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STATEMENT BY

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BEFORE THE

**COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES**

ON

**DEFENSE BASE ACT INSURANCE FOR THE LOGISTICS CIVIL
AUGMENTATION PROGRAM, AUDIT OF LOGISTICS CIVIL
AUGMENTATION PROGRAM OPERATIONS IN SUPPORT OF
OPERATION IRAQI FREEDOM**

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House Committee**

Mr. Chairman and distinguished Members of the Committee, it is my pleasure to be here today and have the opportunity to discuss with you our audit of Defense Base Act Insurance related to the Logistics Civil Augmentation Program—commonly called LOGCAP.

I have been with U.S. Army Audit Agency for more than 31 years and became The Deputy Auditor General for Acquisition and Logistics in October 2005. The Agency is the Army's internal audit organization, and we provide objective and independent auditing services that help Army leaders make informed decisions, resolve issues, use resources effectively and efficiently, and satisfy statutory and fiduciary responsibilities. The scope of our audit responsibility includes selecting the subjects and organizations within the Army to audit, as well as responding to requests for audit service from Army officials.

Throughout its history, Army Audit Agency has deployed with our troops—in Vietnam and Bosnia, during Desert Shield and Desert Storm, and lately in support of Operation Enduring Freedom and Operation Iraqi Freedom. We have performed extensive audit work on LOGCAP in support of Operation Enduring Freedom and Operation Iraqi Freedom dating back to 2002.

In December 2004 General Casey, then Commander of the Multi-National Force – Iraq, asked us to audit LOGCAP operations supporting Operation Iraqi Freedom. LOGCAP is the Army's program for using civilian contractors as an additional means to adequately support the current and programmed force by performing selected services during wartime and other operations. The principal objective of LOGCAP is to provide combat support and combat service support to combatant commanders and Army service component commanders, primarily during contingency operations, throughout the full range of military operations, including reconstitution and replenishment.

General Casey's goal was to reduce overall LOGCAP costs without degrading the welfare of our deployed forces. Accordingly, we established two

audit objectives to help reach the Army's goal. These objectives were to determine if:

- Overall management of the program was adequate.
- The contractor was providing the needed services in a cost-effective manner.

Since beginning our LOGCAP work in support of OEF/OIF, we have issued 31 audit reports that include potential monetary benefits totaling about \$273.1 million. We have also identified other cost avoidance initiatives we could not reasonably estimate the value of. Our LOGCAP audits have covered various topics such as overall program management, dining facility operations, supply support activity operations, warehouse operations, cross-leveling and distributing contractor-acquired property, bulk and retail fuel operations, and Defense Base Act (DBA) insurance.

DBA insurance is basically workers' compensation insurance. DBA insurance carriers provide benefits to contractor and subcontractor employees who are injured or killed under normal work conditions, while working on U.S. Government financed contracts performed outside the United States.

DBA insurance (in conjunction with the War Hazards Compensation Act) also covers war-risks (injury, death, capture, or detention). However, no premium is charged for war-risk coverage because, under the War Hazards Compensation Act, the U.S. Government reimburses insurance carriers for claims paid that were a direct result of a war-type incident. In effect, the U.S. Government self-insures itself against war-related injuries and deaths. DBA insurance rates are based on a percentage of the contractor's payroll costs for both contractor and subcontractor employees.

Because DBA insurance is required by law, and because the LOGCAP contract is primarily a cost-reimbursable contract, the cost of this insurance is ultimately paid by the U.S. Government.

We performed the audit of Defense Base Act insurance for LOGCAP because of the:

- Large amount paid for DBA insurance under the contract.
- Significant fluctuations in DBA insurance rates from year to year.
- Complexity of the DBA program.
- Army's and DOD's increased use of contractors in war zones.
- Government-wide implications of potential cost avoidances.

The objective of our DBA audit was to determine if adequate controls were in place to minimize costs paid for DBA insurance under the LOGCAP contract. We concluded that the Army was at risk of paying more than necessary. Although the Army had taken some actions to reduce DBA insurance costs, we believe additional actions were needed to minimize costs. We issued our audit report, Audit of Defense Base Act Insurance for the Logistics Civil Augmentation Program (Report: A-2007-0204-ALL) on 28 September 2007.

Here's what we found:

- DBA insurance represented a significant cost of the LOGCAP contract. The LOGCAP contractor paid about \$284.3 million in premiums for DBA insurance in FY 03 through FY 05. The premiums increased steadily each fiscal year--from about \$4.7 million in FY 03 to about \$164.7 million in FY 05.
- DBA rates (a percentage of the contractor's total payroll costs for both contractor and subcontractor employees) increased substantially for Iraq and Kuwait in FY 03 (3.75%) and FY 04 (16.2%). The rate then declined to 13.8% in FY 05 and 8.5% in FY 06.
- The premium increases and year-to-year rate fluctuations seemed inconsistent with the risk associated with providing workers'

- The U.S. Government reimburses insurance carriers for claims resulting from war-type incidents. As a result, the primary risk is the cost of claims associated with injuries and deaths under normal working conditions.
 - The contractor reported safety statistics that were much lower than the U.S. private industry average.
- The estimated amount of claims expected to be paid as a result of normal workplace injuries and deaths was substantially less than the DBA premiums the Army had paid. The insurance carrier would pay about \$73.1 million in normal workers' compensation claims for FY 03 through FY 05, or about 26% of the total \$284.3 million in premiums paid during this period.
- Excessive DBA premiums may have been paid because DBA rates are applied to total payroll costs. Total payroll costs include base pay, overtime pay, foreign-service bonuses, post differential, and danger pay. However, benefits the insurance carriers pay under the DBA program are based on an employee's average weekly wage and are capped by statute. Many of the contractor's employees earned wages that exceeded the cap.
- The LOGCAP contractor pays many of its employees an incentive for working in dangerous areas such as Iraq and Kuwait. From 1 January 2003 to 30 September 2005 the LOGCAP contractor paid about \$23.1 million in premiums related to the "danger pay" component of payroll. We recommended that the Office of the Assistant Secretary of the Army for Acquisition, Logistics and Technology (ASA (AL&T)) use more cost-effective means of providing workers' compensation insurance to contractor and

- Require contractors to use insurance carriers that use retrospective rating plans in determining DBA insurance premiums.
- Self-insure for DBA insurance for countries where war-risk hazards have been recognized by the Department of State.
- Change the definition of remuneration (payroll) used in computing DBA insurance premiums to exclude danger pay and place a salary cap on an individual's wages that exceed the current Department of Labor approved benefit level.

The Office of the ASA (AL&T) partially agreed to the recommendation and provided alternative measures. The Office stated that:

- It would review the results of the Army Corps of Engineers centrally managed pilot program.
- Competition under the pilot program had successfully reduced rates and it will consider implementing an Armywide program based on the pilot program.
- In the interim, it would carefully audit DBA premiums with the assistance of the Defense Contract Audit Agency to make sure that the base used to calculate insurance rates is fair and reasonable.

Although the Office of the Assistant Secretary didn't fully agree with all parts of the recommendation, the actions it proposed met the intent of the recommendation.

In closing, I would like to say we are continuing our LOGCAP work and are reviewing DBA insurance under contracts issued by the U.S. Army Contracting Command office in Kuwait. We also recently agreed to review the cost-effectiveness of the Corps of Engineers DBA Pilot Program.

I am very proud of my auditors on the ground with our Soldiers in Iraq, Afghanistan, and Kuwait. Their dedication and hard work have provided valuable, real-time help to the Army. I appreciate the opportunity to testify before you today to provide a summary of our audit of DBA insurance for LOGCAP.

I will be glad to respond to your questions.