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Independent Accountant's Report on the Application of Agreed-Upon Procedures Relating to Bureau of Information Resource Management Enterprise Network Management Office GSA-FEDSIM Millenia Contract Task Order GS-T0004AJM049

Report Number: AUD/PP-06-08, March 2006

Leonard G. Birnbaum and Company, LLP, Certified Public Accountants, performed the Agreed-Upon Procedures under Department of State, Office of Inspector General, Contract No. SAQMPD04D0033, and by its acceptance this report becomes a product of the Office of Inspector General.

Howard J. Krongard

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Inspector General

3/14/06

Date

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Summary

The Office of Inspector General (OIG) issued a report in August 2005, *Review of the Department's Compliance With the State First Policy for Acquisitions* (AUD/PP-05-42) that included specific coverage of the General Services Administration (GSA) Federal Systems Integration Management Center (FEDSIM) Millenia Contract Task Order GS-T0004AJM049. Before the review by OIG, the Bureau of Information Resource Management, Office of Executive Director (IRM/EX) staff provided oversight of the Department of State's (Department) Enterprise Network Management (ENM) effort and identified concerns related to the management of the program. Thus, at IRM/EX's request, OIG contracted with Leonard G. Birnbaum and Company, LLP, to perform agreed-upon procedures on the GSA-FEDSIM Millenia Contract Task Order to address IRM's concerns. Our work covered the period from the inception of the ENM effort on December 1, 2003, through June 30, 2005.

The current management of the above-referenced contract was not working effectively to benefit the Department's information technology (IT) needs. Specifically, the use of the FEDSIM Millenia contract as a procurement vehicle has led to the Department's relinquishing its contracting officer and contracting officer's representative functions to GSA. In government procurement, those two roles provide internal control.

GSA's FEDSIM operation is funded only by the fees it earns from other government agencies and not by appropriations. As such, the FEDSIM staff assigned the role of contracting officer for procurement by another agency has a conflict of interest, in that his or her job depends on funds generated by the customer agencies rather than by the conscientious application of federal procurement standards and principles. To eliminate this conflict and to maintain internal control, we are recommending that IRM, in coordination with the Department's primary procurement element, the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management (A/LM/AQM) independently procure the required ENM effort rather than renew the FEDSIM Millenia Contract Task Order.

Perhaps the most glaring example of this conflict, in this case, was the willingness of the GSA contracting officer to transfer approximately [redacted] from estimated labor costs to award fees at the behest of the Department's ENM program office; a transfer that was patently at variance with the Federal Acquisition Regulation. Also, while the award fees significantly increased, some direct labor rates rose unchecked by upward of [redacted] percent. In addition, the absence of internal controls over spending has resulted in an excessive "burn rate" for labor costs. For the approximately [redacted] in labor and fees that should cover about 74 months of effort, about [redacted] or [redacted] percent, was spent from December 1, 2003, through June 30, 2005. At this pace, the funds would be exhausted in 43 months.

The scope of work did not adequately define the requirements for this ENM effort. Accordingly, the current procurement vehicle – an open-ended, cost-plus-award-fee contract – was not appropriate because it precluded the effective fiscal management of individual subtasks. An indefinite-quantity, indefinite-delivery (IDIQ) contract provides more effective control. Such was not possible under the present arrangement because the FEDSIM Millenia contracts are themselves IDIQ contracts and part of a larger task order, a U.S. Agency for International

Development (USAID) effort. Issuance of an IDIQ contract line item under an IDIQ task order would be difficult to manage, particularly as the Millenia contracts vest the contracting officer and contracting officer's representative responsibilities with GSA rather than the Department.

The report recommends that IRM, in coordination with A/LM/AQM, procure the ongoing ENM effort through an IDIQ-type contract in order to implement more effective control over what is currently an imprecisely defined scope of work. On December 8, 2005, OIG and its independent accountant, held an exit conference with IRM executive office and program officials on the engagement's findings and recommendations. IRM program officials provided additional information that is incorporated into the report. In addition, IRM officials agreed to work with A/LM/AQM to implement OIG recommendations that will transfer the ENM procurement and contract oversight responsibilities to the Department. OIG also spoke with the A/LM/AQM's division director for IT products and services, who said that if given ENM requirements with a definitive scope of work, A/LM/AQM could compete the requirements and monitor performance of the contract. In written responses to the draft report, both IRM and A/LM/AQM reiterated agreement with the report recommendations and outlined steps to transfer the ENM procurement and contract oversight responsibilities to the Department. (See Attachments A and B.) OIG commends IRM for adhering to the State First Policy that through the Department's contract administration of Enterprise Network Management requirements should realize over $7.7 million in savings by avoiding unnecessary administrative costs. In addition, the Department will not be subject to the approximately $186,000 average annual administrative fees paid to GSA for contract administration.

Background

GSA has awarded several FEDSIM Millenia contracts. These contracts provide a vehicle for GSA to assist other federal agencies in the design and implementation of IT projects. GSA IT staff participates to varying degrees in the management and administration of such projects, particularly the award of task orders, and GSA bills the participating agency for the time and costs of its staff in performing such services. Under this arrangement, the functions of contracting officer and contracting officer's representative are transferred from the participating agency to GSA.

The Millenia contracts are IDIQ contracts. Companies that have been awarded Millenia contracts are required to bid for individual tasks to be awarded under the FEDSIM Millenia program.

ENM combined its ongoing IT requirements with those of USAID to form a single task to be competed by GSA and awarded to a Millenia contractor. Although there is an initiative to coordinate the Department's IT projects with those of USAID, there is no indication that the ENM effort is part of that initiative.

The ENM effort was identified as separate contract line item numbers under the task order, and awarded on a combination of cost plus award fee and cost plus fixed fee as shown in Table 1. The current task order is a follow-on procurement.

Table 1:Estimated Costs and Pricing Type for Line Items Eight Through Eleven

Line Item	Description	Pricing Type	Est. Cost	Fee	Total
0008	Labor	CPAF	$80.32	[redacted]	[redacted]
0009	Tools	CPFF	[redacted]	[redacted]	[redacted]
0010	Tech Refresh	CPFF	[redacted]	[redacted]	[redacted]
0011	Oth.Dir.Costs	CPFF	0.60	.0120	**0.61**
Total			[redacted]	[redacted]	[redacted]

Legend: CPAF = Cost plus award fee
CPFF = Cost plus fixed fee
Note: Dollars in millions; may not total owing to rounding.
Source: GSA.

Agreed-Upon Procedures for Review

IRM/EX requested that agreed-upon procedures address the following issues:

1. compliance with requirements of the State First Policy for Acquisitions;
2. significant labor rate increases;
3. passthrough charges paid to the prime contractor;
4. funding discrepancies covering specific periods of performance;
5. award fees being taken from funding for labor;
6. potential fee avoidance on commodity purchases;
7. excessive burn rate;
8. requirements not adequately defined before work begins;
9. unclear subcontracting and partnering agreements;
10. approvals of award fees increasing from [redacted] to [redacted] within the same contract amount; and
11. payment for Northrop Grumman office space.

Below are details on the findings for each of these issues, followed by our recommendations.

1. Compliance With State First Requirements

Discussions with representatives of A/LM/AQM disclosed that the award of the ENM effort to the GSA FEDSIM program had been reviewed for compliance with State First requirements. This review, however, took place after the award. State First policy articulated in Department Notice 2002_05_039, issued by the Office of the Procurement Executive (A/OPE) on May 20, 2002, requires that transfer of funds to another agency for acquisition services may only be made after consultation with A/LM/AQM. IRM incorporated this requirement into IRM Notice Number 2002-81, dated August 9, 2003.

We were unable to determine why these requirements were not followed. For the record, we suggested that IRM, A/LM/AQM, and A/OPE document the noncompliance with Department Notice 2002_05_039.

2. Significant Labor Rate Increases

The review of billing documents showed that some increases to direct labor rates appeared excessive. A comparison of wage rates as of December 31, 2004, for 109 Northrop Grumman employees to rates for the same employees in March 2005 disclosed an average increase of [redacted] percent, with 30 employees receiving increases of [redacted] percent or higher. Ten employees received increases of [redacted] percent or higher.

Nothing in the terms and conditions of the contract, however, can prevent such increases without the government's having to demonstrate that the increased rate is unreasonable, which is a difficult standard to meet. Under ordinary circumstances, a contractor performing under a cost-reimbursement contract would be deterred from increasing labor rates excessively because of the effect such would have on the rate at which contract funds are consumed (i.e., the "burn rate"), which runs the risk of exhausting contract funds before the end of the period of performance.

No such deterrent exists on this task order because requirements were not precisely defined before award, nor was a detailed, time-phased spending plan developed before solicitation. Consequently, no control exists that can match budgeted to actual financial and schedule performance.

We suggested for future procurements under an IDIQ contract, the contracting officer and the contracting officer's representative document significant labor rate changes and assess any impact on contract funding and completion of work.

3. Passthrough Charges to the Prime Contractor

In discussing this FEDSIM task order, OIG's *Review of Compliance With the State First Policy* states that:

> OIG reviewed an IAA [interagency agreement] where IRM officials were not aware that the contractor subcontracted the procurement services and then charged the program office [redacted] in passthrough fees. OIG reviewed the IAA and the contract . . . concerning this action and found that this charge had no foundation for reimbursement in the contract and therefore should be recovered as a questioned cost.

As noted above, the current task order is a follow-on procurement. Of significance is the fact that the prime contractor on the current task order, Systems Research and Applications Corporation (SRA), was the principal subcontractor on the predecessor task order, and the prime contractor on the predecessor procurement, Northrop Grumman, is now the principal subcontractor. Under the predecessor and current task orders, Northrop Grumman performed work for the Department.

Because SRA is now the prime contractor, it is entitled to assess indirect costs, in accordance with its consistently applied cost accounting practices, to the costs invoiced by its subcontractor, Northrop Grumman, for work performed for the Department. Further, SRA included an application of indirect costs to Northrop Grumman subcontract costs in its original cost proposal for line item 0008, which covers the basic ENM effort. That proposal totaled

(b) (4) [redacted] the current ceiling cost and award fee for line item 0008. Thus, disallowance of these passthrough fees will not withstand a challenge before a board of contract appeals.

The observation in the OIG report that "IRM officials were not aware that the contractor subcontracted the procurement services" is particularly cogent. It points directly to unexpected and adverse effects of transferring contracting officer and contracting officer's representative responsibilities to GSA as required by the FEDSIM program.

SRA's original cost proposal contained the following amounts to be paid to SRA. (See Table 2.)

Table 2:SRA's Original Cost Proposal

Line Item	**Estimated Cost**
Direct Labor and Overhead	(b) (4) [redacted]
Material Handling[a]	(b) (4) [redacted]
General and Administrative Expense[b]	(b) (4) [redacted]
Award Fee[c]	(b) (4) [redacted]
Total	(b) (4) [redacted]

Note: Dollars in millions; may not total owing to rounding.
[a] On Northrop Grumman subcontract costs.
[b] On SRA and Northrop Grumman costs.
[c] To SRA only (does not include award fee to Northrop Grumman)
Source: SRA proposal.

If GSA had procured the ENM effort directly from Northrop Grumman rather than through SRA on the FEDSIM Millenia Task Order, it could have avoided these additional loadings of (b) (4) [redacted] on Northrop Grumman costs. In addition, IRM program officials at the exit conference acknowledged that the award fee of (b) (4) [redacted] to SRA was excessive, at about one-third the total proposal cost of (b) (4) [redacted].

4. Funding Discrepancies Covering Specific Periods of Performance

Funding documents transmitted by ENM program staff to IRM/EX for approval have, in the past, contained conflicting periods of performance. Although the cause of these conflicts was not clear, their existence supports the premise that either requirements were not carefully planned before work began, or for whatever reason, the original plans were not followed.

5. Award Fees Being Taken From Funding for Labor

By modification PS 15 to the task order, GSA reclassified [redacted] of contract value from estimated costs to award fees. GSA representatives said that they did this at the request of ENM and that it was to provide "visibility" to the Northrop Grumman award fee**.** The amount reclassified was approximately $300,000 less than the award fees identified for Northrop Grumman in SRA's cost proposal, which was negotiated without change. Consequently, this reclassification had no effect on the amount of funds available for labor.

GSA has advised SRA that it will rescind this reclassification because the Defense Contract Audit Agency, in reviewing the contract, advised that fees or profit included in the subcontractors' invoices were costs at the prime contract level. The ENM program office should have been aware of this fact or, at a minimum, consulted with A/LM/AQM before requesting GSA to effect this change.

6. Potential Fee Avoidance on Commodity Purchases

Through June 30, 2005, SRA invoiced [redacted] for equipment purchases and [redacted] for related maintenance agreements. SRA included about [redacted] for indirect expenses and $111,400 for fees in its invoices for the equipment purchase cost and [redacted] for indirect expenses and [redacted] for fees in the maintenance agreement amount invoiced. This equates to a markup of about [redacted] percent on the cost of maintenance agreements and equipment, or approximately [redacted] of the estimated total costs and fees for line item 0010.

We noted that A/LM/AQM has a process for acquisition of IT hardware and software at prices lower that those available from GSA Federal Supply System contractors. Further, procurement of such items through A/LM/AQM would have avoided indirect cost and fee assessments by Northrop Grumman and SRA. The A/LM/AQM chief of technology for procurement agreed to handle such acquisitions. In addition, A/LM/AQM should review other IT commodity purchases through GSA for their cost-effectiveness.

A/LM/AQM should procure all commodity purchases in-house rather than through the FEDSIM Millenia Task Order. This will effect significant savings in the cost of the commodities and avoid assessment of indirect costs and fees by the FEDSIM prime contractor and subcontractor. The current estimated cost and fees include approximately [redacted] in indirect costs and fee loadings by current prime contractor.

7. Excessive Burn Rate

The term "burn rate," as used here, refers to the rate at which the estimated cost of the contract is being consumed. The initial estimated cost and award fee for line item 0008 (the majority of the work for the Department), in the amount of [redacted] was intended to cover a period of performance from December 1, 2003, to January 27, 2010, or approximately 74 months. SRA has invoiced, for costs incurred and fees earned from May 1, 2004, through June 30, 2005, a total of [redacted] or about 30 percent of the estimated costs and fees during [redacted] percent of the estimated period of performance. At that rate of spending, funds would be exhausted in 43 months rather than the 74 months of the contract.

The initial estimated cost and fee for line item 0009 was [redacted] covering the same estimated period of performance. Through June 30, 2005, SRA had invoiced [redacted] or [redacted] percent of the total costs and fees during [redacted] percent of the estimated period of performance. At that rate of spending, funds for this line item would be exhausted in 47 months. Similarly, for line item 0010, through June 30, 2005, SRA had invoiced [redacted] or [redacted] percent of the total costs and fees of [redacted] million during [redacted] percent of the estimated period of performance. At that rate, funds for this line item would be exhausted in 23 months.

Representatives of both ENM and GSA said that requirements in Iraq were the cause of the increased burn rate. As a result of a request to furnish documentation supporting this premise, GSA provided the following expenditures for Iraq and Afghanistan through October 4, 2005. (See Table 3.)

Table 3: Expenditures for Iraq and Afghanistan From December 1, 2003, Through October 4, 2005

Line Item	Amount
0008	(b) (4) [redacted]
0009	(b) (4) [redacted]
0010	(b) (4) [redacted]
Total	(b) (4) [redacted]

Note: Dollars in millions; may not total owing to rounding.
Source: GSA.

Even assuming that these amounts are correct, expenditures of $192,500 against line item 0008 simply cannot account for the excessive burn rate under that line item and suggest that neither GSA representatives nor ENM program officials have a clear understanding of why SRA was expending funds at that rate. This, in turn, points to an absence of controls over spending under the ENM program.

8. Requirements Not Adequately Defined Before Work Begins

The excessive burn rate discussed above demonstrates that the work plan for this procurement was either not adequately defined or not adequately developed before work began. Further, ENM's and GSA's position that requirements in Iraq justified an excessive burn rate simply does not withstand scrutiny. Before contract award, the Department had already established its plans for a diplomatic mission in Iraq.

Moreover, the level of effort under line item 0008 has been anything but constant, as shown in Table 4.

Table 4: Level of Effort Under Contract Line Item Number 0008

Performance Period	Amount Invoiced
2004	
July	(b) (4) [redacted]
August	[redacted]
September	[redacted]
October	[redacted]
November	[redacted]
December	[redacted]
2005	[redacted]
January	[redacted]
February	[redacted]
March	[redacted]
April	[redacted]
May	[redacted]
June	[redacted]

Note: Dollars in millions; rounded.
Source: GSA.

This pattern of cost incurrence suggests that the required effort had not been planned in a manner that would reap the benefits of continuity of assigned staff. At the exit conference, an IRM official indicated that overall labor was consistent for the effort to support ENM projects; however, the contractor often deferred or billed late for labor occurring under previous time periods.

9. Unclear Subcontracting and Partnering Agreements

The relationship between the prime contractor, SRA, and the principal subcontractor was unclear. SRA's original proposal for line item 0008 included 20,328 hours for SRA personnel as against 799,907 hours for Northrop Grumman personnel, or approximately 2.5 percent of the hours proposed for Northrop Grumman. Through June 30, 2005, the amount invoiced for SRA direct labor approximated [redacted] percent of the amount invoiced for Northrop Grumman direct labor. Given the prime contractor's responsibilities in managing the contract, this level of involvement by SRA does not seem excessive.

10. Approvals of Award Fees Increasing From [redacted] to [redacted] Within the Same Contract Amount

Please refer to the above discussion, 5. Award Fees Being Taken From Funding for Labor.

11. Payment for Northrop Grumman Office Space

Representatives of ENM said that rent for the Northrop Grumman office space was paid for by the Department and that payment of the rent was specifically provided for in the FEDSIM task order. As of the end of fieldwork, the ENM representatives had not provided us with, or identified, such a contract clause. We noted that the original cost proposal for line item 0008 did not include any amount for such rent, nor was any rent included in the amount negotiated. Therefore, the Department should determine and recover the total rent paid as an ineligible cost under the FEDSIM Millenia Contract Task Order.

Recommendations

Recommendation 1: We recommend that the Executive Director, Bureau of Information Resource Management, in cooperation with the Director, Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, independently procure the required Enterprise Network Management effort rather than renew the FEDSIM Millenia Contract Task Order GS-T0004AJM049.

IRM Response: The IRM executive director agreed that it is in the best interest of the Department to independently procure the required ENM effort rather than renew the FEDSIM agreement. In addition, IRM wishes to continue joint collaboration with USAID.

OIG Response: IRM's proposed actions are responsive, and as stated in the report, the Department's administration of the contract can save about [redacted] in unnecessary costs paid to SRA. OIG considers the recommendation resolved and will close it upon issuance of the new procurement.

> **Recommendation 2:** We recommend that the Bureau of Information Resource Management, in cooperation with the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, procure the ongoing Enterprise Network Management effort through an indefinite-delivery, indefinite-quantity contract based on a more precisely defined scope of work.

IRM Response: The IRM executive director agreed to procure the ongoing ENM effort through an indefinite-delivery, indefinite-quantity contract based on a more precisely defined scope of work. IRM will work with the A/LM/AQM in this effort.

OIG Response: IRM's proposed actions are responsive. OIG considers the recommendation resolved and will close it upon issuance of the new procurement.

> **Recommendation 3:** We recommend that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management make all commodity purchases rather than use the FEDSIM Millenia Task Order GS-T000AJM049. The bureau should also identify other information technology commodity purchases made outside the Department and review them for similar cost-savings.

A/ALM/AQM Response: A/LM/AQM agreed with the recommendation and will make all commodity purchases rather than use the FEDSIM agreement.

OIG Response: A/LM/AQM's proposed actions are responsive, and as stated in the report, the Department's administration of this contract segment can save about [redacted] OIG considers the recommendation resolved and will close it upon issuance of the new procurement.

> **Recommendation 4:** We recommend that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management determine and recover the amount of ineligible rent cost paid under FEDSIM Millenia Contract Task Order GS-000AJM049.

A/ALM/AQM Response: A/LM/AQM deferred this issue to the GSA contracting officer at FEDSIM.

OIG Response: OIG contacted the contracting officer's representative for the ENM effort at FEDSIM, who provided assurances that the rent was eligible under Task Order GSA-000AJM049. On the basis of this response, OIG considers this recommendation closed upon issuance of the report.

Purpose, Scope, and Methodology

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

- We obtained an understanding of the requirements of the Department's State First Policy for Acquisitions.
- We obtained an understanding of the procurement process inherent to the GSA-FEDSIM Millenia Contract Task Order GS-T000AJM049.
- We reviewed relevant provisions of the Federal Acquisition Regulation and the Department of State Acquisition Regulations.
- We reviewed relevant contract provisions and modifications to the contract.
- We reviewed the original cost proposal related to the ENM portion of the FEDSIM Millenia Contract Task Order.
- We analyzed invoices submitted for the ENM effort covering the period from inception on December 1, 2003, through June 30, 2005.
- We interviewed GSA FEDSIM staff assigned to the ENM effort in Washington, D.C., and Department officials in IRM/EX, IRM/ENM, OIG, and A/LM/AQM.

Responses to the draft report were received from A/LM/AQM and IRM, on January 31, 2006, and February 7, 2006, respectively and appear as Attachments 1 and 2. Although IRM does not completely agree with all of the findings contained in the report, both IRM and AQM agree, in general, with the report's recommendations.

The above procedures do not constitute an audit conducted in accordance with generally accepted auditing standards or *Government Auditing Standards*; thus, we do not express an opinion on the adequacy and compliance of the reviewed cost or pricing data. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that there were significant inadequacies or noncompliance related to the areas reviewed. This report relates only to the GSA FEDSIM Millenia Task Order specified above.

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