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Statement of
Honorable Gordon S. Heddell
Acting Inspector General
Department of Defense

before the
Subcommittee on Defense
Committee on Appropriations
United States House of Representatives

on

“Department of Defense Outsourcing”

Chairman Murtha, Congressman Moran, and distinguished members of the Appropriations Subcommittee on Defense, thank you for the opportunity to appear before you and discuss acquisition and contract outsourcing management challenges. I want to emphasize that the Department of Defense Office of the Inspector General (DoD IG) has been a strong supporter of improving acquisition and contracting processes. We want to ensure that the Department and America's warfighters are provided materiel and services that are safe, superior in performance and quality, sufficient in quantity, and within the timeframes needed by the warfighter while balancing taxpayer concerns.

BACKGROUND

The volume and complexity of DoD purchases have increased due to the additional support needed by the warfighter for Operations Iraqi Freedom and Enduring Freedom and other efforts such as humanitarian assistance/disaster relief for Hurricanes Katrina and Rita. DoD spending on contracts in FY 2008 was about \$390 billion, which is more than 2.5 times the \$154 billion spent on contracts in FY 2001. This has resulted in efforts to increase the speed of procurements, specifically those intended to meet urgent warfighter needs. As a consequence, some of these efforts have resulted in less prudent contracting practices. Every acquisition dollar that is not wisely spent is a dollar that is not available to fund other top priorities of the Department of Defense.

Effective and efficient contracting has challenged this nation since its founding and such challenges are ever present today given the global nature of DoD operations and the size of our military. Most significantly, the size and skill of the DoD acquisition workforce has not kept pace with the growth of contracting. Historically, contracting challenges show that there were similar contracting concerns related to overpricing, contractor fraud, inadequate goods,

and the lack of Government oversight. For example, in 1777 during the Revolutionary War:

- General Washington wrote of his concern over the exorbitant prices charged by vendors of required goods.¹
- The Continental Army suffered gravely at the hands of suppliers who engaged in fraudulent practices.²
- Contractors provided the Continental forces with barrels of meat that were filled with stones and tree roots and provided other spoiled food rations, such as rancid flour. The contractors also provided Continental forces with gunpowder that had deteriorated, and thus was unusable.

During the Civil War, contractors provided soldiers shoddy supplies, including clothes, blankets, and shoes that would break down after a one day's march or a little rain.

Today, instead of debris-laden barrels of meat, contractors have built inadequate or unusable facilities, provided defective equipment and parts, stolen fuel, bribed contracting officials, grossly overcharged for goods, and failed to deliver products in a timely manner, if at all. Because of the magnitude of the DoD's purchasing power and the global presence of its personnel and resources, we face particular challenges regarding:

- Fair and reasonable pricing;
- Contract oversight and administration; and
- The dangers of outsourcing inherently governmental functions.

As such, since the early 1990s, the OIG and the Government Accountability Office have identified contracting as a high-risk area within DoD. This vulnerability is exacerbated when applied to supporting operations in Iraq and Afghanistan. As we recently testified to the Commission on Wartime Contracting, contract administrators focus primarily on timely mission accomplishment versus ensuring strict adherence to traditional contract administration procedures, many of which are designed to reduce the risk of fraud, waste, corruption, and abuse. When engaging in contingency contracting, administrators may not consider the increased risk from omission of appropriate controls and oversight of contracting practices, as their priority is to provide goods and services as quickly as possible.

Additionally, as discussed in our most recent Semiannual Report to the Congress, the DoD acquisition and contracting communities, in an attempt to manage the large increases in defense spending with a smaller and less capable workforce, have increasingly turned to contractors to fill roles previously performed by Government employees. Therefore, not only are we challenged with executing enormous amounts of contingency contracting, but we must also oversee a large contractor workforce with an acquisition corps that has been systematically reduced in size and capability since 1990.

IG PERSPECTIVES

In 1998, then DoD Inspector General Eleanor Hill testified³ about our concerns regarding the downsizing of the acquisition workforce and the plan to increase the outsourcing of numerous functions, thus increasing the contract administration workload. Ms. Hill stated that the reductions in the acquisition workforce did not seem to be driven by logical consequence of business reengineering and efficiencies gained, but rather were a reform goal in and of

themselves. She also stated at that time that adjustments to the acquisition workforce should not be driven merely by personnel reduction goals but through management decisions based on sound, reliable, and quantifiable analysis that identify trade-offs in management’s decisions.

Another concern voiced by Inspector General Hill in 1998 was the lack of oversight in services contracting, another high-risk area for waste and mismanagement. Services contracts were a growth area in DoD, and would continue to increase because of the expanded emphasis on outsourcing. In FY 1998, about \$49 billion was spent on services contracts. However, there were almost no oversight mechanisms for service contracting, and the Office of the Secretary of Defense received little information on how the Department was managing services contracts. We saw no comprehensive efforts by the Department to oversee or manage the growth, costs, profits, or fees for services contracts. In just the last decade, the value of services contracting more than tripled and yet the number of acquisition and oversight staff was essentially flattened. DoD is not currently capable of tracking all of the services contracts as shown in the table below. Without good data, it is difficult to manage services contracts and contracts in general.

Value of Service Contracts and Contracts–FY 2008*

Contract Description	Value of Service Contracts	Total Contracts
All Contracts from FPDS	\$ 155.0 Billion	\$ 382.5 Billion
JCCI/A from FPDS	\$ 42.0 Million	\$ 7.5 Billion**

* The chart does not include data for interagency actions for FY 2008. In the Panel on Contracting Integrity Report to Congress for 2008, DoD reported, using Federal Procurement Data System (FPDS) data, that it spent \$13.0 billion on interagency actions in 2007. However, DoD could not provide data for 2008.

** Data was manually loaded from Joint Contracting Command Iraq/Afghanistan (JCCI/A) into the FPDS for FY 2008. In the manual loading, 99.4 % was coded as miscellaneous. As a result, the amount shown for services is not reliable.

DoD IG CONTRACT OVERSIGHT EFFORTS

Through our reviews of the Department's contracting practices, we have continuously identified problems with the pricing of awarded contracts and the subsequent oversight of these contracts after award. Improper oversight often leaves the door open for fraud and other criminal activities, which continue to become more complex in nature. In addition, the Department also faces the challenge of distinguishing what work is inherently governmental. We have provided several examples of work that we have recently conducted in these areas, which shows our on-going commitment in mitigating the vulnerabilities we have identified within the acquisition and contracting arenas.

FAIR AND REASONABLE PRICING

Recent work shows that contracting officials have used inappropriate contracting approaches, ignored acquisition regulations, or used ineffective pricing tools resulting in prices that could not always be determined to be fair and reasonable. Below are a few specific examples.

Mine Resistant Ambush Protection Vehicles. In our report on the Procurement and Delivery of Joint Service Armor Protected Vehicles,⁴ we found that the Marine Corps Systems Command did not properly determine that contract prices were fair and reasonable when they awarded nine firm fixed price contracts for Mine Resistant Ambush Protected (MRAP) vehicles. As of June 30, 2008, the contracts were valued at \$9.1 billion. Contracting officials relied on competition as the basis for price reasonableness even though the awards were made for dissimilar vehicles with a wide range of prices.

For example, for Category I vehicles, the prices ranged from \$306,000 to \$1,089,000. The current lead contracting officer could not explain how the price

evaluation team concluded that prices were fair and reasonable. For \$1.2 billion of non-vehicle items, we found no corresponding independent government cost estimates for evaluation. The Marine Corps also did not obtain volume pricing discounts from two contractors for orders in excess of 1,500 vehicles.

We estimated that for one contractor there was about \$45 million in lost potential savings because of a failure to obtain volume discounts similar to other contractors. One contractor self-initiated price reductions and quantity discounts in 2007. While seemingly laudable, what this voluntary reduction indicated was that the initial prices may have been inflated. We believe the best approach would have been to use the Truth in Negotiations Act to obtain cost or pricing data and ensure fair and reasonable prices.

We concluded that the contracting officials did not adequately evaluate prices during source selection. As a result, the Marine Corps had no assurance that prices paid were fair and reasonable and likely paid more than it should have for the vehicles. Marine Corps officials disagreed with our conclusions related to MRAP contract prices. However, the Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology and Logistics, agreed with our conclusions that Marine Corps officials did not properly determine that MRAP contract prices were fair and reasonable and that quantity discounts should have been sought. We also reported positive news; we complimented the Marine Corps because they took effective actions to accelerate delivery of MRAP vehicles and addressed materiel shortfalls. In addition, the Army and Marine Corps developed MRAP requirements based on theatre commander assessments.

Expeditionary Fire Support System and Internally Transportable Vehicle. In an audit of the procurement of the Expeditionary Fire Support System

and Internally Transportable Vehicle,⁵ contracting officials did not award the contract in accordance with the Federal Acquisition Regulation. As of July 2008, the contract was valued at \$108 million. However, there was no basis to assess the profit or fee negotiated or that fair and reasonable pricing occurred. Since contract award, the average unit cost has increased by 86 percent (\$579,000 to \$1,077,000) for the Fire Support System and 120 percent (\$95,000 to \$209,000) for the Internally Transportable Vehicle. Also, the scheduled delivery has slipped by 22 months for the Fire Support System and 17 months for the Internally Transportable Vehicle. Further, the Expeditionary Fire Support System and Internally Transportable Vehicles were misclassified as non-developmental items when major modifications were needed. Also, source selection personnel did not adequately document and disclose all technical criteria in the solicitation and did not prepare a price negotiation memorandum. Finally, the Marine Corps could not locate a business clearance memorandum, which could meet the requirements for a price negotiation memorandum. We recommended that Marine Corps contracting officers be provided training on their authority and responsibility and that the Assistant Secretary of the Navy (Research, Development, and Acquisition) perform an accountability review of the contracting officer's performance in awarding the contract. The Assistant Secretary agreed with the recommendations.

Public Relations Services. The OIG audit of the America Supports You Program⁶ identified a fundamental lack of segregation of duties in the contracting process, poor contract oversight, and contract prices that were not fair and reasonable. The Deputy Assistant Secretary of Defense for Internal Communication and Public Liaison was responsible for:

- Establishing funding for a Public Affairs support contract;
- Recommending award of the contract to one contractor;

- Overseeing the Contracting Officer's Representatives for the contract;
- Reviewing the contractor's invoices; and
- Approving payments to the contractor.

The absolute control of the contracting process by one individual resulted in the Department not obtaining the services needed at a fair and reasonable price. From FY 2005 to FY 2007, DoD spent \$8.8 million on 6 contracts for public relations services from one contractor. The contracts provided annual rates of payment for managers/executives from \$312,821 to \$662,691 to perform public relations efforts. In addition, the contractor was reimbursed for \$17,345 for duplicate and unallowable charges for such items as liquor, first class airfare, and lodging costs of \$547 per night. The Department planned to cancel the \$15.3 million contract awarded in 2008. The Under Secretary of Defense (Comptroller)/DoD Chief Financial Officer and the Assistant Secretary of Defense for Public Affairs agreed with the report findings.

Spare Parts. The OIG identified in an audit that contractors' uses of unique contracting approaches also caused pricing problems.⁷ When sole-source manufacturers use an exclusive distributor for sales of its parts to the Department of Defense, they put contracting officials in the position of being unable to effectively negotiate prices or obtain best value for noncompetitive spare parts. In some cases, the contracting officer did not perform price reasonableness determinations. In other cases, the contracting officer relied on ineffective tools such as price analysis and cost analysis of dealer costs for price reasonableness determinations. As a result, DoD paid about \$3 million more than fair and reasonable for 33 parts that cost about \$6.9 million. Some of the specific examples we found of questionable pricing follow. The example descriptions are vague so that we do not disclose proprietary data:

- For 25 parts, the Defense Logistics Agency paid 550.7 percent more than we determined fair and reasonable (paid \$2,723.93 per part instead of our fair and reasonable price of \$418.63).
- For 353 parts, the Defense Logistics Agency paid 224.3 percent more than we determined fair and reasonable (paid \$977.37 per part instead of our fair and reasonable price of \$301.38).
- For 30 parts, the Defense Logistics Agency paid 154.6 percent more than we determined fair and reasonable (paid \$1,839.10 per part instead of our fair and reasonable price of \$722.32).

The Director, Defense Procurement and Acquisition Policy, Office of the Under Secretary of Defense for Acquisition, Technology and Logistics, agreed that the Department needs to improve pricing techniques and controls for determining fair and reasonable prices with distributors.

Criminal Investigation Examples of Pricing Problems. The most notorious case investigated by the Defense Criminal Investigative Service (DCIS) involved C&D Distributors, LLC, a company owned by twin sisters that, beginning in 1997 and continuing into 2006, submitted electronic bids to the Department to supply small hardware components, plumbing fixtures, electronic equipment, and other items. Along with the cost of the items sold, C&D made claims for shipping costs, which were processed automatically to streamline the resupply of items to combat troops in Iraq and Afghanistan. The fictitious shipping costs ranged into the hundreds of thousands of dollars, despite the fact that the value of the items shipped rarely exceeded \$100. In the final transaction before the scheme was discovered, C&D billed the Department \$998,798.38 to ship two flat washers that cost \$0.19 each. Over the course of the conspiracy, the defendants obtained approximately \$20.6 million in fraudulent shipping costs.

The money was used to purchase beach houses, high-end automobiles, boats, jewelry, vacations, and other items. The surviving sister and the company pled guilty and are pending sentencing. In this instance, it is clear that the attempt to expedite supplies into a war zone allowed pricing to be manipulated fraudulently through an automated purchasing system that lacked effective internal controls.

American President Lines (APL) recently reached a settlement with the Department of Justice and agreed to pay \$26.1 million to settle allegations that the company overcharged and double billed the Department for transportation of containers from ports to inland delivery destinations in Iraq and Afghanistan. The investigation was initiated based upon a Qui Tam lawsuit alleging that APL systematically billed the Surface Deployment and Distribution Command for transportation related charges that should have already been covered by the assessorial rate being paid under two DoD contracts. An analysis of the records obtained via Inspector General subpoenas provided evidence to substantiate the allegations of cost mischarging on the part of APL.

Also, DCIS investigated allegations of labor mismanagement by ITT Federal Services (ITT) in 2008. It was alleged that ITT billed excessive labor hours against work orders for basic service level repair and ordered excessive replacement parts. The investigation revealed that the contract authorized ITT to bill for a 6-day work week at 12 hours per day for the entire work force without regard for the actual amount of work being done. The lack of oversight on the management of the contract and ITT work force was primarily attributed to two factors: the absence of an administrative contracting officer for more than a year at Camp As Sayliyah, Qatar, and the failure of the contracting officer's representative to effectively perform his duties.

CONTRACT OVERSIGHT AND ADMINISTRATION

Maintaining public support for Defense programs requires good contract oversight and prompt identification of any problems. During the Truman Commission hearings, then Senator Harry Truman indicated, “I have had considerable experience in letting public contracts and I have never yet found a contractor who, if not watched, would not leave the government holding the bag. We are not doing him a favor if we do not watch him.” Senator Truman’s concerns on oversight resonate today.

Contract oversight and administration are especially important on cost-type contracts. In addition, the increased use of contractors and service contracts has heightened the need for close surveillance on contracts. With more reliance on contractors, it is important to clearly draw the line between Government activity and contractor activity and ensure that contractors do not have undue influence on the decision-making process. As noted earlier, in 2008, contracting for services reached approximately \$155 billion. Also, cost-type contracting in recent years accounted for about a third of DoD spending and became more prominent because of the uncertainties associated with expeditionary contracting for the Global War on Terrorism and Hurricanes Katrina and Rita. Lack of adequate oversight and surveillance has led to waste and abuse on DoD contracts.

Inadequate contract oversight on services contracts overseas and in the United States has been a recurring problem identified in reports issued by my office, the Government Accountability Office, and the Service audit agencies as well as the subject of Congressional testimony. The following are a few sample findings.

Hurricane Relief Services. Our recently issued audit report on Hurricane Relief Effort Costs on the Navy Construction Capabilities Contract (CONCAP)⁸

identified that Navy contracting officials did not effectively implement cost control procedures for three CONCAP contract task orders issued to a contractor for recovery efforts associated with Hurricanes Ivan and Katrina. As a result, the Navy had no means to measure contractor cost performance on task orders totaling more than \$229 million and was instead monitoring the contractor's spend rate.

In addition, the Navy contracting officials provided insufficient oversight of the contractor's subcontracting efforts for the three task orders. The contracting officials decided not to review the contractor's analysis of subcontractor prices because the contractor had an approved purchasing system. Navy officials thought that any problems with subcontract pricing would be uncovered by the Defense Contract Audit Agency (DCAA) during its cost incurred audits. Unfortunately, the contractor waited until after the storms before soliciting for proposals to perform the tasks the Navy requested. At that point, the supply and demand for contracting was out of balance, and there was also intense political, public, and operational pressure to restore lost capabilities and to stabilize damaged buildings to prevent further damage. As a result, demand for the labor and material needed to perform the repairs was at its peak and the contractor awarded sole-source or limited competition subcontracts that paid roofers excessive hourly rates. In another example, the contractor was paid \$540 monthly per employee for cell phones. The contractor also purchased \$4.1 million of meals and services that "should have" cost \$1.7 million, and paid a markup on material and equipment of \$7.2 million that increased proportionally to increases in material costs expended in performance. This type of contracting, a cost-plus-percentage-of-cost system of contracting, is prohibited by statute. We also identified about \$8.2 million in unreasonable leases and material markups that should be recovered.

The Navy generally agreed with the report recommendations, reengineered its approach to contracting for emergency construction, and instituted controls in a

new contingency contract. The Navy also suspended payments to the contractor and was working with DCAA to determine the amount to recover from the contractor.

Wireless Local Area Network Services. The OIG reported that during the procurement of the Air Force Second Generation Wireless Local Area Network,⁹ the contracting officer potentially limited competition by not defining the scope of work, and accepted supplies and services valued at \$38.1 million without quality or quantity inspection by a Government representative. The contract, awarded as a firm-fixed price contract, was valued at \$144 million in 2008. However, it operated as a cost-type time and materials contract, which placed all risk on the Department. Each Air Force site had an initial cost estimate for installation, but the contractor was paid for all costs to install the wireless network. At McConnell Air Force Base, the initial cost estimate was \$1.23 million, but cost \$1.54 million, or 25 percent more.

We determined that the contracting officer did not appoint a contracting officer representative or develop a quality assurance surveillance plan. The contracting officer signed acceptance forms that did not show a detailed list of supplies and services, but only showed contract line item, name, and amount. Thus, we paid for items without details of what was purchased. The contracting officer also allowed five contractor personnel (different contractor) at the project management office to function as the contracting officer representatives. The contractor personnel performed inherently governmental functions by making recommendations and observations, and preparing documents about how the contractor for the Second Generation Wireless Local Area Network performed. The contracting officer also allowed the contractor to bill a flat rate for a rental car for every contractor employee. At Patrick Air Force Base, the Air Force was

billed for a rental car for each of 14 contractor employees for about two months. We questioned about \$800,000 in contractor travel cost billings.

The Director, Defense Procurement and Acquisition Policy agreed with our report conclusions and stated that the contracting chain did not provide adequate oversight nor checks and balances in the acquisition process.

Construction Support Services. The OIG reported¹⁰ that the Regional Contracting Command-Bagram contracting officials accepted construction projects that required extensive rework by another contractor to be usable. The audit looked at 42 contracting actions for \$1.9 million of construction. Two contract files were missing and 40 contract files lacked quality assurance surveillance plans and contracting officer's representative designation letters. The contracting personnel stated there was often a lack of qualified personnel available to serve as contracting officer representatives. Examples of rework performed include rewiring of troop housing units, reinstalling sewer lines for latrines, and repairing flooring that was installed improperly.

Capital and Direct Medical Education Overpayments. The OIG Contract Audit Followup Division, which reviews contracting officer actions taken in response to DCAA reports, determined that a TRICARE contracting officer used inappropriate contracting approaches and did not comply with the Federal Acquisition Regulation when he awarded a sole-source contract to identify Capital and Direct Medical Education overpayments.¹¹ The contracting officer failed to justify the contract award and did not properly consider overpayments that the DCAA had already identified, resulting in TRICARE paying unnecessary fees of up to \$4.7 million. The TRICARE agreed to cancel the follow-on contract and instead use the DCAA to identify the overpayments at no additional cost to the DoD, resulting in estimated savings of between \$7.5 and \$10 million.

Navy Actions on Questioned and Unresolved Costs. Our Contract Audit Follow-up team also found that a contracting officer at the Navy's Shipbuilding and Repair facility in Groton, Connecticut, had violated the Federal Acquisition Regulation and DoD policy when she established final indirect rates before taking final action on \$94 million in DCAA questioned and unresolved costs.¹² The same contracting officer improperly used prior-year sustention rates (representing the percentage of prior-year questioned costs agreed to by the contracting officer) to negotiate \$1.6 million in DCAA-questioned costs instead of addressing the current-year questioned costs as required. We recommended that the Navy discontinue the use of these practices.

Improper Advance Agreement. Our Contract Audit Follow-up team determined that a Defense Contract Management Agency (DCMA) contracting officer had improperly entered into advance agreement to reimburse \$950,000 in unallowable legal settlement costs to a contractor.¹³ The contracting officer reimbursed the legal settlement costs despite receiving opinions from a DCMA attorney and the DCAA stating that the costs were unallowable in accordance with the Federal Acquisition Regulation. We recommended that DCMA recoup the \$950,000 and prepare guidelines for entering into advance agreements that comply with regulations.

Maintenance Support Services. The Naval Audit Service reported¹⁴ that ten time and material and labor-hour contracts at the Naval Air Systems Command either lacked quality assurance surveillance plans or documentation that surveillance had occurred. As a result, the Navy could not demonstrate that it received the \$57 million of naval aeronautical support services in accordance with the contract. The Navy initiated corrective action in response to the report.

Engineering Support Services. The Air Force Audit Agency identified in a report¹⁵ that there was inadequate contract surveillance and quality assurance on seven task orders performed in Iraq. The DCMA performed contract surveillance for the Air Force on the task orders. The task orders were for services such as engineering support and power productions. For six task orders, the quality assurance person did not have a copy of the task order. For three task orders, the commander did not appoint a Quality Assurance person to monitor contractor performance for at least 3 months after the task orders were awarded. The Air Force initiated corrective action in response to the report.

Logistics Support Services. The Army Audit Agency identified¹⁶ that on a logistics support contract, contractor invoices were not adequately reviewed and validated before payment. The logistics personnel reviewing the invoices requested the contractor to provide supporting documentation for the invoices. The contractor did not comply. The Contracting Office did not respond to requests from the logistics personnel to request contractor documentation. Consequently, the invoices were paid without supporting documentation. The Army auditors identified \$4.5 million in questionable costs and \$432,000 in nonallowable costs. In response to the report, the Army Contracting Agency agreed to request the DCAA to review the contractor billing rates and to obtain the supporting documentation required to substantiate contractor invoices before payment.

Testing Requirements for Body Armor. We reported that First Article Testing for body armor purchased on Army Contract W91CRB-04-D-0040 was not consistently conducted or scored in accordance with the contract terms, conditions, and specifications.¹⁷ During 21 first article tests conducted for the contract, the testing facility officials did not follow the contract purchase description and test plan requirements for fair shot determination, back face

deformation measurement, or plate size. Also Program Executive Office Soldier scoring officials had the opportunity to select certain plates for scoring while disregarding others. For three first article tests the contractor passed, the selection of certain plates for scoring resulted in the contractor passing the first article test when otherwise the contractor would have failed. We could not make a determination on a fourth test because of insufficient test data. For example, during one test, the Program Executive Office Soldier scoring official disregarded the results on a medium plate and instead scored an extra large plate. Had the scoring official scored the original medium plate that had a partial penetration on the first shot and complete penetration on the second shot, the contractor would have failed the first article test. We believe a Government representative should be present during the testing process to ensure the test plans are followed. However, we determined that a Program Executive Office Soldier official was only present during 4 of the 21 first article tests for the contract.

The Secretary of the Army agreed to identify and collect the ballistic inserts related to the questionable first article tests. The Secretary wanted to ensure that there can be no questions concerning the effectiveness of every soldier's body armor. The Army also stated that since June 2008, there has been a requirement for Government representation at all first article and lot acceptance testing. Also a three-tier scoring methodology was implemented in October 2008 to ensure scoring accuracy.

The Army and the U.S. Special Operations Command independently developed first article testing criteria for body armor ballistic inserts. The testing criteria differed significantly in the number of plates tested, the shot pattern, the environmental conditions, the type of tests and pass or fail guidelines. For example, the Army requires the contractor to submit 25 plates for first article testing and the Special Operations Command requires the contractor to submit 146

plates for Generation III first article testing. Based on testing results, the Special Operations Command can require submission of up to 480 plates for testing. With varied test criteria, DoD does not have assurance that its body armor provides a standard level of protection. The Director, Operational Test and Evaluation, agreed to shape a future test operations procedure for body armor that the DoD will use.

Criminal Investigation Examples of Contract Oversight and Administration. In the well-reported case of John Cockerham, the former Army major admitted to participating in a complex bribery and money laundering scheme while deployed to Kuwait. Throughout 2004 and 2005, Cockerham was responsible for awarding contracts for services to be delivered to troops in Iraq, to include bottled water contracts worth millions of dollars. By the time investigators became aware of Cockerham's illicit activities as a spin-off of another investigation, he had received or was promised more than \$9 million in bribes in return for awarding contracts. The enterprise grew to involve over 30 people and implicated approximately 900 contracts and blanket purchase orders for all manners of goods and services. Clearly, better oversight of contracting officers and effective management and control of contract awards would likely have exposed such blatant corruption and contract exploitation.

In 2008, a former Kellogg, Brown, & Root (KBR) employee who worked in Afghanistan was sentenced to 26 months in prison and \$216,000 in restitution for conspiring to receive bribes, making false statements, and filing false claims. KBR had a contract to provide support services to the U.S. Army at Bagram Airfield in Afghanistan, including unloading truckloads of jet fuel delivered by drivers hired by Red Star Enterprises. Certain KBR employees conspired to accept payments from drivers, who were selling their fuel to parties outside the airfield, in return for providing the drivers with false documents showing that the

truckloads of fuel had been delivered to the airfield. The defendant admitted to receiving bribes from several drivers in return for falsifying their paperwork. According to the indictment, more than 80 truckloads of fuel were diverted for sale outside the airfield between May and September 2006, involving more than 784,000 gallons of fuel valued at more than \$2.1 million. Apparently, no oversight mechanism was in place to monitor and verify fuel deliveries, allowing such an extensive and overt theft of contracted material.

Finally, U.S. Army Major Theresa Baker was involved in two bribery schemes impacting DoD contracts in Iraq. In December 2008, she pleaded guilty to two counts of bribery and two counts of conspiracy. Baker received money and other items in return for providing sensitive contract information and fraudulently awarding contracts to the contractor. Baker also canceled contracts that were awarded to third-party contractors and fraudulently re-awarded them to the contractor. She then authorized the contractor to receive payments, which totaled more than \$700,000, despite the fact that no goods were delivered nor any services performed. As with Cockerham, it is highly likely that such blatant graft and contract manipulation would have been discovered by proactive oversight efforts in its early stages.

INHERENTLY GOVERNMENTAL FUNCTIONS

The extensive reliance on the contractor support workforce has led to instances where contractors are performing inherently governmental functions. The Federal Acquisition Regulation defines inherently governmental as a function that is so intimately related to the public interest as to mandate performance by Government employees. These functions include activities that require either the exercise of discretion in applying Government authority, or the use of value judgments in making decisions for the Government. Additionally, these functions

involve interpretation and execution of the laws of the United States so as to bind it to take or not to take some action by contract, policy, regulation, authorization, order, or otherwise. Examples include determining what services to order, administering contracts, and performing investigations.

Wireless Local Area Network Services. As previously mentioned, we identified that contractor personnel were used as contracting officer representatives for the Air Force Second Generation Wireless Local Area Network contract. We believe the interests of taxpayers are not protected when we have one contractor monitoring another contractor. During the same audit, we identified a potential Anti-Deficiency Act violation and, in a “For Official Use Only” draft report,¹⁸ recommended that the Air Force perform a preliminary investigation to determine if a statutory funding violation occurred. The Air Force Materiel Command provided our draft report to a contractor and directed the contractor to perform the investigation. Contractors that perform an investigation of a potential violation of statute clearly breach the principles of inherently governmental functions. We requested that the Air Force terminate the contract for the investigation.

Insourcing Guidance. In July 2008, we completed a review of DoD Guidelines on considering civilians for new and contracted functions.¹⁹ The review was mandatory by Section 324 of the National Defense Authorization Act for FY 2008. We believe that Section 324 provides the Department the flexibility to better manage its workforce and reduce costs.

The Deputy Secretary of Defense issued guidelines, and the Services are issuing supplemental guidance, on insourcing new and contracted functions. The statute²⁰ and DoD guidance permits insourcing of work that is performed by a contractor and:

- Has been performed by DoD civilian employees at any time during the previous 10 years;
- Is a function closely associated with the performance of an inherently governmental function;
- Has been performed pursuant to a contract awarded on a non-competitive basis; or
- Has been performed poorly, as determined by a contracting officer during the past 5 year period preceding the date of such determination because of excessive costs or inferior quality.

Our report captured some initial successful efforts in the renewed insourcing effort within DoD, which also included potential savings to the DoD. For example, as we stated in our report, the Army identified where actions were taken to insource 99 contractor positions to ensure inherently governmental functions are performed by Government personnel. In addition, for conversions to insourcing the function, the Army calculated that this action would save \$4.8 million initially and \$34.3 million by 2015.

Contractor Common Access Cards. Contractor common access cards permit contractor personnel access to Department installations, resources, and sensitive information. Our report on the contractor common access cards²¹ identified that contractors could become Government sponsors and sponsors who left Government service may have been approving contractors to obtain common access cards. Once this was identified, the Department took action to ensure that contractors were no longer Government sponsors. We also determined that Government sponsors could not document the affiliation of an estimated 33,000 cards to a contract and did not have the card expiration linked to contract completion for an estimated 35,000 cards.

Also, Government sponsors approved an estimated 39,000 contractor employees for a common access card without verifying that required background checks had been initiated or completed. We also reported that about 40,000 contractors had common access cards that identified contractor personnel as having a government general schedule pay grade. Further, about 212,000 contractor personnel had email addresses that misclassified the contractor personnel as U.S. Government personnel. This misidentification is a potential security risk because contractors could misrepresent themselves both in person and on DoD networks to improperly obtain sensitive information. The DoD agreed with the report and was implementing corrective actions. However, the DoD did not provide an acceptable solution for the problem of contractors with improper DoD email addresses and we requested additional comments.

Inadequate controls have allowed contractors to use common access cards to steal DoD property. As previously stated, a DoD contractor used common access cards to gain access to the fuel locations and stole 10 million gallons of fuel in Iraq. The contractor obtained the common access cards by falsely representing to the U.S. Army that the drivers and escorts were employees of a DoD contractor when in reality, the individuals were not employees of any DoD contractor. Controls must be in place to ensure that common access cards cannot be used as a means to steal assets from DoD. Our continuing series of reviews of the controls in place over common access cards will help mitigate risks to the DoD.

ONGOING INITIATIVES

We are actively involved in aggressive audit planning for contracts in Southwest Asia and the DoD depots in the U.S. that support operations in Iraq and Afghanistan. We are also a member of the Panel on Contracting Integrity, and chair its subcommittee on Procurement Fraud Indicators. Further, our efforts also

include launching our fraud indicator website to assist oversight personnel in detecting indicators of potential fraud. The following highlight a few of our ongoing efforts.

Comprehensive Audit Plans for Southwest Asia. In November 2008, the OIG, working with its Southwest Asia Joint Planning Group, facilitated the most recent compilation and issuance of the Comprehensive Audit Plan for Southwest Asia, as required by the FY 2008 National Defense Authorization Act (P.L. 110-181) Section 842, “Investigation of Waste, Fraud, and Abuse in Wartime Contracts and Contracting Processes in Iraq and Afghanistan.” The plan includes audits of contracts and task orders for the logistical support of coalition forces in Iraq and Afghanistan. We have expanded the plan beyond the statutory mandate to show all the oversight work for Iraq, Afghanistan, and Southwest Asia in key issue areas such as financial management, systems contracts, and human capital for contract administration. The Plan includes the individual audit plans of the Inspectors General of the Department of Defense, Department of State, and the U.S. Agency for International Development; and the Special Inspector General for Iraq Reconstruction. It also includes the planned audit work of the Army Audit Agency, Naval Audit Service, Air Force Audit Agency, and DCAA. In total, the Plan contains over 650 planned or ongoing oversight projects that support the DoD efforts in Iraq, Afghanistan, and Southwest Asia. This includes audit work done at depots and other U.S. military installations in support of DoD Southwest Asia efforts.

Audit Plan for Spare Part Purchases and Depot Overhaul. The FY 2009 National Defense Authorization Act (P.L. 110-417) Section 852, “Comprehensive Audit of Spare Parts Purchases and Depot Overhaul and Maintenance of Equipment for Operations in Iraq and Afghanistan,” requires a comprehensive plan for a series of audits related to contracts and task orders for

depot overhaul and maintenance of equipment for the military in Iraq and Afghanistan and spare parts for military equipment used in Iraq and Afghanistan. The statute requires the Army Audit Agency, Naval Audit Service, and Air Force Audit Agency, in coordination with the OIG, to develop the plan to audit equipment, maintenance, and spare parts. We are actively developing this plan with the Service Audit Chiefs.

Panel on Contracting Integrity. Section 813 of the John Warner National Defense Authorization Act for FY 2007 directed the Department of Defense to convene a panel of senior leaders, chaired by the Deputy Under Secretary of Defense for Acquisition, Technology and Logistics, to conduct reviews of DoD progress in eliminating vulnerabilities in the Defense contracting systems that allow fraud, waste, and abuse and affect Operations Iraqi and Enduring Freedom. The Panel established ten subcommittees to support the review of contracting integrity issues: current structure of contracting integrity, sustained senior leadership, capable contracting workforce, adequate pricing, appropriate contracting approaches and techniques, sufficient contract surveillance, contracting integrity in a combat/contingent environment, procurement fraud indicators, contractor employee conflicts of interest, and recommendations for change. The DoD IG representative is a member of the overall Panel on Contracting Integrity, a member of the subcommittee on Adequate Pricing, and is Chairperson of the Procurement Fraud Indicators subcommittee. The Panel identified 21 actions in FY 2008 to improve contracting processes and completed 20 of these actions during the calendar year. The Panel identified an additional 28 for implementation in calendar year 2009.

Fraud Indicators Website. In October 2008, we launched our “Fraud Indicators in Procurement and Other Defense Activities” website. The website is intended to be used by DoD auditors and others to assist in detecting fraud. The

website contains information related to fraud guidance, statistics, and resources; and best practices for auditors. In addition, the website has 40 scenarios and indicators in 10 major topic areas such as contracting/procurement, healthcare, base allowance and housing, and in-theater operations. To date, the website had nearly 6,500 viewers and can be found on our Internet website at <http://www.dodig.mil/Inspections/APO/fraud/Index.htm>.

CLOSING COMMENTS

Again, thank you for inviting us back to testify on contracting and outsourcing within the Department. Thanks to this Committee's support, we are dedicating more resources to provide oversight to tighten controls, strengthen processes, and expand our efforts in all of Southwest Asia. We will continue to work with U.S. law enforcement agencies to identify potential criminal activity for investigation and prosecution. We will also continue to work with the Department's leaders and Congress to correct systemic issues that undermine the Department's ability to effectively mitigate contract risks.

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- ¹ *Writings of George Washington*, Government Printing Office, 1993, as cited in *History of Government Contracting*, Nagle, 1999.
- ² *History of Government Contracting*, p19, Nagle, 1999.
- ³ Testimony before the Subcommittee on Acquisition and Technology, Committee on Armed Services, United States Senate, March 18, 1998, on Acquisition Reform.
- ⁴ OIG, D-2009-046, "Procurement and Delivery of Joint Service Armor Protected Vehicles," January 29, 2009.
- ⁵ OIG, D-2009-041, "Expeditionary Fire Support System and Internally Transportable Vehicle Programs," January 14, 2009.
- ⁶ OIG, D-2009-032, "The America Supports You Program," December 12, 2008.
- ⁷ OIG, D-2008-048, "Procuring Noncompetitive Spare Parts Through an Exclusive Distributor," February 6, 2008.
- ⁸ OIG, D-2008-097, "Hurricane Relief Effort Costs on the Navy Construction Capabilities Contract," May 23, 2008.
- ⁹ OIG, D-2009-036, "Acquisition of the Air Force Second General Wireless Local Area Network," January 16, 2009.
- ¹⁰ OIG, D-2008-119, "Construction Contracting Procedures Implemented by the Joint Contracting Command-Iraq/Afghanistan," September 29, 2008.
- ¹¹ OIG, D-2007-6-002, "TRICARE Contract Award for the Audit of Capital and Direct Medical Education Costs," October 11, 2006.
- ¹² OIG, D-2008-6-005, "Report of Actions on Incurred Cost Audits by the Supervisor of Shipbuilding, Conversion, and Repair, Groton, Connecticut," May 5, 2008.
- ¹³ OIG, D-2007-6-010, "Reimbursement of Settlement Costs at Defense Contract Management Agency, Melbourne," September 28, 2007.
- ¹⁴ Naval Audit Service Report N2008-0048, "Administration of Contracts with Labor Hours at Selected Naval Air Systems Command Activities," September 5, 2008.
- ¹⁵ Air Force Audit Agency Report, F2008-0006-FC1000, "Air Force Contract Augmentation," June 9, 2008.
- ¹⁶ A-2008-0151-ALO, "Logistics Support Contract, Fort Carson, Colorado," June 13, 2008.
- ¹⁷ OIG, D-2009-047, "DoD Testing Requirements for Body Armor," January 29, 2009
- ¹⁸ OIG, D-2009-036, "Acquisition of the Air Force Second Generation Wireless Local Area Network," January 16, 2009.
- ¹⁹ OIG, D-2008-111, "DoD IG Report to Congress on Section 324 of the National Defense Authorization Act for Fiscal Year 2008, Review of DoD Guidelines on Considering Civilians for New and Contracted Functions," July 23, 2008.
- ²⁰ Chapter 146 of Title 10, United States Code §2463.
- ²¹ OIG, D-2009-005, "Controls Over the Contractor Common Access Card Life Cycle," October 10, 2008.