



OIG

Office of Inspector General

U.S. Department of State • Broadcasting Board of Governors

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Middle East Region Operations

June 2016

Management Assistance Report: Questionable Practices Regarding the Department of State Baghdad Life Support Services (BLiSS) Contract, Including Suspected Use of Cost-Plus-a- Percentage-of-Cost Task Orders

MANAGEMENT ASSISTANCE REPORT

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Summary of Review

In January 2016, the Office of Inspector General (OIG) presented a draft of this report to the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management (A /LM/AQM), and to the Under Secretary for Management (M). The draft report stated that, under the Baghdad Life Support Services (BLiSS) contract, the Department of State (Department) improperly awarded three overtime/incentive-fee task orders and one time-and-materials/incentive-fee task order to the contractor, PAE Government Services, Inc. (PAE), using a cost-plus-a-percentage-of-cost (CPPC) contracting arrangement prohibited by Federal procurement laws. OIG made four recommendations to A/LM/AQM and one recommendation to M regarding the award of CPPC task orders.

In response to the draft report, M, who also responded for A/LM/AQM, explained that the Department's Office of the Legal Advisor (L/BA) had reviewed the U.S. Government Accountability Office (GAO) criteria governing a CPPC contracting arrangement and determined that the BLiSS contract was compliant with applicable laws and regulations (see Appendix A). Enclosed with M's January 19, 2016, response were two documents: (1) an audit compliance response dated January 5, 2016, to a separate *Management Assistance Report* (MAR) issued in November 2015 that also involved the BLiSS contract (see Tab 1); and (2) a Memorandum to the [BLiSS Contract] File, dated January 4, 2016, which is meant to document "the background, basis, and justification" for the award of overtime and incentive-pay task orders (see Tab 2).

Based on information it received in the course of its fieldwork for this MAR, OIG initially concluded that the task orders constituted an impermissible CPPC arrangement. However, based on the Department's January 2016 response to the draft of this report, OIG cannot now make a determination on this issue. The written response contained materially new information and facts that OIG cannot at this point verify or assess. Accordingly, this MAR addresses concerns with the timing of the Department's January 2016 written justification documenting the award of overtime and incentive pay task orders, as well as the Department's use of the "changes" clause to provide additional "flexibility" to PAE.

Specifically, in the Department's January 2016 explanation as to why the task orders did not implicate a CPCC arrangement, the enclosed documentation states that compensation from the task orders is paid directly to the employee with no fee to PAE. It also stated that the covered employees were not free to decide how many hours they could work at any time because the contracting officer or contracting officer's representative (COR) had to approve overtime prior to performance. At the time of the audit fieldwork on which this report is based, the Department did not provide documentation to explain the Department's arrangement with PAE. Thus, determining the accuracy of that information was not within the scope of this engagement, and OIG therefore must accept the Department's representation for present purposes. As a result, OIG cannot make any determination as to whether or not the task orders implicated a CPCC arrangement.

In addition, Government contracts contain a "changes" clause that permits the contracting officer to make unilateral changes within the scope of the contract. The BLiSS contract contained

the Federal Acquisition Regulation (FAR) changes clause applicable to firm-fixed-price (FFP) arrangements. On this point, the January 5, 2016, memorandum stated, "The Department determined that more flexibility than allowed by the current FFP labor arrangement was required." However, as explained below, OIG questions whether the Department's response to the draft of this MAR provides sufficient justification for employing the changes clause to replace the FFP labor under the contract with hourly rates, overtime, and/or incentive payments. Again, though, because of the timing of this information, OIG cannot make any final determination on this point.

The draft MAR contained five recommendations regarding the task orders in question. Although the Department did not concur with those recommendations, it also stated in its response that it: (1) discontinued the security crisis overtime pay on September 14, 2015, (2) would discontinue the security crisis incentive pay as of January 4, 2016, and (3) would deobligate all remaining unspent funds from the task orders. Accordingly, notwithstanding OIG's inability to assess the Department's factual statements regarding the task orders, OIG considers all five recommendations previously offered in a draft of this report closed, and no further action from the Department is required.

OIG will continue to monitor the contract arrangements used by A/LM/AQM during OIG's ongoing audit of the BLiSS contract, as well as other contracts in the region, and notify the Department promptly of any issues identified. It is particularly important that the Department maintains contract files consistent with FAR 4.8, "Government Contract Files," which states, "the documentation in the files shall be sufficient to constitute a complete history of the transaction for the purpose of providing a complete background as a basis for informed decisions at each step in the acquisition process." This deficiency was pronounced with respect to this review of BLiSS task orders. In particular, the January 4, 2016, Memorandum to the File, which describes itself as documenting the "background, basis, and justification" for the award of these task orders, was signed and dated, added to the file, and presented to OIG 18 months after the award of the first task order. This practice is inconsistent with Federal regulations, fails to provide a timely picture of the contracting officer's decisions, and leaves room for details to be changed or misunderstood. Moreover, because of the lack of timely information, OIG expended significant time and resources on audit fieldwork without receiving important documentation regarding the task orders at issue.

BACKGROUND

In December 2011, the Department assumed full responsibility from the Department of Defense for leading U.S. operations in Iraq, including the provision of life support services to

U.S. Government personnel formerly provided under contracts administered by the Department of Defense.¹ Life support services include food, water, fuel, and other support services. In July 2013, A/LM/AQM² awarded contract No. SAQMMA13D0120, an indefinite-delivery/indefinite-quantity (IDIQ) contract,³ to PAE to provide life support services and logistics functions for U.S. Government personnel working at various sites in Iraq. These sites include the Baghdad Embassy Compound (Olympia and Embassy Heliport, also referred to as the International Zone), the Baghdad Diplomatic Support Center at the Baghdad International Airport, and the U.S. Consulate General in Basrah. The IDIQ contract also allowed for the addition of other Department sites within Iraq, and A/LM/AQM subsequently awarded a task order under the BLiSS contract to conduct work at the Union III Compound. The BLiSS contract has a maximum performance period of 5 years (base year plus 4 option years) and a not-to-exceed cost of \$1.0 billion (inclusive of all direct costs, indirect costs, and profit/fees).

As of October 2015, the Department issued 15 task orders under the BLiSS contract with a total estimated value of \$536 million. Labor costs under most of these task orders were FFP. The IDIQ contract states, "for firm fixed price task orders, the Government will not pay additional for overtime."⁴ However, A/LM/AQM subsequently issued four task orders⁵ to provide PAE funds to pay its employees for the hours worked beyond their regular schedules and/or for a 25 percent incentive fee to retain employees assigned to the Baghdad Embassy Compound and Diplomatic Support Center. In November 2015, OIG reported⁶ that the Department, without explanation, improperly awarded these four overtime and/or incentive-fee task orders against an FFP contract.

Use of Cost-Plus-a-Percentage-of-Cost Contracts Is Prohibited by Law

Title 41, Section 3905(a), of the United States Code (U.S.C.) states, "The cost-plus-a-percentage-of-cost system of contracting shall not be used." The prohibition against the CPPC system of

¹ Previous Department of Defense support services contracts included the U.S. Army Materiel Command's Logistics Civil Augmentation Program, Defense Logistics Agency contracts for food and fuel, and Army Sustainment Command's Green Equipment Maintenance contract.

² A/LM/AQM awarded the contract using Bureau of Near Eastern Affairs funds. Personnel from the Bureau of Near Eastern Affairs administer and oversee the contract and associated task orders.

³ An IDIQ contract is awarded when the Government cannot predetermine the precise quantities of supplies or services required. These contracts should be used when a recurring need is anticipated as an IDIQ sets the contract scope, terms, and conditions, and acts as an umbrella contract. Task orders are issued under the IDIQ contract to order supplies and services and can be either FFP or cost-reimbursable.

⁴ Federal Acquisition Regulation (FAR) 16.202, *Firm-Fixed Price Contracts*, states that an FFP contract "provides for a price that is not subject to any adjustment on the basis of the contractor's cost experience in performing the contract. This contract type places upon the contractor maximum risk and full responsibility for all costs and resulting profit or loss. It provides maximum incentive for the contractor to control costs and perform effectively."

⁵ Task order contract means a contract for services that does not procure or specify a firm quantity of services and that provides for the issuance of orders for the performance of tasks during the period of the contract.

⁶ *Management Assistance Report: Improper Use of Overtime and Incentive Fees Under the Department of State Baghdad Life Support Services (BLiSS) Contract* (AUD-MERO-16-08).

contracting is reiterated in FAR 16.102, "Policies."⁷ Further, the United States Supreme Court provided the following regarding the use of CPPC contracts:

The purpose of Congress was to protect the Government against the sort of exploitation so easily accomplished under "cost plus a percentage of cost" contracts, under which the Government contracts and is bound to pay costs, undetermined at the time the contract is made and to be incurred in the future, plus a commission based on a percentage of these future costs. The evil of such contracts is that the profit of the other party to the contract increases in proportion to that other party's costs expended in the performance.... By eliminating the risk of loss and permitting the guarantee of a satisfactory but fixed fee, Congress sought prompt performance and lower over-all expenditures for contracts in a rising labor and commodity market than would be offered by contractors who were compelled themselves to assume the risk of these unpredictable costs.⁸

By making CPPC contracts unlawful, Congress intended to eliminate the incentive for contractors to inflate their future costs and thereby increase their profits or fees at the Government's expense.

The Four BLISS Task Orders Reviewed

Three of the task orders—14F2036, 14F3785, and 15F0988—allowed incentive-fee payments on overtime. The fourth task order, 15F1246, awarded on April 24, 2015, is a time-and-materials contract⁹ that pays a 25 percent incentive fee on all hours worked at the Union III Compound. These four task orders collectively are valued at almost \$6.4 million. Table 1 shows the amounts obligated and paid to PAE on each of the four task orders reviewed as of October 2015.

⁷ FAR 16.102(c) states, "a cost-plus-a-percentage-of-cost system of contracting shall not be used."

⁸ *Muschany v. United States*, 324 U.S. 49, 61-62 (1945).

⁹ Time-and-materials task orders pass the greatest risk to the Department because there is no incentive for the contractor to control costs. Payments for labor (time) under a time-and-materials contract are based on an hourly rate multiplied by the hours worked.

Table 1: Total Funds Obligated and Paid on Incentive Pay Task Orders, as of 10/2015

Task Order No.	Service Description	Obligated Amount ^a	Amount Paid to PAE
14F2036	Overtime and Incentive Pay	\$495,739	\$333,759
14F3785	Overtime and Incentive Pay	\$1,709,619	\$1,540,637
15F0988	Overtime and Incentive Pay	\$2,483,105	\$1,094,528
15F1246	Labor and Incentive Pay	\$1,697,267 ^b	\$265,380
Total		\$6,385,730	\$3,234,304

^a The obligated amount is the amount PAE is allowed to invoice on a task order.

^b The full amount obligated against task order 15F1246 is \$19,065,344, which includes contract line items for labor hours, incentive fees, materials, fuel, and travel. However, only \$1,697,267 applies to incentive fees paid against labor hours.

Source: Generated by OIG from data provided by the Department.

RESULTS

Prior to receiving M's explanation in response to a draft of this report, OIG stated that four task orders—14F2036, 14F3785, 15F0988, and 15F1246—awarded and administered by A/LM/AQM under the BLiSS contract contained provisions that constitute a CPPC contracting arrangement. Specifically, OIG considered the incentive fees associated with the task orders applied to the actual performance costs at a predetermined percentage rate, placing the Department in a position of paying fees that increased commensurately as PAE's performance costs increased. As described below, OIG cannot now make any determination as to the nature of these task orders because of the untimely provision of information regarding these issues.

OIG's Determination of a Cost-Plus-a-Percentage-of-Cost Arrangement

OIG was originally concerned that these task orders might constitute a CPPC system of contracting, prohibited by 41 U.S.C. § 3905(a), because the task orders appeared to meet all the characteristics of a CPPC system of contracting as set forth by the United States Supreme Court and the United States Comptroller General. The Comptroller General subsequently developed four criteria for determining whether a contract constituted a CPPC contracting arrangement. The guidelines applicable to this consideration are:

1. payment is on a predetermined percentage rate;
2. the predetermined percentage rate is applied to actual performance costs;
3. the contractor's entitlement is uncertain at the time of contracting; and
4. the contractor's entitlement increases commensurately with increased performance costs.¹⁰

¹⁰ *Marketing Consultants International Limited*, B-183705, 55 Comp. Gen. 554; 1975 U.S. Comp. Gen. LEXIS 12; 75-2 Comp. Gen. Proc. Dec. P384 (1975).

Based on OIG's review of the criteria and the documentation provided by the Department for task orders 14F2036, 14F3785, 15F0988, and 15F1246, including invoices that PAE submitted,¹¹ OIG concluded that each of the four task orders appeared to meet the Comptroller General's criteria for a CPPC contracting arrangement. Specifically, based on the information received during its review, OIG drew the following conclusions:

1. **Payment is on a predetermined percentage rate.** All four task orders state that incentive pay is 25 percent of total compensation.
2. **The predetermined percentage rate is applied to actual performance costs.** For task orders 14F2036, 14F3785, and 15F0988, the 25 percent incentive fee is applied to the employee's total compensation, which is the employee's salary and overtime hours worked (actual performance costs).¹² For task order 15F1246, the 25 percent incentive fee is also applied to the employee's total compensation, which in this case is the employee's salary (actual performance costs).¹³
3. **The contractor's entitlement is uncertain at the time of contracting.** PAE employees earn an hourly rate for overtime worked for task orders 14F2036, 14F3785, and 15F0988. However, the overtime hours worked varied across pay periods and could not be predicted at the time of task order award. For task order 15F1246, PAE employees earn an hourly rate for all hours worked and labor hours may vary between pay periods. In both of these instances, because the total number of hours (overtime or labor hours) to be worked was not defined at the time of the task order awards, the amount to be paid to the contractor (the contractor's entitlement) was uncertain at the time of contract award.
4. **The contractor's entitlement increases commensurately with increased performance costs.** For all four task orders, as the employee's overtime performance or labor hours increased, the incentive fees paid increased.

Because the four task orders reviewed appeared to meet the criteria for a CPPC contracting arrangement, OIG concluded that these task orders violated 41 U.S.C. § 3905(a).

Under Secretary for Management's Explanation and BLiSS Contract Memorandum

In response to a draft of this report, M stated that the Department does not consider the BLiSS contract a prohibited CPPC contract and cited the GAO criteria used to determine whether a method of payment represents a prohibited CPPC contracting arrangement. He also stated that L/BA reviewed the criteria at the time of contract award and determined that the BLiSS contract was compliant with applicable laws and regulations.

¹¹ OIG reviewed invoices associated with these task orders and confirmed that PAE invoiced the Department for incentive fees at 25 percent of performance costs (overtime or labor hours).

¹² Task order 15F0988 describes how to calculate total compensation. OIG verified during invoice reviews that this same calculation was used for task orders 14F2036 and 14F3785.

¹³ Labor costs could not be determined at the time of award for task order 15F1246. FAR 16.601(c) states that a time-and-materials contract may only be used when it is not possible at the time of placing the contract to estimate accurately the extent or duration of the work or to anticipate costs with any reasonable degree of confidence.

M's response included two enclosures. The first is A/LM's January 5, 2016, audit compliance response to OIG's November 2015 MAR¹⁴ that also addressed aspects of the BLiSS contract (see Tab 1). The second enclosure is a Memorandum to the [BLiSS Contract] File dated January 4, 2016, which states that it is meant to document the "background, basis, and justification" for the award of overtime and incentive pay task orders (see Tab 2).

In the January 5, 2016, audit compliance response at Tab 1, A/LM stated that: (1) compensation from the CPPC task orders was paid directly to the employee with no fee to PAE, and (2) the covered employees were not free to decide how many hours they could work at any time because the contracting officer or COR had to approve overtime prior to performance. The statement that PAE received no additional fees from the task orders is information not documented at the time of audit fieldwork on which this report is based. Thus, determining the accuracy of that information was not within the scope of this engagement, and OIG therefore must accept the Department's statement on this point for present purposes.

In the same document, A/LM also stated that the contracting officer invoked the FAR's changes clause (FAR 52.243-1), Alternate II (April 1984), which justifies a change in the *place* of performance. A/LM stated that the "change was caused by the Islamic State in Iraq and the Levant (ISIL) attack in Iraq that started in June 2014, which impacted the ability of PAE personnel to perform in an increasingly difficult environment." On this point, the January 4, 2016, Memorandum to the File at Tab 2 stated, "The Department determined that more flexibility than allowed by the current FFP labor arrangement was required."

Even if it is assumed for purposes of the present report that the task orders reviewed were not a CPPC arrangement, OIG is concerned that the information in the Department's response does not adequately justify its decision to forgo the fixed labor costs, as originally specified by the IDIQ contract, in favor of hourly rates plus overtime and/or incentive payments. As a general matter, an essential purpose of an FFP contract is to require the contractor to assume risk by pricing risk into the fixed cost on which the Government may thereafter rely. See, *e.g.*, *McNamara Construction, Ltd. v. United States*, 509 F.2d 1166, 1169-70, 206 Ct. Cl. 1 (Ct. Cl. 1975) ("we have consistently held that the contractor in a fixed-price contract assumes the risk of unexpected costs. In firm fixed-price contracts, risks fall on the contractor, and the contractor takes account of this through his prices...").

OIG also questions whether a deterioration in the security environment due to the ISIL attacks in Iraq was an adequate basis for the Department to determine that there had been a change in the contractual place of performance as stated in the Department's response. The geographical place of performance was Iraq, which has not been a benign environment for many years. Given that fact, what transpired may not have "represented unexpected impediments" or otherwise justified releasing PAE from its agreed contract to hold labor costs to the FFP labor originally agreed to. *Fluor Intercontinental, Inc., etc. v. Department of State*, 2013-1 B.C.A. (CCH) P35,334 (CBCA 2013) (citing, *inter alia*, *United States v. Brooks-Callaway Co.*, 318 U.S. 120 (1943)) (Under

¹⁴ *Management Assistance Report: Improper Use of Overtime and Incentive Fees Under the Department of State Baghdad Life Support Services (BLiSS) Contract* (AUD-MERO-16-08, November 2015).

this contract, PAE assumed both expected and unexpected risks.). *Northrop Grumman Corp. v. United States*, 47 Fed. Cl. 20, 56-57 (2000) (citing various cases addressing assumption of risk for fixed-price contracts); *see also, e.g., Fluor, ibid* (rejecting contractors' claims for additional labor costs when risks of deteriorated security conditions in Haiti should have been recognized and anticipated prior to award, given that the contract expressly emphasized the fixed nature of the contract price). Again, though, OIG is not able to analyze fully this issue given that it did not receive the Department's complete justification for the change until after the audit fieldwork had been completed. Indeed, OIG noted the lack of information on these issues in a separate but related MAR, commenting, "[a]s of the date of this report, OIG has not received any additional documentation that justifies the award of overtime and incentive fees, even though Department guidance requires that this information be retained in the contract file and be readily available."¹⁵

CONCLUSION

Although OIG initially concluded that the task orders constituted an impermissible CPPC arrangement, OIG cannot make a determination on this issue at this time. Moreover, in a January 5, 2016, attachment to M's January 19, 2016, memorandum to OIG, the Department stated that it discontinued the security crisis overtime pay on September 14, 2015, would discontinue the security crisis incentive pay as of January 4, 2016, and would deobligate all remaining unspent funds from the task orders. Therefore, OIG considers all five recommendations previously offered in this report closed and no further action from the Department is required.

Nevertheless, for the reasons discussed above, it is questionable whether a change in security conditions due to the ISIL attacks in Iraq was a change in the place of performance within the scope of the FAR's changes clause. Accordingly, OIG questions whether the Department provided adequate justification for replacing the FFP labor, as originally provided by the contract, with hourly labor rates, overtime, and/or incentive arrangements under the task orders examined in this report, resulting in additional cost to the Department.

OIG will continue its oversight of contracts in Iraq and elsewhere to ensure the Department administers taxpayer funds in accordance with Federal law. For OIG to conduct this oversight effectively, it is crucial that the Department maintain contract files consistent with FAR 4.8, "Government Contract Files." This provision states, "the documentation in the files shall be sufficient to constitute a complete history of the transaction for the purpose of providing a complete background as a basis for informed decisions at each step in the acquisition process." With respect to this review of BLiSS task orders, the Memorandum to the File, which intends to document the background, basis, and justification for the award of these task orders, was signed and dated on January 4, 2016, added to the file, and presented to OIG 18 months after the

¹⁵ *Management Assistance Report: Improper Use of Overtime and Incentive Fees Under the Department of State Baghdad Life Support Services (BLiSS) Contract* (AUD-MERO-16-08, November 2015).

award. This practice is inconsistent with Federal regulations, does not provide a timely picture of the contracting officer's decisions, and leaves room for details to be changed or misunderstood. This continues to be a major management challenge for the Department and will remain an audit focus of OIG.¹⁶

¹⁶ *Management Alert: Contract File Management Deficiencies*, (MA-A-0002, March 20, 2014).

APPENDIX A: UNDER SECRETARY FOR MANAGEMENT RESPONSE



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United States Department of State

*Under Secretary of State
for Management*

Washington, D.C. 20520

January 19, 2016

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MEMORANDUM

TO: OIG/AUD – Norman P. Brown

FROM: M – Patrick F. Kennedy *PK*

SUBJECT: *Draft Management Assistance Report: Improper Use of Cost-Plus-a-Percentage-of-Cost Task Orders Under the Department of State Baghdad Life Support Services (BLiSS) Contract*

Thank you for the opportunity to provide comments on the subject Management Assistance Report. The point of contact for this response is Mr. James Moore who may be reached at 703-875-(b) (6).

Recommendation 1: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, immediately terminate all active task orders under the Baghdad Life Support Services contract that use the cost-plus-percentage-of-cost contracting arrangement or modify the task orders to comply with Federal law.

Recommendation 2: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, immediately deobligate all remaining unspent funds awarded against the cost-plus-a-percentage-of-cost contract line items under task orders SAQMMA14F2036, SAQMMA14F3785, SAQMMA15F0988, and SAQMMA15F1246 and inform Pacific Architects and Engineering Government Services, Inc., that expenses can no longer be incurred against those contract line items.

Recommendation 3: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, take immediate measures to recover any payments made against the cost-plus-a-percentage-of-cost contract line items under task orders SAQMMA14F2036, SAQMMA14F3785, SAQMMA15F0988, and SAQMMA15F1246.

Recommendation 4: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, review contracts

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performed in Iraq and other countries with high-risk security environments and, if the awards used the same cost-plus-a-percentage-of-cost contracting arrangement, immediately implement Recommendations 1, 2, and 3 for those awards.

Recommendation 5: OIG recommends that the Under Secretary for Management assess the internal controls employed by the Bureau of Administration, Office of Logistics Management and the Office of the Legal Adviser, Office of Buildings and Acquisitions that allowed the award of prohibited cost-plus-a-percentage-of-cost task orders and determine what corrective actions must be implemented to prevent this prohibited contracting arrangement from recurring.

Management Response (1/13/2016): The Department disagrees with the five recommendations in this MAR. As previously communicated in the response to the MAR titled, "Final Report - Management Assistance Report: Improper Use of Overtime and Incentive Fees Under the Department of State Baghdad Life Support Services (BLiSS) Contract (AUD-MERO-16-08, November 2015)", the Department does not consider the BLiSS contract a prohibited or illegal cost-plus-a-percentage-of-cost contract.

In 1993 (B-252378), the Government Accountability Office articulated the four criteria it uses to determine whether a method of payment represents a prohibited cost-plus-a-percentage-of-cost arrangement, as follows:

- (1) payment is at a pre-determined rate,
- (2) the pre-determined rate is applied to actual performance costs,
- (3) the contractor's entitlement is uncertain at the time of contracting, and
- (4) the contractor's entitlement increases commensurately with increased performance costs.

The Office of the Legal Adviser (Buildings and Acquisitions) reviewed the criteria at the time of contract award and determined that the BLiSS contract is in compliance with applicable law and regulations. The Department is taking no further action since the contracting actions taken are deemed proper and appropriate.

Attachments:

- Tab 1 – Response to BLiSS MAR AUD-MERO-16-08, January 2016
- Tab 2 – Memo to the Contract File BLiSS SCIP/SCOT

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TAB 1



United States Department of State
Washington, D.C. 20520

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January 5, 2016

MEMORANDUM

TO: OIG/AUD – Norman P. Brown

FROM: A/LM – Jennifer A. McIntyre *J.A. McIntyre*

SUBJECT: *Management Assistance Report: Improper Use of Overtime and Incentive Fees Under the Department of State's Baghdad Life Support Services (BLiSS) Contract*

Thank you for the opportunity to provide comments on the subject Management Assistance Report. The points of contact for this response are Mr. Matthew Colantonio who may be reached at 703-875-(b) (6) and Mr. James Moore who may be reached at 703-875-(b) (6).

Recommendation 1: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, terminate task order SAQMMA15F0988 awarded to Pacific Architects and Engineering Government Services, Inc., for incentive pay.

Management Response (1/5/2016):

- a) The Security Crisis Overtime Pay (SCOT) was discontinued on September 14, 2015.
- b) On January 4, 2016, A/LM/AQM is discontinuing Security Crisis Incentive Pay (SCIP) for PAE personnel performing work within Baghdad.
- c) AQM respectfully disagrees with OIG's assertion that the SCIP and SCOT requirement lacked justification. AQM does acknowledge that inadequate documentation was provided within the contract file and addresses the various OIG findings below. In addition to responding to each OIG recommendation, the complexity, visibility, and importance of this contract necessitate AQM to clarify some perceived misinterpretations in OIG's findings regarding the BLiSS contract.
- i) Firm-Fixed Price Nature of the Task Orders

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On page 1 of the OIG's report, OIG states the following, "Specifically, the labor costs on the BLiSS contract were established as firm-fixed-price (FFP), and the FAR does not allow a contractor under an FFP contract to receive an adjustment based on a contractor's cost experience." AQM needs to correct this misperception. The BLiSS IDIQ contract does not establish labor costs as FFP. Section B.2 of the BLiSS contract states "This is an indefinite-delivery, indefinite-quantity (IDIQ) contract, as defined in FAR 16.504...Contract types for the individual task orders will fall under one or more of the following, depending on the type, complexity, and urgency of the task order requirement: fixed-price, cost-reimbursement, labor-hour, and/or time-and-materials." As such, the most appropriate contract type for each individual task order is determined on a case-by-case basis. Most BLiSS task orders issued to date have been issued with labor identified on a FFP basis but these SCIP and SCOT task orders are cost contract types.

The FAR discusses the potential need for changes in price even under a FFP arrangement. Government contracts contain a "changes" clause which permits the Contracting Officer to make unilateral changes, in designated areas, within the general scope of the contract. The changes clause applicable to FFP arrangements under the BLiSS contract is included in Section I (FAR Clause 52.243-1 Changes – Fixed-Price (Alt II)). AQM should have formalized such a change by creating a memo to the file and intends to take corrective action on this point (see Section D, Corrective Action).

ii.) Cost-Plus-Percentage-of-Cost

Cost-plus-a-percentage-of-cost (CPPC), as the OIG states, is prohibited. As stated in the U.S. Supreme Court findings on *Muschany v. U.S.* (1945), "The evil of such contracts is that the profit of the other party to the contract increases in proportion to that other party's costs expended in the performance." AQM concurs that we have no authority to issue a CPPC contract; however, we disagree with the OIG's findings that we have issued a CPPC order.

OIG supported its finding with the Court of Appeals for the Federal Circuit Case in *Urban Data Systems*, 699F2d 1147 (Fed Cir 1983). Under this case, the Court affirmed that a CPPC existed and the matter was remanded for proper calculation of amounts due to appellant. However, under its case summary overview, it clearly states that CPPC arrangement was due to subcontracts' "price adjustments expressed in terms of percentage **profit** per unit cost". By definition, a CPPC system allows the Contractor (PAE) to receive a higher fee or profit amount based on its fee rate as it incurs more cost.

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These SCIP/SCOT tasks do not result in a CPPC for the following reasons. As stated in the task order terms and conditions of the questioned task orders, no fee is allowed to the contractor on incentive pay or overtime. Compensation goes directly to the employees. The only additional charges to the Government are G&A costs, and the related increase to the required Defense Base Act (DBA) insurance. PAE receives no fee/profit in either program regardless of cost or as cost rises. Specifically, the 25% incentive pay went directly to PAE's employees and no percentage went to PAE as fee/profit. OIG's conclusion gives the appearance that PAE employees are free to decide how many hours they may work at any time. This is not the case as overtime must be approved by the CO or COR prior to performance.

iii.) FAR Part 16 Incentive Type Contract

The OIG incorrectly associates SCIP with FAR Subpart 16.4, titled "Incentive Contracts". The language under FAR 16.401 further describes its appropriate use "when supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under the contract to the contractor's performance." The Contractor makes no profit or fee on the task order incentive pay, only G&A.

The SCIP and SCOT were issued as Cost Reimbursable task orders, with no fee (see FAR 16.302). With regard to the question of "incentive," per FAR 31.205-6(b)(2), "Compensation for each employee or job class of employees must be reasonable for the work performed. Compensation is reasonable if the aggregate of each measurable and allowable element sums to a reasonable total. In determining the reasonableness of total compensation, consider only allowable individual elements of compensation. In addition to the provisions of 31.201-3, in testing the reasonableness of compensation for particular employees or job classes of employees, consider factors determined to be relevant by the contracting officer. Factors that may be relevant include, but are not limited to, conformity with compensation practices of other firms—(i) Of the same size; (ii) In the same industry; (iii) In the same geographic area; and (iv) Engaged in similar non-government work under comparable circumstances."

The issuance of incentive pay (often under the title of "danger pay" or "post hardship differential pay") has been included as a contractual provision in Iraq and Afghanistan for a number of years, and has been issued by a number of agencies. Examples of other large contracts in Iraq and Afghanistan that the Department currently provides incentive pay include the Worldwide Protective Services, the

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Medical Service Support Iraq contract, and the Afghanistan Life Support Services contract (ALiSS).

AQM acknowledges that creating a new title for the incentive pay (SCIP) may have caused unnecessary confusion, and use of the IDIQ identified terms (Post Hardship Differential Pay or Danger Pay) would have been clearer.

d) Corrective Action

The basis and justification for which the Contracting Officer (CO) invoked the Changes Clause FAR 52.243-1 Alternate II (Apr 1984) was a change in the place of performance. The change was caused by the Islamic State in Iraq and the Levant (ISIL) attack in Iraq that started in June 2014, which impacted PAE personnel's ability to perform in an increasingly difficult environment as discussed below and resulted in the issuance SCIP and SCOT task orders to ensure retention of critical employees during this period and mission accomplishment. A memo is being placed in the contract file providing this information and is provided with this response.

Recommendation 2: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, deobligate all remaining unspent funds awarded against task orders SAQMMA14F2036, SAQMMA14F3785, and SAQMMA15F0988, and inform Pacific Architects and Engineering Government Services, Inc., that expenses can no longer be incurred against these task orders.

Management Response (1/5/2016): A/LM/AQM will deobligate all remaining unspent funds from task orders SAQMMA14F2036, SAQMMA14F3785, and SAQMMA15F0988. The Government intends to deobligate all remaining funds upon the expiration the latest task order SAQMMA15F3018.

Recommendation 3: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, inform contracting officers and other contract management personnel that award and administer contracts in countries with high-risk security environments that the practice of awarding overtime and incentive fees for firm-fixed-price labor contract line items must be discontinued unless the contracting officer can justify the award with a documented analysis of the validated need, cost-benefit, and merits of such an award in accordance with the Federal Acquisition Regulation.

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Management Response (1/5/2016): AQM agrees to inform contracting officers that they may not award overtime and incentive fees for firm-fixed-price labor contract line items unless the contracting officer can justify the award with a documented analysis of the validated need, cost-benefit, and merits of such an award in accordance with the Federal Acquisition Regulation.

Recommendation 4: OIG recommends that the Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, review contracts performed in Iraq and other countries with high-risk security environments and, if the awards cannot be justified with a documented analysis of the validated need, cost-benefit, and merits of such an award in accordance with the Federal Acquisition Regulation, consider terminating task orders, deobligating all remaining unspent funds, and informing contractors that expenses cannot be incurred against these task orders.

Management Response (1/5/2016): All contracts awarded by AQM follow the FAR and go through the Quality Assurance approval process before award. If it is determined that the award cannot be justified with the necessary documented analysis at that time, AQM will not award the contract.

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TAB 2



United States Department of State

Washington, D.C. 20520

MEMORANDUM TO THE FILE

SUBJECT: BLISS IDIQ Contract SAQMMA-13-D-0120
 Change Orders to BLISS Task Orders: SAQMMA-14-F-0721
 SAQMMA-14-F-1065
 SAQMMA-14-F-1020
 SAQMMA-14-F-0436
 SAQMMA-14-F-0762

Reference: SCIP/ SCOT Task Orders SAQMMA-14-F-2036
 SAQMMA-14-F-3785
 SAQMMA-15-F-0988
 SAQMMA-15-F-3018

This memorandum documents the background, basis and justification that led to the issuance of the BLISS security crisis incentive pay (SCIP) and overtime (SCOT) task orders.

BACKGROUND

The Department of State (DOS) Office of Acquisition Management (AQM) administers the Baghdad Life Support Services (BLISS) indefinite-delivery, indefinite-quantity (IDIQ) contract to provide crucial services such as food, fuel, waste management, and airfield support in Iraq. DOS sites with task orders include the Baghdad Embassy Compound (BEC), other sites within the Baghdad International Zone (Heliport, Olympia, and Prosperity), the Baghdad Diplomatic Support Center (BDSC), and the Consulate General (CG) Basrah.

At the start of June 2014, the Islamic State in Iraq and Syria (ISIS) attacked multiple Iraqi cities and eventually came within 50 miles of Baghdad. DOS was required to downsize the number of DOS and contractor personnel at BDSC and BEC by relocation of personnel that begun 15 June 2014 from Baghdad to Basrah for contractors and Amman for government employees. Limited contractor and Federal personnel returned to Baghdad in Nov 2014 through Jan 2015. However, a cap on total numbers of Americans and Third Country Nationals imposed by the National Security Council remains in place.

Population increased at BEC and BDSC due to the arrivals of DOD and Coalition forces. Prior to the crisis, DOS populations at BEC/IZ and BDSC were roughly about 2,000 and 1,100 respectively. By December 2015, the populations at BEC/IZ and BDSC grew to roughly 3,500 and 2,500 respectively. Due to the cap, the number of Post personnel and contractors living and working in Baghdad could not increase with the overall population.¹

¹ At the peak of the security crises, PAE had relocated 221 personnel from BEC and BDSC to Basrah, a 34% population shift. Personnel who were deemed critical to mission success remained at BEC and BDSC (to include: cooks, drivers, airfield operations, fire department, and waste removal.).

REQUEST FOR CHANGE ORDER AND DECISION

Due to the ISIS attacks the heightened danger, PAE submitted a request for change order on 17 June 2014 to provide additional incentive pay for their personnel who remained in Baghdad.

PAE reported that as the situation developed, they began to have candidates in the recruiting pipeline that, based on the new security threat, discontinued their deployment at the “normalized state” salaries offered. PAE employees also expressed reservations about continuing to work in Baghdad.

The Department determined that more flexibility than allowed by the current FFP labor contract arrangement was required. On June 19, a meeting was held with NEA, and Post to discuss and address the merits and alternatives of PAE’s change request for subject BLISS task orders. Of specific concern was the threat of mission failure by having a large number of PAE contractors quit work due to the ongoing physical threat as well as the increased hardship of working in a city that was facing constant reports of attacks by gunfire and explosions from ISIS and other forces. Without PAE personnel being maintained at a level that continued providing basic life and operation services, the Embassy could not be fully staffed and the mission would suffer. And earlier it had been recognized that the salaries offered by PAE were based on the government assumption that with normalization of conditions and environment in Iraq, the need to pay premiums to attract and maintain a workforce was not required. However, with the invasion of Iraq by ISIS, the environment had changed. The government recognized that this only applied to PAE—other contractors came to work in Baghdad prior to the concept of normalization and were compensating their employees at a higher (essentially a war-time rate), and there was less risk of employee’s departing.²

A follow-on meeting held June 20, AQM, NEA, Post, and PAE met to discuss PAE’s proposed solution. PAE proposed all existing task orders should be left alone and for DOS to issue a separate cost-reimbursement (no fee) task order for overtime and danger pay. Overtime would be to compensate for the increased workload expected of the contractor with a cap on numbers of personnel who could live and work in the area. Incentive pay would be to incentivize Americans and foreign nationals to take employment and work in an area of heightened danger.

DOS subsequently agreed to provide SCIP and SCOT with the following conditions:

- i. Both will only be provided to PAE personnel working in the greater Baghdad area.
- ii. The incentive pay and overtime pay are both “pass through’s” in that PAE will not charge any fees other than G&A and the DBA required insurance. In other words, PAE will not profit from this decision.
- iii. With prior authorization from the COR, straight overtime (no premium) will be provided to those employees who perform tasks above and beyond their designated full-time weekly hours for local nationals (LNs), Third Country Nationals (TCNs) or American Nationals (ANs).
- iv. Security crisis incentives pay at 25% of total compensation for ANs and TCNs who remain in Baghdad as mission-essential personnel.
- v. PAE will set-up discrete charge codes to track the FFP and CR labor and cost separately.
- vi. PAE commits to providing a detailed weekly report, which demonstrates each labor hour charged as overtime at each location

² In a recent survey conducted in November, 2015, 44% of PAE personnel indicated their intent to discontinue their employment if SCIP ends. However, the Post Regional Security Office (RSO) reported recently in its monitoring of security environment and risks of ISIL attacks in Baghdad indicated the risk of personnel performing services in imminent danger has been reduced due an increased military presence. The RSO also indicated DOS Sites located in Baghdad is still considered a high threat Post. With this report, Post Management has now recommended to end SCIP after Jan 4, 2015.

- vii. PAE commits to providing increased internal control to ensure personnel are properly charging their overtime only after their completion of full time equivalent (FTE) weekly hours.
- viii. The period for SCIP and SCOT would be three months with the option to renew. The decision to renew would be made by DOS, based upon the security environment in Baghdad.

CHANGE ORDER - BASIS AND JUSTIFICATION

The basis and justification for which the Contracting Officer invoked the Changes Clause FAR 52.243-1 Alternate II (Apr 1984) was a change in the place of performance. The "place of performance" was altered by the ISIS invasion of Iraq which impacted and restricted PAE's ability to perform.

All the factors described above contributed to the CO's decision to invoke the changes clause in the execution of referenced SCIP SCOT task orders from June 2014 through Jan 2016.

DETERMINATION OF FAIR AND REASONABLE PRICE

The fair and reasonable price determination of the SCIP SCOT task orders was based on the following:

- i. PAE's proposed a 25% incentive pay increase of total compensation to AN and TCN personnel assigned to DOS sites in Baghdad (BEC and BDSC) for the duration period of the ISIS crisis. The PAE proposed incentive pay percentage was based on price comparisons made between the current OMSS labor prices awarded under firm fixed price (FFP) arrangement obtained through full and open competition in 2012, as compared to the previous FFP negotiated under the PAE O&M Bridge contract.³ The Bridge contract's FFP was determined fair and reasonable based on FFP prices established under the predecessor DOS BEC O&M Contract, established through full and open competition in 2007.
- ii. In 2007, Iraq was considered a contingency operation area and labor rates were higher due to the war environment. In 2012, DOS considered Iraq to becoming a normalized environment and advertised its solicitation as such. The result of DOS analysis indicated BLISS and OMSS labor compensation rates awarded in 2012 and 2013 were significant reduced, averaging 32% less, from the predecessor DOS O&M contracts.
- iii. With respect to SCOT, overtime pay is based on actual reimbursement of overtime hours worked at employees' regular straight pay rates. Overtime hours must be preapproved by the COR in accordance with the IDIQ Contract based on the shortage of staffing caused by DOS imposed CAP.
- iv. The SCIP and SCOT tasks were negotiated as cost contract with no fee/profit arrangement.

Based on the above comparison, the 25% SCIP increase and COR pre-approved overtime costs are considered fair and reasonable. Since implementation of SCIP, PAE has not experienced the steep attrition that was anticipated by all parties associated with the contract. In the period from June 2014 – June 2015, PAE mobilized 277 new hires and demobilized 146 personnel. DOS' decision to end SCIP after January 4, 2016, is based on apparent reduced risk of ISIS attacks.

(This memorandum has been modified to remove the "Sensitive But Unclassified" markings in response to a request from OIG. The original with signatures dated January 4, 2016 is maintained in the CO's files).

³ There was no historical information for BLISS. However, consideration of the KBR rates under LOGCAP were considered. Also, where labor categories were similar between OMSS and BLISS (e.g. drivers, laborers) that was considered also.

_____/signed/_____
Don Schlienz
TEAM LEADER
A/LM/AQM/WWD/RSB

DATE: _____

Approved by: _____/signed/_____
JOHN STEVER
CONTRACTING OFFICER
DIVISION CHIEF
A/LM/AQM/WWD/RSB

DATE: _____

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