United States Department of State

Office of Inspector General

Agreed-Upon Procedures Review of Daily Direct Labor, Aerial Support Equipment and Indirect Expense Rates Proposed by Blackwater Security Consultants, Incorporated, Contractor's Accounting System & Timekeeping Procedures

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Leonard G. Birnbaum and Company, LLP, Certified Public Accountants, performed the review under Department of State, Office of Inspector General, Contract No. SAQMPD04DO033, and by acceptance this report becomes a product of the Office of the Inspector General.

Cameron R. Hume
Acting Inspector General

Jan 31 05
Date

[redacted]

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INDEPENDENT ACCOUNTANT'S REPORT

Subject: Agreed Upon Procedures Report on the Review of Daily Direct Labor, Aerial Support Equipment and Indirect Expense Rates Proposed by Blackwater Security Consultants, Incorporated, Contractor's Accounting System & Timekeeping Procedures.

Summary

We performed the procedures described below in review of the proposed rates at the request of the Office of Inspector General (OIG). Although we did not take exception to the proposed base labor rates, our review did disclose differences in the proposed indirect expense rates and other direct costs proposed as an element of the proposed total daily rates.

The proposed rates and the results of our review are contained in Exhibits A, B & C and related Schedules.

We recommend that the contracting officer consider the adjustments presented in the exhibits and schedules of this report in the negotiation of a definitive contract.

Our review also disclosed that the contractor's current timekeeping procedures in Iraq are deficient and that its current accounting system is not considered adequate for accumulating costs on government contracts or to support billings under this contract without the use significant ancillary records and worksheets.

The results of our review of, and related recommendations on, the contractor's timekeeping procedures and accounting system are contained in Appendices 1 and 2, respectively.

We recommend that the contracting officer require Blackwater Security Consultants, Inc. to correct the deficiencies noted in Appendices 1 and 2 related to its timekeeping procedures and accounting system.

Background

This proposal was submitted to definitize letter contract number S-AQMPD-04-D-0061 awarded to Blackwater Security Consultants, Inc., pursuant to section 16.603 of the Federal Acquisition Regulation (FAR). The contract provides for Protective Security Services for the American Diplomatic Mission in Iraq and the American Ambassador to Iraq and his residence in Iraq, including aerial, administrative and logistical support. The period of performance contemplated under this contract is June 11, 2004, to June 10, 2005.

Purpose, Scope, and Methodology

We performed this agreed-upon procedures engagement in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of OIG. Consequently, we make no representation regarding the sufficiency of procedures described below either for the purpose for which this report has been requested or any other purpose. The procedures we performed are summarized as follows:

a. We verified the mathematical accuracy and validated the formulas used by the contractor in the pricing of this proposal.

b. We verified the proposed base direct labor rates of those positions identified as expected to participate in the contemplated contract, where appropriate, to payroll records or other supporting documentation.

c. We evaluated the proposed indirect cost rates by comparison to the most current actual historical or forecasted rates as considered appropriate.

d. We evaluated the underlying supporting documentation for the proposed other direct costs included in the contractor's proposed daily labor rates.

e. We evaluated other rates and factors used by the contractor in the development of the proposed daily rates as considered appropriate.

f. We reviewed the contractor's timekeeping procedures in Iraq to determine if they are adequate to ensure reliable billings under this contract.

g. We reviewed the contractor's accounting system to determine if it is adequate for accumulating costs under government contracts and to support billings under this contract.

Because the above procedures do not constitute an audit conducted in accordance with generally accepted government auditing standards, we do not express an opinion on the adequacy and compliance of the reviewed cost or pricing data. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that there were significant inadequacies or noncompliance related to the areas reviewed other than noted. This report relates only to the rates, procedures, and systems specified above.

Our review was performed during the period October 22 through November 20, 2004, at Blackwater's facilities in Moyock, North Carolina, and our office in Alexandria, Virginia.

Leonard G. Birnbaum and Company, LLP

Leslie A. Leiper, CPA, Senior Partner

Explanatory Notes **EXHIBIT A**

Note 1 – Direct Labor

All of the positions listed are classified as independent contractors by Blackwater. All are paid at a specified daily independent contractor contract rate for each day they are deployed in Iraq and physically present at their duty station. Blackwater priced out the proposed daily labor cost on the premise that the independent contractors are paid for seven days per week although they are only required to work six days in accordance with the statement of work. The proposed "daily" labor rates are computed to recover the seven days pay over six "billing" days. This method is considered acceptable as long as these individuals only actually work six days and Blackwater bills for the six out of seven days actually worked. Our review of timekeeping procedures (Appendix 1), however, disclosed that, at present, Blackwater only accounts for the number of days these individuals are physically present while deployed at their duty station and not the days actually worked. Billings to the Department are manually adjusted to ensure that the Department is billed only for six days for each seven days deployed.

For purposes of our review, we compared the proposed rates to the contract rates specified in the "Independent Contractor Service Agreement" executed by Blackwater and the individual contractors, and to actual amounts paid and verified Blackwater's calculations. Based upon our review, we have not taken any exception to the daily direct labor cost as proposed.

In the event that the Department chooses to pay Blackwater for "deployment" days in lieu of "days worked," Blackwater would have to be required to resubmit its proposal to adjust these labor rates downward.

Note 2 – Holiday Premium Pay & Bonus

Holiday Premium Pay. [redacted] We verified the proposed incentive to the amounts specified in the current Independent Contractor Service Agreement and have not taken any exception to the amount as proposed.

Bonus. [redacted]. We verified the proposed incentive to the amounts specified in the current Independent Contractor Service Agreement and have not taken any exception to the amount as proposed.

Note 3 – Health & Welfare and Uniform Maintenance

Blackwater included estimated costs for health and welfare and uniform maintenance in its daily proposed rates. Health and welfare costs are estimated cost for the general health and welfare of personnel, while on deployment status. [redacted]

[redacted] Based upon our review, we have not taken any exception to the amounts proposed for Health & Welfare and Uniform Maintenance.

Note 4 – Dedicated Overhead

For this proposal, Blackwater did not use an "overhead" rate in the traditional sense. That is, an overhead rate based on an overhead expense pool applied to direct labor. Blackwater instead "identified" those indirect individuals and other costs that it deemed are "dedicated" to this contract and grouped these costs into a "pool" entitled "Dedicated Overhead." The base used to allocate these costs is the estimated total direct costs over the period of performance of this contract. The resultant "dedicated overhead" rate proposed for this contract is 5.99 percent. Based upon our review, we have questioned 3.36 percent of the proposed rate as follows:

	Proposed	Questioned	Adjusted	Questioned Rate	Ref.
Dedicated Overhead Expense Pool					
Labor	803,538.51		803,538.51		a.
Equipment	1,899,754.33	1,774,138.88	125,615.45	2.45%	b.
Management Reserve	766,098.13	766,098.13	0.00	1.06%	c.
Profit	862,790.79	862,790.79	0.00	1.19%	d.
Administrative Processing Costs	0.00	(836,144.84)	836,144.84	(1.16%)	e.
Total	4,332,181.76	2,566,882.95	1,765,298.80		
Dedicated Overhead Allocation Base					
Total	72,330,079.40	5,251,887.79	67,078,191.61	(0.18%)	f.
Dedicated Overhead Rate	5.99%		2.63%	3.36%	

a. Represents estimated labor cost for personnel that have been designated as dedicated to this contract. We compared the proposed labor cost to current payroll records and have not taken any exception to the amounts as proposed.

b. As part of its proposed equipment costs, Blackwater included costs equating to $520,005.22 to purchase five armored vehicles plus operating expenses to be used to transport personnel to and from Baghdad Airport in Iraq. The contractor indicated that it purchased these vehicles to provide some protection for its personnel as it felt that vehicles currently available in Iraq were not adequate for this purpose. We discussed this with the contracting officer, who indicated that the contractor was not required to purchase these vehicles as they are not called for in the statement of work. Our review of the statement of work also did not disclose a requirement for these vehicles. The contracting officer also indicted that the government has sufficient vehicles in Iraq that can be used for this purpose. As a result, we have questioned the costs included in the contractors' proposal to purchase these vehicles plus the operating costs (i.e., maintenance, repair, etc.)

Blackwater also included costs equating to $1,254,133.66 for six drivers at $750 a day to operate these vehicles. Our review disclosed that these "drivers" are the protective security specialists deployed in Iraq. The cost for these personnel is already being recovered in the daily rates being proposed. As a result, inclusion of additional costs for drivers in dedicated overhead is, in effect, a duplication of labor costs. Consequently, we have questioned the costs included in the contractor's proposed Dedicated Overhead in total.

c. Blackwater included an estimated Management Reserve in its proposal "to cover unforeseen occurrences such as loss of transport vehicles, multiple helicopter incidents, emergency evacuation or re-deployment of personnel, etc." The contractor did not provide a basis for this estimate except to indicate that it "is equal to less than 1 percent of total expenditures forecasted for this contract at the time of bid proposal."

It is our opinion that these costs fall under the definition of contingencies under FAR 31.205-7. FAR further states that contingencies "that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government" are to be excluded from cost estimates. As a result, we questioned the proposed Management Reserve in total.

In the event that these unforeseen conditions do occur, the contractor should be required to submit a separate claim detailing the resultant costs.

d. Our review disclosed that in addition to profit in Note 6 applied to total costs proposed, Blackwater included profit in its "dedicated overhead." This results not only in a duplication of profit, but also a pyramiding of profit because, in effect, Blackwater is applying profit to profit. As a result, we have questioned the proposed amount in total.

e. As stated in Note 3 to Schedule A-1, we have questioned Administrative Processing Costs as an Other Direct Costs as it is our opinion that these are indirect costs. As a result, we included an estimate of these indirect administrative costs (based on the contractor's calculations) in the Dedicated Overhead pool.

f. As stated above, Blackwater only allocated Dedicated Overhead expenses to total direct costs proposed. Because we have questioned other direct costs included in total direct costs proposed, we have adjusted the proposed base to reflect elimination of the direct costs questioned except for the ODCs questioned as part of the Daily Rate in Note 4 to Schedule A-1. For these costs, we have only questioned their inclusion as part of the Daily Rate, not the costs themselves.

Questioned Dedicated Overhead represents the application of the:

1. questioned rate to total direct costs proposed; and
2. recommended rate to total direct costs questioned.

Details of our calculations are contained in Schedule A-2.

Note 5 – General & Administrative (G&A) Expenses

The contractor proposed G&A expenses by applying a proposed G&A rate of [redacted] percent to total direct costs proposed, exclusive of dedicated overhead. The contractor did not provide a basis for this rate, but did provide details on its current forecasted yearend rate of [redacted] percent. Our review of the contractor's actual experience as of August 2004 disclosed that the forecasted rate was in line with its forecast. Our review, however, also disclosed that its forecasted rate included interest in the G&A expense pool equating to [redacted] percent of the rate. Interest is expressly unallowable in accordance with FAR 31.205-20.

For purposes of our review, we have used the contractor's forecasted rate, less the unallowable interest, resulting in a questioned rate as follows:

Proposed G&A Rate	[redacted]
Forecasted Rate	
Less – Interest	
Recommended Rate	
Questioned Rate	

Questioned G&A expenses represents application of the:

1. questioned rate to total direct costs proposed; and

2. recommended rate to total direct costs questioned.

Details of our calculations are contained in Schedule A-2.

Note 6 - Profit

The proposed profit represents 23.6 percent of total proposed costs. We note that the contractor's worksheets indicated that the proposed profit rate is 19.07 percent. This, however, appears to be a formula error and the actual rate proposed is 23.6 percent of total costs proposed. Profit is a matter under the purview of the contracting officer.

Note 7 – Difference

The amounts in this section are presented solely for the convenience of the contracting officer in developing a negotiation objective. They represent only the arithmetic difference between the amounts proposed and the related questioned amounts. These amounts should not be considered as audit approved or recommended amounts because the amounts depend partly on factors outside the realm of auditing expertise, such as opinions on technical matters and other requirements under the contract.