

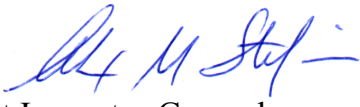


Memorandum

**U.S. Department of
Transportation**
Office of the Secretary
of Transportation
Office of Inspector General

Subject: **ACTION:** Report on Oversight of
Security Screener Contracts, TSA
FI-2003-025

Date: February 28, 2003

From: Alexis M. Stefani 
Principal Assistant Inspector General
for Auditing and Evaluation

Reply to
Attn. of: Meche: x61496

To: Under Secretary of Transportation for Security

This report presents our audit results on the Transportation Security Administration's (TSA) oversight of security screener contracts. This audit was initiated in response to concerns raised at an oversight hearing before the House Subcommittee on Transportation Appropriations on April 17, 2002. Our audit objectives were to evaluate whether (1) rates charged to TSA were supported by contractor records and were in accordance with contract requirements, (2) contractor invoices were supported, and (3) oversight and administration of screener contracts were effective. Our scope and methodology are discussed in Exhibit A.

INTRODUCTION

On November 19, 2001, the President signed the Aviation and Transportation Security Act (the Act) that created TSA. The Act required that TSA assume control of security screening at the Nation's 429 airports no later than 3 months after the date of enactment, and perform passenger screening at airports with a Federal workforce by November 19, 2002. TSA began paying for contract passenger screening services on February 17, 2002. Because TSA did not yet have the staffing or infrastructure for the agency, the Federal Aviation Administration (FAA) awarded contracts and performed contract administration until August 16, 2002, when TSA assumed responsibility for these functions.

From the first day of TSA's existence, the Department of Transportation (DOT) and TSA were faced with many significant challenges and short statutory milestones. During the first 3 months, TSA was getting organized and had very few Federal employees. New requirements for passenger screening were being developed to

ensure more thorough screening of passengers. To meet the requirements by February 2002, FAA had to issue multiple contracts and agreements for each of the 429 airports. The urgency of the situation required that DOT, FAA, and TSA act quickly to provide a contract screening workforce until a Federal workforce could be hired and trained.

To meet the continuing need for security screening, TSA used 74 private companies that were onsite at airports providing screener services for air carriers. There was not enough time to award contracts with negotiated rates. Therefore, FAA, on behalf of TSA, entered into letter contracts. Letter contracts were used because the Government's interests required that contractors be given binding commitments until final contract rates could be negotiated.

Contracts were to be based on contractors' costs. Contractors were to propose hourly billing rates (to include direct costs for employee pay, indirect costs for overhead, and profit) based on actual costs incurred under agreements with air carriers for similar services during the previous 12 months. Initially, actual rates were to be negotiated by May 2002. Because of the weak controls we identified and actual rates had not been negotiated by July 2002, we issued a memorandum on July 17, 2002, recommending that TSA hire the Defense Contract Audit Agency (DCAA) to audit the major screener contracts.

In TSA's January 21, 2003 response to our draft report, the Under Secretary of Transportation for Security expressed how important it is for our final report to contain adequate background about how these screener contracts were developed and managed. The Under Secretary also stated that TSA faced a severe budget crisis during this time. In August 2002, when TSA assumed the contract administration from FAA and funding became available, TSA implemented the Office of Inspector General recommendation to employ DCAA and also engaged the Defense Contract Management Agency (DCMA) to administer and negotiate the screener contracts.

On November 15, 2002, because these contractors would have been out of the passenger screening business by November 19, 2002, and the final negotiated rates could have been substantially less than those proposed by contractors, we made three additional recommendations in our draft report that TSA (1) withhold payments until DCAA audits were completed, (2) recover improper payments, and (3) report contract management as a material internal control weakness. TSA agreed and reported contract management as a material weakness and withheld more than \$90 million in payments to the high-risk contractors. The Under Secretary's comments are summarized on pages 12 and 13, and the complete text of management comments is in the Appendix. We consider the actions taken to be reasonable and responsive to our recommendations.

RESULTS IN BRIEF

TSA deployed a Federal workforce to screen passengers at all airports¹ by November 19, 2002, thereby eliminating contract screeners. As of October 23, 2002, TSA had not negotiated final rates for 61 of the 74 contractors, including all major contractors.

Increased Billing Rates to TSA. TSA obligated about \$1 billion for the 74 security screener contracts as of October 23, 2002. Our review of contract rates focused on 13 of the 74 contractors² that accounted for 93 percent of passenger screening costs. Of the 13 contractors, 7 charged TSA the same rates or slightly higher rates than were charged to air carriers. The other 6 contractors accounting for 69 percent of the contract screening costs raised their hourly billing rates ranging from 58 percent to 97 percent above the rates charged to air carriers. Comparing hourly billing rates charged air carriers to the rates charged TSA, and using the same work hours through November 19, 2002, we estimate the six contractors would charge TSA about \$305 million³ more than they would have charged air carriers.

The contractors stated that the higher hourly rates resulted from pay raises for employees and increased overhead costs, such as severance pay, workers compensation and state unemployment insurance. While the six contractors increased amounts paid to their employees, we found that two contractors paid employees at pay rates lower than the rates used to support the increased hourly billing rates. If the two contractors continued paying employees at the lower rates, we estimate TSA could be overcharged by about \$10 million.

We recognize that overhead costs could be higher. However, we found that none of the six contractors could provide adequate documentation supporting the higher overhead costs. About \$165 million of the increased payments was attributed to the higher overhead rates. During our audit, one contractor voluntarily reduced its hourly billing rates by 10 percent after we visited its corporate headquarters, resulting in a \$9 million savings to the Government. After DCAA completed its audit of this contractor, the audited rate further reduced the hourly billing rate and resulted in additional savings of about \$32 million.

¹ Federal employees were to perform screening duties at 424 airports by November 19, 2002. The remaining 5 airports will continue using contract screeners under a pilot program.

² Because this information may be considered business confidential, the identity of screener companies and airport locations we visited are not discussed in this report, but were provided to TSA.

³ In computing the \$305 million, we did not question the contractors' increases in proposed hours to provide additional passenger security screening.

Monitoring of Screener Contracts. Initially, we found oversight and internal controls over screener contracts were not adequate at the airports we visited. Four of the six contractors we visited charged TSA for hours not worked performing screener duties, but these improper charges went undetected because TSA was not monitoring contractor performance. For example, two contractors charged for 30-minute meal breaks, which could result in TSA being charged about \$4 million for unallowable meal breaks through November 19, 2002.

We also found contractor employees (1) arriving late or departing early, but signing in and out as though they worked their scheduled hours; (2) performing nonsecurity functions (skycap duties) for air carriers while charging time to TSA; (3) being charged to TSA while they were on vacation or other leave; and (4) being charged twice. Our results were based on samples at two airports and would not necessarily be representative of conditions at all contractors and airports. However, the findings demonstrated weak controls and the need for monitoring these contracts.

In addition to our work, TSA's Office of Inspection performed similar reviews of two contractors at three different airports and found that internal controls were not followed, contractors billed for employees who were on vacation, and TSA was charged for services not performed.

Because these contractors would be out of the passenger screening business by November 19, 2002, the urgency for corrective actions prompted us to send a memorandum on July 17, 2002, with a summary of our audit results to the Deputy Secretary of Transportation, the Under Secretary of Transportation for Security, and the Assistant Secretary for Budget and Programs. In the memorandum, we recommended that TSA require contractors to provide cost data and negotiate hourly billing rates by August 31, 2002; prioritize contractors for audit by DCAA; establish procedures for TSA representatives to verify hours worked by contractor employees; and recoup improper payments.

Because progress to obtain contractors' cost data had been slow, and DCAA had not yet completed audits of any of the 13 contractors as of October 23, 2002, we recommended in our draft report that TSA withhold payments until DCAA audits were completed. We also recommended that TSA recover improper payments and report a material internal control weakness in the Department's 2002 Federal Managers' Financial Integrity Act report to Congress and the Office of Management and Budget.

TSA Corrective Actions. TSA agreed with all of our recommendations and is taking or has already taken corrective actions in response to our audit. In August 2002, TSA contracted with DCMA and DCAA for contract administration and contract audit services, respectively. DCAA initiated audits of 14 contractors, including the

13 contractors that accounted for 93 percent of passenger screening costs. TSA also contracted for onsite inspections of security screener contractors at the larger airports. TSA plans to complete audits of the 14 contracts by February 2003, and had negotiated 56 of the 74 contracts as of February 26, 2003.

DCAA audits had questioned costs of about \$149 million. DCAA also had developed hourly audited rates for five of the six contractors that had substantially increased their rates to TSA. Using the audited rates rather than the contractor-billed rates, TSA will save at least \$67 million on the rate changes alone.

TSA also is withholding more than \$90 million in payments to the contractors pending completion of audits and reported contract management of the contract screener program as a material internal control weakness. TSA plans to complete all negotiation actions by April 2003.

FINDINGS AND RECOMMENDATIONS

Six Contractors Substantially Increased TSA Billing Rates

As of October 23, 2002, TSA obligated about \$1 billion for 74 security screener contracts. We focused our audit on 13 contractors that accounted for about 93 percent of the obligations. We found that 7 of the 13 contractors charged TSA the same rates or slightly higher hourly billing rates than were charged to air carriers.

However, six contractors accounting for about 69 percent of contract screener costs increased their hourly billing rates⁴ by more than 50 percent when TSA took over the contracts on February 17, 2002. Rate increases for the six contractors ranged from 58 percent to 97 percent above the rates charged air carriers, as shown in Table 1.

Table 1
Hourly Billing Rates for Air Carriers and TSA

Contractor	Hourly Rates Billed Air Carriers*	Hourly Rates Billed TSA*	Percent Increase
Contractor #1	\$ 9.83	\$19.39	97
Contractor #2	\$13.75	\$26.00	89
Contractor #3	\$14.91	\$28.00	88
Contractor #4	\$11.11	\$19.81	78
Contractor #5	\$15.18	\$24.77	63
Contractor #6	\$13.52	\$21.37	58

*Rates by contractor are for passenger screeners at one airport. Cost for passenger screeners at these locations accounted for about 77 percent of total hours.

According to the contractors, the increases in hourly billing rates resulted from pay raises for employees and higher overhead costs. Guidance to the contractors required that proposed rates for the letter contracts be based on actual costs incurred under air carrier agreements during the previous 12 months. However, we found that hourly pay rates increased from \$1 to \$4.60 per hour, and overhead and profit rates as a percentage of the pay rate more than doubled for four of the six contractors, as shown in Table 2.

⁴ Hourly billing rates include direct costs (such as employee pay), indirect costs (such as overhead), and profit.

Table 2
Comparison of Overhead and Profit Rates

Contractor	Employee Hourly Pay Rates	Hourly Rates Billed to Customers¹	Overhead and Profit (Percent of Pay Rate)
Contractor #1			
Before Feb 17	\$ 6.90	\$ 9.83	42
After Feb 17	\$11.50	\$19.39	69
Contractor #2			
Before Feb 17	\$ 9.00	\$13.75	53
After Feb 17	\$12.00	\$26.00	117
Contractor #3			
Before Feb 17	\$10.00	\$14.91	49
After Feb 17	\$14.00	\$28.00 ²	100
Contractor #4			
Before Feb 17	\$ 8.25	\$11.11	35
After Feb 17	\$11.00	\$19.81	80
Contractor #5			
Before Feb 17	\$10.00	\$15.18	52
After Feb 17	\$14.00	\$24.77	77
Contractor #6			
Before Feb 17	\$ 9.00	\$13.52	50
After Feb 17	\$10.00	\$21.37	114

¹Rates before February 17 were billed to air carriers, and rates after February 17 were billed to TSA.

²After we visited the corporate headquarters, the contractor voluntarily reduced its hourly rate to \$25.48, effective June 14, 2002.

Contractor Employees Pay Rates

We visited three of the six corporate offices and contacted the other three to obtain amounts paid to employees before and after February 17, 2002. We found that the six contractors increased the amounts paid to their employees but two contractors, with about 9,000 employees at 44 airports, were not paying some of their employees at the pay rates used to develop the TSA hourly billing rates. For example, contractor #4 was paying its passenger screeners \$8.25 per hour at one airport, rather than \$11.00 per hour. When advised of our finding, the contractor stated it would retroactively pay its passenger screeners at that airport the \$11.00 per hour rate. If the two contractors continued paying employees at the lower rates, we estimate the TSA could be overcharged by about \$10 million. TSA has directed DCMA to ensure that this issue is addressed during contract negotiations.

Increased Overhead Rates

The six contractors that substantially increased the hourly billing rates provided little or no support to show that overhead rates charged to TSA after February 17 were fair and reasonable. We determined these higher overhead rates caused increased billings to TSA totaling about \$165 million. Contractors were required to provide specific cost data, including components and support for the hourly billing rates and actual costs incurred for the previous 12 months. Contractors established separate hourly billing rates for each airport. The FAA instructed contractors to reference proposed amounts in the letter contracts to actual costs incurred.

About 4 months after the letter contracts were signed (and 1 month after the contract rates were to be negotiated), we visited contractor corporate offices and found the contractors could provide neither adequate documentation to support overhead costs incurred nor the basis for the proposed amounts. Rather, contractors based overhead costs such as general and administrative expenses, general liability insurance, workers' compensation insurance, and state unemployment insurance on estimates that were based on percentages of direct labor costs or proposed billing rates. However, the contractors could not provide documentation to support the rationale for percentages used, or that the percentages were based on actual costs.

For example, two contractors attributed increased overhead costs to severance pay. However, we found that severance pay was overstated because the contractors included costs for employees who were not entitled to severance pay. The Worker Adjustment and Retraining Notification Act does not require severance pay to employees hired for less than 6 months or those who work less than 20 hours per week. One of the two contractors based its increased severance costs on employees working 240 hours (8 hours per day for 30 days) when employees actually worked far fewer hours. Also, severance pay would not be required if contractor employees were given 60 days notice before the contracts expired.

We also found that the screener contractors did not have well-defined cost accounting systems for allocating overhead costs. However, the proposed billing rates for overhead and profit appear excessive when compared to rates charged to air carriers. For this reason, TSA needs to take quick action to review contractor cost data, and negotiate fair and reasonable hourly billing rates. During our audit, one contractor voluntarily reduced its initial hourly billing rates by about 10 percent after we visited its corporate headquarters. We estimate this action will save the Government about \$9 million through November 19, 2002. After DCAA completed its audit of this contractor, the audited rate further reduced the hourly billing rate and resulted in an additional savings of about \$32 million.

Impact of Increased Hourly Billing Rates

Comparing the hourly billing rates that the six contractors charged TSA to hourly billing rates charged air carriers, we estimate these six contractors would charge the Government an additional \$305 million through November 19, 2002. Our estimate is based on assumptions that (1) the increased passenger screener hourly billing rates were representative of all labor categories for all airports serviced by the contractors, (2) the contractors would have charged air carriers and TSA for the same number of hours through November 19, 2002, and (3) the airports would not have been federalized⁵ until November 19, 2002.

The six contractors provided screening services to 173 airports and many of these airports used more than one of the six contractors, including the Nation's largest airports. As shown in Table 3, the six contractors would be paid from about \$16 million to \$127 million more than if they billed TSA the same hourly rates they billed air carriers before February 17, 2002.

Table 3
Impact of Increased Hourly Billing Rates

Contractor	Air Carrier Hourly Billing Rate	TSA Hourly Billing Rate	Hourly Billing Rate Change	Increased Billings to TSA (Millions)
Contractor #1	\$ 9.83	\$19.39	\$ 9.56	\$ 19.1
Contractor #2	\$13.75	\$26.00	\$12.25	\$ 15.9
Contractor #3	\$14.91	\$28.00	\$13.09	\$127.0
Contractor #4	\$11.11	\$19.81	\$ 8.70	\$ 93.1
Contractor #5	\$15.18	\$24.77	\$ 9.59	\$ 26.9
Contractor #6	\$13.52	\$21.37	\$ 7.85	\$ 22.8
Total	-	-	-	\$304.8

Monitoring of Contractors

Although we were able to locate all employees who signed in on daily timesheets during our unannounced floor checks at two airports in May 2002, we initially saw virtually no monitoring of contractor performance and timesheets by TSA representatives. TSA was not verifying that contractor employees worked the hours they recorded and charged to TSA.

⁵ We recognize that Federal screeners have been deployed to some locations where the six contractors were providing screening services. The amount of actual unsupported cost will need to be developed by DCAA audits. As of October 23, 2002, TSA deployed Federal screeners to 195 of the 429 airports.

On the days we made our floor checks, we observed poor controls over timesheet procedures and contractor performance. For example, one contractor charged TSA for hours its employees did not work. We saw the contractor's employees arriving late and departing early, but signing in and out at their regularly scheduled work hours. We saw another contractor's employees performing nonsecurity functions but recording their work hours on security timesheets. We traced the nonsecurity hours recorded on timesheets on the day of our floor checks to total hours charged to TSA. We identified seven employees who worked nonsecurity jobs (skycap duties) who were charged to TSA for security work (40 hours at \$510). This contractor provided security services at 95 airports with over 8,000 employees.

At contractor corporate offices, we identified improper charges that went undetected because TSA was not adequately monitoring contractor practices for recording employee hours. We traced timesheet hours to payroll records and contractor invoices and found that:

- Two contractors charged for 30-minute meal breaks. The Instructions for Developing Your Pricing Proposal for Contract Definitization specified that meal breaks of 30 minutes or more were not to be compensated as work time, and employees were to be considered "off-the-clock." We computed the average cost of meal breaks to be \$1,344 per day at the two airports we visited. Considering that these two contractors had about 11,000 employees at more than 70 airports, we estimate that TSA could be charged about \$4 million for unallowable meal breaks through November 19, 2002.
- One contractor inappropriately billed for vacation time and other leave for eight employees. Contractor officials confirmed that employees were on leave and not performing security screening at airports on the days in question. We traced the leave hours to contractor invoices charged to TSA.
- One contractor charged TSA twice for 763 employee hours through April 2002 at one airport. The contractor recorded employee hours on timesheet summaries by employee name as well as by employee position. We computed an improper charge of about \$15,000.

Our results were based on samples at two airports and would not necessarily be representative of conditions at all contractors and airports. However, the findings demonstrated weak controls and the need for monitoring these contracts.

The TSA Civil Aviation Security Operations Plan issued February 15, 2002, required the Interim Federal Security Representative to provide on-site monitoring of contractor performance and verify that total hours recorded on contractor time sheets matched hours on contractor invoices. However, because of the lack of staff and

infrastructure, TSA withdrew their guidance so that the focus of its limited staff was on operational security. As mentioned earlier, no TSA representative verified that contractor hours were worked and screening services were provided prior to TSA authorizing payments. TSA officials agreed that on-site monitoring was needed in light of our audit results. In October 2002, TSA contracted for onsite inspections of security screener contractors at the larger airports.

Initially, final contracts were to be negotiated by May 2002. However, only 13 of the 74 letter contracts had been negotiated and 61 contractors (including the 13 contractors that accounted for 93 percent of the contract passenger screening costs) continued to charge TSA at the proposed hourly billing rates in the letter contracts as of October 23, 2002. Minimal assurance existed that payments made to screener contractors were fair and reasonable and security screening services were provided.

Because of the urgency for corrective actions, we sent a memorandum on July 17, 2002, with a summary of our audit results to the Deputy Secretary of Transportation, the Under Secretary of Transportation for Security, and the Assistant Secretary for Budget and Programs. We recommended that TSA require contractors to provide cost data to finalize contracts by August 31, 2002; prioritize contractors for audit by DCAA; establish procedures for TSA field representatives to verify actual hours worked by contractor employees; and recoup improper payments.

TSA agreed with our July 2002 recommendations and contracted in August 2002 with the DCMA and DCAA for contract administration and audit services, respectively. As of August 30, 2002, the letter contract files were transferred to DCMA for negotiation. As of October 23, 2002, DCAA had initiated audits of 14 contractors, including the 13 contractors that accounted for 93 percent of passenger screening costs. TSA had received cost data from 52 of the 74 contractors, including 4 of the 6 contractors discussed in this report. However, no DCAA audits were completed and TSA had negotiated hourly labor rates for 13 of the 74 contractors.

In addition to our work, and at the request of the Associate Under Secretary for Finance and Administration who had similar concerns, TSA's Office of Inspection performed similar reviews of two contractors at three airports and found that internal controls were not followed, contractors billed for employees who were on vacation, and TSA was charged for services not performed. Because TSA will pay about \$1 billion for screener services, these findings represent a material internal control weakness. The results of our audit and TSA's inspections have been provided to our Office of Investigations.

RECOMMENDATIONS

We recommend that the Under Secretary of Transportation for Security:

1. Withhold contractor payments until DCAA audits are completed and the final hourly billing rates have been negotiated.
2. Recover improper payments to include unsupported overhead costs and unallowable costs for meal breaks.
3. Report contract management as a material internal control weakness in the Department's 2002 Federal Managers' Financial Integrity Act report to Congress and the Office of Management and Budget.

MANAGEMENT COMMENTS

A draft of this report was provided to the Under Secretary of Transportation for Security on November 15, 2002. The Under Secretary agreed with our recommendations and provided the following comments.

In response to our draft report, the Under Secretary expressed how important it is for the final report to contain adequate background about how these security contracts were developed and managed. The Under Secretary stated that an ambitious and necessary charge to TSA was to enter into agreements and transfer any contracts providing passenger screening security services that existed at the nation's commercial airports by February 2002.

According to the Under Secretary, the FAA legal and procurement team, operating with limited staff to meet this unanticipated and unprecedented requirement, nonetheless generously undertook the lead to put in place contracts with 74 screener companies and 58 domestic airlines that would allow TSA to meet the February 2002 deadline. FAA accomplished this job on time while managing literally hundreds of policy questions in order to complete the task.

Although FAA entered into 74 contracts, the total number of task orders and contracts under the screener program was well in excess of 600 agreements. The initial plan was to begin to definitize the letter contracts within 90 days, but this proved to be an unreasonable and unworkable expectation because the vast number of screener companies were unfamiliar with Federal contracting standards and suffered from a lack of knowledge about how to prepare a proposal that could be readily validated.

In conjunction with the transition of oversight of all screening operations to TSA in February 2002, DOT decided not to contract with the then-largest provider of airport

screening services, Argenbright, which certainly impacted FAA contract management staffing and contractor pricing. At the same time, there were numerous variables that complicated contract definitization, which made it impossible to definitize the contracts in the manner TSA had initially set.

According to the Under Secretary, TSA faced a severe budget crisis by early summer. When funding became available, TSA immediately implemented the OIG's recommendation to employ DCAA to audit the 14 high-risk contracts transferred to TSA. TSA also hired DCMA to negotiate, definitize, and administer the screening contracts and airline agreements.

TSA also awarded a contract to conduct floor checks at 11 selected airports and established procedures to require TSA field representatives to verify that daily time sheets reflect hours actually worked by contractor employees. In addition to contractor compliance reviews, TSA implemented extensive voucher examination procedures to verify daily time sheets and identify additional questioned costs for possible recoupment by DCMA.

Specific comments by the Under Secretary and updates on TSA actions on the OIG recommendations are provided below.

Recommendation 1: TSA will withhold contractor payments until DCAA audits are complete. TSA issued guidance to DCMA on December 6, 2002, to withhold payments on all invoices received on the largest contracts. TSA is holding over \$90 million in payments to the 14 contractors. As of February 26, 2003, DCMA had definitized 56 of the 74 contracts. TSA expects to complete all audits and invoice reconciliation for passenger screening contracts by April 2003.

Recommendation 2: TSA will exercise rights under the contracts to recover improper payments identified by DCAA. TSA will request that DCMA use the DCAA audit results for identifying recoveries and offset amounts where improper or unsupported payments were made, or where unallowable costs were billed. TSA will follow contractual and legal guidelines for executing recoveries. TSA expects to complete this action by April 2003.

Recommendation 3: TSA reported contract management of the contract screener program as a material weakness in the Department's 2002 Federal Managers' Financial Integrity Act report, and continues to provide monthly updates to DOT on progress of corrective actions.

The complete text of management comments is in the Appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

Actions taken and planned by TSA are reasonable. As of February 26, 2003, DCAA audits had questioned costs of about \$149 million which includes projected hours that may not have been incurred or ever billed. DCAA also had developed audited rates for five of the six contractors that had substantially increased their billing rates to TSA. Using the audited rates rather than the contractor-billed rates, TSA will save at least \$67 million on the rate changes alone, as shown in Table 4.

Table 4
Comparison of Hourly Rates Billed to TSA
With DCAA Audited Rates

Contractor	Hourly Rates Billed TSA	DCAA Audited Rates	Difference Per Hour	Estimated Savings (millions)
Contractor #1	\$19.39	\$16.58	\$2.81	\$ 5.6
Contractor #2	\$26.00	\$20.34	\$5.66	\$ 7.4
Contractor #3	\$28.00	\$23.81	\$4.19	\$40.6
Contractor #4	\$19.81	*	*	*
Contractor #5	\$24.77	\$21.48	\$3.29	\$9.2
Contractor #6	\$21.37	\$19.92	\$1.45	\$4.2
-	-	-	-	\$67.0

*Contractor #4 had not submitted a proposal as of February 26, 2003. DCAA had audited vouchers totaling \$118 million and questioned costs of about \$33 million (28 percent).

Because TSA is transferring to the Department of Homeland Security (DHS) on March 1, 2003, we will provide this report, along with TSA action plans and estimated completion dates, to the DHS Office of Inspector General for followup to ensure corrective actions are taken.

We appreciate the courtesies and cooperation of DOT, TSA, FAA, DCAA, and DCMA representatives. If you have any questions concerning this report, please call me at (202) 366-1992, or John Meche at (202) 366-1496.

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EXHIBIT A. SCOPE AND METHODOLOGY

We interviewed the TSA and FAA Contracting Officers, reviewed letter contract files, and obtained financial summary data on screener contract funding, obligations, and payments at TSA and FAA Headquarters.

We selected two airports for our review, one small and one large, and observed on-site passenger screener activities of the five private security companies at these airports. We conducted unannounced floor checks at the small and large airport on May 23 and May 30, 2002, respectively. We observed contractor employees' arrival and departure times during shift changes to evaluate whether time sheets reflected actual employee hours worked. We also evaluated whether contractors followed company policy and procedures for recording and approving employee hours on time sheets. We traced employee hours recorded on time sheets to contractor invoices submitted for payment from February 17 through April 30, 2002.

We contacted eight private security companies and visited the corporate offices of five companies. At the corporate offices, we reviewed employee payroll records to verify employee pay rates and prior contractor agreement with air carriers, and documented systems used in generating and supporting invoices. We also requested documentation in support of hourly billing rates. We contacted eight other private screener companies and obtained information regarding their billing rates to TSA and air carriers.

We performed the audit from May through October 2002. We conducted the audit in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States. To prepare the final report, we also obtained and used results from DCAA audits and DCMA negotiations.

EXHIBIT B. MAJOR CONTRIBUTORS TO THIS REPORT**THE FOLLOWING INDIVIDUALS CONTRIBUTED TO THIS REPORT.**

<u>Name</u>	<u>Title</u>
Earl Hedges	Program Director
Mary Smothers	Project Manager
George Banks	Senior Auditor
Michael Weisz	Senior Auditor
Renee Yancy	Auditor
Kevin Kelly	Auditor
Larry Walker	Auditor
Brian Frist	Analyst

APPENDIX. MANAGEMENT COMMENTS

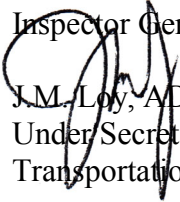


United States Department of Transportation
TRANSPORTATION SECURITY ADMINISTRATION

400 Seventh Street, S.W.
 Washington, DC 20590

January 21, 2003

MEMORANDUM TO: Kenneth M. Mead
 Inspector General

FROM:  J.M. Loy, ADM
 Under Secretary of
 Transportation for Security

SUBJECT: Oversight of Security Contracts, Project Number
 02F3019F000 – Update

1. Introduction

This memorandum supplements and updates my earlier written comments (November 5, 2002 and December 17, 2002) about progress that the Transportation Security Administration (TSA) has made in oversight of airport security contracts and our work on issues raised in your November 15, 2002, draft report on this matter.

It is important that your final Report on Oversight of Security Contracts contain adequate background about how these contracts were developed and managed, so I have addressed a few of those matters. In addition, I would like to convey specific comments and updates on the actions taken by TSA that coincide with the five excellent recommendations made in your July 17, 2002, memorandum, and the three new recommendations contained in your draft report.

At the outset, I would like to thank you and your staff for working so closely with TSA in oversight of these important contracts. Your counsel and support has been invaluable.

2. Background

As you know, the TSA was created under Title I of the Aviation and Transportation Security Act (ATSA), November 19, 2001, directly in response to the September 11, 2001, terror attacks. An ambitious and necessary charge to the Under Secretary was to enter into agreements and transfer any contracts providing passenger screening security services that existed at the nation's 442 commercial airports by February 19, 2002.

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

TSA signed a Memorandum of Agreement with the Federal Aviation Administration (FAA) to negotiate and administer contracts for these passenger and baggage screener security services until TSA could assume operational responsibility for the screening program.

On a parallel track, TSA simultaneously launched an aggressive effort to design, test, and begin initial deployment of the program that would, by year's end, support an entirely new federal workforce and to acquire and install technology system to meet the law's passenger and checked baggage screening requirements.

3. FAA's Award of 74 Screener Contracts and 58 Domestic Airline Agreements

The FAA legal and procurement team, also operating with limited staff to meet this unanticipated and unprecedented requirement, nonetheless generously undertook the lead to put in place contracts with 74 screener companies and 58 domestic airlines that would allow us to meet the February 2002 deadline. Managing literally hundreds of policy questions in order to complete the task, they accomplished this job on time.

Contracts with the airlines were necessary because a considerable amount of screening and checkpoint supervisory work was being conducted by airline employees. As of the February transition date, TSA was required to pay for and operationally supervise airline personnel performing certain specific screening functions. These 58 contracts involved complex operations at virtually every one of the 442 commercial airports and involved significant legal and procurement work. The airline contracts were nonetheless executed and definitized on time and as expected. Managing these contracts was made easier by the fact that the airlines were generally organized more efficiently to operate under government contracting requirements.

This was not generally the case with the third party screening companies, which were operating prior to February 2002 under a much different contracting regime with the airlines. The Department of Transportation's (DOT) screening company contracts were task order contracts, and in many cases they covered more than one airport. For example, the Worldwide Security Associates contract provided for services 11 airports, therefore requiring 11 separate task orders or contracts and 11 distinct proposals. A handful of contracts with the largest screening companies covered many more airports. At numerous airports, TSA inherited screening contracts with multiple firms within a single airport.

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

Although the FAA entered into 74 such contracts, the total number of task orders and contracts under the screener program is well in excess of 600 agreements. The initial FAA/TSA plan was to begin to definitize¹ the letter contracts within 90 days from February 15, 2002, or beginning May 17, 2002. This proved to be an unreasonable and unworkable expectation.

The vast number of the 74 screener companies were unfamiliar with federal contracting standards and suffered from a general lack of knowledge about how to prepare a proposal that could be readily validated. The detailed cost and accounting controls that DOT demanded were not typically required in the contracts that these security companies had with the airlines. In order to sort through such issues, FAA extended the deadline for contractor proposals to begin to definitize each contract until July 23, 2002.

It is essential to understand that the rates contained in the letter agreement contracts constituted a price ceiling, and were signed with a clear expectation that the definitization process would generally yield a lower cost to TSA. The letter contract mechanism allowed TSA to establish “not-to-exceed” rates that were then urgently needed to allow for the transition to Federal ownership and to formulate an adequate fiscal year 2003 Emergency Supplemental request for TSA airport screening services.

In conjunction with the transition to TSA oversight of all screening operations in February 2002, the DOT also decided not to contract with the then-largest provider of airport screening services in the United States, Argenbright. This one firm had approximately 40 percent of airport screening contracts. TSA undertook steps immediately after the February transition to move the Argenbright screening services to other screening companies or directly to the TSA. This was a challenging step, not only because of the size of the project, but because neither TSA nor potential contractors knew in early February the schedule for the ultimate transition to TSA screening.

The Argenbright transition certainly impacted FAA contract management staffing and contractor pricing. The Argenbright contracts were re-competed and outsourced to other firms with whom TSA had already executed letter agreements. Those firms were required to modify their initial letter agreements with us to include a modified transition schedule, work plan, and the estimated expenses associated with this additional work. TSA worked with contractors around the country to make this transition as soon as possible after the February contract transition date.

At the same time, there were numerous other variables that complicated contract definitization. It was simply impossible in February to estimate accurately the turnover

¹ Definitization encompasses having contractors provide cost and pricing data and labor rates for screener security services; contracts are negotiated consistent with Department of Labor standards. Generally, rates are jointly negotiated between the contractor and the government. Once the terms of the contract are negotiated, the contract is signed by the contract screening company and the government.

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

rate among the screener workforce (new recruits had a new and substantially higher training cost). TSA was still designing and testing checkpoint and baggage protocols -- we had not yet awarded core contracts needed to conduct deployment assessments and fix draft transition schedules. Further, Congress significantly cut the President's appropriation request and did not appropriate Emergency Supplemental funds until the end of July 2002, thus delaying and changing our initial deployment plan and schedule. All of this ultimately made it impossible to definitize the contracts in the manner we had initially set for TSA.

Immediately after the award of the letter contracts to private screener companies, the FAA began to administer the contracts. FAA established an entirely new system and for payment and management of the contracts and the hundreds of task orders for each airport location. In the first few months, the program office was inundated with contractual and staffing issues, which were raised by the various contractors and TSA security responsible for the airport.

Despite these difficulties, I must say that virtually every single one of these companies made and upheld a very impressive commitment to work with TSA to continue screening operations, while improving ongoing security operations.

4. Oversight of Screener Contracts

At the time the screener contracts were transferred to FAA on behalf of TSA, the TSA also lacked operational staffing at the 442 commercial airports nationwide and at TSA Headquarters. Pulling primarily from FAA field security staff, TSA assigned Interim Federal Security Representatives (IFSRs) to supervise screening at the nation's commercial airports. Working on behalf of TSA, the IFSRs had little or no support staff and typically represented the only TSA employee presence at the airports. In many instances, the IFSR was responsible for more than one airport.

Initial guidance by TSA to the IFSRs on June 3, 2002, included orders to assume contract oversight of the financial functions associated with the screening contracts at each airport. This decision proved to add an unworkable burden to the already overworked IFSRs. TSA therefore withdrew guidance requiring on-site contract oversight at individual airports on July 5, 2002. The first Federal Security Directors (FSD) were deployed in March 2002 to replace the IFSRs, but meaningful numbers did not complete training and arrive at their airports until July. Initially, the FSDs too had little administrative support.

On August 16, 2002, the FAA formally transferred contract administration of the 74 undefinitized screener letter contacts and 58 definitized air carrier agreements to TSA. TSA reassumed obligation authority of the remaining \$560 million in unliquidated obligations of the \$1.2 billion in total programmatic obligations in September 2002. At

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

that time, 43 of 74 required proposals had been received, with only 39 sufficient to begin review for definitization. The 39 proposals that were deemed sufficient to begin review for definitization did not include the largest screening companies.

5. OIG Review of Screener Contracts and TSA's Adoption of OIG's Suggestions

In the June 2002, the TSA Office of Inspections conducted a limited review of two commercial screening companies to determine if adequate procedures to prevent payments for inappropriate screener charges were in place. They determined that adequate procedures were not in place. These reviews were at the request of the TSA Associate Under Secretary for Finance and Administration, who had concerns about contract administration oversight at airports nationwide and the appropriateness of screener charges presented to TSA.

Simultaneously, and at the Department's request, the OIG also conducted similar site visits to assess these same sets of concerns. The OIG issued a July 17, 2002, memorandum outlining their findings. On August 2, 2002, TSA's Office of Inspections issued a similar report and findings. Both reports confirmed lack of sufficient oversight due to insufficient resources. Both called for remedial actions and additional resources to be allocated to this matter.

For a variety of reasons, TSA and the OIG determined that the government's interests would best be served by auditing the 14 high-risk contracts first, then completing the definitization process. TSA developed a risk-based approach to prioritize and review cost and pricing data, and to audit data and overhead rates in 14 high-risk contractor proposals representing 93 percent of the dollars obligated against these contracts.

By early summer, TSA faced a severe budget crisis. When funding became available at the beginning of August, TSA immediately implemented an OIG recommendation to employ the Defense Contract Audit Agency (DCAA) to audit the 14 high-risk contracts transferred to TSA. We also hired the Defense Contract Management Agency (DCMA) to negotiate, definitize, and administer the screening contracts and airline agreements. Once the audit results were received, negotiation and definitization of the highest risk contracts could begin.

6. Definitization Process, Airport Visits, Audit Completion and Recoupment

DCMA, on behalf of TSA, immediately began enforcing contract provisions that all contractors submit cost and pricing data. Contractors were notified that TSA would consider the option unilaterally to definitize contracts without negotiation if proper cost proposals were not received.

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

Additionally, TSA, working with its Office of Inspection and the OIG, drafted a statement of work to perform additional oversight at Category X, I, and II airports. A contract was awarded to conduct floor checks at 11 selected airports. TSA provided preliminary feedback to DCAA and DCMA from weekly reports where there appeared to be risk factors at these airports. DCAA and DCMA were provided the draft report of findings for their review in December 2002.

TSA also established procedures to require TSA field representatives to verify that daily time sheets reflect hours actually worked by contractor employees. Guidance was issued to all FSDs nationwide to perform floor checks for contractor compliance and additional oversight. TSA has conducted assessments to gauge the success of this effort and is currently analyzing the results. TSA has received over 173 FSD floor checks and our analysis of these results continues. In addition to the compliance reviews conducted by the contractor, TSA also implemented extensive voucher examination procedures prior to Contracting Officer Representative providing sign-off. This is to verify available daily time sheets and identify additional questioned costs for possible recoupment by DCMA.

To date, the supplemental voucher examination program has reviewed \$53.2 million in invoices, with voucher examinations continuing through April 2003. Additional questioned costs may be identified for potential recoveries under this program as well.

7. Government Withholding of Contractor Invoices and Contract Closure

As you know, to ensure that the government's interests were served, TSA directed DCMA to withhold contractor payments until DCAA audits are completed and the final hourly billing rates have been negotiated. TSA issued guidance via memorandum on December 6, 2002, for DCMA to withhold payments on all invoices in-house and all future invoices received on the 14 largest contracts. TSA is holding well over \$90 million in invoice payments to the 14 high-risk contractors.

Because one of the screener contractors was in bankruptcy, minimal payments continued on this contact to ensure no work stoppages. TSA's Office of Chief Counsel in conjunction with the cognizant Assistant U.S. Attorney (AUSA) will address recoveries during the bankruptcy proceedings. (By agreement, the bankrupt company cannot disseminate funds to its creditors without the express permission of the court in consultation with the AUSA.) TSA is instituting a hotline to afford former contractor screener personnel a means to provide information that may support additional areas for recovery by TSA.

Memorandum for Kenneth M. Mead

Subject: Oversight of Security Contracts, Project Number 02F3019F000 – Update

8. Conclusion

By mid-February 2003, all of the audits at the largest screening company contracts will be completed. Data from the completed audits has, of course, been shared with the OIG. TSA, with the assistance of DCMA and DCAA, is currently working to complete definitization of all contracts and resolve all final invoices. DCMA is definitizing contracts not being audited by DCAA. To date, DCMA has definitized 49 of the 74 contracts.

We anticipate having sufficient data for DCMA to identify questioned costs and make recoveries or deny payments on questioned or improper costs billed or paid by the government. TSA expects to complete this action by April 2003, unless all final invoices have not been received. In sum, TSA is working to bring outstanding issues regarding the screening firm contracts to a prompt close by late April 2003.

Because of the many issues associated with standing up the new agency -- and acknowledging the management issues outlined herein and in your draft report -- management of these screening company letter contracts has not met the performance standards that TSA is committed to meet in our contract work. TSA has therefore reported contract management as a material weakness in the DOT's fiscal year 2002 Federal Managers' Financial Integrity Action (FMFIA) report to Congress and the Office of Management and Budget. The statement and memorandum were submitted to the Assistant Secretary for Budget and Programs, Office of the Secretary of Transportation, December 20, 2002.

TSA is committed to ensuring that the FMFIA commitments made in the report are followed. Obviously we do not expect such weaknesses to recur at TSA. Appropriate steps have been taken to bring this matter to a complete and responsible close.

We have attached a chart showing critical path dates and decision points that correlate to the recommendations in your memorandum and draft report, as well as the overall programmatic responsibilities incurred under the contracts in place during airport federalization.

We will continue to update you as our progress continues. Again, we again appreciate the oversight efforts and the OIG partnering with TSA on this most challenging endeavor. We of course invite and welcome our continued partnership with your office.

Attachment



World Events Congress

WTC/Pentagon	Aviation Transportation Security Act (creation of TSA)
09/11/2001	11/19/2001

FAA	FAA	FAA	FAA	FAA	FAA	FAA	FAA	FAA	FAA	FAA
MOA w/ FAA - delegated contracting authority	FAA issues 74 letter contracts 58 OTAs	FAA program stand-up/Replacement of Argenbright Services	DOT OIG Site Inspections	TSA Issues IFSR Guidance for on-site contract oversight	TSA Office of Inspection limited reviews	TSA Rescinds IFSR Guidance for on-site contract oversight	DOT OIG Issues memorandum on results of audits	FAA extended contract proposal due date because of lack of proposals	TSA Office of Inspections issues results of limited review	
02/12/2002	02/15/2002	2/15/02-6/30/02	5/00/2002	07/05/2002	6/00/02	7/5/02	7/17/02	07/23/02	8/00/02	

TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA	TSA
TSA Office of Acquisitions develops risk-based approach for 14 contracts representing 93% of funds obligated against contracts (appx. \$1B)	FAA Transfers Contracts to TSA 74 Letter 58 OTA	TSA Receives Contracts from FAA	TSA signs MOA w/ DCMA	TSA signs MOA w/ DCAA	TSA Receives Contracts from FAA	Return of Obligation authority for \$560M from FAA to TSA	Additional oversight inspections begin at Cat X, I, & II Airports	FSD on-site contract policy written & approved by Aviation Ops	FSD on-site floor checks begin nationwide for contracts in place	Awarded contract for COR Voucher Examination program put into place to review invoices	DCMA directed to withhold screener payments on 14 high-risk contracts	TSA FMFIA Material Weakness Reported to DOT for FY 2002	Contractor report received for oversight inspections of Cat X, I, & II Airports	\$53.2M in voucher examinations begins	DCMA/DCAA provided preliminary performance results of oversight inspections for Cat I, II, & X Airports	DCAA Audits complete with the exception of three reports	Begin implementation of Office of Internal Affairs and Program Reviews Hotline for Screener Complaints	DCMA begins definitization of 14 high risk contracts using DCAA audits as basis	Recoveries to be sought on final invoice payments by DCMA
08/01/2002	08/16/02	08/31/02	8/6/02	8/21/02	08/30/2002	09/19/2002	10/25/02 - 11/15/02	11/06/2002	12/06/2002	12/5/2002-4/15/02	12/06/2002	12/20/2002	12/20/2002	12/20/2002	12/23/2002	01/09/2002	1/3/2003 - 2/15/2003	1/9/2003-3/15/03	3/31/03-4/30/03

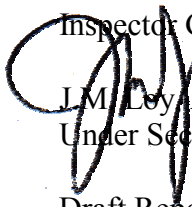


United States Department of Transportation
TRANSPORTATION SECURITY ADMINISTRATION

400 Seventh Street, S.W.
 Washington, DC 20590

December 17, 2002

MEMORANDUM TO: Kenneth M. Mead
 Inspector General

FROM:  J.M. Loy, ADM
 Under Secretary of Transportation for Security

SUBJECT: Draft Report on Oversight of Security Contracts, TSA
 Project Number: 02F3019F000

Thank you for providing me with an opportunity to present written comments to your Draft Report on Oversight of Security Screener Contracts issued November 15, 2002. I would like to further update you on our oversight efforts.

As you know, the Transportation Security Administration (TSA) continues to actively work with your staff as we take actions and make plans for ongoing oversight functions. We are adding your three new recommendations to an attachment that was provided to you in a November 5th memorandum, and we are updating that attachment. TSA is addressing the three new recommendations in the following ways:

- TSA will withhold contractor payments until audits are complete;
- TSA will exercise rights under the contract to recover improper payments identified by the Defense Contract Audit Agency (DCAA); and
- TSA will ensure that the contract management as a material weakness is reported in the Department's 2002 Federal Managers' Financial Integrity Action report to Congress and the Office of Management and Budget.

Regarding your request for TSA to comment on the validity of the \$179 million in questioned costs, TSA acknowledges that based on the site inspections by the TSA Office of Inspections and the Department of Transportation's Office of the Inspector General's site-visits early on in the oversight process, the validity to question \$179 million exists. The DCAA has been provided guidance to specifically review for these types of questioned costs and identify them in their final audit report to TSA. These audits will be the basis for TSA to exercise rights under the contract to recover improper payments.

I would like to update you on our efforts in the context of the “required actions” you have suggested that TSA undertake:

<u>Action Required</u>	<u>TSA’s Actions Taken and Plans</u>
Enforce contract provisions that all contractors submit cost and pricing data	The contractors have been requested to submit cost or pricing data as part of TSA’s effort to definitize the contracts.
Establish a process to prioritize and review cost and pricing data, to include using the DCAA to audit the data and overhead rates.	TSA signed an agreement with the Defense Contract Management Agency (DCMA) for contract support, including definitization of the contracts. The definitization of the contracts will include a review of the cost or pricing data submitted by the contractors. The Defense Contract Audit Agency (DCAA) is supporting this effort, including providing necessary audit review of cost or pricing data. DCMA and DCAA are working to ensure that rates are reasonable, based on an appropriate combination of cost and price analysis, and market research. TSA, DCMA, and DCAA established a risk-based approach for the review of the cost or pricing data that places the greatest emphasis on the 13 largest dollar contracts.
Conduct negotiations and definitize all contracts by August 31, 2002.	TSA will use its agreements with DCMA and DCAA to complete the definitization of the contracts. DCMA, with the support of DCAA, will definitize the contracts as soon as possible but the August 31 date cannot be met. Definitization proposals were due from the contractors on July 23rd. However, FAA had not worked the proposals received and the transfer to DCMA took place August 16 th . Further, completed proposals have not yet been received for all contractors. Also, many initial proposals will be inadequate for negotiation since most of the screener contractors are unfamiliar with Federal requirements. Additionally, a DCAA audit requires at least 30 days from submission of a complete contractor proposal. DCMA will begin negotiations with the contractors once the audits are completed. TSA understands the need to prioritize this work based on risk. Therefore, TSA placed emphasis on definitizing large dollar contracts and those involving a known risk first, followed by lower risk, small dollar contracts. DCAA expects to complete the audit of 93 percent of funds representing on the 13 largest contracts by mid-December 2002.
Expand the statement of work for the oversight contract or enter into an agreement with DCAA, as appropriate, to perform oversight work as soon as possible.	With the IG’s input, TSA drafted a statement of work (SOW) to accomplish this goal. Until passage of the recent budget supplemental, TSA had insufficient resources to fund the contract. Funding was made available and a contract awarded. The contractor performed floor checks at 11 selected airports. As part of its audit work, BearingPoint provided preliminary feedback to DCAA where there appeared to be risk factors in Category X, I, and II airports. We expect to provide DCAA a draft report prepared by BearingPoing the week ending December 13, 2002, of the results of the floor checks. TSA expects a final report from BearingPoint by the end of December 2002 for the 11 airports where floor checks were performed.

Recoup improper payments based on finalized overhead rates or payments for hours not worked.

TSA will take steps to recoup any overpayments to the contractors. The preferred method of recouping overpayments is immediate garnishment of the full amount on the next invoice. However, TSA is sensitive to the possibility that this approach in some circumstances could lead to unacceptable work stoppages. Deferment and/or partial repayments may be necessary to ensure contractor solvency, in certain situations, and continued performance of essential services.

Establish procedures to require TSA field representatives to verify that daily time sheets reflect hours actually worked by contractor employees.

Guidance has been issued to the IFSRs and FSDs at the airports. TSA has conducted assessments to gauge the success of this effort and is currently analyzing the results. However, because of a lack of staffing at the airports to conduct the full range of compliance inspections necessary to ensure the government's interests, TSA also plans to use a contractor to conduct additional compliance reviews. In addition to the compliance reviews conducted by the contractor, TSA is also implementing extensive voucher examination procedures prior to COTR signature to verify daily time sheets.

Withhold contractor payments until DCAA audits are completed and the final hourly billing rates have been negotiated.

TSA advised DCMA to withhold sufficient invoices to cover potential over billings for the 13 largest contracts that do not have hourly billing rates negotiated and where DCAA audits are not complete. TSA issued that guidance via memorandum to DCMA on December 6, 2002, to withhold payments on all invoices in-house and all future invoices received on the 13 largest contracts. Because ITS is in bankruptcy, payments must continue on this contract; however, recoveries will be addressed by TSA's Office of Chief Counsel during the bankruptcy proceedings. TSA expects complete invoice reconciliation for passenger screening contracts by February 28, 2003, unless contractors supply very late invoices to TSA. In that event, we anticipate reconciliation within 30 days of receipt of invoice.

Recover any improper payments for unsupported or unallowable costs.

TSA will exercise rights under the contract to recover improper payments identified in the DCAA final audits findings. TSA will request that DCMA use the DCAA audit results for identifying recoveries and offset amounts where improper or unsupported payments were made, or where unallowable costs were billed. TSA will follow contractual and legal guidelines for executing recoveries. TSA expects to complete this action by February 28, 2003, unless all final invoices have not been received. In that event, TSA anticipates reconciliation within 30 days of receipt of invoice.

Again, the information generated by your review of our efforts has proven extremely helpful. If you have any additional suggestions about how we might improve our oversight of the contracts, I would certainly appreciate them. I look forward to our continued collaboration.



United States Department of Transportation
TRANSPORTATION SECURITY ADMINISTRATION

400 Seventh Street, S.W.
Washington, DC 20590

November 5, 2003

MEMORANDUM TO: Kenneth M. Mead
Inspector General

FROM: J.M. Ledy, ADM
Acting Under Secretary
of Transportation for Security

SUBJECT: Review of Airport Screening Contracts

Thank you for providing us with an update on your review of the Transportation Security Administration's (TSA) oversight of the airport security screening contracts in your memorandum of July 17, 2002. I would like to update you on our oversight efforts as well as to request your assistance in conducting additional audit review of the screening contracts.

As you know, TSA has been actively involved in discussions with your staff since April 2002 concerning oversight for the screening contracts. TSA has been implementing a plan to improve the oversight of the contracts which includes the following:

- Issuance of field guidance to the Interim Federal Security Representatives (IFSR's) and Federal Security Directors (FSD's) at the airports;
- Inspection of selected, non-random sites for billing inconsistencies;
- Transfer of contract responsibilities from FAA to TSA; and
- Procurement of contractor services.

Regarding the second item, TSA Inspections has concluded a limited review of screening contractors for billing inconsistencies at Los Angeles, Seattle, and Spokane airports. As in the case of your own reviews to date, TSA Inspections has reported a number of billing problems involving two screening companies, some of which involve inappropriate charges to TSA. The Associate Under Secretary for Inspections has referred these contractors to you for investigation. I also would like to request your assistance in reviewing the billings of other screening contractors to ensure the opportunity for a

Memorandum for Kenneth M. Mead
Subject: Review of Airport Screening Contracts

timely follow-up and investigation, if necessary, of any other significant billing inconsistencies.

Attachment

I would like to update you on our efforts in the context of the “required actions” you have suggested that TSA undertake:

<u>Action Required</u>	<u>TSA’s Actions Taken and Plans</u>
Enforce contract provisions that all contractors submit cost and pricing data	The contractors have been requested to submit cost or pricing data as part of TSA’s effort to definitize the contracts.
Establish a process to prioritize and review cost and pricing data, to include using the DCAA to audit the data and overhead rates.	TSA has signed an agreement with the Defense Contract Management Agency (DCMA) for contract support, including definitization of the contracts. The definitization of the contracts will include a review of the cost or pricing data submitted by the contractors. The Defense Contract Audit Agency (DCAA) will support this effort, including providing necessary audit review of cost or pricing data. DCMA and DCAA will work to ensure that rates are reasonable, based on an appropriate combination of cost and price analysis, and market research. TSA will work with DCMA and DCAA to establish a risk-based approach for the review of the cost or pricing data that places the greatest emphasis on large dollar contracts.
Conduct negotiations and definitize all contracts by August 31, 2002.	TSA will use its agreements with DCMA and DCAA to complete the definitization of the contracts. DCMA, with the support of DCAA, will definitize the contracts as soon as possible but the August 31 date cannot be met. Definitization proposals were due from the contractors on July 23rd. However, FAA has not worked the proposals received and the transfer to DCMA was only completed on August 16 th . Further, completed proposals have not yet been received for all contractors. Also, many initial proposals will be inadequate for negotiation since most of the screener contractors are unfamiliar with Federal requirements. Additionally, a DCAA audit requires at least 30 days from submission of a complete contractor proposal. DCMA will begin negotiations with the contractors once the audits are completed. TSA understands the need to prioritize this work based on risk. Therefore, TSA will place emphasis on definitizing large dollar contracts and those involving a known risk first, followed by lower risk, small dollar contracts.
Expand the statement of work for the oversight contract or enter into an agreement with DCAA, as appropriate, to perform oversight work as soon as possible.	With the IG’s input, TSA has drafted a statement of work (SOW) to accomplish this goal. Until passage of the recent budget supplemental, TSA has had insufficient resources to fund the contract. Now that funding has been made available, a contractor can be selected. The contractor will perform floor checks at selected airports as part of its audit work and provide feedback to DCAA where there appears to be risk factors in Category X, I, and II airports.
Recoup improper payments based on finalized overhead rates or payments for hours not worked.	TSA will take steps to recoup any overpayments to the contractors. The preferred method of recouping overpayments is immediate garnishment of the full amount on the next invoice. However, TSA is sensitive to the possibility that this approach in some circumstances could lead to unacceptable work stoppages. Deferment and/or partial repayments may be necessary to ensure contractor solvency, in certain situations, and continued performance of essential services.

Establish procedures to require TSA field representatives to verify that daily time sheets reflect hours actually worked by contractor employees.

Guidance has been issued to the IFSRs and FSDs at the airports. TSA has conducted assessments to gauge the success of this effort and is currently analyzing the results. However, because of a lack of staffing at the airports to conduct the full range of compliance inspections necessary to ensure the government's interests, TSA also plans to use a contractor to conduct additional compliance reviews. In addition to the compliance reviews conducted by the contractor.

Again, the information generated by your review of our efforts has proven extremely helpful. If you have any additional suggestions about how we might improve our oversight of the contracts, I would certainly appreciate them. I look forward to our continued collaboration.