Audit Report

OFFICE OF THE INSPECTOR GENERAL

"SUPER" SCIENTIFIC, ENGINEERING, AND TECHNICAL ASSISTANCE CONTRACTS AT THE BALLISTIC MISSILE DEFENSE ORGANIZATION

Report No. 94-077 April 8, 1994

This special version of the report has been revised to omit contractor sensitive and Privacy Act data.

Department of Defense

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Acronyms

ARI	Applied Research, Incorporated
BMDO	Ballistic Missile Defense Organization
COTR	Contracting Officer's Technical Representative
DFARS	Defense Federal Acquisition Regulation Supplement
DSA	Decision Sciences Applications, Incorporated
FAR	Federal Acquisition Regulation
FR/IQ	Fixed-Rate/Indefinite Quantity
G&A	General and Administrative Expenses
GRC	General Research Corporation
SETA	Scientific, Engineering, and Technical Assistance
TBE	Teledyne Brown Engineering

INSPECTOR GENERAL
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April 8, 1994

MEMORANDUM FOR COMPTROLLER OF THE DEPARTMENT OF DEFENSE
DIRECTOR, BALLISTIC MISSILE DEFENSE ORGANIZATION
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on "Super" Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization (Report No. 94-077)

We are providing this report for your review and comment. The audit was performed as part of the audit of the procurement system and role of support services contractors at the Ballistic Missile Defense Organization as requested by the Secretary of Defense. This is the first in a series of reports from the audit. Comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all audit recommendations be resolved promptly. As a result of management comments, we revised the findings, monetary benefits, and one recommendation. Therefore, the Director, Ballistic Missile Defense Organization must provide comments on the unresolved recommendations and monetary benefits by June 9, 1994. See Appendix D for the unresolved recommendations and the specific requirements for your comments.

We appreciate the courtesies extended to the audit staff. If you have any questions on this audit, please contact Mr. Garold E. Stephenson, Audit Program Director, at (703) 692-3179 (DSN 222-3179) or Mr. Henry F. Kleinknecht, Audit Project Manager, at (703) 692-3288 (DSN 222-3288). The distribution of this report is listed in Appendix G. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

This special version of the report has been revised to omit contractor sensitive and Privacy Act data.

Office of the Inspector General, DoD

Report No. 94-077 **April 8, 1994**
(Project No. 2CH-5031)

"SUPER" SCIENTIFIC, ENGINEERING, AND TECHNICAL ASSISTANCE CONTRACTS AT THE BALLISTIC MISSILE DEFENSE ORGANIZATION

EXECUTIVE SUMMARY

Introduction. This is the first in a series of reports from an audit requested by the Secretary of Defense of the procurement system and role of support services contractors at the Ballistic Missile Defense Organization (BMDO). From April 1988 through September 1992, BMDO obtained about 3.2 million staff hours of support services costing $262 million under three "super" scientific, engineering, and technical assistance (SETA) contracts with The Analytic Sciences Corporation (the contractor), The BDM Corporation, and the Riverside Research Institute. The three super SETA 5-year cost-plus-award-fee, level-of-effort, term contracts had identical provisions.

Objectives. The overall objective of the audit was to evaluate the effectiveness of the procurement system and the role of support services contractors at BMDO. Specific objectives of this audit were to determine whether use of support service contractors was cost effective; whether the contract administration process and applicable internal controls were effective; and whether costs charged to contracts were allowable, reasonable, and allocable.

Audit Results. Contracted super SETA services were not cost-effective, and although the contract type offered BMDO flexibility, the contracts provided inadequate financial accountability and little incentive for contractors to control costs.

- Services acquired through the super SETA contracts are more costly than using in-house DoD civilian and military employees. We calculated BMDO could reduce costs by about $46 million for FYs 1995 through 1999 by gradually reducing its super SETA contract support by 275 staff years and hiring DoD civilian employees to accomplish its mission (Finding A).

- The BMDO contracting officer did not establish adequate procedures for effective cost control and did not effectively manage super SETA contract SDIO84-88-C-0018 (the contract) valued at about $109.2 million. As a result, total contract costs for labor, indirect costs, and other direct costs increased by almost $26.9 million; the contractor's award fee increased commensurately with increased performance costs; and the risk of personal services contracting increased (Finding B).

- The BMDO contracting officer did not administer the award fee in accordance with contract terms. As a result, BMDO paid an award fee of $481,365 that was not in accordance with contract terms, and BMDO may have provided the contractor a competitive advantage over the other two super SETA contractors (Finding C).

- The contractor charged facility and administrative and clerical support costs as direct costs to the contract and also as part of the overhead rate, and acquired general purpose equipment as Government property and received a fee on the costs of the equipment. In addition, the contractor did not comply with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose." As a result, BMDO paid the contractor questioned costs of $ * million as direct costs for facility and administrative

*Proprietary data removed.

and clerical support without reducing overhead rates, allowed the contractor to purchase $ * of general purpose equipment as Government property that should have been financed by the contractor, and paid the contractor an award fee of $71,196 on the Government property (Finding D).

- The contractor billed BMDO questionable costs for coffee and tea services, catered meals, and kitchen appliances as direct costs to the contract. The contractor also did not comply with Cost Accounting Standard 402 for coffee and tea services. As a result, $ * of questioned costs were charged to the contract (Finding E).

- The contractor and its subcontractors staffed projects in the Washington, DC, area with out-of-town employees and did not reduce per diem rates for employees on long-term temporary duty. As a result, BMDO paid more than $700,000 on four task orders to staff projects in the Washington, DC, area with out-of-town employees, and employees on long-term temporary duty received $53,904 of questionable per diem (Finding F).

Internal Controls. We identified material internal control weaknesses at BMDO in the acquisition of support services and administration of the super SETA contracts. See Part I for the internal controls reviewed and Part II for details on the weaknesses.

Potential Benefits of Audit. BMDO could reduce costs $46 million by reducing its super SETA contract support for FYs 1995 through 1999 and by hiring DoD civilian employees to accomplish its mission. BMDO should also initiate action to recover about $2.2 million from the contractor for questioned costs. Implementation of other recommendations will strengthen the internal controls for contract administration by increasing BMDO contract oversight. Appendix E summarizes potential benefits from the audit.

Summary of Recommendations. We recommended that BMDO reduce contracted services and use more DoD civilian personnel to accomplish its mission, use completion and fixed-price type contracts, establish additional contract management and cost control procedures, perform cost realism analysis, justify contractor-acquired Government property, document contract changes, and initiate action to recover questioned costs. We also recommended that the administrative contracting officer notify the contractor of the contractor's noncompliance with Cost Accounting Standard 402.

Management Comments. The Deputy Comptroller of the Department of Defense (Management Systems) and the Director, Defense Logistics Agency, generally agreed with the recommendations directed to them. BMDO agreed that $46 million would be saved by reducing its contracted services and using DoD civilian personnel to accomplish its mission. BMDO also agreed that the administrative effort required to properly manage the type of contract used was excessive and the resources were not available. BMDO disagreed that a requirement existed to justify and document maximum award fees negotiated on cost-plus-award-fee contracts and that contract changes were not documented. BMDO also disagreed on who should provide the contractor with technical direction and direct the contractor's level of activity and labor mix. A summary of management comments on the recommendations is in Part II, and a summary of comments on the findings is in Part III. See Part IV for the full text of management comments on this report.

Audit Response. We disagree that contracting officers are not required to justify and document the maximum award fees established for cost-plus-award-fee contracts. We also disagree that the contracting officer's technical representative should be directing the contractor's labor mix and level of activity.

*Proprietary data removed.

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This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Part I - Introduction

three super SETA contractors. The contract type offered BMDO flexibility but less financial accountability and provided little incentive for contractors to control costs.

The three super SETA contractors supported BMDO in areas such as management and programmatic/technological development of weapon systems and sensor systems, all phases of program management support for the Brilliant Pebbles system, and definition of the overall system architecture.

The largest of the three super SETA contracts, SDIO84-88-C-0018, awarded to The Analytic Sciences Corporation, had a total estimated cost of $167.5 million, a level of effort of 3.1 million staff hours, a maximum award fee of $25.1 million, and a 5-year performance period. As of March 31, 1993, The Analytic Sciences Corporation had incurred costs on contract SDIO84-88-C-0018 of about $136.1 million, delivered about 1.8 million staff hours, and received an award fee of about $17.8 million. For the same period, The BDM Corporation had incurred costs of about $112.2 million, delivered about 1.5 million staff hours, and received an award fee of about $15.1 million, and the Riverside Research Institute had incurred costs of about $35.4 million, delivered about 600,000 staff hours, and received an award fee of about $3.8 million.

On March 26, 1993, BMDO issued "bridge contracts" to the three super SETA contractors to continue program and management support. BMDO issued 12-month, not-to-exceed, letter contracts to The Analytic Sciences Corporation, The BDM Corporation, and the Riverside Research Institute for $31.3 million, $22.1 million, and $2.8 million, respectively.

Objectives

The audit was made at the request of the Secretary of Defense to evaluate the effectiveness of the procurement system and the role of support contractors at BMDO. The Director, BMDO, recommended that the General Counsel, DoD, and the Director of Defense Procurement jointly review BMDO's use of contractor support. The Secretary of Defense decided that the Inspector General, DoD, should perform the review. This is the first of a series of reports in response. Other reports will cover BMDO Small Business Administration section 8(a) support services contracts and qualifications of the BMDO acquisition corps to manage the program and evaluate work of support services contractors.

Specific objectives of this audit were to determine whether:

- use of support service contractors was cost-effective;

- the contract administration process and applicable internal controls were effective; and

- costs charged to contracts were allowable, reasonable, and allocable.

We did not assess whether internal controls were adequate to preclude contractors from any conflicts of interest or performance of inherently Governmental functions because the area had recently been reviewed by the staff of the Senate Subcommittee on Federal Services, Post Office, and Civil Service, Committee on Governmental Affairs.

Scope and Methodology

Review of Super SETA Contracts. We reviewed the three basic super SETA contracts, related modifications, and monthly management status reports from March 31, 1988 (date contracts were awarded) through September 30, 1992. The total labor costs, other direct costs, and award fee earned for the three super SETA contracts for that period was $262,360,960. The total level of effort delivered was 3,191,649 staff hours. Total travel costs for the period were $7,939,515.

Detailed Review of Contract SDIO84-88-C-0018. We reviewed The Analytic Sciences Corporation's best and final offer, the basic contract, the contract modifications, the task plans, the task orders, the audit reports, and the invoices to determine whether billings were in accordance with applicable laws, procurement regulations, and contract terms. Our review focused on costs charged to the contract from its inception through September 30, 1992. As of September 30, 1992, The Analytic Sciences Corporation had incurred labor costs and other direct costs on the contract of about $109.2 million, had delivered about 1.5 million staff hours, and had received an award fee of about $14.5 million. The Analytic Sciences Corporation's travel costs were about $3.5 million. We also reviewed DoD and contractor policies for charging facilities, property, other direct costs, travel, and labor costs. We interviewed BMDO officials, the contracting officer and the contracting officer's technical representatives (COTRs), the administrative contracting officer, and Defense Contract Audit Agency officials. We performed audit work at The Analytic Sciences Corporation and five of its major subcontractors: Applied Research,

Incorporated (ARI); Decision Sciences Applications, Incorporated (DSA); General Research Corporation (GRC); SPARTA, Incorporated (SPARTA); and Teledyne Brown Engineering (TBE).

Detailed Review of Task Orders on Contract SDIO84-88-C-0018. We examined labor costs, award fees, other direct costs, and travel claims for The Analytic Sciences Corporation and subcontractor employees, as well as for consultants that were charged to task orders 42, 55, 62, 65, and 69. From inception of each task order through September 30, 1992, the task orders had a total value of about $76.7 million. The labor costs were $60.1 million, other direct costs were $5.2 million, travel costs were $2.6 million, and the award fee earned was $8.8 million. We reviewed all labor costs and award fees, $2.2 million of other direct costs, and $1.9 million of travel claims. In addition, we selectively reviewed the resumes of professional contractor employees and compared their stated qualifications to contract requirements.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from April 1992 through September 1993. The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. Accordingly, we included such tests of internal controls as were considered necessary. We used computer-processed data from the contractor's job cost report and detail of selected costs incurred report to accomplish the audit objectives. We compared computer-processed data to source documents and determined the data to be reliable. Organizations visited or contacted are listed in Appendix F.

Internal Controls

Internal Controls Assessed. BMDO had operating instructions relating to maintaining contract files, performing prenegotiation reviews, using undefinitized contractual actions, issuing contract task orders, and providing facilities to contractors. We reviewed BMDO's internal controls to determine whether contracting officers and contractors complied with the operating instructions, the DoD Directives, the Federal Acquisition Regulation (FAR), the Defense Federal Acquisition Regulation Supplement (DFARS), the specific contract sections, and the Cost Accounting Standards. The complete text of the FAR criteria is in Appendix A. The complete text of the contract sections used as criteria is in Appendix B.

Implementation of DoD Internal Management Control Program. For BMDO, the key elements of the internal management control program were the participation of senior management and the evaluation and development of

more detailed policy and procedures. In 1988, BMDO issued an internal management control report that addressed steps to improve the tasking and administration of management support contracts. The improvements included developing a uniform contract format, providing additional COTR training, consolidating support requirements into the three super SETA contracts, and establishing one program manager for centralized management and control of the three super SETA contracts. BMDO also performed risk assessments of the contract management function, developed contract operating instructions, and performed informal reviews of the procurement system as part of the implementation of the internal management control program.

Internal Control Weaknesses Identified. The audit identified material internal control weaknesses as defined by DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987. Internal controls for contract administration and management were not adequate to document in contract files the basis for establishing the maximum award fee and use of cost-reimbursement contracts. Further, internal controls did not provide effective cost controls, did not verify whether contract changes were directed by the contracting officer, did not verify whether cost realism analysis was performed, did not prevent COTRs from directing the contractor's level of activity and labor mix, did not validate compliance with contract terms, did not prevent charging the same costs directly and indirectly to the contract, did not justify contractor acquisition of Government property, and did not control contractor travel costs. Recommendations A.2.f., A.2.g., A.2.h., B.1.b., B.2.a., B.2.b. C.2.a., C.2.b., D.2.a., D.2.b., D.2.c., and F.2., if implemented, will correct the weaknesses. The monetary benefits that can be realized by implementing the recommendations related to internal controls are described in Appendix E. A copy of the report will be provided to the senior official responsible for internal controls within the Office of the Under Secretary of Defense for Acquisition and Technology.

Prior Audits and Other Reviews

No audits or procurement management reviews performed within the past 5 years related specifically to the effectiveness of the procurement system and role of support contractors at BMDO. The Senate Committee on Governmental Affairs reviewed service contracting at BMDO, and the following audits and reviews addressed issues that were relevant to the audit.

Senate Hearing. On July 24, 1992, the Senate Committee on Governmental Affairs hearing, "The Star Wars Program and the Role of Contractors," addressed the extensive use of support contractors by BMDO to manage research programs. Based on Senate Committee on Governmental Affairs analysis, three major concerns with BMDO's use of support contractors were:

- over-reliance upon contractors to perform the most sensitive internal work of the program,

- extensive reliance on contractors, making the program susceptible to potential conflicts of interest, and

- excessive costs for support contractors when compared with costs for DoD civilian employees.

Inspector General, DoD. Report No. 91-115, "Consulting Services Contracts for Operational Test and Evaluation," August 22, 1991. The report stated that the Military Departments' operational test agencies frequently used the same services contractors that participated in the development of the systems to support operational tests for major Defense acquisition systems. The Director, Operational Test and Evaluation, and the test agencies also used repeated and extended services contracts that were not as cost-effective as developing an in-house capability to support operational tests. Recommendations were made to initiate additional procedures and internal controls and to replace services contractors with DoD civilian employees. Management agreed to establish internal controls that would prevent services contractors who participated in the development of systems from supporting the operational tests of those systems. Management nonconcurred with the recommendations to replace services contractors with DoD civilian employees. The recommendation to replace services contractors with DoD civilian employees was referred to the Deputy Secretary of Defense for resolution. In his April 23, 1992, memorandum, the Deputy Secretary of Defense directed:

> 1. The Assistant Secretary of Defense for Force Management and Personnel, in coordination with the Secretaries of the Military Departments, the Director of Operational Test and Evaluation, and the Comptroller of the Department of Defense, shall review the use of civilian employees and contractor support in operational test activities in the Department of Defense and recommend to me by July 1, 1992, any changes to policy or practice that may be appropriate to increase the efficiency of use of human resources by those activities.
>
> 2. The General Counsel of the Department of Defense, in coordination with the Secretaries of the Military Departments and the Director of Operational Test and Evaluation, shall review indefinite quantity, task order contracts used by

> Department of Defense operational test activities for compliance with law and Department of Defense policy and provide to them such legal advice as may be appropriate as a result of that review.

Report No. 92-120, "Reasonableness of Costs Charged to Support Services Contract MDA903-88-D-0018," June 30, 1992. The report stated that the Defense Supply Service-Washington contracting officer and the Army Operational Test and Evaluation Command COTRs were not adequately administering the contract, and both the administrative contracting officer and Defense Contract Audit Agency had been removed from the contract administration process. Recommendations were made to initiate additional procedures and additional internal controls, to reinstate the administrative contracting officer and Defense Contract Audit Agency in the contract administration process, and to recover unallowable costs. Management concurred with the recommendations and collected $102,035 of questioned costs.

Deputy General Counsel (Acquisition and Logistics). Memorandum for the General Counsels of the Military Departments and Defense Agencies, "Review of Contracts Supporting Operational Test and Evaluation," April 5, 1993. The review disclosed that most of the contracts in place at the operational test activities of the Military Departments contained vague, generic statements of work. The Deputy General Counsel (Acquisition and Logistics) concluded that the contracts did not feature detailed statements of work from which specific supplies or services could be ordered for delivery and that the use of delivery orders to acquire staff hours of effort rather than to schedule delivery of specific predefined supplies or services did not comply with FAR 16.504, "Indefinite-quantity Contracts." Further, when delivery orders required that contractors provide no more than labor hours in the performance of various mission-related functions, the risk increased substantially that the arrangement violated FAR 37.1, "Service Contracts-General," regarding personal services contracting.

Director of Defense Procurement. "Department of Defense Review of Services Contracts for the Director, Office of Management and Budget," June 30, 1993. The review determined that DoD had adequate policies and procedures for monitoring services contracts, for evaluating their cost effectiveness, for holding contractors accountable for results, and for ensuring that the services performed by contractors were not inherently Governmental functions. The review also concluded that services contracts were accomplishing their objectives. The review examined a random sample of 42 contracts including 3 BMDO contracts. The report contained no recommendations.

Other Matters of Interest

The National Defense Authorization Act for Fiscal Year 1993 Conference Report, section 236, "Limitation Regarding Support Services Contracts of the Strategic Defense Initiative Organization," October 1, 1992, provided that BMDO could not spend more than $135 million for the procurement of contract support services for FY 1993. The conference report stated:

> The conferees are aware that only 259 federal employees were assigned to SDIO [Strategic Defense Initiative Organization] in August 1992 to manage the largest single R&D [research and development] program in the Defense Department, and that SDIO has used contracts to procure the technical, scientific, and engineering support required to accomplish its mission. The conferees urge the Director of SDIO to minimize the disruption caused by this limitation by first reducing contracts for administrative, clerical, management support, studies and analysis, and consultant services.
>
> The Secretary of Defense is directed to undertake a study of the civilian and military manning levels in SDIO in order to determine the number and qualifications of civil service employees required to provide the services SDIO has previously been procuring by contract. The Secretary shall take actions to ensure that SDIO has sufficient civilian and military personnel to accomplish its mission as defined in the Missile Defense Act.

Finding A discusses the results of the BMDO study of DoD civilian and military manning levels in BMDO.

Part II - Findings and Recommendations

Finding A. Cost-Effectiveness of Contracted Services

The BMDO contracting officer awarded three cost-plus-award-fee, level-of-effort, term super SETA contracts that were not as cost-effective as using in-house DoD civilian and military employees or fixed-price contracts. BMDO awarded the super SETA contracts because BMDO was not authorized sufficient in-house employees to perform its mission. Also, the contracting officer could not provide documentation to justify the use of cost-type contracts or the basis for establishing the maximum award fee. We calculated that BMDO could reduce costs about $46 million by gradually reducing its super SETA support by 275 staff years for FYs 1995 through 1999 and by hiring DoD civilian employees to accomplish the BMDO mission.

Background

Use of Contracted Advisory and Assistance Services. DoD Directive 4205.2, "Acquiring and Managing Contracted Advisory and Assistance Services (CAAS)," February 10, 1992, provides policy, responsibilities, and procedures for the management, acquisition, and use of contracted advisory and assistance services to meet DoD requirements. DoD Directive 4205.2 applies to advisory and assistance services acquired directly by contract from non-Governmental sources to support or improve organization policy development, decision making, management and administration, program and project management and administration or to improve the effectiveness of management processes or procedures. Such services may take the form of information, advice, opinions, alternatives, analyses, evaluations, recommendations, training, and technical support.

DoD Directive 4205.2 provides the following guidelines that should be used to determine when contracted advisory and assistance services are an appropriate resource:

> a. When suitable in-house capability is unavailable or cannot be obtained in time to meet the needs of the DoD Component, or it is not cost-effective to establish an in-house capability (for example, because the special or unique skills or expertise are not required full-time).

> b. When the requirement is anticipated to be of a short-term, temporary period of time. If the requirement is for a long or continuing period, an analysis should be performed to determine if in-house or contracting out is the most efficient means of performance.

Further, DoD Directive 4205.2 states that contracted advisory and assistance services may not be continued for longer than 5 years without review for compliance with DoD Directive 4205.2 by the DoD Component contracted advisory and assistance services Director or designee.

BMDO Contract Operating Instructions. BMDO Operating Instruction 01, "Contract Files," May 29, 1990, requires each contracting officer to establish files containing the records of all contractual actions. BMDO Forms 85 and 86, "Contract File Checklists," describe the required documentation. BMDO Operating Instruction 02 (Revision 1), "Prenegotiation Reviews," May 1, 1993, requires a prenegotiation memorandum or briefing for all acquisitions of supplies or services expected to have a value of $25,000 or more.

Guidance on Retired Military Personnel Pay. Title 5, United States Code, section 5532 (5 U.S.C. 5532), "Employment of Retired Members of the Uniformed Services; Reduction in Retired or Retainer Pay," provides guidance on the reduction of retired or retainer pay for retired military officers working for the Government. Section (g)(1) states the Director of the Office of Personnel Management may, at the request of the head of an Executive agency:

> . . . waive the application of the preceding provisions of this section on a case-by-case basis for employees in positions for which there is exceptional difficulty in recruiting or retaining a qualified employee.

Title 10, United States Code, section 2397b (10 U.S.C. 2397b), "Certain Former Department of Defense Procurement Officials: Limitations on Employment by Contractors," provides guidance for a person who is a former military officer or DoD employee or a former or retired member of the armed forces about accepting compensation from a contractor during the 2-year period beginning on the date of the person's separation from service in DoD.

Cost-Effectiveness of Contracted Super SETA Services

Contractor Staff-Year Costs. We calculated The Analytic Sciences Corporation (the contractor),[1] staff-year costs by labor category for five task orders (task orders 42, 55, 62, 65, and 69) on contract SDIO84-88-C-0018 (the contract),[1] using 1,860 staff hours to establish staff-year costs. The staff-year costs for each labor category were based on the contractor's burdened hourly labor costs. Burdened costs consist of direct labor, overhead, general and administrative expense (G&A), and award fee earned. As of September 30, 1992, the contractor provided 331,075 staff hours for a burdened labor cost of $28,774,941 on the five task orders.

Table 1 provides a summary of the high, low, and average (mean) staff-year costs by labor category for the contractor personnel.

Table 1. Range of Contractor Staff-Year Costs

Labor Category	High	Low	Average
2	$369,950	$118,070	$218,891
	300,309	104,526	188,044
	268,088	96,167	153,112
	268,088	67,175	145,897
	126,684	91,219	101,160
	124,376	81,183	96,958
	95,426	51,576	74,567

DoD Civilian, Military, and Fixed-Price Contract Staff-Year Costs. We compared the staff-year costs for contractor personnel to staff-year costs for DoD civilian and military personnel. The DoD civilian and military personnel costs were taken from a June 1992 Aeronautical Systems Division, Air Force Systems Command (now Air Force Materiel Command) study, ASD-TR-92-5009, "A Determination of Military and Civilian Personnel Costs as Related to a Member of Technical Staff." We also compared contractor personnel costs to personnel costs on a fixed-rate/indefinite quantity (FR/IQ) contract used by the Army Operational Test and Evaluation Command.

[1] For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

[2] Proprietary data removed.

Similar Minimum Personnel Requirements. The Army FR/IQ contract provided similar technical support for operational testing and continuous comprehensive evaluation of major Defense acquisition programs and nonmajor weapon systems the Army procures. The Army FR/IQ contract had similar minimum personnel requirements for comparable contract labor categories. For example, the minimum personnel requirements for the senior systems engineer-project leader on the Army FR/IQ contract were:

> Master's degree in an engineering discipline or closely related discipline (e.g., Operations Research, Physics, Mathematics) plus ten years experience in military systems design, development, and test. At least two years of experience in the preparation of requests for proposals, including specifications, technical proposal requirements, schedule, data item requirements, etc., for the operational testing of Major, Category I or DAP [Defense Acquisition Program] systems. Also, experience shall include software verification and validation efforts with at least two years experience as program manager or at a project supervisory level or equivalent experience.

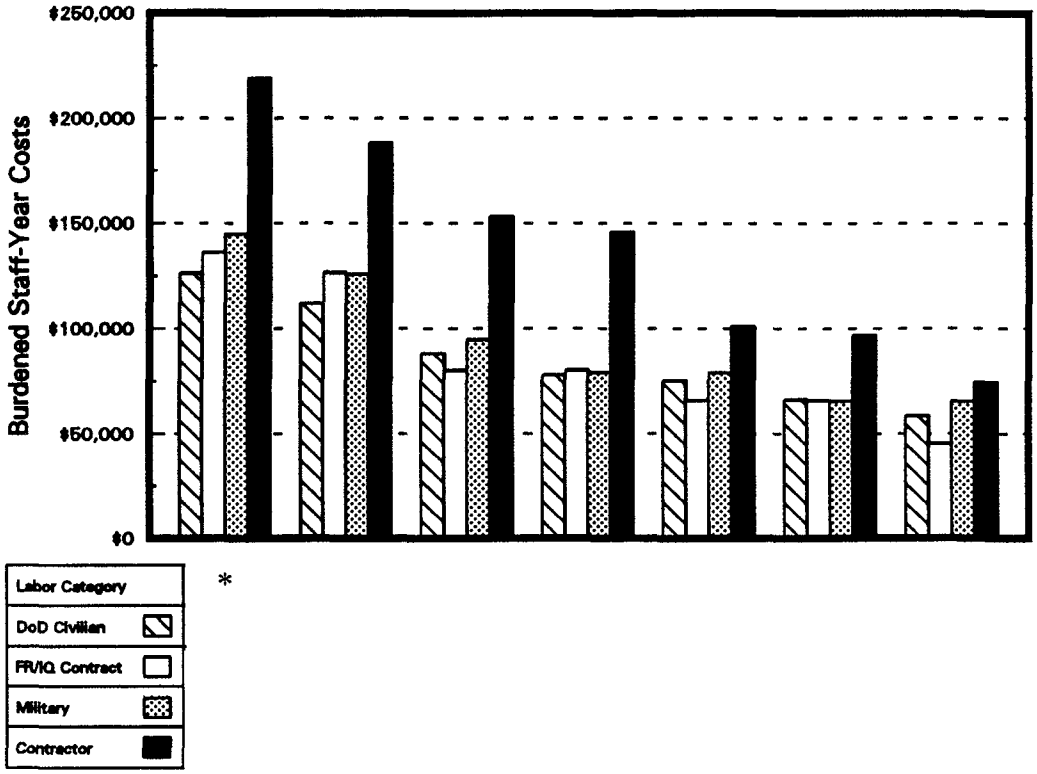
The BMDO contract requirements for a senior engineer/scientist were:

> (a) Education: bachelor's degree and an advanced degree in an engineering or scientific field related to the Work Area/Subarea (see SOW) [Statement of Work] in which the individual performs.
>
> (b) Qualifications: 5 years experience in one or more technological area directly related to the Work Area/Subarea in which the individual performs and 10 years experience in general engineering or related scientific field.

Staff-Year Costs Comparison. The average staff-year costs for contractor personnel were higher than costs for DoD civilian or military personnel in the same labor categories, or comparable personnel on the Army FR/IQ contract. For example, the average cost for a contractor * on the contract was 73 percent higher than a DoD civilian * 61 percent higher than a * leader on the Army FR/IQ contract, and 51 percent higher than a military * The composite cost (total cost divided by total hours) for contractor employees averaged about 62 percent more than the cost for DoD civilian employees.

Figure 1 compares staff-year costs for DoD civilian employees, Army FR/IQ contract employees, military employees, and contractor employees.

*Proprietary data removed.



*

Figure 1. Comparison of Burdened Staff-Year Costs

Subcontractor Staff-Year Costs. The staff-year costs for the contractor's five major subcontractors were also higher than staff-year costs for DoD civilian or military employees or contracted services on the Army FR/IQ contract. For example, the average staff-year cost for a subcontractor * was 61 percent higher than the cost for a DoD civilian * 50 percent higher than the cost for a * on the Army FR/IQ contract, and 41 percent higher than the cost for a military *

Award Fee and Administrative Cost on Subcontractor Costs. The BMDO costs for subcontractor work included an award fee for both the contractor and subcontractor and a subcontract administrative cost for the contractor. These additional award fee and subcontract administrative cost factors could increase subcontractor costs by a maximum of 29.74 percent. The award fee and subcontract administrative cost factors included maximum award fees of percent for the contractor and percent for subcontractors and a subcontract administrative cost factor of percent for the contractor. The factors are applied to each other, so the total factor exceeds the sum of the

*Proprietary data removed.

three factors. The total subcontractor costs to BMDO for the five task orders reviewed was $34,042,499, which included award fees and subcontract administrative costs of $7,123,166, or a 26.46 percent increase from actual subcontractor costs.

Figure 2 shows the burdened staff-year costs for subcontractors on the contract and the impact of the award fee and subcontract administrative cost factor on the staff-year costs.

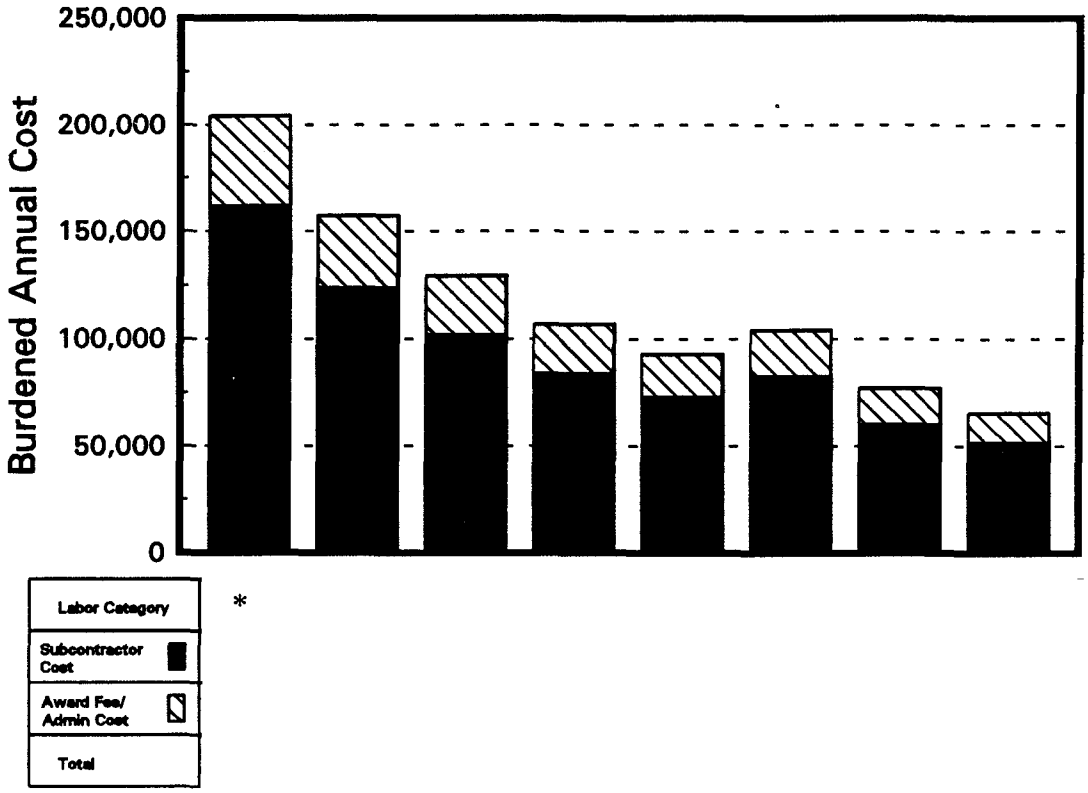


Figure 2. Burdened Staff-Year Costs for Subcontractors

Other Contractors' Award Fee or Profit and Administrative Cost on Subcontractor Costs. The maximum award fee and subcontract administrative cost factors for subcontractor work on the second-largest super SETA contract was 35.82 percent. The fee and subcontract administrative cost factor included maximum award fees of * percent for the prime contractor, * percent for the subcontractors, and a subcontract administrative cost of * percent for the prime contractor. As of September 22, 1992, total costs on the second largest contract were about $92 million (excluding travel) with subcontract costs totaling about $51 million, or 55 percent. By comparison, the

*Proprietary data removed.

total composite mark-up factor for subcontractor costs on the Army FR/IQ contract was 15.44 percent. The profit and subcontract administrative cost factor included a prime contractor profit of * percent, a subcontractor profit of * percent, and a subcontract administrative cost of * percent for the prime contractor.

Establishment of a Maximum Award Fee Objective and Justification for Maximum Award Fee Negotiated. BMDO could not provide documentation that the contracting officer ever established a prenegotiation objective for establishing the maximum contract award fee percentage required by FAR 15.807, "Prenegotiation Objectives." Further, no documentation justified the basis for determining the negotiated maximum award fee percentage required by FAR 15.808, "Price Negotiation Memorandum." We believe that establishing a 15 percent maximum award fee for the prime contractor and a maximum award fee of 9 or 15 percent for the prime contractor on subcontractor costs and maximum award fee was excessive, based on the profit analysis factors in FAR 15.905-1, "Common Factors." FAR 16.301-3, "Limitations," implements the maximum fee allowed by statutory limitations for experimental, developmental, or research work at 15 percent.

Military Personnel

Need for Retired Military. BMDO needs experienced personnel who are familiar with the BMDO mission and who understand the DoD acquisition system. Military personnel, who gained this knowledge and experience working for the Government, upon retirement were hired by support services contractors to provide BMDO the needed expertise.

Compensation of Retired Military. Dual compensation provisions require retired military officers to take reduced retired pay if they obtain a DoD civilian position unless they obtain a waiver from the Director of the Office of Personnel Management. Consequently, the reduced retired pay is a disincentive for retired military officers to become DoD civilian employees.

Hiring Restrictions on Retired Military. Retired military personnel may obtain jobs with DoD contractors with no reduction in retired pay, but may be prohibited from accepting employment with a contractor for 2 years if the job involves matters for which they were responsible during the last year of active duty, as required by 10 U.S.C. 2397b. We did not identify any military personnel that did not follow the proper procedures before obtaining employment with the contractor. However, the use of retired military personnel as support services contractors is not as cost-effective as hiring them back as DoD civilians

*Proprietary data removed.

and paying them their full military retirement benefits. We believe BMDO should request exemption from the DoD hiring freeze to reach retired military personnel and request dual compensation waivers for military personnel that retire and apply for key DoD civilian positions.

Retired Military Contractor Staff. Contractor and subcontractor staff members, as well as consultants, were retired military personnel who previously worked at either BMDO or related Army and Air Force major commands. We identified 27 retired military officers (8 generals, 11 colonels, 6 lieutenant colonels, and 2 majors) who worked for the contractor, its subcontractors, or as consultants to the contractor on task orders 55, 62, 65, and 69. Five of the retired military officers previously held key positions at BMDO. For example, one retired colonel, who was formerly the BMDO Director for Strategic Architecture, worked for one of the contractor's subcontractors as the Brilliant Pebbles Integration Support Subtask Leader. Another retired colonel, who had served as the BMDO Director for Test and Evaluation, was the contractor's Brilliant Pebbles Task Manager. A third retired colonel, who had been the BMDO Chief of Program Elements, was the Architecture Integration Study Task Manager for the contractor. In addition, a retired major general, who was formerly the BMDO Deputy Director and Source Selection Authority for the contract, became a consultant to the contractor. Each retired military officer received full military retired pay while working on the contract.

Costs for Retired Military as DoD Contractors. The burdened staff-year costs were significantly less for active-duty military personnel and DoD civilian employees with full military retirement benefits than the burdened costs for retired military personnel working for the contractor. For example, the staff-year cost for an active-duty * was $185,253; the staff-year cost for a retired * working as a DoD civilian employee with full military retirement benefits was $223,996; while the retired * working for the contractor with full military benefits cost about $340,442, about 52 and 84 percent more, respectively.

Figure 3 compares costs of active-duty military, retired military working as DoD civilian employees with full military benefits, and retired military officers working for the contractor with full military benefits.

*Proprietary data removed.

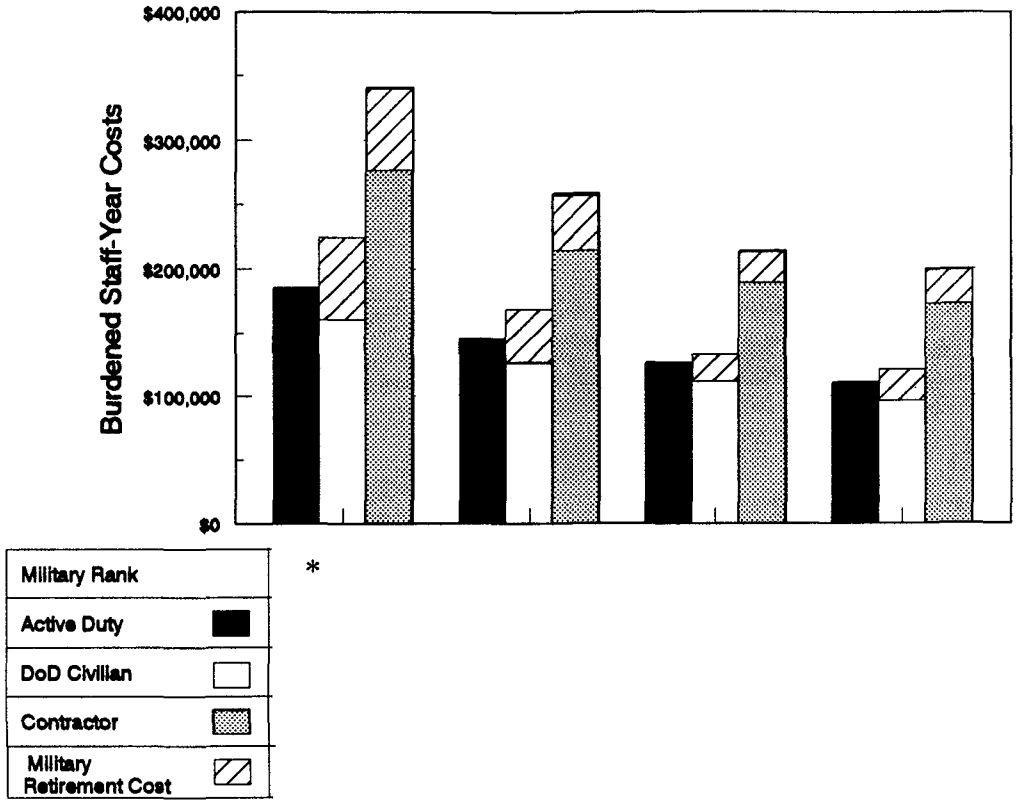


Figure 3. Comparison of Staff-Year Costs for Active-Duty Military, Retired Military Working as DoD Civilian Employees, and Retired Military Officers Working for the Contractor

Consultant Costs

The contractor charged BMDO a total of $2,233,153 for consultants on task orders 55, 62, 65, and 69 through September 1992. Eight of the consultants were retired military officers (six generals, one colonel, and one lieutenant colonel) who cost BMDO $664,006.

Tasks Performed by Consultants. The retired military officers performed tasks that we believe BMDO program officials should perform. The tasks included reviewing the acquisition strategy and the major defense acquisition program process; attending BMDO Board of Directors meetings; reading reports to Congress; reviewing and critiquing briefings; reviewing DoD

*Proprietary data removed.

Directive 5000.1, "Defense Acquisition," and DoD Instruction 5000.2, "Defense Acquisition Management Policies and Procedures;" preparing a Total Quality Management plan; providing other daily support; and attending meetings.

Compensation Paid to Consultants. Although the contract required contracting officer approval of consultants, the contractor was not required to get BMDO approval for the amount of compensation paid to consultants. We believe the contracting officer should approve the amount of compensation paid to consultants on cost-reimbursement contracts when the costs are not identified in the task plans.

Table 2 provides a summary of the daily rates for consultants who were retired military officers and the total costs charged to the four task orders. The consultants did not have normal overhead costs because they worked either at BMDO or at a contractor facility.

Table 2. Cost of Retired Military Consultants

Rank	Daily Rate	Contract Cost
*	$1,000	$ 84,108
	850	5,441
	700	34,213
	960	49,758
	700	56,871
	600	136,967
	500	122,768
	600	173,880
Total		$664,006

BMDO Manpower Authorizations

BMDO continuously tried to increase its manpower authorization with little success. In March 1992, the Director, BMDO, reported 46 contracts, valued at more than $630 million, for systems engineering and technical assistance. The annual support provided by these contracts was 1,348 staff years. BMDO was authorized 259 military and DoD civilian employees for FY 1992. In May 1992, BMDO conducted a manpower requirements review that showed current authorizations of 270 employees and manpower requirements of 723, a difference of 453 new positions. The 453 new positions would reduce contractor support by 420 staff years.

*Proprietary data removed.

Table 3 provides a chronology of actions taken by BMDO to increase its staff.

Table 3. Chronology of BMDO Actions to Increase Staff

Year Action Taken	Action Taken	Staff Authorized
1987		223
1988	40-space increase approved.	263
1989	Requested 87-space increase. Increase approved in FY 1990 FYDP [5-Year Defense Plan] for growth to 350.	350
1990	Execution of 87-space increase denied. DoD Comptroller deletes increase from data base. Request for 35 of 87 spaces denied.	263
1991	Request for 21 spaces for theater missile defense 12 spaces approved for growth to 275. Exemption from management headquarters reductions denied, reduced by 11 spaces.	264
1992	6-space increase approved for theater missile defense for growth to 270 spaces. Request for deferment of 11-space management headquarters reduction denied. Manpower survey identified a requirement for an additional 453 Government positions.	259
1993	PBD [Program Budget Decision] 756 authorizes strength to 270 spaces. DoD Comptroller correction (+1) to 271 spaces. Management headquarters reduction (-11) spaces.	260
1994	100-space increase in FYDP authorized by PBD 756. Marine officer authorization (+1) space.	361

Cost-Effective Use of DoD Civilian Employees

Super SETA Contract Support Costs. BMDO obligated about $331 million on the three super SETA contracts and three super SETA bridge contracts for FYs 1989 through 1993, about $66 million annually. The obligated amount does not include travel costs. We calculated a composite hourly labor rate for the five task orders (42, 55, 62, 65, and 69) based on a total of 736,242 staff hours for contractor and subcontractor employees from the following labor categories: senior engineer/scientist, senior analyst, engineer/scientist, analyst, associate engineer/scientist, associate analyst, and graphics. The total burdened cost associated with the labor hours was $60,822,507 and did not include travel or other direct costs. The total burdened cost divided by the total staff hours resulted in the composite hourly labor rate of $82.61. Based on a staff year of 1,860 staff hours, we calculated that the contractor's staff-year cost was about

$153,659. Because annual super SETA contract support costs were about $66 million, we calculated that BMDO purchased about 431 staff years of support each year on the super SETA contracts.

Potential Benefits of Increased DoD Civilian Support. Using the DoD civilian employee staff-year costs identified in Figure 1, we developed a staff-year composite labor rate based on the same percentage from each labor category as the contractor composite labor rate. The composite staff-year cost for a comparable DoD civilian employee was $97,947. Consequently, we determined BMDO could reduce costs $55,712 per staff year, or 36.26 percent, by using DoD civilian employees versus super SETA contract support.

Table 4 shows the reduced costs associated with gradually replacing 275 staff years (55 staff years per year for 5 years) of super SETA contract support with DoD civilian employees.

Table 4. Benefits From DoD Civilian Support

Staff-years	1995	1996	1997	1998	1999	Total
55	$3,064,160	$3,064,160	$3,064,160	$ 3,064,160	$ 3,064,160	$15,320,800
55		3,064,160	3,064,160	3,064,160	3,064,160	12,256,640
55			3,064,160	3,064,160	3,064,160	9,192,480
55				3,064,160	3,064,160	6,128,320
55					3,064,160	3,064,160
275	$3,064,160	$6,128,320	$9,192,480	$12,256,640	$15,320,800	$45,962,400

Contract Type and Justification

Contract Type. The cost-plus-award-fee, level-of-effort, term contract offers flexibility to both the Government and contractor, but has several disadvantages including insufficient technical and financial accountability and inadequate incentives to control costs. For BMDO's purposes, the use of a cost-plus-award-fee, level-of-effort, term contract was not appropriate because BMDO had not established sufficient procedures and controls to monitor financial and technical performance as described in Findings B, C, D, E, and F. We believe the type of contract used was not appropriate to purchase staff hours of various labor categories identified in the contract. FAR 16.404-2, "Cost-plus-award-fee Contracts," provides guidance on cost-plus-award-fee contracts.

At the completion of the bridge contracts, BMDO will have 6 years of experience with the three super SETA contractors. This experience should permit BMDO to use some type of completion contract or firm-fixed price contract for the necessary labor categories on future super SETA contracts with only minimal risk to the contractors. BMDO currently plans to award a new super SETA contract or contracts at the completion of the bridge contracts in March 1994.

BMDO Contract Type Justification. BMDO could not provide the determination and findings required by FAR 16.301-3 to document that the cost-plus-award-fee, level-of-effort, term contract was likely to be less costly than any other contract type or that obtaining the supplies or services required without the use of this contract type was impractical. BMDO could have used some type of completion contract or fixed-price contract because firm-fixed labor rates for the contract labor categories could have been negotiated. The composition of the contract labor categories was not so unique or complex that the contractors could not have taken such risks into account when computing their bids.

Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract. (FAR 16.301-2,"Application")

Recommendations, Management Comments, and Audit Response

Management Comments and Audit Responses to the Finding. See Appendix C for a summary of management comments and the audit response to the comments.

1. We recommend that the Comptroller of the Department of Defense prepare alternative decision documents for Defense Resource Board consideration to provide the Ballistic Missile Defense Organization the necessary funds for increased DoD civilian staff years and reduced contracted services.

Comptroller of the Department of Defense Comments. The Deputy Comptroller (Management Systems) stated that the issue of appropriate staffing levels for BMDO had been raised on many occasions during the past several years, most notably during Defense Acquisition Board reviews of major BMDO programs and during the annual budget review. During the FYs 1993-1994 budget review, the Comptroller staff prepared a Program Budget Decision that recommended an increase in BMDO civilian end strength financed by reallocating funds previously budgeted by BMDO contractor services. This action, which was approved by the Deputy Secretary of Defense, was specifically taken to "reduce reliance on contractor personnel." The impact of that adjustment on BMDO operations would not have been realized when the audit was performed.

Based upon the actions already taken to increase BMDO end strength, significant reductions made to BMDO program funding levels, and the fact that a revised manpower requirements analysis will be required before the development of any future alternatives, the recommendation to propose further BMDO civilian staff increases was unnecessary. The Deputy Comptroller stated his analysts would continue to assess BMDO staffing requirements during the annual budget review and would prepare recommendations for alternative staffing/funding levels, if warranted, based upon the results of their review.

BMDO Comments. BMDO concurred with the recommendation and stated that it was on record with Congress, the Deputy Secretary of Defense, and other senior Office of the Secretary of Defense staff that it would use in-house decreased contractor support funding to pay for additional Government personnel. BMDO also stated that it had requested and received an exemption to the DoD hiring freeze.

Audit Response. The Comptroller of the Department of Defense comments are responsive to the intent of the recommendation. The cost comparison of contracted services and in-house DoD civilian employee support showed that in-house personnel were less costly to perform recurring requirements. BMDO has stated that a new manpower study will be initiated in March 1994 with a planned completion by June 1994. The new manpower study may determine that additional adjustments to the mix of in-house and contractor personnel are warranted.

2. We recommend that the Director, Ballistic Missile Defense Organization:

a. Conduct a new manpower-requirements study to determine the in-house DoD civilian staffing requirements needed to perform the Ballistic Missile Defense Organization mission.

Management Comments. BMDO concurred with the recommendation and stated a new manpower study would be initiated in March 1994 with planned completion by June 1994.

b. Gradually reduce super scientific, engineering, and technical assistance contract support for FYs 1995 through 1999 based on the results of the manpower requirements study in Recommendation 1, and hire DoD civilian employees to accomplish the Ballistic Missile Defense Organization mission.

Management Comments. BMDO concurred with the recommendation and stated that the results of the pending manpower study would form the basis for determining any additional manpower requirements. BMDO stated that the reduction in contractor support will result in monetary benefits of $45,962,400.

c. Request dual-compensation waivers for military personnel who retire and accept key DoD civilian positions.

Management Comments. BMDO concurred with the recommendation and stated dual compensation waivers would be requested where appropriate.

d. Establish procedures in operating instructions for contracting officers to approve the amount of compensation paid to consultants on cost-reimbursement contracts when the costs are not identified in task plans.

Management Comments. BMDO nonconcurred with the recommendation and stated that the FAR established detailed criteria for determining the reasonableness of consultant costs. Further, the audit had not demonstrated that compensation paid to consultants was unreasonable for the skill level required. BMDO stated the average cost for the retired military officer consultants was about 2 percent higher than the cost of an average active-duty military officer of the same rank. Also, the appropriateness of the qualifications of the consultant is primarily a determination for the technical person responsible for managing a task.

Audit Response. The finding identifies tasks performed by consultants that BMDO personnel should have performed. The contracting officer should ensure consultants are not required to perform those tasks. Further, consultant costs represented a significant direct cost element on the task orders reviewed. For cost-reimbursement contracts, the contracting officer should approve estimated consultant costs in task plans or replans to establish the appropriate contract fee or profit. Unless the estimated consultant costs are identified in the task plans or replans and approved by the contracting officer, the contractor

cannot receive profit or fee on the consultant costs. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

e. Establish procedures in operating instructions for contracting officers to analyze profit or fee based on profit-analysis factors that include contractor effort, contract cost risk, Federal socioeconomic programs, capital investments, cost-control and other past accomplishments, and independent development and to develop prenegotiation objectives.

Management Comments. BMDO nonconcurred with the recommendation and stated that DFARS 215.974 precludes a structured analysis of profit or fee on cost-plus-award-fee contracts.

Audit Response. Although DFARS 215.974 does not require a structured analysis, FAR 15.905-1 requires that contracting officers shall consider using profit-analysis factors when analyzing profit, whether or not using a structured approach, unless it is clearly inappropriate or not applicable. The profit-analysis factors to be considered include contractor effort, contract risk, and capital investments by the contractor. We request BMDO to reconsider its position and provide additional comments as part of its comments on the final report.

f. Establish procedures to verify that contract files for negotiated contracts include a price negotiation memorandum that documents the basis for determining the profit or fee prenegotiation objective and the profit or fee negotiated.

Management Comments. BMDO stated its contract file checklist provides that the weighted guidelines method for developing a prenegotiation profit objective is required with the negotiation memorandum for other than award fee contracts.

Audit Response. We agree that the weighted guidelines method is not required for developing a prenegotiation profit objective for award fee contracts. However, the contracting officer is required to document in the price negotiation memorandum the basis for determining the maximum award fee prenegotiation objective and the maximum award fee negotiated on cost-plus-award-fee contracts. FAR 15.807 states the contracting officer shall establish a prenegotiation objective before the negotiation of any pricing action including a profit or fee objective. FAR 15.808 states the contracting officer shall prepare a price negotiation memorandum that documents the basis for determining the profit or fee prenegotiation objective and the profit or fee negotiated. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

g. Establish procedures to verify that contract files for cost-reimbursement contracts include a determination and findings showing that the contract type selected is likely to be less costly than any other type or that obtaining supplies or services of the kind or quality required without the use of this contract type is impractical.

Management Comments. BMDO concurred with the recommendation and stated an internal agency instruction was issued on September 26, 1990, to correct the internal control weakness regarding documentation for cost reimbursement contracts. BMDO further stated that the files for all FY 1993 cost type contracts were reviewed and the required documentation was present in all files.

h. Discontinue the use of cost-plus-award-fee, level-of-effort, term contracts unless the contracting officer has established sufficient procedures for technical and financial accountability and adequate incentives to control costs.

Management Comments. BMDO concurred with the recommendation and stated in its response to the finding that cost-plus-award-fee, level-of-effort, term contracts are no longer being used.

Response Requirements Per Recommendation

See Appendix D for a detailed list of the responses required from management on the final report.

Finding B. Contract Management

The BMDO contracting officer did not establish adequate procedures for effective cost control and did not effectively manage contract SDIO84-88-C-0018 (the contract),* a cost-plus-award-fee, level-of-effort, term contract valued at $109.2 million. In addition, between March 1988 and April 1993, 7 different BMDO contracting officers had responsibility for the contract. The BMDO contracting officers:

- did not establish, at contract or task order inception, a baseline estimated cost, a required level of effort, and a maximum award fee to evaluate and measure The Analytic Sciences Corporation's (the contractor's)* actual cost performance;
- allowed the contractor to replan task orders, initially awarded on a competitive basis, using higher labor and overhead rates, thus increasing the estimated costs for award fee purposes;
- increased the estimated costs and the maximum award fees for the 6-month award fee performance periods during the performance periods, after the performance periods had ended, and, in one instance, after the award fee evaluation was completed;
- permitted the COTRs to direct the contractor's level of activity and labor mix; and
- did not perform adequate cost realism analysis.

As a result, total contract staff-hour costs increased by almost $26.9 million; the contractor's award fee increased commensurately with increased contract costs; and the risk of personal services contracting increased.

* For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

Background

DFARS Criterion. DFARS 215.805-70, "Cost Realism Analysis," provides that the contracting officer should perform cost realism analysis when a cost-reimbursement contract is anticipated in competitive acquisitions, even when adequate price competition exists, to ensure that proposed costs are consistent with the technical proposal.

Contractor's Method for Calculating Labor Rates. The contractor had 15 pay categories based on salary ranges for engineering direct labor: 1A through C, 2A through C, 3A through C, 4A through C, and 5A through C. For example, an employee in the 1A pay category could have an hourly labor rate of $55, an employee in the 2A pay category could have an hourly labor rate of $38, and an employee in the 4C pay category could have an hourly labor rate of $16. The contractor proposed direct labor rates for the labor categories specified in the contract (senior engineer/scientist, senior analyst, engineer/scientist, etc.) based on various mixes (percentages) from the contractor's pay categories and the average hourly labor rate for the category. Consequently, when the contractor used more individuals from its higher pay categories than proposed for a contract labor category, staff-hour labor costs for the contract labor category increased.

Contract Baseline

Negotiated Rates Not Used as Baseline. The contractor's March 16, 1988, best and final offer proposed labor hours and labor costs by contract labor category and other direct costs for the contractor and its major subcontractors. The labor costs were based on the contractor's March 1988 hourly labor rates, an escalation factor, and burden factors for overhead and G&A, which established a burdened hourly labor rate for each contract labor category. The contractor's proposed labor hours, labor costs, and other direct costs were used to arrive at the level of effort (staff hours) and estimated costs in the contract section B-5, "Schedule."

BMDO relied on the contractor's proposed costs in the best and final offer as a significant element of the contract award. Consequently, BMDO could have used the burdened hourly labor rates in the best and final offer as a baseline to measure the contractor's cost performance for award fee purposes and as a motivator for cost-effective performance from the contractor. However, BMDO did not require the contractor to use the burdened hourly labor rates in

the contractor's best and final offer to establish estimated costs for award fee purposes, and the contractor's cost performance was not evaluated against the proposed rates.

Proposed Staff-Year Costs Versus Actual Staff-Year Costs. We calculated the contractor's actual and proposed staff-year costs using the actual and proposed burdened hourly labor costs. We used 1,860 staff hours to equal a staff year. Because the actual burdened hourly labor costs included a factor for profit, we included the same factor in the proposed burdened hourly labor rates.

The contractor's actual burdened staff-year costs for each contract labor category were higher than the staff-year costs proposed in the March 16, 1988, best and final offer. For example, the actual staff-year cost for a senior engineer was 22 percent higher than the proposed cost.

Figure 4 shows a comparison of the contractor's actual and proposed burdened staff-year costs for each labor category.

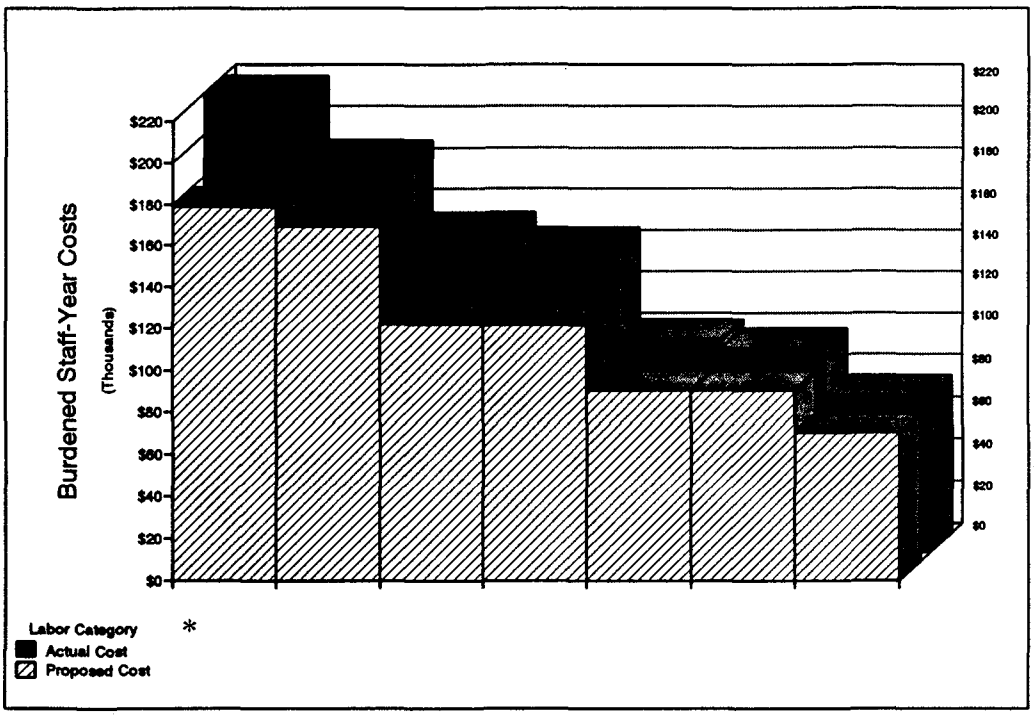


Figure 4. Contractor Actual Versus Proposed Burdened Staff-Year Costs

*Proprietary data removed.

Contract Modifications to Increase Baseline. The BMDO contracting officer issued contract modifications to acquire additional staff hours for certain contract labor categories, which increased the total contract level of effort. Contract section H-5, "Surge Requirements," enabled the contracting officer to acquire from the contractor additional quantities of the contract labor categories. Contract section B, "Supplies or Services and Prices/Costs," of the basic contract established the estimated cost, maximum award fee, level of effort, and period of performance. Contract section B-5 established the original contract baseline level of effort at 1,956,250 staff hours for a total estimated cost of $101,768,732, or an average composite hourly labor cost of $52.02. The total estimated costs and level of effort were based on the proposed labor hours and associated burdened costs and other direct costs identified in the March 16, 1988, best and final offer and did not include travel costs.

Contract modification P00021, dated November 28, 1989, exercised the surge provisions of the contract and increased the estimated cost, maximum award fee, and level of effort by 100 percent for the first 3 years of the contract. Contract modification P00042, dated March 29, 1991, exercised the contract year 4 option and increased the estimated cost, maximum award fee, and level of effort by 50 percent for option year 4. Contract modification P00062, dated April 1, 1992, exercised the contract year 5 option and established the total contract level of effort of 3,260,400 staff hours for an estimated cost of $167,514,511, or an average composite hourly labor cost of $51.38.

Table 5 provides a summary of the estimated cost, maximum award fee, level of effort, and hourly labor cost.

Table 5. Comparison of Basic Contract Versus Surged Estimated Cost, Maximum Award Fee, and Level of Effort

Contract or Surge Modification	Contract Years	Estimated Cost	Maximum Award Fee	Level of Effort (hours)	Hourly Labor Cost
Basic	1-3	$ 54,177,883	$ 8,126,682	1,089,450	$49.73
Basic	4	23,135,791	3,470,369	429,400	53.88
Basic	5	24,455,058	3,668,259	437,400	55.91
Total	1-5	$101,768,732	$15,265,310	1,956,250	$52.02
P00021	1-3	108,355,766	16,253,365	2,178,900	$49.73
P00042	4	34,703,687	5,205,553	644,100	53.88
P00062	5	24,455,058	3,668,259	437,400	55.91
Total	1-5	$167,514,511	$25,127,177	3,260,400	$51.38

Actual Level of Effort for Contract Years 1 Through 5 Unchanged. The contractor's September 30, 1992, monthly management status report showed that, from the inception of the contract, the contractor provided 1,528,761 staff hours at a total cost of $109,208,101 for labor and other direct costs, or an average staff-hour cost of $71.44. The total cost, including travel, was $112,712,365, for an average staff-hour cost of $73.73. The total cost does not include award fee. The monthly management status report did not include contractor clerical and administrative hours.

Using the factor for clerical and administrative costs identified in the best and final offer, we calculated that the contractor provided a total of 1,602,620 staff hours at an average hourly cost of $68.14. This $68.14 hourly cost was 32.6 percent higher than the $51.38 average staff hour cost in contract Section B-5. Also, the contractor delivered only 1,602,620 staff hours, 353,630 staff hours less than the 1,956,250 staff hours required under the basic contract for contract years 1 through 5. Consequently, the contract modifications that surged the level of effort on the contract did not increase the number of staff hours, as shown in table 5. Instead, the modifications increased the baseline estimated costs and maximum award fee to fund the original level of effort required under the basic contract for contract years 1 through 5. Based on the staff-hour cost in contract section B-5, we calculated that total contract staff-hour cost had increased by $26,859,911 ($68.14 - $51.38 = $16.76 x 1,602,620 staff hours = $26,859,911).

Award Fee on Contract Performance Cost Increases. BMDO established the maximum award fee based on the contractor's estimated costs for individual task orders and did not consider the staff-hour cost identified in contract section B-5.

Contract modification P00075 showed that the maximum award fee through award fee period 9, ending September 30, 1992, was $16,557,003, and that the award fee earned by the contractor was $14,519,612, which represented 13.3 percent of the contractor's labor costs and other direct costs of $109,208,101. Consequently, BMDO paid the contractor an award fee of $3,572,368 on staff-hour cost increases of $26,859,911 over the estimated staff hour cost in contract section B-5 ($26,859,911 x 13.3 percent = $3,572,368). Consequently, the contractor's award fee increased commensurately with increased performance costs.

Task Order Baseline

Establishing Baselines. The contracting officer did not establish at the inception of individual task orders a baseline estimated cost, a required level of effort, and a maximum award fee to evaluate and measure the contractor's actual cost performance. The contracting officer did not require the contractor to submit a detailed breakout of contractor pay categories and rates and the percentage of each contractor pay category that comprised the contract labor categories at the inception of the contract, task orders, and upon subsequent technical changes. This breakout should have been used to define the contracted labor mix (technical requirements of the contract) to permit pricing and evaluation of subsequent changes.

Using Best and Final Offer or Competitive Task Order Rates. The contracting officer also did not require the contractor to use the labor rates and burden factors in the March 16, 1988, best and final offer or the labor rates and burden factors that supported competitively awarded task orders to establish estimated costs and the maximum award fee for individual task orders. Pursuant to contract section H-9, "Task Award Procedure," the contract permitted the contractor to submit to the contracting officer revised task plans as necessary resulting from changes to the schedule, performance, and estimated cost or level of effort (more than plus or minus 10 percent variance). Consequently, the contractor submitted task order replans, requiring contracting officer approval, that increased the estimated costs and maximum award fee whenever actual costs exceeded estimated costs. Further, the contracting officer increased the estimated costs and maximum award fee for one task order award fee period after the period had ended and the award fee evaluation was completed. As a result, the contractor's potential for earned award fee was increased with increased cost of work performed. The following summaries provide examples of contract management and cost control problems on individual task orders.

Task Order 55. The contracting officer allowed the contractor to deliver fewer staff hours than required by the task order task plan and to receive an award fee based on the estimated costs associated with the required, not actual, staff hours. The contracting officer also increased the estimated costs and maximum award fee for one award fee performance period after the performance period had ended and the award fee evaluation was completed.

Task Order 62. Task order 62 was awarded on a competitive basis based on a proposed staff-hour cost of $55.88 for the base period. The contracting officer allowed the contractor to replan the task order using $75.79, a significantly higher staff-hour cost than the $55.88 proposed, thus increasing the estimated costs for award fee purposes. The contracting officer approved task order replans after the staff-hour costs had increased, and the contractor used the replans to keep actual staff-hour costs in line with estimated staff-hour costs for the task order.

COTR Direction. The COTR inappropriately directed the contractor to change its level of activity and labor mix, which resulted in higher staff-hour costs. The COTR also provided significant amounts of technical direction to the contractor. The direction provided by the COTR results in changes to the scope of work for the contract or task order and changes to the contractor's labor mix. Only the procuring contracting officer and administrative contracting officer can change or modify the terms of a contract or take any action which obligates the Government and such action must be set forth in a formal modification to the contracts. The amount of COTR-directed activity is also of concern in regard to personal services contracting and increased contract costs. FAR 37.104, "Personal Services Contracts," states that a personal services contract is characterized by the employer-employee relationship it creates between the Government and the contractor's personnel.

Task Order Replans. The BMDO contracting officer replanned estimated costs and the maximum award fee three times during the base period of performance and did not establish a baseline estimated cost until the work was almost completed. The last baseline replan was less than 2 weeks from the completion of the base period of 26 months. These replans increased costs by 82.33 percent and staff hours by only 34.42 percent.

Figure 5 shows the percent increase in estimated costs and staff hours for each replan, and actual costs and staff hours as of September 30, 1992.

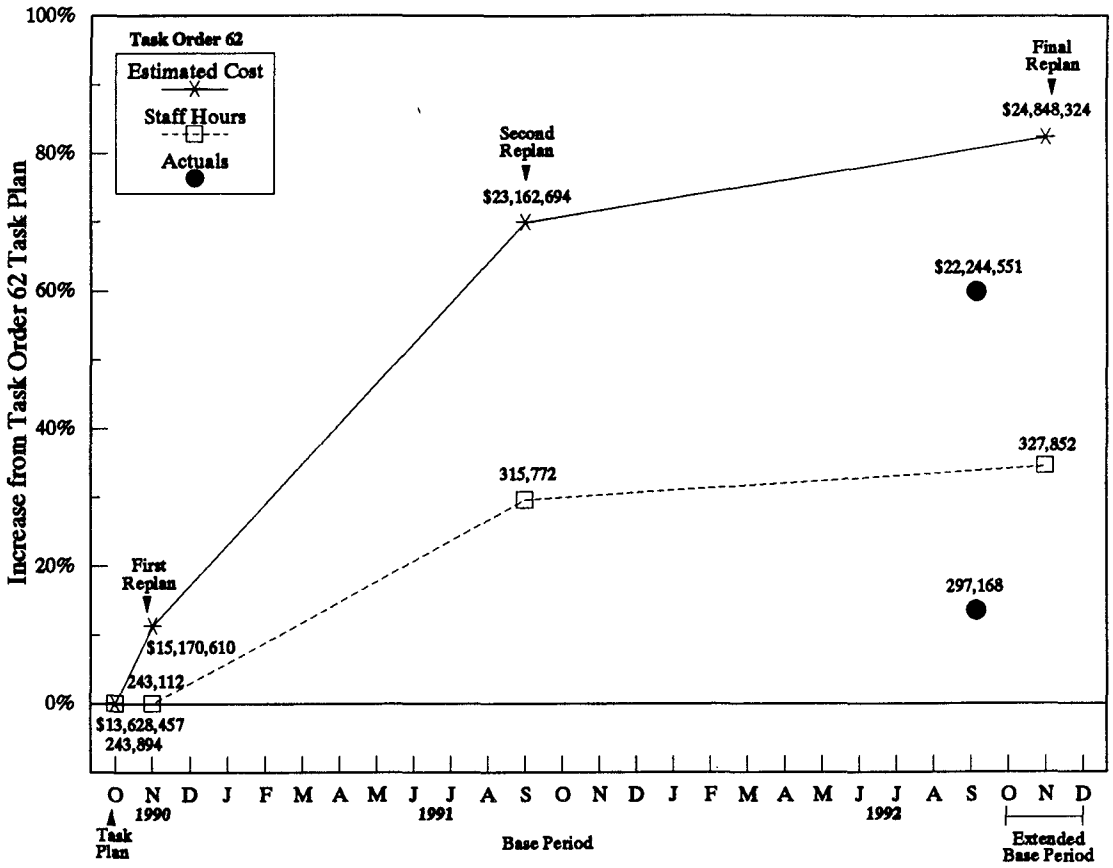


Figure 5. Comparison of Task Order 62 Estimated Costs and Staff Hours for Task Plan and Replans

Hourly Labor Rate. BMDO competitively awarded task order 62 to the contractor based on a proposed composite hourly labor cost of $55.88 for the 2-year period ending September 30, 1992. However, 1 month after the task order was awarded, the November 1990 management status report showed the contractor's actual hourly labor cost was $68.86, 23.23 percent higher than the proposed hourly labor cost. The actual hourly labor cost for the total contract in November 1990 was $65.15, 16.59 percent higher than the proposed hourly labor cost. The first task order replan in December 1990 provided a labor mix of more senior personnel and raised the estimated hourly labor cost to $62.40; however, the contractor's actual hourly labor cost at that time was $70.33. The second task order replan in September 1991 raised the planned hourly labor cost to $73.35; however, the contractor's actual hourly labor cost had been higher than the replanned hourly labor cost for 11 months. The second replan made the proposed hourly labor cost higher than the actual hourly labor cost, but by May 1992 the contractor's actual hourly labor cost of $73.78 was higher than the planned hourly labor cost. The contractor's

November 20, 1992, summary of the contract changes raised the planned hourly labor cost to $75.79 and ensured the contractor's actual costs were less than the estimated costs. The contracting officer approved replans after actual performance costs had increased and the contractor used the replans to keep actual performance costs "on track" with estimated costs. Although the replans did change some of the work requirements, the cost performance increases had already occurred and the replans were used to increase the baseline. The monthly management status reports show a progressive increase in the contractor's actual hourly labor costs from $68.86 in November 1990 to $75.05 in December 1992, a 8.99 percent increase over the 2-year period. Considering the contractor proposed a yearly escalation factor of between 4 and 5 percent, this increase appears reasonable.

Figure 6 compares the contractor's planned, replanned, and actual staff-hour costs for task order 62 and the actual contract staff-hour costs.

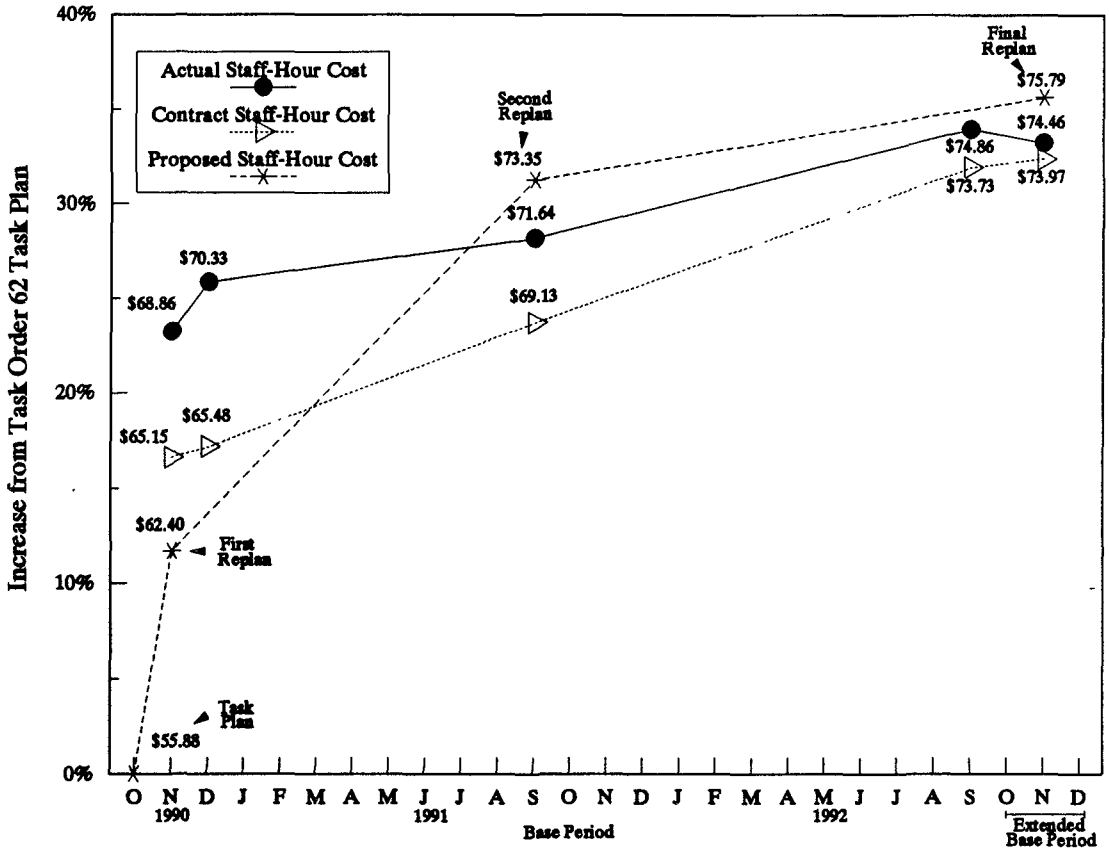


Figure 6. Comparison of Planned, Replanned, and Actual Task Order 62 Staff-Hour Costs and Actual Contract Staff-Hour Costs

Contract Labor Category Costs. The increases in labor hour costs were not due to changes in the contract labor category mix. A comparison of labor and overhead rates from the original task plan with each replan and with the actual costs shows that the replans were used to increase the labor rates for specific contract labor categories and thus increase the estimated costs.

Task Order 65. The contracting officer and the contractor did not establish a baseline estimated cost and maximum award fee before the start of award fee periods of performance and increased the baseline estimated cost and maximum award fee during and after the award fee periods. Establishing the estimated costs after a substantial portion of the work was completed provided the contractor with insufficient incentive to control costs.

Table 6 shows the contract modifications and dates and the dates the contractor submitted task plans or replans to establish or change the baseline estimated costs for award fee periods 7, 8, and 9. Each contract modification and contractor replan that increased estimated costs also increased the maximum award fee.

Table 6 . Task Order 65 Costs Estimated During and After Award Fee Period

		Estimated Costs for Award Fee Periods and (Contractor Task Plan or Replan Date)		
Contract Modification	Contract Modification Date	Period 7 Apr. 1991-Sept.1991	Period 8 Oct. 1991-Mar. 1992	Period 9 Apr. 1992-Sept. 1992
P00048	Aug. 7, 1991	$3,493,933 (July 12, 1991)		
P00051	Sept. 26, 1991	$3,586,752 (Not Available)	$2,792,983 (July 12, 1991)	
P00052	Sept. 30, 1991	$3,725,882 (Not Available)		
P00057	Dec. 30, 1991		$3,313,883 (Nov. 20, 1991)	
P00063	Apr. 24, 1992		$5,036,599 (Feb. 28, 1992)	
P00070	Sept. 18, 1992			$4,154,800 (July 2, 1992)

Task Order 69. The contracting officer definitized task order 69 and established the baseline estimated cost and maximum award fee 7 months after work began. Consequently, the estimated costs and maximum award fee for award fee period 9, ending September 30, 1992, were not established until after the end of the award fee period. The estimated costs were based on actual labor and other direct costs of $8,116,523 for task order 69 and transfers totaling $247,010 from task order 55. Because the contracting officer did not establish the estimated costs until after the work was completed, the contractor received an award fee that was based on actual costs.

Cost Realism Analysis

Composition of Proposed Hourly Labor Rate. The BMDO contracting officer did not perform adequate cost realism analysis on individual task orders to verify whether the contractor's proposed labor costs were consistent with the proposed staffing in the contractor's technical proposal. We compared the contractor's proposed hourly labor rate for * on task order 62 with the staffing in the technical proposal and determined the proposed labor costs and the technical proposal staffing were not consistent. Task order 62 was competitively awarded based on the contractor's June 29, 1990, task plan that proposed an unburdened hourly labor rate of * for a * . The contractor based the proposed hourly labor rate on the following composition from its pay categories: 17 percent * , 15 percent * 7 percent * , 36 percent * and 25 percent *

Technical Proposal Staffing. The contractor's technical proposal identified hours associated with two employees from its highest pay category, that were not included in the cost for the proposed hourly labor rate. In an October 14, 1993, letter, the contractor stated that the hours for one employee not bid in the original proposal could not be accurately assessed because work orders were not known. The contractor stated that the hours for the other employee were inadvertently deleted from the cost of the proposed hourly labor rate. The contractor's August 30, 1991, replan took into account the actual work requirements and the labor population known to be performing the work and proposed an unburdened hourly labor rate of * an increase of 19 percent, for a * The contractor based the * rate on a composition from its pay categories that included the costs for the * employees (8 percent * , 17 percent * 5 percent * 9 percent * 35 percent * , 17 percent * and 9 percent *).

*Proprietary data removed.

b. Perform cost realism analysis to determine whether the contractor's proposed costs are consistent with the technical proposal.

Management Comments. BMDO partially concurred with the recommendation and stated realism was consistently a part of the cost criterion in competitive source selections. FAR 15.603, "Purpose," requires realism analysis as part of the source selection procedures. Local supplementation guidance has already been issued in the BMDO Source Selection "How To" Samples Book. The internal control weakness associated with this recommendation should be deleted.

Audit Response. The comments address the cost realism of contract proposals rather than the cost realism analysis of the contractor's proposed labor costs on individual competitive or sole source task orders. We request BMDO provide additional comments on the recommendation as part its comments to the final report.

Response Requirements Per Recommendation

See Appendix D for a detailed list of the responses required from management on the final report.

Finding C. Contract Terms

The BMDO contracting officer did not administer the award fee for The Analytic Sciences Corporation (the contractor)* relating to subcontractor fees in accordance with the terms of contract SDIO84-88-C-0018 (the contract),* and improperly permitted the contractor to cap the maximum award fee paid to its subcontractors at 10 percent versus 15 percent for one task order. This occurred because the contracting officer did not ensure that the existing contract terms relating to award fee were consistent with the actual administration of the award fee or did not issue contract modifications to amend the contract terms relating to award fee. As a result, BMDO paid the contractor an award fee of $481,365 on the fees of the subcontractors that was not consistent with the contract as written. Also, for one task order for which the maximum subcontractor award fee was reduced to 10 percent, BMDO reduced the incentive for outstanding performance by subcontractors and may have provided the contractor a competitive advantage over the other two contractors that proposed a 15 percent maximum award fee for their subcontractors.

Background

FAR Criterion. FAR 31.201-2, "Determining Allowability," identifies factors to be considered when determining whether a cost is allowable including terms of the contract. The complete text of the FAR criterion is in Appendix A.

Contract Sections. Contract section H-20, "Award Fee," established the award fee criteria and provides that the award fee incentive flowdown is in accordance with contract attachment 4, "Award Fee Flowdown Plan," which states that the contractor cannot earn profit on subcontractors' profit.

* For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

Award Fee Flowdown Plan. The award fee flowdown plan established a two-part award fee. Part A resulted from the contractor's evaluation of individual subcontractors' performance and Part B resulted from BMDO's evaluation of the total contractor and subcontractor effort. See Appendix B for text of the contract award fee flowdown plan.

Award Fee on Subcontractor Fees

Contract Award Fee Payment Requirements. The contractor included the Part A award fee of its subcontractors in the total estimated cost base for its award fee. However, the award fee flowdown plan proposed by the contractor and incorporated into contract section H-20 clearly precluded the contractor from earning an award fee on subcontractors' fees. The contract provided that the maximum Part A award fee for each subcontractor would be removed from the total estimated cost base for the contractor's award fee. Thus, based on the contract terms as written, the contractor was not entitled to an award fee of $481,365 on its subcontractors' maximum Part A award fees.

Contractor Interpretation. Contractor officials stated that, during finalization of the contract terms, they proposed changes to contract section H-20 to clarify the language regarding the removal of subcontractor fees from the estimated cost base for the contractor's award fee. However, BMDO declined the contractor's proposed change to contract section H-20 as being too difficult to administer, a disincentive for high-level contract performance, and of questionable value to BMDO when potential cost savings were compared to administrative and disincentive problems. Contract section H-20 was not changed.

BMDO Contracting Officer Interpretation. In a November 9, 1993, letter to the Inspector General, DoD, the BMDO contracting officer stated that, at the point of contract award, the contractor's proposed change to contract section H-20 was rejected and the section was unchanged. The contracting officer stated that "H-20 clearly reflects the intent of the parties." BMDO never questioned the contractor receiving an award fee on subcontractor fees. The task plans submitted by the contractor and approved by the contracting officer clearly showed that the contractor was proposing an award fee on subcontractor fees.

The contract files contained no documentation explaining the BMDO position during finalization of the contract terms. However, the award fee flowdown plan was incorporated into contract section H-20 and did not need to be clarified, because once the plan was incorporated, contract section H-20 clearly

provided for the removal of subcontractor fees from the estimated cost base for the contractor's award fee. BMDO should either request the contractor to return $481,365 or amend the contract terms to permit the contractor to earn an award fee on subcontractors' fees.

Subcontractor Maximum Award Fee

Award Fee Flowdown. The contracting officer permitted the contractor to cap the award fee paid to its subcontractors on task order 62 at 10 percent and did not correspondingly modify contract section H-20 that incorporated the award fee flowdown plan. The award fee flowdown plan basic premise was to provide an incentive to subcontractors for outstanding performance. The original contractor award fee flowdown plan, which established a maximum award fee of 15 percent for subcontractors as specified by BMDO, was a key element of the contract proposal evaluation.

> In all cases, the Team member [the subcontractor] will be eligible for an award within the range of 0-15 percent as specified by BMDO. (Contract attachment 4)

Subcontractor Maximum Award Fee Cap. The task plan submitted by the contractor and other documentation in the contract files did not state that subcontractors' fees would be capped at 10 percent. However, subcontractor proposals and billings show that the contractor capped subcontractors' fees at 10 percent. The task plan submitted by the contractor included only 3 percent of subcontractor costs for the Part A award fee, which meant that the Part B award fee for the subcontractor would normally have been 12 percent of the subcontractor estimated costs. The subcontractors would have received 80 percent and the contractor 20 percent of the maximum part B award fee of 15 percent. By proposing only a 3 percent Part A award fee for its subcontractors, the contractor reduced the fee that the contractor could normally earn on subcontractor work. However, when the contractor capped the award fee for its subcontractors at 10 percent, this in effect took a portion of the award fee from the subcontractors and gave the portion of the fee to the contractor.

The separate, 0-15 percent two-part award for each Team member establishes a valuable incentive for extraordinary performance while, at the same time, avoids the need to take from one Team member to reward another. (Contract attachment 4)

Through award fee period 9, September 30, 1992, the contractor earned an award fee of $3,045,944 on estimated costs of $22,275,584 for task order 62, representing a Part B award fee of 13.67 percent. Based on the terms of the award fee flowdown plan, the subcontractors should have received 10.936 percent and the contractor should have received 2.734 percent for the Part B award fee on subcontractor estimated costs. However, by capping its subcontractors' maximum fee at 10 percent, the contractor received 6.67 percent while the subcontractors received 7 percent for the Part B award fee. Consequently, the contractor received an additional award fee of 3.936 percent on subcontractor costs. Based on the total subcontractor costs of $8,679,976, as of September 30, 1992, the contractor received an award fee of $341,644 that would have gone to the subcontractors had the subcontractors' fee not been capped at 10 percent.

The BMDO Assistant Director of Contract Operations stated for task order 62 that was competed between the super SETA contractors:

> As a result of this intensely competitive environment, TASC [The Analytic Sciences Corporation] proposed a "cap" award fee of 10 percent for subcontractor and this fact was evidenced by their proposal and the subcontractors' proposals for Task Order 62. The report cites that the terms of the contract required that the subcontractors receive the cap award fee of 15 percent. A contract's terms and conditions may be modified by mutual consent, as was the case with the award fee flowdown clause.

The contract provided that outstanding performance would be compensated by higher award fees and BMDO intended the incentives to reach major subcontractors whose performance contributed to such outstanding performance. Consequently, the contract provided that subcontractors would be eligible to receive a maximum award fee of 15 percent. Therefore, we believe the terms of the contract were changed and that any actions that change or modify the contract terms should be set forth in formal written contract modifications.

Task Order Competition. As part of the award fee flowdown plans incorporated in each of the three super SETA contracts, BMDO specified that subcontractors would be eligible for a maximum award fee of 15 percent. However, on task order 62, which was competed between the three super SETA contractors, BMDO allowed the contractor to propose a maximum award fee of only 10 percent for its subcontractors when the other two super SETA contractors proposed maximum award fees of 15 percent for their subcontractors. The lower maximum award fee provided a competitive advantage to the contractor. Further, the purpose of the 15-percent maximum award fee was to "encourage truly extraordinary performance." Permitting the contractor to pay its subcontractors a maximum award fee of only 10 percent was contrary to the extraordinary performance objective.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Ballistic Missile Defense Organization:

1. Instruct the contracting officer for contract SDIO84-88-C-0018 to initiate action to recover $481,365 for the award fee that The Analytic Sciences Corporation received on its subcontractors' fees, or amend the contract to allow award fee on subcontractors' fees.

Management Comments. BMDO nonconcurred with the recommendation and stated that the fact that attachment 3 and attachment 4 of the contract are inconsistent does not provide a basis for the Government to recover the award fee of $481,365. The relevant issue is the intent of the parties at the time of the contract and the established practices for 5 years during the period of performance. The contracting officer's statement of record reflects that it was clearly the intent of the parties to include the subcontractor fee in the estimated cost for determining the maximum award fee. Therefore, the contractor is entitled to the award fee on its subcontractors' maximum Part A award fees. A modification for the purpose of correcting the record serves no purpose because the contractor was entitled to the questioned award fee. The finding and recommendation are inappropriate and should be deleted and the monetary benefit set forth in Appendix E deleted.

Audit Response. BMDO obviously does not want to pursue recovering the award fee of $481,365 from the contractor. However, attachment 3 and attachment 4 of the contract were not inconsistent. The figure BMDO cited in attachment 3, that showed the subcontractor's fee as an element of cost to the prime contractor, was actually in attachment 4 and did not show the

subcontractor's fee as an element of cost to the prime contractor for determining the maximum award fee. We contacted the original contracting officer who was uncertain whether the Government agreed to pay the prime contractor fee on its subcontractors' maximum Part A award fees. Further, the contract was not administratively complete and has not been closed out. Therefore, we believe the contracting officer either needs to recover the award fee paid on subcontractors' maximum Part A award fees or amend the contract to allow the award fee on subcontractors' fees. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments to the final report.

2. Establish procedures to verify that contracting officers:

a. Follow the award fee payment contract terms as written.

b. Document with written contract modifications any changes to the contract terms relating to the award fee flowdown plans.

c. Notify all super scientific, engineering, and technical assistance contractors when award fee flowdown plans are changed to allow contractors to pay their subcontractors lower award fees than those required by the contract.

Management Comments. BMDO nonconcurred with the recommendation and stated that the recommendation is not applicable. Specifically, based on review of the super SETA contracts, the contracting officer followed the award fee payment terms, the award fee flowdown clause did not change, and notification of competitors if plans were changed would amount to leveling or divulging source-selection-sensitive information.

Audit Response. The intent of the recommendation is to preclude the condition that occurred on contract SDIO84-88-C-0018. Capping the subcontractors' maximum award fee at 10 percent, by mutual consent between the prime contractor and its subcontractors, did change the intent of the contract between BMDO and the prime contractor. BMDO contemplated a limited competition among the three super SETA winners. Each contract contained a similar award fee flowdown plan to ensure the subcontractors received the necessary incentives for outstanding performance. Therefore, allowing one contractor to reduce subcontractor incentives for outstanding performance created an unfair advantage over the other two contractors who did not. Discussions with all of the contractors regarding the intent of the award fee flowdown plan would not be leveling or divulging source-selection-sensitive information if all parties were provided the same information for the purposes of clarifying the provisions in the proposal and if no information entitled to

protection was revealed. We request BMDO reconsider its position on this recommendation and provide additional comments when responding to the final report.

Response Requirements Per Recommendation

See Appendix D for a detailed list of the responses required from management on the final report.

Finding D. Costs for Facilities, Administrative and Clerical Support, and Government Property

The Analytic Sciences Corporation (the contractor)* charged facility and administrative and clerical support costs as direct costs to contract SDIO84-88-C-0018 (the contract)* and also as part of the overhead rate, and acquired general purpose equipment as Government property and received a fee on the costs of the Government property. The contractor's improper charges for facility and support costs and acquisition of Government property occurred because the BMDO contracting officer did not adequately evaluate the task plans submitted by the contractor and did not comply with procurement policies, regulations, BMDO operating instructions, and contract terms. Also, the contractor did not comply with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose." As a result, BMDO paid the contractor $ * million as direct costs for facility and administrative and clerical support without reducing overhead rates, allowed the contractor to acquire $ * of general purpose equipment as Government property that should have been financed by the contractor, and paid the contractor an award fee of $71,197 on the Government property.

Background

DoD Policy. On November 25, 1986, the Under Secretary of Defense for Acquisition issued a memorandum on Government-owned property in the possession of Defense contractors that stated:

> The new procurement of industrial facilities with defense funds for use by contractors must be drastically limited if we are to reduce government-ownership. Providing existing government property to contractors must also be limited. This property shall be financed by the private sector except under highly unusual circumstances. Part 45.302 of the Federal Acquisition Regulation (FAR) sets forth exceptions when facilities may be provided.

* For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

*Proprietary data removed.

The contracting activities' implementation of FAR exceptions have become too loose and are permitting the furnishing of large amounts of general purpose equipment that should be privately financed.

All DoD components must exercise more discipline in carrying out the existing policies not to provide government-owned facilities to defense contractors.

FAR Criteria. The following FAR sections were used as criteria: 31.201-2, which describes the factors to be considered when determining allowability; 45.101, "Definitions," which defines Government property; and 45.302, "Providing Facilities," which describes the conditions under which the Government may provide Government property to contractors. The complete text of the FAR criteria is included in Appendix A.

Contract Terms. Contract section H-22, "Government Will Not Furnish Facilities," states that the Government would not provide facilities to the contractor. See Appendix B for the text. Also, contract attachment 3, "Award Fee Determination Plan," part D.7, "Sufficiency of Facilities and Support Services," provides an incentive for the contractor to establish its own "outstanding facilities," not to require the Government to provide facilities.

BMDO Contracts Directorate Operating Instructions. BMDO Operating Instruction 09, "Providing Facilities to Contractors," March 15, 1991, establishes policy and procedures for providing facilities to contractors. The instruction states that the contracting officer is responsible for ensuring that one of the exceptions described in FAR 45.302-1, "Policy," exists in the applicable contract before facilities can be provided to a contractor. The contracting officer is required to prepare either a memorandum for the record or a determination and finding and to maintain a copy of the records in the contract file indicating the type of exception used to justify providing facilities to a contractor.

Cost Accounting Standard. Cost Accounting Standard 402 states that each type of cost is allocated only once and on only one basis to any contract or other costs objective. Further, double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools that are allocated to that cost objective. The complete text of Cost Accounting Standard 402 is included in Appendix A.

Direct Costs

Facilities Provided to Contractors as Direct Costs. The BMDO contracting officer allowed the contractor to charge the costs for two contractor facilities as direct costs to the contract. The contracting officer approved the contractor's task plans which identified facility costs as direct costs. The facility costs included costs associated with office space, furniture, telephones, security, and miscellaneous office supplies. In addition, the contractor charged the contract for the same costs as part of the overhead rate. The two facilities, located in Rosslyn, Virginia, were an Architecture Integration Study Center for task order 65 and a National Missile Defense Center for task order 69. We determined that 25 contractor employees and 64 other super SETA contractor and subcontractor employees, as well as consultants, used the Rosslyn facilities. Employees for the contractor stated that the Rosslyn facilities were their only office facilities.

Leased Office Space, Furniture, and Telephones. The contractor directly charged the contract $792,093 (excluding G&A and profit) for leased items such as office space, furniture, and telephone equipment. Normally, the contractor would finance these costs and own the facilities and equipment. The contractor's disclosure statement provided that new office furniture and other personal property would be amortized over a period of 7 years.

The contractor entered into leases for furniture that were not cost-effective. For example, in January 1991, the contractor began a 12-month lease for office furniture (lease no. 374391) that gave the contractor the option to buy the furniture for the purchase price less total payments made during the initial 12-month lease period. The purchase price was the same as the cost to lease the furniture for 2 years. After leasing the furniture for 1 year, the contractor could purchase the furniture for an additional cost equal to a second-year lease. However, after the initial year, the contractor extended the lease for an additional 12 months when the contractor could have purchased the furniture for the same price. Had the contractor purchased the furniture, no additional costs would have been billed to the contract. The lease costs for the furniture for the first year were $46,110. For an additional cost of $49,315, or a total cost of $95,425, the furniture could have been purchased. In January 1994, BMDO will have paid the contractor to lease the furniture for 3 years at a cost of $138,329. The contractor also receives a fee on these costs. We believe that BMDO should require the contractor to acquire furniture at the lowest cost to the Government.

Miscellaneous Office Expenses. The contractor charged the costs of office supplies, telephones, monthly phone bills, badges, security systems, and guard services directly to the two task orders even though the costs for these types of items were included as part of the overhead rate.

Administrative and Clerical Support. The contractor also charged the costs of temporary services to provide administrative and clerical support directly to the contract as other direct costs. The temporary employment agencies provided "executive secretaries, secretaries, word processors, Macintosh operators, and facilities administrators." However, the contractor normally *

Summary of Facility and Administrative and Clerical Support Costs Charged Directly to the Contract. Contractor representatives stated that facility and administrative and clerical costs were charged as direct costs to the contract because other contractors were also using the facilities and the contractor did not believe its overhead rates would fully cover the costs. However, the contractor could have charged the other contractors occupancy costs to reduce its facilities costs. Further, after the contractor was allowed to charge facility and administrative and clerical costs as direct costs, the contractor should have adjusted its overhead rates to avoid any duplicate charges.

Table 7 provides a summary of the facility and administrative and clerical costs charged directly to the contract that were also in the overhead rate.

*Proprietary data removed.

Table 7. Costs Charged Directly to the Contract

Description	Task Order 55	Task Order 62	Task Order 65	Task Order 69	Total
Administrative/ Clerical support	$ 30,175	$29,912	$ 295,250	$ 43,937	$ 399,274
Office Supplies	9,017	219	39,295	8,237	56,768
Leased office space	14,426	0	435,860	139,562	589,848
Leased furniture	30,460	0	99,601	7,406	137,467
Leased or purchased telephone equipment and costs	8,998	354	50,574	4,852	64,778
Security	250	241	12,760	989	14,240
Subtotal	$ 93,326	$30,726	$ 933,340	$204,983	$1,262,375
*					
Total	*	*	*	*	*

Indirect Costs

Overhead Costs. The contractor also charged BMDO full overhead rates, about * percent of direct labor costs, for the employees that worked in the two direct-cost facilities for task orders 65 and 69. The full overhead rate included costs for *

Consequently, BMDO paid for facility costs twice, both as direct costs and indirect costs, for contractor employees working at the two facilities. We determined that the direct labor costs through September 30, 1992, for the contractor employees located at the facilities were about $638,619, and the associated overhead costs were about * Using the lower contractor off-site overhead rate of about * percent for the year ending December 31, 1992, the overhead costs would have been about * a difference of $408,716. We did not determine the cost impact for the other two super SETA contractors, subcontractors, and consultants that worked at the two facilities charged directly to the contract. However, all of the contractors will need to reduce their overhead cost charges to account for the facilities that were provided as direct costs to the contract.

*Proprietary data removed.

Overhead Accounts. The following is a list of several of the specific overhead accounts from the contractor's chart of accounts and account descriptions that finance costs for the items that were also charged as direct costs to the contract. The contractor also has an overhead account that could be used to charge other contractors for leasing space at a contractor facility.

- *
- *
- *
- *
- *
- *
- *
- *

*Proprietary data removed.

Government Property

Contractor-Acquired Government Property. BMDO incorrectly permitted the contractor to acquire Government property for contractor use and receive a fee on the costs. FAR 45.302-1, provides guidance on the exceptions when agencies may provide Government property to contractors. We found no exceptions that would allow BMDO to provide the contractor with the type of Government property provided. The contractor-acquired Government property was general-purpose equipment, which included various software packages, laser printers, surge protectors, computer disks, keyboards, color monitors, hard drives, and turbo mouses needed by the contractor to support BMDO or any other program. The contractor normally financed the costs for these items and amortized the automation equipment over a period of 5 years with computer software amortized over the same period or the remaining useful life of the associated computer equipment. FAR 45.302-3, "Other Contracts," provides that no profit or fee shall be allowed on the cost of contractor-acquired Government property.

Table 8 provides a summary of the contractor-acquired Government property costs on the task orders reviewed.

Table 8. Contractor-Acquired Government Property Costs

Description	Task Order 55	Task Order 62	Task Order 65	Task Order 69	Total
Government Property	$20,836	$389,497	$48,535	$10,214	$469,081
*					
Total	*	*	*	*	*

Leased Items. Because leased items charged directly to the contract are not Government property, the procurement regulations relating to Government property do not apply. Further, the BMDO contracts operating instruction on facilities and Government property did not address providing these leased facilities to contractors, and the contract files did not contain a memorandum for the record or determination and findings to justify providing the leased facilities and equipment to the contractor. Allowing the contractor to lease facilities and equipment and to charge the costs directly to the contract creates additional problems, especially in circumstances in which procuring the items

*Proprietary data removed.

becomes more cost-effective, in effect, making them Government property. BMDO may not be able to justify providing items such as furniture to contractors as Government property. However, if BMDO permits the contractor to lease furniture and charge the costs direct to the contract, the items must be purchased as Government property once it becomes cost-effective to do so.

Contracting Officer Actions

Approval of Task Plans. The contracting officer did not perform adequate cost analysis of the task plans and replans submitted by the contractor to prevent the same costs from being charged twice, both as direct costs and as indirect costs. The contracting officer stated that, because of time pressures, the contracting office support services contractors helped perform the cost analysis on task plans and replans and then briefed the contracting officer on the results. The task plans and replans show that the contractor proposed facility and administrative and clerical costs as direct costs and also proposed its full overhead rate. However, BMDO did not require the contractor to use the contractor's lower off-site overhead rate, which eliminated overhead costs for many of the items that were charged direct to the contract.

Justification for Facilities and Government Property. DoD policy and the FAR provide few exceptions when the Government may furnish Government property to contractors or allow contractors to acquire property for the Government. The basic policy is that contractors finance facility and equipment costs. Consequently, contractors decide when to purchase or lease items, and the costs for these items are normally allocated through overhead. Certain high-dollar items must be capitalized and amortized. The Government does not want contractors to acquire Government property for contractor use. None of the FAR exceptions relating to Government property permitted the contracting officer to provide the contractor with contractor-acquired Government property and to also pay a fee on the costs of acquiring the property. Further, the contract files did not contain, as required by BMDO contract operating instructions, a memorandum for the record or a determination and findings prepared by the contract officer to justify the facilities or Government property provided to the contractor.

Cost Accounting Standard 402

The contractor did not comply with Cost Accounting Standard 402. The contractor charged BMDO facility and administrative and clerical costs that were normally allocated to overhead as direct costs without reducing the contractor's overhead rates.

> Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective. (FAR Appendix B)

In addition, the other two super SETA contractors and their subcontractors may not be in compliance with Cost Accounting Standard 402 if they also included costs for the items that were charged as direct costs to the contract in their overhead rates. The administrative contracting officer under the Defense Contract Management Command, Defense Logistics Agency, has final responsibility for determining compliance or noncompliance with Cost Accounting Standard requirements and notifying the contractor after receiving a report of noncompliance from a Government audit agency.

Recommendations, Management Comments, and Audit Response

Management Comments and Audit Response on the Finding. See Appendix C for a summary of management comments and the audit response to the comments.

1. We recommend that the Director, Ballistic Missile Defense Organization, instruct the contracting officer for contract SDIO84-88-C-0018 to:

a. Initiate action to recover $1,597,100 for facility and administrative and clerical costs, associated general and administrative expenses, and award fees that were charged as direct costs to the contract without eliminating like cost items from contractor overhead rates.

Management Comments. BMDO nonconcurred with the recommendation and stated that insufficient information was available to allow the Government to issue a Cost Accounting Standard 402 collection action and validate the questioned costs. However, BMDO has requested an audit from DCAA on the appropriateness of the questioned costs for contractor-acquired Government property, with a subsequent determination from the administrative contracting officer expected by December 31, 1994. BMDO further stated that the lease charges appear to be properly charged as other direct costs because the property involved was not contractor-acquired property.

Audit Response. We consider the action initiated by BMDO to be responsive to the intent of the recommendation. We still believe that the lease charges should not have been charged as direct costs because similar costs were in the contractor's overhead rate. Therefore, we request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

b. Initiate action to request a refund of $71,196 for fees paid on contractor-acquired Government property.

Management Comments. BMDO nonconcurred with the recommendation and stated the FAR restriction on profit and fee on Government property was not effective until January 22, 1991, after the super SETA contracts were awarded.

Audit Response. We agree the basic contracts were awarded before the FAR restriction on fee for contractor-acquired Government property was effective, but the basic contract also provided that the Government would not provide facilities to the contractor and that no facilities should be acquired by the contractor for the account of the Government. Further, all Government property identified in the report was acquired based on task plans (contract changes) submitted by the contractor and approved by the BMDO contracting officer after the effective date of the FAR restriction on profit or fee for contractor-acquired Government property. Therefore, we believe the contractor should not have received fee on the contractor-acquired Government property. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

c. Initiate action to change contractor costs for furniture from direct charges to overhead costs or acquire furniture as contractor-acquired Government property when leases are not cost-effective.

Management Comments. BMDO nonconcurred with the recommendation and stated there was insufficient data to lead to a determination that leased costs should be indirect and the contractor asserted that leased facility costs were incurred solely for the SETA contract, and therefore, were identifiable as direct. BMDO further stated that the recommendation for the contractor to acquire facilities (furniture) for the account of the Government when leases were not cost effective was inappropriate because the contractor's lease versus purchase decision must be based on the application of sound business judgment. Finally, BMDO stated the administrative contracting officer would undertake a review of the contractor's lease versus purchase decision as to reasonableness, with a completion date of September 30, 1994.

Audit Response. We agree that contractors make the lease-versus-purchase decision based on sound business judgment when leases are charged as indirect costs. Should a contractor decide to purchase the leased items, the leased items become the property of the contractor. However, we believe when contractors lease items and charge the costs as direct costs to the contract, a decision to purchase the leased items would make the leased items Government property. Therefore, we believe the Government should be involved in the lease-versus-purchase decision when the items are charged as direct costs to the contract and could become Government property. We consider the review of the reasonableness issue by the administrative contracting officer to be responsive to the intent of the recommendation.

d. Request the administrative contracting officer to determine whether the other super scientific, engineering, and technical assistance contractors and their subcontractors working in the Rosslyn facilities charged as direct costs to the contract complied with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose."

Management Comments. BMDO concurred with the recommendation and stated they initiated an analysis of overhead and off-site rates. Where inconsistencies exist, apparent Cost Accounting Standard 402 violations will be referred to the administrative contracting officer. The analysis was scheduled to be completed by June 30, 1994.

2. We recommend that the Director, Ballistic Missile Defense Organization:

a. Establish procedures in contracts operating instructions for contracting officers to reduce contractor overhead rates when facilities that were included in overhead rates are charged directly to the contract.

b. Establish procedures in contracts operating instructions for providing leased office space, furniture, telephones, and other miscellaneous items to contractors as direct costs.

c. Verify that contract files contain a memorandum for the record or determination and findings to justify any Government property provided to contractors as required by the contracts operating instruction.

Management Comments. BMDO concurred with the recommendations and stated the BMDO Property Directive 4275, currently in staffing, would address these issues. The target completion date for staffing of the Directive was April 29, 1994.

3. We recommend that the Director, Defense Logistics Agency, request the administrative contracting officer to notify the contractor of its noncompliance with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose," because overhead rates included costs for facility, administrative and clerical support, and coffee and tea services (Finding E) that were also billed direct to the contract.

Management Comments. The Defense Logistics Agency concurred with the recommendation and stated DCAA was currently auditing the contractor's revised Cost Accounting Standard disclosure statement and would address the adequacy and compliance of the items as they pertain to the contract. DCAA would also perform Cost Accounting Standard compliance audits at the other two contractors pertaining to the super SETA contracts. Completion of these audits was planned for July 1, 1994. Subsequent to receipt of the audit, the cognizant administrative contracting officer would determine Cost Accounting Standard 402 compliance. The Defense Logistics Agency would implement the DCAA audit findings by September 30, 1994.

Response Requirements Per Recommendation

See Appendix D for a detailed list of the responses required from management on the final report.

Finding E. Other Direct Costs

The Analytic Sciences Corporation (the contractor),* billed BMDO questionable costs for coffee and tea services, catered meals, and kitchen appliances as other direct costs. The questionable costs were billed to contract SDIO84-88-C-0018 (the contract)* because the contractor believed the other direct costs associated with coffee and tea services, catered meals, and kitchen appliances were reasonable and resulted in cost savings to the Government. Normal contract oversight by the contracting officer and COTRs would not have identified these costs. The contractor also did not comply with Cost Accounting Standard 402 for coffee and tea services. As a result, $ * of questioned costs were billed to the contract.

Background

FAR Criteria. FAR 31.201-2 describes the factors to be considered in determining whether a cost is allowable; FAR 31.201-3, "Determining Reasonableness," describes the considerations and circumstances for determining whether a cost is reasonable; and FAR 31.201-4, "Determining Allocability," describes the conditions when a cost is allocable to a Government contract. The complete text of the FAR criteria is provided in Appendix A.

Cost Accounting Standard Criterion. Cost Accounting Standard 402 provides the criteria for allocating costs. The complete text of Cost Accounting Standard references is provided in Appendix B.

Other Direct Costs

The contractor billed BMDO questionable costs for coffee and tea services, catered meals, and kitchen appliances as other direct costs.

* For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

*Proprietary data removed.

Table 9 provides a summary of the questionable other direct costs billed to the contract.

Table 9. Questionable Other Direct Costs

Description	Task Order 55	Task Order 62	Task Order 65	Task Order 69	Total
Coffee Service	$ 159	$ 0	$ 3,372	$1,308	$ 4,839
Catered meals,	2,759	23,995	6,057	37	32,848
Kitchen appliances	199	0	662	0	861
Subtotal	$3,117	$23,995	$10,091	$1,345	$38,548
*					
Total	*	*	*	*	*

Coffee Service. For the leased facilities in Rosslyn discussed in Finding D, the contractor used a monthly coffee service to provide its employees with coffee and tea, cocoa, creamer, sugar, Tylenol, Advil, paper towels, and dishwashing liquid. The contractor charged the costs for these services directly to the contract as other direct costs rather than the overhead account for these costs (9221-Employee Welfare-Coffee and Tea). Thus, every time the contractor charged BMDO $100 for coffee, the contractor also received $ * for G&A and award fee. The contractor stated that the coffee and tea service benefitted the entire team (Government, other BMDO contractors, and subcontractors) at the two leased facilities in Rosslyn. We concluded that these costs were not ordinary and necessary for the conduct of business or contract performance and were questionable. Because the contractor has an overhead account to cover coffee and tea, the contracting officer should initiate action to recover the $6,128 for costs, G&A, and award fee associated with the coffee service.

Catered Meals. The contractor billed BMDO for catered breakfasts, lunches, breaks, and dinners for program reviews, management meetings, and contract negotiations. The catered meals included various quiches, imported cheese garnished with kiwi, sheet cakes, punch, salsa and chips, and assorted sandwiches, fruits, pastries, sodas, cookies, muffins, and juices. These catered services were also used to support a program anniversary celebration and a Christmas party. The contractor considered these catered events to be "working" meals because of time constraints (participants were too busy or matters were too important to break). The contractor stated that catered meals were provided only when such meals made good business sense in terms of saving time and money, and were needed to maintain the flow and continuity of important, time-critical discussions. We find it difficult to accept that the contractor deserves to earn $ * of G&A and award fee for every $100 BMDO

*Proprietary data removed.

spent on catered lunches. Also, on a contract for which BMDO is paying $118,000 to $370,000 to purchase the services of a * it is not reasonable to expect BMDO to also pay for a catered lunch for that * Either the contractor or the individuals should pay for catered lunches. No contract provisions required BMDO to pay for contractor meals, and only the task plan for task order 65 identified any costs associated with "Meetings/Conferences" that were approved by the contracting officer. We concluded that these costs were not ordinary and necessary for the conduct of business or contract performance and were questionable. The contracting officer should initiate action to collect $41,522 of costs, G&A, and award fee associated with the catered meals.

Kitchen Appliances. The contractor purchased a microwave and a refrigerator for the leased facilities and charged the costs directly to the contract as other direct costs. No contract provisions required BMDO to pay $860 for kitchen appliances and $ * of associated G&A and fee. These costs are not recognized as ordinary and necessary for the conduct of business or contract performance and are considered questionable. The contracting officer should initiate action to collect $1,086 of costs, G&A, and award fee associated with the kitchen appliances.

Cost Accounting Standard 402 Compliance

The contractor did not comply with Cost Accounting Standard 402 because the contractor billed coffee and tea costs indirectly as part of overhead and also charged BMDO directly as other direct costs. Cost Accounting Standard 402 states that double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective. Actions taken by the administrative contracting officer on Recommendation 3, in Finding D should correct accounting problems associated with the coffee and tea service costs.

Contracting Officer, COTR, and Contractor Position

Government Oversight and Contracting Officer Actions. Normal contract oversight by the contracting officer and COTRs would not have identified the costs for coffee and tea services, catered meals, and kitchen appliances charged as other direct costs. The contracting officer stated that the contractor's monthly management status report, plus the use of a post-performance audit, was sufficient to identify questionable contract costs. Based on results from our

*Proprietary data removed.

audit, the BMDO contracting officer notified the contractor in an October 13, 1993, letter that the questioned costs were not allocable or reasonable and were therefore unallowable.

Contractor Position on Other Direct Costs. The contractor stated "... catered meals were provided only when such meals made good business sense in terms of saving time and money, and needing to maintain the flow and continuity of important, time-critical discussions." The contractor estimated "... that the savings in burdened labor cost alone resulting from working through a meal (after making allowances for inefficiencies) was more than five times the cost of each meal. As a result, the contractor believes "Subject ODCs [other direct costs] were ordinary, expected, prudent - in short, reasonable - and, in the case of catered meals, resulted in significant cost savings to the Government."

Recommendations, Management Comments, and Audit Response

Management Comments and Audit Response on the Finding. See Appendix C for a summary of the management comments and the audit response to the comments.

We recommend that the Director, Ballistic Missile Defense Organization, instruct the contracting officer for contract SDIO 84-88-C-0018 to:

1. Initiate action to recover questioned costs of $6,128 for coffee and tea services; $41,522 for catered meals; and $1,086 for kitchen appliances.

Management Comments. BMDO concurred with the recommendation and stated action was taken to collect $31,118.43 of the $41,522 recommended for catered meals. BMDO stated the difference represented costs for catered meals that were considered random not routine. The questionable costs for the coffee and tea service and the kitchen appliances were referred to the administrative contracting officer. Collection action was estimated to be completed by June 30, 1994.

2. Notify contractors that costs for coffee and tea services, catered meals, and kitchen appliances are not allowable as direct charges to contracts.

Management Comments. BMDO concurred with the recommendation and stated contractors were notified that the questioned costs were not allowable as direct charges to the contract.

Finding F. Contractor Travel Costs

The Analytic Sciences Corporation (the contractor),* and its subcontractors staffed projects in the Washington, DC, area with out-of-town employees and did not reduce per diem rates for employees on long-term temporary duty. The contractor and subcontractors used out-of-town employees because they did not establish adequate "direct support groups" located at contractor facilities near the Pentagon. In addition, the contractor was not required to identify travel costs and the purpose of travel in the task plans approved by the contracting officer. The contractor also sent large numbers of employees to conferences and meetings at various locations with only COTR approval and without identifying the associated costs. As a result, BMDO paid more than $700,000 on four task orders to staff projects in the Washington, DC, area with out-of-town employees; employees on long-term temporary duty received $53,904 of excessive per diem; and BMDO paid contractor travel costs for Brilliant Pebbles kickoff meetings of about $41,000.

Background

Contract Sections. Contract section B-5 provides that travel and per diem costs are reimbursable items subject to allowable costs under the Joint Travel Regulations and FAR 52.216-7, "Allowable Cost and Payment."

Contract section H-3, "Travel and Travel Costs," requires the COTR to approve contractor travel.

Contract attachment 1, "Statement of Work," part 4.1.1., "Direct Support Group," provides guidance on direct support and supplementary support group personnel. The complete text of the contract sections is in Appendix B.

Joint Travel Regulations. Joint Travel Regulations section 4455, "Time Limitation on Temporary Duty (TDY) Except TDY for Training," states that:

* For the purposes of this finding, we will refer to The Analytic Sciences Corporation as "the contractor" and to contract SDIO84-88-C-0018 as "the contract."

The threshold for long-term TDY is 6 months because Comptroller General decisions have rarely sanctioned TDY beyond 6 months (see 64 Comp. Gen. 205 (1985) and 62 Comp. Gen 560 (1983)). A reduced fixed per diem, normally 55 percent of the rate prescribed or the TDY location (see pars. C4560 andC4561-4a) is payable to employees while on long-term TDY assignments of more than 180 calendar days at one location. Experience shows that a 55 percent rate is adequate in most cases to cover the cost of lodgings, meals and incidental expenses when the employee makes long-term arrangements for lodging, such a renting an efficiency or one bedroom apartment.

Support From Out-of-Town Contractor Employees

Travel Costs to Washington, DC. We reviewed travel claims on task orders 42, 55, 62, and 65 for the contractor and four of its subcontractors (ARI, GRC, TBE, and SPARTA). We reviewed $1.87 million of travel claims and determined that $1.05 million was spent for travel to Washington, DC. We identified 29 contractor and subcontractor employees that were out-of-town "direct support group" personnel. The out-of-town contractor employees worked more than 1,000 hours on the task orders, and individual employees traveled to Washington, DC, on temporary duty for more than 30 days. The employees incurred total travel costs of $709,042, including G&A, to work temporary duty in Washington, DC. The travel costs do not include labor costs for commuting time between the employees' permanent duty station and their temporary duty station in Washington, DC. Contract attachment 1, provides that, unless specified otherwise, all direct support group personnel shall have the capability to interact with BMDO personnel on a daily, on-call basis.

> They shall be located at a contractor facility within 25 miles of the Pentagon which is easily accessible from the Pentagon by public, contractor-provided or equivalent transportation. (Contract attachment 1)

Long-Term Temporary Duty to Washington, DC. Of the 29 out-of-town direct support group personnel, 5 were on long-term (more than 180 calendar days) temporary duty to Washington, DC, and received full per diem rates. Three of the five contractor employees on long-term temporary duty stayed in corporate apartments. The travel was of a continuous nature, even though the employees periodically returned to their permanent duty stations on weekends. For example, from March 16, 1992 through September 15, 1992, one employee

spent 112 (87 percent) of 132 normal work days in the Washington, DC, area on temporary duty. From November 1, 1991, through April 30, 1992, another employee spent 102 of 124 normal work days, 82 percent, in Washington, DC, on temporary duty. The Joint Travel Regulations provide that a reduced fixed per diem, normally 55 percent of the rate prescribed, is appropriate for employees on long-term temporary duty of more than 180 calendar days at one location. Based on the reduced per diem rates, the five individuals received $53,904 of per diem that we believe is questionable.

Table 10 provides information on the reduced per diem rates for contractor employees on long-term temporary duty.

Table 10. Long-Term Temporary Duty to Washington, DC

Contractor (Task Order)	Position	TDY Period	Days TDY	Total Travel Cost	Per Diem Cost	Per Diem Cost (55 percent)	Questioned Per Diem
GRC (62)	Senior Engineer	Mar. 1991-Jan. 1993	393	$130,635	$ 51,682	$31,476	$20,206
SPARTA (65)	Senior Engineer	Jan. 1991-Nov. 1992	287	79,775	29,505	22,365	7,140
SPARTA (65)	Senior Engineer	Feb. 1991-Sep. 1992	237	69,988	22,012	15,859	6,153
Contractor (62)	Senior Engineer	May 1991-Apr. 1992	220	42,908	25,676	15,595	10,081
ARI (65)	Senior Analyst	Feb. 1991-May 1992	187	33,531	23,369	13,046	10,324
Total				$356,837	$152,244	$98,341	$53,904

The GRC senior engineer who traveled to Washington, DC, for 393 days at a total cost of $130,635 was located in Albuquerque, New Mexico. The contractor's proposal stated that the senior engineer would be relocated to Washington, DC, by October 1, 1990. The senior engineer never moved to the Washington, DC, area and thus continued to receive per diem. However, in February 1991, the contractor proposed to relocate the senior engineer to Albuquerque because a large share of the work was to be performed in that geographic area. The COTR approved the proposed relocation, even though the senior engineer always lived in the Albuquerque area and actually performed little work for the contract in that geographic area.

Relocating the senior engineer permanently to Washington, DC, where the majority of the work was being performed, as originally proposed by the contractor would have cost the Government significantly less than paying per diem for the senior engineer to travel weekly between Albuquerque and Washington, DC.

Conferences and Meetings

The contractor and its subcontractors sent large numbers of employees to conferences and meetings at various locations with only the COTR's approval and without identifying the associated costs. For example, the contractor and its subcontractors sent 21 employees to the Brilliant Pebbles kickoff meetings in Denver, Colorado, and Los Angeles, California, at a total travel cost of about $41,000. The monthly management status report for May 1991 showed that 21 contractor employees attended the meetings, but the report did not break out the costs associated with travel to the kickoff meetings.

Recommendations, Management Comments, and Audit Response

Management Comments and Audit Response on the Finding. See Appendix C for a summary of management comments and the audit response to the comments.

Revised Recommendation. Based on management comments, we revised Recommendation 2. to periodically review contractor travel and ensure that extraordinary expenditures were reviewed, properly documented, and adequately justified.

We recommend that the Director, Ballistic Missile Defense Organization:

1. Instruct the contracting officer for the contracts to initiate action to recover questioned costs of $53,904 for the per diem paid to contractor employees on long-term temporary duty.

Management Comments. BMDO concurred with the recommendation and stated action to recover the $53,904 would be initiated by the administrative contracting officer. Collection action would be completed by December 31, 1994.

2. Periodically review contractor travel and assure that extraordinary expenditures are reviewed, properly documented, and adequately justified.

Management Comments. BMDO nonconcurred with the draft report recommendation to establish procedures in operating instructions for contracting officers to require contractors identify travel costs for out-of-town employees in contract task plans, to require contractor employees on long-term temporary duty use reduced per diem rates, and to approve travel costs for conferences and meetings of large numbers of contractor employees. BMDO stated that, in view of the volume of travel and the potential for abuse, BMDO concurred with the recommendation that special care should be given to management of contractor-incurred travel costs.

Audit Response. We revised the recommendation in response to comments from BMDO. We request BMDO provide comments on the revised recommendation as part of its comments on the final report.

Response Requirements Per Recommendation

See Appendix D for a detailed list of the responses required from management on the final report.

Part III - Additional Information

Appendix A. Federal Acquisition Regulation Criteria

The following parts of the FAR were used as criteria in the course of the audit.

3.501, "Buying-in."

3.501-1, "Definition."

"Buying-in" means submitting an offer below anticipated costs, expecting to--

(a) Increase the contract amount after award (e.g., through unnecessary or excessively priced change orders); or

(b) Receive follow-on contracts at artificially high prices to recover losses incurred on the buy-in contract.

3.501-2, "General."

(a) Buying-in may decrease competition or result in poor contract performance. The contracting officer must take appropriate action to ensure buying-in losses are not recovered by the contractor through the pricing of (1) change orders or (2) follow-on contracts subject to costs analysis.

(b) The Government should minimize the opportunity for buying-in by seeking a price commitment covering as much of the entire program concerned as is practical by using--

(1) Multiyear contracting, with a requirement in the solicitation that a price be submitted only for the total multiyear quantity; or
(2) Priced options for additional quantities that, together with the firm contract quantity, equal the program requirements (see Subpart 17.2).

(c) Other safeguards are available to the contracting office to preclude recovery of buying-in losses (e.g., amortization of nonrecurring costs (see 15.804-6(f) and treatment of unreasonable price quotations (see 15.803(d)).

15.8, "Price Negotiation."

15.807, "Prenegotiation Objectives."

(a) The process of determining prenegotiation objectives helps the contracting officer judge the overall reasonableness of proposed prices and to negotiate a fair and reasonable price or cost and fee. In setting the prenegotiation objectives, the contracting officer shall analyze the offerer's proposal, taking into account the field pricing report, if any; any audit report and technical analysis whether or not part of a field pricing report; and other pertinent data such as independent Government cost estimates and price histories. This process may include fact-finding sessions with the offerer when the contracting officer deems appropriate.

(b) The contracting officer shall establish prenegotiation objectives before the negotiation of any pricing action. The scope and depth of the analysis supporting the objectives should be directly related to the dollar value, importance, and complexity of the pricing action. When cost analysis is required, the analysis shall address (1) the pertinent issues to be negotiated, (2) the cost objectives, and (3) a profit or fee objective.

(c) The Government's cost objective and proposed pricing arrangement directly affect the profit or fee objective. Because profit or fee is only one of several interrelated variables, the contracting officer shall not agree on profit or fee without concurrent agreement on cost and type of contract. Specific agreement on the exact values or weights assigned to individual profit-analysis factors (see 15.905) is not required during negotiations and should not be attempted.

15.808, "Price Negotiation Memorandum."

(a) At the conclusion of each negotiation of an initial or revised price, the contracting officer shall promptly prepare a memorandum of the principal elements of the price negotiation. The memorandum shall be included in the contract file and shall contain the following minimum information:

(1) The purpose of the negotiation.

(2) A description of the acquisition, including appropriate identifying numbers (e.g., RFP No.).

(3) The name, position, and organization of each person representing the contractor and the Government in the negotiation.

(4) The current status of the contractor's purchasing system when material is a significant cost element and the current status of other contractor systems (e.g., estimating, accounting, and compensation) to the extent that these additional systems were affected and were considered in the negotiation.

(5) If certified cost or pricing data were required, the extent to which the contracting officer-

(i) Relied on the cost or pricing data submitted and used them in negotiating the price; and
(ii) Recognized as inaccurate, incomplete, or noncurrent any cost or pricing data submitted; the action taken by the contracting officer and the contractor as a result; and the effect of the defective data on the price negotiated.

(6) If cost or pricing data were not required in the case of any price negotiation exceeding the thresholds set forth at 15.804-2(a)(1), the exemption or waiver used and the basis for claiming or granting it.

(7) If certified cost or pricing data were required by the contracting officer under 15.804-2(a)(2), the rationale for such requirement.

(8) A summary of the contractor's proposal, the field pricing report recommendations, and the reasons for any pertinent variances from the field pricing report recommendations. Where the determination of price reasonableness is based on cost analysis, the summary shall address the amount of each major cost element (i) proposed by the contractor, (ii) recommended by the field or other pricing assistance report (if any), (iii) contained in the Government's negotiation objective, and (iv) considered negotiated as a part of the price.

(9) The most significant facts or considerations controlling the establishment of the prenegotiation price objective and the negotiated price including an explanation of any significant differences between the two positions. To the extent such direction is received, the price negotiation memorandum (PNM) shall discuss and quantify the impact of direction given by Congress, other agencies, and higher level officials (i.e., officials who would not normally exercise authority during the award and review process for the instant contract action) if the direction has had a significant effect on the action.

(10) The basis for determining the profit or fee prenegotiation objective and the profit or fee negotiated.

(b) Whenever a field pricing report has been submitted, the contracting officer shall forward a copy of the price negotiation memorandum (PNM) to the cognizant audit office and a copy to the cognizant administrative contracting officer. When appropriate, information on how the advisory services of the field pricing support team can be made more effective should be provided separately.

15.9, "Profit"

15.903, "Contracting Officer Responsibilities."

(a) When the price negotiation is not based on cost analysis, contracting officers are not required to analyze profit.

(b) When the price negotiation is based on cost analysis, contracting officers in agencies that have a structured approach shall use it to analyze profit. When not using a structured approach, contracting officers shall comply with 15.905-1 in developing profit or fee prenegotiation objectives.

(c) Contracting officers shall use the Government prenegotiation cost objective amounts as the basis for calculating the profit or fee prenegotiation objective. Before the allowability of facilities capital cost of money, this cost was included in profits or fees. Therefore, before applying profit or fee factors, the contracting officer shall exclude any facilities capital cost of money included in the cost objective amounts. If the prospective contractor fails to identify or propose facilities capital cost of money in a proposal for a contract that will be subject to the cost principles for contracts with commercial organizations (see Subpart 31.2), facilities capital cost of money will not be an allowable cost in any resulting contract (see 15.904).

(d)(1) The contracting officer shall not negotiate a price or fee that exceeds the following statutory limitations, imposed by 10 U.S.C. 2306(d) and 41 U.S.C. 254(b):

(i) For experimental, developmental, or research work performed under a cost-plus-fixed-fee contract the fee shall not exceed 15 percent of the contract's estimated cost, excluding fee.
(ii) For architect-engineering services for public works or utilities, the contract price or the estimated cost and fee for production and delivery of designs, plans, drawings, and specifications shall not exceed 6 percent of the estimated cost of construction of the public work or utility, excluding fees.
(iii) For other cost-plus-fixed-fee contracts, the fee shall not exceed 10 percent of the contract's estimated cost, excluding fee.

(2) The limitations in subdivisions (1)(i) and (iii) above shall apply also to the maximum fees on cost-plus-incentive-fee and cost-plus-award-fee contracts. However, a deviation to the maximum-fee limitation for a specific cost-plus-incentive-fee or cost-plus-award-fee contract may be authorized in accordance with Subpart 1.4.

(e) The contracting officer shall not require any prospective contractor to submit details or its profit or fee objective but shall consider them if they are submitted voluntarily.

(f) If a change or modification (1) calls for essentially the same type and mix of work as the basic contract and (2) is of relatively small dollar value compared to the total contract value, the contracting officer may use the basic contract's profit or fee rate as the prenegotiation objective for that change or modification.

15.905, "Profit-analysis factors."

15.905-1, "Common factors."

Unless it is clearly inappropriate or not applicable, each factor outlined in paragraphs (a) through (f) of this subsection shall be considered by agencies in developing their structured approaches and by contracting officers in analyzing profit whether or not using a structured approach.

(a) *Contractor effort.* This factor measures the complexity of the work and the resources required of the prospective contractor for contract performance. Greater profit opportunity should be provided under contracts requiring a high degree of professional and managerial skill and to prospective contractors whose skills, facilities, and technical assets can be expected to lead to efficient and economical contract performance. Subfactors (1) through (4) following shall be considered in determining contractor effort, but they may be modified in specific situations to accommodate differences in the categories used by prospective contractors for listing costs:

(1) *Material acquisition.* This subfactor measures the managerial and technical effort needed to obtain the required purchased parts and material, subcontracted items, and special tooling. Considerations include (i) the complexity of the items required, (ii) the number of purchase orders and subcontracts to be awarded and administered, (iii) whether established sources are available or new or second sources must be developed, and (iv) whether material will be obtained through

routine purchase orders or through complex subcontracts requiring detailed specifications. Profit consideration should correspond to the managerial and technical effort involved.

(2) *Conversion direct labor.* This subfactor measures the contribution of direct engineering, manufacturing, and other labor to converting the raw materials, data, and subcontracted items into the contract items. Considerations include the diversity of engineering, scientific, and manufacturing labor skills required and the amount and quality of supervision and coordination needed to perform the contract task.

(3) *Conversion-related indirect costs.* This subfactor measures how much the indirect costs contribute to contract performance. The labor elements in the allocable indirect costs should be given the profit consideration they would receive if treated as direct labor. The other elements of indirect costs should be evaluated to determine whether they (i) merit only limited profit consideration because of their routine nature or (ii) are elements that contribute significantly to the proposed contract.

(4) *General management.* This subfactor measures the prospective contractor's other indirect costs and general and administrative (G&A) expense, their composition, and how much they contribute to contract performance. Considerations include (i) how labor in the overhead pools would be treated if it were direct labor, (ii) whether elements within the pools are routine expenses or instead are elements that contribute significantly to the proposed contract, and (iii) whether the elements require routine as opposed to unusual managerial effort and attention.

(b) *Contract cost risk.* (1) This factor measures the degree of cost responsibility and associated risk that the prospective contractor will assume (i) as a result of the contract type contemplated and (ii) considering the reliability of the cost estimate in relation to the complexity and duration of the contract task. Determination of contract type should be closely related to the risks involved in timely, cost-effective, and efficient performance. This factor should compensate contractors proportionately for assuming greater cost risks.

(2) The contractor assumes the greatest cost risk in a closely priced firm-fixed-price contract under which it agrees to perform a complex undertaking on time and at a predetermined price. Some firm-fixed-price contracts may entail substantially less cost risk than others because, for example, the contract task is less complex or many of the contractor's costs are known at the time of price agreement, in which case the risk factor should be reduced accordingly. The contractor assumes the least cost risk in a cost-plus-fixed-fee level-of-effort contract, under which it is reimbursed those costs determined to be allocable and allowable, plus the fixed fee.

(3) In evaluating assumption of cost risk, contracting officers shall, except in unusual circumstances, treat time-and-materials, labor-hour, and firm-fixed-price, level-of-effort term contracts as cost-plus-fixed-fee contracts.

(c) *Federal socioeconomic programs.* This factor measures the degree of support given by the prospective contractor to Federal socioeconomic programs, such as those involving small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, handicapped sheltered workshops, labor surplus areas, and energy conservation. Greater profit opportunity should be provided contractors who have displayed unusual initiative in these programs.

(d) *Capital investments.* This factor takes into account the contribution of contractor investments to efficient and economical contract performance.

(e) *Cost-control and other past accomplishments.* This factor allows additional profit opportunities to a prospective contractor that has previously demonstrated its ability to perform similar tasks effectively and economically. In addition, consideration should be given to (1) measures taken by the prospective contractor that result in productivity improvements and (2) other cost-reduction accomplishments that will benefit the Government in follow-on contracts.

(f) *Independent development.* Under this factor, the contractor may be provided additional profit opportunities in recognition of independent development efforts relevant to the contract end item without Government assistance. The contracting officer should consider whether the development cost was recovered directly or indirectly from Government sources.

15.905-2, "Additional Factors."

In order to foster achievement of program objectives, each agency may include additional factors in its structured approach or take them into account in the profit analysis of individual contract actions.

16.3, "Cost-Reimbursement Contracts"

16.301-2, "Application."

Cost-reimbursement contracts are suitable for use only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract.

16.301-3, "Limitations."

A cost-reimbursement contract may be used only when-

(a) The contractor's accounting system is adequate for determining costs applicable to the contract;

(b) Appropriate Government surveillance during performance will provide reasonable assurance that efficient methods and effective cost controls are used;

(c) A determination and findings has been executed, in accordance with agency procedures, showing that (1) this contract type is likely to be less costly than any other type or (2) it is impractical to obtain supplies or services of the kind or quality required without the use of this contract type (see 10 U.S.C. 2306(c), 2310(b), and 2311 or 41 U.S.C. 254(b), 257(b) and 257(a)); and

(d) See 15.903(d) for statutory limitations on price or fee.

16.404-2, "Cost-plus-award-fee Contracts."

(a) Description. A cost-plus-award-fee contract is a cost-reimbursement contract that provides for a fee consisting of (1) a base amount fixed at inception of the contract and (2) an award amount that the contractor may earn in whole or in part during performance and that is sufficient to provide motivation for excellence in such areas as quality, timeliness, technical ingenuity, and cost-effective management. The amount of the award fee to be paid is determined by the Government's judgmental evaluation of the contractor's performance in terms of the criteria stated in the contract. This determination is made unilaterally by the Government and is not subject to the Disputes clause.

(b) Application. (1) The cost-plus-award-fee contract is suitable for use when-

(i) The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance, or schedule;
(ii) The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the Government with the flexibility to evaluate both actual performance and the conditions under which it was achieved; and
(iii) Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits.

(2) The number of evaluation criteria and the requirements they represent will differ widely among contracts. The criteria and rating plan should motivate the contractor to improve performance in the areas rated, but not at the expense of at least minimum acceptable performance in all other areas.

(3) Cost-plus-award-fee contracts shall provide for evaluation at stated intervals during performance, so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected. Partial payment of fee shall generally correspond to the evaluation periods. This makes effective the incentive which the award fee can create by inducing the contractor to improve poor performance or to continue good performance.

(c) Limitations. No cost-plus-award-fee contract shall be awarded unless-

(1) All of the limitations in 16.301-3 are complied with;

(2) The maximum fee payable (i.e., the base fee plus the highest potential award fee) complies with the limitations in 16.301-3; and

(3) The contract amount, performance period, and expected benefits are sufficient to warrant the additional administrative effort and cost involved.

31.201-2, "Determining Allowability."

(a) The factors to be considered in determining whether a cost is allowable include the following:

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting principles and practices appropriate to the particular circumstances.

(4) Terms of the contract

(5) Any limitations set forth in this subpart.

31.201-3, "Determining Reasonableness."

(a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

(b) What is reasonable depends upon a variety of considerations and circumstances, including-

(1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
(2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations;
(3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
(4) Any significant deviations from the contractor's established practices.

31.201-4, "Determining Allocability."

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it-

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

37.104, "Personal Services Contracts."

(a) As indicated in 37.101, a personal services contract is characterized by the employer-employee relationship it creates between the Government and the contractor's personnel. The Government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by the civil service laws. Obtaining personal services by contract, rather than by direct hire, circumvents those laws unless Congress has specifically authorized acquisition of the services by contract.

(b) Agencies shall not award personal contracts unless specifically authorized by statute (e.g., 5 U.S.C. 3109) to do so.

(c) (1) An employer-employee relationship under a service contract occurs when, as a result of (i) the contract's terms or (ii) the manner of its administration during performance, contractor personnel are subject to the

relatively continuous supervision and control of a Government officer or employee. However, giving an order for a specific article or service, with the right to reject the finished product or result, is not the type of supervision or control that converts an individual who is an independent contractor (such as a contractor employee) into a Government employee.

(2) Each contract arrangement must be judged in the light of its own facts and circumstances, the key question always being: Will the Government exercise relatively continuous supervision and control over the contractor personnel performing the contract. The sporadic, unauthorized supervision of only one or a large number of contractor employees might reasonably be considered not relevant, while relatively continuous Government supervision of a substantial number of contractor employees would have to be taken strongly into account (see(d) below).

(d) The following descriptive elements should be used as a guide in assessing whether or not a proposed contract is personal in nature:

(1) Performance on site.
(2) Principal tools and equipment furnished by the Government.
(3) Services are applied directly to the integral effort of agencies or an organizational subpart in furtherance of assigned function or mission.
(4) Comparable services, meeting comparable needs, are performed in the same or similar agencies using civil service personnel.
(5) The need for the type of service provided can reasonably be expected to last beyond 1 year.
(6) The inherent nature of the service, or the manner in which it is provided, reasonably requires directly or indirectly, Government direction or supervision of contractor employees in order to--
(i) Adequately protect the Government's interest;
(ii) Retain control of the function involved; or
(iii) Retain full personal responsibility for the function supported in a duly authorized Federal officer or employee.

(e) When specific statutory authority for a personal service contract is cited, obtain the review and opinion of legal counsel.

(f) Personal services contracts for the services of individual experts or consultants are limited by the Classification Act. In addition, the Office of Personnel Management has established requirements which apply in acquiring the personal services of experts or consultants in this manner (e.g., benefits, taxes, conflicts of interest). Therefore, the contracting officer shall effect necessary coordination with the cognizant civilian personnel office.

Part 45, "Government Property"

45.101, "Definitions."

(a) "Contractor-acquired property," as used in this part, means property acquired or otherwise provided by the contractor for performing a contract and to which the Government has title.

"Government-furnished property," as used in this part, means property in the possession of, or directly acquired by, the Government and subsequently made available to the contractor.

"Government property," means all property owned by or leased to the Government or acquired by the Government under the terms of the contract. It includes both Government-furnished property and contractor-acquired property as defined in this section.

"Plant equipment," as used in this part, means personal property of a capital nature (including equipment, machine tools, test equipment, furniture, vehicles, and accessory and auxiliary items) for use in manufacturing supplies, in performing services, or for any administrative or general plant purpose. It does not include special tooling or special test equipment.

"Property," as used in this part, means all property, both real and personal. It includes facilities, material, special tooling, special test equipment, and agency-peculiar property.

"Real property," as used in this part, means land and rights in land, ground improvements, utility distribution systems, and buildings and other structures. It does not include foundations and other work necessary for installing special tooling, special test equipment, or plant equipment.

"Special test equipment," as used in this part, means either single or multipurpose integrated test units engineered, designed, fabricated, or modified to accomplish special purpose testing in performing a contract. It consists of items or assemblies of equipment including standard or general purpose items or components that are interconnected and interdependent so as to become a new functional entity for special testing purposes. It does not include material, special tooling, facilities (except foundations and similar improvements necessary for installing special test equipment), and plant equipment items used for general plant testing purposes.

"Special tooling," as used in this part, means jigs, dies, fixtures, molds, patterns, taps, gauges, other equipment and manufacturing aids, all components of these items, and replacement of these items, which are of such a specialized nature that without substantial modification or alteration their use is limited to the development or production of particular supplies or parts thereof or to the performance of particular services. It does not include material, special test equipment, facilities (except foundations and similar improvements necessary for installing special tooling), general or special machine tools, or similar capital items.

(b) Additional definitions also applying throughout this part appear in those subparts where the terms are most frequently used.

45.302, "Providing Facilities."

45.302-1, "Policy."

(a) Contractors shall furnish all facilities required for performing Government contracts except as provided in this subsection. Government facilities provided to contractors shall be individually identified in the solicitation, if possible, and contract. Agencies shall not furnish facilities to contractors for any purpose, including restoration, replacement, or modernization, except as follows:

(1) For use in a Government-owned, contractor-operated plant operated on a cost-plus-fee basis.
(2) For support of industrial preparedness programs.
(3) As components of special tooling or special test equipment acquired or fabricated at Government expense.
(4) When, as a result of the prospective contractor's written statement asserting inability to obtain facilities, the agency head or designee issues a Determination and Finding (see Subpart 1.7) that the contract cannot be fulfilled by any other practical means or that it is in the public interest to provide the facilities.

(i) If the contractor's inability to provide facilities is due to insufficient lead time, the Government may provide existing facilities until the contractor's facilities can be installed.

(ii) Mere assertion by a contractor that it is unable to provide facilities is not, in itself, sufficient to justify approval. Appropriate Government officials must determine that providing Government facilities is justified.

(iii) The determination shall include findings that private financing of the facilities was sought but not available or that private financing was determined not advantageous to the Government. The determination shall also state that the contract cannot be accomplished without Government facilities being provided.

(iv) The original determination shall be included in the contract file.

(v) No determination is required when the facilities are provided as components of special tooling or special test equipment acquired or fabricated at Government expense

(5) As otherwise authorized by law or regulation.

(b) Agencies shall not-

(1) Furnish new facilities to contractors unless existing Government-owned facilities are either inadequate or cannot be economically furnished;

(2) Use research and development funds to provide contractors with new construction or improvements of general utility, unless authorized by law; or

(3) Provide facilities to contractors solely for non-Government use, unless authorized by law.

(c) Competitive solicitations shall not include an offer by the Government to provide new facilities, nor shall solicitations offer to furnish existing Government facilities that must be moved into a contractor's plant, unless adequate price competition cannot be otherwise obtained. Such solicitations shall require contractors to identify the Government-owned facilities desired to be moved into their plants.

(d) Government facilities with a unit cost less than $10,000 shall not be provided to contractors unless-

(1) The contractor is a nonprofit institution of higher education or other nonprofit organization whose primary purpose is the conduct of scientific research;

(2) A contractor is operating a Government-owned plant on a cost-plus-fee basis;

(3) A contractor is performing on a Government establishment or installation;

(4) A contractor is performing under a contract specifying that it may acquire or fabricate special tooling, special test equipment, and components thereof subsequent to obtaining the approval of the contracting officer; or

(5) The facilities are unavailable from other than Government sources.

45.302-2, "Facilities Contracts."

(a) Facilities shall be provided to a contractor or subcontractor only under a facilities contract using the appropriate clauses required by 45.302-6, except as provided in 45.302-3.

(b) All facilities provided by a contracting activity for use by a contractor at any on plant or general location shall be governed by a single facilities contract, unless the contracting officer determines this to be impractical. Each agency should consolidate, to the maximum practical extent, its facility contracts covering specific contractor locations.

(c) No fee shall be allowed under a facilities contract. Profit or fee (plus or minus) shall be considered in awarding any related supply or service contract, consistent with the profit guidelines of Subpart 15.9.

(d) Special tooling and special test equipment will normally be provided to a contractor under a supply contract, but may be provided under a facilities contract when administratively desirable.

(e) Agencies shall ensure that facility projects involving real property transactions comply with applicable laws (e.g., 10 U.S.C. 2676 and 41 U.S.C. 12 and 14).

45.302-3, "Other Contracts."

(a) Facilities may be provided to a contractor under a contract other than a facilities contract when one of the following exceptions applies:

(1) The actual or estimated cumulative acquisition cost of the facilities provided by the contracting activity to the contractor at one plant or general location does not exceed $1,000,000;
(2) The number of items of plant equipment provided is ten or fewer;
(3) The contract performance period is twelve months or less;
(4) The contract is for construction;
(5) The contract is for services and the facilities are to be used in connection with the operation of a Government-owned plant or installation; or
(6) The contract is for work within an establishment or installation operated by the Government.

(b) When a facilities contract is not used, the Government's interest shall normally be protected by using the appropriate Government property clause or, in the case of subparagraph (a)(5) of this subsection, by appropriate portions of the facilities clauses.

(c) No profit or fee shall be allowed on the cost of the facilities when purchased for the account of the Government under other than a facilities contract. General purpose components of special tooling or special test equipment are not facilities.

FAR Appendix B. Part 9904 - Cost Accounting Standards

9904.402, "Cost Accounting Standard -- Consistency in Allocating Costs Incurred for the Same Purpose."

9904.402-20, "Purpose."

The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective. The criteria for determining the allocation of costs to a product, contract, or other cost objective should be the same for all similar objectives. Adherence to these cost accounting concepts is necessary to guard against the overcharging of some cost objectives and to prevent double counting. Double counting occurs most commonly when cost items are allocated directly to a cost objective without eliminating like cost items from indirect cost pools which are allocated to that cost objective.

9904.402-40, "Fundamental Requirement."

All costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. No final cost objective shall have allocated to it as indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective. Further, no final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included in any indirect cost pool to be allocated to that or any other final cost objective.

Appendix B. Contract Sections

The following contract sections were used as criteria during the course of the audit.

Section G-5, "Contracting Officer's Technical Representative."

b. The contractor is advised that only the Procuring Contracting Officer (PCO) and Administrative Contracting Officer (ACO) can change or modify the terms of this contract or take any other action which obligates the Government and then such action must be set forth in a formal modification to the contract. The authority of the COTR is strictly limited to the specific duties set forth in his/her letter of appointment, a copy of which will be furnished to the contractor. Contractors who rely on direction from other than the PCO or ACO (or a COTR acting within the strict limits of his responsibilities as set forth in his letter of appointment) do so at their own risk and expense as such actions do not bind the Government contractually. Any questions concerning the authority of a Government employee to direct the contractor contractually should be referred to the Contracting Officer.

Section H-3, "Travel and Travel Costs."

a. All travel required in the performance of this contract to perform tasks assigned must be approved by the Contracting Officer prior to performance of such travel. Such approval will be included in the formal Task Order issued in accordance with Special Contract Requirement H-9. Task Orders may be modified from time to time to accommodate increased travel requirements when deemed necessary in the performance of technical effort.

b. The contractor agrees to use tourist or coach class air travel and economy rental cars while traveling. Per diem rates shall be in consonance with the Joint Travel Regulation in effect at the time of travel. If the contractor exceeds the costs which would result from the above parameters, written justification must be provided with regular invoices for payment. If this justification is not satisfactory to the Government, it may be cause for disallowance of the costs considered to be excessive.

c. Allowable travel costs shall be determined in accordance with FAR 31.205-35. The contractor agrees that billing to the Government for travel costs will be only for reimbursement of costs incurred, and will not include fee, or any burdens except where the contractor's approved DCAA accounting procedures include burden for travel.

Section H-3, "Travel and Travel Costs," modification P00001, dated August 23, 1988, deleted paragraph a. and replaced it with the following paragraph a:

> a. All travel required in the performance of this contract to perform tasks assigned must be approved by the Contracting Officer's Technical Representative (COTR) prior to performance of such travel. Task Order approval does not constitute approval of travel. Task Orders may be modified from time to time to accommodate increased travel requirements when deemed necessary in the performance of technical effort.

Attachment 1, "Statement of Work."

Part 4.1.1., "Direct Support Group."

> Unless specified otherwise all direct support group Personnel shall have the capability to interact with SDIO personnel on a daily, on call basis. They shall be located at a contractor facility within 25 miles of the Pentagon which is easily accessible from the Pentagon by public, contractor-provided or equivalent transportation. The contractor shall provide office space and all necessary materials, equipment, and supplies (except for those items specifically identified as being Government furnished) required in performance of this contract.

Part 4.1.2., "Supplementary Support."

> The Supplementary Support shall consist of specialists who are on call from within the contractor's company resources or from other sources, perhaps from other than the direct support location. Supplementary support may be necessary when the services of highly-specialized experts are required on a short-term basis or when SETA is required in areas of technical expertise not otherwise provided in the DSG [Direct Support Group].

Section H-9, "Task Award Procedure."

> h. In performing the work designated in the Task Order, the contractor(s) must follow the approach as described in the Task Plan submitted by the contractor to the Contracting Officer. If any revision becomes necessary to the schedule of performance, estimated cost (more than + or - 10% variance), or level of effort (more than + or - 10% variance), the contractor shall promptly submit to the Contracting Officer a revised Task Plan with explanatory notes. The contractor's revised Task Plan will be reviewed by the Contracting Officer and comments will be furnished within fifteen (15) calendar days from the date of submission.

Section H-12, "Definition of Labor Categories."

a. Contractor labor categories are to be as follows:

Senior Engineer/Scientist

Engineer/Scientist

Associate Engineer

Senior Analyst

Analyst

Associate Analyst

Clerical/Administrative

Graphics

Section H-14, "Surge Requirements."

a. Additional quantities of one or more of the labor categories listed in special contract provision H-12 may be called for under CLIN [Contract Line Item Number] 0006 by the Contracting Officer giving notice to the contractor at any time during the period of performance of this contract. Within 30 days after such notice, the contractor shall provide the additional quantities called for. Such notice shall be the issuance of a unilateral contract modification by the Contracting Officer. Accompanying the notification shall be a Task Order in accordance with the provision of clause H-9, to which the contractor shall respond. The Government's requirements for additional tasks may be continuing or intermittent in nature.

b. The surge described above may be exercised in whole or in part solely at the discretion of the Government; however, in no event will the aggregate maximum of increased effort called for hereunder exceed 100 percent of the applicable contract year CLIN. Surge exercised in any given contract period will be valid for a period not-to-extend beyond that contract period.

Section H-16, "Order of Precedence."

a. The Schedule (excluding Statement of Work);

b. Contract Clauses;

c. Other terms of the contract, when attached or incorporated by reference;

d. The Statement of Work

Section H-20, "Award Fee."

b. The maximum award fee available for any evaluation period shall be based on 15 percent of the total estimated costs of all task orders issued and that portion of the performance period of an order, falling within an evaluation period. For example, where an order is issued at contract announcement with a 12 month period of performance and an estimated cost of $100,000, $7,500 would go into the award fee pool for the first 6 month evaluation period and $7,500 into the pool for the second evaluation period.

c. The award fee shall be based on established estimated costs of task orders and shall not exceed 15% of the total estimated costs for such orders under this contract.

d. The Award Fee Determination Plan is in accordance with Attachment 3.

e. Award fee incentive flowdown is in accordance with Attachment 4.

Attachment 4, "Award Fee Flowdown Plan."

Part 3.1.1, "Operation of TASC's [The Analytic Sciences Corporation] Plan."

TASC's plan features a separate award fee for each Team member. In all cases, the Team member will be eligible for an award within the range of 0-15% as specified by SDIO. The award will consist of two parts -- Part A, resulting from TASC's evaluation of the individual Team member's performance and Part B, resulting from SDIO's evaluation of the performance of the entire team. The sum of the two parts would yield the maximum 15% award.

Part A will be established by including a specified percentage of each Team member's non-travel cost as part of the total estimated cost of each Task Plan. This amount will range between 4-10% depending on the following factors: (1) the portion of the Task Plan to be accomplished by subcontractors, (2) the nature of the work, and (3) the complexity of the management responsibility. Part B will be the balance of the 15% maximum award. For this part, TASC will flow down the same composite score which resulted from SDIO's evaluation of the performance of the entire team. Funds for Part B will be taken from those awarded by SDIO.

In all but one Task Plan estimate submitted as part of this offer, TASC has included 9% of each Team member's cost for Part A. Task Plan 1.2 is submitted with a 4% amount. TASC intends to include only 4% of costs when more than 90% of the effort in a given Task will be performed by subcontractors. This is in response to specific concerns raised by the Government during discussions. For Part B, therefore, in all but Task Plan 1.2, a Team member would be eligible for a maximum award of 6% -- that is, 15% minus 9%. In Task Plan 1.2, the maximum Part B award would be 11% -- 15% minus 4%.

TASC's own fee would consist of the remainder of SDIO's award after flowing down Part B to the Team member. Table 3.1-1 . . . displays the profit to be realized by The contractor under its Performance Award Plan. Given the responsibilities of the prime contractor, including the financing of payments to subcontractors and the mobilization of all resources necessary for high quality performance, TASC believes such fees to be both reasonable and warranted.

Part 3.1.2, "TASC's Performance Award Incentives."

- Assuring Innovative Management by TASC - As Prime, TASC will be optimally effective in managing the Team if its profitability is unaffected by TASC's award to any Team member. Therefore, TASC will establish separate, two-part awards for each Team member. The establishment of individual awards assures TASC's objectivity when evaluation the performance of Team members and eliminates any possibility of a financial conflict of interest. It also removes from the total estimated cost base for TASC's Award Fee (as established under Clause H20) an amount equal to the maximum Part A Performance Award for each Team member. Thus, TASC cannot earn profit on Team members' profit.

- Rewarding Truly Extraordinary Performance by Team members - TASC's program is designed to encourage truly extraordinary performance which, in the words of the solicitation, "substantially contributes to a high award fee determination." The separate, 0-15% two-part award for each Team member establishes a valuable incentive for extraordinary performance while, at the same time, avoids the need to take from one Team member to reward another.

- Relating Each Team Member's (Subcontractor's) Profit Both to its Performance and to the Team's Performance - Part A of the award fee of each Team member will be based on an evaluation of its performance by TASC's Performance Award Board. Part B of the award fee will be based on the evaluation SDIO makes of the Team as a whole. Both parts will be distributed to the Team members consistent with an algorithm that yields above average fees only when performance is of high quality.

- Rewarding Teamwork and Cooperation in Performance of the Work - Although the major purpose of our program is to establish incentives for superior performance by each company, it is critical that this not be accomplished at the expense of teamwork and efficiency in achievement of program objectives. Therefore, our program has several features to encourage cooperative effort. First, Part B of the Award will be based solely on SDIO's evaluation of Team performance. Second, a portion of the evaluation of each Team member for Part A will be based on the member's contribution to the team and to coordination of effort. Finally, the establishment of separate awards, for each Team member and for TASC, assures cooperation among all Team members, including TASC.

- Relating TASC's Profit to the Performance of the Team - The Solicitation establishes an SDIO Award Fee Review Board to evaluate performance of the Team as a whole. TASC believes that the results of that evaluation should determine the level of profit earned by TASC. The role of TASC as manager of an activity as complex as the SETA contract is critical to the achievement of SDIO objectives. Therefore, TASC proposes that the SDIO award be the sole determinant of TASC's profit.

Section H-22, "Government Will Not Furnish Facilities."

The contractor's obligation to perform this contract is in no way conditioned upon the providing by the Government of any facilities, as defined in FAR 45.301. Accordingly, no such facilities shall be either acquired by the contractor for the account of the Government nor does the Government plan to furnish any facilities to the contractor.

Appendix C. Management Comments and Audit Responses on the Findings

Finding A. Cost-Effectiveness of Contracted Services

Management Comments on Cost-Effectiveness of Contracted Services. BMDO commented that our statement, "BMDO awarded the super SETA contracts because BMDO was not authorized sufficient in-house employees to perform its mission," was speculative and that no basis exists for concluding that none of the effort would have been accomplished by contractors.

Audit Response. We did not conclude that all of the contractor effort should have been performed by in-house DoD civilian and military employees. Contracted services are appropriate to acquire special knowledge and skills not available in the Government and the services needed are short-term, nonrecurring in nature. However, a significant amount of the work performed by the super SETA contractors that helped BMDO accomplish its mission could have been done by DoD civilian and military employees. Further, the fact that a large number of the contractor employees were retired military officers indicates that knowledge and skills required were available in the Government.

Management Comments on Staff Year Cost Comparison, Subcontractor Staff Year Costs. BMDO commented that the cost comparisons were based on a single contract and that BMDO had an excellent record of using competition and effective contract management to obtain high quality services at reasonable cost with rates frequently much lower than those reflected in the report.

Audit Response. We did use a single contract, the largest super SETA contract, for our cost comparison. The contract used for our comparison had the lowest composite hourly cost (total contract cost divided by total staff hours) of the three super SETA contracts. Therefore, we believe that the cost comparison methodology would apply to the other contracts.

Management Comments on Award Fee and Administrative Cost on Subcontractor Costs. BMDO stated that showing the maximum award fee and subcontract administrative cost increases of 29.74 percent and 35.82 percent on subcontractor costs for two of the super SETA contracts was misleading. BMDO stated that the audit ignored the fact that total cost to a prime includes subcontractor fees. Further, the maximum award fee for the prime was limited to 15 percent; to characterize it otherwise would lead, falsely, to a conclusion that regulatory restraints on profit or fee were exceeded.

Audit Response. The intent of showing the maximum award fees and administrative cost factors on subcontractor costs was to show the effect of pyramiding of profit or fee on subcontractor costs. The pyramiding of profit or fee on the three super SETA contracts significantly increased the overall cost to the Government. Often, as was the case on the Army FR/IQ contract, the prime contractor's fee is reduced for subcontractor work. Reducing the prime contractor's fee for subcontractor work provides additional incentive for the prime contractor to perform the work and may also increase competition.

Management Comments on Contractor Staff-Year Costs. BMDO stated the comparison of burdened staff-year costs with the Army FR/IQ contract was not valid. The BMDO contracts did not prescribe delivery of labor hours in accordance with the "minimum personnel" requirements, and the contractor's requirement to deliver a specified mix of labor was determined by the competitive task ordering process. For example, under the Army FR/IQ contract, one would expect the contractor to staff the effort with individuals whose experience and education were very close to the minimum. Under the BMDO contract, it was expected that there would be a wide range above the minimums described in the request for proposal. Furthermore, Inspector General, DoD, Report No. 92-120, "Reasonableness of Costs Charged to Support Services Contract MDA903-88-D-0018," June 30, 1992, stated that almost 50 percent of the professional employees did not meet the minimum contract requirements.

Audit Response. We believe the Army FR/IQ contract was similar enough to the BMDO contract to provide a valid comparison of burdened staff-year costs. For example, the Army had FR/IQ contracts with several contractors, and task orders were awarded to the contractors based on the best qualifications of key individuals identified in task plans. We found no support that individuals on the BMDO contract were more qualified than individuals on the Army FR/IQ contract. Further, Inspector General, DoD, Report No. 92-120 stated the professional employees did not meet the minimum contract requirements for personnel categories or skill levels billed. The firm-fixed price hourly labor costs and lower profit negotiated in the Army FR/IQ contract were the significant factors in the lower labor costs on the Army FR/IQ contract.

Management Comments on Establishing a Maximum Award Fee Objective and Justification for Maximum Award Fee Negotiated. BMDO stated that DFARS 215.974 contains no requirement for a structured analysis when determining the maximum contract award fee. Further, FAR 16.404-2(a) states, "The amount of the award fee to be paid is determined by the Government's judgmental evaluation of the contractor's performance in terms of the criteria stated in the contract."

Audit Response. The contracting officer should document and justify the basis for negotiating the maximum award fee for subcontractors and prime contractors on cost-plus-award-fee contracts. FAR 15.807 states the contracting officer shall establish a prenegotiation objective before the negotiation of any pricing action including a profit or fee objective. FAR 15.808 states the contracting officer shall prepare a price negotiation memorandum that documents the basis for determining the profit or fee prenegotiation objective and the profit or fee negotiated. FAR 15.905-1 provides common factors that shall be considered by agencies contracting officers in analyzing profit whether or not the contracting officers use a structured approach.

Management Comments on Military Personnel. BMDO stated that the implications in the finding about retired military contractor staff would lead to the conclusion that something improper was done when specific individuals were hired as consultants, and was inappropriate and must be deleted. BMDO also stated that using the word "selected" in regard to hiring retired military personnel to fill key DoD civilian positions may convey pre-selection for a civilian position, which is not permitted under civil service regulations.

Audit Response. We addressed retired military personnel working as support services contractors for two reasons: to show the total DoD cost to utilize retired military personnel as support services contractors and to pay full military retirement benefits and to show that the knowledge and skills contracted for were available in the Government. Based on management comments, we revised the finding relating to hiring retired military personnel to fill key DoD civilian positions.

Management Comments on BMDO Manpower Authorizations. BMDO commented that 259 instead of 263 DoD civilian and military employees were authorized for FY 1992.

Audit Response. Based on the management comments, we revised the finding.

Management Comments on Potential Benefits of Increased DoD Civilian Support. BMDO recommended 275 staff years of super SETA support be replaced by DoD civilian employees instead of our suggested 230 staff years.

Audit Response. The 230 staff-year reduction of super SETA contract support and replacement with DoD civilian employees was based on our calculation of a reasonable portion of the effort that could be brought in-house. Based on management comments, we revised the finding to reflect the 275 staff-year reduction of super SETA support and replacement with DoD civilian employees and adjusted the total potential cost benefit accordingly.

Management Comments on Contract Type and Justification. BMDO stated that, at the time of award, a cost-plus-award-fee, level-of-effort, term contract was determined to be the most suitable for the effort required. However, in retrospect, the administrative effort required to properly manage the contract was excessive, and the resources were not available to properly manage the contract. BMDO also stated it was unclear what type of fixed-price contract the Inspector General, DoD, was recommending as an alternative. Further, Inspector General, DoD, use of the Army FR/IQ contract as a basis of comparison was inconsistent because the report also stated that time-and-material contracts were inappropriate. Furthermore, the report did not support that a stable environment existed in which the Government support requirements could lead to a fixed labor mix and thus a fixed-price composite labor rate.

Audit Response. The type of fixed-price contract referred to was a FR/IQ contract. Further, Inspector General, DoD, Report 92-120 stated contract administration for the Army FR/IQ contract was inadequate and did not state the contract type was inappropriate. Report 92-120 did identify Inspector General, DoD, Report No. 91-010, "Administration of Time-and-Materials Contracts at the U.S. Army Troop Support Command," November 7, 1990, that found the contracting officer inappropriately awarded time-and-materials contracts when other contract types were more appropriate. Finally, although we agree significant "programmatic turbulence" existed, we do not believe the complexity or uniqueness of the work increased so much that the contractors could not have taken such risks into account when computing their bids. Thus, we believe a FR/IQ contact could have been used.

Finding B. Contract Management.

Management Comments on Negotiated Rates not used as a Baseline. BMDO stated that the three super SETA contracts were not independent contract awards but were conceived as a "master agreement." The terms of the master agreement contemplated a limited competition among the three super SETA winners. Thus, the labor mix used for the original full and open competition served only to provide a common baseline to assist in determining which players would participate in the master agreement.

Audit Response. The labor mix used for the original full and open competition was used as a basis for contract award and to establish the estimated cost, maximum award fee, and level of effort for the contract and contract surges as shown in table 5. The labor mix proposed should have been the contractor's best estimate of the labor requirements to perform the contract. Consequently, the contracting officer should use this labor mix as a baseline to determine whether the labor mix for the contractor's original proposal was accurate. Further, not all of the task orders were competitively

awarded. Some task orders were awarded on a sole-source basis. The labor mix does not refer only to specific contract labor categories but also to the mix of individuals that represent a specific labor category. The contractor controls the mix of individuals for specific labor categories, which causes the rates to fluctuate.

Management Comments on Proposed Staff-Year Costs Versus Actual Staff-Year Costs. BMDO stated the staff-year cost increase from the original contract proposal was not in dispute. However, the comparison of the actual staff-year cost with that of the original competition without consideration of the competitive aspects of the master agreement or the contract change process is clearly inappropriate and misleading.

Audit Response. Contractors should take the risks of programmatic turbulence into account when computing their bid on these types of contracts. A comparison of the contractor's actual labor costs to the proposed labor costs is useful in determining whether the contractor proposed a lower grade mix of senior engineers than the level needed to perform the contract. On contracts such as the super SETA contracts, changes are inevitable, but the changes do not necessarily mean the complexity of the scope of work has changed from the original contract proposal.

Management Comments on Contract Modifications to Increase Baseline, Actual Level of Effort for Contract Years 1 through 5 Unchanged, and Award Fee on Contract Performance Cost Increases. BMDO stated that the report accurately showed the procedure used to surge the contract. In retrospect, the surge procedure was unnecessary because the surge increased the number of hours that could be ordered and resulted in no effect on the award fee pool. Each award fee pool was established by Government-approved task orders as to the scope of work and the estimated cost. The facts presented in the audit do not constitute a contract overrun scenario because the cost growth was a result of Government-directed contract changes.

Audit Response. We did not classify the cost increase as a contract overrun.

Management Comments on Task Order Baseline. BMDO stated that an initial baseline was established for each task order but the initial baseline did not have the fidelity/detail required to evaluate and measure the contractor's actual cost performance in relation to eventual contract changes. BMDO also stated that the implication that BMDO permitted contractors to replan task orders when actual costs exceeded estimated costs was incorrect and that the report contained no evidence to support that contractors replanned task orders to increase the maximum award fee. BMDO stated that BMDO repeatedly demonstrated to the auditor that all replans were necessitated and dictated by Government programmatic changes and that the contracting officer approved each change.

BMDO stated that the inference that the contractor orchestrated contract changes to enhance its profit is an inappropriate conclusion drawn from a lack of understanding of the programmatics and the contracting process. Further, the implication that the contractor's potential for earned award fee was increased with cost of work performed is inappropriate and not based on facts. Of particular concern is the report's total lack of acceptance of demonstrated Government directed technical changes during the period of performance.

BMDO's analysis showed costs associated with the contractor's direct labor categories for the ending labor mix on two of the task orders reviewed had decreased or only slightly increased. BMDO stated that Government-directed changes to the contract labor mix are technical changes for which the contractor has a right to an equitable adjustment of cost and fee.

Finally, BMDO stated that at no time did a "Personal Services" situation exist and that direction given through the contractor's management does not constitute personal services.

Audit Response. We agree that the contracting officer approved each task order replan submitted by the contractor. However, the contracting officer's approval of task order replans was often after the cost increase had occurred, and the task order replans were used to increase estimated costs to correspond with actual costs. Section H-9 of the contract provides for the contractor to submit task order replans when a variance exists between estimated and actual costs. Consequently, the replans raise the maximum award fee and eliminate any variance between estimated costs and actual costs.

The contractor's potential for earned award fee increased with the increased cost of work performed. For example, the contractor could propose a certain labor mix and then use a more expensive labor mix that would raise the estimated cost and maximum award fee. BMDO did not know the contractor's proposed labor mix for the contract labor categories in the original contract proposal and the contractor's task plans and replans for individual task orders. BMDO has no basis to assume that all technical changes and increases in the level-of-effort resulted in a requirement for the contractor to use a more expensive labor mix than proposed. Further, we have clearly demonstrated that the contractor used a more expensive labor mix on task orders before the contracting officer approved the task order replans.

BMDO's analysis of costs associated with the contractor's labor categories does not consider the fact that the contractor's labor categories were completely different from the contract labor categories. The contractor's proposed costs for the contract labor categories was based on a certain mix, unknown to BMDO, of the contractor's labor

categories. Also, BMDO should not be directing changes to the contractor's proposed labor mix. The Government may change the scope of the work, requiring the contractor to change the proposed labor mix, for which the contractor has a right to an equitable adjustment of cost and fee.

We believe that direction given to contractor personnel by the COTR can constitute personal services. For example, when the COTR consistently tasks and instructs the contractor's program manager which contractor employees should work on specific tasks, such actions result in performance of personal services. Further, COTRs are not authorized to direct the contractor's level of activity and labor mix and thereby affect contract costs.

Management Comments on Cost Realism Analysis. BMDO stated the conclusion that "the contractor proposed an inaccurately low hourly labor rate for senior engineers/scientists and was able to raise the labor rate after task order award" and the associated "buying-in" allegations are misleading and inaccurate. BMDO stated the cost increase on task order 62 was because the Government directed that only senior level people should work on the Task Force requirements.

Audit Response. The contractor's technical proposal included two senior engineers/scientists from the contractor's highest pay category that were not included in the cost proposal. The contractor agreed that hours were inadvertently deleted from the cost proposal. Again, we do not believe the Government (COTR) should direct the contractor to use only high-level people; the contractor should make the decision on which level personnel to use.

Finding C. Contract Terms

Management Comments on Inconsistency Between Contract Attachments 3 and 4. BMDO stated that the finding maintains that contract attachment 4, "Award Fee Flowdown Plan," precludes the contractor from earning fee on its subcontractors' maximum Part A award fee. However, contract attachment 3, "Award Fee Determination Plan," Figure 3.1-1, "TASC's [The Analytic Sciences Corporation's] Two-Part Performance Award Flow-down Plan," shows that the team member's fee was included as an element of costs to the contractor. Further, the contracting officer's statement of record for the auditors reflected the intent of the parties to pay the contractor fee on its subcontractors' maximum Part A award fees.

Audit Response. Figure 3.1-1 is not in contract attachment 3 but is in contract attachment 4. The figure shows the maximum award fee as "15 percent of the total team [contractor and subcontractor] cost," and does not show that the team member's (subcontractor's) fee was considered an element of cost to the contractor for

determining the maximum Part B award fee. We contacted the original contracting officer who prepared the statement of record. He was uncertain whether the Government agreed to pay the contractor fee on its subcontractors' maximum Part A award fees.

Management Comments on Capped Award Fee for Task Order 62. BMDO stated that the 10 percent cap on award fee paid to subcontractors on task order 62 was a matter of mutual consent between the prime contractor and its subcontractors. Consequently, the intent of the contract between BMDO and the contractor was not changed, nor did the award fee flowdown plan in the contract change by this decision. Also, the contract award fee flowdown plan shows that the contractor could propose a Part A award fee for its subcontractors ranging from 4 to 10 percent.

Audit Response. The original super SETA contract solicitation to prospective offerers stated "Since outstanding performance will be compensated by higher award fee, the SDIO [BMDO] intends that incentives reach major subcontractors whose performance contributes to such outstanding performance. Offerers shall address in their management plan the mechanism proposed to achieve this. This element of the management plan will be an important ingredient in the management proposal evaluation . . ."

The contractor's award fee flowdown plan provided that subcontractors would be eligible to earn, in all cases, a maximum award fee of 15 percent. The maximum award fee would consist of two parts. Part A, ranging from 4 to 10 percent, would be based on the contractor's evaluation of the subcontractor' performance. Part B, representing the difference between the Part A award fee percent and 15 percent, would be based on BMDO's evaluation of the entire team's performance. Therefore, the sum of the two parts would always yield the maximum 15 percent award.

Finding D. Costs for Facilities, Administrative and Clerical Support, and Government Property

Management Comments on Direct Costs, Indirect Costs, Government Property, Contracting Officer Actions, and Cost Accounting Standard 402. BMDO stated the findings relating to direct costs, indirect costs, and Cost Accounting Standard 402 involved the contractor's practice of charging certain costs that were normally charged indirect, as direct, while applying the full overhead rate. BMDO stated the issue was referred to the administrative contracting officer and the cognizant DCAA auditor for determination of the relevant facts and collection of costs pursuant to the Cost Accounting Standard administrative clause of the contract.

BMDO stated that the issue relating to the contractor charging certain leased costs as a direct cost in a manner inconsistent with its established accounting practice may be incorrect. Leased costs identifiable to single final-cost objective are direct costs to the contract. Further, if the Government incurred leased costs in an amount in excess of the cost of ownership, the excess cost would generally be considered unallowable. BMDO stated this issue was being forwarded to the cognizant administrative contracting officer to determine the relevant facts and issue an opinion as to the cost reasonableness.

BMDO stated that the FAR restriction on profit and fee on Government property was not effective until January 22, 1991, after the super SETA contracts were awarded.

Audit Response. We agree with BMDO that the primary issue is whether the contractor can bill items that are normally charged as indirect costs, as direct costs, and also bill the full overhead rate.

The discussion on leased office space, furniture, and telephones charged as direct costs to the contract was to show that normally the contractor included these costs that were charged direct, as indirect costs, in the contractor's overhead rate. Further, the contractor's overhead rate included a percentage factor for these items.

In regard to the fee on Government property, the basic contract provided that the Government would not provide facilities to the contractor. All Government property identified in the report was identified in task plans submitted by the contractor and approved by the BMDO contracting officer after the effective date of the FAR restriction on profit or fee for contractor-acquired Government property.

Finding E. Other Direct Costs

Management Comments on Other Direct Costs; Cost Accounting Standard 402 Compliance; Contracting Officer, COTR, and Contractor Position. BMDO stated the coffee service and kitchen appliance other direct costs have been referred to the administrative contracting officer and DCAA for final determination and collection action. The issue of numerous catered meals was subject of a Notice of Intent to disallow, and a contracting officer's final determination was issued that disallowed the charges.

Audit Response. BMDO has taken appropriate actions in response to the finding.

Finding F. Contractor Travel Costs.

Management Comments on Support from Out-of-Town Contractor Employees, Conferences and Meetings. BMDO stated a standard form had been generated to approve contractor travel. The use of the form will standardize COTR approval of travel and associated costs. A study of SETA contractor travel for the third quarter FY 1993 was also performed and required corrective action taken.

Audit Response. Action taken by BMDO should improve controls over contractor travel.

Appendix D. Response Requirements Per Recommendation

BMDO is required to respond to the final report for the items indicated with an "X" in the table below.

Finding Recommendation	Response Should Cover: Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
A.2.d.	X	X	X	
A.2.e.	X	X	X	
A.2.f.	X	X	X	IC
B.2.a.	X	X	X	IC
C.1.	X	X	X	M
C.2.a.	X	X	X	IC
C.2.b.	X	X	X	IC
C.2.c.	X	X	X	
D.1.a.	X	X	X	M
D.1.b.	X	X	X	M
F.2.	X	X	X	IC

*M = monetary benefits; IC = material internal control weakness.

Appendix E. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.	Economy and Efficiency. Provides the necessary budget adjustments to support increased DoD civilian staff.	Included in A.2.b.
A.2.a.	Economy and Efficiency. Determines in-house DoD civilian personnel requirements through manpower requirements study.	Included in A.2.b.
A.2.b.	Economy and Efficiency. Reduces super SETA contract support for FYs 1995 through 1999 and uses DoD civilian employees to accomplish mission.	Funds put to better use of $45,962,400.[1]
A.2.c.	Economy and Efficiency. Encourages key military personnel who retire to fill DoD civilian positions and reduces overall costs to the Government through dual compensation waivers.	Undeterminable.[2]
A.2.d.	Economy and Efficiency. Gives contracting officers control over the amount of compensation paid to consultants.	Undeterminable.[2]
A.2.e.	Economy and Efficiency. Directs contracting officers to use profit-analysis factors to analyze fee or profit and determine prenegotiation objectives.	Undeterminable.[2]

[1]The actual amount of monetary benefits will be based on the results of the manpower requirements study and the actual costs of hiring additional DoD civilian personnel.

[2]The monetary benefits cannot be determined without analysis that would not result in additional benefits.

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.2.f.	Internal Controls. Documents the basis for determining profit or fee in price negotiation memorandum and includes it in contract files.	Nonmonetary.
A.2.g.	Internal Controls. Documents the basis for using cost-reimbursement contracts in contract files.	Nonmonetary.
A.2.h.	Internal Controls. Discontinues the use of cost-plus-award-fee, level of effort, term contracts unless adequate cost control procedures are established.	Undeterminable.[2]
B.1.a.	Economy and Efficiency. Assists in evaluating and measuring actual contractor performance cost by establishing a baseline of estimated costs for required level-of-effort, and maximum award fee.	Undeterminable.[2]
B.1.b.	Internal Controls. Bases task order replans on changes directed by the contracting officer and not contractor performance cost increases.	Undeterminable.[2]
B.1.c.	Economy and Efficiency. Uses labor and overhead rates and other direct costs based on competitive contract or task order awards as firm price commitments for estimated costs and maximum award fee purposes.	Undeterminable.[2]
B.2.a.	Internal Controls. Prevents COTRs from directing the contractor's level of activity and labor mix.	Undeterminable.[2]
B.2.b.	Internal Controls. Uses cost realism analysis to determine whether contractor-proposed costs are consistent with technical proposals.	Undeterminable.[2]

[2] The monetary benefits cannot be determined without analysis that would not result in additional benefits.

Recommendation Reference	Description of Benefit	Amount and /or Type of Benefit
C.1.	Economy and Efficiency. Directs contracting officer to recover award fee that the contractor received on its subcontractors' award fee or amend the contract to allow the payment.	Questioned costs of $481,365.
C.2.a.	Internal Controls. Directs contracting officers to administer award fee payments in accordance contract terms.	Undeterminable.[2]
C.2.b.	Internal Controls. Documents changes to the terms of the contract relating to the award fee flowdown plan through contract modifications.	Undeterminable.[2]
C.2.c.	Economy and Efficiency. Improves competitive acquisitions by not allowing the contractor to pay its subcontractors lower fees than other contractors in competitive situations.	Undeterminable.[2]
D.1.a.	Economy and Efficiency. Directs contracting officer to recover costs for facility and administrative and clerical support that were charged as direct costs to the contract when like cost items from overhead rates were not eliminated.	Questioned costs of $ [3]
D.1.b.	Economy and Efficiency. Directs contracting officer to request a refund for fee paid on contractor-acquired Government property.	Questioned costs of $71,196.
D.1.c.	Economy and Efficiency. Requires contractor to acquire furniture or Government to acquire furniture as contractor-acquired Government property when leases are not cost-effective.	Undeterminable.[2]

[2]The monetary benefits cannot be determined without analysis that would not result in additional benefits.

[3]Proprietary data removed.

Recommendation Reference	Description of Benefit	Amount and /or Type of Benefit
D.1.d.	Compliance with Regulations and Laws. Directs Administrative contracting officer to determine whether the contractors working in the facilities that charged direct costs to the contract were in compliance with Cost Accounting Standard 402.	Undeterminable.[2]
D.2.a.	Internal Controls. Prevents contractors from charging costs for facilities as direct costs to the contract and in overhead rates.	Undeterminable.[2]
D.2.b.	Internal Controls. Prevents contractors from charging leased office space, furniture, telephones, and other miscellaneous items to contracts as direct costs.	Undeterminable.[2]
D.2.c.	Internal Controls. Precludes providing Government property to contractors without proper justification.	Undeterminable.[2]
D.3.	Compliance with Regulations and Laws. Provides notification to the contractor of noncompliance with Cost Accounting Standard 402, "Consistency in allocating costs incurred for the same purpose," because overhead rates included costs for facility and administrative and clerical support costs that were also billed direct to the contract.	Nonmonetary.
E.1.	Economy and Efficiency. Directs contracting officer to recover questioned contract costs for coffee and tea services, catered meals, and kitchen appliances.	Questioned costs of $ [3]
E.2.	Compliance with Regulations and Laws. Notifies contractors that coffee and tea services, catered meals, and kitchen appliances are not allowable.	Undeterminable.[2]

[2]The monetary benefits cannot be determined without analysis that would not result in additional benefits.

[3]Proprietary data removed.

Recommendation Reference	Description of Benefit	Amount and /or Type of Benefit
F.1.	Economy and Efficiency. Directs contracting officer to recover per diem paid to contractor employees on long-term temporary duty to the Washington, DC, area.	Questioned costs of $53,904.
F.2.	Internal Controls. Requires periodic reviews of contractor travel.	Undeterminable.[2]

[2]The monetary benefits cannot be determined without analysis that would not result in additional benefits.

Appendix F. Organizations Visited or Contacted

Office of the Secretary of Defense

Director of Defense Procurement, Washington, DC

Department of the Army

Space and Strategic Defense Command, Huntsville, AL

Defense Organizations

Ballistic Missile Defense Organization, Washington, DC
Defense Contract Audit Agency, Alexandria, VA
  Defense Contract Audit Agency Branch Office, Burlington, MA
Defense Logistics Agency, Alexandria, VA
  Defense Contract Management Area Operations, Boston, MA

Non-Government Organizations

Applied Research, Incorporated, Huntsville, AL
Decision Science Applications, Incorporated, Huntsville, AL
General Research Corporation, Santa Barbara, CA
SPARTA, Incorporated, Laguna Hills, CA
Teledyne Brown Engineering, Huntsville, AL
The Analytic Sciences Corporation, Reading, MA

Appendix G. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Under Secretary of Defense for Personnel and Readiness
Comptroller of the Department of Defense
Director of Defense Procurement

Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Contract Audit Agency
Director, Defense Logistics Agency

Non-Defense Federal Organizations

Office of Management and Budget
Office of Federal Procurement Policy
National Security and International Affairs Division, Technical Information Center, General Accounting Office
Chairman and Ranking Minority Member of each of the following Congressional Committees and Subcommittees:

- Senate Committee on Appropriations
- Senate Subcommittee on Defense, Committee on Appropriations
- Senate Committee on Armed Services
- Senate Committee on Governmental Affairs
- House Committee on Appropriations
- House Subcommittee on Defense, Committee on Appropriations
- House Committee on Armed Services
- House Committee on Government Operations
- House Subcommittee on Legislation and National Security, Committee on Government Operations

Senator David Pryor, U.S. Senate

Part IV - Management Comments

Comptroller of the Department of Defense Comments

OFFICE OF THE COMPTROLLER OF THE DEPARTMENT OF DEFENSE

WASHINGTON, DC 20301-1100

(Management Systems)

MAR 10 1994

MEMORANDUM FOR DEPUTY ASSISTANT INSPECTOR GENERAL AUDITING

SUBJECT: DoDIG Draft Report: "Super" Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization"

We have reviewed the draft OIG Report No. 2CH-5031, "Super" Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization." The draft report contains a recommendation that the DoD Comptroller prepare alternative decision documents for Defense Resource Board consideration that would increase DoD civilian staff years and funding in order to reduce BMDO contracted services.

The issue of appropriate staffing levels for BMDO has been raised on many occasions during the past several years, most notably during Defense Acquisition Board reviews of major BMDO programs and during the annual budget review. During the FY 1993-94 budget review, DoD Comptroller staff prepared a Program Budget Decision which recommended an increase in BMDO civilian end strength financed by reallocating funds previously budgeted for BMDO contractor services. This action, which was approved by the Deputy Secretary of Defense, was specifically taken to "reduce reliance on contractor personnel." The impact of that adjustment on BMDO operations would not have been realized during the conduct of the OIG investigation due to the lead time necessary for its implementation. In addition, the recent SECDEF Bottom Up Review substantially reduced BMDO program funding levels resulting in a lessened requirement for increases in civilian end strength.

Based upon the actions already taken to increase BMDO end strength, significant reductions made to BMDO program funding levels, and the fact that a revised manpower requirements analysis would be required prior to the development of any future alternatives, we believe that the draft report recommendation to propose further BMDO civilian staff increases is unnecessary. Our analysts will continue to assess BMDO staffing requirements during the annual budget review and will prepare recommendations for alternative staffing/funding levels, if warranted, based upon the results of their review.

Alvin Tucker
Deputy Comptroller
(Management Systems)

Ballistic Missile Defense Organization Comments

Final Report Reference

DEPARTMENT OF DEFENSE
BALLISTIC MISSILE DEFENSE ORGANIZATION
7100 DEFENSE PENTAGON
WASHINGTON, DC 20301-7100

DCTO

March 7, 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING

SUBJECT: Response to DoD IG Report of December 23, 1993

Attached are the Ballistic Missile Defense Organization's (BMDO) comments on the findings, recommendations, and potential monetary benefits set forth in your draft Audit Report on "Super" Scientific Engineering and Technical Assistance (SETA) contracts at BMDO (Project No. 2CH-5031).

The BMDO appreciates your efforts in evaluating the effectiveness of our procurement system and the role of support services contractors at BMDO as requested by the Secretary of Defense. It is noted that this report will be the first of a series in response to the Secretary of Defense and, since it will set the precepts for succeeding reports, it is incumbent on us that we ensure it is complete in every respect. In this regard, administratively, the BMDO is a separate agency and not a field activity of the Department of Defense as noted in the Introduction of the Report

Revised

The review of The Analytic Sciences Corporation's (TASC) five-year contract was a substantial undertaking. I recognize that the review was broad based and examined not only the varied aspects of the specific contract, but also the BMDO procurement system which produced the contract itself. Please note that during the six-year period covering the performance of this contract and the audit, BMDO's contracting capability has significantly matured to an effective system. Therefore, many of the audit finding and conclusions, although accurate at the time, no longer reflect current practice. The BMDO comments pertaining to the Department of Defense Inspector General's recommendations reflect this perspective.

Where we have agreed with the auditor during the audit, recommendations have been transformed into aggressive corrective action as noted in our response to individual recommendations. In some cases, we have not agreed with the audit finding or, in a limited number of instances, with the factual accuracy. We look forward to resolving these differences with your staff in the near term.

The BMDO point of contact for this effort is Mr. Michael J. Allison, Assistant Director, Contract Operations, (703) 693-1560.

MALCOLM R. O'NEILL
Lieutenant General, USA
Director

Attachment:
As stated

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

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Cost-Effectiveness of Contracted Services

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services 12

PARAGRAPH HEADING: "Finding A. Cost-Effectiveness of Contracted Services"

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: The finding that "BMDO awarded the super SETA contracts because BMDO was not authorized sufficient in-house employees to perform its mission." is speculative. Perhaps, if there had been more in-house employees, the scope and cost of the super SETA contracts may have been less; but this is pure hindsight. The scope and costs of these contracts were developed responsibly, and there is no basis for concluding that none of this effort would have been accomplished by contractors.

Pages 16-17

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services 15 and 16

PARAGRAPH HEADINGS: Staff Year Cost Comparison; Subcontractor Staff Year Costs

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: BMDO concurs with the finding that in-house DoD civilians and military employees are generally more cost effective. As the IG report acknowledges, BMDO has made persistent efforts to obtain additional in-house personnel and substantial increases are anticipated for FY94 and subsequent years.

It should be noted that the comparisons reflected in Figure 1 and Figure 3 of the draft audit report are based on a single contract. Generally, BMDO has an excellent record of using competition and effective contract management to obtain high quality services at reasonable cost with rates frequently much lower than those reflected in the IG report. The comparison with the Army OPTEC contract is misleading. (See Discussion on Contract Type.)

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 16

PARAGRAPH HEADING: Award Fee and Administrative Cost on Subcontractor Costs

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CONCUR/NON-CONCUR: Non-concur

COMMENTS: The discussion in which the "additional award fee and subcontract administrative cost factors could increase subcontract costs by a maximum of 29.74%" is misleading. The audit ignores the fact that total cost to a prime includes fee of a subcontractor. Maximum award fee for the prime was limited to 15% - to characterize it otherwise would lead, falsely, to a conclusion that regulatory restraints on fee were exceeded. Additionally, the report fails to point out that the minimum was only * (G&A) nearly 12% lower than the composite mark up factor cited for the Army FR/IQ contract. (A contract for which "minimum contract requirements were not met" - see comments on Other Contractor's Award Fee or Profit and Administrative Cost on Subcontractor Cost.)

These same comments apply to any comparison with the second largest Super SETA contract. Note that DCAA recommended a BDM subcontract administrative cost for that contract of * percent, which was higher than TASC. The point, if there is one to be made, is unclear, i.e., what is the audit standard by which these contracts are being measured?

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

Pages 14-17

PAGE NUMBER: 13 - 17

PARAGRAPH HEADING: Contractor Staff-Year Costs
CONCUR/NON-CONCUR: Non-concur

COMMENTS: The audit comparison between the labor requirements of the Army Operational Test and Evaluation Command (OPTEC) contract is not valid. Note that the TASC contract does not prescribe delivery of labor hours in accordance with the "minimum personnel" requirements as the auditor suggests. The contractors requirement to deliver a specified mix of labor (often with the proposed staff uniquely identified by the contractor's task order proposal) is determined by the competitive task ordering process. The "minimum personnel" requirements are therefore not comparable from one contract to another, nor from one contract type to another. For example, under the fixed rate OPTEC contract, one would expect the contractor to staff the effort with individuals whose experience and education were very close to the minimum. Under the BMDO contract, it was expected that there would be a wide range above the minimums described in the RFP. Rather, two task orders performing with similar work product may be comparable as to the cost of various technical labor used therein. In this regard, BMDO finds the comparison with the Army contract inconsistent with the terms of the TASC contract.

*Proprietary data removed.

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Furthermore, we find comparisons to the OPTEC contract curious since DoD I.G. Audit Report 92-120 stated "that almost 50% of the professional employees did not meet the minimum contract requirements." This comparison is similar to comparing the price of a fully MILSPEC-compliant bolt to a non-compliant bolt of the same size and stating that the Government would have received a better deal on the non-compliant bolt, even though it failed to meet specifications.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 18

PARAGRAPH HEADING: Establishment of a Maximum Award Fee Objective and Justification for Maximum Award Fee Negotiated

CONCUR/NON-CONCUR: Non-concur

COMMENTS: DFAR 215.974, Fee requirements for cost-plus-ward-fee contracts states:

> **215.974 Fee requirements for cost-plus-award-fee contracts.** In developing a fee objective for cost-plus-award-fee contracts, the contracting officer shall--
>
> (a) Follow the guidance in FAR 16.404-2 and 216.404-2;
>
> (b) Not use the weighted guidelines method or alternate structured approach;
>
> (c) Apply the offset policy in 215.973(b)(2) for facilities capital cost of money, i.e., reduce the base fee by the lesser of 1% of total costs or the amount of facilities capital cost of money; and
>
> (d) Not complete a DD Form 1547.

The foregoing is quoted in its entirety.

In accordance with DFAR 215.974, there is no requirement for a structured analysis (furthermore, it is precluded). All statutory regulations regarding fee were complied with. Additionally, FAR 16.404-2(a) states, "The amount of the award fee to be paid is determined by the Government's judgmental evaluation of the contractor's performance in terms of the criteria stated in the contract."

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 18-20

PARAGRAPH HEADING: Military Personnel

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: The Government (BMDO) does not contract for retired military personnel. Rather, it contracts for services with required skill levels -- it is up to the offeror to obtain those skills from whatever source he/she chooses. There are no instances where BMDO has, or will, identify "military experience" as an evaluation element.

The inferences in the paragraph titled Retired Military Contractor Staff would lead one to the conclusion that something improper was done when specific individuals were hired as consultants, etc., is inappropriate and must be deleted. As noted previously, all regulations were complied with by individuals cited therein.

Last sentence on hiring restrictions: "We believe...are selected for key DoD civilian positions." This sentence needs to be changed. The word selected may convey pre-selection for a civilian position which is not permitted under civil service regulations and the paragraph does not address the DoD hiring freeze. To avoid ambiguity, the wording should be changed to: "We believe...request exemption from the DoD hiring freeze in order to reach retired military personnel and request dual compensation waivers for military personnel that retire and apply for key DOD civilian positions." Revised

The DoD hiring freeze should be addressed in a separate paragraph. When a military member retires, he is outside DoD for hiring purposes. In order to reach BMDO's retired military expertise, we need an exemption from the DoD hiring freeze. Following that approval, we would request waivers for dual compensation on a case-by-case basis.

Regarding dual compensation waivers, there are three categories to obtain a waiver for dual compensation: emergency hiring, recruiting difficulty, and in very rare cases, exception for a particular individual. The only category that applies to BMDO is recruiting difficulty.

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Pages 21-22

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 22

PARAGRAPH HEADING: BMDO Manpower Authorizations

CONCUR/NON-CONCUR: Concur except for the following correction.

Revised

COMMENTS: Fourth sentence: "BMDO was authorized 263 military and DoD civilian employees for FY1992. Change the number to 259. This matches the chronology in Table 3.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 23

PARAGRAPH HEADING: Potential Benefits of Increased DoD Civilian Support

CONCUR/NON-CONCUR: Concur (See comments)

Revised

COMMENTS: The report does not explain why (the DoDIG) chose 230 staff years (or 46 staff years per year) of super SETA contract support to be replaced with DoD civilian personnel. Since BMDO received an additional 100 civilians in FY1994 and the President's Budget has projected an increase of 100 civilians in FY1995 and 75 civilians in FY1996, it is suggested that the number be changed to 275. Therefore, the table should be changed to reflect 55 (275 + 5) staff years per year for 5 years which equates to a total savings of $45,962,400 based on a contractor staff year cost of $153,659 and the potential benefit for recommendation A.2.b in appendix H revised upward to $45,962,400.

Pages 23-24

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 24

PARAGRAPH HEADING: Contract Type and Justification

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: DFAR 216.404-2(b)(1) sets forth the criteria for application of CPAF LOE contracts. At the time of award, a CPAF LOE contract was determined to be most suitable for the effort and it

did meet the requirements set forth in the DFAR provision. However, in retrospect, the administrative effort required to properly manage the contract was excessive and the resources were not available to properly manage the contract. As a result, CPAF LOE contracts vehicles are no longer being utilized by BMDO for similar effort.

However, the audit finding that the CPAF Super SETA contract was not as cost effective as a fixed price contract is not supported by either the facts presented in the working draft or the circumstances at the time of contract. Since the basis for this conclusion is not clearly stated, BMDO can only assume that it is based on the assumption that the contractor would have bid the same rates under a fixed-price (fixed rate) proposal as he did for the cost reimbursement proposal or at most, the rates that BDM proposed under the OPTEC contract. Neither of these assumptions can be supported.

DFAR 216.404-2(b) states that "[T]he cost-plus-award-fee (CPAF contract is also suitable for level of effort contracts where mission feasibility is established, but measurement of achievement must be by subjective evaluation rather than objective measurement." FAR 16.601, time and Materials Contract may be "used only when it is not possible . . . to estimate accurately the extent or duration of the work or to anticipate costs with any degree of confidence." It goes on to note that "a time and materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency" "[T]herefore appropriate government surveillance . . . is required. . .". Given these, as well as considering other alternatives, the contracting type decision was correct, given the objective of incentivizing outstanding contractor performance.

Further, the auditor's recommendation that the BMDO either fix the price of labor rates, suggesting a time-and-materials contract, or enter into a completion form of contract is inconsistent with the prevailing uncertainties in cost, schedule and technical performance, which would form the basis of such a course of action (note that technical requirements within the TASC contract directly affect the contractor labor rates or mix which directly affects the contract labor rate within the TASC contract).

Note FAR 15.905-1(b)(3) which equates time-and-materials, labor-hour, and firm-fixed price, level-of-effort with a cost type level-of-effort contract. It is unclear what the IG means by "fixed price" in this context. One cannot equate "fixed rate" with firm fixed price.

If, in the opinion of the DOD IG, this contract is similar in scope and complexity to the OPTEC contract with BDM, it should be noted that page 5 of DoD I.G. Audit report 92-120 states "Contracting Officers inappropriately awarded time-and-materials contracts when other contract types were more appropriate." The I.G.'s position on when the use of time-and-materials contracts is appropriate should be clarified.

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Furthermore, the audit report does not provide a factual basis to demonstrate a stable environment in which the Government support requirements could lead to a fixed labor mix and thus a fixed price composite labor rate. The contract history clearly demonstrates a constantly changing Government technical requirement demanding different labor profiles for various evolving work efforts. A fixed price labor rate would have grossly aggravated the already monumental administrative burden imposed by this contract.

It should be noted that programmatic turbulence in the current budgetary environment is worse today than it was in the past. That fact alone creates uncertainties which drive contract type decisions toward a cost-type contract.

As a final note, it is recognized that the determinations and findings required by FAR 16.301-3 were not present in the contract file. That notwithstanding, the files for all cost-type contracts awarded in FY93 have been reviewed with the result that required documentation was present in all of the files. Therefore, the Internal Control weakness regarding documentation regarding the use of cost reimbursement contracts has been corrected, and therefore the finding is not based on the present circumstances at BMDO.

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FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 25

RECOMMENDATION: A.1

CONCUR/NON-CONCUR: Concur

COMMENTS: BMDO is on record with Congress, the DepSecDef, and other senior OSD staff that it would use in-house decreased contractor support funding to pay for additional Government personnel. At no time did BMDO ask for additional funding for increased Government personnel and does not deem it appropriate in this era of fiscal constraint. BMDO has internally capped its contractor support dollars for FY1994 at $125M, $10M less than FY1993, and will use those dollars to pay for the 100 additional civilians in FY1994.

BMDO has requested and received an exemption to the DoD hiring freeze so that BMDO may hire the best qualified people, including retired military personnel where appropriate.

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 25

RECOMMENDATION: A.2.a.

CONCUR/NON-CONCUR: Concur

COMMENTS: With the completion of the Bottom-Up Review and the change in BMDO's mission, BMDO will be reorganized. This reorganization should be completed by the end of February and a new manpower study will be initiated in March with planned completion by June 1994.

Note: Table 3 should be modified to indicate that in 1992 "SDIO conducted a manpower survey that identified a requirement for an additional 453 government positions." Revised

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 25 Page 26

RECOMMENDATION: A.2.b.

CONCUR/NON-CONCUR: Concur

COMMENTS: BMDO has already been authorized an additional one hundred government positions for FY94. The results of the pending manpower study will form the basis for determining any additional manpower requirements. However, as previously noted, the $38.4 million potential benefit cited in Appendix H should be $45,962,400.

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FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 25 Page 26

RECOMMENDATION: A.2.c.

CONCUR/NON-CONCUR: Concur

COMMENTS: BMDO will request dual compensation waivers where appropriate.

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 20 and 25

PARAGRAPH HEADING: Consultant Costs

RECOMMENDATION: A.2.d.

CONCUR/NON-CONCUR: Non-concur

COMMENTS: FAR 31.205-33 establishes detailed criteria for determining the reasonableness of consultant costs. In this regard, further supplementing these criteria/procedures by BMDO is not appropriate. Note, that in no case has the IG demonstrated that compensation paid to consultants was unreasonable for the skill level required in accordance with FAR 31.205-33. This is a recommendation without a finding. In fact, an analysis of Table 2 and Figure 3 demonstrate that the actual costs paid under this contract for retired consultants was approximately 2% higher than the cost of an average active-duty military officer of the same rank. These consultants were not average officers!

It appears that the IG is making a distinction between approval of the consultant and approval of the terms and conditions of the subcontract (consulting agreement). This is inconsistent with the FAR and DFARS. Under FAR Part 44 and DFARS Part 244 the contracting officer's consent requirements are already well defined. The appropriateness of the qualifications of the consultant is primarily a determination for the technical person responsible for managing a contract. Contracting Officers in BMDO have challenged the appropriateness of using high priced consultants in the past and will continue to do so in the future.

It should be noted that oversight by BMDO technical managers, contracting officers and DCAA is more than sufficient to assure that a contractor who contracted with a high priced consultant, without prior consultation with the appropriate Government managers (both the COTR and the contracting officer) would be subject to appropriate follow-up action/disallowance of costs as a direct charge.

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FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 25

RECOMMENDATION: A.2.e. and A.2.f.

CONCUR/NON-CONCUR: Non-concur

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COMMENTS: The discussion on the associated finding is reiterated as follows:

215.974 Fee requirements for cost-plus-award-fee contracts. In developing a fee objective for cost-plus-award-fee contracts, the contracting officer shall--

(a) Follow the guidance in FAR 16.404-2 and 216.404-2;

(b) Not use the weighted guidelines method or alternate structured approach;

(c) Apply the offset policy in 215.973(b)(2) for facilities capital cost of money, i.e., reduce the base fee by the lesser of 1% of total costs or the amount of facilities capital cost of money; and

(d) Not complete a DD Form 1547.

In accordance with DFAR 215.974, there is no requirement for a structured analysis (furthermore, it is precluded). All statutory regulations regarding fee were complied with. Additionally, FAR 16.404-2(a) states, "The amount of the award fee to be paid is determined by the Government's judgmental evaluation of the contractor's performance in terms of the criteria stated in the contract."

The contract file checklist clearly indicates that the weighted guidelines is required with the negotiation memorandum (for other than award fee contracts). The coverage in the FAR and the DFARS is clear and local supplementation would be redundant and inappropriate.

For the above reasons, the recommendations cited, associated finding, and related internal control weaknesses should be deleted.

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FINDING: A: Cost-Effectiveness of Contracted Services

PAGE NUMBER: 26

Page 28

RECOMMENDATION: A.2.g.

CONCUR/NON-CONCUR: Concur

COMMENTS: BMDO established DCT OI 01 on September 26, 1990. The Internal Control weakness regarding documentation regarding the use of cost reimbursement contracts do not reflect the current condition and should be deleted. The files for all cost type contracts awarded in FY93 have been reviewed with the result that required documentation was present in all of the files.

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FINDING:	A: Cost-Effectiveness of Contracted Services
PAGE NUMBER:	26
RECOMMENDATION:	A.2.h.
CONCUR/NON-CONCUR:	Concur
COMMENTS:	None

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

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- Proposed Staff-Year Costs Versus Actual Staff-Year Costs (Page 14)
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RESPONSE TO DODIG DRAFT AUDIT REPORT
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Page 30

FINDING: B: Contract Management

PAGE NUMBER: 28

PARAGRAPH HEADING: Negotiated Rates not used as Baseline

CONCUR/NON-CONCUR: Non-concur

COMMENTS: The audit description of a financial baseline created by the original "Super SETA" competition is inaccurate. The inaccuracy lies in the fact that the three Super SETA contracts were not independent contract awards but were conceived as a "Master Agreement." The terms of the master agreement contemplated a limited competition among the three Super SETA winners. The limited competition for each future task order would then result in a financial baseline (competitively determined) for each government requirement. Thus, this labor mix used for the original full and open competition served only to provide a common baseline to assist in determining which players would participate in the "Master Agreement."

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ON "SUPER" SETA CONTRACTS AT BMDO

Page 31

FINDING: B: Contract Management

PAGE NUMBER: 28

PARAGRAPH HEADING: Proposed Staff-Year Costs Versus Actual Staff-Year Costs

CONCUR/NON-CONCUR: Non-concur

COMMENTS: The increase in staff-year cost from the original contract proposal are not in dispute. The audit infers that such increases are cost overruns or a result of the contractors' independent action. The contractors' direct-labor rate did not increase significantly over the life of the contract. The increase in staff-year cost generally occurred as a result of (1) subsequent competition under the "Master Agreement", or (2) Government-directed changes to the work requirements (task order modifications and/or replanning). In this regard, the comparison of actual staff-year cost with that of the original competition without consideration of the competitive aspects of the "Master Agreement" or the contract change process is clearly inappropriate and misleading.

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FINDING: B: Contract Management

PAGE NUMBER: 29 - 31

Pages 32-33

PARAGRAPH HEADING: Contract Modifications to Increase Baseline; Actual Level of Effort for Contract Years 1 through 5 Unchanged; and Award Fee on Contract Performance Cost Increases

CONCUR/NON-CONCUR: Concur

COMMENTS: The procedure utilized to surge the contract, as stated, is accurate. In retrospect, this procedure was unnecessary in that it only served to increase the number of hours that could be ordered and resulted in no effect on the award fee pool.

Each award fee pool was established by government-approved task orders as to the scope of work and the estimated cost. The facts presented in the audit do not constitute a contact overrun scenario (non-fee bearing) since the cost growth was a result of government-directed contract changes.

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FINDING: B: Contract Management

PAGE NUMBER: 31-34

Pages 34-39

PARAGRAPH HEADING: Task Order Baseline

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: There was an initial baseline established for each task order, but it did not have the fidelity/detail required to evaluate and measure the contractor's actual cost performance in relation to eventual contract changes.

Non-concur with the finding on page 32 regarding use of Best and final rates for the contract since, as previously noted, the BAFO was incorporated into a "Master Agreement" which did not establish fixed rates to be needed as a baseline.

The implication on page 32 that the BMDO permitted contractors to replan task orders when actual cost exceeded estimated cost is incorrect. The audit provides no evidence that this occurred other than the fact that task orders were "replanned" (technical changes) during their period of performance and the actual cost at completion exceeded the estimated cost at inception. Given the rapidly

changing SDIO program at the time, contract change was and is a natural course of events. BMDO has repeatedly demonstrated to the auditor that all replans were necessitated and dictated by Government programmatic changes, and that the Contracting Officer approved each change.

The inference that the contractor orchestrated contract changes to enhance its profit is simply an inappropriate conclusion drawn from a lack of understanding of the programmatics and the contracting process. Further, such a finding also implies a lack of Government control over its fiduciary responsibility which is very serious and must be demonstrated by the facts. This finding must be either fully substantiated or withdrawn from the report.

The inference that the contractor's potential for earned award fee was increased with cost of work performed is inappropriate and not based on facts. The audit finding that the Contracting Officer increased the estimated cost of performance during and after performance is confusing. Increased performance is a natural consequence of changing the technical specifications (enhanced labor mix driven by more complex tasking) and level of effort requirement. Of particular concern, is the report's total lack of acceptance of demonstrated Government directed technical changes during the period of performance. Throughout the audit process, BMDO demonstrated the rapidly changing programmatic environment prevalent during the contract period of performance necessitating numerous contract changes or replans. The report's failure to recognize the data presented in this matter and the resultant persistence with an inaccurate finding does not aid either party in resolution of the issue(s).

We note that a review of the nature of cost growth arising from the contract indicated that increases occurred almost exclusively in the contract direct labor mix and not the TASC actual fully burdened labor rate. This is a highly significant fact when determining the cost of an overrun as opposed to a Government directed technical change for which the contractor has a right to equitable adjustment in cost and award fee. Specifically, an analysis of the contractor's fully burdened bid and actual labor rates applied to task order 55 and 69 (selected because of the similarity of the work and duration of the effort) revealed that 7 of the 13 direct labor categories actually were underrun while two others increased by less than 1% of the bid rate. To determine the dollar impact of TASC rate increases, we applied the task order 55 and 69 ending contracting labor mix to the bid rates at inception of the task order and to the actual booked labor rates at conclusion of the task order. We then computed the difference in cost of labor (fully burdened through G&A). The difference amounted to $3,276 during a three-year period with a direct labor base of $1,150,594. The total effect on award fee is then only $491.40. This analysis isolates the effects of the contractor's labor escalation and demonstrates the actual labor cost difference directly attributable to TASC. Note that such analysis removes the effects of Government directed changes to the contract labor mix. Under the terms of the LOE contract, Government directed changes to the contract labor mix are technical changes for which the contractor has a right to an equitable adjustment of cost and fee. In this respect, the audit

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assertion that the Government paid fee on cost overruns is seriously flawed. The incorrect interpretation of the contract terms and the persistent lack of recognition of the Government-directed contract changes led to an inappropriate conclusion and finding.

The final comment on this section regards the statements on Task Order 62 that "the COTR inappropriately directed the contractor to change its level of activity and labor mix, which resulted in higher staff-hour costs. The amount of COTR-directed activity is of concern in regard to personal services contracting and increased contract costs. At no time did a "Personal Services" situation exist. Again, we have repeatedly demonstrated during the audit that the contracting officer approved each change. Further, a personal services relationship may exist when a government person gives direction to an individual contractor employee. Direction given through the contractor's management does not constitute personal services. The "Technical Direction" clause and the COTR letter define the kind of technical direction that the COTR can give. A COTR who failed to give such direction to the contractor, when appropriate, would not be performing his/her responsibilities under the contract.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: B: Contract Management

Page 39

PAGE NUMBER: 35

PARAGRAPH HEADING: Cost Realism Analysis

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: The conclusion that "the contractor proposed an inaccurately low hourly labor rate for senior engineers/ scientists and was able to raise the labor rate after task order award" and associated "buying-in" allegations are misleading and inaccurate. TASC's original Task Plan for Task Order 62 provided for an initial labor mix of more senior personnel and some junior people to be trained as the work was performed. As the work progressed and the junior personnel gained experience they would take over and the senior personnel would move to other projects. However, the Government directed that only senior people should work with BDM on the Task Force requirements. This Government direction resulted in a richer labor mix in the first replan.

The need for cost realism analysis has long been recognized by BMDO, and cost realism has always been part of the source selection criterion. Recently, as part of an ongoing source selection improvement process*, source selection/cost realism documentation has been enhanced as evidenced by the following examples:

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Cost Realism Analysis

RFP Number	Analysis Location
SDIO84-93-R-0003 (Intel Threat)	Competitive Range Briefing and Decision Briefing
SDIO84-93-R-0008 (SETAPO)	Competitive Range Briefing and Decision Briefing
SDIO84-93-R-0007 (Options Assessment)	Decision Briefing and Proposal Analysis Report
SDIO84-93-R-0015 (Technical Security Services)	Decision Briefing and Proposal Analysis Report
HQ0006-94-R-0002 (IPA)	Competitive Range Briefing/ Decision Briefing/Proposal Analysis Report

The *BMDO Source Selection "How To" Samples Book* describes this process.

The documentation is source selection sensitive, containing proprietary information, however, it is available for review, if desired. Since this finding/recommendation has been implemented, it is recommended that it be deleted from the report as an Internal Control weakness.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

Page 40

FINDING: B: Contract Management

PAGE NUMBER: 36

PARAGRAPH HEADING: Contract Administration

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: As already noted, we concur with comments regarding establishment of an adequate baseline for the negotiation of contract management changes. (See also comments on Task Order Baseline.)

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FINDING: B: Contract Management

PAGE NUMBER: 36

RECOMMENDATION: B.1.a.

CONCUR/NON-CONCUR: Concur

COMMENTS: The requirement for a well-defined baseline for the purpose of cost tracking is well understood and clear in BMDO

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existing policies and practices. Written DCTO policies/procedures documenting these practices will be completed by September 30, 1994, in conjunction with the conclusion of a test to electronically transmit data in a real-time mode, substantially enhancing contract oversight capabilities.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: B: Contract Management

Page 41

PAGE NUMBER: 36

RECOMMENDATION: B.1.b.

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: The recommendation that BMDO develop operating instructions in order to preclude task order "replans" prompted by contractor performance increases is inappropriate. Our examination of the situation revealed that the contracting officer often failed to adequately document changes as they occurred, and the impact of these changes on the cost and technical baseline. In this regard, BMDO/DCTO will develop internal operating procedures requiring documentation of task order contract technical changes NLT June 30, 1994.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: B: Contract Management

PAGE NUMBER: 36

Page 41

RECOMMENDATION: B.1.c.

CONCUR/NON-CONCUR: Concur

COMMENTS: Procedures will be incorporated into the DCTO policies/procedures written as a response to recommendation B.1.a.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: B: Contract Management

PAGE NUMBER: 37

Page 41

RECOMMENDATION: B.2.a.

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: Technical direction is the responsibility of the COTR. Technical direction may be prepared by the COTR and

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communicated by the contracting officer or may be provided directly by the COTR to the contractor with contracting officer in an oversight role. In any case, the COTR is the Government manager with responsibility to assure that the level of activity and labor mix is appropriate.

There appears to be an assumption by the IG that the contract forbids the Government (PCO or COTR) from directing changes to the level of activity or the labor mix to meet changing conditions or short turn-around requirements. Actually, the plain language of the contract contemplates that the Government may provide such direction and provides for variances up to + or - 10% and negotiation of revisions to the individual task orders if required.

To ensure that the COTRs understand their roles, responsibilities, and limitation(s) of authority, BMDO conducts mandatory COTR training for all COTRs and specifically sets forth their responsibilities in letters to each COTR, with a copy to the contractor so there is a full understanding of the COTR's authority. The notification of changes clause, in conjunction with the appointment letter, sets the stage for the contractor notifying the contracting officer of any inappropriate exercise of authority.

Finally, the contracting officer's review of the Monthly Contractor Performance Reports provides the ability to respond to and research reasons for labor rates becoming out of balance, which could indicate improper COTR direction.

In summary, adequate controls/procedures are already in place, and the Internal Control weakness associated with this recommendation should be deleted.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: B: Contract Management

Page 42

PAGE NUMBER: 37

RECOMMENDATION: B.2.b.

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: Realism is consistently a part of the cost criterion in our competitive source selections. The list of competitive source selections provided in the discussion on Cost Realism demonstrate that BMDO is highly sensitive to the cost realism issue.

FAR 15.603 requires realism analysis. Local supplementation has already been issued in the *BMDO Source Selection "How To" Samples Book*. The Internal Control Weakness associated with this recommendation should be deleted.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

INDEX

Contract Terms

- Award fee on Subcontractor Fees; Recommendation C.1 (Page 22)
- Subcontractor Maximum Award Fee; Recommendation C.2 (Pages 23)

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: C: Contract Terms

PAGE NUMBER: 39

PARAGRAPH HEADING: Award fee on Subcontractor fees

RECOMMENDATION: C.1

CONCUR/NON-CONCUR: Non-Concur

COMMENTS: The contract clause H-16 "Order of Precedence" clearly delineates that "contract clauses" have precedence over "Other terms of the contract, when attached or incorporated by reference." If an ambiguity arises over the administration of the award fee, the contents of contract clause H-20 "Award Fee" has precedence over the contractor's proposed Award Fee Flowdown Plan that was incorporated as an attachment.

Clause H-20 of the contract describes the Award Fee determination process and states that the Award Fee Determination Plan is in accordance with Attachment 3 and the Award Fee incentive flowdown is in accordance with Attachment 4. The IG report maintains that the Flowdown Plan precludes the contractor from earning an award fee on subcontractors fees, yet it is clearly portrayed at Attachment 3, Figure 3.1-1 that the team member's fee is included as an element of cost to TASC. That Attachment 3 and Attachment 4 are inconsistent does not provide a basis for the government to recover cost arising from this fact. The relevant issue here is what was the intent of the parties at the time of the contract and the established practices for 5 years during period of performance. The record, previously provided to the auditor in the contracting officer's statement, reflects that it was clearly the intent of the parties to include the subcontractor fee. Therefore, the contractor correctly included the Part A award fee of its subcontractors in the total estimated cost base for its award fee. The contractor is entitled to the award fee of $481,365 on its subcontractors' award fee in accordance with the requirements of contract clause H-20.

Given that the contract was physically complete in March '93 and the contractor <u>was</u> entitled to the questioned award fee of $481,365 on it's subcontractors' costs, which included all award fees, a modification for the purpose of correcting the record serves no purpose. The finding and the recommendation are inappropriate and should be deleted and the monetary benefit set forth in Appendix H deleted.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: C: Contract Terms

Final Report Reference

Pages 46-48

PAGE NUMBER: 40-42

PARAGRAPH HEADING: Subcontractor Maximum Award Fee

RECOMMENDATION: C.2

CONCUR/NON-CONCUR: Non-concur

COMMENTS: The statements "[T]he BMDO Assistant Director, Contract Operations stated that the contractor proposed a 10 percent cap on the award fee paid to subcontractors and that the award fee flow-down clause was modified verbally by mutual consent. ..." This statement, which referred to the modification as a result of mutually agreed upon action by the parties was misquoted. The term "verbally" was not used; BMDO does not advocate verbal modification of contracts, which was mentioned in the Task 62 discussion. The 10 percent cap on award fees paid to subcontractors was a matter of mutual consent between the prime contractor (TASC) and their subcontractors. Because the task orders were competed among the three Super SETA contracts, and due to the fact that Task Order 62 was intensely competed, TASC and its subcontractors mutually consented to propose a lower amount of fee on Task Order 62. These facts did not change the intent of the contract between BMDO and TASC, nor did the Award Fee Flowdown clause in the contract change by this decision. Further, TASC proposed at attachment 3, page 3-1 that, Part A [of the Award Fee] will be established by including a specified percentage of each Team member's non-travel cost as part of the total estimated cost of each Task Plan. This amount will range between 4-10%.

Revised

The finding is misleading and inaccurate, and Recommendation C.2 is not applicable. Specifically, there is no requirement, based on analysis/review of the Super SETA contracts to "establish procedures to verify that contracting officers: follow the award fee payment contract terms as written (this was done); document changes to contract terms (see discussion on Award Fee on Subcontractor Fees); or notify competitors when award fee flowdown plans are changed (The plan was not changed and, furthermore, to do what is suggested would amount to leveling/divulging source selection sensitive information).

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

INDEX

Costs for Facilities, Administrative and Clerical Support, and Government Property

- Direct Costs; Indirect Costs; Government Property; Contracting Officer Actions; Accounting Standard 402 (Page 25)
- Recommendation D.1.a. (Page 26)
- Recommendation D.1.b. (Page 26)
- Recommendation D.1.c. (Page 27)
- Recommendation D.1.d. (Page 27)
- Recommendations D.2.a, D.2.b. and D.2.c. (Page 28)

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Pages 53-59

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 45-51

PARAGRAPH HEADING: Direct Costs; Indirect Costs; Government Property; Contracting Officer Actions; Accounting Standard 402

CONCUR/NON-CONCUR: Partially Concur

COMMENTS: Direct costs, indirect cost and the CAS 402 finding are redundant findings arising from a single condition. Specifically, the contractor's practice of charging certain costs, that are normally charged indirect, as direct (office space, furniture, telephones, security and miscellaneous office supplies) as direct while applying the full overhead rate. The central issue is whether the costs were incurred "for the same purpose, in like circumstances" (see CAS 402.40). The limited facts presented by the audit established only that the costs were similar in nature. The audit did not establish the facts so as to ascertain if cost were incurred under like circumstances. In this regard, BMDO has referred these findings to the Administrative Contracting Officer and cognizant DCAA auditor for a determination of the relevant facts and collection of costs pursuant to the CAS Administrative clause of contract.

The auditors' finding that the contractor direct charged certain leased costs in a manner inconsistent with it's established accounting practice may be incorrect. It is not clear from the audit when circumstances (in terms of the assignment of costs) applied to the cited lease No. 374391. Facilities established specifically to fulfill Government requirements (such as the AIS) may incur leased cost directly allocable to the contract. In this case, leased costs are identifiable to a single final-cost objective and are therefore direct. However, contractor facilities established for general purpose use should result in such costs being distributed as they are not assignable to a single final-cost objective. The facts in this case are not clear. Further, if the Government incurred leased costs (whether direct or indirect) in an amount in excess of the cost of ownership, we would generally consider the excess cost unallowable because they would not be reasonable (FAR 31.201-3). Specifically, such costs would not be incurred by a prudent businessman in the conduct of a competitive business. In the instant case, many task orders were issued for relatively short duration (1 year). Herein it may not be prudent for the contractor under such circumstances to exercise purchase options on leases without a reasonable guarantee of continued performance. In this regard, we are forwarding this action to the cognizant ACO to determine the relevant facts and issue an opinion as to the cost reasonableness.

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In the paragraph "Government Property," the report states, "FAR 45.302-3, 'Other Contracts,' provides that no profit or fee shall be allowed on the cost of contractor-acquired government property." The prohibition of fees on facilities under FAR 45.302-3(c) did not take effect until January 22, 1991, long after the SETA contract was awarded. Prior to that date, there was no prohibition in the FAR on the payment of fees on facilities except under facilities contracts.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

Page 59

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 51

RECOMMENDATION: D.1.a.

CONCUR/NON-CONCUR: Non-concur

COMMENTS: There is insufficient information available to allow the Government to issue a CAS 402 collection action and/or validate this recommendation and the benefit/questioned costs cited in Appendix H. On September 9, 1993, the BMDO requested an audit of contractor-acquired property from DCAA, Burlington. On December 30, 1993, DCAA requested technical assistance from BMDO to complete the audit. The preliminary technical analysis/report which resulted was delivered to DCAA on February 15, 1994, and conclusion of the audit is now expected by September 30, 1994, with a subsequent determination from the ACO expected by December 31, 1994. Appropriate collection action regarding disallowance of costs will therefore be completed by December 31, 1994.

Further, the $1,597,100 includes $792,093 in lease charges that would have, on face value, been properly charged to ODCs since the property involved was not contractor acquired government property. The questioned costs will be referred to the ACO for a final determination and collection action taken, if appropriate, by September 30, 1994. The benefit cited in Appendix H is therefore questionable and should be deleted.

Appendix E

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

Page 60

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 51

RECOMMENDATION: D.1.b.

CONCUR/NON-CONCUR: Non-concur

COMMENTS: As noted in the comments under "Government Property," FAR 45.302-3 prohibitions against allowance of fees on

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the costs of contractor-acquired property was not in effect when the contract was awarded, and the recommendation and the benefit-questioned costs cited in Appendix H should be deleted.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 51 Page 60

RECOMMENDATION: D.1.c.

CONCUR/NON-CONCUR: Non-concur

COMMENTS: There is insufficient data to lead to a determination that leased costs should be indirect and whether or not the costs were incurred "for the same purpose, in like circumstances." It is, furthermore, inappropriate to direct the contractor to distribute the cost of the cited leases without establishing the facts to show that such costs are not identifiable with the single final cost objective. TASC asserts that the leased facilities cost were incurred solely for the SETA contract and, therefore, were identifiable as direct. The recommendation that the contractor acquire facilities (furniture) for the account of the Government when leases are not cost effective is inappropriate. The contractor's lease versus purchase decision must be based on the application of sound business judgment.

As a result of a meeting held at DCAA's Burlington facility on February 15, 1994, the ACO will undertake a review of the contractors lease versus purchase decision as to reasonableness, DCAA is also reviewing whether or not an off-site overhead rate should have applied to the contract. The lease-versus-purchase review will be completed by September 30, 1994, and the off-site overhead rate review by June 30, 1994.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 52 Page 61

RECOMMENDATION: D.1.d.

CONCUR/NON-CONCUR: Concur

COMMENTS: On February 1, 1994, the BMDO initiated an analysis of overhead and off-site rates. Where inconsistencies exist, apparent CAS 402 violations will be referred to the ACO. The analysis is scheduled to be completed by June 30, 1994.

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Pages 61-62

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: D: Costs for Facilities, Administrative and Clerical Support, and Government Property

PAGE NUMBER: 52

RECOMMENDATION: D.2.a., D.2.b. and D.2.c.

CONCUR/NON-CONCUR: Concur

COMMENTS: The revised BMDO Property Directive 4275, currently in staffing, will address these issues. The target completion date for staffing of the Directive is April 29, 1994.

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

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Other Direct Costs

- Other Direct Costs: Cost Accounting Standard 402 Compliance; Contracting Officer COTR and Contractor Position (Page 30)
- Recommendation E.1 (Page 30)
- Recommendation E.2 (Page 31)

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Pages 63-66

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: E: Other Direct Costs

PAGE NUMBER: 53-56

PARAGRAPH HEADING: Other Direct Costs: Cost Accounting Standard 402 Compliance; Contracting Officer COTR and Contractor Position

CONCUR/NON-CONCUR: Concur

COMMENTS: Coffee service and kitchen appliances ODCs have been referred to the ACO and cognizant DCAA auditor for a final determination and collection action pursuant to the Cost Accounting Standard (CAS) Administration Clause under the contract. In accordance with CAS 402.40, said determination on "double charging" will comprise of an analysis to determine if the costs were incurred "for the same purposes, in like circumstances." The issue of the numerous catered meals was the subject of an October 13, 1993, Notice of Intent to disallow $31,118.43 (vs. the cited amount of $41,522, which could not be validated) pursuant to FAR 52.242-1, as not allocable or reasonable. On January 6, 1994, a contracting officer's final determination was issued which disallowed these charges. The ACO/DCAA is currently conducting an audit to verify the amount to be disallowed which is scheduled for completion by March 11, 1994. A demand for payment will be issued by the PCO not later than March 31, 1994.

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: E: Other Direct Costs

PAGE NUMBER: 56

RECOMMENDATION: E.1

CONCUR/NON-CONCUR: Concur

COMMENTS: Action has been taken to collect $31,118.43 of the $41,522 recommended for catered meals (see comments on finding). The $6,128 for coffee and tea service and the $1,086 for kitchen appliances has been referred to the ACO. The audit of same will be completed by March 31, 1994, and June 30, 1994. collection action forecasted to be completed by June 30, 1994. The amount of benefit set forth in Appendix H should be revised downward to $38,332.

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: E: Other Direct Costs

PAGE NUMBER: 56

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RECOMMENDATION: E.2

CONCUR/NON-CONCUR: Concur

COMMENTS: Recommend that verbiage be revised to add after "allowable," "as a direct charge." These costs are allowable as an indirect charge. Revised

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

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Contractor Travel Costs

- Support from Out-of-Town Contractor Employees; Conferences and Meetings (Page 33)
- Recommendation F.1 (Page 33)
- Recommendations F.2.a., F.2.b, and F.2.c (Page 33)

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RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: F: Contractor Travel Costs

PAGE NUMBER: 58-60 — Pages 68-69

PARAGRAPH HEADING: Support from Out-of-Town Contractor Employees; Conferences and Meetings

CONCUR/NON-CONCUR: Concur

COMMENTS: A form, "Request for Contractor Travel" (attached), has been generated and staffing began on October 16, 1993 at BMDO for approval as a standard form. In the interim, the form has been integrated into the COTR training course for use in approving travel. The use of the form will standardize COTR approval of travel and associated costs.

In mid-July 1993, all SETA contractors were requested to provide a record of travel incurred for the third quarter of FY93 to see if there were abuses/assess the need for internal controls. Inputs from contractors were reviewed and "questionable travel" forwarded to the COTR's for their comment. This portion of the study will be concluded by the end of February and required corrective action taken. As of February 7, 1994, replies from COTRs have substantiated the reasonableness of reviewed travel.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: F: Contractor Travel Costs

PAGE NUMBER: 60 — Page 70

RECOMMENDATION: F.1

CONCUR/NON-CONCUR: Concur

COMMENTS: Action will be initiated by the ACO to recover the $53,904. Collection action will be completed by December 31, 1994.

RESPONSE TO DODIG DRAFT AUDIT REPORT ON "SUPER" SETA CONTRACTS AT BMDO

FINDING: F: Contractor Travel Costs

PAGE NUMBER: 60 — Page 71

RECOMMENDATIONS: F.2.a., F.2.b, and F.2.c — Revised

CONCUR/NON-CONCUR: Non-concur

COMMENTS: In view of the volume of travel and the potential for abuse, BMDO concurs with the recommendation that special care should be given to the management of contractor incurred travel costs. There are some difficulties with the IG recommendations:

(1) "Direct support group" is a meaningless term outside the context of this particular contract. Furthermore, all significant other direct costs (ODC) should be identified in contractor-prepared cost proposals and task plans -- it is not appropriate to single out one category of ODC. This is already being accomplished by our procedure for approval of travel. Accordingly, recommendation F.2.a. should be deleted.

(2) A contract clause is more appropriate than an operating instruction to bind the contractor and assure compliance with FAR Part 31. This already exists and forms the basis for disallowance of cost(s). Accordingly, recommendation F.2.b should be deleted.

Management of contractor travel has been and will be accomplished by the COTR. There will be occasions when it is appropriate and most cost effective to have all or most the Government or key contractor personnel working on a particular project at the same meeting. In many situations there is no substitute for face-to-face communications, and the cost in delay or poor communications which would result without the face-to-face communication would be greater than the cost of the travel. A kickoff meeting for a major program with an expedited schedule and a very high priority may justify the attendance of a relatively large number of Government and contractor personnel.

It is not our intent to establish arbitrary thresholds, but to assure that extraordinary expenditures are reviewed and properly documented. This is being accomplished. Accordingly, recommendation F.2.c. should be deleted.

Therefore, recommendation 2 should be deleted in its entirety along with the associated Internal Control Weakness.

Defense Logistics Agency Comments

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
CAMERON STATION
ALEXANDRIA, VIRGINIA 22304-6100

IN REPLY REFER TO DDAI

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MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: OIG Draft Report on "Super" Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization (Project No. 2CH-5031)

This is in response to your 23 December 1993 request.

2 Encl

JACQUELINE G. BRYANT
Chief, Internal Review Office

cc:
AQCOE
AQCBA

TYPE OF REPORT: AUDIT

PURPOSE OF POSITION: INITIAL POSITION

AUDIT TITLE: Draft Report on "Super" Scientific, Engineering and Technical Assistance Contracts at the Ballistic Missile Defense Organization (Project No. 2CH-5031)

FINDING D: Costs for Facilities, Administrative and Clerical Support and Government Property.

The contractor charged facility and administrative and clerical support costs as direct costs to the contract and also as a part of the overhead rate, and acquired general purpose equipment as Government property and received a fee on the costs of the Government property. The contractor's improper charges for facility and support costs and acquisition of Government property occurred because the BMDO contracting officer did not adequately evaluate the task plans submitted by the contractor and did not comply with procurement policies, regulations, BMDO operating instructions, and contract terms.

Also, the contractor did not comply with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose." As a result, BMDO paid the contractor $1.6 million as direct costs for facility facility and administrative and clerical support without reducing overhead rates, allowed the contractor to acquire $493,207 of general purpose equipment as Government property that should have been financed by the contractor, and paid the contractor an award fee of $71,197 on the Government property.

DLA COMMENTS: Concur. The first part of Finding D pertains to the Ballistic Missile Defense Organization contracting officer.

The second part of this finding pertains to Defense Contract Management Command's Administrative Contracting Officers (ACOs). Federal Acquisition Regulation (FAR) 42.302 (11) (iii) states that Contract Administration Offices shall "Determine the contractor's compliance with Cost Accounting Standards and disclosure statements...." As detailed at Recommendation D.3, the cognizant ACOs are awaiting the issuance of Cost Accounting Standards compliance reports for the three Ballistic Missile Defense Organization contractors. Defense Contract Audit Agency is currently performing CAS compliance audits at two of the contractor facilities, and a compliance audit at the third facility is planned for the very near future. ACOs will determine Cost Accounting Standards compliance upon receipt of audit reports.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
( ) Nonconcur
(X) Concur; however, weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

ACTION OFFICER: Joseph F. Hugar, AQCOE, 274-7753
PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Acting Executive Director, Contract Management, AQC, 17 Feb 94
COORDINATION: J. Heiser, CAILP, 8 Feb 94
D. Stumpf, DDAI, 17 Feb 94
[illegible], DDAI, 23 Feb 94

DLA APPROVAL: 25 FEB 1994

[illegible]
Principal Deputy Director

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TYPE OF REPORT: AUDIT

PURPOSE OF POSITION: INITIAL POSITION

SUBJECT: Draft Report on "Super" Scientific, Engineering and Technical Assistance Contracts at the Ballistic Missile Defense Organization (Project No. 2CH-5031) (See Page 52 of draft report)

RECOMMENDATION D.3: Recommend that the Director, Defense Logistics Agency, request the administrative contracting officer to notify the contractor of its noncompliance with Cost Accounting Standard 402, "Consistency in Allocating Costs Incurred for the Same Purpose," because overhead rates included costs for facility, administrative and clerical support and coffee and tea services (Finding E) that were also billed direct to the contract.

DLA COMMENTS:
Partially Concur. Defense Contract Management Command (DCMC) Administrative Contracting Officers (ACOs) are currently fully performing their duties with regard to Cost Accounting Standards (CAS) provisions in BMDO contracts. Federal Acquisition Regulation (FAR) 42.302 (Contract administration functions) states that the ACO shall "Determine the contractor's compliance with cost accounting standards...." DCMC ACOs are guided by established procedures in fulfilling this responsibility. Upon receipt of a noncompliance report from the Defense Contract Audit Agency (DCAA), the ACO requests the Financial Services element to issue a pricing report to assist in the establishment of an initial finding of compliance or noncompliance. DCMC action pertaining to CAS noncompliances commences with the issuance of the audit report by the DCAA field office. In the case of these SETA contracts, the cognizant DCAA field office has not surfaced any noncompliance in audit reports furnished to the cognizant ACOs. DCAA tells us that they are currently auditing The Analytic Sciences Corporation's revised CAS disclosure statement and will address the adequacy and compliance of these items as they pertain to the SETA contract. DCAA is also performing a CAS compliance audit pertaining to the SETA contract at the Riverside Research Institute. In addition, DCAA is scheduling a start date of 7 Feb 94 for a CAS compliance audit pertaining to the SETA contract at The BDM Corporation. Completion of these audits is planned for 1 Jul 94. Subsequent to receipt of audits, the cognizant ACOs will determine CAS 402 compliance. DLA will implement the DCAA audit findings by 30 Sep 94.

INTERNAL MANAGEMENT CONTROL WEAKNESSES:
( ) Nonconcur (DCMC ACOs have not received any DCAA audit reports reflecting noncompliance with CAS 402).
(X) Concur; however, weakness is not considered material
( ) Concur; weakness is material and will be reported in the DLA Annual Statement of Assurance.

DISPOSITION:
(X) Expected completion Date: 30 Sep 94

RECOMMENDATION MONETARY BENEFITS: Benefit is nonmonetary.
DLA COMMENTS: Agree.
ESTIMATED REALIZATION DATE: Not applicable.
AMOUNT REALIZED: Not applicable.
DATE REALIZED: Not applicable.

ACTION OFFICER: Joseph F. Hugar, AQCOE, 274-7753

PSE REVIEW/APPROVAL: Glenn Patrick Phillips, RADM, USN, Acting Executive Director, Contract Management, AQC, 17 Feb 94

COORDINATION: Joel Heiser, CAILP, 8 Feb 94
D. Stumpf, DDAI, 17 Feb 94
[illegible], DUDI, 23 Feb 94

DLA APPROVAL:

LAWRENCE P. FARRELL, JR.
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