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August 24, 2004

The Honorable Donald H. Rumsfeld
Secretary of Defense
The Pentagon
Washington, DC 20301

Dear Secretary Rumsfeld:

I have obtained a copy of an August 16, 2004, memorandum from the Defense Contract Audit Agency (DCAA) to the Army Field Support Command, which administers Halliburton's LOGCAP troop support contract. In the memo, DCAA "strongly encourages" the Army to withhold 15% of the government's payments to Halliburton until the company submits adequate justifications for the high costs of its work in Iraq. I am writing to ask how the Defense Department plans to respond to this memorandum, a copy of which I have enclosed for your convenience.

Fundamentally, the question raised by the DCAA memorandum is whether Halliburton will continue to receive special treatment from the Defense Department. As documented in the memorandum, DCAA has "identified significant unsupported costs" submitted by KBR, the Halliburton subsidiary operating in Iraq, and found "numerous, systemic issues ... with KBR's estimates."¹ Under these circumstances, the Federal Acquisition Regulation (FAR) requires the Defense Department to withhold 15% of Halliburton's billings to protect the interests of the taxpayer. But it is unclear if the Administration will take this required step.

This issue first arose in March 2004, after previous DCAA audits found that Halliburton had failed to submit adequate cost estimates for its LOGCAP work in Iraq. Such estimates were needed to "definitize" the costs of LOGCAP task orders worth billions of dollars. Under section 52.216-26 of the FAR, the Defense Department should have commenced withholding 15% of the reimbursements to Halliburton until the cost estimates were submitted and the task orders were

¹ Memorandum from Defense Contract Audit Agency to U.S. Army Field Support Command (Aug. 16, 2004).

definitized.² Instead, the Defense Department gave Halliburton three extensions — totaling four and a half months — that delayed the required withholding of payments.³

The third extension expired on August 15, and the Defense Department must now decide whether to begin applying the 15% withholding provision, as the procurement regulations require, or whether to grant Halliburton yet another extension.

DCAA's views on this issue are clearly set out in the August 16 memorandum to the Army Field Support Command. With potentially hundreds of millions of taxpayer dollars at stake, DCAA has concluded that continued special treatment for Halliburton would be unwarranted. The memorandum states unambiguously: "we strongly encourage you not to extend the implementation of this clause any further and only allow payment of the 85 percent as specified in the clause until KBR submits adequate proposals on all proposals deemed inadequate."⁴

DCAA explained:

Inadequate proposals have, and will continue to, result in significant delays in issuing our audit reports, significant unsupported costs, and/or reports containing an adverse opinion, which impairs the Government's ability to negotiate contracts in a timely manner. The very purpose of FAR 52.216-26 is to provide an incentive to negotiate contracts in a timely manner.⁵

Despite months of efforts by DCAA to obtain accurate cost information, the auditors reported that "[t]o date, KBR has not provided ... basic supporting data for the significant task order proposals."⁶ According to DCAA, "While contingency issues may have had an impact during the earlier stages of the procurements, clearly, the contractor should have adequate supporting data by now."⁷ DCAA specifically addressed whether the previous extensions had

² Federal Acquisition Regulation, 48 C.F.R. 52.216-26.

³ Army Field Support Command granted Halliburton a 30-day extension to April 30, a 45-day extension to June 15, and a 60-day extension to August 15.

⁴ Memorandum from Defense Contract Audit Agency to U.S. Army Field Support Command, *supra* note 1.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

succeeded in prompting Halliburton to correct its deficiencies and found that they did not. According to the memorandum:

Your June 15 letter to KBR stated you would continue to assess the timeliness and quality of cost proposals received and progress toward successful definitization. We do not believe the quality of KBR's proposals has improved. ... [E]ach successive update continues to be significantly deficient.⁸

DCAA concluded: "It is clear to us KBR will not provide an adequate proposal until there is a consequence. Therefore, we strongly encourage you not to extend the implementation of this clause any further and only allow payment of the 85 percent as specified in the clause."⁹

The dollar amounts involved are large. As the memorandum explains, DCAA examined seven task orders with a combined proposed value of \$4.33 billion. The auditors identified unsupported costs totaling \$1.82 billion under these task orders — over 40% of the value of the task orders. Although unsupported costs were identified in every one of the seven task orders, the largest unsupported costs involved task order 59, which covers support for our troops in Iraq. Out of a proposed value of \$4,187,731,000 for task order 59, DCAA found that \$1,808,164,000 of the costs proposed by Halliburton were unsupported. Contrary to Halliburton's claim that its cost estimation problems were unique to Iraq, DCAA also found "significant unsupported costs" for two Afghanistan task orders.¹⁰

The memorandum appears to be based in part on an August 4, 2004, audit report by DCAA of Halliburton's operations in Iraq. Although the Defense Department has to date failed to respond to my staff's requests for a copy of this audit, an article in the *Wall Street Journal* recently reported that the audit concluded that Halliburton's "internal control policies" are "inadequate for providing verifiable, supportable, and documented cost estimates that are acceptable for negotiating a fair and reasonable price."¹¹

The August 16 DCAA memorandum and the August 4 audit are only the latest indictment of Halliburton's flawed accounting and business practices. Over the past eight months, auditors from DCAA, the Government Accountability Office, and the Coalition Provisional Authority

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ Wall Street Journal, *Pentagon Questions Halliburton on \$1.8 billion of Work in Iraq* (Aug. 11, 2004).

Inspector General have repeatedly and consistently criticized multiple aspects of Halliburton's activities in Iraq. These government audits have found widespread, systemic problems with almost every aspect of Halliburton's work in Iraq, from cost estimation and billing systems to cost control and subcontract management.¹² Congressional testimony by former KBR employees has provided further documentation of inflated and unjustified charges by Halliburton.¹³

The Defense Department has not responded appropriately to these findings. To the contrary, despite the company's record of overbilling and shoddy accounting, the Defense Department has awarded Halliburton large new contracts and repeatedly waived the application of federal procurement regulations. This special treatment of Halliburton should end.


¹² See, e.g., DOD News Briefing (Dec. 11, 2003) (reporting that Halliburton overcharged to import gasoline into Iraq from Kuwait by \$61 million through September 30, 2003); Defense Contract Audit Agency, *Audit Report No. 3311-2004K24020001* (Dec. 31, 2003) (finding significant deficiencies in Halliburton's cost estimating system); Defense Contract Audit Agency, *Status of Brown & Root Services (BRS) Estimating System Internal Controls* (Jan. 13, 2004) (recommending contacting DCAA before entering into future negotiations with Halliburton); Defense Contract Audit Agency, *Audit Report No. 3311-2002K11010001* (May 13, 2004) (identifying several deficiencies in Halliburton's billing system and subcontract management); Coalition Provisional Authority Inspector General, *Federal Deployment Center Forward Operations at the Kuwait Hilton* (June 25, 2004) (finding Halliburton billed for unauthorized and unnecessary expenses at the Hilton Hotel in Kuwait); Coalition Provisional Authority Inspector General, *Audit of the Accountability and Control of Material Assets of the Coalition Provisional Authority in Baghdad* (July 26, 2004) (finding that Halliburton could not account for about \$61 million in CPA property in Iraq); and Government Accountability Office, *DOD's Extensive Use of Logistics Support Contracts Requires Strengthened Oversight* (July 2004) (finding ineffective planning, inadequate cost control, and insufficient training of contract management officials under LOGCAP in Iraq).

¹³ House Committee on Government Reform, *Hearings on Contracting and Rebuilding of Iraq: Part IV* (July 22, 2004).

The Honorable Donald H. Rumsfeld
August 24, 2004
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I look forward to hearing what actions you plan to undertake in response to the August 16 memorandum from DCAA.

Sincerely,

A handwritten signature in black ink that reads "Henry A. Waxman". The signature is written in a cursive, slightly slanted style.

Henry A. Waxman
Ranking Minority Member

Enclosure