

**Statement of Mr. William H. Reed  
Director, Defense Contract Audit Agency  
Senate Armed Services Committee  
April 19, 2007**

Mr. Chairman, members of the Committee, my statement will summarize the Defense Contract Audit Agency's (DCAA) oversight of contract costs related to military operations and reconstruction in Iraq including audit work related to the Logistics Civil Augmentation Program.

**DoD Contract Performance Oversight Responsibility**

DCAA has been an integral part of the oversight and management controls instituted by DoD to ensure integrity and regulatory compliance by contractors performing services in Iraq. DCAA's services include audits and professional advice to acquisition officials on accounting and financial matters to assist them in the negotiation, award, administration, and settlement of contracts. Decision-making authority on DCAA recommendations resides with contracting officers within the procurement organizations who work closely with DCAA throughout the contracting process.

**DCAA Staffing and Actions**

Since April 2003, DCAA has worked with all U.S. procurement organizations, including those of the United States Agency for International Development and the State Department, to establish the resources and planning information needed to provide audits of contracts for Iraq Reconstruction. To carry out these extensive audit requirements, DCAA opened an office in Iraq in May 2003 and implemented planning and coordination procedures to effectively integrate audit work between that office and more than 50 DCAA CONUS Audit Offices with cognizance of companies performing contracts in Iraq. DCAA is responsible for auditing Iraq-related

contracts at 93 contractors. These contractors hold more than 175 prime contracts with contract ceiling amounts of \$51.8 billion, of which \$38.5 billion had been funded at the end of FY 2006.

DCAA audits of cost-reimbursable contracts represent a continuous effort from evaluation of proposed prices to final closeout and payment. Initial audits of contractor business system internal controls and preliminary testing of contract costs are carried out to provide a basis for provisional approval of contractor interim payments and early detection of deficiencies. Comprehensive contract cost audits are performed annually throughout the life of the contract and are used by the contracting activity to adjust provisionally approved interim payments and ultimately to negotiate final payment to the contractor.

### **DCAA Audit Results**

Through FY 2006 DCAA has issued more than 1,800 reports on Iraq-related contracts. We estimate issuing another 600 reports in FY 2007. DCAA oversight of contracts in Iraq has found a number of problems. Our actions have ranged from recommending changes in business processes – to reduction of proposed or billed costs – to referral of our findings to the Inspector General for investigation and possible legal action against a contractor. Overall, these audits have recommended reductions in proposed and billed contract costs of \$4.9 billion. Where appropriate, DCAA has taken action to reduce contractor billed costs for disputed amounts pending a contracting officer decision. In addition, DCAA has identified \$5.1 billion of estimated costs where the contractor did not provide sufficient information to explain the basis for the estimated amounts. These unsupported costs were usually resolved through contractor submission of additional supporting information at the time of contract price negotiation.

## **Logistics Civil Augmentation Program**

The Logistics Civil Augmentation Program or LOGCAP is the single largest Iraq-related contract. The LOGCAP contract was awarded to the Halliburton subsidiary, Kellogg, Brown and Root (KBR) and currently has a contract ceiling of \$22.5 billion. The contract provides for logistical and life support for U.S. troops and civilians in Iraq, Kuwait and Afghanistan. DCAA has provided comprehensive and continuous contract audit oversight on the LOGCAP program. The results of our audit work to date by major type of activity are as follows:

1. Support to Army Contracting Officers in the Pricing of Contracts - DCAA audits of 68 LOGCAP task order proposals valued at \$16.2 billion resulted in audit exceptions (costs questioned) of \$1.9 billion. DCAA has received and analyzed the results of negotiations on task orders valued at \$12.8 billion. Negotiated price reductions of \$600 million have been achieved to date. A recent example of our audit work in this area is our review of the proposal for task order 139. Task order 139 is the latest order for dining facilities, laundry and other life support measures for the U.S. troops and civilians. Our review of the initial proposal was completed in August 2006. DCAA questioned \$262 million of the \$3.7 billion proposal. KBR agreed to \$160 million of the questioned cost and the balance was addressed at recent negotiations. Most notable is that this pricing action was a significant improvement over previous similar proposal reviews which were plagued by estimating deficiencies, causing multiple proposal submissions and delays in negotiating the task order price.
2. Reliability of Business Systems Affecting Contract Costs – DCAA audits have addressed the adequacy of contractor internal controls and business systems, as well as compliance with acquisition regulations and contract terms. While KBR’s business systems are

adequate overall, DCAA reviews have disclosed a number of estimating and accounting system deficiencies requiring improvement. The contractor has submitted corrective action plans and DCAA, in coordination with the responsible contracting officers, are monitoring progress in making the needed improvements.

3. Accelerated Testing of Billed Costs - Due to the unique risks of contingency contracting and conditions in Iraq, DCAA has placed more emphasis on examining contractor costs as they are being incurred, rather than waiting until the contractor submits its annual incurred cost claim. One example of our audit work in this area is our review of dining facility costs. KBR provides meal services to the troops and other DoD personnel at over 60 dining facilities in Iraq and Kuwait. DCAA audits beginning in late 2003 found that KBR and its subcontractors were basing their payment requests on an estimated number of meals which substantially exceeded the actual number of meals served. For the period May 2004 to May 2005, DCAA withheld \$212 million from KBR interim billings pending resolution of this matter. KBR and its subcontractors believed that the terms of their respective contracts and subcontracts permitted this billing practice. The Army contracting officer negotiated a settlement which denied reimbursement of \$55.1 million of the actual cost. The early identification of this issue by DCAA, and the support of the Army Sustainment Command contracting officials, led to KBR negotiating new subcontracts which corrected the billing practices of concern to DCAA and the Army. We estimate that the new subcontract terms and prices saved more than \$200 million over what would have been paid under the old subcontract terms for a comparable period.

In this example and others, DCAA worked closely with the Army acquisition community, both at the Headquarters and field level, to reduce contractor billed costs for potentially

unreasonable expenditures. In the past, DCAA withholdings have totaled more than \$230 million on LOGCAP task orders. Currently, DCAA is withholding \$49.6 million from KBR billings. A recent example is the withholding related to security costs. The LOGCAP contract specifically states that the Army will provide necessary security to contractor personnel performing on the contract. As such, the Army believes costs incurred by KBR and its lower tier subcontractors for security are unallowable and should not be reimbursed under the LOGCAP contract. DCAA is working with the Army to identify lower tier subcontractor security costs and the Army has directed DCAA to withhold \$19.7 million from KBR billings.

### **Closing**

In closing, I want to underscore that DCAA is an integral part of the oversight and management controls instituted by DoD to ensure an integrated and well-managed contract audit process in Iraq. We have had a continuous presence in Iraq and the Middle East Theatre of Operations since May 2003, staffing our office entirely with civilian volunteers. To date more than 180 DCAA auditors have served tours and fortunately, none have been injured or killed. The challenges in applying business practices and auditing in Iraq are daunting and have required our auditors to be flexible while insisting that the Department will not tolerate the billing of costs that do not comply with contract terms or are not appropriately documented and supported. DCAA has been and will continue to be vigilant about contract audit oversight and protecting the taxpayers' interests.

I look forward to addressing whatever questions or comments you have on DCAA's important role in Iraq. Thank you.