheim. Over the past, you were prepared to stay flat?

Mr. Ricci. We -- again -

Commissioner Zakheim. Last year, you didn't request an increase, even though you had all this stuff going on and hundreds and millions of dollars being flushed down the toilet, and you didn't ask for any more people?

Mr. Ricci. I can provide the data -

Commissioner Zakheim. Well, no. Did you or didn't you?

Mr. Ricci. I don't -- again, that is not -- I am not on that side of the house, sir, the comptroller side. But no, I don't believe that we asked for tremendous increases -

Chairman Thibault. David, Dov, if I can, I think we can focus it, because then I think you will know. You went from 102 to 14 and you have got, as Dov says, lots of dollars, lots of challenges. And that is present, end of fiscal year 2009. Are you going forward in 2010 with the same 14, or did you ask, to restate Dov's question, did you ask for 25 or 50 -

Commissioner Zakheim. Yes.

Chairman Thibault. -- in order to get the job done?

Mr. Ricci. I have personally asked for more from our comptroller with what they take forward. Again, I can't -

Commissioner Zakheim. Okay.

Mr. Ricci. -- guarantee that that will go forward.

Commissioner Zakheim. Okay, fine. Let me ask Director Stephenson, so we were talking a little earlier about you get a crack at these corrective action plans and essentially you say, well, they have done something, they haven't done something. It takes six to 12 months. So what then happens? You go back to DCMA and you tell them they haven't done it, or to the Army? Who do you go to and what do you say?

Ms. Stephenson. It will be back to DCMA. Can I give it in two different scenarios? We have the instant scenario with DynCorp right now. They have three inadequate systems. They have submitted a corrective action plan. The DCMA contracting officer asked us to look at it, whether we thought the action plan, as written, if implemented as written, was adequate. We determined one of the three was not, and at that point in time, we wrote the contracting officer and DynCorp and said this needs to be improved before it is even considered an adequate corrective action plan.

On the other two that were considered adequate, given that they were just implemented, were given about three months to get a cycle in of costs that we can adequately test under the new process and then we will initiate an audit. Once that audit is complete, it is issued back to DCMA, and because it is a LOGCAP IV contractor, we have an agreement with the Army that we include the Army on anything that we issue on LOGCAP IV. So they will be aware if there is, indeed, an issue.

And in the meantime, if we find problems, we will do suspensions on a real-time basis and not wait for that system report opinion to be issued.

Commissioner Zakheim. So if you have a corrective action plan that was put together in 2004 or 2005, you will keep coming back and saying they still haven't done anything, correct?

Ms. Stephenson. That is right, and we will follow up -

Commissioner Zakheim. Okay.

Ms. Stephenson. -- with the recommendation for a withhold and suspension.

Commissioner Zakheim. Okay. So now, Mr. Ricci, given that, are you saying that even though you have been told the corrective action plan has not been implemented, your hands are tied and you still can't have a withhold?

Mr. Ricci. Sir, I can withhold costs if we can show the logical nexus or causality between the deficiency and that cost. If we don't do that, it is essentially a penalty. So that is why -

Commissioner Zakheim. Okay, fine. Then let me ask Director Stephenson, when you go back to Mr. Ricci's organization, do you show the logical causality?

Ms. Stephenson. Yes.

Commissioner Zakheim. You do? So then why can't you -

Ms. Stephenson. Case in point.

Commissioner Zakheim. Fine. Okay, good.

Ms. Stephenson. Task Order 159, \$1 billion in October 2008. I don't think you get any better than that.

Commissioner Zakheim. Okay. So Mr. Ricci, if DCAA shows you logical causality, are you ruling that they are illogical? The fact that \$1 billion -

Ms. Stephenson. One billion -

Commissioner Zakheim. -- billion with a "B", sir -

Mr. Ricci. One billion -

Commissioner Zakheim. -- was considered suspended doesn't in and of itself give -- it is suspended, right?

Ms. Stephenson. No. If I can elaborate -

Commissioner Zakheim. Please.

Ms. Stephenson. -- this was on a forward pricing proposal. It was \$1 billion that KBR did not perform adequate price competition or adequate

analysis of the subcontracts. This is not a suspension. This is they failed to do their job.

Commissioner Zakheim. Okay. To my simple mind, that is a pretty logical causality. Tell me why my mind is even simpler than that and it is an illogical causality.

Mr. Ricci. Okay. We will take that one example about the price analysis, okay. To the extent that that did occur, again, we know we have the differences of opinion regarding the purchasing system, okay. But if I can show that the lack of adequate price analysis has led to unallowable costs, and I can kind of say that that is five percent of the total cost, yes, I can withhold costs with the notice to disallow costs. It is the blanket, say, I have a deficiency so it is ten percent.

So again, the labor accounting system that April mentioned before, I can see how the labor accounting, you can definitely quantify it. You can do things also like disallow all the labor costs. So again, I am not saying we can never do it. I am saying it is not as broad as -

Commissioner Zakheim. But nobody is arguing with you about the breadth of it -

Mr. Ricci. Okay.

Commissioner Zakheim. -- and I want to go back to what my Co-Chairman, Mr. Shays, has said. You know, when DCAA comes to you with something that looks pretty rigorous to me, and this is a pretty rigorous organization. I think they are amongst the best in the U.S. Government or anywhere in doing this kind of work. And they come to you with a rigorous argument and a rigorous case, there are two ways you could go. You could go and say, hey, we are losing billions of dollars here. It is affecting the people in the field, the men and women in the field. I have a strong case to back me up. I am going to withhold.

Or you could do what you have done, which is to find a way not to withhold. And it troubles me very, very deeply that you are coming up with reasons not to do things that, frankly, are undermining the efficiency and the safety of our people in the field, as Co-Chairman Shays pointed out very eloquently.

Chairman Shays. Commissioner Ervin?

Commissioner Ervin. Let me just pick up on that, if I may. I agree with this. I mean, I certainly, and I think it is true to say that all of us are trying to be fair to you, Mr. Ricci, here, but you seem to be searching for an excuse, a rationale for not doing what is clearly called for. Can't we just stipulate that there is definitely a nexus between deficiency and cost? It may be a question of how much the cost is, but can't we stipulate to that?

Mr. Ricci. Depending on what the deficiency is. I don't believe all of them logically lead to the suspension of costs -

Commissioner Ervin. Well, what about some of them, and what about this particular -

Mr. Ricci. Some -

Commissioner Ervin. What about this particular \$1 billion instance?

Mr. Ricci. I think -- I believe that we would need more granularity about what the specific deficiencies are and how they led. The issue that I would have with this is, again, I just sent my purchasing system team in there and they found -- they didn't find any additional defects in the system. Because a cost is suspended doesn't mean it is ultimately not allowed. So that is the issue I have.

But certainly on a lot of these systems, we can look for greater opportunity to implement the withholds, and one thing that I will do is to pursue a policy that lays out when it is appropriate, because we saw it didn't happen here, and I can speak for the contracting officers. You can bring lots before you. They would have the same position as me. And again, I have coordinated this with our General Counsel. They also have the same concerns that we show this nexus, but it is arbitrary.

Commissioner Ervin. By the way, is there a statutory or regulatory requirement that a nexus be shown?

Mr. Ricci. Yes. We believe that the regulations indicate there should be such a nexus so that it doesn't end up being a de facto penalty.

Commissioner Ervin. Can you submit for the record a statement from your counsel to that effect and that points to the regulatory requirement that you think is -

Mr. Ricci. Sir, it is an interpretation of the regulation, but I will provide something to that effect.

Commissioner Ervin. All right. Now back to the corrective action plan, is there a statutory or regulatory requirement to accept a corrective action plan before it has been implemented and validated by DCAA, a statutory or regulatory requirement that you have to accept it before then?

Mr. Ricci. I just want a little clarification. There is a -

Commissioner Ervin. Sure. Are you required by law or by regulation to accept a corrective action plan before that plan has been implemented and before it has been validated as having been implemented by a DCAA audit?

Mr. Ricci. The regulations for most of the business systems, the seven that I presented, okay, not the ones that DCAA does -

Commissioner Ervin. Let us talk about the ones we are talking about in the hearing today.

Mr. Ricci. That is difficult, sir, because of those, the accounting, the purchasing, the estimating, there is contractual requirements in the contracts for contractors to maintain those systems. The other related internal controls -- I understand why they are important and I understand how DCAA does the reviews, but they are not expressly, explicitly set forth in the contract and the requirements for what is adequate is not subject to the rulemaking process but rather contained within the DCAA's own internal memo, so --

Commissioner Ervin. Who writes these contracts? Do you have the right to insert into the contract whatever language you think is necessary in order to hold a contractor's feet to the fire?

Mr. Ricci. There are provisions for special clauses, but generally they are the standard clauses prescribed by regulation. There are very few, say, tailored or custom clauses.

Commissioner Zakheim. Could you yield a second on that one, Clark?

Commissioner Ervin. Sure.

Commissioner Zakheim. There are few tailored clauses, but the government in writing a contract, like anyone who writes a contract, can write what they want and then the contractor can decide whether or not to accept, isn't that correct, Mr. Ricci?

Mr. Ricci. Yes, sir. Yes, Commissioner. Again, we don't write the contracts -

Commissioner Zakheim. Well, let me ask Mr. Parsons. You can write what you want, correct?

Mr. Parsons. Sir, for an individual contract, as long as it is within the laws and the regulations, the answer would be yes. But if you are going to put clauses in multiple contracts, there is a rulemaking process that has to be followed and that has to be vetted. That is why there is a FAR Council and a DAR Council that does that. I think that is what Mr. Ricci is saying, is that many of these issues -- and that is why I would submit I think what needs to be done at the OSD level is all these systems need to be examined. How are they called out in the regulations? What are the standards, and let us get on with it.

Commissioner Ervin. Do you have a comment to make about this issue, Ms. Stephenson?

Ms. Stephenson. I have seen it happen without a contract clause. I was unaware until we were preparing for this hearing last week that DCMA felt that there had to be an explicit requirement in the contract clause for a withhold or we would have pursued a regulatory or statutory change because I have seen it done in a number of other instances, not on the LOGCAP contractors, but others, especially small to medium companies. I see it happen when there are inadequate systems.

The explicit requirement to have a system of internal controls is upon every contractor. To say that there is not a contract clause to have an adequate billing system, to me, doesn't make sense. You have to have these -- you have to have a system of internal controls to have sound financial records, to have a sound system. I am a little bit baffled by that analysis.

Mr. Ricci. Can I clarify what I meant? Okay? The purchasing estimating systems, there is a specific contract clause in every contract that lays out the requirements and what would be considered acceptable or adequate. The other internal control systems relative to accounting don't have that, and that is the disconnect between the seven I presented, because when I was asked to come here, the focus was contractor business systems. I went through the regulation and I pulled out those systems that are supported by a contract clause. It is not that I didn't want to necessarily address these, but again, it is difficult when the criteria and standards are in the audit manual, not in the contract, which I believe would be an improvement, and I believe April agrees, if we did mandate these expressly in the contract.

Commissioner Ervin. Thank you.

Chairman Shays. Commissioner Grant? Excuse me. Commissioner Green?

Commissioner Green. Thank you, Mr. Chris.

[Laughter.]

Commissioner Green. Let me take you off the hook for a moment, Mr. Ricci, and you may want to comment on this later, but for you, Director Stephenson, do you think it is realistic to have the current standards for business systems apply in a contingency requirement and are they practical in the real world? Do non-contingency contractors meet the business requirements more readily than contingency contractors?

Ms. Stephenson. First of all, we recognize in the early stages of a contingency environment, there is -- there is situations where contractors need to be brought on contract to deliver goods and services when the business systems may not have been audited or the business systems that were audited may have significantly changed because of the contingency. We recognize that. And we recognize that there is a need to get the goods and services in absence of having sometimes an audited system. And in that case, we recommend that inadequacies be handled through fee withholds, through cost withholds, through other incentives throughout the process.

However, the issue becomes just how long does a contingency operation last? We are now six years into this war. Is that a reasonable period of time to say that we are still in a contingency environment when it comes to accounting system, billing system? I would say not. However, if a hurricane hit the Gulf Coast tomorrow and there had to be contractors going in there and putting new roofs the next day, yes, I would say that we would have to give, in that case.

Commissioner Green. Mr. Ricci, any comment?

Mr. Ricci. I believe that the availability of subcontractors makes it more difficult -- I mean, three people got killed over the weekend over there, so I believe it is different.

Commissioner Green. Mr. Parsons, we have got indications that certain historical records, project files, data, et cetera, may not have been passed on from KBR to the new contractor. When transition planning was accomplished by the Army, what steps were taken to ensure that the transition of people and data were made efficiently and effectively from KBR to the successor contractor?

Mr. Parsons. Sir, I will have to get back to you on the exact details, but I do know that transition plans were proposed, were evaluated by the LOGCAP program office, including our offices forward in Kuwait and even in Afghanistan, and then so those were reviewed to see if they were adequate. And then there was oversight that was provided during that transition point, the transition phase, by the LOGCAP IV offices.

I think you probably have had that discussion, that there was a lot of lessons learned in Kuwait with the eaches and the details, probably much more than we had thought of originally, which has been now incorporated into the Afghanistan lessons learned, and I am sure there will be some lessons we learn out of there as we go to Iraq. But if you want the specifics, I will have to get back to you.

Commissioner Green. Yes. Apparently, some things have fallen through the cracks in the oversight of that. A last question, and let me direct it to Director Stephenson since you were the only one who seemed willing to support the proposal for an oversight group, or at least consider that. If we were to ultimately make some kind of a recommendation that a higher-level oversight group be established to deal and resolve the differences between these two organizations, DCAA and DCMA, how would you propose the makeup of that group be constructed?

Ms. Stephenson. My initial thought is that it should be at the under secretary level, and perhaps it could be the Under Secretary with AT&L, with the Under Secretary Comptroller. That is one possibility. However, I am sure that there are other possibilities if we give it some additional consideration. But that would be my initial thought.

Commissioner Zakheim. Can I?

Commissioner Green. Yes.

Commissioner Zakheim. You know, there is supposed to be a Deputy Chief Management Officer by law. Would you see that individual as perhaps doing the job that Commissioner Green has been talking about?

Ms. Stephenson. It could be. And as I said earlier, I am willing to try anything, and if that is what the Department would like, I will try it and we will see if it works. If that doesn't work, I am willing to try something else to see if it works.

Commissioner Green. Thank you very much.

Chairman Shays. Thank you, Commissioner Green.

Mr. Ricci, you have been a little more on the hot seat than the others. Mr. Parsons, it has been kind of quiet for you today. Ms. Stephenson, you have kind of been on the side that seems to connect more with the Commissioners up here.

But, Mr. Ricci, I just want to say, you are known to be one of the most knowledgeable people in contracting. You are extraordinarily hard working and you are a very good American and we appreciate your service. We would like to see things change a bit. So it is -- I think sometimes when you go down a route, you kind of feel like you have to stick with it. But we would like you to kind of think anew and act anew.

So I would just end by saying, Ms. Stephenson, you are going to be looking at the whole issue of adequate and inadequate.

The second issue is, we think it is dysfunctional, the way this system seems to be working, and with no disrespect to you, Mr. Ricci, we think that there needs to be a little more adjustment on DCMA's part than DCAA's part as it relates to this. And it is not a disrespect to any of you, but I think that is fairly clear.

I think that it is fairly clear your CPSR teams, going from 102 down to 14, it is illogical, given that now, more than half of the folks in the battlefield or in the battle arena are contractors, and so we are going to ask you to look at that.

And with this whole issue of withholding money, not paying, whatever, we think you can do it now. You have kind of boxed yourself where you need more authority, but that needs to be resolved, as well. We are going to ask the folks that oversee you to take note of this hearing. We are going to come back in 60 days to see what has changed, and we think that it is not rocket science to change this. And then we are going to all feel like we are headed in a much better direction, because we started this hearing saying the system is bad, getting worse, and we want it the other way around.

So I want to thank all of you for being here. We are going to take a 30-minute recess, but we all know you are great Americans, you are working hard, and we appreciate your love of your country and the hard work you put into it for our fighting men and women. So thank you.

We will be recessing for 30 minutes. I am willing to see how well we can communicate as a Commission. Do you need -

Commissioner Gustitus. When is the other panel?

Chairman Thibault. One o'clock.

Chairman Shays. Okay. So the other panel was called at one, so we are going to have 50, and thank you very much, Commissioner. See, we can work together up here, too.

[Recess.]

Chairman Shays. I will call this hearing back to order and to say that before we start with the second panel, Mr. Parsons rightfully reminded me that I had said that any one of the panelists who wanted to make kind of a closing statement to correct records or to just emphasize a point would have that opportunity, so Mr. Parsons, I am very grateful that you reminded me of that and so we will start with you. Is there anything that you would like to just put on the record before we go to the next panel?

Mr. Parsons. Yes. There are a couple of things. First of all, and just reflecting back on the morning here where there appeared to be quite a bit of division between the panel members, I would like us to walk away knowing that we really do want to work together and look at the future and how we make improvements. I have committed and will continue to follow through with April with meeting with her and also with DCMA to talk about these important issues, not only the contractor business systems, but also with the task orders under LOGCAP IV.

I can tell you that Mr. Loehrl, who is my Director of Contracts out at Rock Island Contracting Center, has met and has discussed these business system issues with his counterparts in each of the companies. It is the intent of myself and Mr. Harrington, who is the Deputy Assistant Secretary of the Army of Procurement, to meet with each of these contractors to discuss the importance of these business systems. So I want to assure you that the Army senior leadership is committed to working these hard issues.

And I think, as Mr. Shays said, that these are complex business systems. I know a couple of folks said, well, this shouldn't be rocket science, but the truth of the matter is they are complex. There is a lot of room for interpretation and I think there is a lot of work that has to be done to make this better for the future.

I do want to emphasize, on the Afghan task orders, we had to make a decision come May-June time frame on the time line to get those task orders awarded. We looked at what the additional delay might entail if we asked DCAA to go in and do some detailed audits on those cost proposals and came up to the conclusion that any further delay on getting those task orders awarded in the time frame that we did was not going to meet the operational needs of the Army.

And that gets to Mr. Green's point. The contracting officer has got to make this tradeoff, meeting the operational needs of the war-fighter and at the same time having to care about protecting taxpayers' interests.

So a decision was made to go ahead and award those task orders under Afghanistan. However, we have agreed and we are working with DCAA to go in and do post-audit reviews of the cost baselines that were proposed by each of these contractors. So we are going to get some detailed cost information out of the contractors that supported those proposals that

they submitted and we are going to ask DCAA to do that audit to give us a baseline.

If we find that there were some differences, you know, significant differences of what was proposed versus what DCAA is finding these cost baselines, that will be taken into consideration, as I said, on our decision on whether we are going to exercise further options for that work or if we need to make some withholds, as has been suggested by Ms. Stephenson, and I have talked with Mr. Loehrl and the contracting officer and we are not adverse to doing so.

As I mentioned, these systems are important. The whole thrust of LOGCAP IV was to put emphasis on these business systems, and they will be addressed in the award fee proceedings as we move forward and in the determination on whether or not options will be exercised as we award these task orders.

We also are working with DCAA on the audit of the Iraq task orders. Our contracting officers have shared the solicitation with DCAA. We are getting input. We are still having some discussions on the extent of how much audit activity we think is needed versus what DCAA is, but we will work through that and you have got my commitment that we will continue to work with DCAA as we move forward.

So I just wanted to add those points, and again, thank you for the Commission's interest in it. It is an important area. We think when you take a look at the extent of the business systems issues we have got across our contractor baseline, the root causes need to be identified and resolved. Thank you.

Chairman Shays. Thank you very much, Director Parsons. So Director Stephenson?

Ms. Stephenson. I had two points that I wanted to say, and I will keep it brief in the interest of this afternoon's session.

One, I didn't want to leave the impression that an inadequate system is any different than an inadequate in part system. They do have serious material deficiencies. We would not report a deficiency unless it had a material impact on government contracts. However, Commissioner Shays, as you asked, we will reexamine that.

The second thing is, Commissioner Shays, I wanted to second what you said about Mr. Ricci. I realize he has taken a lot this morning, but in our working relationship, he is one of actually the people who has resolved a number of issues that we have had with contracting officers, although this one is one in which we disagree on. He actually has been the type we have been able to make a phone call and he helps resolve them, and so I did want to second what you had to say about Mr. Ricci.

Chairman Shays. Thank you. Mr. Ricci?

Mr. Ricci. I just want to say that I sincerely appreciate being invited over here to discuss the business systems, as well as our interpretation

of the regulations governing them. You know, I understand that it is unpopular, but it is our best interpretation of the regulations as they exist today, as well as longstanding practice.

But, you know, we will look at proposing additional regulatory changes that we think will help us to do a better job at getting correction, and we will also work -- just the final thing I want to mention is that over the past, say, 15 years, decade of acquisition reform, there has really been, I would say, kind of almost direction to the government folks to try to work with your industry counterparts, and I think to the extent that DCMA perhaps has not taken the strongest action that maybe it could have over the years, part of it does go to that climate which we can work to change over time. Thank you.

Chairman Shays. Thank you. I appreciate all of your candidness and we look forward to meeting with you in approximately 60 days. We look forward to those folks that have input on what you do, helping sort this out. And we look forward to some changes.

Yes, absolutely, Mr. Commissioner.

Chairman Thibault. I just want Mr. Parsons -- I am really impressed when you mentioned Ed Harrington and I am really pleased that we are able to draw in that kind of talent and that kind of background in this critical area. So good luck, good fortune to all of you, and thanks.

Chairman Shays. Thank you all very much.

We will go to now our second panel. Our second panel is Bill Ballhaus, President and CEO of DynCorp; David Methot, Executive Director of Compliance, Fluor Government Group; Bill Walter, Director of Government Compliance at KBR. And why don't you stay standing because then we will just swear you in and take care of that while you are standing.

And by the way, if there is anyone else in your company that maybe you might turn to answer a question, we would ask that they stand up so we don't have to swear in someone a second time. So stay standing, if you would. Is there anyone in your companies that you might want to respond to questions? We don't have to take their name now, but if you want them to -- okay.

So raising your right hand, do you solemnly swear or affirm that the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth?

Mr. Methot. I do.

Mr. Walter. I do.

Mr. Ballhaus. I do.

Chairman Shays. Thank you. I note for the record, all of our witnesses have responded in the affirmative.

And so -- do I pronounce it Methot? How do I pronounce your name.

Mr. Methot. Meth-ott [ph].

Chairman Shays. Methot. Thank you. Mr. Methot, thank you for coming, and we are going to start off with you and then we will just go right down the line. And we are saying six to seven minutes would be our wish. At seven minutes, I would ask you to close. But if you close before, that is all right, too. And I am going to make the same point this time. I don't think I will forget. If you have closing comments, you will be able to do that. If you weren't asked a question you want to put on the record.

Mr. Methot, you have got the floor.

TESTIMONY OF DAVID METHOT, CHIEF COMPLIANCE OFFICER, FLUOR GOVERNMENT GROUP

Mr. Methot. Co-Chairman Thibault, Co-Chairman Shays, and members of the Commission on Wartime Contracting in Iraq and Afghanistan, thank you for the opportunity to discuss Fluor's business systems. My name is David Methot and I serve as Executive Director of Compliance for Fluor Corporation's Government Business Segment.

Fluor is a Fortune 500 company with over 42,000 employees serving five business segments, including energy and chemicals, industrial and infrastructure, global services, power, and the U.S. Government and international agencies. Our total revenue last year was \$22 billion, of which the smallest business segment was the government's, with six percent revenue, performing work for the Department of Energy, State, Homeland Security, and Defense.

Fluor has been actively supporting the U.S. Government for over 60 years. Throughout this period, we have supported the Government's needs, including the Manhattan Project, the Strategic Petroleum Reserve, missile defense infrastructure in Alaska, the closure and remediation of DOE's facilities at Frenald, Ohio, disaster response and recovery support for FEMA in response to natural disasters and Hurricane Katrina and Rita, and projects for several defense agencies in Iraq and Afghanistan.

Fluor's ongoing projects in Iraq and Afghanistan consist of task orders under contracts for the U.S. Army Corps of Engineers, Transatlantic Program Center, and under the Army's LOGCAP IV program. Fluor was awarded the CETAC II contract in January of 2004 and has performed work under 22 task orders between 2004 and 2008. We are still performing work under four of those task orders.

Fluor was awarded one of three LOGCAP IV contracts in July of 2007. The Army Contracting Command has competed eight task orders and Fluor has received four awards. Fluor's first award was in September of 2008 for an expansion of Afghanistan Regional Command East, which consisted of the establishment and continuing live support for four forward operating bases. This was followed by an additional award in October 2008 for calibration and repair services for military equipment in Iraq and Afghanistan.

In December 2008, Fluor received an award for construction, expansion, and continuing life support of eight forward operating bases in Afghanistan RC South. Recently, Fluor was awarded a task order for base life support and theater transportation functions for U.S. and coalition forces in the Afghanistan North area of responsibility.

The total value of the task order is over \$7 billion over five years, including one base year with four one-year option extensions. We are now working closely with the Army to plan and coordinate the transition of this work.

As the Chief Compliance Officer of Fluor's Government Group, I directly report to the President of FGG and have an independent reporting relationship up through our Corporate Compliance Officer to the Audit Committee of Fluor's Board of Directors, as well as the Corporate Compliance and Ethics Committee. I am accountable for ensuring Fluor complies with Federal contracting requirements and for implementing and overseeing an effective business ethics and compliance program. This includes maintaining government-approved business systems. I am supported by our corporate finance operations for DCAA and DCMA coordination of our corporate business systems and indirect rate agreements.

Fluor's business systems and processes are well established and designed to support global execution of engineering, procurement, construction, and O&M services to its customers. These systems are designed to support execution excellence and include effective internal controls and sound business operations. FGG's business systems have received hundreds of reviews over the years and were determined to be adequate by the U.S. Government.

Historically, any business system internal control audit issues identified have been resolved with the government. Where deficiencies were identified, timely corrective action plans were submitted to the government and an appropriate level of senior management attention ensured implementation. Follow-up audits have routinely resulted in adequacy determinations of the affected business system.

As Chief Compliance Officer for Fluor's Government Group, I am proud of our track record of performance and compliance across our government agencies. On behalf of over 2,100 employees of FGG, we are cognizant of the unique role we play in support of U.S. and coalition forces operating in Iraq and Afghanistan. I look forward to your comments, questions, and dialogue about Fluor and our business systems.

[The prepared statement of Mr. Methot follows:]

Chairman Shays. Thank you. Mr. Ballhaus?

TESTIMONY OF WILLIAM BALLHAUS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DYNACORP

Mr. Ballhaus. Thank you. Chairman Thibault, Chairman Shays, and members of the Commission, on behalf of DynCorp International's 25,000 employees

serving in over 30 countries, thank you for the opportunity to participate in this hearing.

I would like to start today by summarizing the three major points that shape the recommendations in my full statement, and I would like to request that my full statement is included in the record.

Chairman Shays. It will be put in the record.

Mr. Ballhaus. Thank you. The three points: Point one, Contingency operations are different and offer unique challenges versus executing similar work in peaceful environments. At DynCorp International, with our experience supporting U.S. national security and foreign policy objectives around the world, we understand these unique challenges intimately and firsthand.

Point two, successful contingency operations require trained leadership, capable of making timely decisions. While business systems and policies are enablers, it is people that make things happen.

And point three, successful contingency operations require a culture of performance, transparency, timeliness, and accountability throughout the acquisition life cycle from both contractors and government employees.

Let me touch on each of these three points briefly and summarize my recommendations. First, on unique challenges. The Commission is well aware of the unique challenges associated with contingency contracting. Rapidly changing missions and requirements are at the top of the list. But not least of all, contingency operations present a number of personal challenges for our people, from tough living conditions and working environments to long days, weeks, and months. This looks nothing like what you might see in domestic operations. These environments are austere, they are hostile, and they are not for everyone. Our employees understand these risks, yet they are motivated to serve and stand shoulder to shoulder with the war-fighter. And it isn't just for the money. Our employees come to work to make a difference, to serve today for a safe tomorrow.

To date, 65 employees from DynCorp International and our joint ventures have paid the ultimate sacrifice for our country and our company. Dozens more have been injured. This is a reality of contingency support and it is why I recommended to the Commission our Employee Assistance Program as a model for contractors to support fallen and injured employees and their families.

Second, on the topic of leadership, I was pleased to see that this was an area of the Commission's interim report. I fundamentally believe that successful contingency operations require, for both contractors and the government, competent, capable, motivated leadership, properly positioned to get the job done. On our largest and toughest programs, like LOGCAP and GLS, I personally select our program leaders. Similarly, I support the Commission's interim finding on the need to deploy trained, dedicated contracting officer representatives and administering contracting officers to the field. The need for dedicated, well-trained

leadership in wartime operations is amplified by the unique challenges of the environment.

Third and finally, successful contingency operations require a culture of transparency, accountability, and an intense focus on performance across the board. Even with the best leadership and business systems, there will be issues. The key to success is instilling a proactive culture that works hard to prevent issues, but when they do occur, works hard to fix them fast.

At DynCorp, we set a standard for ourselves of perfection with respect to program performance and compliance matters. Now, we realize the impracticalities of this standard. We are not perfect. But it is an ambition that drives our culture to be proactive in preventing issues and responding fast when they occur.

The need for accountability and responsiveness is behind two additional recommendations included in my statement. First, on the topic of business systems, I have recommended, in addition to adopting a more graduated adequacy determination scale, like was discussed this morning, that DCAA should adopt standards for prompt review of contractors' corrective actions and responses. We have responded promptly and thoroughly to DCAA findings, as this Commission has noted, and would appreciate timely follow-up from DCAA to reevaluate our systems.

Second, on the topic of undefinitized contract actions, which I know is a significant topic of the Commission's May 4 hearing, I have recommended that contractors be allowed to invoice and be paid as long as the contractor is responsive and accountable in supporting contract definitization. It can be penalizing to ask contractors to partially fund work scope when the contract definitization process is not completely within their control. On the other hand, I fully support withholding payments when contractors aren't responsive in this process.

I want to thank you again for the opportunity to appear today and I look forward to answering any questions that you might have and addressing any topics that may have come up this morning. Thank you.

[The prepared statement of Mr. Ballhaus follows:]

Chairman Shays. Thank you. Mr. Walter?

TESTIMONY OF WILLIAM WALTER, SENIOR VICE PRESIDENT AND DIRECTOR OF GOVERNMENT COMPLIANCE, KBR

Mr. Walter. Thank you. I am the Senior Vice President of Government Compliance for KBR, with oversight responsibility for the business systems we are talking about here today. KBR looks forward to helping the Commission identify lessons learned that can be applied to current operations as well as focused, actionable recommendations that will enable positive changes to the contingency contracting process.

Critical to this discussion is the unique operating challenges inherent in a war zone, as well as understanding the challenges posed by competing

governmental priorities inherent in a contingency contracting environment. KBR uses a variety of business systems to manage the day-to-day operations. These include systems to acquire goods and services and to estimate, accumulate, and report costs incurred to provide the services to provide the support to the war-fighter. The primary systems include accounting, billing, purchasing, estimating, and property. Our systems are regularly reviewed and approved by the government. Just last month, the government's most recent review resulted in the continued approval of our purchasing system.

These approvals are not done in a vacuum. DCMA and DCAA are resident in KBR facilities throughout the world, with close to 50 government personnel in our Houston offices, alone. We are in daily dialogue with government representatives to ensure cooperative communication and implement feedback in real time to provide transparency and to improve our services. For example, KBR leads interactive monthly meetings with representatives from DCMA and DCAA regarding business systems.

Throughout our history as a government contractor, which dates back to World War II, KBR's business systems have been appropriate and sufficient. Our business systems evolved over the years to keep pace with the also evolving requirements of the government and the marketplace. Prior to the Iraq War, our most recent experience had been supporting military forces in the Balkans. Based on the volume, based on the original LOGCAP III scope of work, we anticipated that the volume of work would be comparable.

However, as everyone knows, what happened in Iraq was dramatically different. The magnitude and urgency of the logistical support needed in Iraq presented new and extraordinary contracting challenges that any company with any business system would have faced.

As you know, the military and their contractors encountered a rapidly changing and increasingly perilous situation in Iraq. It was in this environment that the initial levels of services required of KBR under the LOGCAP III contract evolved to meet the exigencies of the situation that America's courageous soldiers, civilians, and contractors who support them confronted. This was true with respect to the number of personnel on the ground, the duration of the troop presence, and the hazards posed by the insurgency.

While the original contract clearly stated the essential services that KBR would perform, the specific requirements associated with those, such as the location, the types of facilities that would be available, or those types of facilities that would have to be built at each camp and the availability of supplies and services were constantly in flux. Thus, contractors frequently developed solutions to wartime logistical challenges on the ground and in real time to support the 211,000 service members at over 215 sites throughout the theater. In this volatile situation, the pace of paperwork trailed the pace of demand for services and this led to further challenges for KBR and the governmental administrative teams.

Another inherent challenge relates to the expectation of acceptable quality and extent of documentation. In the Iraq and Afghanistan

theaters, while there may be vendors that can provide the services, few, if any, have experience with the level of documentation expected by the U.S. Government. When this is combined with the demand for KBR to provide services to the war-fighter in an extremely compressed schedule in a war zone, the resulting documentation often does not meet the traditional Stateside expectation.

It is helpful to provide one specific concrete example of the contracting challenges that KBR faced at the outset of the Iraq War. Given the immediate needs of operations, KBR identified an urgent requirement for diesel heavy-duty SUVs. We went to the local dealerships in Kuwait and we were charged the market rate of \$43,000 per vehicle. Subsequently, KBR worked diligently to put a supply chain in place to procure these types of vehicles at a discounted fleet rate by December of that year. This is but one of the examples of the realities of contracting in a war zone and the demands placed on a contractor to meet the government's demand on its schedule.

With regard to the application of business systems in this challenging and ever-changing environment, we identified the need in 2003 to upgrade our accounting system to keep pace with the significant increase in data requirements associated with LOGCAP III. During the implementation of this change, we invited DCAA to participate and observe the entire process. Further, once the system implementation was complete, KBR made presentations to DCAA personnel on its functionality and operation.

Our business systems have evolved over time. As security, communications, and the acquisition workforce improved, we identified opportunities to utilize more Stateside business systems and processes. KBR was often the leader on these issues. We continue taking steps, as necessary, to maintain the best business systems and to serve the military's needs in Iraq and around the globe.

Finally, our experiences in Iraq and extensive history in government contracting afford us a somewhat unique perspective on the challenges faced by the military and its wartime contractors. Perhaps the most vivid observation I might make is that contractors are often faced with multiple and at times competing priorities from the government with respect to our contract. The military commander on the ground may express an immediate need with the urgency of real-time battlefield necessities.

But the Army Sustainment Command and DCMA are responsible for overseeing our contract and both give us instructions on what is or is not required or permitted under the contract. DCAA and other after-the-fact auditors come in later and provide their view. As you might imagine, many contract expenditures and actions look different to the soldier and his commander during the heat of the battle than they may appear months or years later by a Stateside auditor.

As the contractor, we face the challenge of meeting the very real needs of the Army fighting the war while also satisfying the important demands of the contracting officers and government auditors. If the Commission can identify the means that will allow the government to speak with one voice in instructing its contractors in future wartime contingencies, this would

be a significant improvement to the current expeditionary contracting system.

A second observation involves the nature of the auditing process. From our perspective, the current audit process for adequacy determinations contains too many subjective aspects that vary significantly between auditors, leaving the contractor in an untenable position. A greater reliance on objective criteria would provide contractors with an enhanced ability to meet and exceed the government's expectations and would indeed result in increased contractor efficiency for the government.

Chairman Shays. Mr. Walter, if you would finish up in the next minute.

Mr. Walter. Yes. I am finished now. I look forward to answering your questions.

[The prepared statement of Mr. Walter follows:]

Chairman Shays. I wanted to catch my breath here.

[Laughter.]

Chairman Shays. We are going to start out with my Co-Chairman, Mr. Thibault.

Chairman Thibault. Great. I need a microphone. Okay, thank you. I have a couple of points, three maybe, or questions and points, and then I am going to defer five minutes of my time to Professor Tiefer, who has been leading the Commission efforts on logistical support, and since the three companies are logistical support, I thought that made sense. But I am salvaging my last five minutes. You don't get any of that, Professor Tiefer.

Mr. Methot, I just want to share something and then sort of calibrate and give you an opportunity. In your statement, page five -- you don't have to look it up, it is only one sentence and you have probably got it more comfortable than I do -- you make a statement that Fluor Government Group's business systems have received multiple reviews over the years and were determined to be adequate by the U.S. Government.

Now, what I want to share with you, and it is all marked up because -- not because of anything any company did, but because I was trying to understand it and because it points to some of the coordination and issues within the government, but the point is, is it shows those nine system and material management, warehousing, inventory isn't one that DCAA looks at in a manufacturing environment. Service companies tend not to have that.

And I just want to share with you that six of their reviews, DCAA's reviews on Fluor -- it is one of those companies that, you are aware of this, a little slow for DCAA to be getting into and looking at. So they list, based on their cycle, which is every three years, six of those nine as overdue. In other words, they have got audits to do, and I want to share that with you because Fluor, with your current, I guess I would call

it winning structure in terms of contract award, while you are only six percent, I am willing to bet you are going to be more than six percent in the future, just doing some simple math.

But what I wanted to also point out is the other three, the most three recent reviews -- billing, inadequate in part; compensation, inadequate -- that is September 2008 -- and February 2008, indirect costs and other direct costs, which is primarily the incurred cost submission was inadequate in part. So I would caution you that as someone that is really expanding, one of the issues, and Mr. Walter brought it out, is that sometimes the challenges are greater than you anticipate. I share that.

Mr. Methot. Thanks, Commissioner.

Chairman Thibault. Mr. Ballhaus, I commend you for being here. I commend all of you for being here and thank you.

What I want to share in this -- and if I take one more minute, then, Charles, you only get four, but I am wrapping up -- I am not usually one for visuals, but this is a big visual that your Chief Financial Officer gave me. A lot of paper for you all. And what this is is three responses to those most recent reports that you talked about in your testimony, Ms. Stephenson talked about in her testimony, one for labor, one for billing system, and one for compensation system, a corrective action plan and what you have done.

For the record, I think it is important that -- and April said that on two of them, she has backed off her standard recommendation to do withholds because she liked your corrective action plan. And your Chief Financial Officer, he is the one -- I read it and I was very impressed and I was very curious. We put an ex-DCAA Deputy Regional Director who is on our staff and a current contracting officer, very senior, who is on our staff, to look at all three, and they were very impressed. So I commend you for your actions to do that in terms of doing that. And it is important, I think, that this Commission, when an organization is responsive, that they step out and acknowledge that.

And my question, which I think you can help with, is I also commend you for having your Chief Financial Officer -- all the government compliance folk and all that were there -- when we talked about finances, he was representing the company. That was very impressive, because he knew inside and out the issues we were talking about. You primarily do government business. So to me, that made all the sense in the world.

And you are here. Why are you here versus your Government compliance person?

Mr. Ballhaus. First of all, thank you for the compliments. Second of all, I am here because my name was on the invitation letter from the Commission to attend the hearing. But also, I think it sends a strong message and it is a message that reflects our corporate attitude around performance and compliance.

You know, with our role as a contractor supporting U.S. national security and foreign policy objectives, our role is to both perform and be compliant, and when we have issues that come up around our billing systems, we take them very seriously.

Now, one of the reasons why you may have gotten the response that you did and the thick pieces of paper that you held up is we review many of those issues weekly with me, and so the fact that our CFO, Mike Thorne [ph.], was knowledgeable and responsive on those matters is no response to me.

Chairman Shays. Thank you. I am going to cut you off here -

Mr. Ballhaus. Thank you, sir.

Chairman Shays. -- because you made the point, and we are going to give Mr. Tiefer 12 minutes, these four and then his. Thank you.

Commissioner Tiefer. I thank Mr. Thibault for his extraordinary generosity, characteristic of him, but extraordinary nevertheless.

Mr. Walter, we heard testimony this morning by April Stephenson about the problems -- and this is in the context of the drawdown of contractors in Iraq -- the problems that will be posed by KBR's labor system. You may have heard this. Excuse me for once again setting the stage.

They sent me to Baghdad. I sat with General Odierno. He shared his challenges and perceptions and he said -- I am shortening this now -- quote, "We have looked at LOGCAP as we close these bases. That is the plan. Close the camps. Close the bases. Shrink the footprint and the costs," the footprint, meaning the number of people, both contractors and soldiers. That is the footprint. Shrink it.

As we close these bases, I wasn't seeing a reduction of contractors. We had to make LOGCAP accountable. LOGCAP in Iraq means KBR and its subcontractors. It can't mean anybody else.

Now, what I want to ask you starts with, when I was asking the DCAA Director, because she hasn't completed the cycles of labor system evaluations, she referred me to the most recent Task Order 159, the one that had over \$1 billion in questioned and unsupported costs, and specifically to the \$368 million in direct labor costs which were questioned -- not merely unsupported, not merely give us some more documents, questioned -- part of this is your job. Are you familiar with that \$368 million, and did DCAA, in fact, question that?

Mr. Walter. I do not have access to the final DCAA audit report that was associated with TO 159. I do have bits and pieces of it. I do have the piece on the \$1 billion of unsupported cost, which I would like to make the comment that that really is not an accurate statement where it is perceived as if it is an overbilling. What that is is a disagreement between KBR and the DCAA auditor looking at a series of individual subcontracts with respect to what does make adequate competition with respect to those particular items. But I will look into the \$300 million,

and if I get that information, I will gladly provide a response to you, sir.

Commissioner Tiefer. Fair enough.

I handed out some documents. I apologize for doing this stuff at the last minute. We were, in effect, rushed from a trip to Baghdad into the preparation for this hearing and it has been an effort to put stuff together.

The first is a two-page article from the Washington Post which I use only because it mentioned specifically the five percent contractor drawdown. There are many articles on this subject. This is not special. This is a short question and answer. You have awareness of this five percent drawdown figure for contractors in Iraq?

Mr. Walter. I am familiar with that, yes, sir.

Commissioner Tiefer. Good. The next page is about the audit we just talked about. I want to skip it. My only reason for including this color chart is to show sort of the vision of the logistics people of how to carry out General Odierno's order. That is, this is the total sort of grasp down, slide down, glide down they would like to see of the contractor footprint, and then they break it down into U.S. people, Iraqi people, the LNs and the third-country people, the TCNs, and those three add up to the graph. A glide down.

Now, what happened after General Odierno gave his January 31 order that is on the public record in the Washington Post is that there was in the following month an implementation, and that is a couple of pages later, and I won't rush it. You can take your time following it. There is something -- you see the big "unclassified" stamp at the top, and it is a memo to your guy LaBoa, your regional guy, and the subject is "Contracting Officers Direction for Freezing KBR Personnel in Iraq."

What it says is, number one, the intent of this letter is to begin a responsible drawdown of personnel and to decrease the cost and the footprint -- the cost and the footprint. The footprint is the number of soldiers and the number of contractors. He wants to freeze it.

There are a couple of interesting things I want to lay the groundwork on here and then I am going to ask you. The interesting things about this, it is directed at KBR. It is not directed at contractors generally. It is directed at KBR. KBR is, if you want to be very, very rough about it, about half the contractors in Iraq. It is not directed at all of them. It is just directed at KBR.

And the second thing is, it is a rather strong measure. It is a freeze. When one of our team talked to the PCO, Kevin Larkin, about this, he said, although it mentions the Odierno order, it is also because there had been a \$50 million cost overrun in Iraq and that that is why those -- the factors in his mind led to him saying, we have got to have a freeze, a very forceful measure.

Are you familiar with any of this?

Mr. Walter. I am familiar with some of the pieces of this, sir, not all the details.

Commissioner Tiefer. I appreciate your short answer. Do you want to name what pieces are familiar?

Mr. Walter. Okay. When I was in Iraq the last time, this topic of conversation came up. We work very closely with our contracting officer in theater. We did talk with Kevin Larkin. And while the contract is -- was on a freeze status, there is a lot of additional work that goes on. We get requests every day to be able to perform additional work to be able to support the soldiers, in addition, to be able to support the withdrawals. As you do decide to move down the footprint, the Army doesn't necessarily have the resources available to be able to shut down the buildings, shut down the camps, shut down the housing units and move them to other locations.

Commissioner Tiefer. Okay. I understand.

Mr. Walter. Generally, that is something that KBR is -

Commissioner Tiefer. I got the part. Change orders. Okay. ACLs and local.

There was another thing that we ran into and concern. I mentioned the things that were at the top level. They also didn't -- they flew me out to a forward operating base being closed down by the Marines, a place called Baharia in the Sunni Triangle, and there we got the picture. We saw the picture from the bottom and the top, that senior and junior government officials were concerned about and are seeking to guard against what they call the shell game, that KBR will move its employees between bases rather than demobilizing them out of theater, because that is the real goal, not to have them -

You close Base A, they go to Base B. They are waiting around to see where they can be tasked. You close Base B, they move around to Base C. They are waiting around to be tasked. That doesn't reduce the footprint, and yet it seems that the systems that they can get at, the internal control systems, are inadequate. They say they can't get at reducing the actual numbers of KBR.

So here is what I wanted to ask. We also got -- oh. One of the things I wanted to ask was, when I say that the internal control systems aren't strong enough, did you hear April Stephenson describe this morning that she said your internal control systems for labor are not adequate and they recently gave you a statement of conditions and -- SOCAR, you know, statement of conditions. Are you familiar with that? Yes?

Mr. Walter. Yes, I am.

Commissioner Tiefer. She said -- I asked if she considered that kind of a criticism of your existing systems. It came out of Baghdad. Did you take it as a criticism?

Mr. Walter. What we take it as is a misunderstanding at first. There is a large transition of people coming into theater. The systems that are in place, the processes and the expectations are quite different. So what we have -- when we got the initial statement of conditions and recommendations, it said that KBR does not take into consideration the existing staffing when it creates an Administrative Change Letter, or ACL, estimate.

We disagreed with that, and what I have tasked our team to do is to get the people from our estimating department to work with the DCAA auditor and demonstrate how they accomplish and how they do utilize that internal control process.

Commissioner Tiefer. Well, I am glad you are familiar with the SOCAR and the precision and brevity of your answers is admirable. You are not stalling me. I appreciate it.

What I read them as particularly concerned about is -- it goes over and over, proposing the duplicate fee, paid fee twice, paid fee twice, that their understanding is that these change orders -- which you describe, which are still coming in, they were coming in for Project Safe in order to have electricians come in and fix all the electrical problems caused originally by your defective work on housing -- not you personally, KBR's. Those were change orders.

Now you say change orders, which are called ACLs here, Administrative Change Letters, that they are very concerned, to put it mildly -- which is why they issued this -- that you take fee both off the original contract, and if there is an ACL, even if the old labor is used for the new labor, you take it off the old contract, and then another time off the ACL. Am I correct, that is what they are concerned about?

Mr. Walter. That is what they are concerned about, and sir, I am concerned that that is what they believe is happening. We do have internal controls in place. We have worked the process of Administrative Change Letter estimating with the government very rigorously over the past five years. As we do that, one of the first things we do look at is the availability of existing personnel. If they are there, then there is a no-cost change, no additional fee, no additional anything. However, if there is additional resources that are required, then those are the resources that we are going to have to bring into theater to be able to do those things.

My expectation is that by the auditors and by my estimating team in Iraq sitting down to go through and demonstrate how they take that into consideration, we can put this concern of the DCAA auditor to rest.

Commissioner Tiefer. Well, in the meantime, the drawdown is going to be attempted, an attempt to bring the numbers down. Let me show you two pieces of paper we have put together. One, still in the packet, although

I am losing track of it, is a color chart -- this color chart put together by our logistics team leader, Steve Sternlieb, a man of objectivity and dedication. He has tried to pull the data together quickly since we came back from Iraq, and some of this is preliminary.

What it shows is the two lines at the bottom should add up to the one at the top. One shows -- the two lines at the bottom, one is the downward decline in non-KBR labor. That is the green dotted line. That has a fast slope down. And then there is the blue dotted line. That is almost level, slightly downhill. We estimated it is six percent, 6.2 percent, of KBR labor.

And so the cuts in labor are not coming from KBR. The reductions in labor are coming disproportionately from the other contractors. Is it possible -- you tell me what your understanding is. Is that different from your understanding?

Mr. Walter. Part of the drawdown is where KBR, as a result of discussions with Kevin Larkin and others, we went through and performed a personnel reduction plan to reduce the number of personnel in theater. At the same time, while the drawdown of Iraq is happening, the requirements for our statement of work are not necessarily happening at the same time, so we still have the same footprint and we still have to provide the same support for -

Commissioner Tiefer. I have been reminded my time is running out, so I have a last quick question. The last piece of paper I have there is your PAR, it is called in KBR language, and it has a phrase called "Faces Without Spaces" that you still -- and it seems the faces are personnel you have who don't have assigned slots. It seems like you still have a loose pool of labor there waiting for work. You are not reducing like the other contractors. Instead, you are keeping this pool of unassigned labor. And it seems to me that is very contrary to General Odierno's hopes for our footprint. Do you want to respond? Go ahead.

Mr. Walter. I will -- I am not aware of that particular piece of information. I will find out about it, and in the ten-day period, hopefully, I will have an opportunity to provide a response for the record on that.

Commissioner Tiefer. Thank you. My time is up.

Chairman Shays. Let me just ask, will there be a lot of answers where you are not aware of the -- are you the person that should be answering these questions or is there someone else that should be at this desk?

Mr. Walter. Sir, if we are talking about business systems, I will be able to answer the majority of the questions. In respect to a specific operational action that was taken by Guy LaBoa and his team in theater, I may be aware of it, but I would hate to misquote the record.

Chairman Shays. Okay. Thank you. Mr. Henke?

Commissioner Henke. I would like to go after a line of questioning that, frankly, mystifies me, and if I could just start with an understanding so we can share the same understanding, briefly, you are each publicly traded companies, yes?

Mr. Ballhaus. Yes, sir.

Mr. Methot. Yes, sir.

Commissioner Henke. You each comply with -- you are overseen by the SEC and other agencies and you file financial statements and 10(k)s and everything else that goes along with that, right?

Mr. Methot. Yes.

Commissioner Henke. You each have an external auditor, right?

Mr. Methot. Yes.

Commissioner Henke. Can you state the name of that audit firm that performs your external audit?

Mr. Methot. For Fluor, it is Ernst and Young.

Commissioner Henke. Okay.

Mr. Ballhaus. Deloitte.

Commissioner Henke. Deloitte.

Mr. Walter. KPMG.

Commissioner Henke. KPMG, okay. So you have these different audit firms. Now, they provide you -- I assume each of you has an unqualified clean opinion on your financial statements, is that -

Mr. Methot. That is true.

Commissioner Henke. Is that correct?

Mr. Ballhaus. Yes.

Commissioner Henke. What would the reaction be to your company's value, much less your company's reputation, if you were to lose that opinion, to have either a qualified opinion or an adverse opinion from your external auditors, which basically would say that your books aren't worthwhile? What would be the general sense of reaction to that? Briefly.

Mr. Ballhaus. I will answer for DynCorp. I think it would be significant.

Commissioner Henke. Okay.

Mr. Ballhaus. I think it would represent a lack of confidence in our financial systems.

Commissioner Henke. Okay.

Mr. Walter. I agree with that.

Mr. Methot. I would agree with that, Commissioner.

Commissioner Henke. Okay. So you have each got a clean opinion. If you would lose that opinion, it would be probably one of your CFO's worst days, right? I am making light of a very serious thing, I guess. But here is what I don't quite connect. If the standards are public companies here, government accounting here, then I can understand why it is so difficult to climb this mountain, to get greens instead of reds and yellows.

But the piece I am trying to put together in my mind is if you are externally audited, clean opinions, you are Sarbanes-Oxley compliant, I would imagine, so you are doing all of that, but at the same time, we can't produce -- these are the same systems that run your financial statements that run billing and estimating, your financial accounting systems. What am I missing? You have got a good opinion, but at the same time, you have got systems that are not passing muster. What am I not getting?

Mr. Ballhaus. Sir, I will take that first and then give the other witnesses a chance to respond. For our systems here, and it was discussed earlier today, we have three systems that just in June were assessed as inadequate. So this is a real-time issue for us. To your analogy, I think it is a good one. I think it is not only a CFO's potential worst nightmare, it is also a CEO's potential worst nightmare and something we take very seriously.

There were 19 findings. Across those three systems, there are roughly 19 findings. And somebody earlier said this is not rocket science, and I agree, and I believe that all of those issues are correctable and fixable, and as Commissioner Thibault has described, we have approval or at least agreement from DCAA on two of our three systems and our corrective actions. The third is our compensation system and I believe there are five questions that DCAA came back with, that when I looked at them, I think they are all easily answerable, fixable, correctable.

The issue that I see is, and this came up this morning, as well, there is some subjectivity in the approach to show or demonstrate compliance to a regulation. And within that subjectivity, people can have a different opinion of what it takes to be complaint. These rankings represent what the auditors who came to see us and evaluate our systems at that point in time determined to be findings and inadequacies that needed to be addressed. So as we sit here today, that is the current status of our system, but I do believe that those 19 findings are all addressable.

Commissioner Henke. Good. Thank you. Mr. Walter?

Mr. Walter. We also take this very seriously. I was hired by the company in 2003 based on the experience that I had in helping companies with these types of issues. When we came in, we have taken a very serious look and a very focused effort on identifying the issues raised by the auditors as they come in, and if we need to implement a corrective action, we will implement the corrective action.

There are some cases -

Commissioner Henke. You say, if we need to.

Mr. Walter. There are some cases where we may not agree with the auditor's position -

Commissioner Henke. You disagree, okay.

Mr. Walter. -- as to whether an item is a significant deficiency or not, and those, we work directly with the auditor and we do have monthly meetings that we have had for the past couple of years to discuss the specific issues being raised, and if a corrective action plan is required, what are the steps we are taking, how are we progressing against those steps.

Commissioner Henke. Roughly how much of the time do you take issue with the findings as opposed to just shrugging and fixing?

Mr. Walter. I would say -

Commissioner Henke. One in -

Mr. Walter. -- probably about half the time, the issues we look at, we agree with, and we will make the changes -

Commissioner Henke. In the case where you disagree with the auditor -

Mr. Walter. Yes, sir.

Commissioner Henke. -- what happens? It just stays status quo, stays yellow or red until when?

Mr. Walter. With the items that are disagreeing with -- where we do disagree with the auditor, those do remain status quo, but there are just a very small handful of those particular items. The other issues, when the auditor does raise a question and they identify what the issue is, half the time, it is simply getting people together to really understand what the reality is on the contingency side, where the people are working in the battlefield, as opposed to what an auditor may expect with a company that has a sophisticated manufacturing system where they have blueprints and manufacturing production schedules, which we do not have in Iraq.

Commissioner Henke. Okay. Mr. Methot?

Mr. Methot. From Fluor's perspective, I would agree with the first two witnesses' comments in general. Of the three systems you see there of Fluor that are either inadequate or inadequate in part of the years, there isn't one issue in there that isn't addressable. Why aren't they complete, or why aren't they resolved? Clearly, there is a process that you heard at length this morning and that process goes through a contracting officer and with DCAA. We, too, have monthly meetings with our DCAA offices that review us as well as our Corporate Administrative Contracting Officer, and we attempt to resolve issues. Much of that are status reporting. But quite frankly, when it gets right down to it, it is a matter of adjudication from a contracting officer and we provide all the appropriate supporting data that we need to provide in order for that individual to make a decision.

Commissioner Henke. Okay. I need to move on to the next part of the question.

Mr. Ballhaus, in your statement, you made the -- I am struck by this statement. You say, "In some cases, we may not have concurred with DCAA's findings, but we have revised our procedures or process as recommended by DCAA."

Mr. Ballhaus. That is correct.

Commissioner Henke. What is your philosophy operating there?

Mr. Ballhaus. I believe of the 19 findings -- and I may not have these numbers exactly right -

Commissioner Henke. Yes.

Mr. Ballhaus. -- but there are maybe two or three that we didn't agree with. That said, we decided to follow their recommendation. And I do want to comment that the findings in our systems have nothing to do with the billion lines of software code. It is literally -

Commissioner Henke. Processes --

Mr. Ballhaus. -- policies, procedures, and training, **those kinds of things. And we looked at it and we said, look, we don't agree. We may not think this is** absolutely necessary, but in the subjectivity around compliance, we are going to follow their lead and their recommendation because we want those systems green.

Commissioner Henke. We will give it to you. We will do it, right?

Mr. Ballhaus. Absolutely.

Commissioner Henke. I think, to me, that is a strong statement. It is a clear statement of intent, and you are spending your time, it seems, fixing rather than disagreeing professionally. If I read all of your testimony here about the three systems, it seems like you are waiting to hear back from DCAA o get a different grade. You have responded in three of three cases, and to me, that is a leaning forward position, waiting to hear back from -

Mr. Ballhaus. Sir, just to be fair to DCAA, because they have responded to the corrective action plans -

Commissioner Henke. Right -

Mr. Ballhaus. -- the next step would be for them to come in -

Commissioner Henke. That is right.

Mr. Ballhaus. -- and assess the adequacy of the controls that we put in place.

Commissioner Henke. Give it a quarter or two -

Mr. Ballhaus. That is something that we will be ready for in the September time frame and welcome it.

Commissioner Henke. Thank you.

Chairman Shays. Commissioner Gustitus?

Commissioner Gustitus. Well, the logical follow-up to that is, Mr. Walter, if DynCorp finds this doable, why doesn't KBR find this doable? Why does KBR have to go from 2003 to 2009 with DCAA's determination that you haven't met the adequacies of these systems? Why is it so simple for Mr. Ballhaus and it is so complicated for you?

Mr. Walter. Well, I wish I knew the complete answer to that, but I can tell you that KBR does share the same attitude. We -

Commissioner Gustitus. I don't see the action supporting that statement.

Mr. Walter. Well, not in the results on the table, ma'am, but we have -

Commissioner Gustitus. Where is that, then, if it is not on the results on the table?

Mr. Walter. It is in the meetings that we do hold with the DCAA. For example, in our accounting system, the auditors have identified that we don't have policies and procedures with respect to unallowable costs and they have identified that we don't have procedures with respect to updating our cost accounting standards. We update our cost account standards disclosure statements annually. We do have a policy and procedure in place that we provided to the auditors several years ago. The same for the unallowable costs.

Yet the audit reports have not had the complete follow-through as we have gone through. Part of why I hold the monthly meetings is to try to push this particular requirement to try to get the answers to these items so that we can get down to be able to make that yellow the green.

Commissioner Gustitus. Well, not only has the yellow not become green, but on the purchasing system, the yellow has become red, and yet you are saying that you are doing everything you can to meet the terms and conditions of having an adequate business system. How does the purchasing system go from yellow to red?

Mr. Walter. The purchasing system went from yellow to red per Ms. Stephenson's comment, because of the billion dollars of unsupported costs on the Task Order 159 flash report that came out that hit both estimating as well as purchasing. In that, we had kept DCAA informed of the subcontractors that we were competing. We had re-competed every single contract in the Iraq theater for that particular task order.

As the DCAA came up with questions for our team in the form of a statement of conditions and recommendation, they identified that they had concerns with where we didn't always go with the low bidder on some subcontracts, and on those where we didn't bid, or we didn't go with the low bidder, we provided the DCAA with documentation that we sat down with the government and we showed them what our recommendations were and the government came to us and said, but if you swap out the competitors here, there is going to be some additional cost to the government that you need to take into consideration. So therefore, the incumbent is actually a lower cost. We provided that documentation. We provided the procurement files to the DCAA for those particular subcontracts.

We also have some subcontracts where DCAA saw that we had bidders that were higher than a subcontract where we had exercisable options and the recommendation was made that we needed to go in and negotiate a lower price on the exercisable option, even though that was a valid competed subcontract.

Commissioner Gustitus. So basically, you think DCAA is wrong and you are going to do what you want, despite what DCAA says -

Mr. Walter. No, ma'am -

Commissioner Gustitus. -- or you are going to convince DCMA to go with you as opposed to DCAA. I mean, is that what happens? You do a lot of lobbying with DCMA to make this -

Mr. Walter. No, ma'am, that is not the case at all -

Commissioner Gustitus. -- yellow and red go green?

Mr. Walter. What we do is, in this particular item, we have had a lot of challenges in the past because of poor communication. When it came to Task Order 159, we set up a subcontracting plan to identify which subcontracts we would re-compete. We kept DCAA apprised of that. DCAA would not review it, because under their guidelines, until they had a complete package, they would not be able to audit that package for fear of an IPT or a conflict of interest. We kept them informed. We kept providing the documentation.

At the time the task order was executed, we issued those subcontracts and we had to continue performance. The question is, on those subcontracts that are existing and we are performing on, the question is, is there adequate price competition on those? Did KBR's procurement team in theater who made the decision and worked with the government do the right thing?

So it is not a question of us trying to tell DCAA that we are trying to lobby with somebody else. It is the contingency environment that we are working in. I can't withhold those subcontracts and say, I am not going to award the contract and not provide the support to the soldier for the food service or for the firefighting, which is what those contracts were. So we are trying to work through it, but it is the events of the day and the fact that you can't -- you can't stop something as it -

Commissioner Gustitus. Do you think DCAA has it in for you? I mean, do they treat you in a more challenging way than they treat Fluor or they treat DynCorp?

Mr. Walter. I can't answer that question because I don't know how they treat -

Commissioner Gustitus. Ms. Stephenson is pretty upset about KBR's business systems. I mean, I don't think she is making it up from her perspective.

Mr. Walter. I -

Commissioner Gustitus. So why do you think that this is -

Mr. Walter. I think that it is a significant -- there is a significant impact of the war in trying to get things to move effectively. In doing that in the past, we didn't have, as I said, good communication with the DCAA.

Commissioner Gustitus. Okay. I want to go into the withhold here. I only have two-and-a-half minutes left. Back in 2004 -- we have talked

about the utility or non- utility of withholds from contractors this morning. Back in 2004, there was a recommendation by a contracting officer for a 15 percent withhold of KBR. You were at KBR at that time, because you were there in 2003.

Mr. Walter. Yes, ma'am.

Commissioner Gustitus. And KBR objected to that withhold.

Mr. Walter. Yes, we did.

Commissioner Gustitus. I would say you mightily objected to the withhold and you sought a waiver of the withhold. The law requires a withhold if you don't have a definitized contract and you wanted a waiver of the 15 percent withhold, is that right? That is right.

Mr. Walter. We wanted a waiver of the withhold, yes, ma'am.

Commissioner Gustitus. Yes. And so it ended going up to Deidre Lee, who was the Director of DPAP, in order to get that withhold, right?

Mr. Walter. I believe that is who it went to.

Commissioner Gustitus. Right. So we are looking at the role of contracting in a contingency environment, and I want to ask you, because I am trying to get at whether contractors in a contingency environment have us over a barrel to some extent because of our concerns about the protections of the soldiers. So it is important for me to know whether anybody at KBR essentially argued up the contracting chain of command that if you were subject to the 15 percent withhold and you didn't get the award fee that you were looking for, that the needs of the troops might not be met. Was that the reason you were supportive of a waiver and against the withhold, that you thought it would have a consequence to the soldiers in the field?

Mr. Walter. Umm, we have had many discussions about that because there has been a lot of publicity about allegations associated with that particular time that came out years later. I do know that I was at Rock Island and we were having a teaming conference when that particular issue came up. I was not in support of that because we had already had significant investment of our own working capital -

Commissioner Gustitus. You were not in support of what?

Mr. Walter. Of the 15 percent withhold, for two reasons. Number one, we had already had a significant investment of our own working capital in the program. And the second item was the fact that the reason for the delay in definitizing the task orders, which is what caused the issue -

Commissioner Gustitus. Right.

Mr. Walter. -- was the fact that from the end of 2002 through the beginning of 2003, there were a significant number of task orders that were issued to support the escalation of the war.

At the same time as the task order was issued, Task Order 59, which was the largest one, we had an estimate in place. We had provided that to the government. And that was basically to provide food service for the troops in a very rapid manner.

Commissioner Gustitus. I just want to know, though, whether you argued that the 15 percent withhold would affect the needs of the troops.

Mr. Walter. I cannot recall making that argument, ma'am. No.

Commissioner Gustitus. My time is up.

Chairman Shays. I don't want to drop this, because this is a key point. The key point is that the withholds don't happen because there is either a direct or implied view that if the withhold happens, the service doesn't get provided to the troops.

I would have thought you would have said, let me state unequivocally, whatever happens, we are going to make sure we provide the service, and we would not under any circumstance withhold that service. Are you prepared to say that or not?

Mr. Walter. That would be my view, sir, yes.

Chairman Shays. I don't understand, your view. What does your view mean? Is that the view of your company? You are not here with your view. You are here as the company -

Mr. Walter. Sir -

Chairman Shays. and if you are not the right person to sit here, we need someone else. Can you speak for your company?

Mr. Walter. Yes, I can speak for my company.

Chairman Shays. Okay. Then I would like an answer to the question.

Mr. Walter. We will not let the service to the soldier go down.

Chairman Shays. And the next question, then, is have you ever implied, either directly or implied to the government, that if they withheld money, the service would not be provided?

Mr. Walter. I have not, and I am not aware of any statement that was made such as that.

Chairman Shays. By your company?

Mr. Walter. By my company.

Chairman Shays. Okay. Thank you. Commissioner Zakheim?

Commissioner Zakheim. Yes. You mentioned that you have had monthly meetings with DCAA, Mr. Walter.

Mr. Walter. I have monthly meetings on systems and I invite DCAA, yes, sir.

Commissioner Zakheim. When did those meetings start?

Mr. Walter. The initial meeting was associated with our procurement system, and that one began in 2004.

Commissioner Zakheim. Two-thousand-and-four, okay.

Mr. Walter. Yes.

Commissioner Zakheim. Now, I am looking at this chart here and I see that DCAA has felt that your estimating systems have been inadequate in part since 2005, September 2005. We are now in August of 2009. By my simple reckoning and by what you just said, you have had 47 meetings with DCAA and you couldn't work it out, whereas Mr. Ballhaus says he goes out of his way to work it out. Were you guys stonewalling?

Mr. Walter. No, sir.

Commissioner Zakheim. Why can't you work it out, after 47 meetings?

Mr. Walter. With respect to our estimating system, the initial issue that was raised dealt with the ability to update proposals for actual costs that were incurred after a task order began. We worked very closely with DCAA. We worked very closely with the Army to figure out -- as the progress is progressing, you are incurring actual costs. As you incur actual costs, under the Truth in Negotiations Act, we have to be able to identify all of our cost or pricing data, which includes actual costs that we are including.

As we were performing under Task Order 59, we were incurring costs. As we submitted the proposal to the government, that proposal was then audited. Time has passed. I now have more actual costs that I have to go back and put into my cost estimate. It is a vicious cycle that we were stuck in. Under Task Order 89, the following -

Commissioner Zakheim. Wait a minute. You say it is a vicious cycle you were stuck in. You were stuck in it because you refused, obviously refused, and now after 47 meetings, to turn around and say, well, okay. We will solve this. I mean, that is the only vicious cycle. Otherwise, Mr. Ballhaus could say he is in a vicious cycle.

Mr. Walter. No, sir -

Commissioner Zakheim. Fluor could say they are in a vicious cycle. Why is your cycle any more vicious than anybody else's?

Mr. Walter. When it comes to the inclusion of the actual costs into the estimating system, we did find a way to accomplish that to the

satisfaction of the auditors, we thought, okay, and as we updated our policies and procedures, we got the estimating system in place. We have also had outside audits -

Commissioner Zakheim. That chart says it has not been completely addressed. It is yellow.

Mr. Walter. I understand. It is -

Commissioner Zakheim. You obviously haven't satisfied the auditors.

Mr. Walter. The issues that are still open on our estimating, sir, are differences of judgments.

Commissioner Zakheim. Well, but that is my point. After 47 meetings, you still haven't sorted it out. Let us go to another one, billing, okay. That is December 2006. So now we are not talking about 47 meetings, we are talking about, roughly, I don't know, 30-some-odd meetings. Okay. Why haven't you sorted that one out?

Mr. Walter. Okay. For the record, with the procurement system, that is the one that started out in 2004 and it was not a monthly meeting. For the estimating, the accounting, and the billing system, those started at the end of 2007.

Commissioner Zakheim. So for quite some time, you didn't really reach out to DCAA at all, is what you are telling me.

Mr. Walter. No, sir. I personally believe that we were trying to work it out with DCAA. We had proposed many different ways to accomplish it. But based on the environment that we are working in, the -

Commissioner Zakheim. The environment? What do you mean? This isn't 2003. I was in the government in 2003 -

Mr. Walter. Yes, sir -

Commissioner Zakheim. -- and 2004 and I can tell you, the environment now is not what it was in 2003 and 2004 and you know it.

Mr. Walter. It is a different environment -

Commissioner Zakheim. So talk to me about -

Mr. Walter. -- but it is not at all a Stateside environment.

Commissioner Zakheim. Well, let us be honest. No, it is not a safe environment. It is not the environment of this particular committee room.

Mr. Walter. Yes.

Commissioner Zakheim. But you are not going to tell me it is as unsafe now as it was in 2003 and that, therefore, you cannot deal with an

environment where these other two companies seem perfectly able to deal with the environment. Why is your environment so different?

Mr. Walter. What we are working with is, and I believe that we do have open and honest dialogue with the auditors in theater. We are not trying to say, we are not going to accept your changes. We try to adjust -- address the changes as they are presented. Sometimes we do get stuck behind the power curve, and right now, our estimating system is deficient in the eyes of the DCAA because of the purchasing system review.

Commissioner Zakheim. Okay. Well, what about the billing and accounting systems?

Mr. Walter. The accounting system, we have basically two items that we are trying to work through with the DCAA. The one deals with the description that we put into a field in our automated system that is associated with a journal voucher. So if we have a journal entry that goes into the accounting system, our accountants used to just put in a phrase that said, "Transfer costs." We have gone in and we have provided updated descriptions. We have provided training so that our guys who are doing that -

Commissioner Zakheim. I have got only two minutes and 20 seconds. Can you give me the answers to those questions for the record, please, what the differences DCAA are and what is holding you up from making, you know, from accommodating DCAA on these two other areas.

My final question is simply this. You have just made a statement that you couldn't withhold anything from a sub, because after all, you are relying on those subs. My question is, why aren't you -- haven't you looked for other subs? Is there only one sub in the world for every particular task? Last time I checked in the Gulf, there were quite a few subs, I mean, people dying to be subs. So if somebody isn't performing, somebody -- after all, you, as the prime, are responsible for your subs.

I don't know whether you give them a limitation of liability or what. The government is indifferent to that. You are responsible as the prime, and if your sub isn't performing, you can't come back to the government and say, well, the sub is not performing. You just terminate for default and get yourself another sub, in effect.

Now, to what extent have you ever done that? Have you fired a single sub? If so, how many subs have you fired?

Mr. Walter. We have fired some subs. I would have to get the exact number for you, but significant dollar amounts of subs, especially in the 2002 to 2003 time frame.

Commissioner Zakheim. No, I am much more interested in recently. I mean, 2002-2003, we know.

Mr. Walter. Recently?

Commissioner Zakheim. You have talked about 2003. Give me in the last two years.

Mr. Walter. I just mentioned to Commissioner Gustitus, with the re-compete for Task Order 159, we re-competed every single subcontract that was out there. For those subcontracts where we had a new vendor, they came in with a lower price, those were the ones that we attempted to replace. There were some that were identified where there were additional costs that the government would incur which made it more economical for the government for us to continue with the incumbent contractor.

So there has been a significant change in the, both the make-up of the subcontractors that do work for KBR. These subcontracts are normally on about a six-month contract with a six-month option, and if they are not performing, then we will re-compete that particular subcontract.

Commissioner Zakheim. And you have done that?

Mr. Walter. Yes, sir. We have done that.

Commissioner Zakheim. Thank you.

Chairman Shays. Commissioner Ervin?

Commissioner Ervin. Thank you. Most of my questions are going to be to KBR, and that being so -- probably all of them in this eight-minute round -- I want to preface that by saying I am not anti-contractor. I think that is true for all of us. And I am not anti-KBR. In fact, in reviewing the submissions of each of you three, there were three comments that I particularly supported and two of those comments were KBR ones.

One was that contractors ought to be involved at the inception of contingency conflicts. I strongly agree with that. We talked about that internally.

And the second is that government needs to speak with one voice so it is clear to you contractors what you can and cannot do.

That leads to my first question to KBR, and we have talked a little bit about this already, but I think we all understand the exigencies of the inception of the war in Iraq and the inception of the war in Afghanistan. But as a number of us have noted and it is clear, we are now in 2009 and these problems largely persist with regard to KBR. In fact, in certain instances, they have actually gotten worse.

And so my question -- I was struck by your boast, really, in your statement on page two, "Our systems are regularly reviewed and approved by the government." What you really mean by that is that your systems are regularly reviewed and approved by DCMA, by DCAA, and doesn't that go to what you said earlier, that the fact that government doesn't speak with one voice in this instance allows KBR, to be candid, to play DCMA off against DCAA and to tout yourself, as you have done in your statement, by saying that the government has reviewed and approved your systems?

Mr. Walter. It is not my intent to play one agency off of the other, sir. What we do is when we have a system and a system approval for the current confines of the regulations, they state that the administrative contracting officer determines the adequacy of that system. We are playing by the rules and we are doing our best to try to satisfy the DCAA auditors with the examples that they present to us and with our corrective actions that we have put in place that we are complying with the framework guidelines.

Commissioner Ervin. Well, I appreciate that answer, because I think by that answer and by your statement here, you really have underscored for us what really is the fundamental problem, or at least a fundamental problem -- probably the fundamental problem that ought to be corrected by this Commission. That you could say in your statement and now defend that your systems are regularly reviewed and approved by the government, notwithstanding what we have heard from DCAA, I think says a lot.

Now, let me ask some specific questions. One is this. There was a Tiger Team review, we understand from Ms. Stephenson's testimony, of various subcontracting practices that KBR was involved in early on. I guess the threshold question is, what is KBR's -- and I am going to ask this of the other contractors if I have a chance to -- what is KBR's philosophy about making the results of your internal reviews, whatever you call them -- internal reviews, management reviews, whatever -- available to the government when we are talking about taxpayers' money and when there might be evidence of fraud that your team has either uncovered or substantiated?

Mr. Walter. What I would like to make a statement on is very clearly that of the individuals who have been identified as committed fraud for KBR, those are management reviews that were completed by KBR where, through the voluntary disclosure program and through our ethics program, we went to Department of Justice to make sure that they understood all the information we had, the results of our investigations.

With regards to the Tiger Team that you are talking about, we have provided DCAA with access to the members of the Tiger Team. As I mentioned in my statement, as this thing took off, there were a lot of things that were happening in the 2002-2003 time frame and the documentation was lacking, in great part because we could not get enough trained procurement professionals in theater.

Commissioner Ervin. Okay. Since my time is limited, you are saying that you made the Tiger Team available, the personnel available to DCAA to talk to, is that what you said?

Mr. Walter. Yes, sir.

Commissioner Ervin. And have you provided to DCAA the results, the actual documentation that the Tiger Team arrived at?

Mr. Walter. What I have explained to the DCAA is the Tiger Team's role was to ensure that the procurement files were current, accurate, and complete. So the Tiger Team provided -- the procurement files that we provided were the work product of that Tiger Team.

There is a question about a memo that was cited in the Wall Street Journal that we cannot track down. I don't know what that is. I have not been able to provide that memo or anything about that memo to the DCAA. But we have provided the time sheets, the individuals, the invoices from outside consultants that we were using to help us get that period of time caught up.

Commissioner Ervin. So your testimony is that any and all documentation produced by the Tiger Team to KBR management has, in fact, been provided to DCAA, to the best of your knowledge?

Mr. Walter. To the best of my knowledge.

Chairman Shays. All right. Could we just really clarify, because this is a point under oath, and I am only saying that because I want you to be very sure that if this team put together documents that was available to management that was not shared with DCAA, then your question would be incorrect. So I want to have you -- and I am asking it a second time because we are going to check it out and you will not be in doubt of our interest in this.

Mr. Walter. Mm-hmm.

Commissioner Ervin. So I would like you to just stop a second and think, is there any documentation that was provided to you that you did not share with DCAA that was related to any of the activities of the Tiger Team?

Chairman Thibault. Before you answer that -

Chairman Shays. No, let him answer it.

Chairman Thibault. Okay, go ahead. I want to add one more part to the question -

Chairman Shays. Okay.

Chairman Thibault. -- and the one more part to the question, you know, I am having deja vu as I am listening to this discussion because I was directly involved in that debate. And the reason the Tiger Team was set up is because KBR decided to do that and had issues to address. But also the reason it was set up was to defer certain government decisions and they requested that DCAA hold off on doing some work that DCAA wanted to do themselves. I was directly involved in communicating with our staff there. And so we agreed.

The debate began shortly thereafter because the agreement was all work product would be provided, and that is the proper verbiage, that anyone there provided, and then there was this long drawn-out debate about, well, and then it finally ended up, well, it was just conversation, so we will give you access to the people. That is kind of where it is at.

But I will restate the question in the language of the land, which is, is there any other work product that has not been provided to the government?

Mr. Walter. I was very involved in the Tiger Team. I am also very involved in the DCAA audit of 2003 and 2004, where this has come up a number of times. The purpose of the Tiger Team was to send experienced procurement officials in on a short-term basis so that they can update the procurement files. That information has been provided to the DCAA.

I am not aware of any special reports that the Tiger Team put together, and I was very involved in it, okay, so I am not aware of any reports that we have not provided to DCAA. The only issue of contention is a document as some sort of an internal memo that was specified during a Wall Street Journal article that I have searched high and low within our firms, through the executives, to try to obtain a copy of, and I cannot provide something that I don't have.

Chairman Thibault. Okay. The only other thing I would say -- that is a clear answer -- is I would consider work product memoranda, as whether that or notes or reports, status reports and the like. And what I have heard is there is no other work product that you are aware of.

Mr. Walter. Not that I am aware of, sir.

Chairman Shays. I am going to ask the question again. I am going to ask, have you provided any and all information to DCAA or any other government -- excuse me, DCAA, that was presented to you, anyone in the company, to the board, to the CEO, that was not provided -- let me state it -- I am going to restate it -- is any and all information that the Tiger group did that was presented to management, either memorandums, e-mails, "special reports" as you named it, or any other document, been provided to DCAA? Do they have all of the documents that any of the management team has received?

Mr. Walter. Based on the exceptional detail of your scope, I request that I be able to check to make sure that I have answered that. I do not believe that we have provided every e-mail that says "Tiger Team," but I do believe that we have provided all of the principal documents that identify that.

Chairman Shays. I think it is better to qualify, and then let me just make this point, that any documents that you discover, will you give them to DCAA?

Mr. Walter. I will review that with my management team.

Chairman Shays. Well, any document -

Mr. Walter. I can't think of any reason why I wouldn't, sir.

Chairman Shays. Then any documents that you don't, I would like you to inform the committee what documents you haven't given.

Mr. Walter. I will do that.

Chairman Shays. Okay.

Commissioner Ervin. I think I have a couple more minutes left. Just let me broaden this a little bit. What is KBR's position -- let us forget the Tiger Team specifically -- what is KBR's position about making available to the government, DCAA in particular, the results of all internal reviews and management reviews regarding performance in theater?

Mr. Walter. With regards to management reviews that we do for evaluating journal vouchers, evaluating time sheets, we do share those results with the DCAA. We were initially hesitant to do that, in great part because I wasn't satisfied with the quality of the reviews that we are doing, but for about the past year-and-a-half or so, we have been providing those reviews. The only documents that we do not provide to DCAA are internal audit reports.

Commissioner Ervin. Mr. Ballhaus, what is your -- what is DynCorp's position on this?

Mr. Ballhaus. Yes. Well, relative to internal audit reports, we do give DCAA access to our reports. I don't believe we give them copies of the work product, but we do allow them to look at those and have access to them.

Commissioner Ervin. Mr. Methot?

Mr. Methot. Same with Fluor. We generally provide listings of all of our internal audits and all of our management assessments performed during a year as part of different internal controls reviews, and so we generally do provide those. But in some cases, we don't -- in most cases, we do not provide the actual work product themselves.

Commissioner Ervin. Let me just ask two final questions, then I will continue this in the second round. The promise of LOGCAP IV and the transition from LOGCAP III to LOGCAP IV was that the government, the taxpayer, the American people, would realize some savings because of the greater competition that would be induced by that, and there have been a number of examples already to suggest that that hasn't happened. It may not happen going forward, all of which is very troubling to us, as you might imagine.

In particular, back to you, Mr. Walter, we understand that KBR made it very difficult, extremely difficult, for those KBR employees who wished to do so to be employed by your successor, by DynCorp, to do so, and that the first KBR employees who advised that they were going to or had accepted positions with DynCorp were summarily fired and ordered to leave Kuwait within 48 hours, and this included a number of employees with many years of service to KBR. Is our understanding correct?

Mr. Walter. There are certain visa issues that are associated with working in Iraq. To be there on a work visa, you have to be an employee of KBR. Unfortunately, due to the processes and legal issues associated with being in the country under a sponsor, we had to demobilize those employees that were going to work for Fluor, or to DynCorp.

Commissioner Ervin. So you are saying to us that in those instances where you fired people, it is because they had visa issues and not because they advised you that they intended to work for DynCorp?

Mr. Walter. Well, once the employee makes the decision to work for DynCorp, I have to find out how that employee is going -- or how I am going to get the work done that that employee was doing. Once they tell us that they are going to work for DynCorp, it was our practice to terminate the employees at that date so that they could go work for DynCorp, do whatever they needed to do. Our team did make recommendations to the government crew on the transition about the issues associated with visas and the importance of getting all of those things lined up.

Commissioner Ervin. Let me ask one final question. IT systems and deletion of files -- it is our understanding that in the course of the transition, again, from LOGCAP III to LOGCAP IV, that KBR removed hard copies of extensive maintenance data on vehicles. Did that, in fact, happen? Did you delete the electronic files, and if so, why did you do that? And if you did that, after I hear your explanation for it, I presume that there is a back-up of that and I would like to know whether you would make the back-up available.

Mr. Walter. Unfortunately, that is an operational issue. This is the first time that I have heard that statement coming up, and I have been involved in many briefings on the transition. I will have to talk to the transition team for Kuwait to get you that answer, sir.

Commissioner Ervin. All right. So this particular issue, you are completely unaware of?

Mr. Walter. I have heard of many different challenges that we face, but I have never heard of that, that type of issue, sir.

Commissioner Ervin. Thank you. I am done.

Chairman Shays. Just a quick one to Mr. Ballhaus. Are you aware of the issue?

Mr. Ballhaus. No, sir, I am not.

Chairman Shays. Okay. Commissioner Green?

Commissioner Green. My question is sort of a follow-on to what Commissioner Ervin said, and I would like Mr. Ballhaus to respond in a more general way. But when contractors turn over, it is common for the incoming contractor, of course, to hire a lot of personnel from the outgoing, the existing contractor. I assume that both in your estimating and labor systems, you would include assumptions about how many of those folks that you would plan to hire.

In preparing your cost proposals, and after award of the transition plan, to what extent did you assume that you would hire the outgoing contractor's workforce, and what obstacles, if any, did you encounter in

Kuwait, and how did it affect the assumptions in your cost and labor estimating systems?

Mr. Ballhaus. Yes. Let me answer it this way. In our proposal for the Kuwait task orders, we had a certain assumption and plan for mix of personnel, and specifically I mean mix of expats versus local nationals, that was a different mix that was utilized by the incumbent, and that was our plan and that is what our proposal was based on.

As we got awarded the contract and worked with the customer on the specifics of the transition plan, there was a compression of the transition, and what that compression forced to happen was rather than allow for the time to shift the mix so that the labor cost savings could be achieved, because with a lower mix of expat to total population, it is a lower cost, because of the compressed transition, we were forced to take on a larger percentage of the incumbent workforce than we had planned. With a longer transition, we were planning on more time for recruiting so that we could change the mix of the workforce. As the customer directed a shorter transition, we were forced to keep the same mix. And so the question around why wasn't there a cost savings, that is one of the reasons why there wasn't a cost savings yet, because we weren't able yet to shift the mix, but we will over time.

The other two areas, if I could just address for a second, on the Kuwait task orders that led to an increase in our current proposed costs over the proposal were strictly attributable to scope, and specifically relative to what was bid, there was roughly a 50 percent increase in the number of facilities that we were asked to actually take on versus what we were asked to propose, and it is just natural that as the number of facilities grows, that the cost of the program is going to grow.

And there was one other example. I think it had to do with shuttles and managing a convoy of buses that was roughly double what we had proposed, and so as we adjusted our cost estimates for the true scope on the program, that number went up, also.

So I just wanted to clarify on those additional points of scope growth in addition to the mix issue. I apologize for going off-track on your question.

Commissioner Green. No, that is fine. The other one, I would just like to reinforce what Commissioner Ervin said when he commented about deletion of files and destruction of any records and just clarify that a little so we get an accurate response back. I think it is our sense that IT systems should prevent -- have systems that prevent the deletion of files and provide backup. In the course of that particular one, it was reported that KBR did, in fact, remove hard copies of extensive maintenance data and they also deleted the electronic files for such records. There was another incident not related to that, related to an air field transition that existing project files were also not forthcoming to the new contractor, which caused some delay.

So the question is, how is it that an IT system would allow the deletion of these files containing government data, and does the backup of deleted

files, if so, is KBR prepared to turn those over. I know you are going to provide that for the record, but I am very interested in that.

The last question for this round that I have, kind of a softball, and I would like responses from any or all of you, and that is, Mr. Walter, in your testimony, and you made reference in your oral presentation, also, it would be helpful if the Commission would identify means that will allow the government to speak with a single voice in instructing contractors. I would like to hear how you would propose -- and Mr. Ballhaus and Mr. Methot, you also, if you are interested -- how you would propose that be done to simplify your life.

Mr. Walter. To simplify our life, the single voice, however the government develops it, would work for us. As I said in my testimony, I do take guidance and direction from ACOs in the theater. I take direction from contracting officers. I get input from DCAA, and we do our best. As I try to answer the questions for one individual and to satisfy their interpretation of how something should be done, I oftentimes go awry of another person's interpretation.

Within the contingency environment, it is not just the bullets flying, et cetera. It is also a very significant transition impact. Most of the government individuals in theater are there for 180 days. That is generally a half a year. That causes me with significant challenges. As that individual is there, they get up to speed with the contingency environment. Then they have got their ticket home. There is another person in and now I have to, as I am going along a path, all of a sudden, I am not in the same channel that I thought I was before.

So what I would like to see, something that would significantly help me is longer terms for individuals in theater. Our individuals are generally there -- they have a one-year contract. Generally, on average, I think they are there for about 18 months. That constant turnover as well as the different voices causes us a great concern. So however the government decides to do it, we are a contractor. We will find our way to work within that confine.

Commissioner Green. Mr. Ballhaus?

Mr. Ballhaus. I think a single voice would be helpful, but I think for me, as I just reflect on the challenges that we are trying to work through, timeliness and urgency would be the characteristic that I would like to see shifted and changed most.

I think, you know, most systems can work or fail and it depends on the people that are in them and their attitude and their mindset. I think, based on what we heard this morning, there is an opportunity to improve the system and one voice might help that.

At the same time, we do a lot of work within the existing system, and I think that if, across the board between government and contractors, there is accountability, focus, and timeliness of response, things would work a lot better.

So, as I mentioned earlier, a recommendation around standards for response, standards in terms of time line of response and follow-up on assessments like -- or business systems is something that I think would have a lot of value.

Commissioner Green. Thank you. Mr. Methot?

Mr. Methot. I believe that clearly a single voice in the government would be a great improvement. In my mind, the issues we have had in the past clearly fall between a subjective evaluation process that leads to differences of opinions, differences of opinions between the contractor and the government and between the two government agencies. Clearly, one single voice would get rid of that kind of a situation and lead to more timely determinations of adequacy and reduce the confusion that exists today.

Commissioner Green. Thank you.

Chairman Shays. Speaking with one voice doesn't mean that it would necessarily be DCMA's position. It might be DCAA's position. And so, Mr. Walter, in your statement, when you said, "Our systems are regularly reviewed and approved by the government," that was DCMA, and if you did DCAA, it would more likely say, "Our systems are regularly reviewed and disapproved by the government."

I think, of all the things that I have heard today, I think that is the most telling because it does illustrate the problem that we had, and it was Mr. Ervin's comments, and I thank him for really making it clear. And the only reason I am repeating it is in the mix of other things like you are under oath and the Tiger Team and all that, I don't want Mr. Ervin's basic point to be missed.

I am wrestling with the fact that, somehow, we had this conversation with Commissioner Zakheim to which we are referring to those charts and they are all yellow, and somehow it seems like a matter-of-fact conversation. They are all yellow. Well, we just disagree, and so therefore, case closed.

I almost feel like -- I am the youngest of four boys and I tell people that my oldest brother is the smartest -- excuse me, the most intelligent, and I am the smartest, and it is because I learned from all the mistakes that my brothers made so I didn't make those stupid mistakes they did. I probably did a few others, but I learned a lot.

And so I am thinking, your two partners, Mr. Walter, on the dais, they are newer kids on the block and they learned from the bad habit, I think, that KBR got into, and that was basically go with DCMA and forget DCAA and, you know, we will just tough it through. I think the better approach is, even if you disagree, try to comply. I mean, I think that is one of the lessons that I am seeing happen here. We all support contracting. We all know that it is indispensable. If we voted in Congress to have the military be the tip of the sphere, then we don't want it to be cooks. We may not want them to be security guards in every instance. Maybe in some

we would. We don't want them building buildings. We don't want them doing things that contractors can do.

So we don't need to be sold on the need to have contractors. But what I need to be sold on is that there is going to be some general outrage with what has happened in the past, and somehow, what I have been hearing is, well, that is the way we did it.

I have been stunned to learn -- and I am naive about this -- that subcontractors basically aren't really auditable. You have got to go through the prime. And 70 percent of all the work is through subcontractors. How convenient. I am stunned by the fact that people can put in three hours or four hours as a contractor on plumbing or electrical work and charge for 12. That is an outrage. And when I have asked people about it, they say, well, that is kind of the way we do it. Or why we might have 12 plumbers when we only need two, and we charge for 12. And then when I am asking people why that happened, they said, well, it is kind of in the contract they have to be on duty 12 hours at a time.

What I want to ask each of you, if you were -- and I am going to give you some choices -- if you, and maybe it is not even the work you do, but it tells me your mentality -- if you were asked to build a new dining facility when you had just renovated one right there and you know the troops are leaving, would you renovate that new dining facility or would you tell the government, are you sure you want me to do this because you don't need it?

I would like to know, if you had 12 people assigned to do the job of two, would you say, well, we have 12. That is what the contract is. Or would you come back proactively and say, we only need two? And by the way, we don't need to charge you for 12 hours. We will have one person of the five that are there on call and the other three will only put in an eight-hour day.

I want you to tell me what your approach would be with the government, and I am going to go down the line and have you respond.

Mr. Methot. Well, the way Fluor would approach that is, in your first example, if there is a dining hall facility there and we are asked to build one right next to it, clearly, we would ask if that was what was necessary, only because we are taxpayers, too, and stewards of the taxpayers' dollar. If we are directed to do it under the task order and we are contracted to do that, of course, we are going to build that facility.

In your other example, if we have got multiple servicemen assigned, electricians assigned, whatever the example is, and we don't have sufficient people, we are not going to charge for work not performed. But again, we are new kids on the block. Again, this is a philosophy. Clearly, we always go to our contracting officer or their representative and ask, are you sure you want us to do this? So clearly, that is a philosophical approach of, hey, we have got to protect the taxpayers' dollars.

Mr. Ballhaus. Sir, we do the right thing. A significant piece of our business is training and mentoring and we work ourselves out of business over time. That is the intent of a big piece of our business. So we are used to working through a program, working down work scope to try and do the right thing.

Over the last year, I can give you examples of where we have laid people off on cost-plus programs trying to get costs out of the system so that we could have and deliver to the government a more cost-effective, better value system. So in the example that you raised, it is a hypothetical example, but to me, that doesn't pass the "goofy" test. Doing the right thing, we would come forward and say that is not something we would be interested in doing.

Chairman Shays. Mr. Walter?

Mr. Walter. With respect to your example, sir, that is a case where the government speaking with one voice would be great. Under our LOGCAP contract, we did renovate a dining facility and we did what we thought was a fantastic job on that dining facility. At the same time, under a separate contract, or under a separate agency, they requested -- they sent out a solicitation to a number of groups that said, we would like people to bid on this particular work. We bid on that work and we won through a separate organization of the company. So having one government agency working, or one voice working there would have helped to avoid any potential concerns that you would have on that. With -

Commissioner Henke. It was still both DOD, right?

Mr. Walter. I am sorry?

Commissioner Henke. There were two DOD agencies?

Mr. Walter. Two different DOD agencies, yes, sir.

Commissioner Henke. Okay.

Commissioner Gustitus. Could I just -

Commissioner Henke. No, it was one department. It was the DOD that was tasking you with that, and it was probably the Army in both cases, right?

Mr. Walter. Correct.

Commissioner Zakheim. So it was the Army in both cases and nobody from KBR went to anybody senior in the Army and said, what in God's name are you doing?

Mr. Walter. We did not have the visibility into the details. We didn't know what the planning was. We were -

Commissioner Zakheim. You knew they were -- excuse me. May I? You knew that they were asking for a new facility. You knew that you had just

renovated a facility. You are going to tell me you know nobody in the Army to go to and say, what is going on here, to save the taxpayer money?

Mr. Walter. The way that KBR has been forced since set-up of the LOGCAP contract is we are not allowed to be able to set up marketing per se with the people that we have on LOGCAP. They do what they are told to do by the customer in theater. The work to build -

Commissioner Zakheim. Now, wait a minute. This is not marketing. This is not marketing. This is going from a senior official, such as yourself, to a senior official in the Department of the Army and saying, this is nuts. This has nothing to do with marketing. In fact, it is the opposite of marketing. It is walking away from something. I don't understand why you guys simply did not go to the Under Secretary or the Deputy Under Secretary or a four-star or a three-star and say, do you and the Army realize what you have just done?

Mr. Walter. With all of the publicity and all of the information that is out there today, it makes it seem as though that is a crystal clear question that should be answered. At the time, this was -- the dining facility that was built was built under a Corps of Engineers contract to provide a building, one of many types of construction that we have done throughout theater when we have bid on.

Commissioner Gustitus. Can I just ask or point out, haven't you had criticism from several award fee boards that you don't proactively seek cost savings? The answer is yes, by the way.

Mr. Walter. Okay, the answer -- I would have to go back to the award fee -

Commissioner Gustitus. It is yes.

Chairman Shays. Let me just end, Mr. Walter, with this question. Is there anyone fired either who worked for KBR or was a KBR sub as a result of the work with the Tiger Team? I will repeat it again -

Mr. Walter. I am just trying to think, sir -

Chairman Shays. No, I want you to think -

Mr. Walter. I heard the question clearly -

Chairman Shays. -- and this is not a trick question. It is something we want on the record. Is there anyone fired either who worked for KBR or was a KBR sub as a result of the work of the Tiger Team?

Mr. Walter. I will have to check on that and get back to you, sir.

Chairman Shays. Okay. How long do you think that would take?

Mr. Walter. I should be able to get it done within the ten days you requested.

Chairman Shays. Okay. Why don't you get it in the next five days, because you will just be able to go back to your office and someone will know. So if you would get that back in the next five days, that would be appreciated.

Mr. Walter. I will be happy to do that.

Chairman Shays. Thank you. Mr. Thibault?

Chairman Thibault. Thank you. I just want to wrap up what we were saying before, Mr. Ballhaus. I had a reason to ask you that, obviously, about your personal role, because again, my history over a long time is when a CEO and a Chief Financial Officer, with no disrespect for all the other critical positions in the company, take a personal interest in contracting, financial issues, and the like, including interface with the government at all levels, and your Chief Financial Officer, the DCAA manager person, she said that she met regularly. Whenever she had an issue, she would pick up the phone and talk to your Chief Financial Officer, not the Government Compliance Deputy Director or something like that, even though they go to that person, that person is critical, and he said that has helped a lot. So I share that.

I just have a couple of items. Mr. Walter, I would ask you -- I think that we agreed on Commissioner Gustitus' question relative to was there any discussion about companies' ability to feed and house troops, was there any that they would deny work, couldn't do the work due to a withhold. When we visited a couple of locations, and I don't know if it is two or three letters, but I got them. They were given to us. Maybe they were given to some others on this -- I see some head nods.

I have seen correspondence -- I don't know the who said, what said -- that said that something along the lines that if a withhold is taken, specifically that the company could be put under financial stress -- I believe those are the words used -- and that so-and-so and so-and-so and so-and-so in the company -- and this was written and it was signed by someone in the company -- it could impact our ability to -- and I am making this part up, but it means the same thing -- to house and feed.

So I would ask you, in your research on this for the record to go back and take a look and see if it is there. I am not trying to box you in.

Mr. Walter. No, and I won't be boxed. I will find the answer -

Chairman Thibault. Okay, because I have seen it and, you know, we all have files and pick up folders and I have it somewhere in a pick-up folder.

Part of why I led in with -- this is my next-to-last here -- part of why I led in with the question to Mr. Ballhaus is -- let me just be candid -- after our last hearing, we got quite a letter from the President of KBR and we, as a Commission, discussed it and I got -- too strong a word, but I got beat up a bit for not jumping up and responding really quick, and then we talked about it. And the point that because there were numerous items in there that we could have gone back and forth and clarified and

got into this proverbial pithy contest about, well, you really said this, but it could have been this, or that is not correct or something like that, so I was kind of consciously sitting on my hands as I was getting pummeled.

But then time elapsed, and so we wrote a letter to your President after about a month, and it has been out there for -- I will make a number up, six or seven weeks -- and we said to him, you know, we would be glad to discuss anything that is of concern to you, but would really like to meet with you. The Commission wants to meet with you, the President, because we would like the opportunity -- and I am paraphrasing -- to get a constructive dialogue going. We made that offer in the letter. We have heard nothing back.

Now, what I am trying to make the point is if you take any other message back in this, and I know that it has sort of been Bill Walter day, and I commend you for that, for standing up there and staying calm and giving good answers, but it is that we would like to engage -- KBR is an important supplier we would like to work with and understand. We are trying to be prospective. Sometimes you live in the past or in the present with issues in order to identify what can be done in the future, and we would like to do that.

So if you would take that message back. I have seen that individual sitting behind you shaking his head back and forth and running back and forth. I will be glad to e-mail the letter asking for that session-

Mr. Walter. Yes, if you could, because with everything with the Wartime Commission, as I said in my written testimony, we have made every effort to try to be as cooperative and provide as much information to the Commission as we have. We met with you in Kuwait. We met with you in Iraq.

Chairman Thibault. Right.

Mr. Walter. I have got no qualms about that. I have a lot of opinions that I am willing to share, and I have.

Chairman Thibault. Sure.

Mr. Walter. But as for a letter that came in from the Commission to our President, I have not seen that -

Chairman Thibault. It was signed by the two Co-Chairs, myself and Mr. Shays -

Mr. Walter. Okay.

Chairman Thibault. I accept that you haven't seen it, but like I said, if you take a singular message back from this, it is that we are trying to engage in a constructive dialogue and we haven't asked for the -- we are going to ask for it, Mr. Methot, but -- and we appreciate you being here. No disrespect to the two of you. You both are very knowledgeable about the company, but we are going to be asking the same thing, and there is a

reason, because it impacts us. We would like to get the feel for this is really important to us.

Mr. Methot. Absolutely.

Chairman Thibault. So if you could take that back, I will be glad tomorrow morning, or we have got a hearing tomorrow, so tomorrow afternoon, to e-mail that to you.

Mr. Walter. Okay.

Chairman Thibault. All right. Thanks. That is my nickel.

Chairman Shays. Thank you. Mr. Thibault?

Chairman Thibault. Oh, all right. I get another five minutes.

Chairman Shays. Or Tiefer.

Chairman Thibault. Charles, thank you for giving me your five minutes, buddy.

Chairman Shays. You are on, Charles.

Commissioner Tiefer. Okay. Mr. Methot, I mostly would like to deal with you with some questions for the record afterwards. I think you are about -- you are about to face the transition in Afghanistan. We studied the one in Kuwait. It was hell. And everyone agreed -- one of the few agreements, that on all corporate sides and the government side, they all agreed Afghanistan was going to be really hell to have a transition in.

So I am curious about your plans, and also the process of becoming a government contractor. Are you going to follow the route over the waterfalls into the -- or are you actually going to take the trouble to learn government contracting and set things up right? They both thought they would. Neither of them did.

Okay. Questions for the record. Mr. Walter, I have a request for you to provide information to Mr. Sternlieb. The last page -- I didn't get to it -- of the PAR has this chart. I am not going to question you in detail about it, just the range of movement of KBR people. It looks like a big movement, doesn't it, until you look. It is the area between 20,000 and 21,000, and it is not even the whole area. It is like a very small movement.

Now, what we would like is if you would arrange and Mr. Sternlieb could get the week the weekly briefing that you already give the PCO on personnel. This is not one "idiot" more work, the weekly briefing on personnel you already give the PCO, and if he could talk to the personnel people on the PAR, not you, although you are welcome to have somebody in the room. It is not that kind of thing. The PAR can only be understood by people who are immersed in it. We want to understand it. He wants to understand it. Agreeable?

Mr. Walter. It is agreeable.

Commissioner Tiefer. Okay. Third, we had some questions from my fellow Commissioners and I feel I let them down because they asked questions about your transition in Kuwait, and these are sort of -- I am not sure what the format will be, but they are for both Mr. Ballhaus and Mr. Walter.

First of all, the notion that you fired people when they were going to quit or when they were going to work for the other company, that is nonsense. As in any transition between an incumbent and next contractor, the people who are doing the work want to know whether they will still be able to keep their jobs when the new contractor comes in. They want to be able to ask, if you are coming in, will I be able to continue work for you?

There are places where the incumbent and new contractor are like in a revolving door and the same people do the work. We all know that in government contracting. I hope you know that. I teach at the University of Baltimore Law School. My students know it. You are familiar with the situation. You are firing people who just wanted to know, will I be able to keep my job? We got this firsthand. The person who was taking us around was Lee Thompson's Deputy, Tommy Mark. He also was asking the question about -- and telling us about what happened with the computer records and the paper records that were destroyed. Doug Horn came across the ocean to be there. He said, yes, we removed our proprietary information.

I don't want to get a QFR from you that says, well, we doubled our proprietary information. It was maintenance records on vehicles. Come off it.

So what we might want -- it is the people with more stars on their shoulder than me who decide this, not just QFR on this subject. It might even be a briefing or a briefing to our staff where the people who actually did the transition deal with the actual issues that we got from very responsible government officials. Are you agreeable to something like a staff briefing on those subjects?

Mr. Walter. Yes, I am.

Commissioner Tiefer. Mr. Ballhaus?

Mr. Ballhaus. Can I make -- I am agreeable, and can I make one comment?

Commissioner Tiefer. Sure. I don't have much time, though.

Mr. Ballhaus. Okay. Fifty-seven seconds. I think staff briefings are very useful and I like getting program reviews from my team. But on something like the Kuwait transition, I actually went in-country myself and met with Tommy Marks and was there the week of June when the transition went into effect, and I saw the challenges that our team faced. I saw the issues that we had. But the remarks and the feedback I got from our team was very positive. I went and met with Tommy and he was

positive, also, but he gave us some issues and concerns that needed to be worked out, issues that had happened on the transition and concerns looking forward.

So while I am agreeable to the staff briefings, I personally think there is a lot of value to going in-country and -

Commissioner Tiefer. I did.

Mr. Ballhaus. -- face-to-face, meeting with -

Commissioner Tiefer. Now I want to find out about the things that have been denied here. Okay. But by people who are not first-line.

Last thing for you, Mr. Walter -- sorry, I am running out of time -- it is about the 15 percent withhold back in 2005. Suppose we are able to find the letter that we think, the mysterious letter in what happened was that the contracting officer, when you made orally the suggestion that this would have strategic impact, vague but strategic effect, he said, give me a rough order of magnitude. You didn't give him a rough order of magnitude. You gave him a letter, a letter that was useful for going over his or her head.

If we find this mysterious letter, would you allow our staff to interview the officials, if they are still around, who were involved in the letter? I don't want to just, oh, there is a letter, and I don't want to play, oh, you are under oath. That is not what it is about. It is about finding out if there was such a letter, how it could be generated and then become lost in the mists of time.

Mr. Walter. I believe we are talking about the same thing that Commissioner Thibault asked about, and I said that I would go back and try to find that information.

Commissioner Tiefer. And I am saying, if there is such a letter, can we interview those who were involved in it?

Mr. Walter. I don't see why we wouldn't be able to do that, if they are still with the company.

Commissioner Tiefer. Thank you.

Chairman Shays. Commissioner Henke?

Commissioner Henke. Just by the nature of having a Congressional Commission and meeting in this room and a public dialogue can come across a certain way. But part of the charter of this Commission, at least as we interpret it, is to let people know how significant the contribution of contractors is to American objectives.

I think it would be surprising to the great majority of Americans to know that 1,400 contractors have been killed in this current war. Can you, Mr. Methot, can you tell us, have any Fluor employees been killed in the war, or you are too new to the -

Mr. Methot. Currently, we have had no Fluor employees killed.

Commissioner Henke. Okay. Mr. Walter, how many KBR employees?

Mr. Walter. I don't know the exact number, but it is over 100. But I will get you the exact number. That is something that we take very seriously and we don't want to misrepresent the number. But it does cross multiple contracts, not just the LOGCAP contract that we are talking about here.

Commissioner Henke. Right. Right. Mr. Ballhaus?

Mr. Ballhaus. Sir, we have lost 65. That includes 12 from one of our joint ventures, and you will note from our written testimony -

Commissioner Henke. Yes.

Mr. Ballhaus. -- that is up.

Commissioner Henke. What happened?

Mr. Ballhaus. We lost an employee last week who had a heart attack in Kandahar.

Commissioner Henke. Okay. It is an easy question. It is a short question. It is an end-of-the-day softball question, but I don't want to underemphasize the point that contractors' employees are sacrificing and being killed in this current conflict, as well. You can't find that in a box in the Washington Post as easily as you might the number of troops that have been killed. But I don't want that to go unremarked today in this context. Thanks.

Mr. Ballhaus. Thank you.

Chairman Shays. Commissioner Gustitus?

Commissioner Gustitus. Thank you. Not to beat a dead horse, but I do have to make this one point, which is that DCMA and DCAA did agree on one important item back in 2004, and that was their analysis that Halliburton could actually financially back KBR on the 15 percent withhold. That was an issue, as to whether KBR could sustain itself through the 15 percent withhold, but Halliburton was under contract to back them and those two agencies agreed that Halliburton could do that and would do that.

But then they went on to say that they thought the 15 percent withhold would likely be passed on to the subcontractors and that that would affect the troops. So I want -- somehow, those two agencies got the notion that there was going to be some effect on that withhold with respect to the troops, so that is just an FYI.

Looking at withholds, I want to talk to each one of you about what the significance of a withhold is. We are pushing here for the agencies to be more aggressive in using withholds. If the business systems can't be

deemed adequate, then we have got to use withholds. We have got to use a carrot or a stick to try to make this happen. And the question is, what effect do withholds have on you? I know that is a pretty general question because it obviously depends on the size of the withhold, but let us say a significant withhold. What does that mean to you, Mr. Methot?

Mr. Methot. I can tell you, to Fluor, it gets our attention right away. It has happened to us before, and I think Ms. Stephenson testified to that this morning, and we are working hard to resolve issues that they brought up.

Commissioner Gustitus. Mr. Ballhaus?

Mr. Ballhaus. Yes. I think the term used this morning was a sledgehammer. I agree with that, and it doesn't have to be a big withhold to catch a contractor's attention. We have on one program a \$2.5 million withhold that has been with us for seven months, and in this instance, it is a case where we believe we have properly responded to all of the concerns that were raised back in February, yet there is no response, any indication of how the withhold will end. That is one that not only is it like a sledgehammer, it kind of leaves a bitter taste in our mouths. But in terms of a carrot or a stick to hold contractors accountable, I absolutely support it.

Commissioner Gustitus. Mr. Walter?

Mr. Walter. I agree with Bill on those points. KBR's withholds that we have faced over time have been on specific items. For those items that we have -- DCAA may have raised a question, we have agreed in some circumstances not to bill the government for costs. On other ones, we have -- we are going through the entire process where we believe that the costs were incurred reasonably and legitimately and we are pursuing those.

As for a system withhold, if there is going to be a change to the way that the rules are written so that there is a system withhold, what I do ask is that we make sure that, as I said in my testimony, that we do have subjective standards -- or objective standards that we can measure those against.

Commissioner Gustitus. Do you believe there isn't law behind right now a withhold on an inadequate business system? Is that KBR's opinion?

Mr. Walter. That would be our opinion.

Commissioner Gustitus. Your lawyer is saying -- that would be your opinion, that there is not sufficient regulatory authority?

[Pause.]

Mr. Walter. Okay. Could you rephrase the question? I am sorry.

Commissioner Gustitus. I didn't ask it very articulately. Is there sufficient regulatory authority for the government to exercise withholds with respect to inadequate business systems?

Mr. Walter. Umm -- with the experience that I have had, I have not seen that it is there, and as I have read through the regulations, I don't see it there.

Commissioner Gustitus. It doesn't surprise me that you haven't seen that it is there -

Mr. Walter. Oh, well -

Commissioner Gustitus. -- since your business systems have been approved by DCMA.

Let me just piggyback very briefly on what Commissioner Shays said, which is going to this responsibility of contractors to seek cost savings. And I just want to make sure that -- ask each of you, do you believe that you have an affirmative duty to the government to seek cost savings on behalf of the government, whether or not it is explicitly stated in your contract?

Mr. Methot. Absolutely.

Mr. Ballhaus. Yes.

Mr. Walter. Yes.

Commissioner Gustitus. Okay. Good to hear that. And let me just close quickly by saying, Mr. Ballhaus, I just want to put you on notice that we are really gravely concerned about this major cost increase on the task order on LOGCAP IV, that is the 70 percent increase, and that one thing we are really committed to is following LOGCAP IV and the transition very, very seriously and in great detail. I put you on notice, too, Mr. Methot, that we are going to be looking very closely into LOGCAP IV and we want to know why there was this 70 percent cost increase and find out whether it was legitimate or not.

Mr. Ballhaus. Okay. Absolutely, and we would be happy to meet with the Commission. I could even make some remarks now or in follow-on questions, if that would be helpful.

Commissioner Gustitus. We will do it with the Commission later. Thank you.

Chairman Shays. Let me -- I was talking with my Co-Chair. Are you saying that you could provide some of that information on the record right now?

Mr. Ballhaus. Yes, absolutely.

Chairman Shays. Then -

Mr. Ballhaus. Absolutely.

Chairman Shays. Then let us do it.

Mr. Ballhaus. And I think I tried to get to this earlier in one of the previous questions -

Chairman Shays. Let me just say, this is an important question, so you have whatever time you need, and you can follow up if you would like.

Mr. Ballhaus. Okay. Absolutely. I would characterize it as in three buckets in terms of the cost growth, each of which is scope-driven. One that I mentioned earlier had to do with the transition, where the transition time lines got compressed and changed from what we had proposed. And as a result of that, it caused us to adjust our labor and staffing profiles where we had to go with a higher percentage of expats than local nationals. That has a direct cost implication. So being directed to move to a more aggressive time line on the transition, that was one bucket of costs that got adjusted, just based on the -

Commissioner Henke. Can you just tell us from what to what, from X month to Y month, so I have a sense?

Mr. Ballhaus. I can't give -

Commissioner Henke. Or maybe one of your experts could, just so we have -

Mr. Ballhaus. Yes. I can get you that information. I think the relevant piece of data, though, is that it forced us into a profile that looked very different from what we bid. We had bid a ten to 15 percent range in terms of expats to total population and we are now at about 50. We will work that mix over time, but to support the transition and to meet the transition time lines, that was the workforce that we had to accommodate and have in place. So that is one big bucket.

Commissioner Gustitus. Let me just ask you, are the expats charging you more than they charged on the KBR contract?

Mr. Ballhaus. No, they are not.

Commissioner Gustitus. Okay.

Mr. Ballhaus. My understanding is that we transitioned employees at the same salaries from what they were paying with KBR. It is above what we had had in our proposal because of the mix issue, right, because of the mix issue.

Commissioner Gustitus. Yes.

Mr. Ballhaus. And then the other two buckets are really direct scope items. In the proposal, we had proposed O&M for, I believe, 165 facilities, and the actual number that we are supporting today is close to 50 percent higher than that, and that has a direct -

Commissioner Henke. Five-zero?

Mr. Ballhaus. Five-zero, five-zero percent.

And then the third item has to do with shuttle services, and I don't have the specifics -

Commissioner Zakheim. Let me just ask, are those surge tasks, then, that they surged on you and said we want you to go after, or was it scope changes -- it was formally done by the government, correct?

Mr. Ballhaus. Correct. And this has, you know, it has big ripple effects. It not only ties to the cost of the program -- and by the way, I do think we will see cost reductions over time that come from the competition, and when we are able to adjust the skill mix and get to what we have proposed in our proposal, we will see the cost reductions. And we are incentivized and motivated to do it because we know if we don't do it and we don't meet our obligations and we are not cost competitive, there is an opportunity for the government to recompute us and replace us. So this notion of competition, I will tell you personally, it is very, very motivating for us.

Commissioner Gustitus. What percentage of the 70 percent is attributable to the increase in the scope, the direct scope?

Mr. Ballhaus. All of the increase. My understanding is that all of the increase is tied -

Commissioner Gustitus. Well, I am -- no -

Mr. Ballhaus. -- so cost increases -

Commissioner Gustitus. You have got three buckets. The first bucket was the transition time line with the expats versus the nationals -

Mr. Ballhaus. And the skill mix.

Commissioner Gustitus. And the skill mix. The second, you said, is the O& -

Mr. Ballhaus. O&M and facility increase.

Commissioner Gustitus. What percentage of that increase in facilities is attributable to the 70 percent, do you know?

Mr. Ballhaus. I will have to get you the specific data. I think it is in the 30 to 40 percent -

Commissioner Gustitus. Okay.

Mr. Ballhaus. -- range of the total cost increase, but we will -- I would be happy to submit -

Commissioner Gustitus. You will break this down?

Mr. Ballhaus. Yes. It is a very simple story and I would be happy to get it down on paper and supply it to the Commission.

Commissioner Gustitus. Thank you.

Chairman Shays. Commissioner Zakheim?

Commissioner Zakheim. Mr. Ballhaus, did I hear you correctly when you said that you open your internal audits to DCAA?

Mr. Ballhaus. Yes.

Commissioner Zakheim. Okay. Mr. Methot, you said, as I recall, that you kind of list your audits, but you don't open them. Is that correct?

Mr. Methot. That is -- we -- that is correct.

Commissioner Zakheim. Okay. So you open them and you list them. What do you do, Mr. Walter?

Mr. Walter. We do the same thing. We will list -- we provide a listing of our internal audits to the DCAA each year -

Commissioner Zakheim. Okay.

Mr. Walter. -- but we do not provide the results of the internal audits.

Commissioner Zakheim. Okay. So Mr. Ballhaus shows them. Mr. Methot, if DCAA sees something on the list and says, we want to see X, do you show it to them?

Mr. Methot. We show it to them. That is correct.

Commissioner Zakheim. Okay. So Mr. Walter, they either proactively show or reactively show and you don't show at all, is that correct?

Mr. Walter. That is correct.

Commissioner Zakheim. All right. Can you tell me why? I don't understand.

Mr. Walter. Well, the audit reports themselves are very subjective in nature. We do provide the auditors with all of the factual information that the internal auditors will look at, but since their information that is contained in there is very subjective in nature, we don't provide the details of the internal audit reports.

Commissioner Zakheim. Okay. So I assume, therefore, that KBR's audits are more subjective than the other two companies? Is that what you are implying?

Mr. Walter. I have never seen their audit reports.

Chairman Thibault. Dov, can I -

Commissioner Zakheim. Okay.

Chairman Thibault. Can I roll into this?

Commissioner Zakheim. By all means.

Chairman Thibault. I don't want to leave a misimpression about internal auditors. I come out of the audit profession, so let us be fair to them. They are not subjective. And maybe you will tell me you were an internal auditor. I have worked with many industry panels and groups. They audit to very precise standards. I have had the opportunity to see internal audit work papers.

I realize everyone throws out, well, we have got this Newport News thing and we are trying to find some middle ground, but there are companies that will accommodate by sitting down and saying, go ahead and read it, and if something really tweaks you in there, we will make the auditors available to you. There are other companies that give you lists and say that if something by subject title, which rarely happens -- let us just call it like it is, it rarely happens where someone says, oh, that is the assignment that someone is working on. But you are not the only company, Mr. Ballhaus, that does it, but that is certainly -- that is not giving them the work papers and everything else, but there is a precision.

Now, opinions are based on data that is gathered in a structured matter. They have internal audit standards that internal auditors spend a lot of time down in Orlando, Florida, at the Audit Institute for Internal Auditors getting trained, trained, trained. So it is just unfair -- I never was an internal auditor, but I have worked with a lot of government internal auditors, and it is unfair to them to say that it is subjective.

Commissioner Zakheim. Well, I certainly align myself with what my Co-Commissioner just said, but let me just point out that I am exceedingly -- just as one Commissioner and as a taxpayer and as an individual, boy, am I uncomfortable with your answer, not just because of what Mike just said, but because these two other companies are pretty big companies and they don't seem to have the problem you have, and I just want to state for the record my extreme discomfort.

Mr. Methot, if you could turn -- on page seven of your testimony, you talked about the fact that after Katrina, you started a program to relook at subcontracted pricing. Have you done something similar, or are you planning to do something similar with Iraq and Afghanistan?

Mr. Methot. Well, we will do whatever is necessary given the pace of the work. Again, as we are growing rather rapidly, as I described earlier, the pace of contract awards we are catching up to in terms of getting our compliance systems in place. So I am making those analyses right now to determine what kind of similar actions do I need to take in order to ensure we are watching the taxpayers' dollars, because clearly, when you award something in an urgent, compelling environment versus a sustainment environment, you are going to look at things differently. So we will be watching closely.

Commissioner Zakheim. But what you did say you are doing, for sure, is on the same page. You are scanning all the purchase orders and subcontract files. You are doing that now. That is what you say, correct?

Mr. Methot. That is correct.

Commissioner Zakheim. Okay. Mr. Ballhaus, are you doing something like that, or are you contemplating doing something like that?

Mr. Ballhaus. Sir, I would actually have to check -

Commissioner Zakheim. Okay.

Mr. Ballhaus. -- on that. I don't know offhand. I would be surprised if we are not.

Commissioner Zakheim. Okay. Mr. Walter, do you do that? You have been around for seven years, eight years.

Mr. Walter. Yes, sir. We do have a procurement team that reviews the procurement files. They do internal self-evaluations. The results of those are shared with the government auditors.

Commissioner Zakheim. So you are scanning all the purchase orders?

Mr. Walter. In terms of scanning -

Commissioner Zakheim. Well, that is what I asked, yes. I mean, Fluor is doing it and apparently DynCorp is looking into it, thinks they do. Are you guys doing it, and the subcontract files?

Mr. Walter. In scanning and making them -

Commissioner Zakheim. Yes.

Mr. Walter. -- digitally available?

Commissioner Zakheim. So that everything is available, yes.

Mr. Walter. Yes, sir, we are doing that.

Commissioner Zakheim. Okay. That will be all for me right now. Thank you.

Mr. Ballhaus. Sir, just to clarify, we do do it.

Commissioner Zakheim. Thanks very much.

Chairman Thibault. Commissioner Ervin?

Commissioner Ervin. Thank you. Thank you. I will be very brief. I just have a couple of things. First, I want to just clarify what I understood to be the outcome of the exchange that Commissioner Gustitus had with you three about withholds. My recollection of her question was whether each

of you agreed that withholds are hammers, or sledgehammers, whatever you want to call it, that they are real incentives for performance, and all of you agreed to that, of course.

I think I heard you for a second time, Mr. Ballhaus, go further to say that you support as a matter of policy withholds in order to incentivize contract performance. Is that right? I don't want to put words in your mouth, but -

Mr. Ballhaus. I do.

Commissioner Ervin. Okay.

Mr. Ballhaus. I do, and as evidence of that, actually, on the LOGCAP Kuwait task order, we have signed up and agreed to a withhold on a portion of the work that hasn't been definitized until we get it definitized with the customer.

Commissioner Ervin. All right. And did I understand you, Mr. Walter, to say that provided objective, whatever we agree are objective, objective standards are set, that you, too, for KBR, support the notion of withholds as a matter of policy?

Mr. Walter. Yes, sir.

Commissioner Ervin. Okay. You, Mr. Methot, for Fluor?

Mr. Methot. I am sorry. Could you repeat the question?

Commissioner Ervin. The question is whether -- not whether withholds are hammers -

Mr. Methot. Right.

Commissioner Ervin. -- but whether as a matter of policy Fluor supports the notion of withholds -

Mr. Methot. Oh, we do.

Commissioner Ervin. Okay. Hopefully, that will have some impact on DCMA and contracting officers as to whether they think they can do it.

The second and final issue I want to get into, we got into it a little bit with Commissioner Tiefer, but I was a little unclear as to where we left it. This whole issue of the transition, back to the transition, but this time moving employees around from FOB to FOB -- this is really a question for you, Mr. Walter, for KBR -- can you and do you represent to us that, to the best of your knowledge, speaking on behalf of KBR, that there isn't a transfer of KBR employees from FOB to FOB waiting for work, irrespective of this direction from General Odierno that there be a significant drawdown of contractor footprint to match the drawdown of military personnel?

Mr. Walter. There are certain individuals and skill sets that we are recruiting for here currently. If we do have an opening for a specific skill set that is an open position at a location, a FOB, wherever, then we will transfer that person over there so that that particular activity can be taken care of.

Commissioner Ervin. But unless and until there is either a position or a solicitation for a position, for want of a better word, you are not simply allowing people to wait out the clock until such time as that happens?

Mr. Walter. We have requisitions open for -- I don't know the exact number, but it is in the thousands of positions for services in the theater. So there are -- for us, if we have an individual who has a skill set that wants to stay with KBR and I need that particular skill at another location, I, in essence, will not have to spend the cost to transition and train somebody and then ship them into theater. I can simply transfer them across to another location. So to the extent that it makes the existing statement of work accomplishable, then we will make those transfers.

Commissioner Ervin. Thank you.

Chairman Shays. Commissioner Green?

Commissioner Green. Thank you. All of you either have been or will soon be huge and very important contributors to the war effort. Recognizing the effect that you get pulled in a dozen different directions in accomplishing your mission, I have a short statement, comment, and then I would like to ask a question, and I am going to read from a Joint Publication 4-10, Operational Contract Support, dated October 2008. I don't know if you have seen it. But let me read one paragraph here, and then I will ask a question of all of you.

"The continual introduction of high-tech equipment, coupled with force structure and manning reductions and the high operating tempo mean that military forces will often be significantly augmented with contractor support. To do this, contract support integration and contractor management must be integrated into military planning and operations. This is a complex and very challenging process."

And I know, Mr. Walter, in your testimony, you promoted contractor involvement in the operational planning process. My question to each one of you is have any of you been asked by TRADOC, CENTCOM, the Joint Staff, the Army Staff, OSD, anybody, to participate in the planning process, whether that be planning in its pure sense, in training, in exercises, or in briefings? Any of you?

Mr. Walter. I am not aware of any.

Mr. Ballhaus. I am only aware of one example where we have been asked to do that.

Commissioner Green. Could you elaborate?

Mr. Ballhaus. Yes. It is on the police training side, where we have been asked to provide our inputs and our thoughts around the police training program and specifically in Afghanistan and giving our view how it could be improved. That is the only incident that I can specifically think of.

Commissioner Green. Mr. Methot?

Mr. Methot. I am not aware of any requests to participate in that planning.

Commissioner Green. I mean, I think this is a big hole in the whole operation. If you guys aren't involved, not just you, but all contractors are not involved in the planning process as we go to war, whether it is going out to Leavenworth and teaching a class or whether it is going out to Fort Irwin when a unit is running up for deployment, I think our government is making a huge mistake. That is the end of my comment.

Chairman Shays. When we met with the Secretary of the Army, Secretary Geren, he made a very strong point about how he is trying to change the culture of the military so that they value the contracting aspect that is inherent now with the Department of Defense, where half of the personnel are contractors and not men and women in uniform. And part of that is to recognize that by the status that you can be in a track to be a general or an admiral by going this route instead of just becoming a colonel and so on.

He also made a point to us that he thinks that even in military exercises, contractors should participate in the military exercises. I am wondering if any of the three of you have ever been invited to participate in a military exercise. You asked that question?

Commissioner Green. Yes. I think they said no.

Mr. Walter. Well, in a military exercise, we have had contracts where we would basically set up the facility where the exercise is going to be accomplished -

Chairman Shays. That is different, though.

Mr. Walter. But not in the planning. Not in the planning, sir.

Chairman Shays. And the planning and so on and the participation?

Mr. Walter. No.

Commissioner Green. And you have been doing this for how many years now, and nobody is participating?

Chairman Shays. Yes, and that was the questions you were basically driving at. But I want to just be clear that this is something that, you know, as Secretary who is leaving believes strongly should happen, and the nodding of your heads indicate that none of you have been invited to participate in that way. But would you like to, and do you think there is value in your doing that? I would like to -

Mr. Methot. Absolutely, there would -- sorry.

Mr. Ballhaus. Absolutely, yes.

Mr. Walter. Yes.

Chairman Shays. Okay. I am struck by the fact that the military have an oath of office, and I am wondering if there should be serious consideration being given that contractors -- first off, do you have an oath that you would apply to any of your workers? Shaking heads, nodding heads -- let me go right down. Go down.

Mr. Methot. No.

Mr. Ballhaus. No.

Mr. Walter. No.

Chairman Shays. Do you think that there could be value? For instance, part of the oath could relate to this question that related to Ms. Gustitus' question. Do you think your company has an affirmative duty to seek cost savings on behalf of the government whether or not it is explicitly stated in your contract, and I think all of you said yes. But I would wonder if you actually have that as part of your written documents provided to your workers and whether that is part of your training. I suspect it isn't necessarily there.

So let me ask you, though. Is it part of your -- could you each show us a document that says that part of your responsibility is to provide cost savings not to the company, but to the government? I would like to go down to each of you.

Mr. Methot. I couldn't show you a document that showed that.

Chairman Shays. But you would like it. And so it is not a criticism, just asking.

Mr. Ballhaus. I can show you a document. It is a one-page strategic framework for our company and there is a bullet -- one of our focus areas is lean enterprise, and so while it doesn't use those words -

Chairman Shays. That is not using the words that I am getting to.

Mr. Ballhaus. But it does represent the intent.

Chairman Shays. I understand, but we are going to get to that. Mr. Walter?

Mr. Walter. I have not seen it in print.

Chairman Shays. I am just wondering, do you think it would be valuable, one, to have it as part of a written document given to your employees to say, we are looking for cost savings for the company and clearly cost

savings for the government, and any time you see ways that our company could help save the government money, even if it meant reducing our workforce, that we have an obligation to share that information with the government. Do you see any value in that, and would you all be willing to do that as part of your written documents and as part of your training to your employees?

Mr. Methot. Fluor would be willing to do that.

Mr. Ballhaus. We would be willing to do it. I think that there is something more important than that oath, sir, and it is leadership driving that concept from the top. Without it, the oath is irrelevant.

Chairman Shays. Well, the only thing is that the oath would, whether it is an oath or a written document, it would just state some priority of the company that would be clear to your employees so they wouldn't be looked at as traitors to your company if they said, you know what? We are going to reduce the income to the company by one-third because you don't need one-third of these employees. Rather than being considered unfaithful, they would be considered faithful to the government and therefore would be part of the ethics of your company. Mr. Walter?

Mr. Walter. I don't see that we would have any issues in building that type of a thing into our training.

Chairman Shays. Well, the only reason I am thinking of it is if you are part, an inherent part of the military effort, it strikes me that that might be a positive way to go.

I know that we focused more, Mr. Walter, with you because your company has been in business longer and we don't like yellow. We suspect that the other companies are learning by some of your mistakes. We hope that your company is going to reevaluate how they have done things in the past versus how they do things in the future. But we do know that all of you have responded in a very sincere way and we all know that you are very valued to your company and we know that the work that your men and women do for our country is extraordinary valued.

And I will repeat the comment that I made in my opening statement, and that is that the military appreciates what each of you do for them, and that goes a long way with us. We would just like to make sure that it is cost effective in the process.

Mr. Co-Chairman, would you like to make a closing comment?

Chairman Thibault. No. I would just like to be sure that each has an opportunity if they have any final comment that they want to make. Commissioner Shays, my Co-Chair, said if I missed that, then I co-opt the blame, so maybe we could start with you, Mr. Methot.

Mr. Methot. Well, let me just say that as the new kid on the block, we are happy to be here and proud to serve, much like the military would say. We do believe we are part, an integral part of the military operation

support to the soldier in the field in very, sometimes, austere conditions. It is not easy. It is not always easy to find people to go over that want to work in that environment.

But Fluor is 100 percent committed to ensuring that its corporate business systems are adequate and meet the requirements and expectations of our customers, whether it is DCAA or DCMA or the Army Contracting Command. We have a lot of customers when we say the government is our customer, and we are here to please every one of those.

And while we are the new kid on the block, I just want to say we are very happy to be here and we take everything you have said seriously and we will do you proud.

Mr. Ballhaus. Well, we are not a new kid on the block. We have been in this business since right after World War II, including operating in war zones and contingency operations, and we have been in Iraq for several years. We have been in Afghanistan for several years. We have been in places like Africa and Colombia, so we are absolutely not a new kid on the block.

I do really very much respect and appreciate what the Commission is taking on. These are significant issues. They are hard issues, but they are all fixable and addressable.

I hope we got across today, or I got across today a point that reflects the characteristic of our culture at DynCorp. We realize what our job is. It is to perform and support the war-fighter and to do it the right way, that there isn't a separation between performance and compliance. It is one integrated thought. That is our job, to perform and satisfy the war-fighter and do it the right way, and I just want to thank the Commission for your time today. Thank you very much.

Mr. Walter. Thank you. I reiterate many of the same feelings. We have been around for a long time, supporting the government in the various contracts we have had over the past many decades. We do take it seriously. We do strive to work hard and we will continue to strive to try to get the recommendations of the DCAA so that we can get those yellow and red blocks to a green.

I do appreciate your time and I look forward to our future meetings to discuss the other items that came out of this.

Chairman Shays. Thank you all for your closing comments.

With that, am I free to adjourn? We will adjourn. Thank you, Commissioners.

[Whereupon, at 3:33 p.m., the proceedings were adjourned.]