April 17, 2013

Expected Release

2:00 p.m.

Statement of
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Department of Defense Inspector General

before the

Subcommittee on National Security
Committee on Oversight and Government Reform

on

"Contracting to Feed U.S. Troops in Afghanistan: How did the Defense Department End Up in a Multi-Billion Dollar Billing Dispute?"

Chairman Chaffetz, Ranking Member Tierney, and distinguished members of the Subcommittee: Good afternoon and thank you for the opportunity to appear before you to discuss Department of Defense Inspector General (DoD IG) completed and ongoing audits of the Subsistence Prime Vendor Contract in Afghanistan. On behalf of the DoD IG, I would like to thank this Subcommittee for its continued interest and oversight in this area. Taking corrective action to address Inspector General recommendations is essential to good government and the effective stewardship of the taxpayer's dollars. Additionally, identifying and implementing lessons learned is essential to minimizing the risks of repeating mistakes of the past.

Today I will highlight problems identified during our initial audit,[1] Defense Logistics Agency (DLA) actions taken to address the report recommendations, additional opportunities to improve contract administration, and lessons learned that could be applied by DLA to future contracts.

BACKGROUND ON THE INITIAL AUDIT AND THE PRIME VENDOR CONTRACT

DoD IG's overall focus of the audit was to evaluate the DLA's contract administration of Supreme Foodservices GmbH,[2] the prime vendor (PV)[3] for food and nonfood products for our warfighters in Afghanistan. Specifically, the audit reviewed whether the assignment of contracting officer's representatives (CORs) and execution of the Quality Assurance Surveillance Plan (QASP) and procedures were effective for assessing contractor costs and performance.

DLA has the overall responsibility for procuring, managing, and distributing subsistence products throughout the supply chain. In addition, DLA provides worldwide dining hall support to authorized customers, to include providing contract administration for these facilities.

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[1] DoD IG Report No. D-2011-047, "Improvements Needed in Contract Administration of the Subsistence Prime Vendor Contract for Afghanistan," March 2, 2011

[2] The contractor's headquarters are located in Ziegelbruecke, Switzerland.

[3] PV is generally a single commercial contractor that serves as the major provider of products and services to various Federal customers within a geographical region or zone.

Supreme Foodservice GmbH was awarded a 60-month prime vendor contract, starting December 3, 2005. This was a fixed-price, indefinite-quantity contract and was initially valued at approximately $726.2 million.[4] At the time the contract was awarded, the PV was required to provide food and nonfood distribution support to four activities in Afghanistan—Bagram, Kabul, Salerno, and Kandahar.

PV's warehouse in Kabul, Afghanistan

On August 26, 2005, the contracting officer issued a verbal change order, rather than a formal contract modification, for the PV to provide the same food and distribution support to 68 additional activities throughout Afghanistan. According to DLA, security concerns within the warzone and the lack of developed roads in Afghanistan prevented the PV from always using ground transportation to service the additional activities. Consequently, the contracting officer also verbally authorized the PV to use a combination of fixed-wing aircraft, helicopters, and ground transportation. This verbal authorization remained undefinitized for 1 year until the contracting officer modified the contract in August 2006.[5] Although verbal change orders are permissible, the Defense Federal Acquisition Regulation Supplement requires that undefinitized contract actions

[4] An indefinite-quantity contract provides for an indefinite quantity, within stated limits, of supplies or services during a fixed period. Contracting officers may use an indefinite-quantity contract when the Government cannot predetermine, above a specified minimum, the precise quantities of supplies or services that the Government will require during the contract period.

[5] Definitization is the process where certain aspects of a contract that have not yet been finalized such as specific terms, specifications, or prices are formally agreed upon and included in the contract.

be definitized within 180 days of the contract modification. While there are exceptions allowing heads of agencies to waive the 180-day requirement if necessary to support contingency operations, as of April 2010, subsistence contracting officials had not requested a waiver.

Fixed-wing aircraft used to deliver supplies.

Helicopter used to deliver supplies.

As of September 2009, the PV's responsibility to provide food and distribution support had grown to over 150 activities or locations within Afghanistan. Between June 2005 and May 31, 2010, DLA Troop Support personnel paid the PV about $3 billion, including $1.6 billion for food and water and $1.4 billion for nonfood items, such as transportation and storage costs. When the contract was scheduled to end in December 2010, DLA extended it for an additional 2 years.

PRIME VENDOR CONTRACT ADMINISTRATION NEEDED IMPROVEMENT

On March 2, 2011, the DoD IG reported that DLA contracting officials did not provide sufficient oversight of the PV contract, valued at more than $3 billion. This occurred because the contracting officer did not appropriately definitize transportation rates as required by Defense Federal Acquisition Regulation Supplement 217.74, or issue contract modifications, as required by the Federal Acquisition Regulation. Specifically, the contracting officer did not establish permanent transportation rates for over 5 years and did not document that higher reimbursement rates for triwalls were fair and reasonable.[6] In addition, the contracting officer did not develop a QASP and written procedures to monitor the PV's costs and performance. As a result, DLA Troop Support personnel:

- overpaid the PV potentially $98.4 million in transportation costs;
- overpaid the PV approximately $25.9 million for triwalls;
- paid $454.9 million to the PV for airlifting fresh fruit and vegetables without incorporating the airlift requirement in the contract and without documenting whether the airlift price of $3.74 per pound was fair and reasonable; and

Triwall used for chilled products.

[6] Triwalls are three-layered corrugated boxes used for packaging and shipping chilled or frozen food products.

- did not validate whether $103.6 million in triwall costs was accurate and chargeable to the contract.

Some examples of where DLA's oversight was not effective follow:

- The contracting officer did not establish permanent transportation rates in a timely manner. In fact, the verbal change order issued by the contracting officer on August 26, 2005, to provide food distribution support to 68 additional activities was not formally incorporated into the contract until 6 years later in December 2011.

- DLA paid the contractor 100 percent of the triwall rates rather than 75 percent as stated in the contract. DLA and the PV agreed that from July 2006 forward, DLA would reimburse the PV monthly at 75 percent of the rates, pending the definitization of the final rates.

- The contracting officer did not issue a contract modification requiring fresh fruits and vegetables to be airlifted to Afghanistan. In addition, the rate for airlift transportation was not incorporated into the contract, and there was no documentation demonstrating how the contracting officer determined the rates were fair and reasonable.

- The contracting officer did not develop a QASP to monitor vendor performance because contracting officials believed that a generic contract management plan was the QASP. However, this plan only provided a general framework for administering overseas PV subsistence contracts and did not provide specific instructions needed to effectively administer the PV contract for Afghanistan. For example, the plan did not identify the:

    - work requiring surveillance;
    - method of surveillance;
    - technical requirements, or the specifications for inspections and testing.

- Contracting officials did not effectively review the quantities of triwalls billed by the PV and did not independently verify that the number of triwalls billed was correct because customers at forward operating bases were not required to note the quantity of triwalls received.

- The contracting officer did not have detailed written procedures for validating the PV's transportation invoices.

Without a detailed QASP and the appropriate written procedures for reviewing invoices, the CORs lacked important tools to assess the PV's work, determine if the Department was actually receiving the goods and services in accordance with the contract terms, and prevent overpayments before they were made. If there had been a QASP in place during the course of this contract, as required by the Federal Acquisition Regulation, the likelihood of overpayments could have been reduced.

The DoD Office of the Inspector General recommended that the Commander, DLA Troop Support, direct responsible officials to:

- determine fair and reasonable prices for transportation and triwalls and use those prices to definitize the August 2005 verbal change order;

- recover triwall overpayments ($25.9 million as of May 28, 2010);

- request assistance from Defense Contract Audit Agency in determining a fair and reasonable price for airlift requirements from Sharjah, United Arab Emirates, and use the results to determine and document fair and reasonable airlift requirements;

- compute and recover overpayments for transportation and triwall costs;

- develop a QASP; and

- perform a review of the individuals involved in administering the PV contract and initiate appropriate corrective action warranted by the review.

The Acting Commander, DLA Troop Support anticipated that all recommendations would be fully implemented no later than December 31, 2011.

ACTIONS TAKEN BY DLA ADDRESSED SOME OF THE REPORT RECOMMENDATIONS

Based on the anticipated implementation of corrective actions to address the deficiencies identified in initial report, the DoD IG audit team began a follow-up audit to assess the actions taken by DLA. The team reviewed whether DLA Troop Support implemented the recommendations made to address the problems and risks identified during the prior audit, and whether DLA corrective actions addressed the problems. The team recently completed this audit and issued the draft report to DLA on March 29, 2013. DLA is currently reviewing the findings and preparing their response to the report. Because this report is not yet final, it would be inappropriate to describe the findings in detail. However, in general, the audit team noted that DLA officials have taken corrective actions to address some of the recommendations, and there are some areas where additional actions by DLA will result in improved contractor administration and oversight and potentially recover additional funds owed to the Department.

DLA's Collection Efforts and Other Actions Taken

Because the contractor and DLA were unable to agree on a contract price to definitize transportation rates in Afghanistan, the contracting officer unilaterally definitized the prices. The contracting officer also signed and issued a final decision, debt determination, and demand for payment letter to the contractor on December 9, 2011. In summary, the DLA stated that the PV owes the Department approximately $756 million for overpayments of premium transportation fees incurred from December 12, 2005, to September 30, 2011. However, the PV did not voluntarily repay the debt. Instead, the PV filed a claim with the Armed Services Board of Contract Appeals, and according to a DLA Troop Support official, the case is scheduled for late April 2014.

In addition to taking collection actions and finalizing the transportation rates, we noted that DLA appeared to have taken other corrective actions including developing and implementing a QASP. DLA officials reviewed the actions of the contracting officers and determined that no action was necessary because the contracting officers acted within the scope of their authority.

Impact of Ongoing Litigation

There were some recommendations where we could not address DLA's corrective actions because of ongoing litigation. Specifically, we did not validate DLA's analysis or review the accuracy of data supporting their determination that the contractor had been overpaid approximately $756 million. Therefore, we did not evaluate whether DLA had taken appropriate action regarding:

- re-determining fair and reasonable prices for premium transportation services,
- calculating and recovering overpayments for premium transportation, and
- refunding premium transportation overpayments to the Army.

ADDITIONAL OPPORTUNITIES TO IMPROVE CONTRACT ADMINISTRATION EXIST

During the follow-up audit, the team identified additional actions DLA could take to address some of the problems and risks previously reported. These additional actions should strengthen contract administration and oversight, as well as help ensure the Department recoups overpayments. Because the report is not yet final, it would not be appropriate to discuss the areas in detail; however, there are additional efforts DLA should take regarding:

- obtaining and maintaining adequate documentation to support price reasonableness,
- taking additional actions to obtain critical information from contractors, and
- developing strategies to recover overpayments.

LESSONS LEARNED FOR FUTURE CONTRACTS

Some of the problems encountered in the Subsistence PV Contract for Afghanistan contract were highlighted in our updated report on contingency contracting.[7] This report provides a useful tool to senior DoD officials to help prevent many contracting problems. During the initial and follow-up audits of the Subsistence PV Contract for Afghanistan, several important lessons learned regarding contract administration and oversight were identified. Specifically:

- **Definitize contracts within the appropriate amount of time.** Although verbal change orders and other undefinitized contracting actions are permissible, these actions should be incorporated timely into the contract and should be used in limited instances. During periods when these actions remain undefinitized, contract costs and performance risks transfer from the contractor to the Government. Undefinitized contract actions for supplies and services can result in

[7] DoD IG Report No. D-2012-134, "Contingency Contracting: A Framework for Reform 2012 Update," September 18, 2012

a contractor not providing goods and services appropriately and at prices deemed acceptable to the Department. Therefore, it is critical that verbal change orders be incorporated as soon as possible into the contract through formal contract modifications to protect the Department's operational and financial interests.

- **When using provisional rates, verify their reasonableness until the final rates are definitized.** Without a definitized contract, responsible officials should exercise due diligence by verifying the reasonableness of provisional rates and not paying more than these provisional rates. Paying more than actual costs incurred, as evidenced in this contract, may result in costs escalating out of control, and the Department experiencing difficulty recouping overpayments.

- **Ensure adequate documentation is obtained and maintained.** For large and complex acquisitions, such as the Subsistence PV Contract, it is critical that responsible officials document key aspects of the contracting process, as required by laws and regulations, and maintain this documentation as appropriate. This documentation not only provides valuable complete background information, it also serves as a basis for informed decisions at each step in the acquisition process; supporting actions taken; providing information for reviews and investigations; and furnishing essential facts in the event of litigation or congressional inquiries.

- **Use unilateral contracting officer determinations sooner.** Generally, Government contracts contain clauses that permit the contracting officer to make unilateral changes, in designated areas, within the general scope of the contract. A unilateral modification is a contract modification signed only by the contracting officer. Unilateral modifications can be used to make administrative changes and to issue change orders and termination notices. If the Government and the contractor cannot reach an agreement, the contracting officer should consider a

unilateral change (if allowed and warranted). By taking these actions sooner, the Department will be better equipped to collect or offset future payments to the contractor.

- **Prepare and execute a QASP in a timely manner.** Government quality controls, to include developing and implementing a QASP, are not only required but provide a valuable oversight tool that helps ensure the Department actually receives the goods and services it pays for. Surveillance, especially with a large, complex contract like the subsistence PV, is necessary to ensure that the supplies or services conform to contract requirements.

- **Develop and implement specific procedures to verify the accuracy of invoices prior to making payments.** Detailed written procedures help CORs accurately assess contractor invoices and approve only those costs allowable under the terms of the contract. The contracting officer had not developed written procedures to ensure that the cost of triwalls delivered by road to non-forward operating bases was excluded from invoices. In addition, the CORs' review of some transportation invoices was incomplete or inaccurate because they did not include minimum order weights as part of the validation. Had written procedures been established for reviewing invoices, the CORs may have prevented some of the overpayments.

- **Minimize turnover in key positions (for example, contract officer).** Turnover of acquisition professionals can adversely impact the quality and continuity of business. New contracting officers may be at a disadvantage because they are unfamiliar with key aspects of complex contracts and take additional time to establish the appropriate level of contact between the Government and the contractor. With each change in a key position, documentation, issues being tracked, and recollection of key decisions and directions may be lost in the

transition. In the end, the best interest of the Government may suffer because of the turnover in key officials.

CONCLUSION

Our completed and ongoing audits of the Subsistence Prime Vendor Contract in Afghanistan have had a significant impact by prompting DLA to initiate appropriate corrective action for overpayments and by improving contract administration by the Department. We are encouraged by efforts DLA senior leadership has taken to address some of the critical problems we identified, especially efforts to collect the significant amount of overpayments made on this contract. However, to be truly effective, these corrective actions must be applied, as appropriate, across DLA's other contract activities rather than fixing only the problems we identify. The DoD IG will continue to follow up on key recommendations made throughout the Department. Given the fiscal challenges the country is facing, every reasonable effort must be taken to conserve valuable funds and put them to their best possible use.