

Senate Democratic Policy Committee Hearing

“Safeguarding Taxpayer Dollars in Iraq: An Insider’s View of Questionable Contracting Practices by KBR and the Pentagon”

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Chairman Dorgan and distinguished members of the Committee, thank you for the opportunity to appear before you today and share my experience managing the Logistics Civil Augmentation Program (LOGCAP) III contract in Iraq. My name is Charles Smith and I previously served as Chief of the Army’s Field Support Command Division, which was responsible for the LOGCAP III contract and Army War Reserve contracts. Prior to that, I managed various United States Army contracting teams at several organizational levels. I have a B.A. degree in Philosophy and Economics from Washington & Lee University and hold a master’s degree in Public Administration from the Kennedy School of Government at Harvard.

During my time as Chief of the Field Support Command Division, I personally saw KBR submit over \$1 billion worth of unsupported charges to the government. The Defense Contract Auditing Agency (DCAA) documented as much as \$1.8 billion in unsupported costs during that time. Instead of tightening controls over the contract, the Pentagon essentially outsourced oversight over LOGCAP III from the DCAA to a private contractor and waived its normal 15 percent withholding of payment prior to negotiation of estimated costs. The whole process was irregular and highly out of the ordinary. The interest of a corporation, KBR, not the interests of American soldiers or American taxpayers, seemed to be paramount. In 31 years of doing this work, I have never seen anything like the way KBR’s unsupported charges were handled by the Department of Defense.

The years that I spent overseeing the LOGCAP III contract were initially the most fulfilling of my career, because I felt that the services provided under the contract were a key component to the well-being of U.S. troops during wartime. Were it not for the Army's decision to remove me from my position managing the LOGCAP III contract, I would still be serving the military. The Army's decision to remove me from supervision of the LOGCAP contract essentially ended my career with the Army, and made it impossible for me to be promoted to positions of greater responsibility. This was a bitter end to my 31-year career.

LOGCAP III was critical to the life support and comfort of troops in Iraq and, therefore, to the success of their mission. The contract was designed to provide an immediate response to a contingency operation, with the contractor providing Combat Support/Combat Service Support (CS/CSS). So that services under the LOGCAP III contract could begin immediately upon receipt of a request from the Combatant Commander, task orders were awarded on an "un-priced" basis. This meant that the Army used a rough estimate of costs to commence performance. From the inception of hostilities in Afghanistan in 2002, we awarded numerous task orders to KBR on this basis. With the commencement of the war in Iraq in 2003, the number and size of task orders increased exponentially. Awards under LOGCAP III have run at the approximate rate of \$5 billion per year. Oversight support from the Defense Contract Management Agency (DCMA) and the DCAA were also understaffed.

The Department of Defense understaffed management of the LOGCAP III contract from the beginning. During an earlier phase of the LOGCAP contract, known as LOGCAP II, the government provided me with a two and a half-person management team that consisted of a contract officer, a contract specialist, and a part-time lawyer. This provided management for a project worth approximately \$100 million per year. For LOGCAP III, I was once again provided

an management staff of two and a half—but this time it was for a contract that ended up amounting to fifty times more money (\$5 billion dollars per year).

Given the unsupported charges submitted by KBR, that management and oversight was sorely needed. To give two examples, KBR submitted inflated meal counts that did not match DCAA's data on camp populations. The company also submitted invoices for more trucks than could reasonably have been used by the military. Of the more than \$1 billion dollars-worth of overcharges documented by the DCAA, approximately 25 percent of the overcharges were unsubstantiated dining costs, 25 percent were unsubstantiated material purchases, and 25 percent were unsubstantiated labor fees.

KBR's general cost accounting, cost estimating, and sub-contracting systems were so flawed that KBR had to do a mass reconciliation of its accounts. DCAA declared that KBR's projected costs were unacceptable, that they overstated costs, and used incorrect algorithms to estimate future costs. In addition, the work of subcontractors was inadequately documented and they failed to provide the government with a paper trail for work performed.

By May 2004, DCAA had endorsed withholding 15 percent of payments to KBR until the company reconciled its unsupported charges to the government. This was standard contracting practice and a method for encouraging contractors to give an accurate description of costs. The government had waived the 15 percent withholding requirement prior to 2004 due to the repeated changes made in the task descriptions under the contract. In 2004, however, these descriptions were consistent and KBR was expected to provide auditable proof of costs and auditable proposals under the LOGCAP III contract. By May 2004, the base situation in Iraq and Afghanistan had also stabilized. The government was better staffed to audit and negotiate definitization proposals and any delays in definitization would now be the responsibility of KBR.

As a result, the government decided to implement the 15 percent withholding on invoices. The government and KBR agreed upon a definitization schedule. This schedule was predicated on KBR obtaining full approval of their cost accounting, estimating and sub-contracting systems. Failure to meet these schedules would be cause for the government to consider unilateral definitization of task orders. These actions were a coordinated government response, briefed through my chain of command. Concerning the 15 percent withhold, we asked KBR to provide any impacts to the government along with any suggestions on how best to implement this. As always, we attempted to work with KBR to achieve the best outcome on these issues.

In June 2004, the Army Sustainment Command (ASC) Commander, Major General Wade Hampton McManus Jr., retired and was replaced by Brig. General Jerome Johnson. I was requested to meet with General Johnson in the Washington, D.C. area, at KBR's offices. This meeting was also attended by government personnel from the office of the Assistant Secretary of the Army for Acquisition, Logistics and Technology (ASAALT) and HQ of the Army Materiel Command. In a morning session with KBR, I reviewed our position and noted that KBR was not making the necessary progress to provide me with government proposals. In an afternoon session, General Johnson attacked me over the issue of locating our contracting staff in theater. This was rather strange behavior in a government/contractor meeting, more appropriate to a government-only setting.

Following this meeting I spent most of the next month on travel in Iraq, Kuwait and Qatar. I returned in time for a major session with KBR and all of the government participants in contract administration, including DCMA and DCAA. We were still dealing with the issues of disapproved business systems, among others. My Contracting Officer had prepared a letter

implementing the 15 percent withhold and presented this to KBR in an evening session, which I did not attend. The next morning she informed me that KBR personnel told her the decision would be overturned.

Shortly thereafter, my Contracting Officer and I were requested to participate in a conference call with General Johnson, who was in Washington at the time. He directed us to retrieve the letter and issue a different one, which did not implement the 15 percent withhold, but repeated the request for impacts on KBR. We did so. A day later I discovered that I had been removed from my position when I went to a meeting with KBR officials and found a colleague there in my place. Within several months, my Contracting Officer was also replaced.

In August 2004, I was re-assigned to help develop strategy for the LOGCAP IV contract. As I continued to work on the program, developing LOGCAP IV, I attended briefings and meetings in which overall management of the contract was discussed. I observed a number of actions which I did not feel were appropriate contracting. These actions were:

- The 15 percent withhold was waived and has never been implemented to my knowledge.
- General Johnson specifically asked that contractor RCI (now SERCO) be hired to do a pricing review of KBR proposals. RCI's pricing analysis replaced the DCAA audits as the basis for definitizing estimated costs on task orders. My understanding is that RCI performed regression analysis on incurred costs to provide estimates at completion. To do this would have required the auditable data which would have allowed DCAA to complete the audits in the first place.
- Almost all of the costs questioned by DCAA were settled by DoD in favor of KBR.
- \$1 billion in Dining Facility Costs were converted from a cost type contract to fixed price. DCAA had questioned over \$200 million of these costs as unreasonable due to poor sub-contracting. This resulted in the government paying for thousands of meals which were never served to troops. The only result of this conversion was that KBR was protected from a post contract audit, which may have disallowed

payment of these costs as unreasonably incurred. Only cost type contracts are subject to such audits. The profit on this contract was set at 3 percent, the maximum fee KBR would receive on a cost contract.

- Another \$1 billion in dining facility costs were definitized as a cost contract and were given high award fees with no evaluation of work.
- Upon definitization, Award Fee Boards were held which routinely awarded KBR fees which indicated exceptional performance. We should all be aware, that while KBR accomplished many actions in an effective manner for the government, there were problems. These should have been reflected in award fee evaluations.

These actions resulted in recognition of excessive costs incurred by KBR and excessive fee payments. By the time this was done, the Army had a fixed budget for running the war. I was in a meeting with General Casey when he was still the Vice Chief. He was concerned about how to limit the costs of troop support so that other needs could be met. My personal estimate is that these excess costs were more than \$1 billion. This sum was thus unavailable to provide other needed support for soldiers.

I am aware the Army has stated that these payments were necessary to keep KBR from failing to provide the correct support under LOGCAP. I do not believe this was the case. Certainly KBR on occasion told us that cash flow issues threatened performance. These statements were uniformly followed by a senior KBR leader assuring us that KBR would never cease performance under the contract. I believe such action would have significant harm to KBR and threatened the existence of the company. Halliburton, the KBR parent, had provided the government with financial guarantees of performance during the solicitation phase, so they would have been involved in government litigation by such an action. Finally, there were many fine employees at KBR in leadership positions, often former military, who would not consider leaving our troops unsupported after accepting a contract to do so.

Recommendations

Based upon my experience with the LOGCAP contract I would make the following recommendations:

- DoD should conduct further study of the costs and benefits of providing this support through contractors, versus organic military support. Current operations have provided significant data on the costs of using contractors. I believe earlier studies also did not take into account the cost of administration of such a large contractual endeavor. These studies also did not take into account the risk that a contractor will leave the theater, which a soldier did not do. I believe there is such a risk based not on money, but on the force protection situation. Significant casualties might force a contractor to withdraw. These studies also did not take into account the risk associated with deploying over 130,000 non-combatants in place of support troops who can also fight if required.
- Should the decision be to continue to use contractors, then we should use the most effective and efficient contracts. LOGCAP IV makes significant progress in this direction by introducing multiple contractors and competition into the process. Decisions on the use of cost versus fixed price vehicles and payment procedures are among the contractual issues which may be improved.
- Controls on requirements during the first phases of operations should be explored. Contractors are happy to provide as much as the Army orders and should not be expected to encourage restraint.
- The findings of the Gansler Commission must be implemented to provide a deeper and better trained contracting force. DCMA in particular was called upon to administer this contract without the necessary staffing, training and experience base. I was continually impressed with the work done by DCMA managers and Administrative Contracting Officers in trying conditions.

This closes my recommendations. I appreciate your attention to my statement and will be happy to answer any questions you have.