

**Senate Democratic Policy Committee Hearing
“Rewarding Failure:
Contractor Bonuses for Faulty Work in Iraq”**

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Chairman Dorgan and distinguished members of the Committee, thank you for the opportunity to appear before you today to discuss the Army’s Logistics Civil Augmentation Program (LOGCAP) and the Award Fee Process.

I am Charles M. Smith. I retired from government service in February 2008, after 31 years as a contract specialist with the Army. For 24 of those years, I managed various contracting teams at several organizational levels. In 2002, I became the Chief of HQ, Army Field Support Command (now Army Sustainment Command), Field Support Contracting Division. I was responsible for several major service support programs, including LOGCAP. I managed the LOGCAP Program and the LOGCAP III contract until August 2004. I have managed cost-plus award fee contracts. I have been a member of Award Fee Boards and have served as an Award Fee Determining Official.

I am currently the Director of Contracts for a service-disabled veteran-owned small business operating in Davenport, Iowa.

I believe it was highly inappropriate for KBR to receive what amounted to a “bonus” for its faulty work in Iraq. The Defense Department is supposed to issue these “bonuses” – known as “award fees” – only for outstanding work. The electrical work that KBR performed was dangerously substandard, and therefore should not have been rewarded with bonuses. Had I not been removed from my position, I would have objected to the awarding of these bonuses.

The Integrity of the Army's Contracting System

I have many concerns about the way the LOGCAP III contract was managed from August 2004 until the present. I have previously had the opportunity to present some of those concerns to this Committee.

Today, I wish to concentrate on the management of the award fee process on LOGCAP III, which appears to me to have failed to work as it was intended and to have led to poor service for American troops, wasted taxpayer money, and possibly the deaths of soldiers in KBR-operated facilities.

The management of the award fee process under LOGCAP III has called into question the integrity of the Army's contracting system. This system is supposed to provide troops with effective and efficient service by providing incentives to contractors to do excellent work. The award fee process is supposed to evaluate a contractor's performance level and provide a "bonus" or award fee for superior performance. Failure to perform satisfactorily should result in a significantly lower or no award fee. This is not what happened under LOGCAP III.

Instead, the Army provided perverse incentives to KBR by providing the company with substantial award fees without KBR having the required business systems and without performing quality work. This pattern continued even though the Army had documented that KBR had done substandard work.

In 2007 and 2008, KBR received approximately \$84 million in award fees under LOGCAP III Task Order 139 for work that it did in Iraq. This includes \$34.4 million of a possible \$40 million award fee pool that it received in April 2008 after the electrocution death of Ryan Maseth in January 2008 in a KBR-managed facility. I am distressed that such a fine soldier, fine American and beloved family member died in a LOGCAP facility. That the

electrocution of a soldier in a KBR-managed facility did not appear to negatively impact KBR's earned fee leaves me additionally troubled.

The Award Fee Process

Most task orders under LOGCAP III were awarded as cost-plus award fee contracts. A cost-plus award fee contract provides for a fee consisting of a base amount fixed at the inception of the contract and an award fee amount that the contractor may earn in whole or in part based on the contractor's performance. The award fee is supposed to motivate the contractor to excel. The government must be able to specify the performance criteria which are desired, so that the contractor knows what to do to earn the award fee. A cost-plus award fee contract is appropriate where the requirement cannot be specified in the detail necessary for a contractor to accept a fixed price for the work.

When we competed LOGCAP III, all contractors were required to propose fee values they thought acceptable under this contract. KBR proposed a fee scheme of a base fee of 1% of estimated costs and an award fee pool of 2% of estimated costs. When KBR was awarded the contract, this became the fee structure.

Under this fee structure, KBR would receive a guaranteed 1% of estimated costs for performance of the Scope of Work. 2% of the estimated cost would go into an award fee pool. KBR would receive a percentage of this pool based upon the government's evaluation of their performance. Since this contract now is in the \$30 billion range, the award fee pools represent significant potential profit for the contractor, as much as \$600 million.

All cost-plus award fee contracts require the government to develop an award fee plan, which sets forth the government's desired outcomes. Contractor performance in meeting these outcomes will be evaluated to determine the award fee.

The award fee is determined by an award fee process that includes a Fee Determining Official, an Award Fee Review Board, performance monitors, and the contracting officer. Performance monitors track, evaluate and document the contractor's performance in assigned areas and prepare evaluation reports that ensure a fair and accurate assessment of the contractor's performance and recommend changes to the plan to the Award Fee Board. The performance monitors usually include Defense Contract Audit Agency (DCAA) auditors, Defense Contract Management Agency (DCMA) administrative contracting officers, and Technical Representatives provided by the supported unit.

The Chairman of the Award Fee Board convenes the Award Fee Board on a quarterly basis. The board is usually made up of a representative of the contracting office, a DCMA representative, and representatives of the supported unit or Command. The Chairman of the Award Fee Board is an individual designated by the Fee Determining Official.

At the board meeting, the performance monitors provide their evaluation to the board for the performance period. The contractor may also provide a self-evaluation. The award fee board reviews the results of the performance monitors' evaluation of the contractor's performance and considers all information from pertinent sources. The award fee board provides a numerical rating based on the performance of the contract. No award fee is supposed to be given for substandard or unsatisfactory work.

After the board meeting, the Chairman of the Board drafts an award fee recommendation report for the Fee Determining Officer. After reviewing the board's recommendation, the performance monitors' reports and the contractor's self-evaluation, the Fee Determining Officer makes a final decision regarding the award fee and documents that decision in an Award Fee Determination Report. The contracting officer then notifies the contractor of the FDO's decision including an explanation of the assessment of the contractor's performance as measured against the evaluation criteria and the amount and percentage of the award fee earned. The notification will identify significant areas of performance and include the reasons why the fee was or was not earned.

The determination of the FDO (including the amount of the award fee), the determination of contractor performance against the award fee criteria, and the assessment of the nature and success of the contractor's performance is final and not subject to the disputes clause of the basic contract. An unearned award fee does not carry over and is not made part of any subsequent award fee pool. It is lost to the contractor.

LOGCAP III Award Fee Boards

Prior to my leaving the management of the program, no award fee boards had been held for the LOGCAP III contract. I refused to hold the award fee board meetings until we had established the value of the estimated cost base and the award fee pool. Up to that time, KBR was unable to provide adequate information to do so based upon DCAA auditing.

The award fee board process for LOGCAP III commenced in February 2005, following negotiations which accepted the large majority of KBR proposed costs despite DCAA audits. The initial round of boards awarded KBR 82% of the award fee pool dollars available, according to a briefing presented by Army Sustainment Command (ASC) to Tina Ballard, the Deputy to the

Assistant Secretary of the Army for Acquisition, Technology and Logistics. In June 2005, another briefing showed that all dining facilities work received an award fee percentage of about 88%.

The evaluation criteria included timeliness of support, quality of support, and established business systems, which would provide the government with accurate data to negotiate estimated costs and evaluate progress under the contract and cost control. This high percentage for an award fee suggests that KBR did excellent work.

These award fee results are troubling for several reasons:

1. During this period KBR's work was subject to many quality and technical problems. I personally observed problems with maintenance of trucks for the transportation mission and received several calls from a one-star general in Kuwait over that issue. I observed problems with implementing ice production in theatre and problems in supporting the Multi-National Brigade. I also observed Army units performing water purification duties, because KBR was unable to implement this part of their scope of work. Chairman Dorgan, as you know, this Committee has since discovered additional, significant problems with water purification in Iraq.
2. KBR's business systems were not functioning adequately during this period. In fact, their purchasing system, cost accounting system, and estimating system for this program were not approved until 2007. Recent testimony to the Commission on Wartime Contracting by April Stephenson, Director of the Defense Contract Auditing Agency (DCAA), indicates that the DCAA performance evaluators at these award fee boards provided evaluations that did not support any award fee due to these deficiencies. She has stated that the boards were quite contentious as these evaluations met resistance from other board members. Business systems and the related cost control make up a majority of the award fee criteria. Yet failure in these areas did not result in significantly lower fees.
3. KBR's performance on dining facilities was the subject of a DCAA recommendation to withhold payments due to poor contracting leading to charges for meals never served.
4. Based upon the changes to the program instituted in August 2004, the Army seemed to have a preconceived notion that KBR must receive a significant majority of the award fee pool, no matter what their performance was. My impression was one of staged or managed boards designed to reach a pre-determined outcome. Ms. Stephenson's testimony reinforces that impression.

Each of these deficiencies should have resulted in a significantly lower evaluation and a reduced fee. Together the deficiencies provide justification for a very low fee or no fee at all. I certainly do not believe in paying a “bonus” or award fee for deficiencies that endangered the lives of soldiers.

Award Fee Boards Under Task Order 139

Task Order 139 is the successor to Task Orders 59 and 89 as the contract for major base camps in Iraq. Nothing seems to have changed in the Award Fee Board process. In 2007 and 2008, KBR received approximately \$83.4 million in award fees under Task Order 139, even though GAO reports and Congressional hearings, particularly hearings in this Committee, continued to raise significant issues with KBR’s performance.

Most disturbing is that KBR continued to receive award fees in April 2008 after the electrocution death of Ryan Maseth. That the electrocution of a soldier in a KBR-managed facility did not appear to negatively impact KBR’s award fee leaves me very troubled.

It appears that as a result of this incident, significant additional oversight of KBR work was performed. In September 2008, DCMA issued a Level III Corrective Action Request (CAR) citing a systemic failure of KBR’s Quality System under LOGCAP III. This system was obviously deficient during the periods when KBR was receiving award fees in of 82-88% of the pool. The letter from the Director of DCMA to the President of KBR notes that the CAR calls for appropriate contractual remedies.

The Army was aware of KBR’s poor performance in Iraq from 2002 to 2008. There have been numerous government inspections and reports. The Army, however, continued to give KBR high award fees. Those high award fees appear to have sent a message to KBR that performance did not really matter. Award fee boards and decisions are a communications tool

between the government and the contractor. The contractor learns what is important to the government and will respond accordingly.

The Award Fee Board Process Failed

In my opinion, the award fee board process failed under LOGCAP III for a variety of reasons. DCMA was understaffed initially in its role as the contract administrator as was my contracting office at the Army Field Support Command and DCAA. The problems for operating in the environment of Iraq and Afghanistan are not insignificant. However, the major failure appears to me to have been a culture that decided KBR was too big to fail and too important to be held to account.

In August 2004, the Army's approach to KBR underwent a complete change. The goal of award fee boards became one of making KBR financially sound, even if it was not performing in accordance with the contract. This was consistent with actions to rescind the 15% withhold, definitize contract cost estimates well above the DCAA recommended amounts, and remove me from my position. The Army's stated reason is that it was afraid KBR would cease performance or allow their subcontractors to cease performance. I did not think this was a credible threat, as KBR would have lost its military business entirely by this action. I do not believe the Army has stated the real reason for its change in approach to KBR.

Recommendations

Hearings such as this are a critical part of the "Lessons Learned" process. We have to understand what went right and what went wrong about this type of contracting -- or the Army will surely do it again. I would suggest the following actions:

1. The new Assistant Secretary of the Army for Acquisitions, Logistics and Technology, who is the key individual in the Army Acquisition process and for LOGCAP, must be committed to ensuring that the government demands efficient and effective performance

in return for appropriate payments. No contractor should be deemed to big or important to fail. This commitment should be communicated throughout the Acquisition community, especially to the Army Contracting Command. Senior executives should be evaluated on their adherence to this commitment.

2. The Deputy for Procurement to the Assistant Secretary should receive all Award Fee Board files. These should include the original performance evaluations, briefings and minutes of the board along with the board's recommendation and the final determination. Reviews of significant contracts, such as LOGCAP, should be conducted to determine if the final decision is commensurate with the evaluations and the terms of the contract.
3. The Army should review the award fee process under LOGCAP to determine if there was undue influence on the Board, resulting in fees which were unjustified by performance. The Army should explore recourse under the law for recovery of those award fees.

Conclusion

In conclusion, let me read from the Army Contracting Agency's own guidance for Award Fee Board participants:

Although award fee contracts allow judgmental evaluation of the contractor's performance, it must follow a disciplined approach. Documentation ensures the integrity of the award fee evaluation process. Therefore, this documentation should demonstrate that the process set forth in the award fee plan has been followed; that the rating recommendations and final AFDO decisions have been based on actual performance; that performance has been evaluated according to the award fee plan; and that timely feedback was provided to the contractor addressing strengths and weaknesses.

If the Army will follow this guidance in the future, then contractors will receive the proper incentive to perform in accordance with the goals of the contract. I believe that, if this had been done in 2005, then KBR would not have had a failed quality system in 2008, which according to the Director of DCMA, "has resulted in life-threatening conditions for deployed personnel."

Thank you.

Attachment A

Award Fee Board Schematic

