Audit Report

OFFICE OF THE INSPECTOR GENERAL

SMALL BUSINESS ADMINISTRATION SECTION 8(A) SUPPORT SERVICES CONTRACTS AT THE BALLISTIC MISSILE DEFENSE ORGANIZATION

Report No. 95-062 December 30, 1994

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Department of Defense

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Acronyms

BMDO	Ballistic Missile Defense Organization
COTR	Contracting Officer's Technical Representative
CPFF	Cost-Plus-Fixed-Fee
CTI	Comprehensive Technologies International, Incorporated
FAR	Federal Acquisition Regulation

INSPECTOR GENERAL
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December 30, 1994

MEMORANDUM FOR DIRECTOR, BALLISTIC MISSILE DEFENSE ORGANIZATION
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Audit Report on Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization (Report No. 95-062)

We are providing this report for your review and comments. This report is the second of three reports from the audit of the procurement system and the role of support services contractors at the Ballistic Missile Defense Organization. The Secretary of Defense requested the audit. In this report, we also reviewed anonymous allegations of fraud, waste, and abuse on contracts that were sent to Senator David Pryor and forwarded to our office. Comments on a draft of this report were considered in preparing the final report.

DoD Directive 7650.3 requires that all recommendations and potential monetary benefits be resolved promptly. The Defense Logistics Agency comments were fully responsive. The Director, Ballistic Missile Defense Organization, is requested to provide comments on the unresolved recommendations and potential monetary benefits by March 1, 1995. See Appendix C for a list of the unresolved recommendations and the specific requirements for Ballistic Missile Defense Organization 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) 604-9332 (DSN 664-9332) or Mr. Henry F. Kleinknecht, Audit Project Manager, at (703) 604-9324 (DSN 664-9324). The distribution of this report is listed in Appendix F. The audit team members are listed inside the back cover.

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Report No. 95-062 **December 30, 1994**
(Project No. 2CH-5031.01)

SMALL BUSINESS ADMINISTRATION SECTION 8(A) SUPPORT SERVICES CONTRACTS AT THE BALLISTIC MISSILE DEFENSE ORGANIZATION

EXECUTIVE SUMMARY

Introduction. This report is the second of three 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 February 1989 through February 1994, BMDO obtained 958,000 staff hours of support services, costing $47.5 million, under three cost-plus-fixed-fee, level-of-effort, term contracts (CPFF contracts) with Comprehensive Technologies International, Incorporated (CTI). CTI was BMDO's largest Small Business Administration Section 8(a) contractor.

Objectives. The overall audit objective was to evaluate the effectiveness of the procurement system and the role of support services contractors at BMDO. Specific objectives were to determine whether the contract administration process and applicable internal controls were effective and whether costs charged to the contracts were allowable, reasonable, and allocable. In addition, we reviewed anonymous allegations sent to Senator David Pryor of fraud, waste, and abuse on CTI contracts with BMDO. We also reviewed internal controls applicable to the audit objectives.

Audit Results. BMDO either had not established or had not followed existing procedures to effectively manage the three CTI contracts. We did not substantiate the allegations of fraud, waste, and abuse on CTI contracts with BMDO. Details of the allegations are discussed in Other Matters of Interest in Part I. Audit results are discussed in the findings in Part II.

o BMDO contracting officers were not effectively managing three CPFF contracts with CTI. As a result, BMDO contracting officers did not know the type of staff hours approved to perform tasks, did not know whether labor categories provided by the contractor were required to perform tasks, and did not adequately evaluate and control costs on the CTI contracts. We calculated cost overruns on the three CTI contracts totaling about $3.1 million, for which CTI is not entitled to a fee of $233,749 (Finding A).

o CTI awarded five CPFF subcontracts, with a total value of about $12.9 million, that were administered as prohibited cost-plus-a-percentage-of-cost contracts under the three BMDO prime CPFF contracts with CTI. In addition, CTI did not obtain cost or pricing data or perform cost analyses for three of the subcontracts, valued at about $6.5 million. As a result, CTI was using a prohibited system of contracting that rewarded inefficient performance from its subcontractors, and neither CTI nor BMDO could determine whether subcontract prices were reasonable (Finding B).

o CTI and its subcontractor charged 588 labor hours that were not actually worked to one BMDO CPFF contract. As a result, BMDO paid $27,370 to CTI for questioned labor costs (Finding C).

o CTI billed BMDO questioned costs for various miscellaneous items that were not required for contract performance or not authorized in the contract. CTI also billed questionable travel costs and submitted two duplicate billings for travel and catered services. As a result, BMDO was charged $61,248 for questioned costs (Finding D).

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

Potential Benefits of Audit. BMDO should not pay CTI a fee of about $234,000. BMDO also should recover about $89,000 for questioned costs. An undeterminable amount of costs will be recovered from fairly pricing cost-plus-a-percentage-of-cost subcontracts and strengthening the internal controls for contract administration and contract oversight. Appendix D summarizes potential benefits from the audit.

Summary of Recommendations. We recommend that BMDO establish additional contract management and cost control procedures, verify that the procedures were implemented for CPFF contracts, and initiate action to recover questioned costs. We recommend that the Director, Defense Logistics Agency, perform a contractor purchasing system review at CTI or provide consent to subcontract, and determine reasonable prices for CTI subcontracts administered as prohibited cost-plus-a-percentage-of-cost contracts.

Management Comments. BMDO stated that contracting operations and business practices have been dramatically strengthened and the audited contracts do not reflect current conditions. Also, BMDO disagreed with the audit calculation on contract cost overruns and fee payments. BMDO agreed to establish the additional contract management and cost control procedures and to initiate action to recover questioned costs. BMDO disagreed that additional management control procedures were needed to verify that contractor task plans were received, that task orders were issued in a timely manner, and that the administrative contracting officer should be notified of subcontracts awarded by the prime contractor that were not included in the contract proposal. The Director, Defense Logistics Agency, agreed to perform a purchasing system review of CTI and validate CTI subcontracting costs. See Part II for a summary of the management comments on the recommendations, Part III for a summary of the management comments on the report, and Part IV for the full text of management comments.

Audit Response. We congratulate BMDO for improving contracting operations since the audit started. We differ with BMDO on technical issues in a highly complex type of contracting. We stand by our conclusions of cost overruns and fee payments. The recommendations are needed to address the inherent weaknesses of cost-plus-fixed-fee, level-of-effort, term, task order contracts and to improve financial reporting requirements needed to mitigate the inherent weaknesses. We request additional comments from BMDO on the unresolved recommendations by March 1, 1995.

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Part I - Introduction

Background

Mission of the Ballistic Missile Defense Organization. The Ballistic Missile Defense Organization (BMDO) manages, directs, and executes the U.S. ballistic missile defense program. The BMDO primary mission is to develop and acquire systems, subsystems, components, elements, and architectures to achieve the following objectives.

o Deploy a highly effective and rapidly relocatable advanced theater missile defense capability to protect forward-deployed and expeditionary elements of the Armed Forces of the United States, as well as friends and allies of the United States.

o Conduct a technical readiness program so that, should the decision be made to do so, the United States could deploy an antiballistic missile system that is capable of providing a highly effective defense of the United States homeland against limited attacks consisting of accidental, unauthorized launches or deliberate ballistic missile attacks.

o Continue a research program to develop advanced technologies for both near-term and future technology insertion options and new systems options to sustain a highly effective missile defense capability.

The focus of the ballistic missile defense program is the development, acquisition, and integration of theater missile defense and strategic defense against ballistic missile threats to the United States.

Section 8(a) Support Services Contracts. The Small Business Administration Section 8(a) Program was established to encourage firms owned and controlled by socially and economically disadvantaged individuals to participate in Government acquisitions. As of May 1994, BMDO had 10 active Section 8(a) contracts, with a total maximum contract value of about $26 million, excluding Section 8(a) contracts with Comprehensive Technologies International, Incorporated (CTI).

CTI Section 8(a) Support Services Contracts. BMDO requested that the Small Business Administration award CTI three noncompetitive, cost-plus-fixed-fee, level-of-effort, term contracts (CPFF contracts) for support services. As of February 28, 1994, CTI had incurred costs of $44.5 million on the three CPFF contracts, received a fee of $3 million, and delivered 958,218 staff hours.

o CPFF contract SDIO84-89-C-0010 (contract 10)* was awarded to CTI on February 22, 1989, for support in planning acquisitions, preparing

* For the purposes of this report, we will refer to the three CPFF contracts by the last two digits of the contract number.

contract solicitations, preparing contract evaluation items and factors, preparing contract modifications and task orders, and analyzing the acquisition process. The contract was physically completed in December 1992 after CTI had incurred costs of $6.2 million, received a fee of $412,000, and delivered 119,000 staff hours.

o CPFF contract SDIO84-90-C-0012 (contract 12) was awarded to CTI on June 26, 1990, for support in graphics and publishing documents. As of February 28, 1994, CTI had incurred costs of $6.8 million, received a fee of $460,000, and delivered 171,000 staff hours.

o CPFF contract SDIO84-89-C-0042 (contract 42) was awarded to CTI on September 30, 1989, for support in planning and programming all BMDO functions, reviewing progress against technical and financial program baselines, reviewing and auditing program analysis, performing technical engineering and analysis studies, and providing various other directed technical efforts. As of February 28, 1994, CTI had incurred costs of $31.5 million, received a fee of $2.1 million, and delivered 668,000 staff hours.

Table 1 shows a summary of costs incurred, fee, and staff hours for the three contracts.

Table 1. Summary of Costs Incurred, Fee, and Staff Hours on CTI Contracts

Contract	Costs Incurred (millions)	Fee (millions)	Staff Hours
10	$ 6.2	$0.41	119,000
12	6.8	0.46	171,000
42	31.5	2.10	668,000
Total	$44.5	$2.97	958,000

Objectives

This report is the second of three reports from an audit requested by the Secretary of Defense to evaluate the effectiveness of the procurement system and the role of support service contractors at BMDO. Specific audit objectives were to determine whether:

o the contract administration process and applicable internal controls were effective and

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

This report discusses Section 8(a) contracts awarded by BMDO and evaluates anonymous allegations sent to Senator David Pryor, to BMDO, and to the Office of the Inspector General, DoD, of fraud, waste, and abuse on BMDO contracts with CTI. The first report, Inspector General, DoD, Report No. 94-077, "'Super' Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization," April 8, 1994, covers cost-effectiveness of contractor support and contract management problems. The third report will cover program management, the acquisition corps, and support services contractors.

Scope and Methodology

BMDO Section 8(a) Contracts. We reviewed the 10 active BMDO Section 8(a) contracts, valued at about $26 million, awarded from December 1990 through September 1993 to contractors other than CTI to determine the contract type and maximum contract amount. We also interviewed Small Business Administration officials and reviewed guidance for contractor participation in the Section 8(a) program.

BMDO Contracts 10, 12, and 42 with CTI. We examined the contractor's best and final offers, basic contracts, contract modifications, task orders, task plans, task descriptions, audit reports, and invoices to determine whether billings were in accordance with applicable laws, procurement regulations, and contract terms. We examined 30 task orders or task order modifications for contract 10, 7 task orders or task order modifications for contract 12, and 56 task orders or task order modifications for contract 42 awarded from October 1988 through September 1993. Our review focused on contract administration and costs charged to the three CPFF contracts with CTI from February 1989 through July 1993. As of February 28, 1994, CTI had incurred costs of $44.5 million, received a fee of $2.97 million, for a total of $47.47 million, and delivered 958,000 staff hours on the three contracts.

We performed audit work at CTI and at two CTI subcontractors: Advanced Marine Enterprises, Incorporated, and Dwyer & Associates, Incorporated. We reviewed CTI billing procedures and examined the timeliness of CTI payments to subcontractors. Under contracts 10, 12, and 42, CTI awarded 13 subcontracts, valued at about $13.4 million. We examined the five largest subcontracts, valued at about $12.9 million.

We evaluated DoD and contractor policies for facilities and Government property and examined labor costs, fixed fees, and other direct costs. We examined travel claims, totaling about $53,000, for one CTI employee for the period October 1989 through July 1993 on contract 42. Total travel costs on contract 42 were about $604,000. We also interviewed BMDO officials, contracting officers, and contracting officer's technical representatives (COTRs). We selectively reviewed the resumes of contractor staff and compared qualifications with the labor categories billed by CTI. We reviewed time sheets submitted by CTI and subcontractor personnel assigned to the

BMDO Visual Product Information Center for the period of May 1, 1992, through April 30, 1993, and compared daily hours charged to the contract to the login, logout computer-processed data maintained by the BMDO Access Control Center for nine CTI employees and five subcontractor employees. We also interviewed eight of the CTI employees and the subcontractor project manager that were assigned to the BMDO Visual Product Information Center to determine timekeeping procedures and to determine the extent of company training and guidance provided to employees regarding timekeeping and time sheet policy.

Anonymous Allegations. We reviewed the anonymous allegations and BMDO internal investigations of the allegations. We interviewed BMDO officials and CTI management and staff personnel regarding the allegations. Details of the allegations are discussed in Other Matters of Interest.

Audit Period, Standards, and Locations. This economy and efficiency audit was made from April 1993 through June 1994. 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 status reports to accomplish the audit objectives. We compared computer-processed data with source documents and determined the data to be reliable. We did not use statistical sampling procedures to conduct this audit. Organizations visited or contacted are listed in Appendix E.

Internal Controls

Internal Controls Reviewed. BMDO had operating instructions for maintaining contract files, performing prenegotiation reviews, using undefinitized contractual actions, issuing contract task orders, and providing facilities to contractors. We reviewed BMDO internal controls to determine whether contracting officers and contractors complied with the operating instructions, the DoD directives, the Federal Acquisition Regulation (FAR), and specific contract terms.

BMDO Internal Management Control Program. The key elements of the BMDO Internal Management Control Program have been the participation of senior management in the program and the evaluation and development of more detailed policy and operating procedures. In 1988, BMDO issued an internal management control report that identified 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 scientific, engineering, and technical assistance contracts, and establishing one program manager for centralized management and control of the three super scientific, engineering, and technical contracts. BMDO also performed risk assessments of the contract

management function, performed informal reviews of the procurement system, and developed contract operating instructions as part of the implementation of the DoD Internal Management Control Program.

Adequacy of Internal Controls. 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 determine the type of staff hours approved by contracting officers to perform tasks, to determine whether labor categories provided by CTI were required to perform the tasks, and to evaluate costs and fixed fee on CPFF contracts. Further, internal controls did not prevent CTI from using a prohibited cost-plus-a-percentage-of-cost system of contracting with its subcontractors and did not determine the reasonableness of subcontract prices on prime CPFF contracts. Recommendations A.1., A.2., B.1., D.2., and D.4., if implemented, will correct the weaknesses that primarily deal with inadequate compliance with existing controls. The potential monetary benefits that can be realized by implementing the recommendations to correct internal control weaknesses are undeterminable. See Appendix D for a summary of the benefits. A copy of the report will be provided to the senior official responsible for internal controls in the Office of the Under Secretary of Defense for Acquisition and Technology.

Prior Audits and Other Reviews

Inspector General, DoD. Report No. 94-077, "'Super' Scientific, Engineering, and Technical Assistance Contracts at the Ballistic Missile Defense Organization," April 8, 1994. The report states that contracted support services were not cost-effective and that, although the contract type offered BMDO flexibility, the contracts provided inadequate financial accountability and little incentive for contractors to control costs. Recommendations were made for BMDO to 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. Management concurred with most recommendations and proposed alternative actions during followup that resolved the remaining issues.

Inspector General, DoD, Report No. 92-120, "Reasonableness of Costs Charged to Support Services Contract MDA903-88-D-0018," June 30, 1992. The report states 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.

Inspector General, DoD, Report No. 91-115, "Consulting Services Contracts for Operational Test and Evaluation," August 22, 1991. The report states 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 the 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 recommendation 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 that:

> 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.

Assistant Secretary of Defense for Force Management and Personnel Review. The review of the use of civilian employees and contractor support in operational test activities in DoD was never completed and recommendations were not provided to the Deputy Secretary of Defense.

> 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.

General Counsel, DoD, Review. The Deputy General Counsel (Acquisition and Logistics) issued a memorandum to the General Counsels of the Military Departments and Defense agencies, "Review of Contracts Supporting Operational Test and Evaluation," April 5, 1993. The review determined that most of the contracts in place at the operational test activities of the Military Departments contained vague, generic statements of work. Thus, the contracts did not contain detailed statements of work from which specific supplies or services could be ordered for delivery, and 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 subpart 37.1, "Service Contracts-General," regarding personal services contracting.

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. According to the Senate Committee on Governmental Affairs analysis, the three major concerns with BMDO use of support contractors were the:

o overreliance on contractors to perform the most sensitive internal work of the program;

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

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

Director, 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 determined that a random sample of 42 services contracts, including 3 BMDO contracts, were accomplishing their objectives. The report contained no recommendations.

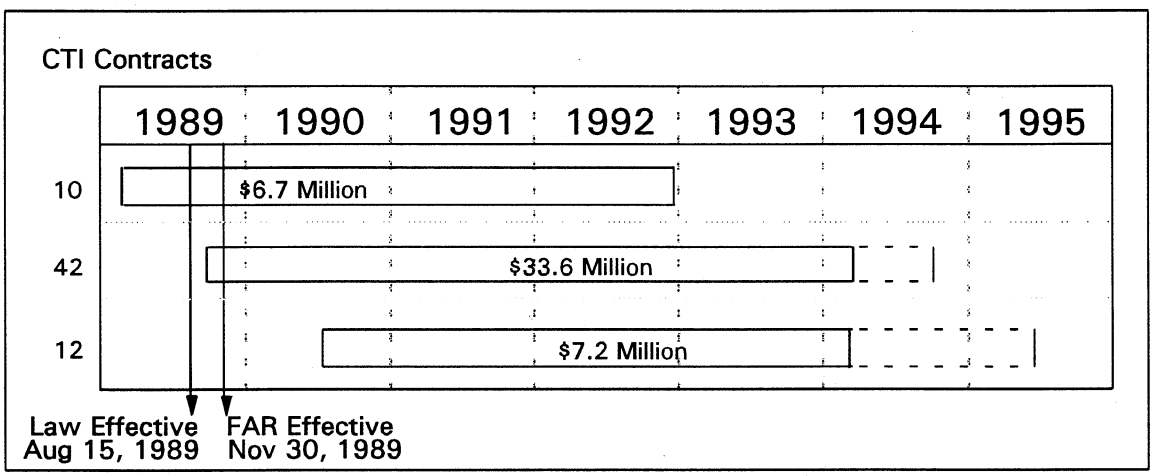
Other Matters of Interest

Anonymous allegations of fraud, waste, and abuse on BMDO contracts with CTI were sent to Senator David Pryor, to BMDO, and to the Office of the Inspector General, DoD. BMDO investigated the allegations to determine whether administrative action was needed against a BMDO employee and whether contracts with CTI needed to be modified. The BMDO review recommended no action against the BMDO employee or CTI. The following summarizes the allegations and indicates whether the allegations were substantiated by our audit.

Allegation. A personal arrangement between a BMDO employee and a CTI employee resulted in three contracts being awarded to CTI without competition.

Audit Result. A personal relationship between the BMDO employee and the CTI employee was not substantiated. However, all three contracts were awarded noncompetitively, and one of the contracts should have been competed.

As shown in the following figure, BMDO contract 10 was awarded before the law (title 15, United States Code, section 637[a][1][D], August 15, 1989) requiring competition on Section 8(a) procurements of more than $3 million became effective. The statute requiring competition on Section 8(a) procurements of more than $3 million was not incorporated into the FAR until after contract 42 was awarded. However, contract 12 should have been competed because the contract was awarded after the effective date of the FAR change requiring competition on Section 8(a) contracts.



Award Dates and Effective Dates of Competition Requirement for Section 8(a) Contracts of More Than $3 Million

We reviewed other Section 8(a) contracts that BMDO awarded in 1992 and 1993 and identified none more than $3 million that required competition (except the follow-on contract to contract 42, which BMDO was competing).

Allegation. CTI employees were charging hours to BMDO contracts while working on other contracts or for other business purposes, and accountability of CTI labor hours charged to BMDO contracts was inadequate.

Audit Result. The allegation that CTI employees were charging hours to BMDO contracts while working on other contracts or for other business purposes was not substantiated. However, contract management problems did result in inadequate accountability and in CTI making incorrect labor charges to BMDO contracts as described in Findings A, B, and C.

Part II - Findings and Recommendations

Finding A. Contract Management

BMDO contracting officers did not effectively manage three CPFF contracts with CTI. As of July 31, 1993, the three CPFF contracts had a total value of about $42.1 million. The CTI contracts were not effectively managed because BMDO contracting officers did not:

o implement procedures to issue task orders in a timely manner, to date task orders, and to obtain task plans from the contractor that adequately described labor categories and labor costs;

o establish procedures to define labor categories and labor mix in the contracts and to require the contractor to bill or track costs against those labor categories; and

o establish an effective method to determine changes in the contractor's labor mix, to evaluate labor and indirect cost increases, and to determine the appropriate fixed fee.

As a result, BMDO contracting officers were not aware of the type of staff hours approved to perform tasks, did not know whether labor categories provided by CTI were required to perform tasks, and did not adequately evaluate and control costs on the contracts with CTI. We calculated cost overruns on the three CTI contracts totaling about $3.1 million, for which CTI was not entitled a fee of $233,749.

Background

Contract Provisions for Task Ordering Procedures. Each of the three CPFF contracts has provisions for task ordering procedures. Contracts 10 and 12 state that the contracting officer will provide CTI with proposed task descriptions that include information on the nature of work to be performed, required completion dates, period of performance, estimated level of effort, estimated costs, and any Government-furnished material to be provided. CTI will then submit to the contracting officer, within 5 working days after receipt of the task description, a task plan that describes the CTI approach, staff hours, key personnel, and costing to accomplish the work. BMDO reviews the task plans, and the contracting officer issues a task order with the approved task plan.

Contract 42 states that CTI will submit to the contracting officer, within 5 days after receipt of each task order, a one-time task plan for the task order. The task plan will identify staff hours on a monthly basis by applicable labor category, by the total staff hours estimated to complete the task, and by the total estimated cost including fee for completion of the task order.

Contract Provision on Level of Effort. The contract section, "Level of Effort," identifies the total staff hours required under each contract. Contract 10 states that CTI could receive the full fixed fee without providing the required staff hours if a lesser number of hours was approved by the contracting officer under the conditions that the contractor either achieves the contract objectives or the variation is minor. Contracts 12 and 42 state that CTI will receive the full fixed fee by providing not less than 90 percent nor more than 110 percent of the specified staff hours. In the event that CTI provides less than 90 percent of the required staff hours, the fixed fee will be reduced accordingly. Contracts 12 and 42 also stipulate that CTI cannot exceed 110 percent of the specified level of effort without a contract modification.

BMDO Operating Instruction on Issuing Contract Task Orders. BMDO Operating Instruction 05, "Task Order Initiation," June 13, 1988, establishes policy and procedures for initiating task orders under task order contracts. The instruction states that the contracting officer will forward the proposed task order to the contractor and obtain a proposal from the contractor that adequately addresses the type and quantity of staff hours necessary to perform the task. Task orders will be issued in written form; will be signed by the contracting officer; and will include the date of order, estimated amount, and level of effort by labor category (and billing rate, if known).

FAR Requirement. FAR 16.306, "Cost-Plus-Fixed-Fee Contracts," states that a CPFF contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fixed fee does not vary with actual cost, but may be adjusted as a result of changes in the work to be performed under the contract.

As stated in FAR 16.306, a CPFF contract may take one of two forms: term or completion. The term contract describes the scope of work in general terms and obligates the contractor to devote a specified level of effort for a stated time period. In a term contract, if the performance is considered satisfactory by the Government, the fixed fee is payable at the expiration of the agree-upon period, and upon contractor certification that the level of effort specified in the contract was expended in performing the statement of work. The term form of the CPFF contract is used only if the contractor is obligated to provide a specific level of effort within a definite time period. Contracts 10, 12, and 42 were term contracts. The completion form of the CPFF contract describes the scope of work by stating a definite goal or target and specifying an end product.

Implementing Task Orders and Task Plans Procedures

Task Order Procedures. BMDO did not follow task order procedures in the contracts and BMDO operating instructions on task order initiation. Specifically, BMDO contracting officers did not date task orders, did not issue task orders until a significant portion of the work was completed, and did not adequately identify the types of staff necessary to perform tasks in the task orders.

Task Plan Procedures. BMDO did not require that CTI provide task plans for each task order, that CTI provide task plans before a significant portion of the work was completed, and that CTI identify labor hours and costs by labor category in the task plans. Consequently, BMDO contracting officers did not know the type of staff approved to perform tasks or whether labor categories provided by CTI were required to perform the tasks, and BMDO contracting officers could not adequately evaluate and control costs on the task orders.

Continuity Impacts the Implementation of Procedures. In addition, BMDO had little continuity of the contract administration function because nine different contracting officers were responsible at various times for the CTI contracts. The lack of continuity for contracting officers would impact the implementation of task order and task plan procedures.

Examples of Task Order and Task Plan Implementation. The following summaries provide examples of procedural problems with the implementation of task orders and task plans.

Contract 10. Task orders 400 through 409 for the period October 18, 1991, through October 17, 1992, were not signed by the contracting officer until April 6, 1992, almost halfway through the period of performance. The estimated costs for the task orders were about $1.8 million to provide about 31,000 staff hours of services. Contractor task plans for 12 task orders identified specific individuals, while contractor task plans for 13 task orders identified labor categories. We could not locate task plans for five task orders. Further, the labor categories and the individuals proposed in the task plans were different from the labor categories and the individuals proposed in the contract.

Contract 12. Task order 3a for the period June 26, 1992, through June 25, 1993, was not dated and appears to have been issued by the contracting officer after the work was completed (based on the date the CTI task plan was signed, April 2, 1993). The estimated costs for the task order were about $2.2 million to provide 48,000 staff hours of services. The labor categories and labor costs identified on the task plan were different from the labor categories and labor costs proposed by the contractor for the contract. The contractor also did not provide task plans for task orders 1 and 2 for the first 2 contract years (June 26, 1990, through June 26, 1992) for about 133,000 staff hours.

Contract 42. Task orders 2, 3, 7, 10, 11, 12, 13, 14, 15, and 18 for the period October 1, 1992, through September 30, 1993, were not dated and appear to have been issued by the contracting officer after the work was completed (based on the dates the CTI task plans were signed). The estimated costs for the task orders were about $9.1 million to provide about 163,000 staff hours of services. The contractor's task plans for the 10 task orders did not identify labor hours and labor costs by labor category and did not identify

indirect cost rates. The contractor did not provide the 10 task plans until September 24 and 28, 1993, several days before the completion of the period of performance. The contractor also did not provide task plans for task orders 1 and 2 for the first 2 contract years (October 1989 through September 1991) for about 229,000 staff hours of support services.

Improve Task Order and Task Plan Procedures. We believe BMDO needs to establish procedures to verify that contracting officers issue task orders before permitting contractors to commence work and that contracting officers must sign task orders when issued. We also believe that BMDO needs to establish procedures to verify that contracting officers obtain task plans from contractors that support task orders and that describe contract labor categories and labor costs.

Defining Contract Labor Categories and Labor Mix

CTI Contracts. The three CPFF contracts did not identify specific labor categories, did not define the minimum education and experience requirements for each labor category, and did not require CTI to bill labor hours or track labor costs against the labor categories that CTI proposed. We determined that CTI charged staff hours to the contracts for employees from labor categories that were not proposed and could establish new labor categories that corresponded to the education and experience requirements of CTI employees. Consequently, because BMDO did not know the type of staff hours for which they contracted, BMDO was unable to effectively determine that costs were reasonable.

Contractor Labor Categories. CTI internal records defined minimum education and experience requirements for each of the labor categories billed to the contract; however, individuals billed in the labor categories to contracts 12 and 42 did not meet the contractor's minimum education and experience requirements.

Table 2 shows the CTI employees and number of hours charged to incorrect labor categories.

Table 2. CTI Charges to Incorrect Labor Categories

Incorrect Labor Category Charged (CTI Grade)	Correct Labor Category (CTI Grade)	Hours Charged to Incorrect Labor Categories		
		Contract 12	Contract 42	Total
Chief Analyst (12)	Program Manager I (12)	2,686	1,535	4,221
Senior Principal Analyst (11)	Desktop Publishing Supervisor (9)	3,812	5	3,817
Senior Principal Analyst (11)	Producer (9)	2,610	0	2,610
Senior Principal Analyst (11)	Senior Technical Writer (8)	207	5,595	5,802
Senior Principal Analyst (11)	Cost Analyst IV (10)	0	5,594	5,594
Senior Principal Analyst (11)	Program Planning & Control Analyst III (9)	0	2,282	2,282
Principal Analyst II (10)	Program Planning & Control Analyst III (9)	0	4,065	4,065
Principal Analyst II (10)	Program Planning & Control Analyst III (9)	0	5,482	5,482
Principal Analyst II (10)	Local Area Network Administrator I (6)	0	1,604	1,604
Principal Analyst II (10)	Marketing Coordinator (6)	0	642	642
Principal Analyst I (9)	Program Planning & Control Analyst III (9)	0	3,696	3,696
Senior Analyst II (8)	Senior Desktop Publishing Specialist (7)	1,818	315	2,133
Principal Engineer (11)	Systems Engineer IV (12)	0	3,277	3,277
Senior Engineer I (11)	Engineer IV (10)	0	3,252	3,252
Senior Engineer I (11)	Engineer IV (10)	0	2,351	2,351
Engineer I (6)	Training Manager (12)	847	0	847
Senior Systems Engineer (10)	Local Area Network Administrator III (10)	0	1,429	1,429
Administrative Director (10)	Senior Desktop Publishing Specialist (7)	1,527	0	1,527
Total		13,507	41,124	54,631

Proposed Versus Actual Labor Categories and Labor Mix. CTI proposed labor categories and a labor mix that were different from the labor categories and labor mix that CTI billed, and BMDO had not established procedures to compare the costs. Consequently, CTI was not providing the specific level of effort specified in the contracts as required by FAR 16.306.

Unknown Labor Categories. For contract 10, CTI proposed staff hours for "direct labor potentials," which were not associated with any specific labor category. These direct labor potentials were staff hours for unknown labor categories proposed at various CTI pay levels. Consequently, BMDO could not determine whether actual labor costs were higher than the proposed labor costs for the labor categories that CTI proposed.

Differences Between Proposed and Billed Labor Categories. BMDO could not determine whether the total contract labor mix for the proposed labor categories had changed and whether the labor categories provided by CTI were required to perform tasks. On contract 42, for instance, the CTI proposal identified only 10 different labor categories; however, as of July 31, 1993, CTI had charged labor hours to the contract for 49 different labor categories.

Comparison of Proposed and Billed Labor Categories. We classified billed labor categories by CTI grade level and matched the grade levels to proposed labor categories to compare labor hours for proposed and billed labor categories. See Appendix A for a comparison of proposed and billed labor hours for CTI labor categories and labor mix for each contract. Figure A-8 shows an example of CTI providing the majority of the labor hours from labor categories that were not proposed. Figures A-8, A-9, A-10, and A-11 show examples of CTI providing fewer labor hours from the highest contract labor categories than proposed, thus changing the overall contract labor mix. These changes to the labor mix should have resulted in changes to the contract that reduced the estimated costs and fixed fee, because CTI was not providing the specific level of effort specified in the contract.

Control of Contract Labor Categories and Labor Mix. We believe BMDO needs to establish procedures in BMDO contract operating instructions that require contracting officers for all CPFF contracts to define labor categories in contracts and to require contractors to bill or track costs against those labor categories. These procedures will enable BMDO to determine whether contractors are providing the specific level of effort specified in the contract.

Evaluating Labor and Indirect Costs Changes to Determine Fixed Fee

Labor Cost Changes. BMDO contracting officers used a "wrap-rate variance" to determine whether actual cost performance was in line with estimated costs. The wrap-rate variance was an hourly labor cost variance that BMDO determined by comparing the proposed staff-hour cost (proposed costs divided by the proposed staff hours) with the actual staff-hour cost (actual costs divided by actual staff hours). We determined that the wrap-rate variance did not accurately measure contract performance (overruns or underruns) because the wrap-rate variance did not consider such factors as changes in CTI's labor mix, use of subcontractor employees rather than proposed CTI employees, and performance of work at a Government site rather than at the proposed contractor site.

Methodology to Evaluate Contract Overruns or Underruns. We developed a methodology to calculate a labor category cost variance for each contract and determine contract overruns or underruns. We also compared the labor category cost variance with the wrap-rate cost variance. Because CTI charged labor hours to the contract from many different labor categories that were not proposed, we judgmentally classified the billed labor categories into proposed labor categories, as shown in Appendix A, for our cost comparison. The following paragraphs summarize the results of the comparison for each contract.

Contract 10. We calculated a labor category cost variance that showed that the contract had an overrun of $206,959, while the wrap-rate cost variance showed an overrun of $430,812. Our analysis showed that the contract had an underrun of $285,362 for CTI labor and an overrun of $492,322 for subcontractor labor. CTI did not propose any subcontractor work for contract 10, although several subcontractor employees were included in the CTI proposal as key CTI employees.

As shown in table 3, the wrap-rate cost variance incorrectly shows the overrun for contract 10 is more than twice as much as we calculated using the labor category cost variance.

On Tables 3, 4, and 5, the total cost difference represents the actual labor hours multiplied by the hourly cost difference.

Table 3. Comparison of Labor Category and Wrap-Rate Cost Variances for Contract 10

(Totals may not add due to rounding of computer-processed data.)

		Proposed		Actual		Difference	
CTI Labor Category	CTI Grade	Labor Hours	Hourly Cost	Labor Hours	Hourly Cost	Hourly Cost	Total Cost
Contractor							
Chief Analyst	12	13,384	$ *	14,303	$ *	($26.76)	($ 382,688)
Senior Principal Analyst	11	20,762	*	12,903	*	0.28	3,662
Principal Analyst II	10	36,960	*	6,275	*	1.05	6,573
Principal Analyst I	9	25,424	*	18,993	*	0.78	14,728
Direct Labor Potentials	8	12,040	*	15,985	*	0.99	15,787
Direct Labor Potentials	6	12,040	*	16,249	*	4.08	66,247
Clerk/Typist	4	24,990	*	4,669	*	(2.07)	(9,671)
Subtotal		145,600		89,376			($ 285,362)
Subcontractor							
Chief Analyst	12	0	*	5,193	*	20.15	$ 104,654
Principal Analyst I	9	0	*	27,104	*	14.30	387,667
Subtotal		0		32,297			$ 492,322
Total Labor Category Cost Variance							$ 206,959
Total Wrap-Rate Cost Variance		145,600	*	121,673	*	3.54	$ 430,812

For contract 10, CTI voucher CO55-84, February 26, 1993, shows that CTI received a 7.75 percent fee on its total costs, including subcontractor costs, and that the fee paid to CTI did not depend on CTI providing a specific level of effort as required by FAR 16.306. Further, CTI is not entitled to a fee of $16,039 that BMDO paid on the cost overrun of $206,959 caused by the subcontractor work.

*Proprietary Data Removed

Contract 12. We calculated a labor category cost variance that showed a contract overrun of $1,059,053, while the wrap-rate cost variance showed an overrun of $189,531. The majority of the contract overrun for the labor category variance occurred because CTI did not propose any subcontractors and then used subcontractors at an hourly cost that was higher than the CTI hourly cost. CTI is not entitled to fee of $70,429 on the cost overrun of $1,059,053 caused by the subcontractor work.

Table 4 shows the significant difference between the contract 12 overrun when calculated using a labor category cost variance and a wrap-rate cost variance.

Table 4. Comparison of Labor Category and Wrap-Rate Cost Variances for Contract 12

(Totals may not add due to rounding of computer-processed data.)

		Proposed		Actual		Difference	
CTI Labor Category	CTI Grade	Labor Hours	Hourly Cost	Labor Hours	Hourly Cost	Hourly Cost	Total Cost
Contractor Site							
Program Manager	11	12,992	$ *	10,196	$ *	$10.58	$ 107,833
Analyst	10	12,992	*	1,089	*	(0.47)	(511)
Analyst	9	24,436	*	3,016	*	3.14	9,461
Maintenance	8	12,992	*	981	*	(1.31)	(1,287)
Analyst	7	12,992	*	5,055	*	0.83	4,197
Administrative Secretary	6	12,992	*	14,482	*	5.36	77,644
Subtotal		89,396		34,818			$ 197,337
Government Site							
Operator	11	12,992	*	3,840	*	(11.09)	($ 42,576)
Operator	10	25,984	*	3,744	*	(10.93)	(40,935)
Operator	8	12,992	*	19,673	*	(1.33)	(26,132)
Operator	7	26,536	*	18,951	*	(0.84)	(15,863)
Subtotal		78,504		46,207			($ 125,506)
Subcontractor	7	0	*	58,850	*	16.78	$ 987,222
Total Labor Category Cost Variance							$1,059,053
Total Wrap-Rate Cost Variance		167,900	*	139,876	*	1.35	$ 189,531

For contract 12, the wrap-rate variance is lower than the labor category variance because CTI provided a larger percentage of staff hours from lower labor categories than proposed. Consequently, CTI is not providing the specific level of effort specified in the contract. In Appendix A, Figures A-8 through A-11 show that CTI failed to provide the proposed hours from the higher level labor categories. Figures A-13, A-16, and A-17 show that CTI actually provided more labor hours from the lower level labor categories than proposed.

*Proprietary Data Removed

Contract 42. We calculated a labor category cost variance that showed a contract overrun of $1.8 million, while the wrap-rate variance showed a higher overrun of $2.3 million. We determined that 47,281 staff hours of work were performed at a Government site, although CTI proposed no work at a Government site. Consequently, when CTI Government site hourly labor costs are compared with CTI proposed contractor site hourly labor costs, a contract underrun is inappropriately created.

Table 5 shows that the correct contract 42 overrun is lower when calculated using the labor category cost variance versus the wrap-rate cost variance.

Table 5. Comparison of Labor Category and Wrap Rate Cost Variances for Contract 42

(Totals may not add due to rounding of computer-processed data.)

		Proposed		Actual		Difference	
CTI Labor Category	CTI Grade	Labor Hours	Hourly Cost	Labor Hours	Hourly Cost	Hourly Cost	Total Cost
Contractor Site							
Chief Engineer	13	5,251	$ *	9,936	$ *	($24.68)	($ 245,264)
Senior Engineer	12	34,605	*	54,409	*	(6.28)	(341,476)
Senior Analyst	11	50,788	*	49,851	*	1.88	93,676
Principal Analyst II	10	50,788	*	35,359	*	0.23	8,296
Engineer	9	50,788	*	37,895	*	4.03	152,669
Senior Analyst II	8	50,788	*	26,640	*	3.58	95,408
Senior Analyst I	7	9,469	*	17,919	*	4.33	77,626
Junior Engineer	6	34,605	*	34,524	*	3.49	120,474
Analyst	5	34,605	*	14,521	*	16.47	239,083
Analyst/Secretary	4	17,647	*	15,161	*	1.93	29,232
Subtotal		339,334		296,214			$ 229,724
Government Site							
Senior Engineer	12	0	*	329	*	(49.07)	($ 16,135)
Senior Analyst	11	0	*	4,008	*	(20.82)	(83,417)
Principal Analyst II	10	0	*	2,410	*	(25.12)	(60,537)
Engineer	9	0	*	8,876	*	(9.56)	(84,810)
Senior Analyst II	8	0	*	1,328	*	(6.54)	(8,684)
Senior Analyst I	7	0	*	3,649	*	(5.26)	(19,208)
Junior Engineer	6	0	*	13,903	*	(4.61)	(64,072)
Analyst	5	0	*	7,566	*	6.51	49,284
Analyst/Secretary	4	0	*	5,214	*	(1.67)	(8,729)
Subtotal		0		47,281			($ 296,307)*
Subcontractor	8	322,804	*	245,119	*	6.58	$ 1,614,024
Total Labor Category Cost Variance							$ 1,843,748
Total Wrap Rate Cost Variance		662,138	*	588,614	*	3.98	$ 2,344,641

*Subtotal not included in total labor category variance because Government site labor costs were not proposed.

*Proprietary Data Removed

The majority of the contract overrun for both variances resulted from increased costs for subcontractors not in the contract proposal. CTI is not entitled to fee of $138,281 on the cost overrun of $1,843,748 caused by the subcontractor work.

Indirect Costs. The contractor's actual indirect cost rates for overhead (CTI site and Government site), general and administrative expense, and material and subcontract handling were different from its proposed indirect cost rates.

Table 6 shows that the actual indirect costs for the three contracts were $849,335 higher than the proposed indirect costs.

Table 6. Cost Variances Caused by Indirect Rate Changes
(Totals may not add due to rounding of computer-processed data)

		Proposed		Actual		
Indirect Element	Base	Percent	Cost	Percent	Cost	Variance
Contract 10						
Overhead (CTI Site)	$ *	*	$ *	*	$ *	($ 38,510)
Material and Subcontract Handling	*	*	*	*	*	(29,493)
General and Administrative Expense	*	*	*	*	*	55,808
Subtotal			$ *		$ *	($ 12,195)
Contract 12						
Overhead (CTI Site)	$ *	*	$ *	*	$ *	$ 37,322
Overhead (Client Site)	*	*	*	*	*	(15,733)
Material and Subcontract Handling	*	*	*	*	*	18,522
General and Administrative Expense	*	*	*	*	*	70,204
Subtotal			$ *		$ *	$ 110,315
Contract 42						
Overhead (CTI Site)	$ *	*	$ *	*	$ *	$ 393,423
Material and Subcontract Handling	*	*	*	*	*	37,740
General and Administrative Expense	*	*	*	*	*	320,051
Subtotal			$ *		$ *	$ 751,215
Total			$11,829,062		$ 12,678,004	$ 849,335

The contractor is not entitled to fee of $63,670 on indirect cost rate increases of $849,335 because the fee is fixed to the negotiated indirect cost rates at contract award. The indirect cost increases were included in the labor category cost variance calculations in Tables 3, 4, and 5.

Fixed Fee Payments. BMDO did not establish procedures to determine the appropriate fixed fee payments on CTI contracts because fee payments were not based on contractor certification that the specific level of effort specified in the contract was expended in performing the statement of work. For contract 10, the CTI fee was incorrectly based on a percentage of actual costs. For contracts 12 and 42, BMDO contracting officers based fixed fee payments on the level of

*Proprietary Data Removed

effort associated with the CTI proposed labor mix in the basic contract, even though the labor mix CTI actually delivered was different. We calculated a total overrun on the 3 contracts of $3,109,760, for which CTI should not receive a fee of $233,749. The majority of the overrun was caused by CTI using subcontractors with higher labor costs than CTI employees that were not included in the three contract proposals. In addition, the contract clauses on level of effort that state that the contractor can deliver less than the required staff hours and still receive the full fee are inconsistent with FAR 16.306.

We believe that BMDO needs to link fixed fee payments to the specific level of effort delivered by the contractor. We also believe that BMDO should not pay CTI a total fee of $233,749 on the CTI contracts.

Recent BMDO Contract Management Actions

In late 1992, BMDO initiated a project to standardize and possibly automate monthly contract management information data from contractors for technical and fiscal oversight of the contracts awarded by BMDO. An initial review by BMDO of contract-data-requirements-list requirements for active contracts revealed cases of inadequate cost performance data available for COTRs to monitor specific types of contracts. These shortcomings precluded adequate early identification by BMDO of cost overruns and contractor-initiated changes to the labor mix of level-of-effort contracts.

In mid-1993, BMDO completed a revised set of data item descriptions, which effectively eliminated the problems. New cost reporting formats were implemented for all new solicitations and contracts and for those contracts for which inadequate cost reporting was identified in mid-1993. In April 1994, BMDO began a test of the automated financial reporting procedures with four pilot contractors. The revised cost reporting data permits real-time analysis of contractor labor rate and mix information on a monthly basis, thus providing the COTR and the contracting officer early identification of potential cost overruns in CPFF term contracts and adverse trends in CPFF completion contracts.

We reviewed the BMDO "Monthly Funds and Labor Hour Expenditure Report," that BMDO is testing to provide data to analyze contractor labor rate and mix information. We believe that the contractor-prepared report, if properly implemented and monitored, will provide the necessary information to determine changes in the contractor's labor mix, evaluate labor and indirect cost increases, and determine the appropriate fixed fee for a specific level of effort.

Recommendations, Management Comments, and Audit Response

Management Comments on the Report and Audit Response. See Appendix B for a summary of management comments on the report and the audit response to the comments. For the full text of management comments, see Part IV.

We recommend that the Director, Ballistic Missile Defense Organization:

1. Establish procedures to verify that contracting officers:

a. Issue task orders before permitting contractors to commence work and date task orders when issued.

b. Obtain task plans from contractors that support task orders and describe labor categories and labor costs.

Management Comments. BMDO nonconcurred with the recommendation and stated that the finding was based on data that were more than 2 years old. BMDO stated the deficiency was corrected 2 years ago and that no corrective action is necessary. BMDO does not consider it appropriate to establish procedures to verify that contracting officers are complying with the stated terms of contracts, and compliance is verified via more generalized management oversight.

Audit Response. BMDO comments are not responsive. The recommendation addresses a systemic problem with the use of CPFF, level-of-effort, term, task order contracts. The timely issuance of task orders and timely receipt of contractor task plans are critical for effective contract management. Without internal management control procedures to verify that the deficiencies are corrected and stay corrected, BMDO has no assurance that these deficiencies will not reoccur. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

2. Establish procedures in contracts operating instructions that require contracting officers for all cost-plus-fixed-fee, level-of-effort, term contracts to:

a. Define labor categories in contracts and require contractors to bill or track costs against those labor categories.

b. Determine changes in the contractor's labor mix, evaluate labor and indirect cost increases, and determine the appropriate fixed fee based on a specific level of effort.

Management Comments. BMDO concurred with the recommendation and stated procedures have been included in a Contract Operations Instruction which was published on December 16, 1994.

3. Instruct contracting officers not to pay the contractor fee of $233,749 on contract cost overruns for contracts SDIO84-89-C-0010, SDIO84-90-C-0012, and SDIO84-89-C-0042.

Management Comments. BMDO stated that the audit computation of fee is incorrect, the final payments of fixed fee will be accomplished at contract closeout, and that at this time, BMDO has not overpaid fixed fee for the three CTI contracts.

Audit Response. BMDO comments are partially responsive. For contract 10, BMDO developed a method to calculate fee that was different from the contract clauses and that was based on a fixed hourly fee rate. The new method to calculate fee considers contract overruns because of increased subcontractor costs and, therefore, satisfies the intent of the recommendation.

For contract 42, the method BMDO used to calculate fee also considers contract overruns due to increased subcontractor costs and also satisfies the intent of the recommendation.

For contract 12, however, we do not believe that the method BMDO is using to calculate fixed fee for contract 12 is appropriate because CTI did not provide the *specific* level of effort proposed in the contract that the fixed fee was based on. As demonstrated in the finding, CTI provided a significantly different labor mix at increased costs from the labor mix proposed. Consequently, we believe the fixed fee should reflect this change in the labor mix. We request BMDO reconsider its position and provide comments on the recommendation as part of its comments on the final report.

Finding B. Subcontractor Costs

CTI awarded five CPFF subcontracts, with a total value of about $12.9 million, that were administered as prohibited cost-plus-a-percentage-of-cost contracts under the three BMDO prime CPFF contracts with CTI. CTI also failed to obtain cost or pricing data and to perform cost analyses for three of the subcontracts, valued at about $6.5 million. These conditions occurred because BMDO did not notify the administrative contracting officer of CPFF subcontracts awarded by CTI after negotiation of the basic contract, and because the administrative contracting officer did not recommend CTI for a contractor purchasing system review (CPSR) or provide CTI with consent to subcontract. As a result, CTI was using a prohibited system of contracting that rewarded inefficiency and uneconomic performance from its subcontractors, and neither CTI nor BMDO could determine whether subcontract prices were reasonable.

Background

Contract Clause on Directed Subcontracts. BMDO contracts 10, 12, and 42 with CTI contain a clause that states that BMDO may direct CTI to subcontract to firms that BMDO identifies to obtain a particular expertise available from limited sources.

FAR Criteria. FAR 15.804-2, "Requiring Certified Cost or Pricing Data," states that certified cost or pricing data are required before the award of a subcontract at any tier, if the contractor and each higher tier subcontractor have been required to furnish certified cost or pricing data, when the subcontract is expected to exceed $500,000. BMDO included FAR contract clause 52.215.24, "Subcontractor Cost or Pricing Data," which implements FAR 15.804-2, in each of the CTI contracts and required CTI to obtain certified cost or pricing data from its subcontractors before awarding any subcontract expected to exceed $500,000.

FAR 44.2, "Consent to Subcontracts," states that the cognizant administrative contracting officer is responsible for consent to subcontracts unless the contracting officer retains the contract for administration or withholds the consent responsibility from delegation to the administrative contracting officer. Consent to subcontracts under cost-reimbursement and letter prime contracts is required from the administrative contracting officer if the contractor does not have an approved purchasing system. The administrative contracting officer responsible for consent shall review the request and supporting data and consider the following.

o Has the contractor performed adequate cost or price analysis or price comparisons and obtained accurate, complete, and current cost or pricing data, including any required certifications?

o Is the proposed subcontract type appropriate for the risks involved and consistent with current policy?

Particularly careful and thorough consideration is necessary when subcontracts are proposed on a noncompetitive cost-reimbursement or labor-hour basis. If the contractor has an approved purchasing system, consent is not required for subcontracts, but advance notification is still required.

FAR 44.3, "Contractors' Purchasing Systems Reviews," states that the objective of a CPSR is to evaluate how efficiently and effectively the contractor spends Government funds and complies with Government policy when subcontracting. The review provides the administrative contracting officer a basis for granting, withholding, or withdrawing approval of the contractor's purchasing system. A CPSR requires a complete evaluation of the contractor's purchasing system. The administrative contracting officer shall approve a purchasing system only after a CPSR discloses that the contractor's purchasing policies and practices are efficient and provide adequate protection of the Government's interests. A CPSR shall be conducted for each contractor whose sales to the Government, using other than sealed bid procedures, are expected to exceed $10 million during a 12-month period and every 3 years thereafter for contractors that continue to meet the requirement.

In the period between complete CPSRs, the administrative contracting officer shall maintain a sufficient level of surveillance to verify that the contractor is effectively managing its purchasing program. Surveillance is accomplished in accordance with a plan developed by the administrative contracting officer with the assistance of subcontracting, audit, pricing, technical, or other specialists as necessary.

The administrative contracting officer must pay special attention to the degree of price competition; the pricing policies and techniques; the method of obtaining accurate, complete, and current cost or pricing data and certification as required; the planning, award, and postaward management of major subcontract programs; and the appropriateness of types of contracts used.

United States Code Prohibition on Cost-Plus-a-Percentage-of-Cost Contracting. Title 10, United States Code, section 2306(a), "Kinds of contracts," (10 U.S.C. 2306[a]) states that the cost-plus-a-percentage-of-cost system of contracting may not be used. 10 U.S.C. 2306(e) states that each CPFF contract shall provide that the contractor must notify the agency before awarding, under the prime contract, a CPFF subcontract.

General Accounting Office Four-Point Test. The criteria for identifying contracts that satisfy the cost-plus-a-percentage-of-cost system of contracting are based on a four-point test cited by the General Accounting Office as follows.

o Payment for profit is based on a predetermined percentage rate.

o The predetermined percentage rate is applied to actual performance costs.

o Contractor entitlement is uncertain at the time of contracting.

o Contractor entitlement increases commensurately with increased performance costs.

Comptroller General Decision. Comptroller General of the United States decision B-23293, "Contracts -- Cost-Plus -- Subcontracts on a Cost-Plus-A-Percentage-of-Cost-Basis," March 13, 1942, states:

> . . . "the cost-plus-a-percentage-of-cost system of contracting shall not be used under this section," and such a subcontract may not be regarded as creating any binding obligation on the United States to reimburse the prime contractor for any payments made in accordance with its terms.

Cost-Plus-a-Percentage-of-Cost Contracts

CTI Subcontracts. We reviewed the five largest CTI subcontracts on BMDO CPFF contracts 10, 12, and 42. The subcontracts contained no contract clauses that related a fixed fee to a specific level of effort as required for CPFF term contracts. Fee payments to subcontractors were based solely on a percentage of actual costs.

Table 7 shows that the fee payments made to subcontractors were based on a percentage of actual costs.

Table 7. Fee Payments to Subcontractors Based on a Percentage of Costs

Prime Contract (Subcontract)	Subcontractor	Year	Actual Costs	Fee Paid	Fee Percent
10 (90-SC-020)	Dwyer & Associates, Inc.	1990	$ 317,496	$ 24,606	7.75
		1991	497,317	38,542	7.75
		1992	791,191	61,317	7.75
		1993	162,676	12,607	7.75
Subtotal			$ 1,768,680	$137,072	
12 (91-SC-023)	Advanced Marine Enterprises, Inc.	1991	$ 461,847	$ 34,639	7.50
		1992	658,156	49,362	7.50
		1993	776,013	58,201	7.50
		1994	67,829	5,087	7.50
Subtotal			$ 1,963,845	$147,289	
42 (90-SC-014)	Advanced Marine Enterprises, Inc.	1990	$ 837,657	$ 62,824	7.50
		1991	860,670	64,550	7.50
		1992	918,901	68,918	7.50
		1993	664,734	49,855	7.50
Subtotal			$ 3,281,962	$246,147	
42 (90-SC-012)	ARIST Corporation	1990-1993	$ 2,688,452	$215,076	8.00
Subtotal			$ 2,688,452	$215,076	
42 (90-SC-015)	Strategic Insight, Inc.	1990	$ 359,104	$ 28,728	8.00
		1991	519,511	41,569	8.00
		1992	461,244	36,900	8.00
		1992	462,949	37,036	8.00
		1993	471,449	35,356	7.50
Subtotal			$ 2,274,257	$179,589	
Total			$11,977,196	$925,174	

Test for Cost-Plus-a-Percentage-of-Cost Contracts. According to the General Accounting Office criteria (the four-point test) for identifying contracts that violate 10 U.S.C. 2306(a), the CTI subcontracts meet all four of the criteria and, therefore, are prohibited cost-plus-a-percentage-of-cost contracts.

Subcontractor Cost or Pricing Data and Cost Analysis

CTI failed to obtain cost or pricing data and to perform cost analyses for three of the five CPFF subcontracts, with a total value of about $6.5 million, as required by the FAR and FAR clauses incorporated into the prime contracts. CTI officials claim that cost or pricing data were not obtained and a cost analysis was not performed because BMDO directed CTI to use the subcontractors. BMDO stated that it did not direct CTI to award any subcontracts, although BMDO did direct CTI to use specific subcontractors on certain task orders. The issue of directed subcontracts does not relieve CTI from its responsibility to obtain cost or pricing data and to perform cost analysis for subcontracts of more than $500,000.

Table 8 shows the value of CTI subcontracts and whether cost or pricing data were obtained and whether a cost analysis was performed.

Table 8. Subcontractor Cost or Pricing Data and Cost Analysis

Prime Contract (Subcontract)	Subcontractor	Contract Value	Proposed as Part of Basic Contract	Cost or Pricing Data Obtained	Cost Analysis Performed
10 (90-SC-020)	Dwyer & Associates, Inc.	$1,905,756	No	No	No
12 (91-SC-023)	Advanced Marine Enterprises, Inc.	$2,111,134	No	No	No
42 (90-SC-014)	Advanced Marine Enterprises, Inc.	$3,614,110	No	Yes	Yes
42 (90-SC-012)	ARIST Corporation	$2,950,119	Yes	Yes	Yes
42 (90-SC-015)	Strategic Insight, Inc.	$2,454,492	No	No	No

Notification of Subcontract Awards

BMDO did not notify the administrative contracting officer of CPFF subcontracts awarded by CTI after negotiation of the basic contract. Although BMDO assigned administration of the three CTI prime contracts to the administrative contracting officer, the administrative contracting officer has no means to know when CTI awards subcontracts after the basic contract has been negotiated. Two of the three CTI basic contract proposals identified no subcontractors; however, CTI subsequently subcontracted almost 50 percent of the work. Before awarding any CPFF subcontracts, 10 U.S.C. 2306(e) requires that the prime contractor notify BMDO. Consequently, we believe that BMDO needs to notify the administrative contracting officer of subcontracts awarded under BMDO CPFF contracts after completion of the basic contract negotiations.

Administrative Contracting Officer Responsibilities

CTI should have obtained consent to subcontract from the administrative contracting officer before awarding CPFF subcontracts under prime BMDO CPFF contracts. The administrative contracting officer is responsible for providing consent to subcontract because CTI did not have an approved purchasing system. FAR 44.2 states that consent to subcontract requires that the administrative contracting officer conduct an analysis of all relevant facts and data including subcontractor cost or pricing data, results of the prime contractor's analyses of subcontractor proposals, and the proposed subcontract type. Considering the CTI apparent breach of the contract terms and its use of a prohibited type of contract action, the administrative contracting officer should initiate action to determine fair and reasonable prices and should seek recovery of any overpayments on the subcontracts.

CTI annual sales to the Government exceeded $30 million for 1991, 1992, and 1993. However, a CPSR for CTI, as required by FAR 44.3, has never been requested by the administrative contracting officer or performed by the Defense Contract Management Command's purchase review team. The administrative

contracting officer stated that CPSRs were primarily requested for larger manufacturing contractors with less emphasis on support services contractors. We believe that a CPSR should be performed at CTI.

Reasonableness of Subcontract Prices

Cost-Plus-a-Percentage-of-Cost Results in Higher Costs to Government. The prohibited cost-plus-a-percentage-of-cost system of contracting rewards inefficiency and noneconomical performance because higher costs to the Government mean a higher fee for the contractor. Consequently, contractors and subcontractors have no incentive to restrain costs to the Government.

Cost or Pricing Data and Cost Analysis to Determine Reasonableness. Cost or pricing data and cost analysis provide the basis to determine whether prices for goods and services are reasonable. Without obtaining cost or pricing data and performing cost analysis, CTI could not determine the reasonableness of subcontract prices paid by the Government.

Recommendations, Management Comments, and Audit Response

1. We recommend that the Director, Ballistic Missile Defense Organization, require contracting officers to notify the administrative contracting officer of cost-plus-fixed-fee subcontracts awarded after completion of the basic contract negotiations under BMDO cost-plus-fixed-fee prime contracts.

Management Comments. BMDO nonconcurred with the recommendation and stated that the notice and consent to subcontract are to be provided to the administrative contracting officer pursuant to the contract terms and conditions.

Audit Response. The BMDO comments are not responsive. We believe that the BMDO contracting officers and the administrative contracting officers should work together as a team to protect the interests of the Government. Two of the three CTI basic contract proposals identified no subcontracts; however, CTI subsequently subcontracted almost 50 percent of the work. Further, although BMDO contracting officers approved the task plans that identified subcontractor effort not originally proposed, the administrative contracting officers were not notified and have no means to know that CTI awarded these subcontracts. We request BMDO to reconsider its position and provide comments on the recommendation as part of its comments on the final report.

2. We recommend that the Director, Defense Logistics Agency:

a. Instruct the administrative contracting officer for contracts SDIO84-89-C-0010, SDIO84-90-C-0012, and SDIO84-89-C-0042 with Comprehensive Technologies, Incorporated, to determine fair and reasonable subcontract costs and seek recovery of any overpayments on the contracts.

Management Comments. The Defense Logistics Agency concurred with the recommendation and stated the Defense Contract Audit Agency had been requested to review the subcontractor costs and initiate any assist audits required to fully account for and analyze their appropriateness. The administrative contracting officer would request any further audit or technical assessments as required by the procuring agency to determine fair and reasonable subcontract costs and to make any necessary payment adjustments. The estimated completion date is April 30, 1995.

b. Request the administrative contracting officer to initiate action to conduct a contractor purchasing system review of Comprehensive Technologies, Incorporated, and develop a surveillance plan to ensure that the contractor is effectively managing its purchasing program or provide CTI with consent to subcontract.

Management Comments. The Defense Logistics Agency concurred with the recommendation and stated the administrative contracting officer has requested the CPSR team to perform a CPSR of CTI. The estimated completion date is April 30, 1995.

Finding C. Contractor and Subcontractor Labor Charges

CTI and its subcontractor, Advanced Marine Enterprises, Incorporated, charged 588 labor hours to BMDO CPFF contract 12 that were not worked. The hours not worked charged to the contract were for guaranteed hours and commuting time to and from the work site. CTI and subcontractor employees also failed to properly account for lunch and break time. CTI claimed that the hours not worked were charged to the contract because CTI wanted to guarantee coverage and because CTI did not have adequate timekeeping procedures. For the period of May 1, 1992, through April 30, 1993, BMDO paid a total of $27,370 to CTI for the questioned labor costs.

Background

FAR Requirement for Determining Allowable Costs. FAR 31.201-2, "Determining Allowability," states that the factors to be considered in determining whether a cost is allowable include reasonableness, allocability, standards promulgated by the Cost Accounting Standards Board, and terms of the contract.

Contract Terms Spell Out Work Hours. Section B-6, "Level of Effort (Man-hours)," of contract 12 states, "man-hours are defined as actual work hours exclusive of vacation, holiday, sick leave, and other absences." Contract section H-21, "Overtime Premiums," states that the contractor shall be required to provide shift operations as necessary. Contract statement of work section 3.0 stipulates contractor requirements for personnel and resources during normal workday schedules and for second shifts.

Visual Product Information Center Support Provided by the Contracts. Contract 12 requires CTI and its subcontractor, Advanced Marine Enterprises, Incorporated, to provide publishing and graphic support to BMDO and the personnel and the resources to operate a central publishing office, the Visual Product Information Center, in BMDO offices at the Pentagon. All personnel entering and exiting BMDO used a computer-processed visitor control system by scanning an automated data reading and entry system with employee-issued badges. The automated data reading and entry system records and stores the time when visitors enter and exit BMDO.

Hours Not Worked Charged to the Contract

CTI and its subcontractor charged for employee hours not worked. Comparison of contractor time sheets with the Access Control Center's computer-processed login-logout records showed instances in which these employees were not in the Visual Product Information Center during the days that hours were charged to the contract, and other instances in which fewer hours were worked than the hours reported on time sheets.

Guaranteed Hours. CTI guaranteed a specific number of hours weekly for two employees, whether the employees worked or not. One of the employees was guaranteed the hours as overtime or in addition to the 40-hour workweek. The second employee was assigned part-time to the Visual Product Information Center and was guaranteed 4 hours per day. The employees' charged the contract for an additional 4 hours daily, even when the hours were not actually worked.

Subcontractor Commuting Time. Subcontractor employees were allowed to bill the contract for commuting time from Crystal City, Virginia, to the Pentagon. The subcontractor project manager for the Visual Product Information Center said that discrepancies between time recorded on weekly time sheets and computer-processed login-logout weekly totals probably occurred because employees were charging time used for commuting to and from the parking lot. Four of the five Advanced Marine Enterprises, Incorporated, employees that were permanently assigned to the Visual Product Information Center parked at a Crystal City parking lot and commuted on the subway to the Pentagon. The employees charged the time for the 20- to 30-minute daily commute to and from the Pentagon work site and the daily subway fees as direct costs to the contract. Commuting costs to an employee's permanent work site are not allowable.

CTI Employee Charges for Lunch and Breaks. Two CTI employees and four subcontractor employees did not deduct time for company-required 30-minute lunch breaks and a 15-minute morning and 15-minute afternoon break from their timesheets for the period of April 1, 1992, through May 30, 1993. Although we were not able to quantify the costs or hours associated with the lunches and breaks, a comparison of the hours on the time sheets with login-logout data maintained by the BMDO Access Control Center indicated that no time was deducted for lunch and breaks. In addition, CTI had a contractual agreement with its workers' compensation insurance carrier to enforce existing rules concerning breaks, lunch, and suggested practices of periodic breaks during the workday.

Guaranteed Coverage and Timekeeping Procedures

Instructions to Charge Guaranteed Hours. Interviews conducted with the employees revealed that they were instructed by the CTI project manager to

directly charge the contract 4 hours for the guaranteed hours, whether or not the employee services were required. According to the CTI project manager, this policy was instituted to provide support as required by the contract statement of work, section 3.0, which states:

> The contractor shall provide the required support on a normal workday schedule and shall provide second shift when necessary, to continue to provide support from 1600 to 2000 hours local time. The contractor shall have the capability to extend coverage to 2400 local time if required.

In addition, the manager of the Visual Product Information Center, a subcontractor employee, was unaware that the two CTI employees had been guaranteed the 4 hours even if services were not required. The manager had not requested the two CTI employees to provide coverage and was not aware of the guaranteed hours policy for the two employees.

Timekeeping Procedures. Interviews with CTI employees assigned to the Visual Product Information Center disclosed that management did not instruct employees to record on their timesheets only the hours that they actually worked. Management also did not tell employees to omit daily hours for lunch, break times, and commuting times.

Summary of Questioned Costs

We identified 588 labor hours that were mischarged for guaranteed hours not worked and commuting time, which amounted to $27,370. The contract was also charged for labor hours while employees were on lunches and breaks, but we were not able to quantify those mischarged costs. Questioned costs for guaranteed hours accounted for 331 hours charged to the contract that were not worked and questioned costs of $11,226. We calculated 257 hours of commuting time for three of the subcontractor employee's for questioned costs of $16,144.

Recommendations, Management Comments, and Audit Response

We recommend that the Director, Ballistic Missile Defense Organization, instruct the contracting officer for contract SDIO84-90-C-0012 to:

1. Notify the contractor and subcontractor that costs for time associated with guaranteed hours, lunches and breaks, and commuting are not allowable.

2. Initiate action to recover $27,370 for questioned labor costs associated with hours not actually worked.

Management Comments. BMDO concurred with the recommendations and stated that the contracting officer has sent the prime contractor a letter of notice of intent to disallow costs.

Finding D. Other Direct Costs

CTI billed BMDO for questioned costs for various miscellaneous items that were not required for contract performance or authorized in the contract. CTI also billed unallowable travel costs and submitted two duplicate billings for travel and catered services. In addition, CTI billed BMDO for commuting costs by subway when DoD shuttle buses were available. CTI billed the questioned costs for various miscellaneous items to the contracts as direct costs because CTI personnel believed that these costs were reasonable and required to adequately perform task orders, and because CTI claims that the items were requested by the COTRs. Also, BMDO had inadequate procedures to review contractor travel and commuting costs. As a result, on contracts 10, 12, and 42, BMDO paid $ * or questionable miscellaneous items, and $3,881 for questionable travel costs and duplicate billings.

Background

Contracting officers use the following criteria to evaluate contractor charges. FAR 31.201-2, "Determining Allowability," 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. FAR 31.201-4, "Determining Allocability," describes the conditions under which a cost is allocable to a Government contract.

Questionable Miscellaneous Items

Table 9 provides a descriptive breakdown of the questioned other direct costs that CTI billed to BMDO contracts 10, 12, and 42. The table also shows the general and administrative expense and the fee allocated to the questioned other direct costs.

*Proprietary Data Removed

Table 9. Questioned Other Direct Costs

Description	Contract 10	Contract 12	Contract 42	Total
Coffee Services	$ 2,229	$ 0	$ 2,386	$ 4,615
Catered Meals	3,689	0	2,249	5,938
Parking Spaces	0	0	13,524	13,524
Cable Television	0	0	2,165	2,165
Recruitment Efforts	795	870	1,102	2,767
Periodicals and Publications	1,602	138	6,785	8,525
Communication Equipment	$ 0	$ 0	$ 9,411	$ 9,411
Subtotal	$ 8,315	$1,008	$ 37,622	$ 46,945
*	*	*	*	*
*[1]	$ *	$ *	$ *	$ *
*[2]				
Total	$ *	$ *	$ *	$ *

1*
2*

Coffee Services. CTI had a coffee service that provided employees with coffee, tea, cocoa, and associated condiments and directly billed the contract $4,615 for these costs. CTI claims that the costs for these services were directly charged to the contract because the service was requested and authorized by one of the BMDO COTRs. Every time the contractor charged BMDO $100 for coffee, the contractor also received $ * for general and administrative expense and a fee of $ * .

We concluded that these costs were not ordinary and necessary for the conduct of business or contract performance and were questionable. BMDO should initiate action to recover the $ * for costs, general and administrative expense, and fee associated with the coffee services.

Catered Meals. CTI billed BMDO $5,888 for catered working lunches, program reviews, and management meetings. The catered meals include donuts, assorted muffins, pastries, sandwiches, fruits, cigarettes, and cookies as well as beverages including juices and soda. CTI considered these charges to be reasonable. However, no contract provisions required CTI to provide meals, nor do any of the task plans identify any costs associated with meetings or conferences. The contractor or individuals should be responsible for their own lunches, not BMDO.

We concluded that these costs were not ordinary and necessary for the conduct of business or contract performance and were questionable. BMDO should initiate action to collect $ * of costs, general and administrative expense, and fee associated with the catered meals.

Parking Spaces. CTI billed $13,524 for 11 spaces in a parking garage near its leased offices. Three of the parking spaces were used by BMDO employees and he remaining 8 spaces were for CTI employees. CTI charged the cost of the parking spaces directly to the contracts because the BMDO COTR had requested that the spaces be provided.

*Proprietary Data Removed

BMDO should request reimbursement in the amount of $ * to recover the cost for general and administrative expense and the fee associated with the 11 parking spaces.

Cable Television. CTI billed cable television services costing $2,165 for the Crystal City facility to BMDO contract 42. CTI believed that access to the C-SPAN and CNN networks was necessary to stay abreast of public hearings affecting BMDO. However, we could not substantiate that access to these networks by CTI was necessary for the performance of contract 42.

BMDO should initiate action to recover $ * for costs, general and administrative expense, and fee associated with the cable television service.

Recruitment Efforts. CTI billed $795 for the services of a job referral company on contract 10. CTI also billed a total of $1,972 for advertisements in the *Washington Post* newspaper for a project analyst position. Although these costs may be allowable under overhead, the costs were not approved as direct costs to the contract by the contracting officer.

BMDO should initiate action to recover the amount of $ * to recover the cost of job referral services, recruitment efforts, and the associated general and administrative expense and fees.

Periodicals and Publications. CTI billed $8,525 for Federal regulations, management manuals, magazines, congressional records, books listing the names of congressional committee and subcommittee support staff, and publications, such as *Space News*, the *Almanac of the Unelected*, and *Dun and Bradstreet* reports. CTI considered this necessary for the performance of the contracts. Although these costs may be allowable under overhead, the costs were not approved as direct costs to the contract by the contracting officer.

BMDO should initiate action to collect $ * of costs, general and administrative expense, and fee associated with the periodicals and publications.

Communication Equipment and Services. CTI billed $8,888 for pagers and pager services to contract 42. CTI purchased the equipment and services at the request of the BMDO COTRs. CTI also purchased a cellular phone and service for a COTR and charged costs totaling $523 to contract 42. The CTI purchase of pagers, cellular phones, and related services was not authorized by the contract, and, therefore, was not allowable. BMDO has an established internal process that requires a separate authorization from the COTRs or the contracting officer for the purchase of these type of items. However, the COTRs requested CTI to procure the pagers and cellular phone. Timely and adequate performance on this contract did not require the use of any of the equipment items that CTI provided to BMDO employees.

The COTRs should return the pagers and the cellular phone and should discontinue the user and maintenance services for the equipment. BMDO should disallow the costs because the procurement of the equipment and services

*Proprietary Data Removed

were not authorized on the contract, and the COTRs requesting CTI to make the procurements did not have contracting authority. BMDO should initiate action to collect $ * of costs, general and administrative expense, and fee associated with the communication equipment.

Questioned Travel Costs and Duplicate Billings

Questioned Travel Costs. CTI billed travel costs amounting to $2,034 for one employee that were not reasonable or allowable. Contract 42 stated that all travel reimbursement would be according to Joint Travel Regulations. From October 1990 through December 1992, one CTI employee submitted vouchers to obtain reimbursement for per diem, lodging, car rental, parking, and telephone charges for stays within his permanent duty station; for meals and laundry expenses while collecting per diem allowance for the same time period; for gas refueling at the higher rates charged by car rental agencies; and for the cost to replace a lost ticket.

Three vouchers showed that the individual returned early from a temporary duty trip and, instead of returning to his residence, which was within the distance limits of his permanent duty station, checked into a hotel. CTI charged all of the expenses related to the overnight stays to the contract. These expenses included per diem for lodging and meals, rental car expenses, parking fees, and a telephone call. Section C45523 of the Joint Travel Regulations states that per diem, of which lodging is an element, shall not be allowed within the limits of the permanent duty station. The permanent duty station is defined as the residence or other quarters from which the employee regularly commutes to and from work. We calculated questioned costs of $510 charged to contract 42 for the unallowable hotel stays.

Other travel costs that were questioned according to the Joint Travel Regulations include the following.

o From November 1990 through August 1992, 10 incidents occurred for questioned costs of about $372 for which BMDO was charged for business and interviews lunches for the same days that the employee was paid full per diem for temporary duty.

o Questioned costs of about $188 for laundry expenses were added to travel claims even though laundry cleaning and pressing of clothing are incidental expenses covered by per diem.

o Questioned costs of about $183 were charged for refueling costs at rental car agencies when CTI policy and procedures state "rental companies have exorbitant refueling charges; therefore, employees should fill the tank just prior to returning the vehicle."

*Proprietary Data Removed

o Questioned costs of about $780 were charged to cover the cost of an airline ticket that was misplaced by the traveler. Consequently, BMDO was charged twice for the airline ticket, even though the traveler is liable for any negligence on his part in safeguarding transportation tickets.

BMDO should initiate action to collect about $2,034 of questioned travel costs and the COTRs should periodically review contractor travel reimbursement claims submitted for payment for allowability and reasonableness.

Duplicate Billings. Two vouchers submitted by two CTI employees were paid twice by CTI. CTI subsequently billed one voucher to contract 10 and the other voucher to contract 42. One CTI employee submitted actual register tape receipts with the first voucher, and the employee submitted a copy of the check used to pay for the items with the second voucher. The employee deducted the cost of items purchased for personal use on the first voucher and included the cost of the personal items on the second voucher. The second employee was paid twice for cost incurred on a single trip. As a result, BMDO paid CTI $1,847 in duplicate payments. After we brought the duplicate billings to CTI's attention, CTI took action to credit BMDO for $ * to include the amount billed for general and administrative expense and fee. BMDO should initiate action to recoup the additional $ * that has not been collected.

Subway Commuting Costs

CTI billed BMDO for subway fare cards for employee travel between the CTI facility in Crystal City to the BMDO facility in the Pentagon. The COTRs and CTI considered these transportation costs necessary for timely performance of contract-related meetings and conferences. However, DoD operates a shuttle bus that runs every 15 minutes between the Crystal City facility and the Pentagon that DoD contractor employees are permitted to use at no cost upon presentation of their Pentagon building passes or DoD badges. We determined that BMDO spent about $13,875 each year on subway costs for contractors to commute between Crystal City and the Pentagon. We calculate that BMDO can reduce costs about $69,375 ($13,875 times 5 equals $69,375) over a 5-year period by requiring contractors to use the DoD shuttle bus.

*Proprietary Data Removed

Table 10 provides a summary of the funds expended for subway fare cards from 1990 through 1993.

Table 10. Cost of Subway Fare Cards Charged by CTI to BMDO Contracts

Contract	Amount Spent	Dates	Years Covered	Yearly Average
10	$ 5,385	June 1989 through Dec. 1992	3.5	$ 1,539
12	8,815	July 1990 through July 1993	3.0	2,938
42	28,195	Aug. 1990 through July 1993	3.0	9,398
Total	$42,395			$13,875

Recommendations, Management Comments, and Audit Response

We recommend the Director, Ballistic Missile Defense Organization:

1. Instruct the contracting officers for contracts SDIO84-89-C-0010, SDIO84-90-C-0012, and SDIO84-89-C-0042 to initiate action to recover costs for questioned miscellaneous items of $ * .

Management Comments. BMDO partially concurred with the recommendation and stated that the action will be referred to the administrative contracting officer for determining the relevant facts and disposition of any disallowance.

Audit Response. Although BMDO partially concurred, the BMDO actions satisfy the intent of the recommendation.

2. Establish procedures to inform contracting officer's technical representatives that costs for coffee services, catered meals, parking spaces, cable television, recruitment efforts, periodicals and publications, and communication equipment and services are not allowable as direct costs to contracts.

Management Comments. BMDO nonconcurred with the recommendation and stated that the recommendation is beyond the scope of the authority and capability of the COTR.

Audit Response. We believe that COTRs are capable of understanding what should and should not be charged directly to Government contracts. We agree that the administrative contracting officer makes the final decisions on charging

*Proprietary Data Removed

a cost as direct or indirect. However, the COTR is normally onsite with the contractor personnel and also sees the contractor bills. For the COTR to act as the "eyes and ears" of the contracting officer, it would be prudent for the COTR to be aware of how certain costs should be charged. We request BMDO provide additional comments on the recommendation as part of its comments on the final report.

3. Instruct the contracting officers for contracts SDIO84-89-C-0010 and SDIO84-89-C-0042 to initiate action to recover costs for questionable travel and duplicate billings of $3,881.

Management Comments. BMDO concurred with the recommendation and stated the action will be referred to the administrative contracting officer for disposition of any cost disallowance.

4. Direct the contracting officer's technical representative to periodically review contractor travel reimbursement claims and other direct costs reimbursements.

Management Comments. BMDO nonconcurred with the recommendation and stated that the recommendation is beyond the scope of the authority and capability of the COTR. The nature of the costs referred to in the finding require the determination of allowability, and the COTR is not responsible or capable of making such a determination.

Audit Response. We did not suggest that the COTR make a determination of allowability of costs. However, we do believe the COTR does have the capability to review a travel voucher and to inform the contracting officer of questionable travel and other direct costs. We request BMDO reconsider its position and provide additional comments as part of its comments on the final report.

5. Establish procedures in operating instructions for contractors to use the DoD shuttle bus instead of the subway for travel when it is more feasible or convenient.

Management Comments. BMDO nonconcurred with the recommendation and stated that the recommendation was not practical or economical. BMDO stated that the commute between BMDO offices at the Pentagon and Crystal City was faster on the subway than on the DoD shuttle bus and, therefore, more economical.

Audit Response. We calculated the commute time between BMDO offices at the Pentagon and Crystal City and found the commute time to be identical (within 1 minute) for both the subway and the DoD shuttle bus. The shuttle bus also runs on a regular schedule and the subway does not. We revised the recommendation so that an option of both types of services is available. This will also permit a more prudent use of DoD and contractor resources. We request BMDO reconsider its position and provide additional comments as part of its comments on the final report.

Part III - Additional Information

Appendix A. Comparison of Proposed and Billed Labor Hours for CTI Labor Categories

The bar on the left in each figure shows the hours that the contractor proposed at the stated labor category (for example, chief analyst) and unspecified labor categories at the same level (for example, 23,800 hours at level 10). The bar on the right in each figure shows the actual hours that the contractor billed for the originally stated labor category and shows the other labor categories that the contractor actually used to complete the contract.

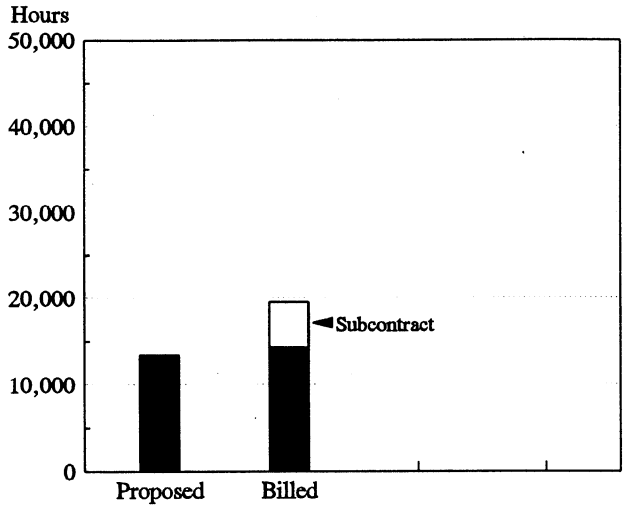


Figure A-1. Chief Analyst (Level 12)

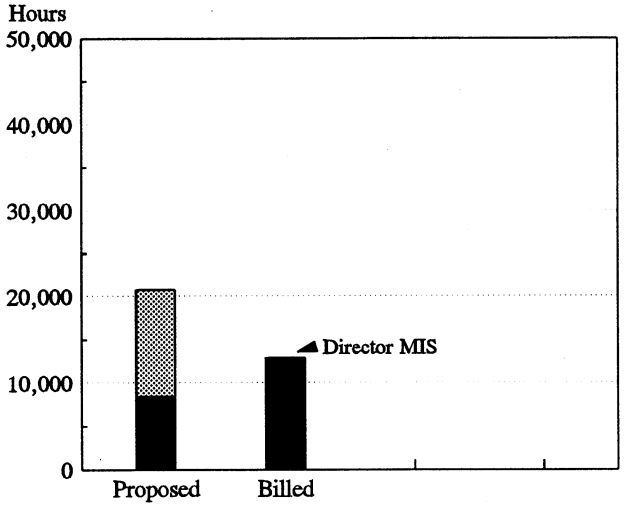


Figure A-2. Senior Principal Analyst (Level 11)

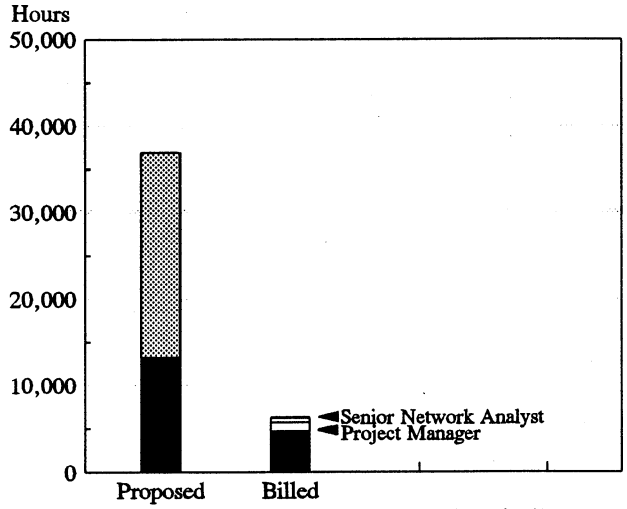


Figure A-3. Principal Analyst I (Level 10)

Contract SDIO84-89-C-0010

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-89-C-0010, CTI Labor

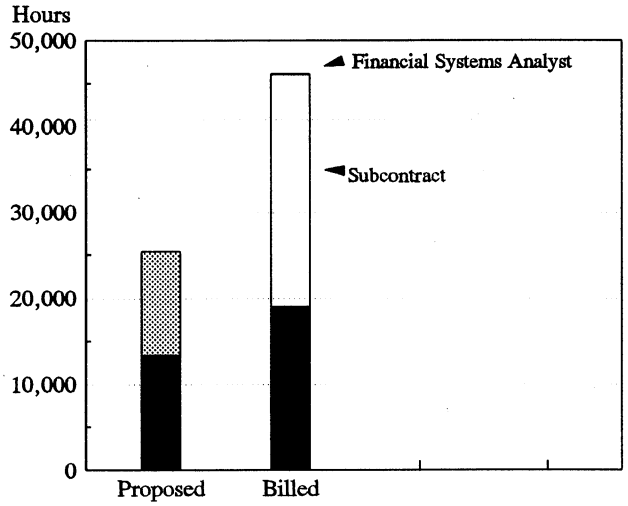


Figure A-4. Principal Analyst I (Level 9)

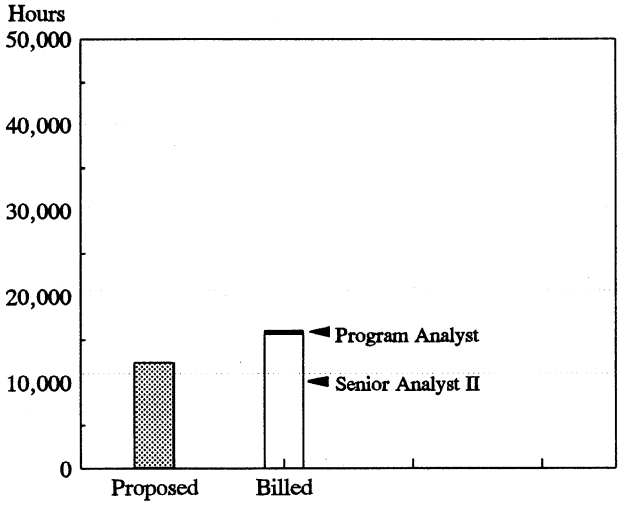


Figure A-5. Direct Labor Potentials (Level 8)

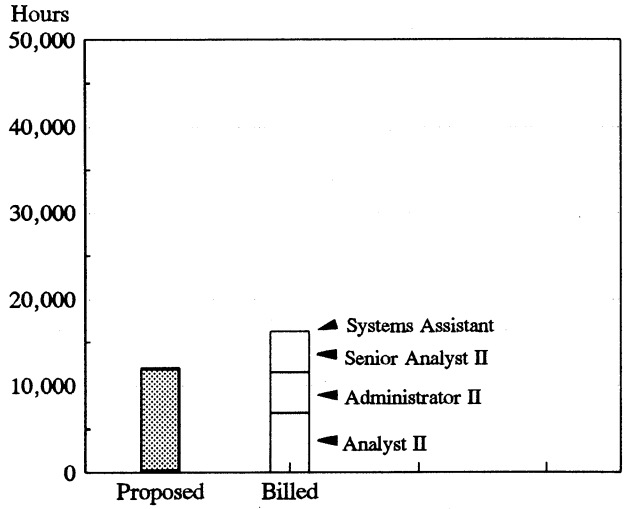


Figure A-6. Direct Labor Potentials (Level 6)

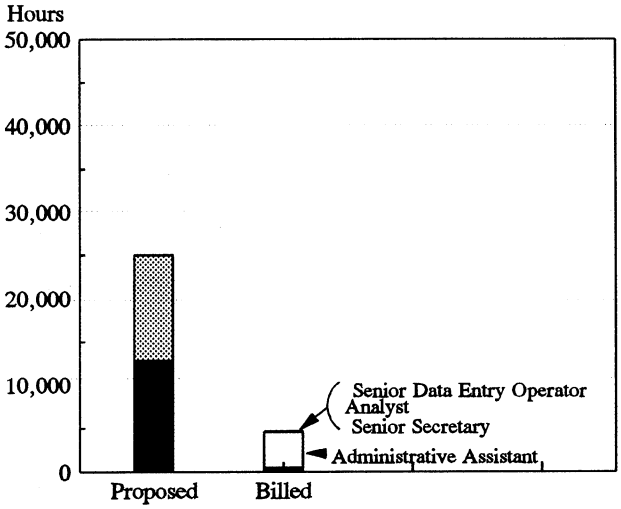


Figure A-7. Clerk/Typist (Level 4)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-90-C-0012, CTI-Site Labor

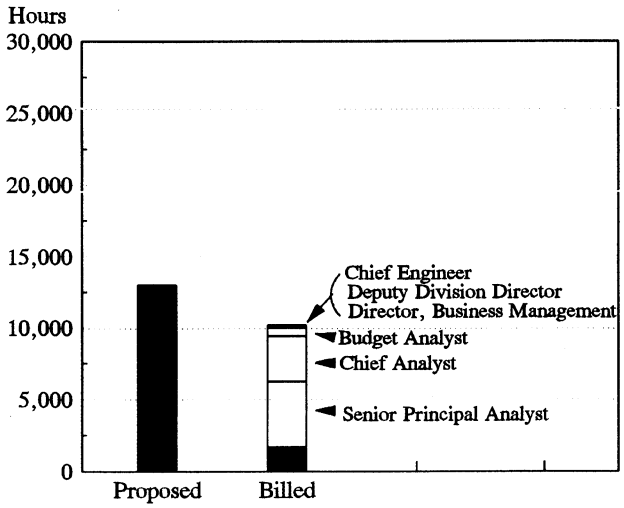


Figure A-8. Program Manager (Level 11)

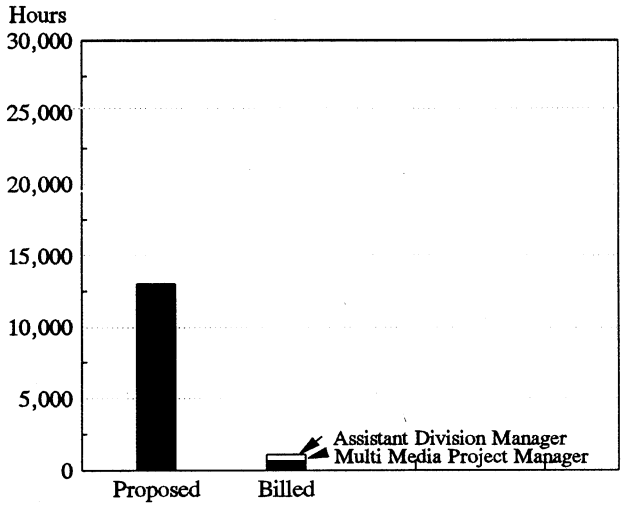


Figure A-9. Analyst (Level 10)

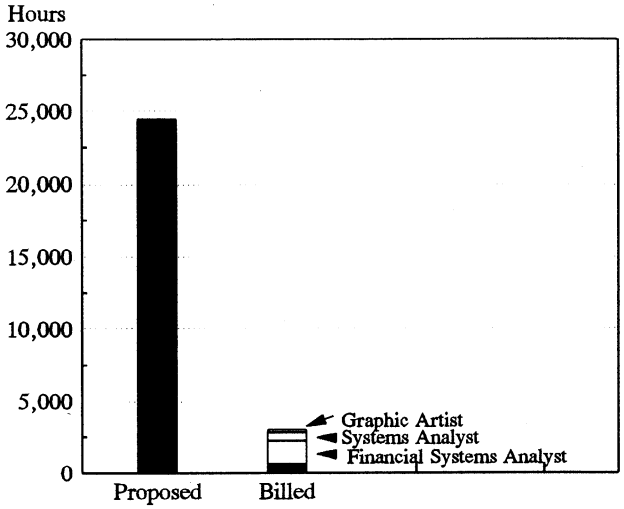


Figure A-10. Analyst (Level 9)

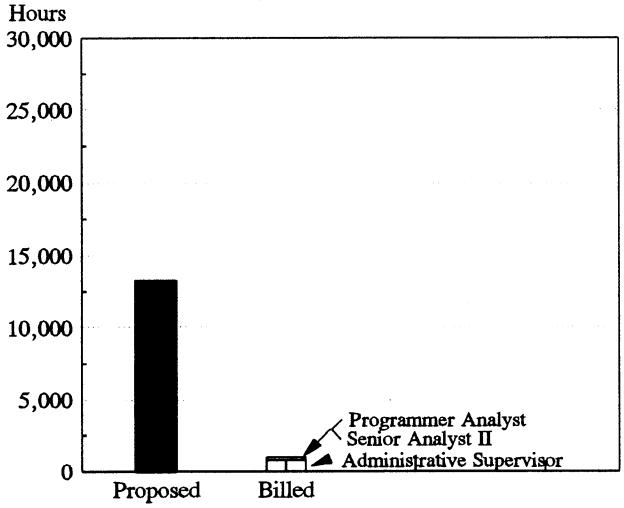


Figure A-11. Maintenance (Level 8)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-90-C-0012, CTI-Site Labor

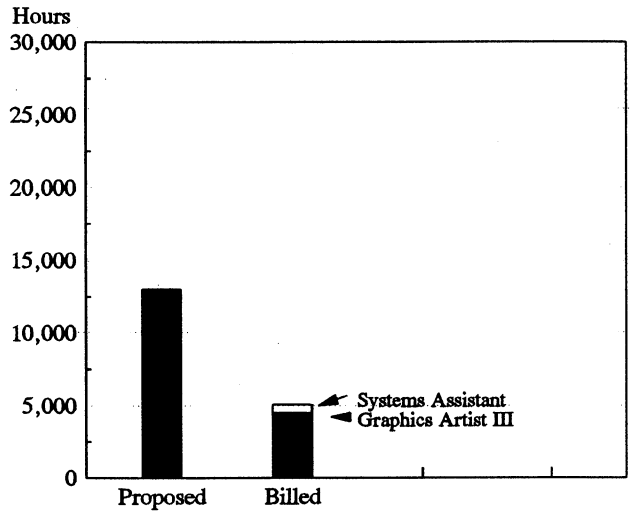


Figure A-12. Analyst (Level 7)

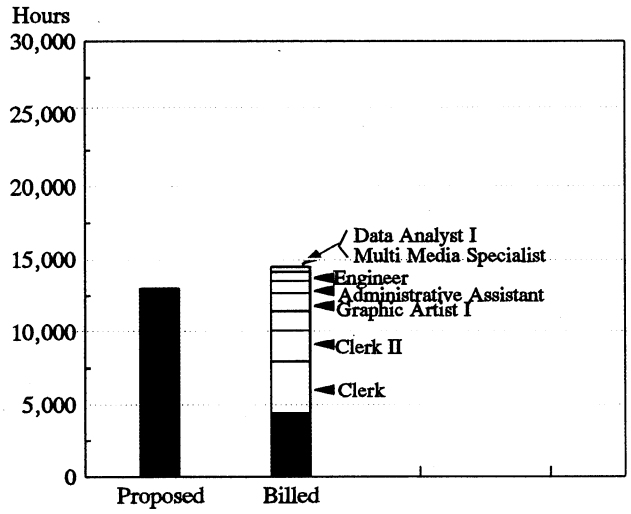


Figure A-13. Administrative Secretary (Level 6)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-90-C-0012, Client-Site Labor

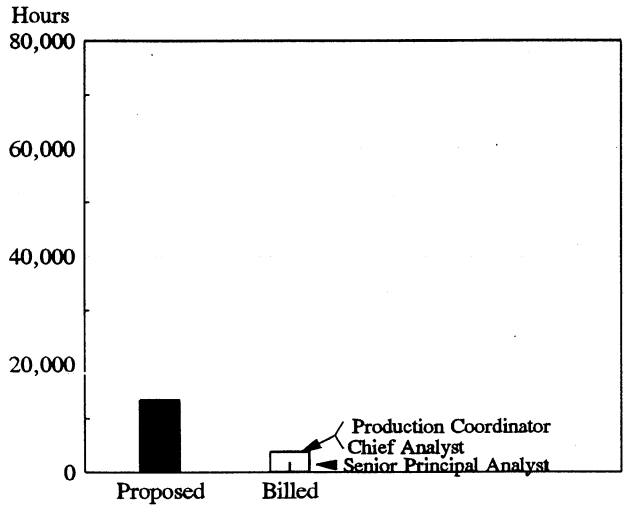


Figure A-14. Operator (Level 11)

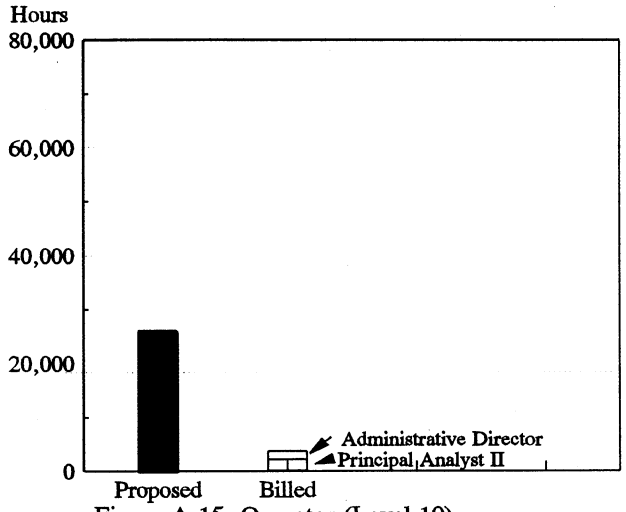


Figure A-15. Operator (Level 10)

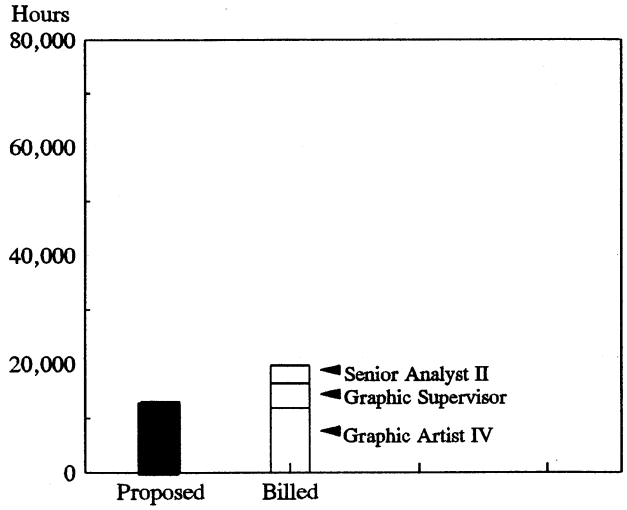


Figure A-16. Operator (Level 8)

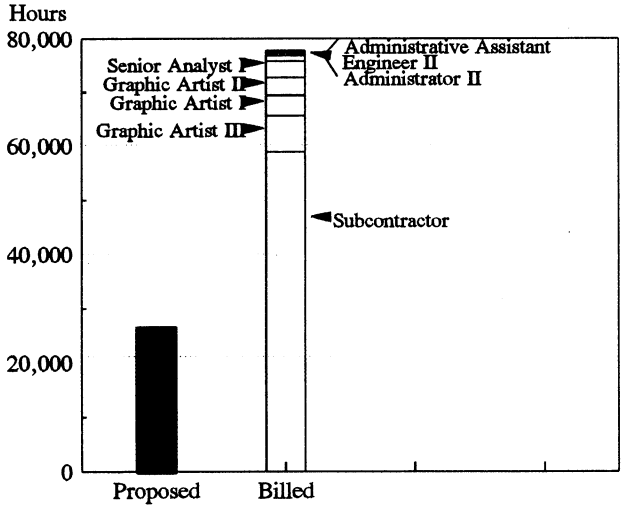


Figure A-17. Operator (Level 7)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-89-C-0042

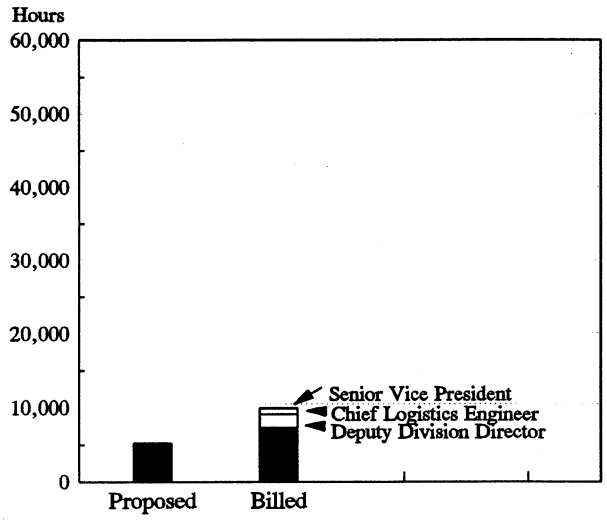


Figure A-18. Chief Engineer (Level 13)

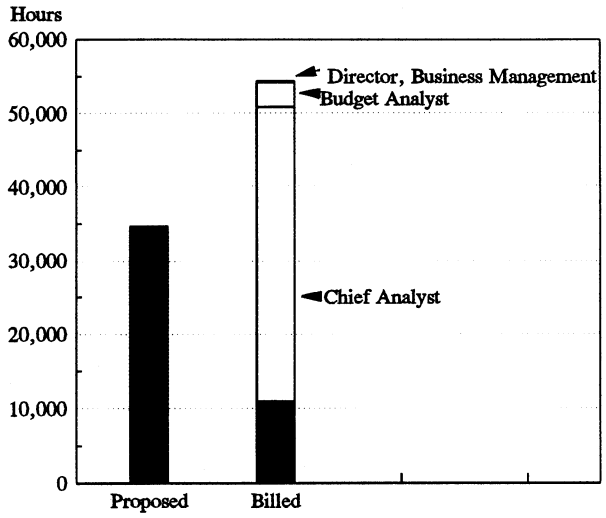


Figure A-19. Senior Engineer (Level 12)

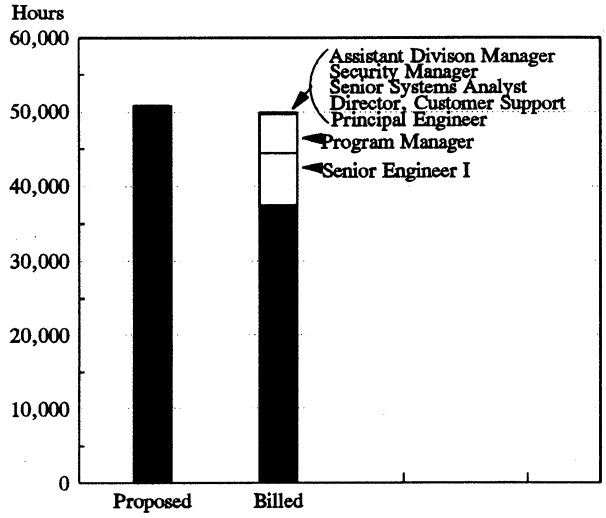


Figure A-20. Senior Principal Analyst (Level 11)

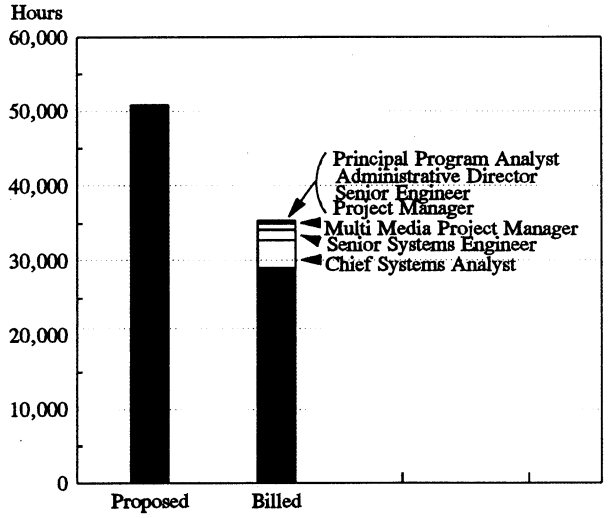


Figure A-21. Principal Analyst II (Level 10)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-89-C-0042

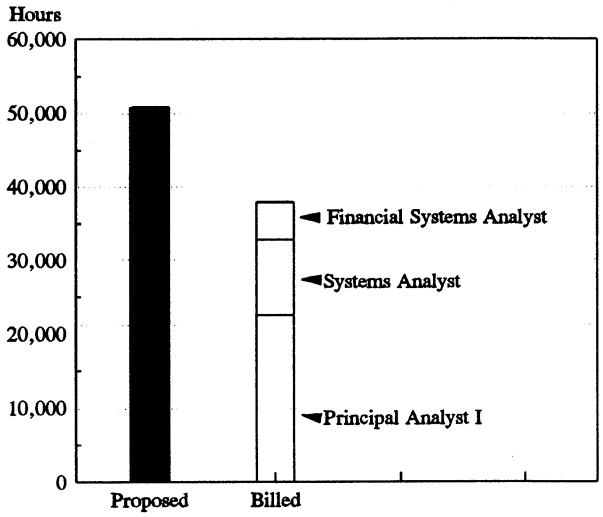


Figure A-22. Engineer (Level 9)

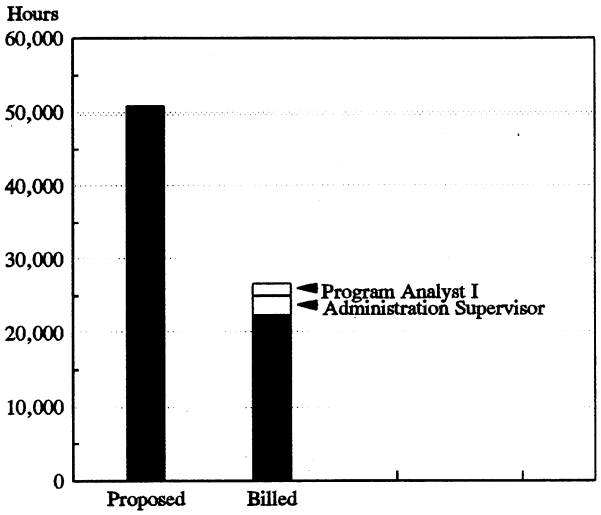


Figure A-23. Senior Analyst II (Level 8)

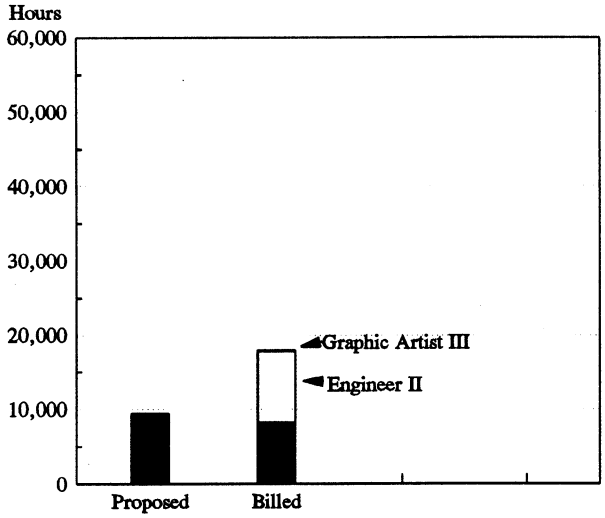


Figure A-24. Senior Analyst I (Level 7)

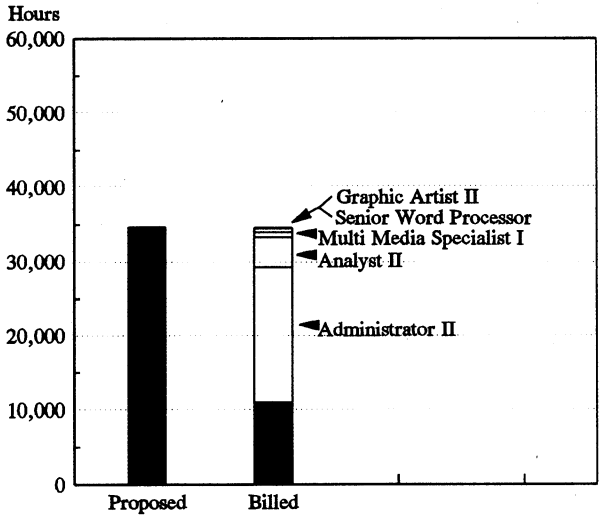


Figure A-25. Junior Engineer (Level 6)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Contract SDIO84-89-C-0042

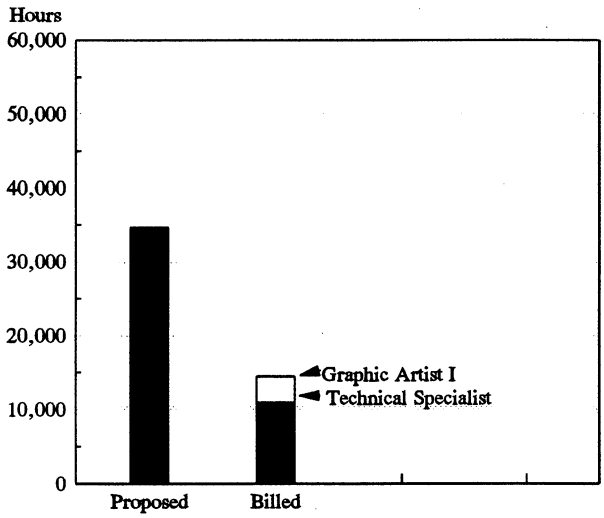


Figure A-26. Analyst/Associate Analyst (Level 5)

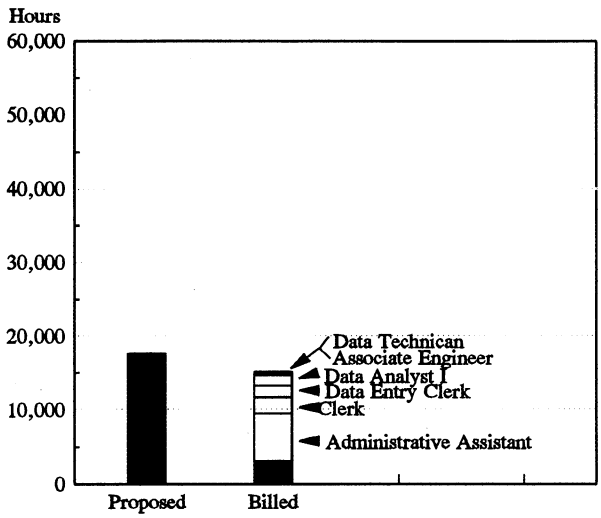


Figure A-27. Associate Analyst/Secretary (Level 4)

Labor Category

Unspecified Labor Categories at Same Level

Labor Categories at Same Level Not Proposed

Appendix B. Management Comments on the Report and Audit Response

Overall Management Comments

Management Comments on Contract Management of BMDO Support Service Contracts. BMDO commented that deficiencies did exist in the early stages of the three contracts and that problems such as the timely issuance of task orders and contractor task plans have been corrected in most instances for nearly 2 years. Additionally, the BMDO system for monitoring contract performance to estimated costs was substantially revised more than 2 years ago. Consequently, the draft audit report contains recommendations to correct conditions that no longer exist at BMDO and have not existed for nearly 2 years.

Audit Response. We are unable to confirm that the deficiencies no longer exist at BMDO. The audit report discusses systemic problems with the use of CPFF, level-of-effort, term, task order contracts. Recommendations made regarding the timely issuance of task orders, timely receipt of contractor task plans, and monitoring of the specific level of effort required by the contract relate to internal management control procedures not currently in place to ensure that the inherent weaknesses with the contract type are, to the extent possible, mitigated.

Management Comments on Computation of Contract Overruns and the Overpayment of Fee. BMDO commented that our computation of contract overruns and overpayment of fee reflected a serious lack of understanding as to the contract terms and conditions. The audit calculation of fee overpayment is not only extremely unusual and unorthodox, but contravenes the contract language. The use of cost variations in contractor labor categories and subcontract labor as a basis for reducing a contractor's fee entitlement is clearly unprecedented and inappropriate. Such an approach is indicative of a lack of fundamental understanding of cost-plus-fixed-fee contracts.

Audit Response. The basic methodology used to calculate fee overpayment was taken from the *Contract Management* article, "CPFF-LOE [level of effort] Contract Financial Reporting," May 1983. BMDO provided the article to us to support the use of the contract type. The article addresses proper financial reporting requirements that can mitigate, to an extent, the inherent weaknesses of the CPFF, level-of-effort, term, task order contracts. The following excerpts from the article address some of the key financial reporting and contract management requirements.

> Overall LOE financial performance may be segregated into three broad cost-performance elements: (1) direct labor (2) indirect costs and (3) other direct costs. By comparing actual to initial contract-negotiated cost performance for the three cost-performance elements,

> actual cost performance in excess of negotiated cost performance can be observed and remedied within the period of performance of the contract such that an overrun does not occur. For example, direct labor rate performance in excess of contract negotiated rate performance (whether, or not, approved in Work Plans) will result in an overrun unless there is favorable financial performance in the remaining cost performance elements.
>
> . . . . . .
>
> To determine whether or not there is an overrun and if so, how much, several assumptions must be made:
>
> . . . . . .
>
> o The cumulative total labor mix of all approved Work Plans is assumed to be a mutually approved budget with respect to labor mix - the quantity and quality of labor - up to the direct LOE labor volume specified in the LOE contract: This assumption is valid and mutually binding since, again, the LOE contractor has proposed a labor mix in his response to each Work Assignment and the Government and the LOE contractor have reached an accord with respect to this labor mix by approving the Work Plans - Independent of the labor mix specified in the solicitation document. Any discrepancy - other than the quantity of direct LOE hours requested by the Government - between the labor mix specified in the RFP and the cumulative total of all approved Work Plans can be argued to be a change in specifications within the Changes Clause.
>
> . . . . . .
>
> The extent to which total actual direct, indirect, and other direct cost performance has exceeded the total of the implicitly authorized total direct, indirect, and other direct cost elements - on an overall contract basis - can be viewed to be an overall LOE contract overrun within the meaning of the Limitation of Cost Clause.

We used the methodology to calculate contract overruns and fee overpayment because the contractor was not providing the specific level of effort negotiated in the contract, as required by FAR 16.306 for a CPFF term contract. Cost variations between the contractor proposed labor category costs used to establish the estimated contract costs and the actual labor category costs were used to calculate contract overruns and fee overpayments. The underlying basis for our computation is that you should only pay fee on what you contracted for and received.

In addition, BMDO did not have task plans for all task orders that were approved by the contracting officer so we could not determine the cumulative, specific level of effort authorized by the task orders. It is difficult to understand how BMDO can pay fee and never have the task plans.

Management Comments on Delivery of Technical Effort (Hours). BMDO stated that the cost-plus-fixed-fee services contracts provide for payment of fee on the basis of successful delivery of technical effort (hours) or accomplishment of definable objectives. These contracts do not provide for an entitlement of fee

on the basis of incurred cost as the audit suggests. More importantly, a contract cost overrun is not the basis for reducing the contract fee entitlement (as the audit suggests); however, it does form the basis of a non-fee-bearing cost.

Audit Response. The subject contracts are CPFF term contracts and provide for the payment of fee based on the delivery of a specific, specified, level of effort (hours) and do not relate to the accomplishment of definable objectives and delivery of an end product as would the completion form of CPFF contract.

The basic disagreement between BMDO and the auditors relates to what constitutes the successful delivery of technical effort (hours). BMDO believes that the contractor is only required to provide the specified number of staff hours identified in the contract to receive the full fixed fee. Consequently, the contractor can provide staff hours from any labor category as long as the total staff hours identified in the contract as the level of effort is reached. We believe that the contractor is required to provide a specific level of effort that is based on the labor mix the contractor proposed and was used to establish the contract estimated costs and fixed fee. If the contractor provides a significantly different labor mix than proposed, the estimated costs and fixed fee should be based on the different labor mix using the original proposed labor category costs. This basic concept is called "paying for only what you received." The BMDO lack of oversight on the contracts and payments made shows that, for a period of time, this concept was not followed.

For example, a contractor proposes 10 hours of senior engineer effort at $150 per hour and 10 hours of junior engineer effort at $50 per hour for a total level of effort of 20 hours and a total estimated cost of $2,000. Using a 10-percent fee factor, the fixed fee would be 10 percent of the total estimated cost, or $200. The contractor would be entitled to the full fixed fee upon delivery of the specific level of effort and certification that 10 hours of senior engineer effort and 10 hours of junior engineer effort were provided.

However, if the contractor delivers 20 hours of junior engineer effort at $90 per hour, instead of $50 per hour, for a total cost of $1,800, did the contractor deliver the specific level of effort, did a contract underrun occur, and should the contractor be entitled to the full fixed-fee payment of $200?

BMDO believes that a contract underrun of $200 occurred and that the contractor is entitled to the full fixed-fee payment of $200 because the specified 20 staff hours of effort were delivered. However, we believe that the contractor did not deliver the specific level of effort required by the contract and that, under these circumstances, a non-fee-bearing contract overrun of $800 occurred. The correct fixed fee payment should be $100 based on 20 hours of junior engineer effort at the original negotiated estimated hourly cost of $50, or a total estimated cost of $1,000 and fixed-fee of $100.

Management Comments on Contract Management Standards. BMDO commented that the audit consistently makes findings and recommendations that are not based on identifiable standards. In such cases, the appropriate standard should be identified or, in the absence of a standard, the recommendation should be modified to direct the appropriate organization to establish or modify

the standard. The over-application of personal judgment in the auditing process vice identification of sound findings and recommendations predicated on published standards seriously diminishes the effectiveness of the audit as an instrument for BMDO to pursue better ways of doing business.

Audit Response. One of the goals of acquisition reform is to reduce "regulatory overkill." Contracting officers have been empowered to ensure effective contracting, to ensure compliance with the terms of the contract, and to safeguard the interests of the United States in its contractual relationships. Findings and recommendations made in this report are designed to assist the contracting officers in correcting ineffective contracting procedures, ensuring compliance with the terms of the contracts, and safeguarding the interests of the United States without additional Federal regulations. In addition to our explanations in the audit report on how the audit was accomplished, we used common sense.

Management Comments on Internal Controls

Management Comments on Internal Controls for Contract Administration and Management. BMDO commented that the audit incorrectly stated the contract terms and conditions and that this inaccuracy has resulted in incorrect and inappropriate conclusions as to what data the Government were required to obtain and analyze to effectively manage contract performance.

Audit Response. We believe that the audit correctly stated the contract terms and conditions and that the contracting officer should review and know the type of staff hours approved to perform tasks; should determine whether labor categories provided by the contractor were required to perform tasks; and should evaluate costs and fixed fee to effectively manage CPFF level-of-effort, term, task order contracts.

Management Comments on Use of Prohibited Cost-Plus-a-Percentage-of-Cost System of Contracting. BMDO commented that preventing the contractor from using a prohibited cost-plus-a-percentage-of-cost system of contracting with its subcontractors was not the responsibility of BMDO internal controls but the responsibility of the administrative contracting officer. Further, the contracting officers fulfilled their responsibility and performed appropriate cost/price analysis in advance of the award of CTI contracts.

Audit Response. We believe that the BMDO contracting officers and the administrative contracting officers should work together as a team to protect the interests of the Government. Two of the three CTI basic contract proposals identified no subcontractors; however, CTI subsequently subcontracted almost 50 percent of the work. Further, although BMDO contracting officers approved the task plans that identified subcontractor effort not originally proposed, the administrative contracting officers have no means to know when CTI awards these subcontracts.

Management Comments on Finding A., Contract Management

Management Comments on Level of Effort Required by the Contracts. BMDO commented that the level of effort "required" by the contract is specified by the task ordering process.

Audit Response. The BMDO task ordering process did not obtain task plans for all task orders. Consequently, BMDO could not determine a cumulative total of the specific level of effort ordered by the task orders.

Management Comments on Completion-Type Contract. BMDO commented that, although contract 10 was regarded as a level-of-effort contract, the task orders issued directed the contractor to deliver a product or service (denoting a completion-type task). Note that the record reflects that CTI successful completed the stated task order objectives and is, therefore, entitled to the full fixed fee as specified in the contract.

Audit Response. We do not agree that the task orders were completion-type tasks. The task orders basically provided "manpower and materials" to support the BMDO procuring contracting officers on a continuous basis.

Management Comments on Requiring That CTI Provide Task Plans for Each Task Order. BMDO commented that the contracts did require CTI to provide task plans for each task order; however, BMDO did not enforce this action until June 1992 for contract 12 and October 1992 for contract 42. Further, although the files for contract 10 appear to have some missing data, task plans were provided by the contractor.

Audit Response. BMDO agrees that CTI did not provide task plans for each task order. As BMDO commented, BMDO contracting officers did not enforce the contract requirement for the period stated. Contracting officers have been empowered to ensure compliance with the terms of the contract and enforce contract requirements. Consequently, when the term "require" is used in the finding, it also means enforce.

Management Comments on Requiring That CTI Provide Task Plans Before a Significant Portion of the Work was Completed. BMDO states that, contractually, BMDO did require that CTI provide task plans to the contracting officer within 5 working days after receipt of a task order. However, BMDO did not require that CTI submit task plans before a significant portion of the work was completed in all cases. BMDO believes that the failure of contracting officers to obtain task plans in a timely manner had no impact on the ability of BMDO to protect the financial interests of the Government.

Audit Response. We believe that failure of contracting officers to review and approve task plans before the work is completed does hamper the ability of the contracting officers to protect the financial interests of the Government. Task plans are key financial documents needed by the contracting officer to review and approve the contractor's approach, staffing, key personnel, and costs to

accomplish the task. The task plans should identify the staff hours and applicable costs required from each proposed labor category. The task plans also identify subcontractor costs, other direct costs, and any other applicable costs that should be reviewed and approved by the contracting officers.

Management Comments on Requiring That CTI Identify Labor Hours and Costs by Labor Category in the Task Plans. BMDO commented that, for contract 10, CTI did identify either the individual or the labor category with number of hours, rates per hour, and labor costs proposed. BMDO commented that the task ordering procedures for contracts 12 and 42 did require the contractor to submit task plans that described the contractor's approach, staff hours, key personnel, and costs to accomplish the task. However, all task plans that were submitted by CTI did not segregate the labor hours and relative costs by labor categories.

Audit Response. BMDO agrees that all task plans that were submitted by CTI did not segregate the labor hours and relative costs by labor categories. As previously discussed, the term "require" used in the finding also means "enforce" the contract terms.

Management Comments on Task Order 3a of Contract 12. BMDO commented that the fact that the task order was not issued until after performance began had no impact on the Government's ability to survey the contract in this case.

More importantly, the contractor actually underran the contract cost estimate to provide the services provided by the various task orders. The audit inappropriately failed to take into account whether or not BMDO effectively managed the contract as evidenced by the cost underrun while the contractor provided appropriate services.

Further, the claim that the task order may have been issued after the work was completed is an innuendo and not supported by fact. Such a practice violates generally accepted auditing principles.

Audit Response. The failure to issue a task order also means that BMDO did not receive and approve a task plan from the contractor that described the contractor's approach, staff hours, key personnel, and costs to accomplish the task. The Government's ability to survey work is significantly impaired when work performed by a contractor is approved after the work was completed.

The purpose of the finding was to demonstrate that the contractor did not underrun the contract cost estimate because the contractor did not provide the specific level of effort required by the contract. In fact, the contractor provided a lower labor mix (more staff hours from the lower level labor categories) than the proposed labor mix on which the contract estimated cost was based.

Task order 3a was apparently issued after the work was completed, based on the fact that the contractor did not sign the task plan until April 2, 1994. The finding statements are facts that speak for themselves; there is no innuendo.

Management Comments on Estimated Cost and Level of Effort for Task Order 3a. BMDO stated that task order 3a was estimated at $2,335,910 to provide 58,093 staff hours. No issuance date was found.

Audit Response. The copy of the task order and task plan we obtained from BMDO shows an estimated cost of $2,165,492 and 47,932 staff hours.

Management Comments on Different Labor Categories and Labor Costs Identified in the Task Plan Than Proposed by the Contractor for the Contract. BMDO commented that the labor categories and labor costs identified in the task plans were approved by the contracting officer. In addition, the labor categories used to price a task order may be slightly different from those proposed in the original cost proposal. The task order and the aggregate of all task orders should be compared with the contract's estimated cost.

Audit Response. The labor categories and labor costs identified on the task plans were approved after the work was completed and were significantly different from the labor categories proposed for the contract. As shown in Appendix A of the audit report, the labor categories billed by the contractor did not resemble the labor categories proposed by the contractor. Further, we could not determine an aggregate of the task orders because BMDO had not received task plans for all task orders. Minor deviations in labor categories provided versus contracted for are allowed. However, these were not minor deviations.

Management Comments on the Contractor not Providing Task Plans for Task Order 1 and 2 of Contract 12. BMDO commented that CTI did not provide a task plan for task order 1 but CTI did provide a task plan for task orders 2 and 2a.

Audit Response. The CTI task plan for task orders 2 and 2a basically expanded on the objectives identified in the BMDO task description and did not describe staff hours, key personnel, and costing to accomplish the work. Therefore, we did not consider the document a task plan as described in the contact clauses.

Management Comments on Contract Provisions to Identify and Define Labor Categories. BMDO stated that no known requirement exists for CPFF contracts to contain provisions that identify and define labor categories. The contractor's proposal specifically set forth the detailed labor categories, pay levels, hours, labor rates, and employee qualifications.

Audit Response. The three CTI contracts were CPFF level-of-effort contracts through which BMDO was procuring staff hours of effort. Payment was not based on CTI providing a specific deliverable or end product, other than the staff hours. The CTI proposals for the 3 CPFF contracts did identify labor categories and employee qualifications. However, the report shows that CTI did not provide staff hours from labor categories that matched the proposed labor categories. Consequently, BMDO had insufficient control over the type of staff hours CTI charged to the Government.

Management Comment on Requirement to Bill Labor Hours or Track Labor Costs Against the Labor Categories Proposed. BMDO stated that CTI was required to include summaries by labor category for invoices on contract 10; however, the CTI invoices did not break out the individual labor categories. Contracts 12 and 42 required that CTI only bill labor hours. However, CTI was required to track labor hours and labor costs they expended against the labor categories that they proposed separately, and provide this information, if required.

Audit Response. Neither BMDO nor CTI had an auditable means to track labor hours and labor costs expended against the labor categories that were proposed. The primary purpose of Tables 3, 4, and 5 in the audit report was to develop a means to compare labor hours and labor costs expended with labor categories and labor costs proposed and determine whether CTI provided the specific level of effort required by the contract.

Management Comments on CTI Providing Labor Categories and a Labor Mix Different Than Proposed and CTI Not Providing the Level of Effort Specified in the Contract as Required by FAR 16.306. BMDO stated that the statement was incorrect and that the contract terms and conditions did prescribe the level of effort required/agreed to by the parties, not the cited FAR reference. Further, each of the contracts specified a number of staff hours the contractor was required to provide and that, by providing that number of staff hours, the contractor was in conformance with the level of effort required by the contracts.

Audit Response. We believe the contractor should provide a specific number of staff hours that is representative of the labor categories the contractor proposed. For example, the contractor could not propose staff hours from a higher level labor category, then deliver staff hours from a lower level labor category, and still meet the requirement of providing the level of effort specified in the contract.

Management Comments on Successful Contract Performance. BMDO stated that successful contract performance was defined as achieving the stated objectives of the task order, not delivering a specified number of hours.

Audit Response. BMDO has tried to characterize these CPFF, level-of-effort, term, task order contracts as completion type contracts. The three contracts did not require the contractor to complete and deliver specified end products as a condition for payment of the fixed fee and are not completion contracts. As BMDO stated, fixed fee payments were based on the contractor delivering the required number of staff hours.

Management Comment on Wrap Rate Analysis. BMDO stated that they could easily determine whether actual cost performance was in line with estimated costs through calculation and use of a wrap rate analysis.

Audit Response. We believe that the wrap rate analysis was of limited value because the wrap rate analysis gives no consideration to whether the contractor is providing the specific level of effort required by the contract.

Management Comments on Contract Overruns and Underruns. BMDO stated that contract overruns and underruns are determined by a comparison of the total estimated costs to provide a specified level of effort (or achieve stated objectives) with the actual total cost of performance.

Audit Response. We believe BMDO must also consider whether the contractor provided the specific level of effort required by the contract as stated in FAR 16.306. Consequently, consideration must be given to labor categories the contractor proposed and the labor categories the contractor delivered. If the contractor did not provide the specific level of effort required by the contract, the fixed fee should be based on the labor categories the contractor did provide at the proposed labor category costs as previously discussed in this appendix.

Management Comment on Lack of Government Contract Comprehension, Knowledge, and Experience in the Elementary Area of Contract Type and Contract Cost Principles. BMDO commented that the calculation of labor category cost variances or wrap rate cost variances in cost reimbursable contracts does not indicate contract overruns or underruns but are measurements of technical performance and possible inefficiencies or changing circumstances. In addition, subcontracting, whether or not originally proposed, is allowable.

Audit Response. CPFF, level-of-effort, term, task order contracts, require that the contractor deliver a specific level of effort within a definite time period. The contractor's cost proposal that identifies staff hours and labor costs by labor categories becomes the basis for the specific level of effort required under the contract. We believe that, when the contractor's actual costs for the proposed labor categories exceed the contractor's proposed costs on a cumulative basis, a contract overrun must occur because the contractor cannot provide the specific level of effort required by the contract within the estimated cost. Consequently, the labor category cost variance does provide a means to determine contract overruns and underruns. We agree that subcontracting is allowable.

Management Comments on CTI Receiving a 7.75 Percent Fee on Total Costs. BMDO stated that CTI correctly claimed a fee of 7.75 percent of incurred costs for contract 10, less a 15 percent withholding as described in FAR 16.306.

Audit Response. We disagree that CTI was entitled to a fee of 7.75 percent of incurred costs nearly 2 years after the contract was completed. We believe the fixed fee is payable at the expiration of the agreed-upon period, upon contractor certification that the specific level of effort specified in the contract has been expended in performing the contract work.

Management Comments on CTI Fee for Contract 10. BMDO stated that CTI did achieve the objectives of the task orders and that CTI is authorized full fee (per hour) based on the attached spreadsheet. [See Part IV for the spreadsheet.]

Audit Response. After the audit, BMDO developed a new method to calculate fee for contract 10 that was different from the method in the contract clauses. We believe that the new method to calculate fee is reasonable, because CTI essentially provided staff hours from the same labor mix that was proposed for the contract. The new fee calculation was based on an a fixed hourly fee rate, not 7.75 percent of the contractor's incurred costs.

Management Comment on CTI Not Being Entitled to Fee on Subcontractor Overrun. BMDO commented that subcontracting, whether or not originally proposed, is allowable.

Audit Response. We agree the subcontracting is allowable. We took exception to paying CTI a fee of 7.75 percent of the incurred subcontractor costs on contract 10 because the subcontractor costs were higher than the CTI costs for the same individuals. For example, the CTI contract 10 proposal identified estimated labor hours and labor costs for specific individuals. The individual proposed as the chief analyst was proposed at an hourly labor cost of $78.71. After working for CTI for about a year, the individual left CTI, established his own company, and became a subcontractor on contract 10. As a subcontractor on contract 10, the hourly labor cost for the individual increased to $105.95. Consequently, the cost to the Government for the same individual increased by about 35 percent from the proposed cost.

Management Comments on Calculation of Labor Category Cost Variance That Showed a Contract Overrun. BMDO stated that the calculation of labor category cost variances or wrap rate cost variances in cost reimbursable contracts do not indicate contract overruns or underruns, but are measurements for technical performance and possible inefficiencies.

Audit Response. The calculation of labor category cost variances will indicate whether the contractor will be able to provide the specific level of effort required by the contract within the estimated costs or whether a contract overrun or underrun will occur. We agree that the wrap rate cost variances will not indicate contract overruns or underruns.

Management Comments on Labor Category Variance Caused by Subcontractors. BMDO commented that task orders issued by the contracting officer under the contract recognized Advanced Marine Enterprises, Incorporated, as a subcontractor to CTI and that the overrun appears to be an erroneous computation.

Audit Response. We disagree that the overrun is an erroneous computation. The report shows that the actual hourly cost for subcontractors was higher than the hourly cost proposed for CTI employees. Consequently, unless there were changes to the labor mix provided, it is likely CTI cannot provide the specific level of effort required by the contract within the estimated costs, and a contract overrun can occur.

Management Comments on Fee Payment on Cost Overrun for Contract 12. BMDO stated that the current Contract Performance Analysis Summary through

July 31, 1994, indicates that CTI is underrunning the current funding amount for contract 12. No apparent overrun exists.

Audit Response. The BMDO analysis considers only whether the contractor delivers the total specified level of effort (number of hours) for the total estimated cost and does not consider whether the contractor is providing the specific (same labor mix) level of effort identified in the contract proposal. Our analysis shows that CTI did not provide the specific (same labor mix) level of effort identified in the contract proposal. Based on the labor category costs identified in the contact proposal and used to establish the contract estimated costs, the actual contract costs are overrunning the estimated contract costs.

Management Comments on Fee Payment for Contract 42. BMDO commented that contract 42 was overrun and that the cost associated with the overrun was not fee-bearing.

Audit Response. We reviewed the BMDO calculation of the contractor's approximate entitled fee for contract 42 and determined that the BMDO fee calculation was similar to the audit fee calculation. For contract 42, the contractor provided an actual labor mix that was similar to the proposed labor mix. Consequently, the two methods to calculate fee provided similar results.

Appendix C. Management Comments Required

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

	Response Should Cover			
Recommendation	Concur/ Nonconcur	Proposed Action	Completion Date	Related Issues*
A.1.a	X	X	X	IC
A.1.b	X	X	X	IC
A.3.	X	X	X	M
B.1.	X	X	X	IC
D.2.	X	X	X	IC
D.4.	X	X	X	IC
D.5.	X	X	X	

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

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and Type of Benefit
A.1.a.	Internal Controls. Prevents contractors from working without an approved task order.	Nonmonetary.
A.1.b.	Internal Controls. Documents a specific level of effort being purchased.	Nonmonetary.
A.2.a.	Internal Controls. Enables contracting officers to determine contract overruns.	Nonmonetary
A.2.b.	Internal Controls. Prevents contractors from receiving a fee on contract overruns.	Nonmonetary.
A.3.	Economy and Efficiency. Instructs contracting officers not to pay a fee on contract overruns.	Questioned Costs of of $233,749.
B.1.	Internal Controls. Informs the administrative contracting officer of subcontract awards.	Nonmonetary.
B.2.a.	Compliance with Regulations and Laws. Requires the administrative contracting officers to determine fair and reasonable subcontractor costs and to recover overpayments.	Undeterminable.*
B.2.b.	Economy and Efficiency. Provides for review of the contractor's purchasing system or provides consent to subcontract.	Nonmonetary.

*Monetary benefits cannot be determined until analysis is completed by the administrative contracting officer.

Appendix D. Summary of Potential Monetary Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
C.1.	Compliance with Regulations and Laws. Notifies contractors and subcontractors that charging costs for guaranteed hours, lunchtime, breaktime, and commuting time are not allowable.	Nonmonetary.
C.2.	Economy and Efficiency. Directs contracting officers to initiate action to recover amount paid for hours not worked.	Questioned costs of $27,370.
D.1.	Economy and Efficiency. Directs contracting officer to recover $ * of questionable miscellaneous items.	Questioned costs of $ * .
D.2.	Internal Controls. Provides guidance to COTR on allowable direct and indirect costs.	Nonmonetary.
D.3.	Economy and Efficiency. Directs contracting officer to recover $3,881 of questionable travel and duplicated billings.	Questioned costs of $3,881.
D.4.	Internal Controls. Instructs COTR to periodically review contractor travel reimbursement claims and other direct costs reimbursements.	Nonmonetary.
D.5.	Economy and Efficiency. Provides contractors the option to use the DoD shuttle bus instead of the subway to commute to the Pentagon.	Undeterminable

*Proprietary Data Removed

Appendix E. Organizations Visited or Contacted

Defense Organizations

Ballistic Missile Defense Organization, Washington, DC
Defense Contract Audit Agency, Alexandria, VA
  Branch Office, Baltimore, MD
  Branch Office, Herndon, VA
Defense Logistics Agency, Alexandria, VA
  Defense Contract Management Area Operations Manassas, VA

Non-Defense Federal Organization

Small Business Administration, Washington, DC

Non-Government Organizations

Advanced Marine Enterprises, Incorporated, Arlington, VA
ARIST Corporation, Alexandria, VA
Comprehensive Technologies International, Incorporated, Fairfax, VA
Dwyer & Associates, Incorporated, Severna Park, MD
Strategic Insight, Incorporated, Arlington, VA

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Under Secretary of Defense (Comptroller)
Under Secretary of Defense for Personnel and Readiness
Deputy Under Secretary of Defense (Acquisition Reform)
Director, Defense Procurement

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Defense Organizations

Director, Ballistic Missile Defense Organization
Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, Central Imagery Office
Inspector General, Defense Intelligence Agency
Inspector General, National Security Agency
Director, Defense Logistics Studies Information Exchange

Non-Defense Federal Organizations

Office of Management and Budget
Office of Federal Procurement Policy
Technical Information Center, National Security and International Affairs Division, 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
Honorable David Pryor, U.S. Senate

Part IV - Management Comments

Ballistic Missile Defense Organization Comments

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

DCTO

NOV 25 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DOD

SUBJECT: BMDO Comments, Draft Audit Report 2CH-5031.01, Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization

The Ballistic Missile Defense Organization (BMDO) has reviewed the above subject draft audit and provides comments where appropriate as an attachment. With regard to those audit findings where BMDO is in agreement as to the facts and audit conclusions, we have already taken action to correct the shortcomings. This includes initiating action to recover $27,370 in questionable labor cost. There are however areas of the draft report where I have significant concerns.

We noted that the findings, relating to contract management of BMDO service support contracts, were based on data over two years old. One of the contracts was completed in December 1992. Deficiencies did exist in the early stages of the three contracts. These problems (such as the timely issuance of task orders and contractor task plans) have been corrected in most cases for nearly two years. The fact that the audit is silent on the current conditions in this regard is misleading. Additionally, the BMDO system for monitoring contract performance to estimated cost was substantially revised over two years ago. This was disclosed to the DoDIG during the previous audit of the TASC "Super SETA" contract. It is not clear why the draft audit contains recommendations to correct conditions which no longer exist and have not existed for nearly two years. The audit should clearly recognize the recent data as well as history in its characterization of the BMDO procurement system. Failure to do so has resulted in inappropriate conclusions. First, that certain contract management problems still exist, and secondly, that corrective action is yet to be undertaken by BMDO.

The portion of the audit dealing with the computation of contract overruns and the overpayment of fee should be thoroughly reexamined. Our review of the audit findings in this area reflect a serious lack of understanding as to the contract terms and conditions. The audit calculation of fee overpayment is not only extremely unusual and unorthodox, but is in contravention to the contract language.

The use of cost variations in contractor labor categories and subcontract labor as a basis for reducing a contractor's fee entitlement is clearly unprecedented and inappropriate. Such an approach is indicative of a lack of fundamental understanding of cost-plus-fixed-fee contracts. The BMDO cost-plus-fixed-fee SETA contracts provide for payment of fee on the basis of successful delivery of technical effort (hours) or accomplishment of definable objectives. These contracts do not provide for an entitlement of fee on the basis of incurred cost as the audit suggests. More importantly, a contract cost overrun is not the basis for reducing the contractor fee entitlement (as the audit suggests); however, it does form the basis of a non-fee bearing cost. Additional fee was added to the contracts only by modification (increased work) and not as a consequence of a cost overrun. Generally, the fee withhold provisions of these contracts and the provisional approval of public vouchers by DCAA, prevent overpayment of fee in advance of the final voucher and closeout. In the cases of the three audited contracts, the Government's total withhold of fee exceeds the contractors total entitlement of fixed fee.

I am also concerned that the audit consistently makes findings and recommendations that are not based on identifiable standards. In such cases, the appropriate standard should be identified or, in the absence of a standard, the recommendation should be modified to direct the appropriate organization to establish or modify the standard. For example, finding A cites BMDO for failing to "...define labor categories and labor mix in the contracts and to require the contractor to bill or track cost against those labor categories...." Except for labor hour contracts, there is no known regulatory or statutory requirement for such a stipulation. In most cases the approach prescribed in the audit is redundant, unnecessary or even inappropriate. Generally, the contractor's negotiated cost proposal served as a baseline for the labor mix and identification of labor categories needed to meet the contract objectives. This over-application of personal judgment in the auditing process vice identification of sound findings and recommendations predicated on published standards seriously diminishes the effectiveness of the audit as an instrument for us to pursue better ways of doing business.

As I have indicated in my response to the first in the series of BMDO contract audits, the contracting operation has undergone a significant evolution in recent years. Internal controls, policies, procedures and the overall business practices associated with managing contracts have been dramatically strengthened. I would hope that the final audit report will more

appropriately reflect the current BMDO condition. Such an approach would be infinitely more helpful to us as we strive to continuously improve our business systems.

MALCOLM R. O"NEILL
Lieutenant General, USA
Director

Attachment:
As stated

BMDO REVIEW COMMENTS

ADEQUACY OF INTERNAL CONTROLS

AUDIT COMMENT:

"Internal controls for contract administration and management were not adequate to determine the type of staff hours approved by the contracting officers to perform tasks, to determine whether labor categories provided by CTI were required to perform tasks, and to evaluate cost and fixed fee on CPFF contracts."

BMDO COMMENTS: **Non-Concur**

The audit has incorrectly stated the contract terms and conditions. This inaccuracy has resulted in incorrect and inappropriate conclusions as to what data the Government was required to obtain and analyze in order to effectively manage the contracts during performance. In other cases the audit fails to take into account changes in conditions and the correction of errors existing over two years ago. This failure also leads to inaccurate and inappropriate conclusions as to how BMDO is currently managing its contracts.

AUDIT COMMENT:

"Further, internal controls did not prevent CTI from using a prohibited cost-plus-a-percentage-of-cost system of contracting with it subcontractors and did not determine the reasonableness of subcontract prices on the prime CPFF contracts."

BMDO COMMENTS: **Non-Concur**

As to whether CTI's purchasing system was operating in such a fashion to preclude the use of a prohibited form of contract is not a responsibility of BMDO internal controls. The cognizant contract administration office is responsible for assessing the adequacy of the CTI purchasing system and advising the effected contracting officer.

The reported internal control weakness pertaining to the determination of subcontract prices is incorrect. We note that the contracting officers fulfilled their responsibility and performed appropriate cost/price analysis in advance of the award of the CTI contracts. This included an assessment of subcontract forward pricing for the purpose of determining the prime contract estimated cost.

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FINDING A

FINDING	A: Contract Management
PAGE NUMBER:	12-24
PARAGRAPH HEADING:	See Below
CONCUR/NON-CONCUR:	Non-Concur

PAGE/PARA #	AUDIT COMMENT
13/2	The contract section "Level Of Effort" identifies the total level of effort required under each contract... CTI could receive the full fixed fee without providing the required staff hours if a lesser number of hours was approved by the CO.

BMDO COMMENTS:

0010 CONTRACT

The first statement is factually incorrect. The level of effort "required" by the contract is specified by the task ordering process. The second statement is taken out of context and is therefore misleading. Clause B-4.c, Level of Effort states, "the number of hours furnished by the contractor may vary from the number specified in Section B-4 under two conditions: 1) if contractor achieves the objectives defined in the contract to the satisfaction of the CO with expenditure of a lesser number of hours, the contractor shall be deemed to have discharged his obligation and shall be entitled to payment of fee; 2) if contractor does not achieve the objectives defined in contract to the satisfaction of the CO with the expenditure of a lesser number of hours, the CO may nevertheless authorize payment of fee, if CO determines that the variation is minor or occasioned by difficulties inherent in correlating exact number of hours with cessation of contract activity. In absence of such an authorization, the parties will negotiate a reduction in the fee or an extension of the POP without any increase in fee."

Monitoring of cost reimbursable level-of-effort (LOE) contracts requires that, on an overall contract basis, the LOE contractor not exceed the total number of direct LOE labor hours authorized for all work assignments, nor the total authorized cost for all work assignments. This IG statement connotes a substantially different meaning from that presented in contract at clause B-4.c. B-4.c states the primary intention of this contract is for the Government to receive the product; "achieve the objectives." Although regarded as a LOE contract, the task orders issued hereunder directed the contractor to deliver a

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product or service (denoting a completion-type task). Note that the record reflects that CTI successfully completed the stated task order objectives and is therefore entitled to the full fixed fee as specified in the contract.

PAGE/PARA #	AUDIT COMMENT
14/2	BMDO did not require 1) that CTI provide task plans for each TO, 2) that CTI provide task plans before a significant portion of the work was completed, and 3) that CTI identify labor hours and costs by labor category in the task plans.

BMDO COMMENTS:

CONTRACT 0010

1) This comment is inaccurate and misleading. The audit should specify how many of the total task plans required were not provided. Although the files of this completed contract appear to have some missing data, task plans were provided by the contractor. It should be noted that this contract has been completed for nearly two years.

2) H-9c. states that the contractor shall submit its task plan within five days after receipt of the task description. In the first option period, a contract restructuring occurred and submission of task plans and definitization and issuance of firm T.O.s was delayed due to the restructure. Therefore, reasonably these task plans were delinquent. The contractor provided services on the basis of the previous task plans using the same staff and level of effort during the interim period without any degradation to the Government oversight or adverse impact to the contract price.

3) The statement that BMDO did not require that CTI identify labor hours and costs by labor category is a factually incorrect statement. All contractor task plans which were in the files identify labor costs by labor category, rate and number of hours. CTI did identify either the individual or the labor category with number of hours, rates per hour and labor costs proposed.

CONTRACT 0012

1) This statement is misleading. See Section H, H-7 Task Ordering Procedure. Contractually, BMDO did require that CTI provides task plans for each T.O.s, but this action was only enforced from June 1992 to the present. The audit fails to mention the fact that although there was an deficiency in implementing the contract provision early in the performance period, the problem was corrected over two years ago.

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2) True. BMDO did not require that CTI provides task plans before a significant portion of the work was completed. This is not viewed as having a material impact in the cited case because the nature of the services performed under these recurring task orders were routine and repetitive. The absence of timely task orders in this case had not impact on the ability of the Government to direct the technical work in a timely manner and thus protect it's financial interests.

3) The statement that BMDO did not require that CTI identify labor hours and costs by labor category in the task plans is factually incorrect. In accordance with paragraph (c) in Section H, H-7 Task Ordering Procedure, the task plan is to describe the contractor's approach, manhour staffing, key personnel and costing to accomplish the work required. Task plans for the period of June 1992 through September 1994, submitted in response to Task Order no. 2a through 5 did segregate manhours and costs by applicable labor categories. Earlier task plans did not. The audit failed to recognize that this deficiency was corrected two years ago.

CONTRACT 0042

1) This statement is factually incorrect. See Section H, H-2 Task Ordering Procedure. Contractually, BMDO did require that CTI provides task plans for each T.O.s, but this action was only enforced from October 1992 to the present. Again, the audit fails to recognize that the situation was rectified almost two years ago.

2) BMDO did not require in all cases that CTI provide task plans before a significant portion of the work was completed. Contractually, BMDO did require that CTI submits a Task Plan to the Contracting Officer, within 5 working days after receipt of a Task Order. Generally the nature of the tasking under this contract was such that the contractor provided repetitive services using the same or similar staff. This practice, although a deviation from the stated contract terms resulted in no identifiable degradation to the Government oversight or adverse impact to the contract price.

3) The audit is factually incorrect. In accordance with paragraph (e) the formal instruction for preparing a task plan indicates that CTI was to provide manhours by applicable labor category, total manhours estimated to complete the task and total estimated cost including fee. Through October 1993, CTI did not segregate the labor hours and relative costs by labor categories. However, Task plans issued after October 1993 through September 1994, labor hours and costs by labor category were identifiable. Again, the audit failed to recognize that this deficiency was corrected a year ago.

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PAGE/PARA #	AUDIT COMMENT
14/5	T.O.s 401, 402, 403, 404, 406, 407, 408, 409 for the period Oct 18, 1991, through Oct 17, 1992, were not signed by the CO until April 6, 1992, almost halfway through the period of performance.

BMDO COMMENTS:

CONTRACT 0010

Task orders 400 through 409 (including 405) had a start date of 10/18/91 and signed on April 6, 1992. The three CT support contractors were undergoing a replan and were requested to submit a proposal for a reorganization of responsibilities. As noted previously, the T.O.s were not signed until after the contract replan was finalized. See comments relating to 14/2 above also.

PAGE/PARA #	AUDIT COMMENT
14/6	**1)** T.O. 3 for the period June 26, 1992 through June 25, 1993, was not dated and may have been issued by the CO after the work was completed. **2)** The estimated costs for the TO were about $2.2M to provide 48,000 staff hours of services. **3)** The labor categories and labor costs identified on the task plan were different than the labor categories and labor costs proposed by the contractor for the contract. **4)** The contractor also did not provide task plans for T.O.s 1 and 2 for the first 2 contract years (6/26/90 - 6/26/92) for about 133,000 staff hours.

BMDO COMMENTS:

CONTRACT 0012

1) The task order referenced by the audit (actually task order #3a) was a repetitive task in which the performance required was for the same or similar services from period to period. The fact that, for whatever reason, the task order was not issued until after performance began had no impact on the Governments ability to survey the contract in this case. More importantly, the contractor actually underran the contract cost estimate in order to provide the services provided by the various task orders. The audit fails to recognize this fact while attempting to build the argument that the result was a contract overrun. The comments relating to the inappropriate computation of over/underrun is discussed later. The audit inappropriately focused on the Government's failure to issue timely task orders in these cases, and fails to take into account whether or not we effectively managed the contract as evidenced by the cost underrun while the contractor provided appropriate services. The

IG claim that the TO "may have been issued by the CO after the work was completed" is not relevant because the contracting officer has the authority to issue a Task Order after the fact under certain circumstances. Further, the audit comment is inuendo and not supported by fact. Such a practice violates generally accepted auditing principles.

2) Task Order 3A was estimated at $2,335,910 to provide 58,093 hours of services. No issuance date was found.

3) True. The labor categories and labor costs identified on the task plan are different than the labor categories and labor costs proposed by the contractor for the contract. However, the labor categories and labor costs identified on the task plans were approved by the Contracting Officer. It must be made clear that even though the labor categories were ultimately different, the contractor performed the services prescribed by the task order and underran the contract cost. The Government appropriately benefited from this difference. The task order specifies in clearer details the effort and work to be provided for a particular effort under the Statement of Work. Although the labor categories used to price a task order may be slightly different than those proposed in the original cost proposal, the task order and their aggregates should be compared to the contract's estimated cost.

4) The audit is factually incorrect. Although CTI did not provide a task plan for Task Order no. 1, they did provide a Task Plan for Task Order 2, and 2a.

PAGE/PARA #	AUDIT COMMENT
15/2	1) The contractor did not provide the 10 task plans until 9/24 and 9/28, 1993, several days before the completion of the period of performance. 2) The contractor also did not provide task plans for T.O.s 1 and 2 for the first 2 contract years (10/89 through 9/91) for about 229,000 staff hours of support services.

BMDO COMMENTS:

CONTRACT 0042

1) See comments under Page/Para 14/2 above.

PAGE/PARA #	AUDIT COMMENT
15/4	The 3 CPFF contracts 1) did not identify specific labor categories, 2) did not define the minimum education and experience requirements for each

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labor category and 3) did not require CTI to bill labor hours or track labor costs against the labor categories that CTI proposed.

BMDO COMMENTS:

There is no known requirement for CPFF contracts to contain the above provisions exclusive of perhaps labor hour contracts. The requirement (as stated in the audit report draft) appears judgmental and without an appropriate basis given the type of contract under review. The audit should identify the specific statutory or regulatory requirement which forms the basis of this finding.

CONTRACT 0010

1) The RFP requested the contractor to propose the effort under the Government's Statement of Work and relied upon the contractor's expertise to propose the appropriate staffing to accomplish the effort. The contractor's proposal specifically sets forth the detailed labor categories, pay levels, hours and labor rates for each contract period used as a basis for pricing the original contract effort.

2) The proposal also included detailed resumes for those employees proposed from which the Government made an informed decision for award. The technical approach, labor mix, employee qualifications (including education and experience level) were relied upon by the Government when making this award to CTI.

3) The contract contains the clause entitled "H-4, Segregation of Costs" which states that "invoices shall contain summaries of work charged during the period covered, as well as overall cumulative summaries by labor category for all work invoiced to date, by task." CTI invoices, however, do not break out the individual labor categories but invoice total direct labor. I should be noted that the contract called for the completion of specific objectives set forth in the task orders NOT simply the delivery of labor hours.

CONTRACT 0012

1) This contract was awarded in June 1990 and ended in September 1994. It is true that this contract did not identify specific labor categories as there is no requirement to do so. The basis for determining adherence to the contract financial and technical baselines is the contractors cost and technical proposals which form the basis of the contract agreement; 2) and did not define the minimum education and experience requirements for each labor category; however, the award of this contract was based on CTI technical capabilities, that is the experience of its technical staff as indicated on their resume

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provided as an attachment to CTI's Technical Proposal. Accordingly, the RFP did not require that CTI provide a certain percentage of hours by labor categories.

3) Section H, H-4, Segregation of Costs, require that the contractor segregate costs incurred at the lowest level of performance, the Task Order. Furthermore, Invoices must reflect costs incurred at the task order level. Contract did require CTI to bill labor hours, but did not require CTI to track labor costs against labor categories. CTI is required to track labor hours and labor cost they expended against the labor categories that they proposed separately, and provide this information when required.

CONTRACT 0042

1) This contract was awarded in September 1989 and will end in December 1994. It is true that this contract did not identify specific labor categories as there is no requirement to do so. The basis for determining adherence to the contract financial and technical baselines was the contractor's cost and technical proposals which formed the basis of the contract agreement; 2) and did not define the minimum education and experience requirements for each labor category; however, the award of this contract was based on CTI technical capabilities, that is the experience of its key personnel as identified under Section H, H-8 Key Personnel, as well as the experience of its technical staff as indicated on their resume provided as an attachment to CTI's Technical Proposal. Accordingly, there was not a requirement in the RFP for CTI to provide a certain percentage of hours by labor categories.

3) Section H, H-7, Segregation of Costs, require that the contractor segregate costs incurred at the lowest level of performance, the Task Order. Furthermore, Invoices are to contain summaries of work charged during the period covered, as well as overall cumulative summaries by labor category for all work invoiced to date, by line item or Task Order. Contract did require CTI to bill labor hours, but did not require CTI to track labor costs against labor categories. CTI is required to track labor hours and labor cost they expended against the labor categories that they proposed separately, and provide this information if required.

PAGE/PARA #	AUDIT COMMENT
16/1	CTI proposed labor categories and a labor mix that were different from the labor categories and labor mix that CTI billed, and BMDO had not established procedures to compare the costs. Consequently, CTI was not providing the level of effort

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specified in the contracts as required by FAR 16.306.

BMDO COMMENTS:

This is an incorrect statement. The contract terms and conditions prescribe the level of effort required/agreed to by the parties not the cited FAR reference. The cited FAR reference discusses the general nature of cost-plus-fixed-fee contracts in terms of their selection for use, application and limitations. The contracting officer has a significant degree of latitude in structuring a contract within the prescribed contract types so as to satisfy his/her unique requirements. The BMDO contracts comply with FAR 16.306.

CONTRACT 0010

Clause B-4 provides the number of hours per base period and each option period which are not a fixed amount, but the estimated hours required to accomplish the tasking within the statement of work. The clause puts further conditions on these hours at B-4c. The audit fails to recognize that the Contracting Officer issued Task Orders under this contract with a specific tasking within an estimated cost and for a stated number of hours. This procedure is in accordance with FAR 16.306 and the stated contract terms.

CONTRACT 0012

The audit is factually incorrect. As modified under P00023, CTI is required to provide 207,048 manhours and in accordance with Section B, B-6 Level of Effort is not authorized to exceed 100 percent of the specified level of effort. Through August 15, 1994 CTI expended 192,237 manhours. This amount represents 93% of the manhours specified under the contract. Therefore, CTI is in conformance with the level of effort required under the contract and FAR 16.306.

CONTRACT 0042

Again, the audit is factually incorrect. In accordance with modification P00040, CTI is required to provide 739,057 DPMHs to date and in accordance with Section H, H-3 Level of Effort is not authorized to exceed 110 percent of the specified level of effort. Through August 31, 1994, CTI expended 724,093 DPMHs. This amount represents 98% of the DPMH specified under the contract. Therefore, CTI is in conformance with the level of effort required under the contract and FAR 16.306.

SUMMARY

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The level of effort stated in each contract is an estimate and should be regarded as such. CTI was not required to provide exactly the level of effort stated in Section B of the contracts. The level of effort for two of the contracts (0012 & 0042), were established by task orders. The 0010 contract level of effort was also an estimate. However the successful contract performance was clearly focused on achieving the stated task order objectives. In this regard the audit characterization of a requirement per se is incorrect.

PAGE/PARA #	AUDIT COMMENT
16/2	1) CTI proposed staff hours for "direct labor potentials" which were not associated with any specific skill level or labor category. These direct labor potentials were staff hours for unknown labor categories proposed at various CTI pay levels. 2) Consequently, BMDO could not determine whether actual labor costs were higher than the proposed labor costs for the labor categories that CTI proposed.

BMDO COMMENTS:

CONTRACT 0010

1) This statement is factually incorrect. CTI's "direct labor potentials" did, in fact, list the specific skill levels for the labor hours proposed which represented a CTI labor category. The audit fails to recognize the objectives of this contract and the provisions therein. Contract clause H-9, Task Order Procedure, states that Task Orders will be issued..."designating (1) the task to be performed to include required deliverables; (2) the required delivery dates or overall period of performance; and (3) any Government furnished material." The Task Order was issued after Government approval of the contractor's task plan indicating acceptance of the contractor's "approach, staffing and costing" as required and presented in the task plan. Successful contract performance was defined as achieving the stated objectives of the task order NOT delivering a specified number of hours.

The original proposal dated December 1988 listed "key" employees by name and also proposed "potential" hours under specific direct labor grades which easily translated into a specific skill level by the identification of the skill level number and the rate per hour. Per contract clause H-9, Task Order Procedure, the contractor was not required to identify specific labor categories in the task plan, but to provide their "approach, staffing and costing."

2) It was, therefore, easily determined if actual cost performance was in line with the estimated cost through

calculation and use of a wrap rate analysis. Actual cost performance was also reported in the monthly status from CTI which listed each task and its progress. Therefore, actual costs were monitored from these monthly performance reports.

CONTRACTS 0012 AND 0042

The audit is factually inaccurate. There were no direct labor potentials designated in CTI's proposals which were associated with any specific skill level or labor category. The specific skill level or labor category were provided by CTI as part of their cost proposal. Therefore a relationship was created, made available, and a determination through wrap rate analysis as to whether actual labor costs were in line with proposed labor costs could be made. Also, actual cost performance was reported in the monthly status reports from CTI and could be monitored by the Government. The cost proposal submitted prior to award will never match exactly the actual tasking issued during the life of the contract due to the various levels of tasking. The cost proposal is an estimate and should be viewed as such given the chosen contract type.

PAGE/PARA #	AUDIT COMMENT
16/3	BMDO could not determine whether the total contract labor mix for the proposed labor categories had changed and whether the labor categories provided by CTI were required to perform tasks.

BMDO COMMENTS:

See comments above under 16/2 regarding the delivery of labor hours and labor categories. Additionally, contract 0010 was different from 0012 and 0042 in that BMDO was more concerned with the delivery, quality and timeliness of a product vice delivery of hours.

PAGE/PARA #	AUDIT COMMENT
17/4	**1)** BMDO contracting officers used a "wrap-rate variance" to measure overruns or underruns on the CTI contracts. **2)** The wrap-rate variance was an hourly labor cost variance that BMDO determined by comparing the proposed staff hour cost (proposed costs divided by the proposed staff hours) with the actual staff-hour cost (actual costs divided by actual staff hours). We determined that the wrap-rate variance did not accurately measure

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contract overruns or underruns because the wrap rate variance did not consider such factors as changes in CTI's labor mix, use of subcontractor employees rather than proposed CTI employees, and performance of work at a Government site rather than at the proposed contractor site.

BMDO COMMENTS:

CONTRACTS 0010, 0012 AND 0042

1) This statement is factually incorrect. BMDO Contracting officers did not use a "wrap-rate variance" to measure overruns or underruns on the CTI contracts. The wrap rate variance analysis referred to is delineated in the Contract performance Analysis Summary (CPAS). It is used to compare actual costs per hour to baseline costs per hour as an indicator of labor skill mix trends. The words "overrun" or "underrun" on the CPAS merely refer to trends pertaining to variances in direct labor, ODCs and/or indirect costs and do not measure contract overruns or underruns. Contract overruns are determined at closeout for the purpose of fee determination and are computed using the unique contract terms and conditions. 2) The revised CPAS considers all of these factors through analysis of contractor provided data.

NOTE:

IG statements concerning contract "overruns" and "underruns" are factually inaccurate and incorrectly based on the premise that a contract overrun or underrun exists 1) if individual labor category costs exceed the proposed individual labor category costs; 2) if actual (incurred) indirect costs and rates exceed those proposed; 3) if the proposed labor mix exceeds the actual labor mix; 4) if there is a wrap rate variance. Contract over/underruns are determined by a comparison of the total estimated cost to provide specified level of effort (or achieve stated objectives) with the actual total cost of performance. Absent any of the other factors, the total estimated fee is payable to the contractor irrespective of an overrun. An overrun simply means that such cost over the estimated cost are non-fee bearing. The Government decision to pay "overrun" costs has no effect on reducing the contractor's fee entitlement as the audit has done in computing overpayment of fee.

PAGE/PARA #	AUDIT COMMENT
18/2	**1)** We calculated a labor category cost variance that showed that the contract had an overrun of $206,959, **2)** while the wrap rate cost variance showed an overrun of $430,812. Our analysis showed that the contract had an underrun of

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$285,362 for CTI labor and an overrun of $492,322 for subcontractor labor. 3) CTI did not propose any subcontractor work for contract 10, although several subcontractor employees were included in the CTI proposal as key CTI employees.

BMDO COMMENTS:

CONTRACT 0010

These audit comments exhibit a lack of Government contract comprehension, knowledge and experience in the elementary area of contract type and contract cost principles because:

1&2) The calculation of "Labor category cost variances" or "wrap rate cost variances" in cost reimbursable contracts do not indicate contract "overruns or underruns" but are measurements for technical performance and possible inefficiencies or changing circumstances.

3) Subcontracting, whether or not originally proposed, is allowable.

PAGE/PARA #	AUDIT COMMENT
19/1	CTI voucher C055-84, February 26, 1993, shows that 1) CTI received a 7.75 percent fee on its total costs, including subcontractor costs, and 2) that the fee paid to CTI did not depend on CTI providing a specific level of effort as required by FAR 16.306. Further, 3) CTI is not entitled to a fee of $16,039 that BMDO paid on the cost overrun of $206,959 caused by the subcontractor work.

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BMDO COMMENTS:

CONTRACT 0010

1) CTI voucher in question correctly claimed a fee of 7.75% of incurred costs less the 15% withhold per FAR 52.216-8. FAR 16.306 describes the Cost-plus-fixed-fee contract: "A cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract." Subcontractor costs are an allowable cost and therefore should be included in the total amount of incurred costs.

2) The contractor did satisfactorily achieve the objective(s) of the task orders and CTI is authorized full fee (per hour $3.23/hr). Based on the attached spreadsheet for contract SDIO84-89-C-0010, the contractor's claimed fee and entitled fee are as follows:

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CLIN	0001	0101	0201	0301	0401	TOTAL
Entitled Fee	47,292	79,716	106,391	103,063	43,618	380,080
Claimed Fee	43,831	77,940	98,568	148,270	50,187	418,796
Due to BMDO				45,207	6,569	38,715
Due to CTI	3,461	1,777	7,823			

As noted above, the contractor overbilled fee on CLINs 0301 and 0401. The difference between fee due to CTI and fee due to BMDO is $38,715. A notification of intent to collect overpayment of fee will be forwarded to CTI for their review and response.

3) Subcontracting, whether or not originally proposed, is allowable. The basic premise (and the IG's method of calculating same) of a contract "overrun" is seriously flawed. Therefore, CTI's fee amount is correct and they are entitled to payment.

The fixed fee amounts set forth in the contract at Section B are calculated at 7.75% of estimated total costs. The fee amount claimed represents this percentage of total costs for the contract and the option as exercised in P00027 and definitized in P00029. The definitized fixed fee amount for CLIN 0401 is in accordance with FAR 15.903(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."

PAGE/PARA #	AUDIT COMMENT
19/2	We calculated a labor category cost variance that showed a 1) contract overrun of $1,059,053, while the wrap rate cost variance showed a much 2) lower overrun of $189,531. 3) The majority of the contract overrun for the labor category variance occurred because CTI did not propose any subcontractors and then used subcontractors at an hourly cost that was higher than the CTI hourly cost. 4) CTI is not entitled to fee of $70,429 on the cost overrun of $1,059,053 caused by the subcontractor work.

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BMDO COMMENTS:

CONTRACT 0012

1&2) The calculation of "Labor category cost variances" or "wrap rate cost variances" in cost reimbursable contracts do not

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indicate contract "overruns or underruns" but are measurements for technical performance and possible inefficiencies.

3) CTI did not originally propose to use the services of subcontractors. However, provision H-19, Directed Subcontracting/Consultant Requirement, stated that in order to meet required work which demands particular expertise, the contractor may be directed by the Government to subcontract some of this effort. Task Orders issued by the contracting officer under this contract recognized Advanced Marine Enterprises as a subcontractor to CTI. Subcontracting cost, whether or not originally proposed, is allowable. The $1,059,053 appears to be an erroneous computation of an overrun.

4) The current Contract Performance Analysis Summary through 31 July 1994 indicates that CTI is underrunning the current funding amount, which is within the current value. There is no apparent overrun. Furthermore, fee earned/paid to the contractor is based on the hours delivered in accordance with contract clause B-6 Level of Effort (MANHOURS) which precludes payment of fee on overrun situations. CTI is entitled to the $70,429 fee.

Based on the attached spreadsheet for contract SDIO84-90-C-0012, the contractor's claimed fee and entitled fee are as follows:

CLIN	1,2,3	4	TOTAL*
Entitled Fee	$ 361,527	$ 137,496	$ 499,023
Claimed Fee	$ 373,758	$ 122,331	$ 496,090
Due to BMDO	$ 12,231		
Due to CTI		$ 15,165	$ 2,934

*TOTAL does not include optional CLIN 0501.

PAGE/PARA #	AUDIT COMMENT
20/2	We calculated a labor category cost variance that showed a 1) contract overrun of $1.8M, while the 2) wrap rate variance showed a higher overrun of $2.3M. 3) We determined that 47,281 staff hours of work were performed at a Government site, although CTI proposed no work at a Govt. site. Consequently, when CTI Government site hourly labor costs are compared with CTI proposed contractor site hourly labor costs, a contract underrun is inappropriately created.

BMDO COMMENTS:

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CONTRACT 0042

1&2) The calculation of "Labor category cost variances" or "wrap rate cost variances" in cost reimbursable contracts do not indicate contract "overruns or underruns" but are measurements for technical performance and possible inefficiencies.

3) Modification P00015 added without a change in contract value the Program Assessment Center (PAC) (Government site) to the contract which resulted in some Government site labor (lower cost) being incurred by the contractor. The audit characterized this lower cost as the creation of an "inappropriate underrun", even though a decrease in cost or underrun accrues a savings for the Government. The cost to the contractor for providing the PAC plus other open contractual issues involving cost and fee considerations remain to be negotiated on this contract.

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PAGE/PARA #	AUDIT COMMENT
22/1	The contractor is not entitled to fee of $63,670 on indirect cost rate increases of $849,335 because the fee is fixed to the negotiated indirect cost rates at contract award.

BMDO COMMENTS:

CONTRACT 0010

The audit report states incorrectly that the "fee is fixed to the negotiated indirect cost rates a contract award." The fee on a CPFF contract is a fixed negotiated amount, and is not fixed to any specific cost element.

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PAGE/PARA #	AUDIT COMMENT
22/2	The CTI fee was incorrectly based on a percentage of actual costs.

BMDO COMMENTS:

CONTRACT 0010

This statement is factually inaccurate. The fee was a fixed amount at award. Fee was appropriately billed as a percentage of cost incurred (less withholds) during contract performance.

See FAR 16.101 which states that a cost-plus-fixed-fee contract is a contract type in which "the contractor has minimal responsibility for the performance costs and the negotiated fee (profit) is fixed." Each contract contained provisions which specifically fixed the amount of fee payable under the contract. The audit appears to have confused the process of billing fee during the contract performance and the contractor's total fee entitlement upon contract closeout.

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See also FAR 16.306, Cost-plus-fixed-fee contracts, which states that a "cost-plus-fixed-fee contract is a cost-reimbursement contract that provides for payment to the contractor of a negotiated fee that is fixed at the inception of the contract. The fixed fee does not vary with actual cost, but may be adjusted as a result of changes in the work to be performed under the contract."

See also FAR 15.903, Contracting officer responsibilities, which states at (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."

PAGE/PARA #	AUDIT COMMENT	
22/2	BMDO COs based fixed fee payments on the level of effort associated with CTI's proposed labor mix in the basic contract, even though the labor mix CTI actually delivered was different.	Page 21

BMDO COMMENTS:

CONTRACT 0012

This statement implies such a calculation is incorrect which is misleading and represents a fundamental lack of understanding of the contract provisions. In accordance with provision B-6 Level of Effort (Manhours), the fixed fee is based upon the furnishing of the specified level of effort, and not on the proposed labor mix. The proposed labor mix, rates, and other factors (proposed prior to award) serve as a basis for the Government and contractor to negotiate an estimated cost and fixed fee for the effort and ultimately serve as part of the "specification" in the CPFF "term" form of contract. The hours in the contract are the Government's estimate of the number of hours required for contract performance (which are subsequently modified through the task ordering process in response to specific work requirements). Labor categories (mixes) and rates in the contractors proposal are not fixed entities throughout the entire contract period of performance. Furthermore, as changes did occur in the labor mix, it was authorized by the contracting officer by issuance of the task order. Any cost in excess of the approved amount would not be fee bearing. Note that the 0012 contract was UNDERRUN. The audit calculation of an overrun is unorthodox and incorrect.

PAGE/PARA #	AUDIT COMMENT	
22/2	BMDO COs based fixed fee payments on the level of effort associated with CTI's proposed labor mix in	Page 21

the basic contract, even though the labor mix CTI actually delivered was different.

BMDO COMMENTS:

CONTRACT 0042

This statement implies such a calculation is incorrect which is misleading and represents a fundamental lack of understanding of the contract provisions. In accordance with provision H-3 Level of Effort (Manhours), the fixed fee is based upon the furnishing of the specified level of effort, and not on the proposed labor mix. The proposed labor mix, rates, and other factors (proposed prior to award) serve as a basis for the Government and contractor to negotiate an estimated cost and fixed fee for the effort and ultimately serve as part of the "specification" in the CPFF "term" form of contract. The hours in the contract are the Government's estimate of the number of hours required for contract performance (which are subsequently modified through the task ordering process in response to specific work requirements). Labor categories (mixes) and rates in the contractors proposal are not fixed entities throughout the entire contract period of performance. Furthermore, as changes did occur in the labor mix, it was authorized by the contracting officer by issuance of the task order. Any cost in excess of the approved amount would not be fee bearing. Note that the 0042 contract was overrun and the cost associated with the overrun were/are not fee bearing. The audit calculation of the overrun amount is unorthodox and incorrect. Given the fee withhold provisions of the contract, the Government has not overpaid the CTI fee entitlement for this contract.

Based on the attached spreadsheet for contract SDIO84-89-C-0042, the contractor's approximate claimed fee and entitled fee are as follows:

CLIN	0001	0002	0003	0004	TOTAL
Entitled Fee	$762,500	$444,714	$459,670	$475,772	$2,142,656
Claimed Fee	$712,403	$467,907	$480,970	$484,281	$2,145,561
Due to BMDO		$ 23,193	$ 21,300	$ 8,509	$ 2,905
Due to CTI	$ 50,097				

RECOMMENDATIONS FOR CORRECTIVE ACTION - FINDING A

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RECOMMENDATION A.1.a & b: NON-CONCUR

COMMENT: The findings that BMDO failed to obtain timely and complete task plans is predicated on data that is over two years old. BMDO corrected this deficiency two years ago and therefore no corrective action is necessary. Additionally, BMDO does not consider it appropriate to establish procedures to verify that contracting officers are complying with the stated terms of contracts. These actions by contracting officers are fundamental to their job performance. Compliance is therefore "verified" via more generalized management oversight.

RECOMMENDATION A.2.a & b: CONCUR

COMMENT: The recommended procedures have already been included in a DCTO Operating Instruction which is due to be published 15 December.

RECOMMENDATION A3: The computation of fee is incorrect. The final payment of fixed fee to include the release of existing fee withholds will be accomplished at contract closeout. At this time BMDO has not overpaid fixed fee for the three CTI contracts.

FINDING B

FINDING: B: Subcontractor Costs

PAGE NUMBER: 25-31

PARAGRAPH HEADING: All

CONCUR/NON-CONCUR: N/A - This finding to be responded to by DLA except as follows:

PAGE/PARA #	AUDIT COMMENT
29/1	"Before awarding any CPFF subcontracts, 10 U.S.C. 2306(e) that the prime contractor notify BMDO. Consequently, we believe that the BMDO needs to notify the administrative contracting officer of subcontracts awarded under BMDO CPFF contracts after completion of the basic contract negotiations."

BMDO COMMENTS:

The reference to 10 U.S.C. 2306(e) is misleading and does not reflect the implementing regulations under FAR 42.302(51) and 44.202-1. The conclusion that the BMDO notify the ACO is clearly inappropriate and reflects a lack of understanding of the contract administration process. Note that the cited US Code requires that certain contracts contain requirements that the "agency" be notified in advance of the prime contractor placing specified subcontracts. The CTI contracts complied with this requirement in that they contained the clauses at FAR 52.244-2. This clause establishes the notice and consent to subcontract requirements for subcontract management and assure compliance with the statutory requirement for notice to the "agency". Note that, pursuant to the clause, consent is required for subcontracts requiring "notice" under certain conditions. The notice and consent requirements are subcontract management functions which have been delegated to the ACO as a automatic delegation pursuant to FAR SubPart 42.302. The contractor is therefore required to give the ACO "notice." Herein, the agency (BMDO) is represented by the ACO.

RECOMMENDATION FOR CORRECTIVE ACTION - FINDING B

RECOMMENDATION B.1: **NON-CONCUR**

BMDO COMMENT:
The notice and consent to sub-contract are to be provided to the ACO pursuant to the contract terms and conditions. This recommendation is therefore inappropriate.

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*Page 21 blank.

FINDING C

FINDING: C: Contractor and Subcontractor Labor Charges

PAGE NUMBERS: 32-35

PARAGRAPH HEADING: All

CONCUR/NON-CONCUR: Concur

BMDO COMMENTS:

While the computer-processed-login-logout record is not a completely accurate record of when personnel are present at the BMDO worksite, it gives some indication of when personnel are at their BMDO worksite. It should be noted that this system is not a labor charging/accounting system and should not be used as such. The data available from the system does not provide the degree of accuracy necessary for such a task. The Contracting Officer has sent the contractor a letter of intent to disallow the costs considered inappropriate based upon the DOD/IG's finding without waiting for such findings to be verified by DCAA's audit of the contract. The DOD/IG is requested to provide the backup data, supporting the finding, to the Contracting Officer so it can be brought to the attention of the contractor during discussions to recover the costs. We have also brought the finding to the attention of the BMDO General Counsel for review to consider the potential for fraud.

RECOMMENDATION FOR CORRECTIVE ACTION - FINDING C

RECOMMENDATION C.1 & 2: CONCUR

BMDO COMMENT:

The Contracting Officer has sent the prime contractor a letter Notice of Intent to Disallow Costs.

FINDING D

FINDING: D: Other Direct Costs

PAGE NUMBER: 36-42

PARAGRAPH HEADING: Questionable Miscellaneous Items; Questionable Travel Costs and Duplicate Billings; Subway Commuting Costs

CONCUR/NON-CONCUR: Partially Concur

BMDO COMMENTS:

BMDO concurs that the Inspector General has identified costs which may not be allowable in accordance with FAR Part 31 and DFARS Part 231. Specific disallowances will take into consideration the recommendations of the DCAA auditor and any factual information which the contractor may provide.

Note that Table 9 "Questionable Other Direct Costs" in the draft audit report, has several arithmetic errors. If the "Communications Equipment" cost for the 42 contract is $9,411, the total cannot be $1,512. For "Catered Meals", $3,689 plus $2,249 equals $5,938, not $5,888. The subtotals for contracts 10 and 42 are incorrect.

Coffee Services, Catered Meals: The issues regarding coffee services will be resolved in accordance with FAR 31.205-13. Generally, losses from operating food services cannot be recovered if the food services are furnished without charge. Similarly, regarding catered meals, BMDO expects that "straight arrow" procedures will be applied rigorously. Meals provided to Government personnel without charge are clearly not an allowable cost.

Parking Spaces: There is no contract cost principle which governs parking spaces. This issue will be referred to the ACO and the cognizant DCAA auditor for a determination on the basis of reasonableness and consistency.

Cable Television, Periodicals and Publications: Based on the information provided in the audit report, it is apparent that these services, periodicals and publications would generally not have any usefulness or value except in the context of direct support to BMDO. For instance, Dun and Bradstreet reports were acquired to verify the financial condition of specific potential offerors during formal source selections. These issues will be referred to the ACO and the cognizant DCAA auditor for determination on a case by case basis.

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Recruitment Efforts: BMDO concurs that generally these costs should be indirect costs but are subject to the contractors established and approved accounting practices.

Communications Equipment and Services: The contracting officer has taken action to disallow these cost.

Questionable Travel Costs, Duplicate Billings: These issues will be referred to the ACO and the cognizant DCAA auditor for a determination on the basis of reasonableness and consistency. Note, that the net cost for a lost ticket should only be a $60 fee, if the normal procedures were followed.

Subway Commuting Costs: The subway costs were included in the initial CTI cost proposal and accepted as proposed by the Government. The audit recommendation is flawed for two reasons. First, BMDO has no authority to apply a policy intended for Government personnel to contractor personnel. Second, from a strict time and motion point of view, the recommendation would clearly result in increased costs.

DoD Instruction 4515.7, "Use of Motor Transportation and DoD Bus Service in the National Capital Region" governs the shuttle bus service. The instruction establishes an order of preference for Government personnel. DoD scheduled bus service is first. Scheduled public transportation (Metrorail or Metrobus) is second. There is nothing in this Instruction which explicitly contemplates that bus service will be provided to contractor personnel. Compulsory use by contractor personnel is clearly outside of current policy. However, occasional use on a space available basis is apparently contemplated under current policy. Further, our support contractors do use both the DoD shuttle bus and the Metro. If the Inspector General wishes to establish a policy requiring contractor personnel to use only the DoD shuttle bus, it would be most appropriate to coordinate this position with Washington Headquarters Services.

If a policy to this effect were established, a number of issues would have to be addressed. (1) If the numerous contractor personnel in the Crystal City area used the DoD shuttle, would there be room for DoD personnel. (2) Additional busses and drivers would be required. Is it reasonable for DoD to pay for additional buses, drivers and fuel to compete with the Metro over a distance where the Metro is faster and the fare is $1.00. (3) From the point of view of public policy, including energy policy and pollution, does this make sense.

In any case, the economic argument is flawed because it doesn't include the cost of the contractor's time as an incremental cost. If the services of the contractor person costs the Government $50 per hour, an additional five minutes of unproductive time riding the bus costs the Government $4.16. If

the contractor person saves only 1.2 minutes of productive time by choosing the quickest mode of transportation, he/she has covered the $1 cost of the metro trip. Generally, the metro is five or ten minutes faster than the bus, and the Inspector General recommendation would clearly represent a dollar loss rather than a dollar gain.

The shuttle bus runs once every fifteen minutes. From Jefferson Plaza 2 to the Bus Stop B is 20 minutes. From Bus Stop B to Jefferson Plaza 2 is 10 minutes. The walk from Bus Stop B to a typical office in BMDO is 6 1/4 minutes. The total from Crystal City is 26 1/4 minutes. The total from BMDO to Crystal City is 16 1/4 minutes.

The metro runs every three minutes during rush hour and every six minutes during non-rush hour. Three minutes is the time from Crystal City to the Pentagon. On a non-rush hour basis, a trip from Crystal City to a typical office in BMDO is 7 minutes and 20 seconds (riding the escalator up). The reverse trip is 6 minutes and 35 seconds (walking down the escalator).

The cost savings claimed are illusory and the recommended policy would increase costs overall.

RECOMMENDATION FOR CORRECTIVE ACTION - FINDING D

RECOMMENDATION D.1: PARTIALLY CONCUR

BMDO COMMENT: The audit does not provide a sufficient basis for determining a disallowance of cost in all cases. The action will be referred to the ACO for determining the relevant facts and disposition of any disallowance.

RECOMMENDATION D.2: NON-CONCUR

BMDO COMMENT: This recommendation is beyond the scope of the COTR authority and capability. Note that the nature of the costs referred to in the finding could be direct or indirect depending on the prevailing facts. The COTR is not responsible or capable of determining the direct or indirect nature of cost during the contract performance. This is a function of the administrative contracting officer on advice of the DCAA auditor. Such determinations are generally made during periodic incurred cost audits and at contract closeout.

RECOMMENDATION D.3: CONCUR

BMDO COMMENT: This action will be referred to the ACO for determination of the relevant facts and disposition of any cost disallowance.

RECOMMENDATION D.4: NON-CONCUR

BMDO COMMENT: This recommendation is beyond the scope of the COTR authority and capability. Note that the nature of the costs referred to in the finding require the determination of allowability. The COTR is not responsible or capable of making such a determination. This is a function of the administrative contracting officer on advice of the DCAA auditor. Such determinations are generally and routinely made during periodic incurred cost audits and at contract closeout.

RECOMMENDATION D.5: NON-CONCUR

BMDO COMMENT: This recommendation is not practical or economical for reasons stated in the comments above. Additionally, the recommendation is without regulatory basis and should be removed.

SDIO84-88-C-0010 - CTI

CLIN	POP	HRS (P00029)	HRS DELIVERED (INVOICES)	DIFFERENCE
0001	18 OCT 88 - 17 OCT 89	20,616	14,641.5	5,975
0101	18 OCT 89 - 17 OCT 90	41,232	24,156.5	17,076
0102	18 OCT 90 - 17 OCT 91	31,135	31,514.3	(379)
0103	18 OCT 91 - 17 OCT 92	41,739	33,902.2	7,837
0104	18 OCT 92 - 17 OCT 93	9,234	15,141.0	(5,907)
		143,956	119,355.5	24,601

PER CONTRACT

CLIN	0001	0101	0201	0301	0401	TOTALS
COST	$858,736	$1,757,318	$1,372,777	$1,636,315	$562,807	$6,187,953
FEE	$66,552	$136,192	$106,391	$126,814	$43,618	$479,567
TOTAL	$925,288	$1,893,510	$1,479,168	$1,763,129	$606,425	$6,667,520
HOURS	20,616	41,232	31,135	41,739	9,234	143,956
AWARDED COST/HR	**$41.65**	**$42.62**	**$44.09**	**$39.20**	**$60.95**	**$45.70 AVG**
AWARDED FEE/HR	**$3.23**	**$3.30**	**$3.42**	**$3.04**	**$4.72**	**$3.54 AVG**
AWARDED TOTAL/HR	**$44.88**	**$45.92**	**$47.51**	**$42.24**	**$65.67**	**$49.24 AVG**

PER INVOICE #	1055-021 services thru 30-Nov-89	1055-045 services thru 30-Nov-90	1055-067 services thru 15-Nov-91	C055-82 services thru 15-Oct-92	C055-84 services thru 31-Dec-92	TOTALS
COST	$611,014.54	$1,211,799.89	$1,504,411.78	$2,268,033.37	$647,578.95	$6,242,839
FEE	$43,830.63	$77,939.83	$98,568.05	$148,269.70	$50,187.37	$418,796
TOTAL	$654,845.17	$1,289,739.72	$1,602,979.83	$2,416,303.07	$697,766.32	$6,661,634
HOURS AUTHORIZED	**14,641.5**	**24,156.5**	**31,514.3**	**33,902.2**	**15,141.0**	**119,355.50**

*FEE CLAIMED/PAID DOES NOT INCLUDE 15% WITHHELD FEE

ENTITLEMENT

COST INVOICED	$611,014.54	$1,211,799.89	$1,504,411.78	$2,268,033.37	$647,578.95	$6,242,838.53
COST OVERRUN	$1,196.06	$162,249.86	$114,946.29	$939,067.13	($275,265.00)	$962,194.34
ENTITLED COST*	$609,818.48	$1,029,550.03	$1,389,465.49	$1,328,966.24	$922,843.95	$5,280,644.19
ENTITLED FEE**	$47,292.05	$79,716.45	$106,391.00	$103,062.69	$43,618.00	$380,080.19
TOTAL ENTITLED CPFF***	$658,306.59	$1,291,516.34	$1,610,802.78	$2,371,096.06	$691,196.95	$6,622,918.72
FUNDS TO BE RECLAIMED (BILLED FEE LESS ENTITLED FEE)	($3,461.42)	($1,776.62)	($7,822.95)	$45,207.01	$6,569.37	$38,715.39
HOURS	14,641.5	24,156.5	31,514.3	33,902.2	15,141.0	119,355.50
FEE/HOUR	**$3.23**	**$3.30**	**$3.38**	**$3.04**	**$2.88**	**$3.18 AVG**
TOTAL/HOUR	**$44.96**	**$53.46**	**$51.11**	**$69.94**	**$45.65**	**$55.49 AVG**

* ENTITLED COST = AWARDED COST PER HOUR * HOURS AUTHORIZED

** ENTITLED FEE = AWARDED FEE PER HOUR * HOURS AUTHORIZED (NOTE: CLINs 0201 AND 0401 EQUAL MORE THAN AWARDED FIXED FEE, THEREFORE ENTITLED FEE IS EQUAL TO FIXED FEE.

***TOTAL = COST INVOICED + ENTITLED FEE

PER CONTRACT SDIO84-90-C-0012
FEE ON LABOR HOURS PER CLAUSE B-6 LEVEL OF EFFORT

CLIN	BASE PERIOD 0101, 0201, 0301	OPTION 1 0401	OPTION 2 0501	TOTALS
COST	$4,820,364	$1,833,282	LAST PERIOD	$6,653,646
FEE	$361,527	$137,496	INCOMPLETE	$499,023
TOTAL	$5,181,891	$1,970,778	DATA	$7,152,669
HOURS	141,384	51,800		193,184

PER INVOICE #	C083-65 services thru 30-Jun-93	C083-84 services thru 15-Jun-94	TOTALS
COST	$4,780,266.14	$1,654,189.61	$6,434,456
*FEE	$373,758.31	$122,331.19	$496,090
TOTAL	$5,154,024.45	$1,776,520.80	$6,930,545
HOURS	137,358	47,969	185,327

	ENTITLEMENT		TOTAL ENTITLEMENT
COST	$4,780,266.14	$1,654,189.61	$6,434,456
FEE	$361,527.00	$137,496.00	$499,023
TOTAL	$5,141,793.14	$1,791,685.61	$6,933,479

*Note. 1. Fee claimed does not reflect 15% up to $100,000 withheld.
2. Invoiced amounts shown are derived from cost and fee associated with labor hours delivered.

PER CONTRACT SDIO84-89-C-0042
FEE ON LABOR HOURS PER CLAUSE H-3 LEVEL OF EFFORT

CLIN	0001	0002	0003	0004	TOTALS
COST	$10,807,281	$5,929,516	$6,128,930	$6,306,329	$29,172,056
FEE	$762,500	$444,714	$459,670	$475,772	$2,142,656
TOTAL	$11,569,781	$6,374,230	$6,588,600	$6,782,101	$31,314,712
HOURS	277,537	153,840	153,840	153,840	739,057

PER INVOICE #	1076-044 services thru 30-Sep-91	Report services thru 31-Jul-92	1076-84 services thru 30-Jun-93	1076-112 services thru 15-Sep-94	TOTALS
COST	$10,310,470	$6,781,286	$6,896,639	$7,743,887	$31,732,281
*FEE	$712,403	$467,907	$480,970	$484,281	$2,145,561
TOTAL	$11,022,873	$7,249,192	$7,377,609	$8,228,168	$33,877,842
HOURS	266,828.5	159,320.0	151,454.1	150,195.8	727,798.40

	ENTITLEMENT				TOTAL ENTITLEMENT
COST	$10,310,470	$6,781,286	$6,896,639	$7,743,887	$31,732,281
FEE	$762,500	$444,714	$459,670	$475,772	$2,142,656
TOTAL	$11,072,970	$7,226,000	$7,356,309	$8,219,659	$33,874,937

*Note. 1. Fee claimed does not reflect 15% up to $100,000 withheld.
2. Invoiced amounts shown are derived from cost and fee associated with labor hours delivered.

Defense Logistics Agency Comments

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

IN REPLY REFER TO DDAI

7 DEC 1994

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING, DEPARTMENT OF DEFENSE

SUBJECT: OIG Draft Audit Report Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization (Project No. 2CH-5031.01)

This is in response to your 2 September 1994 request.

3 Encl

JACQUELINE G. BRYANT
Chief, Internal Review

cc:
AQCBA
AQCOE

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization **(Project No. 2CH-5031.01)**

FINDING B: Subcontractor Costs. CTI awarded five CPFF subcontracts, with a total value of about $12.9 million, that were administered as prohibited cost-plus-a-percentage-of-cost contracts under the three BMDO prime CPFF contracts with CTI. CTI also failed to obtain cost or pricing data and to perform cost analyses for three of the subcontracts, valued at about $6.5 million. These conditions occurred because BMDO did not notify the administrative contracting officer of CPFF subcontracts awarded by CTI after negotiation of the basic contract, and because the administrative contracting officer did not recommend CTI for a contractor purchasing system review (CPSR) or provide CTI with consent to subcontract. As a result, CTI was using a prohibited system of contracting that rewarded inefficiency and noneconomical performance from its subcontractors, and neither CTI nor BMDO could determine whether subcontract prices were reasonable.

DLA COMMENTS: Concur. The subject DoD IG audit report noted that, although BMDO assigned administration of the three CTI prime contracts cited above to the DLA Administrative Contracting Officer (ACO), the ACO had no means of detecting subsequent CTI subcontract awards without notification from either BMDO or CTI. We agree with these findings and further concur that the ACO should have obtained a Contractor Purchasing System Review (CPSR) or provided CTI with consent to subcontract to determine whether subcontract prices were reasonable.

It should be noted that the ACO had previously reviewed CTI as a candidate for a Contractor Purchasing System Review (CPSR), but due to CTI's relatively small overall size, the CPSR team's limited resources, and the few Requests for Consent to Subcontract, the contract administration office did not schedule one. In light of the DoD IG's concerns, we forwarded a new request to the cognizant CPSR Component Leader on 12 Oct 94. As a requisite to initiating a CPSR, prime contractors are asked to provided preliminary information via a questionnaire. CTI has received the questionnaire and is currently preparing their response. Once the information is received, the CPSR team will review it and determine the scope and scheduling of the review.

In addition to requesting a CPSR for CTI, the ACO is conducting limited subcontract consent activity on contract 0042 in response to BMDO's 14 Apr 94 request for this support.

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: Joe Hugar, AQCOE, 47751
REVIEW/APPROVAL: Robert P. Scott, Exec Dir, Contract Mgmt, 2 Dec 94
COORDINATION: Frank Lalumiere, Team Chief, AQCOE, 47751
Charles Bartlett, COL, USA, AQCO, 43013
Eileen Sanchez, FOE, 46220
D. Stumpf, DDAI, 2 Dec 94
J Bryant, DDAI, 2 Dec 94

DLA APPROVAL: 7 DEC 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
Principal Deputy Director

TYPE OF REPORT: AUDIT

PURPOSE OF INPUT: INITIAL POSITION

AUDIT TITLE AND NO: Draft Report on Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization **(Project No. 2CH-5031.01)**

RECOMMENDATION 2.a.: We recommend that the Director, Defense Logistics Agency, instruct the administrative contracting officer for contracts SDI084-89-C-0010, SDI084-90-C-0012, and SDI084-89-C-0042 with Comprehensive Technologies, Incorporated, to determine fair and reasonable subcontract costs and seek recovery of any overpayments on the contracts.

DLA COMMENTS: Concur. DLA is working in conjunction with BMDO to validate CTI's subcontract costs. We have asked DCAA to review these costs and initiate any assist audits required to fully account for and analyze their appropriateness. The ACO will request any further audits or technical assessments as required by the procuring agency to determine fair and reasonable subcontract costs and to make any necessary payment adjustments.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 30 Apr 95
( ) Action is considered complete.

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.

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DLA APPROVAL:

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AUDIT TITLE AND NO: Draft Report on Small Business Administration Section 8(a) Support Services Contracts at the Ballistic Missile Defense Organization **(Project No. 2CH-5031.01)**

RECOMMENDATION 2.b.: We recommend that the Director, Defense Logistics Agency, request the administrative contracting officer to initiate action to conduct a contractor purchasing system review of Comprehensive Technologies, Incorporated, and develop a surveillance plan to ensure that the contractor is effectively managing its purchasing program or provide CTI with consent to subcontract.

DLA COMMENTS: Concur. As stated in Finding b above, on 12 Oct 94, the ACO requested the CPSR team to perform a CPSR for CTI. Our CPSR Component Leader contacted CTI on 13 Oct 94 to initiate the CPSR process. The contractor is currently responding to the requisite CPSR questionnaire mentioned above, and is scheduled to return it by 14 Nov 94. It is estimated that CTI's CPSR will be completed by the 2nd Quarter 1995. A firm date will be established when the CPSR team receives and has analyzed CTI's questionnaire data.

DISPOSITION:
(X) Action is ongoing. Estimated Completion Date: 30 Apr 95
( ) Action is considered complete.

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.

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DLA APPROVAL:

7 DEC 1994

LAWRENCE P. FARRELL, JR.
Major General, USAF
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Audit Team Members

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

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