

**Statement of Paul Hackler
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Mr. Chairman, Ranking Member Collins, and members of the Committee:

Thank you for the opportunity to speak to you today about DCAA's ELC Buy III proposal audit. I am currently a GS-13 Supervisory Auditor in the Defense Contract Audit Agency's Western Region - Huntington Beach Resident Office responsible for Department of Defense contractor audits. I am a certified public accountant with 25 years of contract audit experience. The 2005 and 2006 ELC proposal audits I supervised were based on a 15-year lot costing scenario designed to allow Boeing to recover approximately \$270 million in losses Boeing incurred as a result of its poor business decision to gear up for a robust commercial cell phone satellite market that failed to materialize. In using a 15-year lot costing approach, Boeing was able to average those losses over 15 years, thereby reflecting higher costs for future missions. In restructuring the program to avoid further losses, the government agreed to reimburse Boeing prospectively for launch capability efforts and Boeing was forced to abandon lot costing for that portion of the program. Boeing seized this opportunity to recover past losses by

developing proposals that violated numerous procurement regulations. In its proposals, Boeing claimed that the cost per launch would decrease in the future and the government needed to compensate Boeing for higher up-front costs. **In actuality, the devastatingly high up-front costs were a direct result of Boeing's unprofitable decision to gear up for a prolific commercial market that failed to materialize.** My office was directed by DCAA upper management to basically play along with this outrageous government bailout!

My testimony today will focus on (1) the inherent problems with Boeing's 2005 and 2006 Delta IV launch capability proposals, (2) the directed audit opinion by DCAA upper management related to the Delta IV Buy III Launch Capability proposal audit issued May 8, 2006, and (3) reprisals by upper management against employees who resisted the management directed audit opinion related to that proposal.

Background

In the late 1990s, Boeing anticipated the emerging cell phone market would deploy satellites as a means to route cell phone traffic. Shortly after Boeing geared up for 300 related launches of its newly developed Delta IV launch vehicle, cell phone providers decided to use land-based towers instead of satellites to route cell phone traffic. As a result, the cell phone satellite

market (previously anticipated to be 75 percent of Delta IV sales) collapsed and the cost per launch skyrocketed. In 2003, Boeing announced it was recognizing \$835 million in losses attributable to the Delta IV program, reflecting Boeing's significantly lower assessment of global demand for launch services.

Since Boeing was losing more than \$100 million per launch, the government decided to restructure the existing Initial Launch Services (ILS) fixed-price contract for 13 launches and all future launches by reimbursing Boeing for launch capability costs on a prospective basis under the ELC contract. This restructuring was intended to make the Delta IV program profitable on a go-forward basis for new procurements, but we were directed by pentagon officials that fixed-prices for the remaining 11 ILS launches were to remain in place and all appropriate government procurement regulations were to be adhered to.

Inherent Problems in the ELC Proposal

In 2005 and 2006, I supervised audits of Boeing's Delta IV Launch Capability proposals. In the 2005 proposal, my team determined the proposal contained serious procurement regulation violations and issued an

adverse audit opinion that prevented the Air Force from awarding the contract. Two of the significant deficiencies in the 2005 ELC proposal were: Boeing's use of a 15-year lot costing methodology never before encountered by DCAA to my knowledge. The other deficiency related to Boeing's failure to obtain detailed pricing data from its subcontractors. Prior to Boeing resubmitting the ELC proposal in early 2006, the Air Force attempted to provide Boeing a waiver from the procurement regulations violated by lot costing. However, the move was unpopular in Washington due to Boeing's recent Procurement Integrity Act violations and Boeing was only granted a waiver from the requirement for subcontractor pricing data. Therefore, Boeing resubmitted its ELC proposal using 15-year lot costing that continued to contain significant procurement regulation violations. Boeing's 15-year lot costing methodology rolls losses directly attributable to the collapse of the cell phone satellite market into future government contracts and violates numerous government procurement regulations, most notably the prohibition against recovering prior losses and charging the government for costs that do not benefit our contracts. At the direction of upper management, our office issued an audit opinion that failed to report serious procurement regulation violations and the Air Force subsequently awarded the initial ELC contract granting Boeing recovery of approximately

\$270 million of past losses suffered in its attempt to corner the nonexistent commercial cell phone satellite market and also substantially increased the price of previously awarded ILS missions. My testimony today focuses on DCAA's indiscretions, however, the Air Force may have gone well beyond DCAA in allowing Boeing to recover losses from its decision to pursue the cell phone satellite market that resulted in recovery of losses of much more than \$270 million in total. I'd be more than happy to answer questions regarding this subject also.

Specific to DCAA's involvement, Boeing's lot costing methodology averages costs to gear up for a nonexistent commercial market over 15 years and multiple government contracts, thereby violating Federal Acquisition Regulation 31.205-23, which prohibits the recovery of these prior losses. For instance, at inception of the Delta IV program, Boeing anticipated and prepared for a commercial market that, if it had materialized, would have purchased well over 100 launches by now, and approximately 300 launches by 2020. However, only one commercial launch has taken place thus far, and no further commercial launches are anticipated. Virtually all of the losses Boeing incurred pursuing the commercial market, such as: constructing a production facility capable of producing 40 rockets per year, purchasing a vessel designed exclusively to transport the 230 ft. long Delta

IV launch vehicle, the cost of excess production equipment, incurring excess procurement and storage charges are included in the lot costing calculation. Some of these costs are still being charged to government contracts.

Boeing's lot costing methodology also violates several other procurement regulations that embody the most fundamental concepts in government or public accounting; e.g. allocating costs to contracts that do not benefit.

Additionally, lot costing violates the requirement to segregate costs by year. By averaging costs over 15 years, Boeing's lot costing methodology constantly shifts costs between years, as the cost per launch increases. The estimated cost per launch has increased several-fold since the program began in the late 1990s.

Due to these violations of procurement regulations and departure from basic accounting principles, all the audit staff involved with the Buy III proposals considered Boeing's lot cost methodology unacceptable as an estimating or accounting practice. It should also be noted that Boeing has recently discontinued lot costing entirely at the direction of its outside auditors.

Directed Audit Opinion by DCAA Upper Management

Mr. Chairman and members of the Committee, despite our documented objections, we were instructed by DCAA upper management to issue an audit opinion that failed to report violations of numerous procurement regulations and allowed the Air Force to compensate Boeing for losses incurred as a result of the collapse of the anticipated commercial market. The departure of estimating techniques employed in the ELC proposal from fundamental procurement regulations, acceptable estimating techniques, and basic accounting principles was so unthinkable that the audit staff documented our disagreement in the audit file. This is the first time in my career I felt it necessary to document my disagreement with a management directed audit opinion.

Reprisals by DCAA Upper management

Over my 25-year career with DCAA, I have jealously protected the American taxpayers' interests at every turn as I attempted to do on the ELC proposal audits. During the course of the two ELC proposal audits, I was harassed and denied a chance at promotion opportunities because I resisted DCAA upper management's pressure to overlook the most egregious estimating scenario I have ever encountered, while the DCAA official responsible for directing this inappropriate audit opinion has been promoted

to the SES level. Early in my career, I would never have suspected this kind of inappropriate behavior could be rewarded, but of late, I've seen it over and over again due to the emphasis placed on performance metrics and customer satisfaction. Audit findings and exceptions have taken a backseat to expediency and personal ambition. I can only hope that bringing these atrocities to your attention results in changes that will make my coworkers and myself proud to be DCAA employees again.

Concluding remarks

Thank you for your time and thank you for this opportunity to bring these matters to your attention. I would be happy to answer any questions that the Committee may have.