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United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Report of Audit

Review of the Kellogg,
Brown & Root Termination
for Convenience
Proposal Contract
S-FBOAD-99-D-0016, Task
Order 57 Havana, Cuba

Report Number AUD/CG-05-22, March 2005

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**Review of the Kellogg, Brown and Root Termination for Convenience
Proposal for Contract S-FBOAD-99-D-0016,
Task Order 57, Havana, Cuba**

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Summary

At the request of the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, the Office of Inspector General (OIG) conducted a review of the termination for convenience proposal submitted by Kellogg, Brown & Root, Inc. (KBR) for contract S-FBOAD-99-D-0016, Task Order 57. OIG's objectives were to determine whether KBR's termination for convenience proposal was prepared in accordance with the Federal Acquisition Regulation (FAR) and assess whether claimed costs were incurred, reasonable, allowable, and allocable.

KBR's termination for convenience proposal submitted under contract S-FBOAD-99-D-0016, Task order 57, did not comply with the FAR. The regulation states, "After termination, the contractor shall submit a final termination settlement proposal to the Contracting Officer in the form and with the certification prescribed by the Contracting Officer." However, KBR did not certify the cost pricing data as specified in the termination notice. Specifically, KBR did not submit the proposal on a total cost basis nor was the submitted pricing information certified.

In addition, OIG was unable to determine whether claimed costs were incurred, reasonable, allowable, and allocable because of a lack of documentation. As a result, OIG questioned \$4.4 million.

In May 2004, OIG told the contracting officer that KBR had not complied with the termination notice. The contracting officer requested KBR resubmit its termination proposal on a total cost basis and certify the cost or pricing data. As of March 2005, KBR had not resubmitted a revised termination for convenience proposal.

OIG discusses the findings in detail and recommends that the contracting officer require KBR to submit a revised termination for convenience proposal. The questioned costs are discussed in the body of the report.

Background

In response to the August 1998 bombings of the U.S. embassies in Nairobi and Dar es Salaam, the Congress provided the Department with approximately \$1.5 billion in emergency supplemental appropriations to improve security worldwide.¹ Principally, the Department was to use the funds to develop an emergency security program to rebuild the embassies in Nairobi and Dar es Salaam, relocate other high-risk embassies and consulates, and improve security at embassies and consulates worldwide. As part of this initiative, on April 23, 1999, the Department awarded an indefinite-

¹ Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. No. 105-277).

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delivery, indefinite-quantity contract to KBR to provide worldwide security upgrade construction services on a task order basis.

On September 29, 2001, the contracting officer awarded fixed-price task order 57 to KBR, with a value of \$5.5 million for the Havana compound security upgrade construction project with an estimated completion date of February 2, 2003. The task order called for KBR to build two new compound access controlled buildings; upgrade the perimeter walls, fences, lighting, cameras, windows, doors, and technical security systems at the main building; and provide similar upgrades at the annex building. The Department of Homeland Security's Immigration and Naturalization Service (now U.S. Citizenship and Immigration Services) and the Department's Bureau of Population, Refugees, and Migration agreed to fund the annex building upgrades. The following is a chronology of major events for the security upgrade construction project in Havana.

Date of Contract Action	Contract Action
September 29, 2001	Fixed price task order to KBR for \$5.5 million, with a contract completion date of February 2, 2003
September 29, 2001	Modification 1, task order increase to \$6.1 million, no justification given
October 22, 2001	Notice to KBR to proceed with work as of October 15, 2001
June 18, 2002	Onsite contractor mobilization in Havana
December 10, 2002	Sixteen secure containers arrive from U.S. to Havana
September 28, 2002	Modification 3, task order increase to \$9.03 million, with a new contract completion date of October 15, 2003
April 11, 2003	Termination notice to KBR, effective April 9, 2003
April 11, 2003	Agreement signed with Cuba for project construction
June 27, 2003	KBR departs Cuba
October 22, 2003	KBR submits termination claim of \$4.4 million

Purpose, Scope, and Methodology

The primary purpose of the review was to determine whether the proposed costs were acceptable as a basis for negotiation of a fair and reasonable price; the proposal complied with applicable federal laws and regulations related to the terms and conditions of the contract; and the direct costs were allowable, allocable, and reasonable per FAR Part 31. The scope included reviewing the claimed costs totaling \$4.4 million in the termination for convenience proposal dated October 22, 2003, for the period September 2001 through June 2003.

To obtain information on the reasonableness, allowability, and allocability of the claimed costs, OIG reviewed KBR's available financial records, available supporting documentation, and internal control structure. To verify expenditures, OIG examined general ledger accounts, invoices, check payments and any other available data relevant to the task order. To determine compliance, OIG considered applicable criteria in examining the books, records, control procedures, and supporting documentation. Criteria used in the review included FAR Parts 31, 49, and 52 and the contract and related documents, such as correspondence.

OIG conducted its review in Arlington, VA, from February 17 to May 13, 2004. On May 13, 2004, OIG placed the review on hold in order to provide KBR time to resubmit the termination for convenience proposal on a total cost basis and to certify the pricing data. The contracting officer had provided the contractor with an additional six months to properly resubmit the documentation. The Office of Audits, Contracts and Grants Division conducted this review under government auditing standards and included such procedures as considered necessary in the circumstances.

Review Results

OIG identified noncompliance with the termination and FAR 49.206-2(b). As a result, OIG questioned costs totaling \$4.4 million, as summarized in Table 1 and detailed in the notes that follow.

Table 1: Proposed and Questioned Costs

Cost Element	KBR Proposed	OIG Questioned	Note
Direct Labor	\$495,293	\$495,293	1
Other Direct Costs	914,408	914,408	2
Subcontractor	2,533,143	2,533,143	3
Open Commitments	42,959	42,959	4
Overhead	(b) (4)	(b) (4)	5
G&A	(b) (4)	(b) (4)	5
Profit	(b) (4)	(b) (4)	6
Mathematical Difference	28	28	7
Total	\$4,402,930	\$4,402,930	

Source: KBR data.

Notes

FAR Part 52.249-2(e) states, “After termination, the contractor shall submit a final termination settlement proposal to the Contracting Officer in the form and with the certification prescribed by the Contracting Officer.” The termination notice required KBR to submit a termination for convenience proposal on a total cost basis, certifying the cost or pricing data. KBR submitted a \$4,402,930 termination proposal. However, the claimed amount includes billable burdened labor rates (as discussed in note 1, below). In addition, KBR did not certify the cost pricing data as specified in the termination. As a result, OIG questioned \$4,402,930, as summarized in the following notes.

1. *Direct Labor* – KBR’s claimed \$495,293 was based on actual hours incurred on the contract. The contractor applied the actual hours incurred for a given labor category to a unit labor rate for the same labor category. The proposed unit labor rate represented a fixed billable rate that was burdened with overhead, general and administrative costs (G&A), and profit. This rate was not what KBR actually paid its personnel. During the review, OIG tried to compute the labor on a cost basis, but was unable to do so because KBR did not provide adequate documentation. Per the termination, KBR was to submit the proposal on an actual cost basis. The amount KBR claimed for direct labor was not on an actual cost basis nor was it certified. As a result, OIG questioned \$495,293 for direct labor.

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2. *Other Direct Costs* – KBR proposed \$914,408 for other direct costs. OIG verified the mathematical accuracy of the proposed amount. In addition, OIG performed transaction testing. However, KBR did not provide all of the supporting documentation. KBR did not maintain all original records for a minimum of one year after the date of transferring the original to microfiche, as required by FAR Subpart 4.7, Contractor Records Retention. OIG's initial evaluation found that the contractor did not appear to be in compliance with its record retention policy. As a result of the inability to verify the proposed costs and the lack of certification of the cost or pricing data, OIG questioned \$914,408 of the other direct costs.
3. *Subcontractor* – KBR proposed \$2,533,143 for subcontractor costs that were submitted by its subcontractor, Morrison International Construction, Inc. (MICI). OIG reviewed the proposed termination costs submitted by MICI to KBR. During the review, OIG requested evidential matter supporting the amounts claimed by MICI. KBR and MICI told OIG that because of a reorganization, MICI did not have any accounting records prior to December 2002. Accordingly, MICI was unable to provide documentation to support a significant portion of the claimed costs. As a result of the lack of documentation and certified cost or pricing data, OIG questioned \$2,533,143.
4. *Open Commitments* – KBR proposed \$42,959 for open commitments. The proposed costs represented items that had accrued but not been paid at the time the proposal was submitted. OIG requested supporting documentation, but owing to the records retention issue discussed in note 2 above, OIG was unable to verify the proposed amount. As a result of the lack of support and certification of the cost or pricing data, OIG questioned \$42,959.
5. *Overhead and G&A* – KBR proposed using its Defense Contract Audit Agency approved indirect rates for each fiscal year and applied the rates to the applicable proposed amounts. However, it did not propose these amounts on a total cost basis and it did not certify them. As a result, OIG questioned (b) (4) for overhead and (b) (4) for G&A.
6. *Profit* – KBR proposed an (b) (4) profit rate applied to the applicable claimed amounts. However, the proposed amounts were not proposed on a total cost basis and were not certified. As a result, OIG questioned (b) (4)
7. *Mathematical Difference* – KBR's termination proposal included a \$28 mathematical difference. OIG was unable to verify the proposed amount. As a result, OIG questioned \$28.

In light of these findings, OIG is making the following recommendation.

Recommendation: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management contracting officer disallow all the proposed costs until KBR submits a proposal in compliance with the termination that is on a total cost basis, certifying the cost or pricing data.