

RECORD VERSION

STATEMENT BY

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“CONTRACTOR BUSINESS SYSTEMS”

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BY THE COMMISSION

Chairmen Thibault and Shays, and distinguished Commissioners of the Commission on Wartime Contracting Acquisition Reform Panel: Thank you for this opportunity to discuss the Army's processes regarding contractor business systems.

Effective business systems are central to the conduct of sound business operations. Contractors must have systems in place such as accounting, payroll, and billing systems at 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 purchased and fabricated material charged or allocated to a contract are based on valid time-phased requirements; and maintain a consistent, equitable, and unbiased logic for costing of material transactions and labor. They 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 to keep up with wartime threats.

In evaluating the relative strength of business systems as part of the source selection process, the contracting officer and source selection authority rely on the input of experts from the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA).

DCAA has access to the contractor's records and is therefore responsible for reviewing the financial and accounting aspects of the contractor's cost control systems and performing other analyses and reviews that require access to the contractor's financial and accounting records supporting proposed and incurred costs.

DCMA has on-site representation at the contractor's location and is therefore responsible for:

- Negotiating forward pricing rate agreements
- Reviewing the contractor's compensation structure
- Determining the allowability of costs
- Directing the suspension or disapproval of costs when there is reason to believe they should be suspended or disapproved
- Approving final vouchers
- Determining the adequacy of the contractor's disclosure statements;
- Determine the contractor's compliance with Cost Accounting Standards and disclosure statements
- Reviewing, approving or disapproving, and maintaining surveillance of the contractor's purchasing system, contractor estimating systems, and contractor material management and accounting systems

- Consenting to the placement of subcontracts

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 and 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 contract baseline and any contract changes received to date. The cost allocation among various work packages must be verifiable and must track back to discrete contract changes. This is the method the Government uses to validate that costs charged under the contract are fair and reasonable. 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 or invoices (with final decision in DCMA's hands) and the contracting officer support that process by insisting that the contractor pay attention to its internal controls. 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 open a dialog with senior managers in the corporate chain. Depending on the severity of the problems, 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 and 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. With service contracts representing an ever increasing percentage of our overall contract dollars, greater emphasis is rightfully being placed on their management and oversight. The Army is dedicated toward executing its warfighting mission while simultaneously protecting the taxpayer's interest. It is my honor to lead the contracting team as we persevere to achieve those goals.

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