

**SUPPORT CONTRACTS: COST CONTROLS
OVER THE NAS IMPLEMENTATION SUPPORT
CONTRACT NEED SIGNIFICANT
STRENGTHENING**

Federal Aviation Administration

Report Number: AV-2003-002

Date Issued: November 15, 2002



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation
Office of Inspector General

Memorandum

Subject: **ACTION:** Report on Support Contracts: Cost
Controls Over the NAS Implementation Support
Contract Need Significant Strengthening
AV-2003-002

Date: November 15, 2002

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

Reply to
Attn. of: JA-10:

To: Federal Aviation Administrator

INTRODUCTION

Objectives and Scope

This is our report on the results of our audit of the Federal Aviation Administration's (FAA) National Airspace System (NAS) Implementation Support Contract (NISC). The cost-reimbursable contract provides Airway Facilities and other FAA organizations a "supplemental" workforce to provide management, engineering, environmental, and automation support services on NAS projects. As of September 2002, FAA had obligated approximately \$383 million on the NISC.

NISC is a cost-reimbursable contract that, by definition, shifts the risk to FAA because the contractor has little incentive to control costs. This requires FAA to perform a high level of contract administration to ensure that the contractor's performance is at a high standard, and that contract costs are allowable, allocable, and reasonable. In addition, NISC is one of the largest dollar value support services contracts issued by FAA, at a potential total cost of \$1 billion over a 10 year period of performance. These two high-risk factors require a concerted effort by FAA to provide effective oversight by ensuring that sound contract administration procedures are provided, enforced, and periodically reviewed.

Our objectives were to determine whether: (1) FAA has adequate contract oversight to ensure invoiced costs are allowable, allocable, and reasonable; (2) FAA has implemented sound business practices over funding and

administering task orders of the contract; (3) the contract provides the most cost-effective means of obtaining support services; and (4) contractor personnel meet skill and qualification standards outlined in the contract.

The audit was conducted between December 2001 and July 2002 at FAA Headquarters and the Eastern Region. In addition, we visited Lockheed Martin Services Incorporated, the NISC contractor. We evaluated contract administration policies and procedures as they applied to 46 active NISC task orders funded for \$97 million. See Exhibit A for details on our methodology. The audit was conducted in accordance with Government Auditing Standards prescribed by the Comptroller General of the United States.

Background

On November 20, 1997, FAA awarded the NISC to Lockheed Martin Services Incorporated and six partner companies to continue the support services provided under the first NISC, which expired in June 1998. The current cost-plus-award-fee contract has an initial 4-year base period with three 2-year option periods and a potential cost of approximately \$1 billion. FAA can procure up to a maximum of 22.5 million labor hours of technical and professional services, which represents approximately 92 percent of the potential contract costs.

NISC provides support services to Airway Facilities' organizations implementing NAS programs. However, other FAA Headquarters and regional organizations may also request NISC support. Examples of the services provided are implementation and integration support, transition support, strategic and operational planning support, engineering support, automation support, and management services support. All work performed under NISC is initiated and authorized by either a Headquarters or regional task order. Task orders describe the general nature of work required, identify deliverables, and are usually issued for 6 or 12 month periods of performance.

Responsibility for administering and monitoring the NISC resides in the Airway Facilities Services' Resource Management Program. The FAA management framework for NISC starts with the NISC Contracting Officer and a designated NISC Program Manager. The Contracting Officer has the legal responsibility for safeguarding the interests of FAA, while the Program Manager is responsible for the technical matters on NISC. To assist the Program Manager, each task order has an Associate Technical Officer (ATO) (also known as task order official) designated to provide technical and general management support to the FAA customer receiving the support services.

RESULTS IN BRIEF

In November 1995, Congress exempted FAA from many of the existing Federal procurement and personnel laws and regulations to address the unique needs of the agency. In addition, Congress directed FAA to develop a new Acquisition Management System to provide more timely and cost-effective acquisitions and improve the quality of equipment and services acquired. While acquisition reform gave FAA more flexibility in acquiring equipment and services, such flexibility requires a more disciplined management control system through sound business practices to ensure that it acquires equipment and services efficiently and controls costs.

Controlling costs is particularly important now. The airline industry is experiencing an unprecedented financial crisis as a result of the events of September 11th, a softening economy, and a reduction in business travel. Airline revenues are down 16 percent as of July 31, 2002, compared to the same period last year, and revenues are not expected to improve in the near future. The steep decline in airline revenues, along with the drop in passenger traffic, has resulted in sharp reductions in the amount of Trust Fund revenues¹ available to fund FAA and its programs. Therefore, it is imperative that FAA, especially in times of extremely constrained budgets and deficit spending, operate like any business and effectively administer its contracts to control unnecessary costs.

Our review found that FAA's oversight of the NISC was seriously inadequate because it did not acquire services efficiently or control costs. Of the 46 active task orders with obligated funds totaling \$97 million, we found approximately \$10 million (10 percent) that was not needed to fund current task orders. In addition, we found approximately \$600,000 remaining idle on one inactive task order for over 28 months. We also found that 22 percent of contractor personnel reviewed did not meet contract requirements for education and experience, and charged approximately 98,000 labor hours at a total cost of approximately \$4.5 million. In addition, contractor invoices were paid without adequate certification that costs were accurate, and FAA had not requested a Defense Contract Audit Agency (DCAA) audit of NISC costs.

This review is the third report issued by our office in the last 2 years identifying a lack of FAA oversight on cost-reimbursable contracts. We have consistently found a lack of basic contract administration at every stage of contract management from contract award to contract closeout.

¹ For fiscal years 2004 through 2007, projected Aviation Trust Fund revenues have dropped over \$8 billion – from an estimated \$55 billion prior to September 11 to an estimated \$47 billion currently.

In our September 28, 2000 report on the Technical Support Services Contract (TSSC), with a potential cost of \$875 million, we reported that FAA did not control costs by developing reliable cost estimates for proposed projects. We found that in a majority of cases, FAA used the contractor's project cost estimate to set the project's budget. We also found that FAA did not evaluate contractor work performance and nearly 10 percent of contract personnel reviewed did not meet contract standards for education and experience. In response to our report, FAA has taken steps to address contract administration weaknesses on the TSSC.

In our May 8, 2002 report on Oversight of Cost-Reimbursable Contracts, we found cost-reimbursable contracts totaling about \$2 billion did not have required incurred cost audits. Also, contract files frequently did not have evidence that contractors' accounting systems were adequate for cost-reimbursable contracts. FAA concurred, or partially concurred, with each of the 13 recommendations in the report. We are evaluating FAA's response and will monitor the implementation of its corrective actions.

To protect the Government's interests, FAA not only needs to hold managers accountable and adhere to the basic principles of contract oversight and administration, but the agency must also make more effective use of DCAA audits. Both Congress and our office have repeatedly told FAA to make more use of DCAA audits.

In addition, FAA should implement performance-based service contracting to reduce costs, improve performance, and increase accountability. Performance-based service contracts, unlike cost-reimbursable contracts, shift the cost-risk of performance to the contractor through performance standards, positive and negative incentives, and a Government assessment of how well the contractor is performing. This basic shift in contract type is important because FAA has a significant investment in service contracts. As of June 2002, FAA had obligated \$4.5 billion to contracts (including the NISC) held by its 10 largest service contractors.

We are recommending that FAA:

- ✓ Immediately request a DCAA audit of the NISC direct and indirect charges, and periodically request audits throughout the life of the contract.
- ✓ Reprogram approximately \$10.5 million in excess funds from the NISC contract and put it to better use on other NAS projects.
- ✓ Perform a complete review of all contractor employees currently charging labor hours on NISC task orders. If they do not meet qualifications, remove them from the contract. Recover the \$4.5 million charged for the 22 contractor personnel that did not meet contract requirements for

qualifications, and any additional funds identified for other contractor employees who do not meet contract qualifications.

- ✓ Designate the NISC as a pilot program and begin implementing performance-based service contracting methods.

FAA Comments and Office of Inspector General Response

On October 17, 2002, FAA provided comments (see Appendix) to our September 30, 2002 draft report. FAA concurred or partially concurred with our recommendations and agreed to take corrective actions to improve management of the NISC. However, all recommendations remain open because FAA did not provide target dates for implementing the recommendations and, in some cases, its response was incomplete or based on inaccurate information.

FAA's response to our recommendation to reprogram \$10.5 million in excess NISC funds was incomplete. FAA reprogrammed \$5 million, but did not address what actions it will take to reprogram the remaining \$5.5 million in excess funds identified during the audit.

FAA partially concurred with our recommendation to review the qualifications of NISC contractor personnel. FAA stated that the 22 resumes selected for review were prior to the implementation of new controls and procedures that were implemented as a result of a June 2000 internal audit, and that the controls were working well. We disagree. We found that 17 out of the 22 unqualified contractor employees continued to charge labor hours for 18 months after the controls were supposedly put in place. In addition, FAA did not issue waivers for any of the 22 contractor employees for their lack of education and experience qualifications.

FAA also stated that it did not believe the issue of unqualified contractor personnel is a significant problem because the majority of the 22 resumes we cited met both education and experience requirements. We disagree. We found that while some of the employees met either education or experience requirements, none of the 22 contractor employees in our sample met the requirements for both. Further, FAA stated that because it did not believe this issue is significant, it would only review a sample of contractor personnel and would seek reimbursement for unqualified contract personnel, if appropriate. FAA believes this amount will be far less than the \$4.5 million cited in our report.

FAA's argument to review only a sample of contractor personnel on the NISC is not convincing. Our review found that 22 percent of the contractor personnel sampled did not meet contract requirements for education and experience. In our opinion, this represents a significant problem. FAA should reconsider its comments and take action to recover the \$4.5 million charged for the 22 contractor

personnel that did not meet contract requirements and any additional funds identified for other contractor employees it finds to be unqualified.

FAA also needs to clarify its response to two recommendations. First, for our recommendation to request DCAA to perform an audit of the NISC direct and indirect charges, it is not clear whether FAA will request an audit of the contractor's cost system, which is applicable to many Government contracts, or a specific audit of NISC direct and indirect costs. Second, in its response to our recommendation to evaluate existing service contracts to determine if performance-based contracting methods could apply, FAA did not provide us with the basis for why it cannot implement performance-based contracting methods for current support service contracts.

FINDING AND RECOMMENDATIONS

Improvements Are Needed to Effectively Manage the NAS Implementation Support Contract

Our review found that FAA's oversight of the NISC was seriously inadequate because it did not acquire services efficiently or control costs. Of the 46 active task orders with obligated funds totaling \$97 million, we found approximately \$10 million (10 percent) that was not needed to fund current task orders. In addition, we found approximately \$600,000 remaining idle on one inactive task order for over 28 months. We also found that 22 percent of contractor personnel reviewed did not meet contract requirements for education and experience, and contractor invoices were paid without adequate certification that costs were accurate. These deficiencies continued to occur because FAA had not conducted periodic program reviews as required by NISC guidelines. In addition, FAA had not requested a DCAA audit of NISC costs. Contract audits are important because they verify the costs claimed by the contractor to its official records, and that costs claimed are allowable in accordance with applicable requirements, such as laws, regulations, standards, and contract terms.

This review is the third report issued by our office in the last 2 years identifying a lack of FAA oversight on cost-reimbursable contracts (see Exhibit B for a summary of prior audits). We have consistently found a lack of basic contract administration at every stage of contract management from contract award to contract closeout. In our September 28, 2000 report on the Technical Support Services Contract, with a potential cost of \$875 million, we reported that FAA did not control costs by developing reliable cost estimates for proposed projects. In our May 8, 2002 report on Oversight of Cost-Reimbursable Contracts, we found cost-reimbursable contracts totaling about \$2 billion did not have required incurred cost audits.

To protect the Government's interests, FAA not only needs to hold its managers accountable and adhere to the basic principles of contract oversight and administration, but the agency must also make more effective use of DCAA audits. This is especially critical for cost-reimbursable contracts since contractors have little incentive to control costs.

In addition, FAA should implement performance-based service contracting to reduce costs, improve performance, and increase accountability. Performance-based service contracts, unlike cost-reimbursable contracts, shift the risk of performance to the service contractors through performance standards, positive and negative incentives, and a Government assessment of how well the contractor is performing. This basic shift in contract type is important because FAA has a significant investment in service contracts. As of June 2002, FAA had obligated \$4.5 billion to contracts (including the NISC) held by its 10 largest service contractors.

Excess Funds Remain on NISC Task Orders

FAA did not reprogram approximately \$10.5 million in excess funds identified on NISC task orders. We reviewed all 46 active task orders with obligated funds totaling \$97 million, and of that amount, identified approximately \$10 million (10 percent) that was not needed to fund current task orders during specified periods of performance. In addition, we found approximately \$600,000 remaining idle on one inactive task order for over 28 months. For example:

- ✓ One NISC task order had approximately \$1.8 million in excess funds, in addition to the funds needed to pay for work through March 31, 2003, which is the end of its performance period.
- ✓ Three task orders had about \$2 million in excess funds, in addition to the funds needed to pay for work through December 31, 2002, which is the end of their performance periods.

While FAA was aware of the additional funds held on task orders, it did not consider them excess and took no action to decrease the funding levels. However, we considered these funds excess because these amounts were not needed to pay for services during the task orders' periods of performance.

In June 2002, FAA's NAS Programming and Financial Management Division provided us a listing of NAS projects currently having funding shortfalls and agreed with our determination that the excess funds on NISC task orders could be reprogrammed and put to better use. For example, the Airport Surface Detection Equipment Model X Program, a technology to prevent runway accidents at small-to medium-sized airports, needed an additional \$3.1 million in fiscal year (FY)

2002. In light of FAA's major funding shortfalls, the excess funds identified on NISC task orders should be reprogrammed and put to better use on other NAS projects.

NISC Contractor Personnel Do Not Meet Contract Requirements for Education and Experience Levels

The NISC Program Management Guide requires the approval of FAA task order officials before the contractor hires an employee to work on the NISC. FAA's approval should be based solely on the person's qualifications stated in the resume and the contract requirements identified for each labor category and skill level. The task order officials can request waivers from the Contracting Officer if the contractor's employee does not meet the minimum personnel requirements contained in the contract.

Contrary to these requirements, FAA task order officials did not verify that contractor personnel met the education and experience requirements contained in the contract for specific labor categories and allowed unqualified personnel to work on the NISC. We identified that 22 out of 99 contractor employees sampled (22 percent), did not meet the contract requirements for the labor category charged, nor did they have a required waiver for the education and experience qualifications. In total, these 22 unqualified contractor employees charged approximately 98,000 labor hours at a total cost of approximately \$4.5 million.

For example, one contractor employee charged approximately 4,610 direct labor hours at a cost of approximately \$255,000 as a Senior Systems Engineer. For a Senior Systems Engineer, NISC requires a Bachelors Degree in Engineering and a minimum of 10 years experience in project management, coordination, implementation, and general engineering. However, the employee's resume identified a Bachelor of Arts Degree in Psychology, and no experience in general engineering.

Another contractor employee charged approximately 4,950 hours at a cost of approximately \$258,000 as a Senior Systems Engineer. The employee had a degree in Social Science/Business and approximately 2 years experience in general engineering. We determined that the employee did not have the required Engineering Degree nor the required years of experience to qualify as a Senior Systems Engineer.

As a result of not ensuring contractor qualifications, FAA cannot provide assurances that NISC is providing the highest possible levels of quality required by the contract. We are recommending that FAA take action to recover the \$4.5 million. In addition, FAA should perform a review of all contractor

employees currently charging labor hours on NISC task orders and ensure that they meet contract requirements for education and experience. If they do not meet qualifications, FAA should immediately remove them from the contract and take action to recover any additional funds already paid.

FAA Paid Invoices Without Consistently Verifying the Accuracy of Contractor Charges

The NISC Program Management Guide requires FAA task order officials to review and certify that the charges on the monthly invoices are correct and the services were provided. Once the invoices are reviewed, a signed receipt acknowledging approval of all invoice costs is to be forwarded to the NISC Program Office. We found that FAA task order officials did not follow these guidelines. These officials did not consistently verify NISC monthly invoice charges or forward signed receipts to the Program Office to document the approval of invoice costs. Although the NISC Program Office did not consistently receive these approvals, the invoiced amounts were paid anyway.

In fact, one task order official stated that she does not spend a lot of time scrutinizing the invoices and relies on the contractor to provide the Government accurate information concerning hours worked and labor charges incurred per invoice. In addition, she stated she did not send a certification to the NISC Program Office verifying the costs were allowable unless she found a problem. This task order is one of the largest NISC task orders, with monthly invoice charges averaging approximately \$490,000.

For another task order, we asked whether the December 2001 invoice containing approximately \$70,000 in direct labor and equipment charges had been certified. The task order official responded that the invoice had not been certified because of a lack of time. At our request, the invoice charges were reviewed and it was determined that an equipment charge of approximately \$11,300, or 16 percent of the invoice, was in error.

We also identified approximately \$90,000 in costs for desktop computers and laptops that, according to a contract clause, should have been paid for by the NISC contractor. While the NISC states that the contractor must pay for the first \$7.9 million of direct computer costs incurred on the contract, FAA did not adequately track computer equipment purchases and ensure that the contractor reimbursed FAA for those costs. Direct computer costs include, but are not limited to, desktop and notebook computers, upgrades, printers, virus software, cc:mail, cardkey security systems, and network/servers. FAA should request a credit from the NISC contractor for the approximately \$90,000 in computer equipment which should have been paid for by the contractor.

Periodic Program Reviews Were Not Performed

FAA could have avoided problems with task order funding, reviewing contractor personnel qualifications, and certifying contractor invoices if management had performed periodic program reviews. The NISC Program Manager is responsible for conducting NISC program reviews to ensure work (such as issuing task orders, reviewing task order funding, reviewing contractor qualifications, and certifying contractor invoices) is being performed properly and in accordance with procedures outlined in the NISC Program Management Guide.

Since contract award in 1997, the Program Manager has not performed program reviews for any of the NISC Headquarters or regional customers to evaluate procedures implemented on their task orders. Although both the Program Manager and Contracting Officer stated that these reviews would have been beneficial, they cited a lack of time and travel funds as reasons for not conducting these reviews. Because FAA did not perform periodic program reviews, it cannot ensure that NISC is receiving support services that meet its needs at a reasonable cost.

FAA Did Not Request DCAA Audits of NISC Costs

Congress and our office have repeatedly told FAA to make more use of DCAA audits. This is especially critical for cost-reimbursable contracts since contractors have little incentive to control costs. In our January 18, 2001 report on the Top 10 DOT Management Challenges, we stated that FAA needed to make greater use of DCAA for assessing costs in order to protect the Government's interests. In June 2001 the House Committee on Appropriations addressed its concern and displeasure because FAA had decreased the number of audits requested by DCAA since this activity was transferred from the Office of Inspector General to the modal administrations a few years ago. The Committee directed FAA to request DCAA audits on all acquisition contracts in excess of \$100 million, and audits on a sample of at least 15 percent of all contracts under \$100 million. On May 8, 2002, we issued a report on FAA's Oversight of Cost-Reimbursable Contracts, which found that since FAA assumed responsibility for funding its contract audits, the number of audits began to drop, going from 35 incurred cost audits in FY 1996 to only 10 in FY 2001.

Despite congressional direction, we found that since award in November 1997, the NISC Contracting Officer had not requested DCAA to perform an independent audit on NISC's direct and indirect charges. Considering the fact that the NISC contract is a potential 10 year, \$1 billion cost-reimbursable contract, FAA should request periodic DCAA audits on NISC to ensure that the Government is only paying for allowable, allocable, and reasonable direct and indirect costs incurred.

Although FAA did agree to participate in DCAA's incurred cost audit of major Lockheed Martin contracts for Calendar Year (CY) 1999, DCAA could not provide assurance that NISC direct costs were analyzed. However, DCAA questioned approximately \$2 million in other direct costs such as miscellaneous expenses, travel expenses, and material expenses because the contractor was unable to provide adequate documentation to support the charges. DCAA withheld an opinion on an additional \$229 million in other direct costs until further assist audits were received.

In addition, a June 2001 DCAA audit report evaluated Lockheed Martin's corporate cost system and related controls. The objective was to assess control risk to determine the degree of reliance that can be placed on the contractor's indirect and other direct cost system as a basis for planning the scope of future audits. DCAA concluded that the contractor's indirect and other direct cost system was inadequate in part, due to inadequate description and documentation of costs. DCAA stated that these discrepancies could adversely affect the organization's ability to record, process, summarize, and report direct and indirect costs in a manner that is consistent with applicable Government contract laws and regulations. Both the Contracting Officer and the Program Manager stated that they had reviewed the DCAA audits and concluded they saw no reason to be concerned about the NISC contractor's direct and indirect charges.

According to DCAA officials, the conclusions reached in the June 2001 report should have provided a red flag to FAA to request an audit on the NISC direct and indirect charges. In addition, the findings from the CY 1999 incurred cost audit and other audits performed by DCAA on the NISC contractor and several other partners should have provided FAA with enough concerns to warrant requesting an independent audit specifically on NISC charges. Therefore, FAA needs to immediately request a DCAA audit of NISC costs and periodically request audits throughout the life of the contract.

FAA Needs to Use Performance-Based Service Contracting for More Effective Management of Service Contracts

To better manage its service contracts, FAA should implement performance-based service contracting to reduce costs, improve performance, and increase accountability. Performance-based service contracts, unlike cost-reimbursable contracts, shift the cost-risk responsibility for contract performance to the contractor by holding contractors accountable for their work. This is achieved through performance standards, positive and negative incentives, and a Government assessment of how well the contractor is performing. The key to using performance-based service contracting is defining a service requirement in

terms of specific performance outcomes rather than broad, nonspecific statements like NISC uses.

The NISC identifies 13 functional areas, which require a broad range of labor categories and skill levels within each labor category. The contract also states that customers will order work efforts as needed from within a “series of generic functional work areas.” Once a customer has chosen the functional area required, the customer chooses the labor mix, skill levels, and number of labor hours required from each.

For example, one NISC task order for “support and assistance to manage, track, and control attrition training requirements for existing equipment and systems” identified the following labor categories, skill levels, and labor hours required for a 5-month period of performance.

Labor Category	Number Required	Skill Level	Total Hours Required
Human Resource Manager/Training Spec.	6	Senior	4,800
Human Resource Manager/Training Spec.	1	Mid	800
Program Analyst	2	Mid	1,600

FAA is only purchasing hours in specific labor categories and does not have measurable outcomes identified to evaluate how well the contractor is providing support to manage, track, and control attrition training requirements for existing equipment and systems. Performance-based service contracting would require FAA to write statements of work in terms of specific outcomes for requirements instead of just identifying labor categories required to do generically written work statements.

According to the Office of Management and Budget, performance-based service contracting has been proven to increase cost savings, decrease the level of contract administration, and increase contractor accountability. For example, in October 1994, the Office of Federal Procurement Policy initiated a pilot program to encourage the use of performance-based service contracting for services such as janitorial, guard, and data entry. Under the pilot program, 15 agencies converted 26 contracts with an estimated value of \$585 million to performance-based methods, and they reported an average of 15 percent reduction in contract price and an 18 percent improvement in satisfaction with the contractor’s work. The Departments of Defense, Transportation, and Energy currently use performance-based service contracting.

In fact, the Department of Transportation included performance-based service contracting as a ONE-DOT priority initiative in an effort to improve service

contracting activities in all the operating administrations. According to a Report on the Performance-Based Service Contracting Pilot Project prepared by the Office of Federal Procurement Policy, the National Highway Traffic Safety Administration (NHTSA) used performance-based service contracting on its contract for property and inventory control systems awarded in 1995. Converting the statement of work from broad (cost reimbursement) to specific (fixed-price) requirements enabled NHTSA to develop performance requirements that defined the work in measurable, mission-related terms. The report concluded that the fixed-price terms allowed NHTSA the opportunity to provide accurate contract pricing on the support service contract.

We discussed using performance-based service contracting on NISC with FAA program officials and the NISC contracting officer. These officials stated that performance-based service contracting may have benefits and it could be demonstrated on several task orders. However, in their opinion, doing so would require a legal review and negotiations between FAA and the contractor, because the NISC contract would have to be modified.

In addition to demonstrating the feasibility of performance-based contracting to the NISC contract, FAA should evaluate its remaining service contracts to determine which contracts can benefit from performance-based service contracting and implement performance-based service contracting, where appropriate. FAA has a significant investment in service contracts. As of June 2002, FAA had obligated \$4.5 billion to contracts (including the NISC) held by its 10 largest service contractors. In our opinion, performance-based service contracting would help FAA effectively manage its service contracts and strengthen contractor accountability.

Recommendations

We recommend that FAA:

1. Reprogram approximately \$10.5 million in excess funds on NISC and put the funds to better use on NAS projects requiring additional funding.
2. Incorporate performance of required NISC contract administration procedures into NISC task order officials' job performance standards.
3. Perform a review of all contractor personnel currently charging labor hours on NISC task orders and ensure that they meet the contract requirements for education and experience for the labor category charged. If they do not meet the requirements, remove them from the contract.

4. Take action to recover the \$4.5 million charged for the 22 contractor personnel that did not meet contract requirements for qualifications, and any additional funds identified for other contractor employees who do not meet the contract qualifications.
5. Request an invoice credit from the NISC contractor for the approximately \$90,000 in computer equipment which should have been paid for by the contractor.
6. Perform periodic program reviews to determine whether FAA personnel are following required contract administration guidelines for implementing and monitoring NISC task orders.
7. Immediately request DCAA to perform an audit of the NISC direct and indirect charges, and periodically request audits throughout the life of the contract.
8. Designate the NISC as a pilot program and begin implementing performance-based service contracting methods.
9. Evaluate its remaining service contracts to determine which contracts can readily benefit from performance-based service contracting methods and ensure that action is taken to implement such methods.

FAA COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

On October 17, 2002, FAA provided comments (see Appendix) to our draft report, dated September 30, 2002. FAA concurred or partially concurred with our nine recommendations, and identified actions either taken or planned to improve management oversight and cost controls over the NISC.

For recommendations 2, 5, 6, and 8, FAA proposed actions to revise job performance standards for NISC personnel; analyze documentation from the contractor on computer equipment charges and determine whether monetary recovery is possible; allocate resources to perform on-site program reviews; and designate NISC as a pilot program for using performance-based contracting methods. We consider these proposed actions to be responsive; however, FAA did not provide target dates for completion of these actions.

For the following recommendations, we do not agree with FAA's response because the proposed actions do not fully address the intent of our recommendations.

For recommendation 1, FAA stated that it has re-baselined the NISC program and reprogrammed \$5 million of NISC funding to meet other agency priorities.

However, FAA did not address the additional \$5.5 million in excess funds that we identified and whether it will reprogram these funds to meet other agency priorities.

For recommendations 3 and 4, FAA stated that unqualified contractor personnel on the NISC was not a significant problem, and that it believes the amount charged by contractor employees that we identified as not meeting qualifications would be far less than the \$4.5 million we reported.

As a result, FAA stated that it would perform only a sample review of NISC contractor qualifications, and if this review identified contractor employees who do not meet qualifications, it would then seek reimbursement as appropriate. FAA also stated that a June 14, 2000 internal audit of the NISC contractor's employee resume concurrence process found a small number of discrepancies and deviations, but that new controls and procedures were completed and they have been working well. Lastly, FAA stated that all 22 resumes selected by the OIG were taken from a time period prior to the new controls and procedures, and that the majority of the 22 resumes we cited met both education and experience requirements. For example, FAA stated that we did not include relevant military experience in determining the qualifications of one contractor employee. We believe that FAA's response to recommendations 3 and 4 is based on inaccurate information.

First, invoices supplied by the contractor show that 17 out of the 22 contractor employees we cited continued to charge labor hours in positions for which they were not qualified for 18 months after the controls were supposedly put in place. Also, FAA took no action to grant waivers for any of the 22 contractor employees for their lack of education and experience qualifications. Second, we found that five contractor employees had the required degree for the labor category charged, but they did not have the required experience. Seven contractor employees had the required experience for the labor category charged, but they did not have the required degree. The remaining 10 contractor employees had neither the education nor the experience qualifications for the labor category charged. Third, in response to FAA's comment that we did not include an individual's relevant military experience, we disagree. In fact, we did accept 3 years experience for this individual as a Flight Operations Manager in the military. However, we did not accept the remaining 9 years in the military, because the experience was unrelated to air traffic control systems and NAS project coordination required by the contract.

FAA failed to support its contention that controls were working well, and that the majority of the 22 contractor personnel met NISC qualifications. Accordingly, we maintain that our conclusions are valid and that unqualified contractor personnel working on the NISC is a significant problem. Therefore, we request FAA to

reconsider its response, perform a review of the qualifications of all NISC contractor personnel, and remove from the contract those who do not meet contract requirements. In addition, we request that FAA take action to recover the \$4.5 million charged, and any additional monies paid to contractors identified in FAA's review that do not meet NISC requirements.

Lastly, although FAA concurred with recommendations 7 and 9, we request that FAA clarify the specific actions that it is proposing. For recommendation 7, FAA proposed that it will request another audit of the contractor's direct and indirect costs. However, past audits by DCAA reviewed the contractor's cost system, which included many Government contracts. As we reported, FAA had not requested audits specifically of NISC costs. Therefore, it is unclear whether FAA intends to request an audit of the contractor's cost system, or a specific audit of the NISC direct and indirect costs. Accordingly, we request that FAA clarify its response to our recommendation and specify whether it intends to request a DCAA audit of the NISC direct and indirect charges.

For recommendation 9, FAA stated that in response to past Departmental initiatives, it has reviewed the existing service contracts and determined that it was not appropriate to reform those existing service contracts to incorporate performance-based service contracting methodology. However, FAA said it will continue a prospective approach towards implementation of performance-based contracting, and evaluate all service contract requirements to determine whether they fit the profile of performance-based service contracting. We request that FAA clarify its position and provide us with the basis for why it thinks that current support service contracts, such as the Technical Support Services Contract, cannot benefit from performance-based service contracting methods.

ACTION REQUIRED

In accordance with DOT Order 8000.1C, we request that you provide target dates for completion of actions identified for recommendations 2, 5, 6 and 8. For the remaining recommendations, your comments do not fully address the intent of our recommendations, and we request that you reconsider your response and provide specific actions, with target dates, to address our recommendations. Please provide your revised response addressing our concerns within 30 days.

If you have questions concerning this report, please contact me at (202) 366-1992, or David A. Dobbs, Assistant Inspector General for Aviation Audits, at (202) 366-0500.

EXHIBIT A. AUDIT METHODOLOGY

To determine whether FAA has implemented sound business practices over funding and administering task orders, we reviewed the funding procedures for 46 active task orders funded at \$97 million, and the administrative procedures for issuing and administering 5 task orders. We tested compliance for these task orders to procedures outlined in the NISC contract and the NISC Program Management Guidebook (Summer 2001). Financial data for each task order were obtained from the Program Management Office's Budget Allocation Tracking System.

To determine whether contractor personnel met skill and qualification standards as outlined in the NISC contract, we judgmentally selected a sample of 99 out of 522 contractor personnel who charged hours on the same 5 task orders mentioned above. We compared the contractor employees' education and experience qualifications outlined in their resumes to the NISC requirements contained in Section J of the contract.

To determine whether FAA has adequate contract oversight to ensure invoiced costs are allowable, allocable, and reasonable, we reviewed 18 active task orders having over \$100,000 in other direct costs. Other direct costs are direct charges other than labor costs which include items such as travel, training, office supplies, printing, and communications equipment.

To determine whether the contract provides the most cost-effective means of obtaining NISC services, we reviewed contractor staffing data, FAA Acquisition Management System policy and guidance, and NISC pre-award contract documents. We also identified and analyzed documentation provided by the Government agencies supporting the use of performance-based service contracting as a preferred acquisition strategy.

In addition, we interviewed FAA officials from the Airway Facilities Services' Resource Management Program (office responsible for the NISC contract) and Assistant Technical Officers responsible for providing technical and general management support to the FAA customers receiving the NISC services. We also interviewed officials from Lockheed Martin Services Incorporated.

EXHIBIT B. RELATED AUDIT COVERAGE

On September 28, 2000, we issued our final report on FAA's Technical Support Services Contract (TSSC), Report Number AV-2000-127. The TSSC, like the NISC, is a cost-reimbursable contract providing support services to FAA customers modernizing the NAS. The 7-year contract, worth approximately \$875 million, had issued about 1,200 national and regional work releases requiring contractor services. We concluded that FAA had not exercised effective management oversight or followed its own guidelines on administering the \$875 million TSSC to ensure that support services were efficiently meeting FAA requirements and were cost-effective.

Specifically, we found that FAA did not (1) control the cost of TSSC projects by developing reliable cost estimates for proposed projects and, therefore, accepted the contractor's estimate without question; (2) close out completed work releases, assess inactive projects for idle funds, and follow correct procedures for obligating and deobligating funds; (3) evaluate the contractor's work performance throughout the life of the project and ensure that contractor personnel met education and experience qualifications; and (4) provide effective program reviews of regional offices performing contract administration procedures.

FAA agreed with all eight recommendations contained in the report and has taken action to address contract administration weaknesses on the TSSC. These actions include using historical data of like projects to develop reliable cost estimates, automating close-out procedures to identify completed work releases with unneeded funds, automating a system to track the completion of customer satisfaction surveys, and incorporating performance standards for contract administration into the evaluation criteria of TSSC officials.

In our May 8, 2002 report on Oversight of Cost-Reimbursable Contracts, Report No. FI-2002-092, we concluded that contracting officers exercised little effective oversight, and, in most cases, lacked the basic information needed to properly manage, pay, and close contracts. We found every stage of contract management, from contract award to close-out, was deficient, lacked accountability, and did not adequately protect FAA from fraud, waste, and abuse. For example, for 21 of 32 contracts reviewed, totaling \$2 billion, FAA did not obtain incurred cost audits as required. In addition, FAA could not locate all or significant parts of 22 contract files totaling \$274 million, and contract files that were maintained frequently did not have evidence that contractors' accounting systems were adequate for cost-reimbursable contracts. In August 2002, FAA concurred, or partially concurred, with each of the 13 recommendations in the report. We are evaluating FAA's response and will monitor the implementation of its corrective actions.

EXHIBIT C. MAJOR CONTRIBUTORS TO THIS REPORT

The following is a listing of team members who participated on the audit of FAA's National Airspace System Implementation Support Contract.

<u>Name</u>	<u>Title</u>
Richard Kaplan	Program Director
Robert F. Prinzbach	Project Manager
Coletta Treakle	Senior Analyst
Erik Phillips	Analyst
Kimberly Dishong	Auditor
Christopher Frank	Auditor
Shirley Murphy	Editor

APPENDIX. MANAGEMENT COMMENTS

Federal Aviation Administration's Response to the Office of Inspector General's (OIG) Draft Report on The NAS Implementation Support Contract

OIG Recommendation 1: Reprogram approximately \$10.5 million in excess funds on National Airspace System (NAS) Implementation Support Contract (NISC) and put the funds to better use on NAS projects requiring additional funding.

FAA Response: Partially Concur. The OIG's concern was that task orders written in one fiscal year ran well into the following fiscal year. Even though these were one year, or multiple-year, task orders, the OIG believed it more appropriate that money should not be obligated in one year past December/January of the next year. Thus, the funds called "excess" by the OIG represent the difference between cash receipts and task order start dates. Nevertheless based on the OIG findings, the FAA decreased the time period covered by some task orders, re-baselined the program, and reprogrammed \$5 million of NISC funding to meet other agency priorities.

OIG Recommendation 2: Incorporate performance of required NISC contract administration procedures into NISC task order officials' job performance standards.

FAA Response: Concur. The FAA will begin to take steps in this area immediately to develop revised standards.

OIG Recommendation 3: Perform a review of all contractor personnel currently charging labor hours on NISC task orders and ensure that they meet the contract requirements for education and experience for the labor category charged. If they do not meet the requirements, remove them from the contract.

FAA Response: Partially Concur. Prior to the OIG's audit, the FAA NISC Contracting Officer initiated an audit of the contractor's employee resume concurrence process for NISC on June 14, 2000. The audit found a small number of discrepancies and deviations. The FAA Program Office developed controls and procedures to correct discrepancies and deviations in the process. These controls and procedures have been working well. All of the 22 resumes selected by the OIG were taken from a time period prior to these expanded controls. Also, based on a careful review of the resumes and discussions with

the task order officials, we believe that a majority of the 22 resumes the OIG cited met both education and experience requirements.

In one example cited in the OIG report, the individual's relevant military project management, coordination, implementation, and general engineering experience was not included in evaluating experience. The NISC contract allows for experience in air traffic systems and NAS planning and project coordination in place of a Bachelors Degree. His experience, both as a seasoned pilot and many roles involving the NAS were not considered by the OIG.

The other case cited in the OIG report concerned an individual who was hired while a labor category change was being processed. This change was executed after the individual became a NISC employee. Therefore, for a short period of time while labor categories were being changed the individual was not properly classified. Controls are now in place to prevent this situation from reoccurring.

While we do not believe this to be a significant issue we will review a sample of contractor personnel qualifications. Should that sample indicate a potential issue, we will then undertake a full-scale review.

OIG Recommendation 4: Take action to recover the \$4.5 million charged for the 22 contractor personnel that did not meet contract requirements for qualifications, and any additional funds identified for other contractor employees who do not meet the contract qualifications.

FAA Response: Partially Concur. To the extent that the FAA review shows that the Agency was charged for contractors who did not meet qualifications, we will seek reimbursement as appropriate. As noted in recommendation 3, we believe this amount would be far less than the \$4.5 million cited by the OIG.

OIG Recommendation 5: Request an invoice credit from the NISC contractor for the approximately \$90,000 in computer equipment which should have been paid by the contractor.

FAA Response: Partially Concur. In its NISC-II proposal, Lockheed Martin and its teammates offered to provide standard computer workstations for their employees up to a value of \$7.9 million. To date, the NISC-II Contractor has expended approximately \$4 million on computer workstations. The NISC-II contractor claims that \$90,000 in costs referenced in the OIG report was for purchases that are outside the guidelines for the standard computer workstations.

The FAA has requested substantiation for these charges from the contractor. After an analysis is performed of the documentation, a determination will be

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made whether the FAA can recover the \$90,000 under the terms and conditions of the NISC contract.

OIG Recommendation 6: Perform periodic program reviews to determine whether FAA personnel are following required contract administration guidelines for implementing and monitoring NISC task order.

FAA Response: Concur. During fiscal year (FY) 2003, the agency will allocate additional resources and travel dollars to NISC for on-site program reviews.

OIG Recommendation 7: Immediately request Defense Contract Audit Agency (DCAA) to perform an audit of the NISC direct and indirect charges and periodically requests audits throughout the life of the contract.

FAA Response: Concur. At FAA request, the DCAA has performed 15 NISC related audits since the inception of the NISC-II Contract. The FAA NISC Program Office has provided \$132,337.00 in funding to support these DCAA audits. The FAA NISC Program Manager and Contracting Officer maintain an ongoing relationship with DCAA and the Program Office relies on DCAA for vital contract information regarding indirect rates and incurred cost audits.

FAA will immediately request another audit of the contractor's direct and indirect cost and will continue to utilize DCAA audits.

OIG Recommendation 8: Designate the NISC as a pilot program and begin implementing performance-based service contracting methods.

FAA Response: Concur. The use of a pilot "performance-based" contracting program on the NISC could yield benefits for the FAA. However, it is not clear that FAA could alter its current contract with Lockheed Martin Services, Incorporated and the NISC teammates. We will endeavor to pilot a performance-based system on limited aspects of the program.

There are several activities would have to occur before a pilot program could be implemented. First, the NISC contract focuses on "how" work is performed. The contract would have to be modified to allow the contractor to focus on outputs produced. For example, the resume concurrence contract requirement would most likely be eliminated. This change would allow the contractor flexibility in using resources to produce outputs--ultimately saving the FAA money.

Second, a training program for using performance-based contracting and developing performance-based Statements of Objectives (SOO) would have to be initiated primarily because the existing NISC work is not readily amenable to performance-based statements of work. Further, customers who develop statements of objectives would have to be shown how they can still incorporate flexibility into SOO's to rapidly respond to changing FAA needs.

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OIG Recommendation 9: Evaluate its remaining service contracts to determine which contracts can readily benefit from performance-based service contracting methods and ensure that action is taken to implement such methods.

FAA Response: Concur. Performance-based services contracting (PBSC) was included in the FY 2000 performance agreements and was designated as a ONE-Department of Transportation (DOT) priority. PBSC is an integral part of fulfilling DOT's mission. The Deputy Secretary of DOT charged Operating Administration Heads to look at contract requirements as they come up for renewal and consider using the PBSC approach, when appropriate.

In accordance with the above, FAA continues to follow a prospective approach towards implementation of performance-based contracting. We evaluate all service contract requirements to determine whether they would fit the profile of PBSC.

As a result of that commitment, the recent FAA Telecommunications Infrastructure (FTI) PBSC was awarded on July 15. The maximum value for the FTI contract is \$3.5 billion over 15 years. The agency fully anticipates spending all of the contract ceiling. FTI touches the core of the operational mission of the FAA. The program will provide telecommunication services to all 5,000 FAA facilities (manned and unmanned) in the country. Furthermore, a lessons learned package from the FTI PBSC acquisition is being prepared and will be briefed to a wide FAA acquisition audience during the second week of November. This will allow others to see how PBSC is properly considered as a method of contracting given certain requirements.

We will continue to examine all service requirements to determine if the application of performance-based contracting methods are appropriate. In response to past Departmental initiatives, we had already reviewed our existing service contracts. As a result of those reviews, we concluded that it was not appropriate to reform those existing service contracts to incorporate PBSC methodology.