

103  
**SPACE STATION CONTRACTING**

---

---

Y 4. EN 2/3: 103-152

Space Station Contracting, Serial N...

**HEARING**

BEFORE THE

SUBCOMMITTEE ON

OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON

ENERGY AND COMMERCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

\_\_\_\_\_  
JULY 27, 1994  
\_\_\_\_\_

**Serial No. 103-152**

\_\_\_\_\_

Printed for the use of the Committee on Energy and Commerce



SUPERINTENDENT OF DOCUMENTS  
WASHINGTON, D.C.

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON, D.C.

U.S. GOVERNMENT PRINTING OFFICE

86-145CC

WASHINGTON : 1995

---

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402

ISBN 0-16-046546-X



103

# SPACE STATION CONTRACTING

---

---

Y 4. EN 2/3: 103-152

Space Station Contracting, Serial N...

**HEARING**  
BEFORE THE  
SUBCOMMITTEE ON  
OVERSIGHT AND INVESTIGATIONS  
OF THE  
COMMITTEE ON  
ENERGY AND COMMERCE  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED THIRD CONGRESS  
SECOND SESSION

\_\_\_\_\_  
JULY 27, 1994  
\_\_\_\_\_

**Serial No. 103-152**

\_\_\_\_\_

Printed for the use of the Committee on Energy and Commerce



SUPERINTENDENT OF DOCUMENTS  
WASHINGTON, D.C.

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON, D.C.

86-145CC

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 1995

---

For sale by the U.S. Government Printing Office  
Superintendent of Documents, Congressional Sales Office, Washington, DC 20402  
ISBN 0-16-046546-X

## COMMITTEE ON ENERGY AND COMMERCE

JOHN D. DINGELL, Michigan, *Chairman*

HENRY A. WAXMAN, California	CARLOS J. MOORHEAD, California
PHILIP R. SHARP, Indiana	THOMAS J. BLILEY, JR., Virginia
EDWARD J. MARKEY, Massachusetts	JACK FIELDS, Texas
AL SWIFT, Washington	MICHAEL G. OXLEY, Ohio
CARDISS COLLINS, Illinois	MICHAEL BILIRAKIS, Florida
MIKE SYNAR, Oklahoma	DAN SCHAEFER, Colorado
W.J. "BILLY" TAUZIN, Louisiana	JOE BARTON, Texas
RON WYDEN, Oregon	ALEX McMILLAN, North Carolina
RALPH M. HALL, Texas	J. DENNIS HASTERT, Illinois
BILL RICHARDSON, New Mexico	FRED UPTON, Michigan
JIM SLATTERY, Kansas	CLIFF STEARNS, Florida
JOHN BRYANT, Texas	BILL PAXON, New York
RICK BOUCHER, Virginia	PAUL E. GILLMOR, Ohio
JIM COOPER, Tennessee	SCOTT KLUG, Wisconsin
J. ROY ROWLAND, Georgia	GARY A. FRANKS, Connecticut
THOMAS J. MANTON, New York	JAMES C. GREENWOOD, Pennsylvania
EDOLPHUS TOWNS, New York	MICHAEL D. CRAPO, Idaho
GERRY E. STUDDS, Massachusetts	
RICHARD H. LEHMAN, California	
FRANK PALLONE, JR., New Jersey	
CRAIG A. WASHINGTON, Texas	
LYNN SCHENK, California	
SHERROD BROWN, Ohio	
MIKE KREIDLER, Washington	
MARJORIE MARGOLIES-MEZVINSKY, Pennsylvania	
BLANCHE M. LAMBERT, Arkansas	

ALAN J. ROTH, *Staff Director and Chief Counsel*

DENNIS B. FITZGIBBONS, *Deputy Staff Director*

MARGARET A. DURBIN, *Minority Chief Counsel and Staff Director*

---

## SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

JOHN D. DINGELL, Michigan, *Chairman*

SHERROD BROWN, Ohio	DAN SCHAEFER, Colorado
MARJORIE MARGOLIES-MEZVINSKY, Pennsylvania	CARLOS J. MOORHEAD, California
HENRY A. WAXMAN, California	JOE BARTON, Texas
CARDISS COLLINS, Illinois	FRED UPTON, Michigan
RON WYDEN, Oregon	
JOHN BRYANT, Texas	

REID P.F. STUNTZ, *Staff Director/Chief Counsel*

BRUCE F. CHAFIN, *Special Assistant*

ROBERT L. ROACH, *Special Assistant*

JEFFREY L. HODGES, *Research Analyst*

DENNIS B. WILSON, *Minority Counsel*

# CONTENTS

---

	Page
Testimony of:	
Abbey, George, Deputy Director, Johnson Space Center .....	35
Dailey, General John R., U.S. Marine Corps, Retired, Acting Deputy Administrator, National Aeronautics and Space Administration .....	35
Draper, Wayne, Comptroller, Johnson Space Center .....	35
Easley, Robert, Director of Procurement, Johnson Space Center .....	35
Hesse, Terri, Director of Business Management, Johnson Space Center ....	35
Holz, Arnold, Chief Financial Officer, National Aeronautics and Space Administration .....	35
Lawrence, Jeff, Associate Administrator for Legislative Affairs, Johnson Space Center .....	35
Lee, Deidre A., Associate Administrator for Procurement, Johnson Space Center .....	35
McConnell, Michael S., Branch Manager, Houston Branch Office, Defense Contract Audit Agency .....	8
McInerney, Pamela, Chief of Staff, Space Station Program Office, John- son Space Center .....	35
Thibault, Michael J., Assistant Director, Policy and Plans, Defense Con- tract Audit Agency .....	8
Trafton, Will, Program Director, Space Station, Johnson Space Center .....	35
Material submitted for the record by:	
Letter from Bill D. Colvin, Inspector General, National Aeronautics and Space Administration, to Hon. John D. Dingell, Chairman, Subcommit- tee on Oversight and Investigations .....	126
Letter from Hon. John D. Dingell, Chairman, Subcommittee on Oversight and Investigations, to Hon. Daniel S. Goldin, Administrator, National Aeronautics and Space Administration .....	127
Letter from Carolyn L. Huntoon, Director, National Aeronautics and Space Administration, to Robert L. Roach, Subcommittee on Oversight and Investigations .....	130



# SPACE STATION CONTRACTING

---

WEDNESDAY, JULY 27, 1994

HOUSE OF REPRESENTATIVES,  
COMMITTEE ON ENERGY AND COMMERCE,  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS,  
*Washington, DC.*

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2123, Rayburn House Office Building, Hon. John D. Dingell (chairman) presiding.

Mr. DINGELL. The subcommittee will come to order.

Pursuant to Rules X and XI of the Rules of the House of Representatives, the Subcommittee on Oversight and Investigation of the Committee on Energy and Commerce is continuing its long-standing investigation of the adequacy of disclosures under the securities laws by government contractors doing business with the Federal Government.

In particular, the subcommittee is now examining the adequacy of those disclosures by major publicly held companies holding significant contracts for work on the NASA Space Station. We are also examining the adequacy of financial and management controls employed by those contractors.

Last year, the subcommittee investigated and held hearings on the DOE's \$13 billion Superconducting Supercollider, the SSC program. It was shown that the SSC project suffered from gross mismanagement by the prime contractor and total inattention by the government—in this case, the Department of Energy.

This situation led to project cost overruns of billions of dollars. The Congress was constantly being misled on the cost of the Supercollider, which grew from about \$4 billion to \$8 billion to about \$13 billion—with no end in sight.

In addition, financial controls were so lacking at the SSC that it was doubtful whether anyone would have figured out a true cost estimate to complete the project.

Today, the subcommittee will examine contractors involved in another program that suffers from confusing cost escalation—NASA's \$30 billion Space Station. The Congress was initially told that the Space Station would cost \$8 billion. Quickly the costs went to \$12 billion. Then the scope of the project was cut back, but the costs rose to \$18 billion.

The project climbed further to the large figure of \$38 billion, and the scope was again cut back and the cost was reduced to \$31 billion. Recently, it was again reduced to \$28 billion. Now, these are estimates and estimates only. They are also estimates only for construction. They do not include launch costs or operating costs.

According to the GAO, launch costs and other key station elements would add another \$10 billion. The GAO estimated that the total cost of the recently terminated Freedom version of the Space Station would be around \$121 billion.

Moreover, NASA has already spent over \$11 billion on the Space Station and nothing has been built. Apparently we have bought rooms full of designs of papers and estimates and other documents, but these are all now largely worthless. That is bad enough, but now we learn that NASA and its contractors on the Space Station have been playing fast and loose with the American taxpayers' hard-earned dollars.

NASA has been asleep at the switch and several of our largest defense contractors working on this project appear to be out of control.

Audits conducted by GAO, NASA Inspector General, and by the DCAA have shown that the contractors were routinely submitting incomplete and inaccurate cost reports essential for monitoring and controlling costs. I note that without these, there is no possibility of really controlling or monitoring costs.

NASA's own guidelines require its contractors to have fully functioning cost reporting systems. These systems are designed to answer questions fundamental to any project, especially one being paid for by the taxpayers: How much do we plan to spend? How much did we spend? What did we get for the money? How much more money do we need to spend to complete the project?

Unfortunately, NASA is not in a position to answer those questions because, as a recent DCAA audit reveals, NASA did not require its contractors to follow the agency's cost reporting guidelines. Essentially, the agency is flying blind on a multi-billion dollar project whose costs will be numbered in the many billions.

Despite critical findings of the GAO, NASA's Inspector General, and DCAA since 1988, NASA has been either unable or unwilling to recognize its problems or the contractors' problems, much less correct these problems. As recently as last month, DCAA was so concerned about the failure of the Johnson Space Center to acknowledge or correct the problems DCAA had identified that DCAA had to take the unprecedented step of briefing NASA headquarters and issuing an audit alert to all DCAA field offices in the hope of forcing NASA to focus on the very serious management problems which that agency had.

NASA for years has been running this program like a hydra-headed beast with four contractors: McDonnell Douglas, Boeing, Rockwell, and Grumman. Lockheed worked as a major subcontractor to three of the four primes. This contributed to the disarray, which, in turn, contributed to various schemes used to mask billions of dollars of cost overruns. NASA was not only aware of these schemes, but condoned them.

First, in McDonnell Douglas' cost report for the month of January 1993, major subcontractor estimates at the completion were unilaterally lowered by McDonnell Douglas by about a half a billion dollars. It was clear that even the subcontractors were lowballing their costs.

When the Inspector General raised this issue with NASA, NASA management argued that it was within the prime contractors' pur-



view to lower subcontractors' estimates. NASA management held this view despite strong evidence that the subcontractor cost estimates themselves tended to be understated.

Second, it has been a routine practice for NASA contractors to incorporate additional work into their contracts without NASA establishing a price for that work. This technique made it possible for McDonnell Douglas to cover up substantial overruns.

For example, McDonnell Douglas included about \$1.5 billion in unnegotiated work as part of its \$6 billion "authorized contract value." Consequently, by inflating its budget, McDonnell Douglas was able to report no cost overrun.

However, if the negotiated contract baseline program was compared to the contractor's cost to complete the project, the program was, in fact, experiencing cost overruns of about \$1.5 billion. When DCAA questioned this practice, McDonnell Douglas responded that NASA told them to report its budget that way.

Third, another Space Station subcontractor, IBM, engaged in highly questionable billing practices. Of the \$490 million of costs incurred by this contractor over 7 years, DCAA is questioning \$107 million as unallowable.

IBM, without authorization, spent \$40 million for equipment, among other things, that they knew were being provided by another contractor. DCAA found this "unnecessary and duplicative" and therefore unallowable.

IBM also charged \$20 million to the Space Station for leasing a building that IBM already owned. This matter is under criminal investigation by the U.S. Attorney in Houston.

Equally curious is the fact that NASA has been unable to supply the subcommittee with any data concerning management costs, award fees, or executive bonuses that have been paid by IBM during this fiasco. We must wonder why IBM is in a position where NASA does not even know how much money it has handed over to IBM.

In December 1993, NASA terminated the four prime contracts and awarded an undefinitized letter contract for \$2 billion to the Boeing Company to serve as the single prime contractor. Although going from four prime contractors to one appears to be an improvement, NASA has not yet demonstrated any capability to get a handle on any of the contractors. Neither Boeing nor the major subcontractors have the fundamental business systems in place to monitor and control costs, schedule, and performance.

Curiously, NASA's last four performance evaluations demonstrated that Boeing's financial controls have not been satisfactory and, in fact, were no better than other contractors. In addition, NASA appeared to be oblivious to Boeing's recent settlement for \$75 million of the Department of Justice's decade-long criminal investigation for mischarging on government contracts. Boeing, in fact, had mischarged on the Space Station contract.

Also, the government has not audited Boeing's overhead since 1986. While the criminal investigations of Boeing were ongoing, the Department of Justice prohibited DCAA from auditing Boeing's overhead. Between 1991 and 1992, Boeing's overhead doubled from 56 percent to 106 percent. With no audits during this period, NASA has no idea what level of overhead is legitimate.

NASA officials recently assured subcommittee staff that they considered Boeing's past performance as a government contractor in choosing them as the prime, and claimed that they were unaware of any ongoing investigations by government agencies of Boeing. The subcommittee staff then contacted the Department of Defense Office of Inspector General concerning its ongoing investigations of Boeing by the Defense Department.

The following is the IG's rather alarming response: "Since its inception in 1982, the Defense Criminal Investigative Service, DCIS, the investigative arm of the Inspector General, Department of Defense, IG DOD, has completed 24 criminal investigations involving the Boeing Company, and currently has eight open, ongoing criminal investigations. The Air Force Office of Special Investigations, AFOSI, has an additional 13 ongoing criminal investigations.

"The company has been convicted of criminal wrongdoing, specifically securities violations, on one occasion in November 1989, which resulted in criminal fines and restitution totaling \$5,220,100 and suspension from government contracting until February 1990. In addition, Boeing entered into two civil settlement agreements with the Air Force in April 1994 and June 1994 to resolve two AFOSI criminal investigations. These agreements resulted in Boeing paying the government a total of \$66 million in civil settlements. Overall, the firm has paid or repaid the government \$161,003,450 in criminal, civil and administrative remedies in connection with closed and continuing investigations.

"Most of the 24 closed investigations, 79 percent, involved procurement fraud allegations and most, 21 percent, also directly involved the parent firm, as opposed to a subsidiary or operating division. Of the eight ongoing DCIS investigations and 13 ongoing AFOSI investigations, 38 percent and 68 percent, respectively, involve the Boeing Aerospace and Electronics operating unit and the Boeing Defense and Space Group."

Is this the company that is best equipped to lead the Space Station out of its management morass? Government contractors should be held to high standards of performance, to cost control, to integrity, to disclosure, and to competence.

We look forward to the testimony of DCAA and of NASA as we continue to examine whether additional administrative and/or statutory reforms are needed to address seemingly chronic problems suffered by major publicly held government contractors. NASA itself recognizes that its contractors must do better if the Space Station is to survive.

We look forward to our hearings today and hearing from persons interested in the matter and able to give answers to the committee which might be helpful in a thoughtful review of contractor performance, contractor reporting, and contractor disclosure.

The committee is delighted to have the opening statement now of our dear friend from Colorado, Mr. Schaefer.

Mr. SCHAEFER. Thank you, Mr. Chairman.

I do appreciate the work that you and the subcommittee staff have done. This investigation has brought to light a lot of problems that this Congress should be looking at.

The management of contractors by the government agencies for which they work has been a long-standing subject for this sub-

committee is scrutiny. In the 1980's, the subcommittee examined the problems that the DOD experienced in managing its contractors.

In 1992, the subcommittee examined how well the Environmental Protection Agency managed its contractors, and last year the subcommittee focused on a contractor management effort at DOE.

Today the subcommittee looks at yet another agency's problems with managing its contractors, the National Aeronautics and Space Administration, or NASA. A recent audit by the DCAA disclosed that NASA's 10 top contractors have serious deficiencies in their business management systems.

These systems, as presently being operated, are incapable of generating reliable cost performance reports, which are the basis for NASA's ability to assess the cost and progress of its programs.

But the contractor deficiencies run much deeper. The DCAA found that the contractors' business systems were incapable of, number one, measuring cost performance; two, maintaining a baseline; three, conducting variance analyses; and four, of generating reliable estimates to complete.

The contractors' business systems could not tell them, or NASA, whether the projects were where they ought to be, given the time and the money spent on them. In congressional terms, these deficiencies mean that Congress needs to be very wary of NASA estimates of costs and of completion dates, since these numbers are not being generated accurately or reliably.

The performance of NASA's flagship program, the Space Station, suggests just what effects these deficient management systems have had. NASA has spent a little over \$11 billion on the Space Station which was estimated to cost the U.S. about \$8 billion when first proposed to Congress.

The Space Station is now in its seventh redesign and things got so bad in 1993 that NASA totally restructured the program and replaced a principal contractor. Now after having spent \$11 billion, NASA tells Congress that we need to spend an additional \$7 billion to complete it.

Until better business management systems are in place, all of these figures are little better than "guesstimates."

Mr. Chairman, contract management is not the most glamorous of oversight activities, but it is one of the most necessary to ensure that the American taxpayers get full value for their hard-earned dollars.

I commend you and the staff, Minority and Majority, for holding this hearing today and look forward to working with you to ensure that government dollars spent on contractors return the value that we certainly do expect.

I yield back the rest of my time, Mr. Chairman.

Mr. DINGELL. The Chair thanks the gentleman.

The Chair recognizes the distinguished gentleman from Texas, although he is not a member of the committee, we will permit him to make an opening statement—I am sorry, the Chair is going to recognize members of the committee first.

The gentleman from Texas, Mr. Barton.

Mr. BARTON. I would be happy to yield to my distinguished friend from Texas, Mr. Hall.

Mr. DINGELL. The Chair recognizes the gentleman. The Chair is proceeding by the rules.

Mr. BARTON. Mr. Chairman, I appreciate the opportunity to participate in the hearing. I think it is an important hearing.

The Space Station is an important scientific venture for this Nation and the world. Obviously we want all the contractors and prime contractors to spend the taxpayers' dollars wisely and appropriately.

I think there are some concerns that there may not have been adequate oversight of their activities. That is why we would like to hear from DCAA and NASA themselves.

At the appropriate time, I will ask a series of questions. I appreciate the opportunity to be here this morning.

Mr. DINGELL. Mr. Brown.

Mr. BROWN. I have no opening statement, Mr. Chairman. Thank you.

Mr. DINGELL. The Chair recognizes the gentlewoman from Pennsylvania.

Ms. MARGOLIES-MEZVINSKY. Thank you, Mr. Chairman and thank you for conducting these hearings this morning.

I am concerned with the budget and financial control systems involving the Space Station and I am very concerned with the seeming disregard of taxpayers' dollars with regard to the Space Station project. We have now spent \$11 billion and what do we have to show for it?

I support the goals of the scientific community to keep the United States a world leader in scientific research and exploration and I believe that work on the Space Station may result in spin-off new technologies. However, I do think that plans and funding for the station must be reviewed in light of our current deficit crisis and we must become more fiscally responsible.

It is my hope that we can work to continue the advancements of research and exploration in the scientific community, but in a fiscally sound and responsible way.

Thank you. I yield back the balance of my time.

Mr. DINGELL. The Chair thanks the gentlewoman.

Although the gentleman from Texas is not a member of the subcommittee, we will under the rules exercise discretion of the Chair and permit him to be recognized for an opening statement.

Mr. HALL. I prefer someone be recognized that may be a member of the committee.

Mr. DINGELL. We have recognized everyone here that is a member of the subcommittee.

Mr. HALL. Mr. Chairman, while I am not a member of the Oversight and Investigation Subcommittee, I thought that it would be somewhat important that I participate in today's hearings.

As you know, I serve as chairman of the Space Subcommittee on the Committee on Science, Space, and Technology with jurisdiction over NASA space projects. The Space Subcommittee has taken its oversight of NASA's programs very seriously, and in particular, has devoted significant attention to the need for procurement reform and better cost management at NASA.

Over the last 5 years alone, the subcommittee has held at least 5 hearings on NASA procurement reform, contract management issues, and potential Space Station overruns, in addition to specific hearings on the Station program and on the budget.

The subcommittee has also developed legislation to address major contracting and procurement issues and has pushed the chief financial officer for the space agency. I believe all the activities have helped strengthen NASA's accountability to the American taxpayer and that is the importance—and certainly I recognize that the chairman knows and believes and has always practiced that accountability to the American taxpayer is number one, not for just your oversight committee, but for your leadership in the Energy and Commerce Committee and here in the Congress.

I think that accountability needs to be by the contractors, by NASA. Also we need to be accountable, for example, FBI stings. We had a leak there that there was massive criminal kickbacks, astronauts were involved. It turned out they spent better than \$2 million investigating and so far only one or two little guys that I know of have been prosecuted.

One I think put the arm on a contractor for a job for some of his relatives. So I think we need to look and be accountable for the expenditure of taxpayer money on some of these audits.

In fact, the topic of today's hearing, the adequacy of contractor cost reporting on the Space Station program, was examined in great depth by the Space Subcommittee just last year. One of the subcommittee's hearings clearly identified the limitations of the Form 533s in tracking and projecting Space Station costs, and highlighted the need for some reforms in NASA's contract monitoring, and also the need for an independent cost analysis capability to address the reasonableness of program cost estimates.

While I would in no way minimize the findings, I don't believe there is any major Federal program for which similar problems could not be uncovered.

I guess, Mr. Chairman, what I wanted to say was the subcommittee has taken the problems identified in the Space Station program seriously and while we don't pretend to be the only ones who can make such an investigation, in the intervening months, we have been tracking NASA's progress and responding to their concerns as the Space Station redesign effort has proceeded. I think NASA is making progress, but I and other members of the subcommittee will continue to push NASA to implement all the needed reforms.

At a later time, I may go into the fact that we have introduced and passed legislation out of the House for independent cost assessments and I was informed of H.R. 2200 and I think H.R. 4800, which was marked up last week.

I appreciate the chairman allowing me to make this opening statement.

Mr. DINGELL. The Chair thanks the gentleman.

The Chair announces that the first panel of witnesses is Mr. Michael J. Thibault, Assistant Director, Policy and Plans, DCAA, Cameron Station, Alexandria, Virginia; accompanied by Michael S. McConnell, Branch Manager of the Houston Branch Office.

Mr. Thibault, I am sure you and Mr. McConnell are aware of the fact that this committee receives testimony of all witnesses under oath.

Do you have objection to testifying under oath?

Mr. THIBAULT. No, sir.

Mr. DINGELL. It is the right of each of you to be advised by counsel.

Do you so desire?

Mr. THIBAULT. No, sir.

Mr. DINGELL. Copies of the rules of the subcommittee and the committee and the House are at the witness table to advise you of your rights during your appearance here and limitations on the powers of the subcommittee.

Gentleman, please each raise your right hand.

[Witnesses sworn.]

Mr. DINGELL. You may each consider yourself under oath.

Gentlemen, please be seated. The Chair will be delighted to receive such statement as you choose to give.

Mr. Thibault, you have been before the subcommittee before and have been of considerable assistance to us and we appreciate the assistance that you are affording us today. I would note that you have assisted us on the inquiries that the subcommittee made in contractor performances at Stanford and also on the superconductor, which was a rather interesting and perhaps entertaining matter.

We are delighted to have you before us today and welcome you with our thanks for your past performance.

Mr. THIBAULT. Thank you, Mr. Chairman.

If it is acceptable, I would request that my entire statement be entered into the record and I would like to simply highlight several aspects of that statement.

Mr. DINGELL. That would be appropriate and, without objection, so ordered.

**TESTIMONY OF MICHAEL J. THIBAULT, ASSISTANT DIRECTOR,  
POLICY AND PLANS, DEFENSE CONTRACT AUDIT AGENCY,  
ACCOMPANIED BY MICHAEL S. McCONNELL, BRANCH MAN-  
AGER, HOUSTON BRANCH OFFICE**

Mr. THIBAULT. Mr. Chairman and members of the subcommittee, you have requested that I testify today on the Defense Contract Audit Agency's budgeting and financial control audits of 10 major contractors of the NASA Johnson Space Center. I will discuss the background of the audits, the common system deficiencies found among the 10 contractors working at Johnson Space Center, their audit recommendations for improvement, and contractor comments.

The NASA Johnson Space Center, already the mission control center for the space shuttle flights, has recently been named the host NASA center for the International Space Station Alpha. In addition to this effort, the Johnson Space Center awards research and development-type contracts, engineering design and maintenance and support contracts, logistics support contracts for other NASA programs, and contracts for the Johnson Space Center operations and functions which support NASA's mission and programs such as security and quality assurance.

Other than the Space Station contracts, most contracts are level-of-effort contracts, which call for providing a certain number of hours of effort in a particular task area.

To provide NASA management with an effective evaluation of contractor cost performance, NASA designed and implemented the NASA contractor Financial Management Reporting System, commonly called the NASA 533 report. Procedures for completing the NASA Form 533 are contained in the NASA Handbook.

Improperly completed Form 533 reports may result in an erroneous measure of contract performance progress and a failure to appropriately estimate the full cost needed for contract completion. Hence, it is vital that contractors' budgetary systems are adequate within their own organizations and that these systems operate efficiently and effectively.

The Houston Branch Office of the DCAA has cognizance of the contract audit activities for contractors performing at NASA Johnson Space Center, Houston, Texas. As a part of the branch office's comprehensive audit of these contractors, auditors reviewed the budgeting and financial control systems of the 10 largest contractors.

Two of the contractors, IBM and McDonnell Douglas, had major contracts on the Space Station program valued at a total of over \$5 billion and the other contractors have had significant engineering services contracts at the Space Center.

The audits were performed to evaluate the effectiveness of overall budgeting and financial controls of government contract costs. These budgetary audits necessarily utilized the NASA Form 533 reports that the 10 contractors had submitted to NASA as part of their contract performance reporting requirements. The audits covered contractor operations for the fiscal year ended 31 December 1993.

In summary, the audits of the 10 major Johnson Space Center contractors found that the contractors' budgetary and financial control systems and the required NASA Form 533 reports do not effectively identify or prevent cost growth. The causes for contractors' failure to identify or prevent cost growth are: One, contractors do not perform a bottoms-up estimate-to-complete, or what is referred to as ETC.

Two, contractors do not analyze or explain cost overruns through techniques such as detailed variance analysis.

Three, contractors do not accurately report contract values or baselines. Contractors are commingling authorized, negotiated contract baselines with undefinitized cost estimates which are not adequately supported or are not authorized in some instances.

Four, contractors do not obtain written authorization from the contracting officer for significant portions of costs prior to incurring the costs.

Five, contractors do not have internal controls to effectively monitor and prevent inefficiencies at contract worktask levels or to reduce or prevent unnecessary or unreasonable costs from being incurred. Contractors also do not perform adequate reviews of staffing or utilization of equipment and facilities.

We believe that there is significant financial risk to NASA Johnson Space Center programs, if contractors' budget and financial

control systems, and the related contractor reporting on NASA Form 533, are left unchanged.

Audit recommendations to correct the system deficiencies found include:

One, all contractors should establish detailed budgets and contract baselines from which to monitor and control costs.

Two, contract baselines, which are first established upon award of a contract, should only be changed if the specific contract scope of work is changed and contractually modified.

Three, cost growth should be estimated by the contractor and authorized under the contract prior to incurrence. Cost growth proposals should be based on detailed budget analyses by contractors which adequately support the need for additional funds.

All contractors should perform an accurate percentage of completion and estimate to complete for each major worktask in process and provide such information to NASA on the Form 533 reports.

The lead or prime contractors for the Space Station Program and the Space Shuttle Operations should be held accountable for the accuracy of subcontractors' NASA Form 533 reports.

Finally, contractors should become more proactive in the management of contract costs. Contractors should be involved in cost reduction efforts and ensure that the government is not being billed for any unnecessary or unreasonable costs.

In general, the 10 contractors' reactions to the reported system deficiencies ranged from concurrence to outright dismissal.

Most contractors attributed the audit findings to compliance with contracting officer direction. Several contractors expressed a willingness to implement strengthened budgetary and financial control systems, if the customer, NASA Johnson Space Center, believed there would be a benefit.

It is our opinion that all contractors should have policies and procedures which would ensure that NASA Form 533 reports are being consistently and accurately prepared. While most of the contractors concurred in general with this objective, the new Space Station contract provides an opportunity to strengthen the contractors' budgetary systems and establish work order baselines from which to monitor, review, and report costs.

DCAA will continue to test and report on the contractors' systems and the accuracy of the contractors NASA 533 performance measurement reports. If the contractors fail to make acceptable progress in resolving the reported system deficiencies, contractual remedies should be considered, such as withholdings on public vouchers or disallowance of cost.

Mr. Chairman, this concludes my statement. I am happy to answer any questions that you or members of this subcommittee may have.

[The prepared statement of Mr. Thibault follows:]

PREPARED STATEMENT OF MICHAEL J. THIBAUT, ASSISTANT DIRECTOR, POLICY AND PLANS, DEFENSE CONTRACT AUDIT AGENCY

Mr. Chairman and members of the Subcommittee. You have requested that I testify today on the Defense Contract Audit Agency's (DCAA) budgeting and financial control audits of ten major contractors of the National Aeronautics and Space Administration (NASA) Johnson Space Center. I will discuss the background of the audits, the common system deficiencies found among the ten contractors working at



Johnson Space Center, audit recommendations for improvements, and contractor comments.

The NASA Johnson Space Center, already the Mission Control Center for the Space Shuttle flights, has recently been named the host NASA center for the International Space Station Alpha. In addition to this effort, the Johnson Space Center awards research and development type contracts, engineering design and maintenance and support contracts, logistic support contracts for other NASA programs, and contracts for the Johnson Space Center operations and functions which support NASA's mission and programs such as security and quality assurance. Other than the Space Station contracts, most contracts at Johnson Space Center are level-of-effort contracts, which call for providing a certain number of hours of effort in a particular task area.

To provide NASA management with an effective evaluation of contractor cost performance, NASA designed and implemented the NASA contractor Financial Management Reporting System, commonly called the NASA 533 report. Procedures for completing the NASA Form 533 are contained in the NASA Handbook. The Handbook, published in 1985, is provided to all NASA project managers and contractors for the administration of the Contractor Financial Management Reporting System. Contract cost data is submitted in a standard format for most contracts on a monthly or quarterly basis, and is used by NASA to plan, monitor, and control the resources available through its awarded contracts.

The Form 533 NASA reports, along with the other required technical and schedule reports, are to provide NASA Project Managers the data necessary for evaluating contractor cost performance. In addition, NASA uses the data for establishing the basis for its accrued revenue and expenditure accounting system. Improperly completed Form 533 reports may result in an erroneous measure of contract performance progress and a failure to appropriately estimate the full costs needed for contract completion. Hence, it is vital that contractors' budgetary systems are adequate within their own organizations and that these systems operate efficiently and effectively. Without adequate budgetary systems, contractor cost performance cannot be accurately determined or reported, nor can contract cost growth be identified soon enough to allow for timely implementation of corrective measures. Accordingly, NASA's missions may not be accomplished in the most efficient and cost effective manner.

The Houston Branch Office of the Defense Contract Audit Agency has cognizance of the contract audit activities for contractors performing at the NASA Johnson Space Center, Houston, Texas. As a part of the Branch Officers comprehensive audit of these contractors, auditors reviewed the budgeting and financial control systems of the 10 largest contractors. These were IBM Corporation, Unisys Systems Corporation, McDonnell Douglas Aerospace Space Station Division, Allied-Signal Technical Services Corporation, Lockheed Engineering & Science Company, Barrios Technology Incorporated, Loral Aerospace Corporation, Rockwell Space Operations Company, CAE-Link Corporation, and Boeing Aerospace Operations Company. Two of the contractors, IBM and McDonnell Douglas had major contracts on the Space Station program valued at a total of over \$5 billion and the other contractors have had significant engineering services contracts at the Space Center.

The audits were performed to evaluate the effectiveness of overall budgeting and financial controls of Government contract costs. These budgetary audits necessarily utilized the NASA Form 533 reports that the ten contractors had submitted to NASA as part of their contract performance reporting requirements. The audits covered contractor operations for the fiscal year ended 31 December 1993.

In summary, the audits of the ten major Johnson Space Center contractors found that the contractors' budgetary and financial control systems and the required NASA Form 533 reports do not effectively identify or prevent cost growth. The causes for contractors' failure to identify or prevent cost growth are:

(1) Contractors do not perform a bottoms up estimate-to-complete (ETC). A detailed ETC based on documented percentage of completion analysis on major worktasks in contractually required under the old and new Space Station contracts. Nevertheless, McDonnell Douglas, the prime contractor for the old Space Station Freedom contract, did not perform this contractual requirement but instead often used the available funding as an ETC rather than making a true projection of the estimate-at-completion.

Most level-of-effort contractors, such as Lockheed, merely report summary level data that computes an ETC by subtracting the incurred contract costs to date from the award target costs. There is no detailed estimate of the true costs to complete the contract tasks.

(2) Contractors do not analyze or explain cost overruns through techniques such as detailed variance analysis. McDonnell Douglas for instance indicated that its per-

formance measurement system was only operational for 39 of the 73 months of the period of performance. Contractors provide only summary explanations in NASA reports which do not provide sufficient information to determine the causes of the overruns and allow for corrective action.

(3) Contractors do not accurately report contract values or baselines. Contractors are commingling authorized, negotiated contract baseline with undefinitized cost estimates which are not adequately supported or are not authorized in some instances. These inflated contract baselines tend to equal their estimates at completion, thus masking any overrun on portions of the contract that have been negotiated. For example, there was \$2 billion in undefinitized value on the McDonnell Douglas Space Station contract which was reported to NASA in the contract baseline while the contract was active. The contract was terminated as of 19 November 1993. The subcontract termination settlement proposal from IBM included approximately \$84 million of the undefinitized costs plus additional fee of \$7.7 million. The amounts for the prime contractor, McDonnell Douglas, will not be known until McDonnell Douglas submits its termination proposal. That is not expected until after the IBM audit and negotiations are completed.

(4) Contractors do not obtain written authorization from the contracting officer for some costs prior to incurring the costs.

(5) Contractors do not have internal controls to effectively monitor and prevent inefficiencies at contract worktask levels or to reduce or prevent unnecessary or unreasonable costs from being incurred. Contractors also do not perform adequate reviews of staffing or utilization of equipment and facilities.

We believe that there is significant financial risk to NASA Johnson Space Center programs, if contractors' budget and financial control systems, and the related contractor reporting on NASA Form 533, are left unchanged.

Audit recommendations to correct the system deficiencies found include:

(1) All contractors should establish detailed budgets and contract baselines from which to monitor and control cost.

(2) Contract baselines, which are first established upon award of a contract, should only be changed if the specific contract scope of work is changed and contractually modified.

(3) Cost growth should be estimated by the contractor and authorized under the contract prior to incurrence. Cost growth proposals should be based on detailed budget analyses by contractors which adequately support the need for additional funds.

(4) All contractors should perform an accurate percentage of completion and estimate to complete for each major worktask in process and provide such information to NASA on the Form 533 reports.

(5) The lead or primary contractor for the Space Station Program and the Space Shuttle Operations should be held accountable for the accuracy of subcontractors' NASA Form 533 reports.

(6) Contractors should become more pro-active in the management of contract costs. Contractors should be involved in cost reduction efforts and ensure that the Government in not being billed for any unnecessary or unreasonable costs.

In general, the ten contractors' reactions to the reported system deficiencies ranged from concurrence to outright dismissal.

Most contractors attributed the audit findings to compliance with contracting officer direction. Several contractors expressed a willingness to implement strengthened budgetary and financial control systems, if the customer, NASA Johnson Space Center, believed that there would be a benefit.

The prime contract for the newly revamped Space Station Program was recently awarded to a new contractor, Boeing Aerospace Operations Company. The contractor was asked to respond to the summary audit findings and recommendations. Boeing's comments were:

(1) Boeing agreed that they will in the future provide a detailed budget and baseline established to monitor and control costs.

(2) Boeing agreed that the baseline should not change unless a specific contract scope of work is changed and contractually modified.

(3) Boeing agreed that cost efficiencies and the correction of inefficiencies should be put in place prior to incurrence of costs. However, costs associated with preparing documentation in a budgetary analysis process may offset any benefit received and therefore must be considered.

(4) If NASA believes that performing a percentage of completion estimate for each major worktask performed would be beneficial, Boeing will comply.

It is our opinion that all contractors should have policies and procedures which would ensure that NASA Form 533 reports are being consistently and accurately prepared. While most of the contractors concurred in general with this objective, the

new Space Station contract provides an opportunity to strengthen the contractors' budgetary systems and establish work order baselines from which to monitor, review, and report costs.

DCAA will continue to test and report on the contractors, systems and the accuracy of the contractors' NASA 533 performance measurement reports. If the contractors fail to make acceptable progress in resolving the reported system deficiencies, contractual remedies should be considered, such as withholdings on public vouchers or disallowance of cost.

Mr. Chairman, this concludes my statement. I am happy to answer any questions that you or the members of the Subcommittee may have.

Mr. DINGELL. Mr. McConnell do you have any comments you would like to make at this time?

Mr. MCCONNELL. No, sir.

Mr. DINGELL. The Chair recognizes members for questions beginning first with the gentleman from Colorado, Mr. Schaefer.

Mr. SCHAEFER. Thank you, Mr. Chairman.

Mr. Thibault, your audit has identified a number of deficiencies in the business system used by NASA's 10 largest contractors. A skeptic might say "So what? DCAA didn't identify anything illegal going on. What difference does it make whether NASA contractor business systems are adequate or not as long as the hardware works?"

Explain to us in layman's terms why these business management system deficiencies should matter to NASA, to Congress, and to the American taxpayers.

Mr. THIBAUT. The absence of effective management and financial control systems greatly increases the risk of either unidentified or disguised contractor cost growth or overruns occurring without appropriate government oversight in that situation. And the absence of these controls which are critical to that government oversight and the government visibility of cost growth simply makes the government's oversight job extremely difficult if not impossible.

Mr. SCHAEFER. The American taxpayer should care because these systems are part of the effort to ensure that the tax dollars are spent wisely and that one contractor is not duplicating the work of another; is that correct?

Mr. THIBAUT. Yes, sir.

Mr. SCHAEFER. I understand that DCAA informed the 10 NASA contractors that they were the subject of the audit, and about DCAA's audit plans in the fall of 1992. Did the contractors make any request that DCAA found unusual?

Mr. THIBAUT. When we first made the request, probably the only thing that was unusual was that the contractors asked for an extended period of time to prepare for the audit.

Mr. SCHAEFER. All of them? All 10 or some of the 10 or what?

Mr. THIBAUT. Virtually all, sir. Typically, there is no specific norm, but usually within 30 days from the time we hold an entrance conference contractors provide requested information necessary to establish the procedures and practices in place. In this particular case, these contractors generally asked for 4 or 5 months delay in order to gather this data in order to sufficiently prepare for the audit, expressing that it was an important audit and therefore they needed the time.

Mr. SCHAEFER. Did DCAA ask the contractors for any data or documents that they weren't required to keep? In other words, did

DCAA ask the contractors to generate otherwise unrequired contracts or data?

Mr. THIBAUT. No, sir, that was not our intent. That is why it was unusual in the sense that we were asking for the support and the procedures and documentation surrounding the NASA 533 reports, cost performance measurement and management reports, information that typically we would anticipate to receive in a very short turnaround.

Mr. SCHAEFER. If I am getting this right, the time lag was extraordinary?

Mr. THIBAUT. Yes, sir. From an audit risk viewpoint, it raises questions as to why it would take so long when it is a simple request for the supporting documentation to support the periodic reports, typically monthly or quarterly, that the NASA Form 533's that are submitted to the customer or to the prime contractors.

Mr. SCHAEFER. Does the difficulty that the contractors experienced in meeting the DCAA request for documents, even with 4 months notice, suggest certain deficiencies in their business management systems?

Mr. THIBAUT. Yes, sir. It suggests certain deficiencies. It raises a question, if you ask a contractor to provide support for its budgeting and financial forecasting systems and they can't generate that support for a substantial period of time. Then if you also find out there is minimal support for it, it certainly does raise those questions, yes, sir.

Mr. SCHAEFER. Did IBM flat out refuse to provide DCAA with the information requested about the management expenses, bonuses and work fees?

Mr. THIBAUT. Yes, sir. One of the information requests that we asked all 10 contractors for was information supporting the awarding of executive or management bonuses as well as background information on fees. Nine of the 10 contractors provided it. One of the 10 contractors, IBM, denied that request.

Mr. DINGELL. Would the gentleman yield? Denied you or did it deny NASA?

Mr. THIBAUT. They denied us, sir, and we worked with NASA to obtain the data. Obviously denial of information that is necessary to establish fair and reasonable costs that are being claimed, paid, vouched, billed, is a very significant event.

Mr. DINGELL. So they refused to deliver the information to you.

Mr. THIBAUT. Yes, sir.

Mr. DINGELL. Did they refuse to deliver the information to NASA also?

Mr. THIBAUT. That is our understanding. We asked NASA for assistance and it was our understanding that NASA was also denied by IBM. I would prefer that question be directed to NASA officials.

Mr. DINGELL. I wonder if IBM would be more cooperative with the committee.

Mr. THIBAUT. I don't know, sir. We have taken our run at it and will continue to take our run at it, trying to work with NASA to obtain the information.

Mr. DINGELL. If you don't receive the information quickly, would you please inform us so we can provide the necessary compulsory process to ensure the cooperation?

Mr. THIBAUT. We will do that. We will document that request one more time and if we are unsuccessful, we will notify the committee.

Mr. DINGELL. Don't request it too many times and don't request it too nicely.

Mr. SCHAEFER. To follow up, Mr. Chairman, in short then, IBM refused to provide the government auditors with information about what our government was paying to do?

Mr. THIBAUT. Yes, sir, information necessary in our opinion to verify that the costs were proper and allowable.

Mr. SCHAEFER. Did IBM offer DCAA justification for its refusal?

Mr. THIBAUT. Mike McConnell, who is our branch manager will answer that question?

Mr. SCHAEFER. Was there a reason?

Mr. MCCONNELL. It was indicated that this was proprietary information that they chose not to give out.

Mr. SCHAEFER. Why would it be proprietary?

Mr. THIBAUT. We would not believe it at all to be proprietary and that is calling it like it is, a bit of a weak reason.

Mr. SCHAEFER. This is very interesting, Mr. Chairman. Is this the only one that refused?

Mr. THIBAUT. Yes as far as providing the information. Nine out of the 10 did not think it was proprietary and in a reasonably timely manner, provided that support.

Mr. SCHAEFER. Based on that and your audit, is NASA getting full value for the money it pays its contractors to maintain the business systems?

Mr. THIBAUT. Certainly in terms of the costs that are being paid for the performance management systems, I think the answer would have to be no, because the systems aren't working as intended or as prescribed by NASA policy guidelines.

Mr. SCHAEFER. We are talking about millions of dollars here.

Mr. THIBAUT. Yes, sir. In fact in the area of performance and award fees alone, we are talking of approximately—I have that here.

Mr. SCHAEFER. I have been told it is approximately \$60 million or thereabouts.

Mr. THIBAUT. Yes, sir. Actually, the total for management costs, bonuses and fees for all of NASA on these 10 contractors we reviewed at Johnson Space Center is \$127 million for that portion of it. The IBM portion is smaller, but that is not included in that total. We don't have access to all of the supporting data.

Mr. SCHAEFER. Is there any chance that NASA could recover some of this money to pay for maintenance of these defective systems?

Mr. THIBAUT. One of the issues that I addressed in my statement, is there are substantial portions of the work at virtually most of these large contractors that is for unauthorized or undefinitized work. In other words, there haven't been specific contracts awarded or identified or modifications identified.

We are in the process of an audit at IBM in order to establish from an audit perspective the amount of that related to IBM's termination. That includes all costs and not just management fee.

Mr. SCHAEFER. Since NASA recognized the deficiencies of its contractors' management systems, what effect did these deficiencies have on the award fees that NASA then gave its contractors?

Mr. THIBAUT. Well, the award fees in our opinion should be based on performance. As far as the actual award fees being made and the criteria for them, I am not in a position to specifically identify what criteria we used to establish that award fee, sir.

Mr. SCHAEFER. Do you think that NASA should consider revising its award fee system to weigh the business management systems more heavily?

Mr. THIBAUT. Yes, sir. We would agree. It is our understanding the portion of the award fee that relates to financial management is very small presently. We would be in support of any action on the part of NASA to put a more substantial weight on that due to the importance of identifying cost growth or cost overruns in a timely manner in order to be able to take appropriate actions.

Mr. SCHAEFER. I understand that DCAA reviewed its draft audit findings with NASA and with the individual contractors. How did the contractors respond?

Mr. THIBAUT. The contractors ran the complete range from in one case, one of the worst responses I have seen in my career, to fairly proactive and positive responses.

Mr. SCHAEFER. What was the worst response?

Mr. THIBAUT. We had a response from Unisys and again you have to understand that many of these same findings were found at each of the 10 locations, so you would anticipate some consistency.

However, in the case of Unisys, to highlight a portion of the response, the individual that responded, a Unisys executive, said, "This is the single most negative and flawed report that I have encountered in my career. It is inaccurate, unfair, incomplete, misleading, unsupported, overexaggerated, unbalanced," and it goes on. So it is not the kind of a response that typically engenders a positive working relationship.

Mr. SCHAEFER. I understand.

One final question. What about IBM?

Mr. THIBAUT. IBM acknowledged in their response agreement with certain of the areas. They were typical of many of the contractors I believe, and that is they indicated that if the customer, NASA, believed it was necessary to make the recommended improvements that they would make them.

Mr. SCHAEFER. Thank you.

Mr. DINGELL. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Thibault, did your review include contractors such as IBM and Bendix and Unisys and Boeing and McDonnell Douglas?

Mr. THIBAUT. Yes, sir.

Mr. BROWN. What is a NASA Form 533?

Mr. THIBAUT. The Form 533 is the primary part of the financial management system which is used to assess contractor performance and report on performance, and it includes progressing on the

particular contract and it is used to manage cost performance growth and reporting, sir. It really is the central document that is used for financial management purposes.

Mr. DINGELL. Would the gentleman yield?

Is any of that proprietary information?

Mr. THIBAUT. Not in terms of anything that we have encountered. I would think an organization may look at it internally as somewhat proprietary, but not in terms of access to government oversight officials.

Mr. DINGELL. You referred to one contractor that refused to make available information either to you or to NASA. I wonder; did they claim that any of that information was proprietary?

Mr. THIBAUT. Michael made the point that that was one of the reasons they gave, that it was proprietary. They among the 10, were the only ones who made the point.

Mr. DINGELL. Should any of that information be in the 533 report?

Mr. THIBAUT. In terms of the bonuses, it would have been included within the costs because these were reimbursed costs that are part of the overall contract costs; so certainly it would be.

Mr. DINGELL. How would this be proprietary in character?

Mr. THIBAUT. We don't believe it could be proprietary.

Mr. DINGELL. Let's stretch our imagination and try to understand how it would have been proprietary.

Mr. THIBAUT. If an individual was paid an employee bonus for contract performance, an individual by name was provided—let's state a figure, \$5,000 for timely delivery or early delivery of a product under budget—

Mr. DINGELL. Is that proprietary?

Mr. THIBAUT. We certainly wouldn't believe that it would be proprietary in terms of not providing access to the government, no. We would take the view that the normal access provisions, in fact, cover information necessary to perform our audit responsibility.

Mr. DINGELL. Thank you.

Mr. BROWN. Were the contractors you mentioned complying with—all those that you said you had reviewed—were they complying with NASA's cost performance reports?

Mr. THIBAUT. No, sir.

Mr. BROWN. None of them.

Mr. THIBAUT. No, sir. At various levels, there were significant deficiencies recurring for all of them, such as all 10 contractors had not properly completed the NASA Form 533. For all 10 contractors, the estimates to complete that I referenced earlier had improper estimates to complete. All 10 contractors, in our opinion, were performing inadequate or nonexistent analysis of direct and indirect costs.

Nine out of 10 contractors, or all 10 contractors we believe had inadequate controls over bonuses and awards. Inadequate controls over downtime and idle time existed at 9 out of 10. We have a series, we could furnish you a summary, that range from only 5 or 6 organizations versus all 10 for a rather long list of deficiencies.

Mr. DINGELL. If the gentleman would permit, would you submit that for the record?

Mr. THIBAUT. Yes, sir.

[The following information was received.]

NASA Johnson Space Center Major Contractors  
(Budget System Deficiencies Summary)

Deficiency	Number of Contractors
NASA Form 533 not properly completed .....	10
Inadequate formal written policies/procedures on completion of NASA 533's/budgets .....	8
Noncompliance with formal written procedures .....	5
Improper estimate-to-completed .....	10
Inadequate audit trail from NASA Form 533 to a specific work break structure .....	5
Unauthorized/unnegotiated cost included in reported incurred cost and/or projected estimate-to-complete cost .....	4
Delays in recording actual costs .....	1
Prime contractor directs subs to improperly complete estimates-to-complete on NASA Form 533s .....	5
Subcontractors' data are not incorporated into the prime contractors' NASA Form 533s .....	2
Financial budgets differ from operational budgets & NASA Forms 533s .....	5
Budgets move with actuals, i.e. adjusted each month/quarter .....	4
Actual hours are moved from an overrun work breakdown structure to another .....	1
Uncompensated hours not included in estimate-to-complete hours .....	4
Untimely update of budgets .....	1
Either inadequate or non-existent indirect/ direct analysis .....	10
Either inadequate or nonexistent utilization of equipment analysis .....	8
Either inadequate or nonexistent utilization of facility analysis .....	4
Inadequate controls over bonuses and awards .....	10
Inadequate controls over idle time and down time .....	9

Mr. BROWN. NASA spent more than \$11 billion on the Space Station and billions more on other Johnson Space Center projects. How do you explain, given the litany you just mentioned of inadequate controls over bonuses and awards, inadequate controls over idle and downtime, one after another after another—how do you explain, given the level of public funds being expended, that these basic problems exist?

Mr. THIBAULT. I think it does go back to our position in the audit report, that when you have an absence of effective financial management and budgetary controls, it gets extremely difficult, if not impossible, to manage cost growth effectively. It goes back to the principal finding in each of these 10 reports, that is the absence of effective financial and budgetary controls by these 10 contractors.

Mr. BROWN. Let me examine a handful of specific contractors. IBM was a major subcontractor on the Space Station; correct?

Mr. THIBAULT. Yes, sir.

Mr. BROWN. They billed the government for approximately half a billion dollars in costs incurred prior to termination of their contract; is that correct?

Mr. THIBAULT. The number is \$492 million, but that is essentially correct, yes, sir.

Mr. BROWN. You conducted an audit of those costs and of the \$492 million that IBM had incurred, you didn't question more than \$100 million of that. Could you explain that?

Mr. THIBAULT. Yes, sir. We have completed the field work on that assignment. We have held the exit conference. IBM is a subcontractor to McDonnell Douglas. There is a total exception that we have taken which is \$107 million out of the \$492 million.

I might say that we have been informed by the prime contractor, McDonnell Douglas, that they intend to ask IBM to resubmit that termination because we have also taken the position that IBM sub-



mitted inadequate cost and pricing data to support the claimed costs as well as that the proposal is unacceptable presently for negotiating a fair and reasonable price because of the significant deficiencies associated with that submission. But we found a bottom line of \$107 million of exceptions that we have briefed to the contractors.

Mr. BROWN. You said IBM was a subcontractor with McDonnell Douglas; correct?

Mr. THIBAUT. Yes, sir. That is correct.

Mr. BROWN. There seems to be some employee bonuses that might have been excessive. I understand that McDonnell Douglas, and in the subcontract with IBM—how did McDonnell Douglas determine its bonuses?

Mr. THIBAUT. Each organization was a little different. McDonnell Douglas, in their case, averaged per employee for each employee, that was eligible for a bonus, 3½ to 4 percent of their base salary regardless of performance, individual performance in support of contract objectives.

Mr. BROWN. So there was no incentive. Those employees that did exceptionally well got the same bonus as those that performed much more poorly?

Mr. THIBAUT. Yes, sir. What we found was that in virtually most cases, the bonuses were not tied to performance on the contracts for McDonnell Douglas.

Mr. BROWN. Was that the same for Lockheed?

Mr. THIBAUT. Yes, sir. Lockheed was a little different in the sense that their bonuses were tied to spending on the operating plan.

Mr. BROWN. The more they spent the higher bonus you got?

Mr. THIBAUT. That was our concern.

Mr. BROWN. There is no incentive to keep government spending down?

Mr. THIBAUT. That was our concern.

Mr. BROWN. What about Bendix?

Mr. THIBAUT. Allied Bendix—theirs was a case where the award bonus was based on spending. They are a level-of-effort contractor, heavily labor intensive, and their award bonus was based on spending at least 92 percent of the level-of-effort funding. If they spent at least 92 percent of the level-of-effort funding, they qualified for a bonus.

Mr. BROWN. Another real incentive to keep government spending down.

Mr. THIBAUT. We were extremely concerned they are not being tied to performance on the contract; yes, sir.

Mr. BROWN. What do the Federal Acquisition Regulations allow for bonuses? If you would explain that and contrast that with how these bonuses were, in fact, decided and liberally handed out by those companies.

Mr. THIBAUT. Yes, sir. The FAR under that cost principle on compensation identifies incentive compensation. I won't read the whole thing, but it highlights "incentive compensation should be based on production, cost reduction or efficient performance," which we are in agreement with. Our concern with the bonuses, as we

have just now outlined, is that they were not based on production, cost reduction or efficient performance in many, if not most cases.

Mr. BROWN. You have completed the Space Station determination, the audit for IBM?

Mr. THIBAUT. Yes, sir.

Mr. BROWN. You have not completed an audit on McDonnell Douglas and others—when will that be?

Mr. THIBAUT. We have been informed by McDonnell Douglas that once the very large subcontract termination for IBM is completed and negotiated, then they will be submitting their termination claim. We have not received any of the other termination claims. However, I am discussing mainly the Houston Branch office's and audit cognizance. Other claims could be received maybe at other DCAA locations.

As far as the Houston Branch, we have no other work load nor at this time do we have a specific schedule.

Mr. BROWN. Why does McDonnell Douglas appear to be waiting until IBM is finished up, if you will?

Mr. THIBAUT. That is a good question. I wouldn't want to speculate for them, but I wouldn't think if they inserted IBM's claim, it would matter, even though it has been found inadequate. We have been told we may get another submission. If they just put a line item in for \$492 million to explain the portion that was IBM, it would seem to us perfectly appropriate for them to provide that submission to NASA for review, but there may be underlying reasons that possibly NASA could shed light on later.

Mr. BROWN. Apparently there is a preliminary report of 2 weeks ago, even though you haven't completed the termination audit for McDonnell Douglas, the preliminary report of July 18, identifying some significant problems of McDonnell Douglas. You had stated the program is experiencing about a \$1.5 billion cost variance overrun. That is in addition to the problems with the subcontractor IBM; correct?

Mr. THIBAUT. Yes, sir.

Mr. BROWN. What could you tell us about that?

Mr. THIBAUT. The preponderance of that cost is for substantial undefinitized work, work which has not been supported by McDonnell Douglas as either definitized or authorized. It hasn't yet been audited by DCAA because the work hasn't been identified for audit, nor has it been negotiated as part of the definitization of that work.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. DINGELL. The gentleman from Texas, Mr. Barton.

Mr. BARTON. Thank you, Mr. Chairman.

I am a new member of this Oversight and Investigation Subcommittee and quite frankly, I haven't participated as fully as I should have in some of the other hearings. Having said that, I think I bring some expertise to this hearing.

I am a registered professional engineer. I worked as a cost control engineer for a major Fortune 500 company. I helped develop and implement a cost estimating system for a multi-billion dollar project, and prior to that was a plant manager that had total profit-and-loss accountability for a printing plant. So I know a little bit about cost estimating and tracking and performance review.

I am also a strong supporter of the Space Station. I come from Texas. I have been to Houston a number of times. At one time I was on the Science Committee and the Space Subcommittee, but I am no longer. So when I come to this hearing, I have mixed feelings.

As a taxpayer, I am absolutely infuriated to read the chairman's report and some of your opening statements. On the other hand, I strongly believe in the vision of the Space Station and the need for the United States to maintain its role in scientific advancement.

So I really kind of looked at this material. It says here that this Form 533 that we keep referring to was designed by NASA and implemented in 1985 and it is called the Financial Management Reporting System. It says that the procedures for completing this form are in the NASA Handbook.

It also says that the handbook is provided to all NASA project managers and contractors for administration of the financial management reporting system. If this has been on the books since 1985, is it just a piece of trash or would it actually work if it were used?

Mr. THIBAUT. I understand that it is used quite effectively in NASA and has been for an extended period. You raise an interesting point about its particular use, a question as far as its applicability, because there was a question initially in our discussion with on-site NASA officials about its applicability, and we were informed by them that this handbook was incorrect. They subsequently retracted that statement and informed us that the handbook, sir, was correct.

Mr. BARTON. I want to be clear on this. The NASA Form 533 with all the accompanying paraphernalia on how to use it is primarily a process for use by NASA personnel themselves or is it to be given to the contractors for them to use to provide data for NASA then to evaluate?

Mr. THIBAUT. No, sir. It is cost performance management. It is intended to be used by the organization, by the contractors. It is subsequently used by NASA. The responsibility for preparing it and for maintaining its integrity as a document or as a system is the organization, the contractor's.

Mr. BARTON. It was designed to be used by the contractors. This was NASA's effort to give them a performance management cost estimating and evaluation tool; is that correct?

Mr. THIBAUT. Yes, sir, consistently so that when NASA interprets the results for multiple locations, they would have consistent interpretations.

Mr. BARTON. Now, I am a new contractor. I am so excited. I have won my first contract with NASA. I really want to get to work. How am I educated on how to use this great instrument of performance reporting? Do I go to a training session here in Washington or in Houston or am I sent the manual and some forms and say, "Go to it. I hope you have enough sense to figure out how to fill them out?"

Mr. THIBAUT. A couple of observations and then I am going to ask Mike for any perspectives from his actual review. Virtually every major contractor has cost performance management systems

in place. All of these contractors that we evaluated, the 10 largest, are sophisticated organizations with the capability established.

Now as far as specific training on the NASA 533 system, I do not know whether or how that is communicated other than procedural policy and probably coordination with NASA officials, but I would ask Mike if he can provide additional perspective on that.

Mr. MCCONNELL. The information on the 533 is supposed to be a reflection of the contractor's specific performance measurement system, which is his budgetary system.

Mr. BARTON. I understand what it is supposed to be, but is there any real effort to train the contractors in how to provide the information and fill out the forms and use the system? Apparently the answer is no.

Mr. THIBAUT. As far as the actual training, I can't answer that. There is a handbook.

Mr. BARTON. Do they have to pass a test that they have read the handbook?

Mr. THIBAUT. I can't answer that, sir.

Mr. BARTON. I think that is our first problem. This thing has been on the books since 1985. It is 9 years later. This audit of the 10 prime contractors—was this self-initiated by DCAA? Was it requested by NASA or did Chairman Dingell or Chairman Brown or somebody request that DCAA do this?

Mr. THIBAUT. No. We do annualized audit planning based on risk. We are aware that significant issues have been addressed and raised, not only in our audits, but other reviews. Our reviews are founded on an evaluation of internal control systems as established by organizations and this was a self-initiated audit by DCAA, by Mr. McConnell in his annual audit planning at Houston Branch.

Mr. BARTON. Is that something Mr. McConnell self-initiates every 9 years, or why this year?

Mr. THIBAUT. We typically look at internal control systems on a cyclical base every 3, 4, or 5 years depending on our knowledge of the system.

Mr. BARTON. This is the first time in 9 years or the second time in 9 years or the third time in 9 years—

Mr. MCCONNELL. In terms of budgetary and financial systems—I came to Houston Branch as the branch manager in 1992, March of 1992. Part of my job managing the audits at that location was to look for high-risk areas which I felt we should put our available audit manpower towards.

Mr. BARTON. So this was a decision that you made as a new project manager in this area. You weren't told to make it, you didn't have a flow chart saying, "It is 1992. I have to do this."

You used your initiative saying, "Looks like there is a problem here. It hasn't been done in a while. We need to do this."

Mr. BARTON. You had the authority to do that?

Mr. MCCONNELL. Yes, sir.

Mr. THIBAUT. I might also add, going back to a point you raised about the effectiveness of the handbook, NASA itself reevaluated the applicability of the 533 about a year ago and as a formal statement, they reinforced the importance of the 533's and the effectiveness and value to NASA that these contractors use this process and

did that in both an explanatory as well as a directive format about a year ago.

Mr. BATON. We have done these audits. I have read the summary of your statement and there is nothing earth shattering in the findings except for the fact that we know NASA and the Space Station have been plagued for years with mission statement, what is the size of it going to be, and apparently if you have been doing your job, which I have no reason to think you haven't been, you are finding the same things over and over again.

Is that fair for me to observe or unfair?

Mr. THIBAUT. I think it is fair to observe that the findings in this audit, while not specifically scoped the same as prior oversight reviews by other oversight organizations, are consistent with those reviews.

Mr. BARTON. We know there are obviously some procedural reporting problems. I want to get to the \$64 question. Let's assume that this committee passed legislation and it was passed in the other body and signed by the President that gave Mr. McConnell the authority to implement his recommendations as long as they are consistent with law, not something totally off the wall.

What would you do? How do we once and for all solve this problem? Is it an attitude problem? Is it a systemic problem or is it something different?

Mr. THIBAUT. In terms of the importance of establishing accountably, essentially the recommendation is to establish financial management systems that will effectively enable those contractors to track and report on financial growth.

Mr. BARTON. It is not a lack of financial management systems. Is it just flat that they don't care because it is taxpayer dollars or NASA is incompetent or it is—

Mr. THIBAUT. The recurring theme and the more positive responses by these organizations was that they acknowledged the benefits of the recommendations and if the customer felt it was appropriate they would take those actions.

Mr. BARTON. That is just bureaucratic garbage.

Mr. THIBAUT. Some of the contractors, without foundation or support, said maybe the cost of the system is greater than the benefits.

Mr. BARTON. What if we, keying off Mr. Brown's questions about incentive contracts, bonuses, actually put some incentives in to save money, paid bonuses based on the ability to save money?

Mr. THIBAUT. We would agree with that statement absolutely.

Mr. BARTON. I thank the chairman.

Mr. DINGELL. The time of the gentleman has expired.

Now, gentlemen, the forms that we are referring to are NASA forms, are they not?

Mr. THIBAUT. Yes, sir. NASA-prescribed forms and system; yes, sir.

Mr. DINGELL. Is it your view that these forms are of value in holding down costs and informing the government of the status of the contract, the billing, the costs, the overruns and whether the contracts are going to be performed on time and according to cost estimates that went into the contract?

Mr. THIBAUT. It is our opinion that these forms and the systems that they support are essential in proper cost management and in controlling costs and in holding costs down, yes, sir.

Mr. DINGELL. You have informed NASA of the findings of your audits on a continuing basis, have you not?

Mr. THIBAUT. Yes, sir.

Mr. DINGELL. Now, you are kind of in the position that some of these terminations, as they are being reviewed by NASA, are, in fact going to impact on the completion and the rules under which other terminations are going to be completed, isn't that so?

Mr. THIBAUT. Certainly in terms of authorized expenditures and whether, in fact, NASA authorized certain expenditures and whether the work was properly definitized or is allowable, that is correct.

Mr. DINGELL. Everybody will know what the rules are and will proceed to take advantage of any benefits that may lay within those rules? Isn't that right?

Mr. THIBAUT. Yes, sir. We would think it would be advantageous to get all these claims in a closely controlled time span in terms of understanding and dealing with it in a current time frame.

Mr. DINGELL. So if we don't do the job of dealing with the first of the contractor's termination, the overruns and other things that will be sanctioned in the first would be an example of the kinds of things that would approved later, is that right?

Mr. THIBAUT. I think precedent could be possibly established or would be established. Yes, sir.

Mr. DINGELL. You stated that the contractor's estimates to complete inappropriately includes at least \$689 million of claims that could not have been approved, authorized or definitized. Could you explain this with regard to McDonnell Douglas?

Mr. THIBAUT. Yes, sir. Out of the \$1.5 billion of substantial undefinitized work is \$689 million where that work has been identified in the 533. But subsequent to audit evaluation, it is not authorized under any modification that has been submitted to NASA for approval. And it raises a significant possibility that costs that have been incurred and claimed and paid may subsequently be found unallowable; substantial portions.

Mr. DINGELL. Was McDonnell Douglas providing assessments of cost overruns to NASA?

Mr. THIBAUT. No, sir. It is our understanding that they did not. There were no detailed reports outlining this because this undefinitized work was not identified and not available and they were not providing reports laying that out. Is that a fair representation?

Mr. DINGELL. They were not providing reports or they were providing reports which did not include that information?

Mr. THIBAUT. It is my understanding there weren't detailed reports providing the variance analysis.

Mr. MCCONNELL. The 533 that we looked at showed no cost variance. The contract value for the McDonnell Douglas contract equaled the estimate to complete. So, therefore, there was no cost variance.

However, the details of the contract value and the estimate to complete were broken out in the backup to the Form 533. It was identified.

Mr. DINGELL. Was that 533 Form being properly handled by the contractor?

Mr. MCCONNELL. No, sir.

Mr. DINGELL. It was not?

Mr. MCCONNELL. The contract value based on the requirements of the handbook indicated that the contract value should only represent the authorized and negotiated cost on the contract, not to include all the undefinitized potentially unauthorized cost as well.

Mr. DINGELL. So it did not comply with the regulations of NASA and was not properly filled out. Did you bring this to the attention of NASA?

Mr. MCCONNELL. Yes, we did.

Mr. DINGELL. Now, was McDonnell Douglas providing assessments then of cost overruns to NASA?

Mr. MCCONNELL. Well, again, the 533 as such did not show an overrun. However—

Mr. DINGELL. They were filing the form, but they were not giving the information that would enable the form to inform NASA about cost overruns, isn't that right?

Mr. MCCONNELL. That is correct.

Mr. DINGELL. Your audit also found that McDonnell Douglas stated that they were authorized by NASA to report contract value differently than that authorized in the NASA Handbook. Is that so?

Mr. THIBAUT. Yes, sir.

Mr. DINGELL. Can you then explain how this took place and who in NASA authorized this alternative method?

Mr. THIBAUT. As part of our coordination with NASA, one of the comments furnished by NASA management, talking about Mr. McConnell's draft report, said the draft in nearly all cases indicates that contractors are not complying with the NASA Handbook. While this is true, NASA has directed each of the contractors on required reporting, the handbook as written is incorrect and in the process of being rewritten.

That was furnished to us and then after our briefing of NASA headquarters, that on-site official subsequently revised his correspondence to Mr. McConnell and stated that it has come to his attention he used a bad choice of words and said the handbook is in fact correct and is the official document.

Mr. DINGELL. They told you that the handbook was correct and it is an official document and that indicated it was to be complied with; is that right?

Mr. THIBAUT. No. They initially said the handbook was incorrect and it was being revised. They subsequently said it was correct. They said, however, in a number of cases the contract schedule had supplemented the handbook requirements.

Mr. DINGELL. In other words, in the contract schedule, they told the contractors to disregard the handbook?

Mr. THIBAUT. Essentially that is the meaning.

Mr. DINGELL. Did they cite an authority for so doing, for advising the contractor that they need not comply with the NASA Handbook?

Mr. THIBAULT. I think they became the authority.

Michael, did they cite an authority other than NASA headquarters which they were following; NASA headquarters is certainly not the case because they have identified NASA policy as correct.

Mr. DINGELL. Has the handbook been corrected?

Mr. THIBAULT. No. In fact, they have withdrawn the statement that the NASA policy was incorrect.

Mr. DINGELL. It has now been withdrawn?

Mr. THIBAULT. Two weeks ago, they withdrew the statement that they had said that the handbook was incorrect stating that it was a bad choice of words. I understand that NASA does not believe a new handbook is necessary and about a year ago they reaffirmed the importance and the continuing value of their cost performance system as it presently exists.

Mr. DINGELL. Where is the cost performance system made public or outlined for the benefit of contractors and NASA employees?

Mr. THIBAULT. Through policies and procedures that are incorporated, I believe, into contractual requirements.

Mr. DINGELL. Is that a publication or is that something that exists in the ether?

Mr. THIBAULT. That is readily available to any organization that wants to bid on work with NASA.

Mr. DINGELL. Does that define how contracts are supposed to be carried out?

Mr. THIBAULT. I believe from a cost performance management and reporting, I think that policy does define how those systems are to be carried out and administered.

Mr. DINGELL. Would you look at that and give us an answer to that question.

Mr. THIBAULT. Yes, sir.

[The document referred to is retained in the subcommittee files.]

Mr. DINGELL. While contracts at IBM and McDonnell Douglas and other contractors have been terminated, hasn't NASA chosen Boeing to be the prime contractor at the Space Station Alpha undertaking?

Mr. THIBAULT. Yes, sir.

Mr. DINGELL. We will start the next round for the members—the gentlewoman from Pennsylvania is here. The Chair recognizes the gentlewoman from Pennsylvania.

Ms. MARGOLIES-MEZVINSKY. Mr. Thibault, one of the primary reasons NASA abandoned the Space Station Freedom and these other contractors was the enormous cost growth associated with the program; is that correct?

Mr. THIBAULT. That is my understanding. Yes, ma'am.

Ms. MARGOLIES-MEZVINSKY. Were you aware that during the past four rating periods dating back to October of 1991 that Boeing has been given either a poor or an unsatisfactory rating by NASA for cost control?

Mr. THIBAULT. We were unaware of that until that was brought up by subcommittee staff.

Ms. MARGOLIES-MEZVINSKY. Is there any reason why you were unaware of it?



Mr. THIBAUT. We are not part of the award process, certainly it is pertinent information to us, but as far as the process to award fee or the process to evaluate contractor performance as part of selection criteria, we provided an independent advisory report ahead of time.

We are not included because we were advisory and we are not part of the actual acquisition selection process. We are independent of that process; so while that is information that I think would have been useful in our evaluation, we were unaware of it until it was brought up by committee staff.

Ms. MARGOLIES-MEZVINSKY. It seems to me that this may be information that you would want to store someplace.

Mr. THIBAUT. Absolutely.

Ms. MARGOLIES-MEZVINSKY. Does it concern you that Boeing has taken the lead in Space Station Alpha, given this track record?

Mr. THIBAUT. Again, we were not part of the criteria for the selection of Boeing. It does concern us, because if, for 4 years in a row, contract financial management and related reporting is deemed by NASA as unsatisfactory or not at a par with what they would like, that raises a significant concern about a very significant program in terms of financial management.

So yes, it is pertinent and it is an area that we believe is sensitive and warrants increased attention.

Ms. MARGOLIES-MEZVINSKY. Are you aware of the recent Boeing settlement with the government for mischarging on Defense and NASA contracts?

Mr. THIBAUT. Yes, ma'am.

Ms. MARGOLIES-MEZVINSKY. Can you give us some details about that settlement?

Mr. THIBAUT. Yes, ma'am. That settlement came in the latter stages of April of 1994. In fact, the information that I will summarize is from a press release by the United States Attorney out of the Western District of Washington.

For the record, I could furnish the entire statement or the entire press release.

Mr. DINGELL. Would you submit that for the record, please, sir.

Mr. THIBAUT. Yes, sir.

[The press release referred to is retained in subcommittee files.]

It essentially included three major areas of costs that were recovered by the government totaling about \$75 million, the largest of which involved Boeing Research and Development costs which Boeing falsely characterized as manufacturing and production engineering. In that case, \$55 million was recovered in the settlement at the end of April of 1994.

The second of three items is Boeing charged the government several million dollars in foreign direct selling costs that were unallowable and the government recovered \$12.4 million as part of that settlement.

In the third case, Boeing charged several millions in hazardous waste disposal costs, contrary to its disclosed accounting practices consistent with cost accounting standards legislation and regulation, and in that case, \$8.8 million was recovered by the government. So there was a total of \$75 million out of that.

Ms. MARGOLIES-MEZVINSKY. Didn't settlement specifically mention Boeing charges, Boeing's charges regarding space robots as well as the Space Station?

Mr. THIBAUT. Yes, ma'am. There was specific mention within the settlement that part of the Boeing mischarging related, a substantial portion—in fact, they cite it as one of the more egregious examples, related to the Boeing division responsible for the application of artificial intelligence to computers, and examples they highlighted were on space robots, Space Station environmental systems and other computer applications were specifically highlighted as areas where cost recovery as substantial.

Ms. MARGOLIES-MEZVINSKY. Does it strike you as singularly odd that at a time Boeing was repaying the government some \$75 million in mischarging, that they would be selected by NASA to lead the cost control effort on the Space Station?

Mr. THIBAUT. The short answer is yes, but I have to qualify that I was not part of that process, so what the level of knowledge was, I am unaware of.

Ms. MARGOLIES-MEZVINSKY. Your agency also conducts overhead audits of major contractors. Your audit work at Stanford University apparently identified major areas of mischarging involved in government support research. I am curious as to what is the most recent year that DCAA has conducted an actual incurred cost overhead review of Boeing?

Mr. THIBAUT. During the time of the audit, it was 1986. Because of the settlement and the ongoing investigation that we previously have been talking about and that the chairman mentioned in his opening statement, we were asked because of the Boeing problems by the U.S. Attorney's Office of the Department of Justice to defer our audits for some 7 or 8 years and Boeing did in fact not make submissions since 1986.

Ms. MARGOLIES-MEZVINSKY. That was the last year Boeing submitted its actual overhead claim?

Mr. THIBAUT. Yes, ma'am.

Ms. MARGOLIES-MEZVINSKY. Thank you, Mr. Chairman.

Mr. DINGELL. The time of the gentlelady has expired.

The Chair advises that the subcommittee will recess while we go to the Floor to vote on the Calvert amendment to the Desert Protection Act. We will have a recess of 15 minutes. We will return at 45 minutes after the hour to continue the proceedings.

[Brief recess.]

Mr. DINGELL. The subcommittee will come to order.

The Chair is going to recognize the gentleman from Texas, Mr. Hall, for questions.

Mr. HALL. Thank you, Mr. Chairman.

Of course, we are all against waste, Mr. Thibault, of the taxpayers' dollar and I might suggest to you that goes for frivolous audits by other government agencies as well. What I am trying to determine is whether or not there is really anything new turned up here today or anything that NASA is not already trying to come to grips with? Do you understand that?

Mr. THIBAUT. Yes, sir.

Mr. HALL. I want to go back to the Form 533 Mr. Barton asked you about. Of course, you say it is a report on performance and

used for financial management. Actually, it is a form simply to show how much the project is going to cost in the future, isn't it?

Mr. THIBAUT. That is a key part of that reporting process; yes, sir. The estimate to complete and the projected cost. Yes, sir.

Mr. HALL. It doesn't deal that much with what has already been spent, but it deals basically with the future; is that an accurate statement?

Mr. THIBAUT. Sir, it deals with both the actual cost incurred as a baseline and then to project future costs. So it deals with both, sir.

Mr. HALL. Have you pointed up any limitations in this form, was that your testimony?

Mr. THIBAUT. No, sir. We have not pointed limitations in the form. We believe that the form and the current process is a viable and effective method for cost performance reporting. Now, as far as improvement to the form, if there could be enhancement, we would be in favor of it. We haven't seen the need based on our evaluation to recommend any.

Mr. HALL. I think Mr. McConnell said or you that the 533 that we looked at showed no cost variance.

Mr. THIBAUT. That was Mr. McConnell.

Mr. HALL. Does that imply that you didn't look at all the 533's? Are they so voluminous that you can't look at all them in your audit?

Mr. MCCONNELL. We just looked at 10 specific 533's.

Mr. THIBAUT. That is 10 on 10 contractors?

Mr. MCCONNELL. That is correct.

Mr. HALL. Actually, it is very complicated and it is not simply a matter of adding and subtracting when you look at the Space Station, is it?

Mr. MCCONNELL. That is correct.

Mr. HALL. It is very complicated in building a Space Station and analyzing the building and the cost and to project the future. That is also true, isn't it?

Mr. MCCONNELL. That is very correct.

Mr. HALL. Change in budgets, change in designs, building air locks, modules or writing software; you are not familiar with how that is done, are you?

Mr. THIBAUT. In terms of the technical aspects, if there are technical requirements, we are not the engineering support of NASA. NASA has engineering support and provides that to us where there are technical questions. So we do not have technical responsibility or oversight; yes, sir.

Mr. HALL. I am not complaining about your adding and subtracting and your reporting. I presume you report the facts the best you can on a very complicated situation.

Mr. THIBAUT. We have a responsibility to report and base our audits on factual data. Yes, sir.

Mr. HALL. The real problem is projecting costs in a technology that is totally new, because the Space Station is new and totally different; is that true?

Mr. THIBAUT. I think it is a complex program with a changing baseline. I think that is one of the recurring situations that we highlighted, the importance of establishing just what that baseline

is and definitizing and authorizing that work so that we can make the forecasts for projected costs. Yes, sir.

Mr. HALL. You seem to be critical of the selection of Boeing. Do you have an opinion as to whether or not they probably had the most information on building a Space Station?

Mr. THIBAUT. Sir, as I tried to say a couple of times, I was not intending to be critical—I did not say that—I do not intend to criticize Boeing for either the selection which we were not involved in, I simply tried to respond to questions about risk situations or cost recovery situations that were expressed, some of which we were familiar with, such as the settlement that we described, and other items, such as NASA's cost performance ratings we had not been familiar with nor been provided that data. I think it is important to note, we were not part of the selection process—

Mr. HALL. I understand.

Mr. THIBAUT. We were not involved with the award of Boeing. So I am not familiar with exactly why Boeing was considered and selected as the most qualified organization.

Mr. HALL. So when I ask whether you have an opinion as to whether or not they have the most information on building of a Space Station, your answer is no?

Mr. THIBAUT. Yes, sir. It is no.

Mr. HALL. Or that they have done the best job to date—you wouldn't have any way of having an opinion on that, would you?

Mr. THIBAUT. I do not have an opinion.

Mr. HALL. Go back to the Form 533. Are you aware of any moves toward identifying the limitations on Form 533?

Mr. MCCONNELL. I am not.

Mr. THIBAUT. I am not.

Mr. HALL. So you are not aware of the fact that the Science, Space and Technology, in particular the Space Committee, has highlighted the need for reforms in a NASA contract monitoring and the need for independent cost analysis?

You are not aware of that and you weren't aware of that when you testified, were you?

Mr. THIBAUT. I was not familiar with your committee's work or its prior recommendations. That is correct.

Mr. HALL. Were you also not aware of the fact that we had implemented the Chief Financial Officer Act of 1990?

Mr. THIBAUT. I am familiar with the Chief Financial Officer Act. Yes, sir.

Mr. HALL. Are you aware of the fact that we have established an independent cost analysis function?

Mr. THIBAUT. Within NASA?

Mr. HALL. Yes.

Mr. THIBAUT. No, sir. I am not familiar with the independent cost analysis function. I have been to meetings with NASA's Chief Financial Officer and I am aware of the importance they place on that responsibility.

Mr. HALL. And that we have appointed an independent cost analysis person; are you aware of that?

Mr. THIBAUT. I do not know who the person is nor have I been briefed by NASA or am I aware that they have a person who does independent cost analysis for NASA.

Mr. HALL. Have you met with Mr. Pinetta?

Mr. THIBAUT. On the independent cost analysis, no, sir.

Mr. HALL. So you are not aware that they have been appointed and they are awaiting Senate confirmation?

Mr. THIBAUT. No, sir.

Mr. HALL. You are really not aware that reforms are underway through Science, Space and Technology and the Space Committee particularly, are you?

Mr. THIBAUT. I think the important point to be made here is that this audit was not established because of the work that was done by a particular organization. These audits were established because of known risks by these 10 contractors at Johnson Space Center.

Two significant contracts relate to Space Station. Eight of the contracts relate to other work at Johnson Space Center and they were established to evaluate and either provide assurance or make recommendations related to these contractors' policies and procedures for budgetary and financial controls on their contracts.

Mr. HALL. Let me ask you and give you an example of one of the DCAA recommendations: "All contractors should establish detailed budgets and contract baselines from which to monitor and control costs."

Do you consider that earth shaking?

Mr. THIBAUT. No. That is an appropriate and necessary budgetary and financing component.

Mr. HALL. Is there anything new in that or do you think NASA or this committee would disagree with that?

Mr. THIBAUT. No. In fact, the reason we made that recommendation is because in our review of these 10 contractors, they did not have effective budgetary systems. The fact that anybody on this committee would feel that is an integral part of that would not be surprising.

Mr. HALL. I am trying to find some value that is added by your audit and to find out how much your audit has cost us to date.

Would you put that information in the record?

Mr. THIBAUT. Yes, sir.

[The following information was received.]

The cost of the DCAA budget and financial control systems audits of ten major NASA Johnson Space Center contractors: approximately \$233,000.

Mr. HALL. How far back does the DCAA audit function go with respect to Johnson Space Center?

Mr. THIBAUT. We have been NASA's principal auditors for a long period of time. Other than the DOD, NASA is our most significant customer and Johnson Space Center, for as long as I have been involved with headquarters since 1980, policy and operational matters, it is my understanding we have been supporting NASA's Space Exploration programs.

For the record, I will provide you a baseline of our audit presence at Johnson Space Center, sir.

[The following information was received.]

The span of time for which DCAA has been performing audits for NASA at the Johnson Space Center: since the Agency's inception in 1965.

Mr. HALL. Among the other things——

Mr. DINGELL. The Chair observes that there is a vote on the Floor. The time of the gentleman has expired.

For that reason, the subcommittee will adjourn for 5 minutes and we will return for further questions.

The Chair thanks the gentleman from Texas for his assistance.

Mr. HALL. I thank the Chair.

Mr. DINGELL. We also thank you Mr. Thibault. I have a couple of little questions that I regretfully will have to ask you to wait to respond to when we come back.

We will return in 5 minutes.

[Brief recess.]

Mr. DINGELL. The subcommittee will come to order.

Mr. Thibault, while we are on this overall subject, how big of a backlog does your agency have in receiving and auditing actual overhead expenses?

Mr. THIBAUT. At the start of 1994, this fiscal year, last October, it was about \$156 billion of unaudited incurred costs. By the end of this year, it will be about \$129 billion of incurred costs. In terms of audit count, the number is just over 14,000 audits, the majority of which are the smaller contractors, under \$10 million.

Mr. DINGELL. Now, I note that recently the Appropriations Committee cut your agency's budget by almost  $\frac{1}{3}$ . What will be the impact of this on DCAA if the cut is sustained?

Mr. THIBAUT. It will have a very adverse impact on our ability to bring our backlog down. It would seriously expose DOD's contract audit capability, and in our opinion, it would be an unacceptable financial risk for the Department in contract audit oversight.

Mr. DINGELL. What will the practical effect of this kind of cut be in terms of losses to the taxpayers, in terms of lack of audit, lack of recovery of funds that are due the government because of inappropriate expenditures, improper billings, waste fraud and abuse?

Mr. THIBAUT. We evaluated the impact of the hundred million dollars reduction by probable audit area and in terms of reduction in force and the immediate impact would be a reduction in force, we probably couldn't put it in place by 1 October, by 1 January of 1995 of about 2,400 auditors.

Mr. DINGELL. You mean you would lose 2,400 auditors?

Mr. THIBAUT. Out of 5500, yes, sir.

Mr. DINGELL. So you will lose almost 50 percent of your work force?

Mr. THIBAUT. Yes, sir, because we are labor intensive and that is where the reduction would be. The impact on our audits would be significant work that we presently do with substantial risk to the government, such as defective pricing, incurred cost audits and forward pricing; we would not be able to perform.

We have gone through with our best estimate of what the impact of that would be and the first year of lost savings based on sustained savings from that reduction would be \$832 million.

Mr. DINGELL. The cost to the taxpayer is \$830 million?

Mr. THIBAUT. Yes, sir.

Mr. DINGELL. Now, what will that do in terms of the number of audits? It will about halve the number of audits you can do, won't it?

Mr. THIBAUT. It will be a substantial reduction. Said another way, in terms of the backlog the majority of those 14,000 audits are for contractors under \$70 million. We would not be able to perform most of those audits, so the small contractors, where significant issues have been raised by this committee and by other committees and other oversight organizations, simply we would not have the resources to address those issues, to do those audits; and whereas the good news for the backlog is it is coming down now under a very challenging environment, it would in the near term turn around and go up substantially.

Mr. DINGELL. The practical result of this would be to leave, you said, about \$830 million in the hands of people who are not entitled to that money? Is that right?

Mr. THIBAUT. It would be unallowable costs that are sustained in the past that would be vouched and paid and remain with these contractors.

Mr. DINGELL. So to save \$100 million, we are going to spend \$830 million and leave money in hands of people they are not entitled to.

Mr. THIBAUT. Yes, sir.

Mr. DINGELL. A lot of these audits that are in your backlog that you won't be able to do will be abandoned forever. You will not ever be able to get back to them because of other work that you will have to do, because of statutes of limitations, because of expiration of regulations and things of that sort.

Mr. THIBAUT. I think that is right. We would build a backlog of unaudited work, but as you accurately represent, the statute of limitations, for example, defective pricing 3 years after final payment would start kicking in and we would be removing that from the auditable backlog.

In the area of forward pricing, our customers, be it NASA trying to definitize contracts in this case, for a significant amount of that work we would not be able to provide independent advisory reports to those customers, and that would undermine their ability to negotiate a fair and reasonable price.

Mr. DINGELL. Mr. Thibault, you have been before this committee on a number of occasions. We always find your assistance to be invaluable to us. Thank you for your valuable assistance.

Mr. McConnell, we appreciate what you have done to help us over the years and we appreciate your appearance today.

The gentleman from Colorado.

Mr. SCHAEFER. I have a couple of questions, if you don't mind.

Mr. Thibault, the DCAA has characterized the now-terminated NASA contract with McDonnell Douglas for Space Station Freedom as a de facto level of effort contract. Why is it characterized this way and what is the harm of a de facto level of effort contract where the deliverable is a piece of hardware?

Mr. THIBAUT. Mike, do you want to take a run at that.

Mr. MCCONNELL. This is long—you could go into a long story on the Space Station. Basically that is what it became. You are right, a de facto level-of-effort contract due to the fact that the contractor's performance measurement systems were not operational for a good period of contract performance and basically money was not

being controlled in the manner that the contract contractually called out for it to be.

Mr. SCHAEFER. Is it true that McDonnell Douglas simply gave up using its cost and scheduling control system at some point even though NASA paid McDonnell Douglas to maintain this system?

Mr. MCCONNELL. McDonnell Douglas indicated to us that their performance measurement system was inoperable for at least the first 2½ years of the Space Station contract.

Mr. SCHAEFER. Did they say why they gave up using this cost and control schedule?

Mr. MCCONNELL. Rebaselining. They indicated that the contract was being rebaselined and they were not able to keep up with this and therefore they didn't use their performance measurement system.

Mr. SCHAEFER. Well, in its failure to maintain a functioning cost and schedule and control system when it was most needed, is it an indication that the McDonnell Douglas portion of the Space Station contract was somewhat out of control?

Mr. MCCONNELL. Well, the McDonnell Douglas response indicated that. Yes.

Mr. THIBAUT. From a financial management viewpoint, that was our opinion, that there were not proper controls to monitor and provide sufficient visibility on cost growth.

Mr. SCHAEFER. In 1993, NASA restructured radically the Space Station contract and selected Boeing to be the new prime contractor. What type of contract has Boeing been working under since it was selected?

Mr. THIBAUT. A letter contract.

Mr. SCHAEFER. How does this letter contract under which Boeing is working differ with unpriced orders or the level of effort contracts or undefinitized?

Mr. THIBAUT. Do you want to take a run at that?

Mr. MCCONNELL. We have a follow-up audit going on right now as to the undefinitized costs, how they are being handled on the letter contract to date. We have just initiated this and I don't have anything really to give you as far as audit results.

Mr. SCHAEFER. Is a letter contract similar to undefinitized work?

Mr. THIBAUT. In terms of risk, it obviously is not as desirable as a final awarded definitized contract based on cost and pricing data that has been audited, evaluated and negotiated.

Again, I would appreciate or I would suggest that NASA can probably provide a better understanding or insight into why this span of time and what their plans are to make final award of the contract and to implement the normal contractual award process.

Mr. SCHAEFER. I appreciate that and we will be asking that.

One final question. Do you know how much money NASA has given Boeing under the terms of the letter contract?

Mr. THIBAUT. We will provide that for the record.

[The following information was received.]

The total amount of costs and fees Boeing has invoiced to NASA Johnson Space Center on letter contract NASIS-1000: \$319,971,898.96 as of 18 July 1994.

Mr. SCHAEFER. I thank the chairman.

Mr. DINGELL. The Chair thanks the gentleman for his assistance this morning.



Gentlemen, the committee thanks you again. You have been of great assistance to us.

The Chair announces that the next panel is a panel composed of General John R. Dailey, Retired, U.S. Marine Corps, Acting Deputy Administrator, NASA; accompanied by Mr. Arnold Holz, Chief Financial Officer; Mr. George Abbey, Deputy Director at Johnson Space Center; Ms. Deidre A. Lee, Associate Administrator for Procurement; and Mr. Robert Easley, Director of Procurement at Johnson Space Center.

Ladies and gentlemen, thank you for being with us today. The Chair advises that it is the practice that all witnesses who appear before this committee testify under oath. Do any of you have objection to so doing?

Do any of you desire to be advised by counsel during your appearance here?

For your information, there are copies of the rules of the subcommittee, rules of the committee, and rules of the House to inform you of your rights and the limitations on the powers of the committee as you appear before us.

If you will each raise your right hand.

[Witnesses sworn.]

Mr. DINGELL. You may each consider yourself to be under oath.

General, we will recognize you at this time for such statement as you choose to give.

General DAILEY. Thank you, Mr. Chairman and members of the subcommittee. With your permission, I will submit a formal statement for the record.

Mr. DINGELL. Without objection, your entire statement will appear in the record and we will recognize you for such summary as you choose to give.

**TESTIMONY OF GENERAL JOHN R. DAILEY, ACTING DEPUTY ADMINISTRATOR, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION, ACCOMPANIED BY ARNOLD HOLZ, CHIEF FINANCIAL OFFICER; GEORGE ABBEY, DEPUTY DIRECTOR, JOHNSON SPACE CENTER, ACCOMPANIED BY DEIDRE A. LEE, ASSOCIATE ADMINISTRATOR FOR PROCUREMENT; ROBERT EASLEY, DIRECTOR OF PROCUREMENT; PAMELA McINERNEY, CHIEF OF STAFF, SPACE STATION PROGRAM OFFICE; WAYNE DRAPER, COMPTROLLER; TERRI HESSE, DIRECTOR OF BUSINESS MANAGEMENT; WIL TRAFTON, PROGRAM DIRECTOR, SPACE STATION; AND JEFF LAWRENCE, ASSOCIATE ADMINISTRATOR FOR LEGISLATIVE AFFAIRS**

General DAILEY. Thank you, sir.

The situation that has been described in the first part of this hearing was recognized by our Administrator, Mr. Dan Goldin, when he arrived from industry over 2 years ago. He recognized that we needed to make significant management reforms and changes in the way that we do business.

He directed the development of a series of management reforms that fixed responsibility and streamlined our ability to manage programs and to operate the agency. Of particular importance was the Space Station Freedom program, the difficulties of which have been

discussed at some length here this morning and were all evident to our Administrator at that time.

He took specific action in that case and created a team to redesign the station and to restructure the management system for the Space Station and, as has been mentioned earlier, this consolidated from multiple prime contractors and centers to a single prime contractor, which is Boeing, and a host center, which is the Johnson Space Center, with the oversight being provided by the program director's office at our headquarters in Washington and the Associate Administrator for Space Flight.

There is also a series of requirements that was identified to enable the individuals associated with these programs and in management positions to better perform their duties and in response to Mr. Barton's question earlier today about the 533 Forms and how do we employ those and do we just deliver a handbook and some instructions and expect people to know how to do it, that is what we were doing.

In our review, it became evident to us that we needed to provide instruction for not only the civil servants who oversee the process, but for the contractors who complete them. Johnson Center created a course in February of this year. We have trained over 200 people at this point, 90 of which are contractors, in the proper execution of this document. That is one of the near-term or immediate action training requirements that we have met, but in addition to that, we have near-term courses that are being set up to provide instruction for specific disciplines in the management area.

But in the long term and perhaps most important is we have created and are ready to implement a program manager course which will develop individuals in NASA as they develop through their career and provide them with the necessary preparation prior to assuming a position of increased responsibility.

This is one of the things that we found in our review of the Space Station program and other programs within NASA that we have been deficient in properly preparing our people for the responsibilities that we have levied upon them. So training has an increased importance in the agency and is being stressed at the highest levels and will be institutionalized so that we don't solve the problem today only to have it return in the future, but it will be a continuing process by which we prepare people to do their jobs.

As part of this Awareness Training program, we have with us today specific individuals from the Johnson Space Center who are charged with the implementation and oversight of these controls that we have for the Space Station program and the other major contracts at Johnson. We thought that it would be valuable experience for them to see firsthand the level of concern that exists here in Washington and at our headquarters over the duties that they are about to perform.

Audits are an important part of our management structure and DCAA provides this service to us. In fact, we are on the same team. We hire them to do audits and to provide us with the insights that are necessary for us to focus on deficiencies and problems that need to be solved, so we consider this to be a valuable, essential service that we must have. We are in agreement with the recommenda-

tions that have been provided to us by the DCAA audit and are in the process of implementing these recommendations.

One thing that became clear to us, however, in the process of preparing for this hearing and the dealings we have had as a result of the audit is that we need to have a closer relationship with DCAA. We need to talk on a more frequent basis. While not compromising their independent status, we need to keep each other informed to a greater extent.

I was concerned this morning when the question was asked about our training program and they were not aware that we have had one in effect and in fact have trained 200 people. That is an example of what I am talking about.

The IBM question about providing information and the fact that we were not aware that they were having difficulty acquiring that information are examples of the type of improved communications that we need to establish with DCAA and the Inspector General and GAO. These are important functions that we have to concentrate on.

We believe that NASA is on the move. We recognize our responsibility to the American people and we are clearly cognizant of the fact that we must ensure that our Nation gets the maximum benefit from every dollar that we spend. We don't have all the answers, nor do we believe that we have everything in place that we need to make sure that we are successful in achieving our goal of achieving maximum benefit from the dollars, but we do believe that we have a system in place and that we have a management team in place that is ready to respond to these developing requirements and are willing to make change and to provide us with the best possible oversight and enabling us to carry out our responsibilities.

With that, sir, I would like to introduce my colleagues at the table. On my far right is Gene Easley, the director of procurement at the Johnson Space Center; Mr. George Abbey, the deputy director at the Johnson Space Center; Deidre Lee, associate administrator for procurement at headquarters; and Arnold Holz, our newly appointed chief financial officer.

Mr. DINGELL. Thank you for being with us.

[The prepared statement of General Dailey follows:]

PREPARED STATEMENT OF GENERAL JOHN R. DAILEY (RET.), ACTING DEPUTY ADMINISTRATOR, NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

Mr. Chairman and Members of the Subcommittee: Thank you for the opportunity to come before you today to discuss NASA's commitment to improving its procurement, financial, and program management practices.

In this era of fiscal austerity and the attendant emphasis on maximizing the return on investment of each federal dollar, NASA is making a concerted effort to streamline and improve the Agency's management practices. NASA has initiated a number of management and procurement reforms, and my associates and I have come today to discuss these reforms and the strides NASA is making in improving the Agency's performance.

The recent Defense Contract Audit Agency review of Johnson Space Center contracts points out a number of areas in which NASA could improve its financial, procurement, and program management practices. We concur with the majority of the audit. Furthermore, NASA had already begun implementation of reforms at the Agency, Center, and Program level.

My testimony addresses NASA's efforts to improve the Agency's management. I shall begin by describing the Agency-level reforms that Administrator Goldin has instituted during his tenure and then touch on the actions that the Johnson Space

Center and international Space Station Program are taking to address the specific recommendations from the DCAA report.

Accurate financial management systems are critical to NASA's successful program management and cost control. We have instituted a number of reforms in the areas of financial management, program management and contract management in response to the Administration's National Performance Review. Significant examples of these reforms include:

**Contractor Financial Management Reporting:** Revision of the NASA Federal Acquisition Regulations (FAR) Supplement to clarify financial management reporting requirements for both NASA and its contractors. Changes address the timeliness and accuracy of reporting, NASA manager roles and responsibilities, and inclusion of subcontractor costs in prime contractors financial management reports.

**Contractor Training:** NASA has developed a course and is training its contractors in NASA financial management (NASA Form 533) reporting requirements. NASA business professionals also participate in the training. NASA plans to train all contractors within the next 24 months.

**Management of Major Systems and Programs:** The NASA Chief Financial Officer/Comptroller and an independent panel of experts annually review and validates program plans and estimates.

**Program Management Council (PMC):** NASA's senior management reviews all NASA programs with development estimates of at least \$200 million on a quarterly basis and at selected milestones to ensure diligent program management. Any program experiencing a 15% cost overrun is subject to a special review and considered for cancellation.

**Contractor metrics:** Major NASA programs are reviewed for cost, schedule, technical and other significant performance areas on a quarterly basis and issues semi-annual "report cards" to contractor CEOs.

**Award Fee:** NASA has issued regulations to improve cost control performance on Agency contracts. This new policy requires that a contractor's profit be repaid to NASA if a project does not meet performance specifications.

**Change Order Policy:** The NASA FAR Supplement has been modified to ensure more effective management of contract changes and control of cost growth. Most change orders over \$1 million must be negotiated prior to issuance. Exceptions must be approved by Center Directors.

**Contractor Rates Forum:** NASA's Space Flight program reviews their top thirty projects annually for direct and indirect contractor rate performance.

**Cost Control:** NASA's Office of Procurement is implementing an initiative which emphasizes cost control with NASA's contractors and within the Agency. The Administrator will meet with Chief Executive Officers of contractors doing business with NASA in August to discuss the issue.

**Incentive Arrangements on Contracts:** NASA is applying incentive arrangements to contracts to achieve greater cost control.

**Performance Based Service Contracting:** NASA is participating in the Office of Federal Procurement Policy's (OFPP) pilot project to implement performance based service contracting Government-wide. NASA is identifying candidate acquisitions and establishing an Agency-wide task force for this initiative.

Johnson Space Center is taking the DCAA recommendations very seriously. Dr. Carolyn Huntoon, Director of Johnson Space Center, will ensure that all of the recommendations in the report are given immediate attention. To that end, the Johnson Space Center has developed a plan of action which addresses each of the DCAA recommendations. Specifically, the following actions are already underway or will be undertaken over the course of the next year:

Contractors will be held accountable for developing appropriate procedures for establishing detailed budgets and baselines. JSC will proactively determine that contractors have complied with contract reporting requirements. Contractors will attend the course: Financial Management Reporting for Contractors.

Change orders over \$1 million will be definitized before issuance unless critical need is approved by the Center Director.

JSC has increased its emphasis on cost control in Award Fee contracts. Contractors instructed in Estimate at Completion (EAC) reporting requirements.

Contractors will perform reviews of indirect rate on major contracts as part of the budget process, specifically looking at: indirect/direct staffing functions and processes; utilization of equipment; and utilization of facilities.

The very survival of the Space Station program depends on how successful NASA and its contractors control and reduce costs, proactively. A key objective of the program redesign effort in 1993 was to streamline and consolidate the NASA and contractor program management structure to allow for the accurate, current and com-

plete collection, reporting, and evaluation of budgetary data. The establishment of a single Space Station program office hosted at a single center with one prime contractor, along with the implementation of the integrated product team (IPT) approach, has greatly enhanced the efficiency and effectiveness of the program budgeting and financial control process. This new management structure and team approach continues to yield dividends as we improve communications and shorten cycle time. As the Defense Contract Audit Agency (DCAA) plays an essential role in assisting NASA in improving its overall financial processes, the Space Station program office, along with the Space Station contractors, has plans that address the following reforms and improvements relative to the DCAA audit report.

**Recommendation #1:** All contractors should establish detailed budgets and baselines from which to monitor and control costs.

**Response #1:** Baselines will be established for the Boeing Prime Space Station effort along with the lower-tier contractors effort (McDonnell Douglas, Rocketdyne, and Boeing Huntsville) immediately following contract definitization. This effort will result in detailed plans for the negotiated scope of work. This baseline process will be accomplished using the Department of Defense validated performance measurement systems currently in place at each of the contractor's plants.

**Recommendation #2:** These baselines should not be constantly changed to reflect actual costs. The baseline costs should only be changed if the specific contract scope of work is changed and contractually modified.

**Response #2:** Once the performance management baseline is established for the Space Station contracts, it will be used throughout the program to conduct evaluation and analysis compared to actual cost including cost analysis, variance analysis, and corrective action plans. The baseline will be changed only by formal modifications to the contract that reflect scope of work changes (see response #3). Any changes of this type will be subject to review by the Program Management Council.

**Recommendation #3:** Cost growth should be proposed by the contractor and authorized under the contract *prior* to the incurrence by the contractor. Cost growth proposals should be based on the detailed budget analysis by contractors which adequately supports the need for additional funds. Cost proposals should be submitted before the incurrence of significant cost.

**Response #3:** We concur.

**Recommendation #4:** The contractor needs to become more involved in the efficient management of its work tasks and in efforts to reduce or prevent costs and correct inefficiencies *before* costs are incurred. These efforts should be documented in the contractor's budgetary analysis process.

**Response #4:** The Space Station program is in the process of finalizing cost negotiation and contract definitization with the prime contractor, the Boeing Company, who in turn is completing negotiation and definitization with its lower-tier contractors. We have had two comprehensive concurrent fact-finding reviews and evaluations of the contractors' proposal that involved NASA, DPRO, and DCAA personnel. The integrated Government/contractor team has understood and evaluated the basis of estimates for the work scope and contractor approach. We have rearranged work flow, assembly, test and verification processes to optimize program efficiencies. The budget will be allocated and agreed to prior to contract definitization. In addition to having a significant portion of the contractor award fee based on budget management, the definitized contract between NASA and Boeing will include an incentive fee feature to encourage and motivate contractor cost performance. Such incentive fee will be paid only after realized contractor cost savings. Furthermore, proactive cost control will be a standing topic for the Program Management Council review processes as stated in NASA Handbook 7120.5, *Management of Major System Programs and Projects*.

**Recommendation #5:** All contracts should perform an accurate percentage of completion and estimate to complete for each major work task performed. The estimate to complete is not the difference between incurred costs and contract target costs.

**Response #5:** Using the validated performance measurement system, Estimate at Complete (EAC) will be evaluated on a monthly basis through the contractor lateral monthly variance analysis meeting. At the time of these evaluations, Space Station management will review the current month's accomplishments against the frozen baseline and any changes to the EAC will be reflected in the current months reporting. Also, a comprehensive program-wide EAC will be prepared on a yearly, semi-annually or a periodic basis as stated in the contractors approved systems. Generally accepted methods for generating EACs will be used, including grass-roots engineering, as well as parametric estimating. NASA monitors the contractor's EAC and its calculation. Space Station management is also provided with periodic independent government EAC, including comparisons with the contractor's data.

Recommendation #6: Contractors should provide NASA with specific schedules as to what it plans to review internally in regards to: (a) indirect and direct staffing functions and processes; (b) utilization of equipment; and (c) utilization of facilities. The specific results of these reviews should be provided as well as corrective action plans and cost avoidance details.

*Response #6:* We concur. The Space Station program office will work with the cognizant DPRO or DCAA personnel to review the contractors' operating plans and forward pricing rate proposals to understand the rationale used in the development of all rates and factors. The review will include the evaluation and analysis of the contractors' business forecast, staffing plan, equipment and facilities utilization assumptions, as well as contingency plan that allow the needed flexibility and agility for rapid response in case of unexpected changes in the business climate and environment.

Recommendation #7: The lead contractors for the Space Station Program (Boeing Corporation) and for the Space Shuttle Operations (Rockwell) should be made accountable for the accuracy of the 533 data. These contractor should be tasked by NASA to ensure that the contractors working under them are reporting accurate cost data and are actively involved in monitoring their contract performance and in controlling cost growth on these major NASA programs.

*Response #7:* NASA concurs. This recommendation is totally consistent with NASA's policy. Improved adherence to these policies is being emphasized by NASA management, for example:

(a) NASA will insure that calculation of business management award fees reflect the accuracy and completeness of Boeing's 533 data.

(b) NASA has developed a new training course on proper 533 preparation procedures and has initiated training for the prime and lower-tier contractors.

Recommendation #8: Contractors should establish specific goals each year as to contract performance and cost reduction objectives. Bonuses should reflect the accomplishment of these specific goals. Bonuses should not be based on predetermined percentages based on employees just "showing up" for work.

*Response #8:* We concur.

Recommendation #9: Each contractor should establish an account to accumulate idle or free time. A specific definition as to what constitutes idle or free time should be established by NASA and given to each contractor. Idle or free time can then be measured periodically to determine if it is reasonable or excessive.

*Response #9:* NASA will work with the DCAA to ensure that appropriate definitions of "non-productive," "idle," or "free time" are included within the disclosure statements of the prime and lower-tier contractors. NASA will emphasize with DCAA the need to maintain constant vigilance on the amount of such time and the rationale for its inclusion in NASA contracts.

NASA has been reforming its financial management, contract management, and program management systems for the past two years. While we have had a number of successes, we are seeking further improvement as we reinvent NASA. DCAA plays an essential role in assisting us in improving NASA's overall financial processes and NASA is aware of the significance of the issues raised in this audit. I hope that we have adequately answered your concerns.

Mr. DINGELL. The Chair is going to recognize the gentleman from Colorado for questions.

Mr. SCHAEFER. Thank you, Mr. Chairman.

General, or anyone else who would care to respond to any of the questions, the DCAA audit, as you know, has disclosed significant deficiencies in the ability of NASA contractors to generate accurate cost performance reports to NASA. Without accurate reliable cost performance reports, how can NASA make intelligent estimates to Congress about what programs, especially large and expensive programs, like the Space Station is actually going to cost us?

General DAILEY. We can't. That is the reason we have implemented these management reforms. I have outlined those in the submission for the record.

We would be glad to discuss any of them in detail that you would like. One that is important though in terms of accomplishing this goal of getting accurate data is to have the people properly trained and then to have an oversight group that understands what we are

trying to accomplish with the forms and the people completing them knowing what we are trying to have displayed.

We don't want to alibi as to our performance in the past, but there are significant activities at the time that some of the audit was taking place and some of the things that were happening in terms of the redesign and restructuring of the program. It is clear that we were not providing the proper guidance and oversight nor were the contractors complying properly, although they were responding in many cases to our own direction, which was not completely accurate.

We think we have the figures in place on this and our training courses are going to be a major portion of achieving that.

Mr. SCHAEFER. I have this audit report in front of me. Looking at the deficiencies that were outlined in two particular pages of contractors not complying with certain requests, part of the problem comes down to this. This is why the Space Station is kind of up and down in Congress because we keep getting different facts and figures as to what it is going to cost. It keeps changing all the time.

This is one of the reasons I think that we have a problem getting this authorization through.

General DAILEY. We agree and we are very concerned about that. That is why we are working as hard as we are to get this under control. I believe that we do have the structure in place now to correct this and to provide the proper information.

Mr. SCHAEFER. In a meeting with subcommittee staff that was held on 21 July, Malcolm Peterson, NASA Comptroller, said that NASA was aware of the overruns even if the contractor's cost performance reports weren't reporting them.

Was NASA truly aware of these overruns independently of the data supplied by the contractors and if so, how?

General DAILEY. Yes, sir. The 533 is one document in the oversight process. We do independent analysis on our own and the program management personnel are also involved on a first-hand basis in daily contact with the efforts of the contractors.

So even though the documents don't reflect the exact status as presented by the contractors, we have a parallel independent analysis that we run at the same time which gives us indications that we can then pursue with the contractors to confirm. But that was one of the major reasons why Mr. Goldin inaugurated these management reforms over 1½ years ago, because we recognized at that time we were having significant problems in controlling costs and the reporting and management system to do that were unwieldy because of the structure that we had.

Mr. SCHAEFER. If NASA knew it, how much was the overrun before this was cancelled?

General DAILEY. I can't put a number on that other than we knew that we had problems and we knew we were in an overrun situation, but part of the difficulty was fixing the exact amount. It depends what time frame you are talking about, too, sir.

Mr. SCHAEFER. I understood you were aware of the overruns independently of the data supplied by the contractors, and if you were aware of them, are you saying that you didn't know how much they were?

General DAILEY. We didn't know the magnitude in detail. Maybe Mr. Abbey can shed light on that.

Mr. ABBEY. I think that was one reason Mr. Goldin was very anxious to initiate a redesign, which led us to the new Space Station, because we were concerned about that overrun. I think we could submit to the record what we estimate that to be, of what that was at that time.

Mr. SCHAEFER. In other words you don't know?

Mr. ABBEY. I don't know the exact number. I can get that for you.

[The following information was received.]

The projected cost growth was the manifestation of several causes and addressed the aggregate costs for three years (FYs 93, 94, and 95) across all the projects in the program. The widely reported growth of \$1.08 billion was an initial projection and was never fully accepted by the program. Through months of hard work, the Space Station Freedom program managed to reduce the problem for the three year period to approximately \$500 million.

Mr. ABBEY. That was part of the fact of why we initiated the redesign to go to Space Station Alpha because of our concern with the configuration as it was with Space Station Freedom.

Mr. SCHAEFER. Isn't this the value of 533's?

Mr. ABBEY. Yes, the 533's would have been a major factor in quantifying that number.

Mr. DINGELL. Would the gentleman yield?

Were you aware of the cost overruns or not aware of the cost overruns?

General DAILEY. We were aware there was a cost overrun. Yes, sir.

Mr. DINGELL. What was done about those cost overruns prior to the time of the audit?

General DAILEY. That was when we initiated the redesign and the restructuring of the Program Office to provide better oversight capability on the part of the government and also to provide a more affordable design for the Space Station.

Mr. DINGELL. When did that happen—before or after the audit?

General DAILEY. That has been underway for the last 18 months.

Mr. DINGELL. The last 18 months.

General DAILEY. Yes, sir, and is now complete and in place.

Mr. DINGELL. Have you done anything to retrieve the overcharges and the cost overruns or to bring the contract under control?

General DAILEY. The contracts are being novated at the present time and we are in the final stages of definitization with Boeing as the prime contractor.

Mr. DINGELL. The Chair thanks the gentleman.

Mr. SCHAEFER. If the Chair would, I would like to ask NASA to submit for the record how long NASA knew and how much the overrun grew during the time that NASA did know this.

Mr. DINGELL. Without objection, the answer to that will be inserted in the record.

[The following information was received.]

After the FY 1993 budget for the Space Station Freedom was approved, NASA began formulating the FY 1994 budget. The preliminary resource requirements submitted by the work packages in December were not dramatically out of line with our September estimates. However, when these requirements were completely ana-



lyzed in January, they turned out to be significantly higher, especially for Work Package 2 at the Johnson Space Center in Houston.

The first actions we took upon learning of the cost growth was to inform Congress and the Office of Management and Budget and initiate an intensive review of the content of the growth and the potential options to mitigate these costs and to determine the cause. These preliminary reviews culminated in a meeting at McDonnell Douglas facilities in Huntington Beach, California, during the last week of January. At this review, we were successful in defining a number of options to reduce costs, but we still did not fully understand the causes of the projected increase.

Although, we began with Work Package 2, we recognized that it would be necessary to review the entire program to find where we could cut, reduce, or reorganize in order to gain efficiencies and realize cost savings. It was for this purpose that we began a series of reviews at our program office in Reston, Virginia, in early February. All work packages, prime contractors, and international partners participated in these reviews. In this way, we could ensure that the reviews would be both comprehensive and coordinated, as well as ensure that we understood any potential cost growth threats from other parts of the program. After examining many options we came up with a number of cost mitigation measures.

The Space Station Freedom program worked very hard to reduce the projected cost increase and had achieved a measure of success, reducing it by 50 percent. Soon thereafter, the Administration directed that NASA redesign the Space Station, with one of the stated goals being a less expensive vehicle.

Mr. SCHAEFER. If NASA did know about the overruns and if NASA knew that the programs would actually cost more than the contractors were telling NASA, what was NASA telling Congress?

Mr. ABBEY. I think again when we were looking at the need to redesign the Space Station and go to Space Station Alpha, that was a major factor in why we went to the new configuration and we projected costs that we felt the Space Station Freedom was going to cost when we presented the design to Dr. Vest's committee and to the Congress and that was last summer.

Mr. SCHAEFER. Did you tell Congress before the redesign?

Mr. ABBEY. We reviewed the redesign with the Vest committee and last summer also with the Congress.

General DAILEY. It is important to point out, sir, that it was not an overrun of incurred cost. It was a projection of what the overrun would turn out to be, and that is why we reorganized the program to keep it from happening.

Mr. SCHAEFER. How big was that?

General DAILEY. That is the number we will give you for the record.

Mr. DINGELL. Are you telling us then that there were no cost overruns, but you were anticipating them. Is that right?

General DAILEY. That is right.

Mr. DINGELL. So there were no cost overruns at all up to the point we are discussing?

General DAILEY. There was not an overrun of incurred costs.

Mr. DINGELL. What is incurred costs?

General DAILEY. I will get somebody up here to explain that, if I may, sir.

Mr. DINGELL. All right.

Let me try and simplify this. What you are telling us was that the budget was not overspent. Is that right?

General DAILEY. That is right.

Mr. DINGELL. But that you knew that because of costs, which either had been developed up to this point or costs which were going to be developed in the future, that the budget would be overspent?

Mr. DAILEY. If we didn't take action.

Mr. DINGELL. Now those are cost overruns which are going to accrue, and the result of that is that what we are seeing here is only a situation where they had not yet shown up on the books, but not where they were not a reality; is that right?

These overruns were a reality. They didn't show on the books because you had not paid for them, but these overruns, in fact, represented costs which had already been incurred by the contractor and which were going to be billed to the government. Isn't that the fact?

General DAILEY. It may be the case. I can't answer that.

Mr. DINGELL. It may be the case or it is the case?

General DAILEY. I don't know. When we provide this information for the record, we will clarify that.

Mr. DINGELL. But it is also a fact that under these cost overruns, work would be shifted to the future, wouldn't it?

General DAILEY. That is one way of accommodating it, yes; or eliminate it.

Mr. DINGELL. It is not unfair to assume that that was going to occur.

General DAILEY. Another way and, in fact, the way that we did accommodate the cost in the redesign was to reduce the scope.

Mr. DINGELL. I thank the gentleman. I am not taking his time away from him, but I wanted to make sure we got this answer on the record.

Mr. SCHAEFER. I am not sure we do, Mr. Chairman, yet.

I am looking at a 1993 Inspector General report that states on page 14, and I quote, "In fact, in most cases, NASA officials use the term 'cost overrun' to mean costs exceeding available funding for a given period, whereas the general understanding of the term is costs exceeding those estimated or contracted for a certain product or level of accomplishment."

Is that correct?

Mr. EASLEY. I think that would be an acceptable definition of what a pure contract overrun would be, what you read.

Mr. SCHAEFER. Didn't NASA use somewhat of a funny definition of overrun that was tied to the Anti-Deficiency Act which NASA recognized as overrun only when the money ran out?

General DAILEY. I don't think that is exactly right, sir. This was a very serious issue that was addressed and we never reached resolution with the Inspector General on this particular—

Mr. SCHAEFER. All right.

Is there any potential advantage to NASA and a contractor underestimating the cost of a contract? That is, is the contractor's fee somewhat based upon the original bid, meaning that overruns are ineligible for award fees?

General DAILEY. You mean a buy-in? Is that what you are referring to; underbidding in order to get the contract?

Mr. SCHAEFER. Lowballing, I guess you could call it.

General DAILEY. That is a technique that is used. One of the management reforms that we have in place is designed to counter that and should a contractor underbid a contract knowingly, we have controls in place through what we call the Program Management Council which is an agency-level review council that reviews all programs over \$200 million on a quarterly basis or as required

based upon changing phases of development, that once a program enters this process and is baselined, if it approaches or achieves a 15 percent overrun in cost or schedule or fails to achieve its technical requirements, it is subjected to review for termination.

That clause was put in specifically to guard against people underbidding intentionally and then having a situation where we have to add additional funding to complete the program. We think we have a fix in place. We have met with the CEO's of all of our companies and made clear what our intention is and we are charging the contractors to bid on performance, not on cost. We are looking for people who can do the job—

Mr. SCHAEFER. So a contractor bids, is given the bid, and it may or may not have been lowballed, but then they are able to go to 15 percent above that bid and still be in compliance; is that correct?

General DAILEY. Yes.

Mr. SCHAEFER. Why do we have a 15 percent leeway here? Why do we have any?

General DAILEY. We believe it is necessary. When you work in a research and development area, you don't know exactly what you are going to get when you start a project. You know what you want and you know what you think technology will enable you to achieve, but you are not sure.

So management reserve is a necessary part of a development program. What we give the contractor is a fixed number. What we carry in reserve over that, they are not aware of, but we are, and that is where we then decide whether we have our own estimate as to what it is going to take to complete the project.

Sometimes it is more than the contractor tells us. We also have the funding based upon what we think it is going to take to do it. That is the flexibility that we give the program manager to operate within his or her program, and when it appears that achieving the goal is going to be possible, but it is costing more than was originally estimated by the contractor, we give them some leeway.

Fifteen percent we feel is a stringent requirement in a research and development environment.

Mr. SCHAEFER. Is there any penalty to the contractor?

General DAILEY. The ultimate penalty would be that they would lose their contract. Another reform that we have in place is called the award fee reform which penalizes them for failure to make their costs or schedule or technical performance and their award is based upon how well they do.

There is greater emphasis now being placed on financial management as part of this. It has been incorporated as part of the award fee criteria, which was an answer to a previous question that came up with the auditors.

Mr. SCHAEFER. Mr. Chairman, I am very concerned about this because if you had 10 percent rather than 15 percent, we probably would have everybody running up to 9½ or 9¾ as we go along. How many times has this occurred? How many times in your experience or anyone else at the table have we had these cost overruns approach the 15 percent level? Is this commonplace?

General DAILEY. It is commonplace.

Mr. SCHAEFER. I would imagine it would be commonplace that they will go up to 15.

General DAILEY. We can review for termination at any time. They could be on schedule and on cost, but not making their technical goals and we could cancel for that reason.

What I am saying is there is an automatic review that goes into effect once they reach the 15 percent level.

Mr. SCHAEFER. Have you cancelled any for default? If so, why not?

General DAILEY. We have tried.

Mr. SCHAEFER. Wait a minute. You have tried. What is the problem?

General DAILEY. There are constituencies associated with every program we have and we have been encouraged to continue some that we have tried to—

Mr. SCHAEFER. I don't understand constituencies. We understand constituencies from our standpoint. Is it the same thing?

General DAILEY. It is exactly the same thing, sir.

Mr. SCHAEFER. Is it Members of Congress?

General DAILEY. Members of Congress have lent it support in cases where we have tried to cancel programs.

Mr. SCHAEFER. Even though you have tried to cancel them, Members of Congress have stepped in and this has been apparently tried because of default?

General DAILEY. Yes, sir.

Mr. SCHAEFER. I yield back, Mr. Chairman, for now.

Mr. DINGELL. The time of the gentleman has expired. The Chair thanks the gentleman.

The Chair would inquire, you say in your statement, "The very survival of the Space Station program depends on how successful NASA and its contractors control and reduce costs proactively."

How important is cost control, then, to the survival of the Space Station?

Mr. ABBEY. We believe it is absolutely critical, sir, that we must maintain this program on cost, on schedule, and achieve our technical goals.

We are committed to doing that. That was what I was trying to cover in my opening statement, is that we believe we have both the structure and the people, employees, to make sure that this happens.

Mr. DINGELL. General Dailey, NASA's own performance review for Boeing for the last four rating periods indicate the performance has been unsatisfactory twice and poor the other two times in cost control.

Now, if cost control and cost reduction are imperative to the survival of the Space Station, how could NASA now be dependent upon a contractor who has consistently demonstrated unsatisfactory or poor cost control abilities on previous Space Station contracts?

General DAILEY. That was a major factor for the task force selection of Boeing as the prime contractor for the International Space Station. We have had extensive discussions with them. They are completely aware of the reforms and the requirements that we have implemented as a part of this transition, and they are step-

ping up the requirements to meet their responsibilities in financial management and in the program development area.

They are a very strong company, with a very sophisticated business management system. They are capable of doing it. We know they are and they know they are.

As I mentioned, NASA was at fault to a certain degree in the previous activities with our failure to provide proper oversight and to require compliance.

Mr. DINGELL. Now, why didn't they have to meet these standards and procedures and requirements of NASA prior to the time that they got to be selected to be the prime contractor? You had four rating periods in which they rated poor or unsatisfactory.

General DAILEY. I think it would have been impractical in the time frame. One of the things we are most concerned about at the moment is this transition we are going through where we don't have a definitized contract, and we are trying to get the program established and on course so that we can start making valid assessments as to where we are.

So I believe that the answer to that would be timing. And the need to—

Mr. DINGELL. At this time I will yield to Mr. Barton for the purposes of asking questions.

Mr. BARTON. Thank you, Mr. Chairman. I have a 1:00 o'clock appointment and I appreciate it. I just want to ask one question.

First, it is comforting to know you are beginning to do something about the Trust Form 533 and the manual. I appreciate that.

I want to go to incentive arrangements on your contracts. Under current law, is it really possible to provide true financial incentives to save money, i.e., if money is saved can you develop an incentive system if they get cash so that they know that if they save money and perform on time that they get benefits?

Let me give you an example. When I was plant manager of a printing plant, we had an incentive program where each month we took our billable dollars and we added up all our costs and in the difference we split half with corporate and we kept half at the company, plant level, and of that half, we distributed that immediately in terms of cash bonuses within 2 weeks from the end of the month. So an average factory worker making \$7 an hour might get a \$150 or \$200 bonus. So they knew if they performed and saved money that they would get an immediate incentive and that at the end of the year we had a big bonus pool and they might get several thousand dollars.

Is it possible under current law and current regulations within NASA to develop some incentive arrangement where everybody who actually saved money and was doing a good job got an immediate cash benefit and at the end of the year a large benefit and in your case as the Deputy Administrator you might get a million dollars?

General DAILEY. Sounds like a great plan to me, sir.

Mr. BARTON. Well, I mean, I don't want to belabor it, and I am using the Chairman's time, but when you know your costs—I knew what paper cost, I knew what ink cost, I knew what natural gas cost, I knew what printing plates cost, I knew what the labor costs were, and I could go to the workers and say, this is what our over-

head is, these are the variable costs and if you will work, you are going to make more money. So it was their money; it wasn't the company's money, you know.

At NASA, if it is their money, and I don't know what NASA's budget is, \$15 billion or somewhere in that range, you start dividing up incentives and the top people make a lot of money, but the lower factory worker could get a bonus of several thousand dollars a year.

Now, can you do something like that in the current system or is it going to take legislation to make that possible?

General DAILEY. I am going to ask Deidre Lee to answer that question, but let me comment generally. In the R&D, it is not quite that straightforward because we don't know what things cost and we don't know exactly how to make them. So there are some risks involved there.

Mr. BARTON. I understand that.

General DAILEY. We believe our new procurement reforms have provided that incentive, and we have met extensively with our contractor leadership and they believe we have got a system in place that will incentivize them, but I will let Dee expand on that, if I may.

Ms. LEE. Under the current process what happens is the contractor earns an award fee based on performance and they can elect to distribute those funds. In fact, we have some contractors who actually do distribute the award fee score and benefit with their direct employees. Different contractors do it differently and we don't direct them specifically how to do that.

Another method we are emphasizing more is an incentive fee with a cost incentive where there is a sharing in the cost savings so for every dollar the contractor saves, the government retains 80 percent, the contractor retains 20 percent. We have a cost share line. We are moving more to those types of contracts.

Mr. BARTON. So you have current authority if you can implement a system that works?

Ms. LEE. Yes.

Mr. BARTON. I thank the Chair. I will pursue this because that is the only way, admittedly, in a R&D system where costs are more indefinite. It is difficult to put an incentive system in place. But you know your overhead, you know your labor costs, and in some parts of your programs you actually build a configuration, you are trying to build something.

General DAILEY. Right.

Mr. BARTON. NASA at one time was the most innovative and admired agency of the government. So you got some goodwill out there that we certainly don't have here in the Congress, and if you use that with the good graces of this committee and the Science, Space, and Technology Committee you could be a role model in how to do things right. I want to see a man on Mars and a woman on Mars in my lifetime and the only way we are going to do that is if we get our act together here, and this is an example of tough love.

Don't get mad at John Dingell because he is calling you up here. He is trying to save the taxpayer dollars, and if we do that we will be able to do some of the visionary things we all want to do.

I thank the chairman for graciously yielding some of his time.

Mr. DINGELL. The gentleman from Texas is most welcome. He has made, I think, some valuable points.

General, could you submit for the record the analysis that NASA conducted of this matter of the Boeing selection particularly with regard to why you selected Boeing despite the poor record on cost control.

General DAILEY. Yes, sir, we will.

[The following information was received.]

In March 1993, the Clinton Administration announced its continued support for the Space Program, but directed NASA to redesign the Space Station to significantly reduce development, operations, and utilization costs while achieving many of the current goals for long duration scientific research.

To carry out the President's decision, NASA established a Station Redesign Team to develop three new technical design options, a streamlined management structure, and a more efficient and accountable acquisition approach. On this latter point, the Team recommended that NASA designate one of the existing Space Station contractors as the single prime contractor, responsible for managing and integrating the Space Station as a vehicle and coordinating the design and development of all necessary hardware. Subsequently, the Advisory Committee on the Redesign of the Space Station, appointed by the Vice President, endorsed the Team's recommendations, particularly the need to designate a single contractor to manage and integrate the Space Station.

In June of 1993, the President accepted the advice of the Advisory Committee and announced his decision to support a restructured Space Station Program. As a significant element of this decision, the Administration urged NASA to make full use of the legal authority and administrative discretion available to designate a single prime contractor for the program. This direction was made more specific in a July 13, 1993, letter from the Office of Management and Budget to NASA.

NASA could have terminated all the existing Space Station contracts and performed a full and open competition for a single prime contractor which would develop its own cadre of subcontractors needed to produce the redesigned Space Station. However, this course of action would have wasted much of the taxpayers' investment to date, delayed the program by one to two years, dissipated the program's talent and expertise, and embroiled the parties in potentially wasteful and time consuming settlement negotiations involved in terminating work, much of which would have to be restarted by the new contractor's team.

As a more efficient and expeditious alternative, NASA elected to select a single prime from among the group of contractors with the knowledge and experience necessary to minimize the time and waste that could occur during program transition. Then, with the consent of all parties concerned, NASA novated the remaining prime contracts to become subcontracts to the single prime.

As expected, novation capitalized on the completed work, eliminated the need to pay a new group of contractors to duplicate progress already made, kept the core of technical talent and expertise intact, and minimized the delay in transitioning to the redesigned Space Station. Moreover, because the establishment of a single prime contractor, and novation of the remaining prime contracts occurred in a short timeframe, NASA quickly and efficiently refocused the program's substantial daily expenditures to the redesigned Space Station.

To implement the direction to select a single prime contractor, NASA established a panel of senior officials in July of 1993. After formulating evaluation criteria for a common frame of reference, the panel gathered information on each prime contractor's responsibilities and historical performance. The panel then applied the previously established criteria to the available information and arrived at a comparative assessment of each contractor's capability to perform the additional and critical functions of management and integration.

The panel's assessment clearly pointed to Boeing as the strongest existing Space Station contractor in relation to the established criteria. Specifically, Boeing is responsible for the truly essential core hardware, that is, the pressurized modules for human habitation; Boeing's integration effort is the most complex required by the Space Station Program, principally because the modules must deal with the human environment; Boeing had successfully demonstrated capability in the key program elements identified in the evaluation criteria; and, Boeing has done the predominant amount of work with the international partners integrating their pressurized modules with those of the U.S.

On August 20, 1993 the NASA Administrator submitted formal notification pursuant to Title 10 U.S.C. 2304(c)(7), to the Speaker of the House, the President of the Senate, and all appropriate House and Senate Space Committees, of a determination to use procedures other than full and open competition to select Boeing as a single prime contractor for the redesigned Space Station program. Pursuant to statutory authority, NASA proceeded to implement the selection after the prescribed notification period, having received no objection from Congress.

In summary, NASA responded to the President's direction to redesign the Space Station and restructure program management by selecting a single prime contractor. It was, therefore, in the public interest for NASA now to move swiftly and effectively to make Boeing the single prime contractor responsible for managing and integrating the Space Station.

Mr. DINGELL. General, the subcommittee has been repeatedly told by the staff at NASA that past performance will be an important factor in the selection of contractors for new work. Do you agree with that?

General DAILEY. Yes, sir.

Mr. DINGELL. Now, let's look at the Department of Defense Inspector General and his comments. He has eight ongoing criminal investigations into practices by Boeing at the Department of Defense. Did NASA know about any of these?

General DAILEY. We are informed by the Inspector General of ongoing investigations when they feel it is appropriate. I don't know whether we know of all the things that they are doing or not.

Mr. DINGELL. Don't you think you ought to know those in that area because it relates to the integrity and the ability and competence of your contractors?

General DAILEY. Those are important things, yes, sir, we don't control the IGs; they are independent agencies and they inform us as they feel it is necessary.

Mr. DINGELL. Sitting there, do you know about any of these eight? Do you know any of the eight?

General DAILEY. I don't know which eight you are referring to, sir, so I don't know whether I know.

Mr. DINGELL. These are ongoing IG investigations of Boeing. To the best of my knowledge, it is all that is going with regard to Boeing at the IG.

General DAILEY. I would have to say I don't, no, I don't know.

Mr. DINGELL. You don't know about it. Are you aware that the Air Force Office of Special Investigations has 13 criminal cases going into the conduct of Boeing?

General DAILEY. No, I was not aware.

Mr. DINGELL. Now, your staff has told the subcommittee staff that when they examine past performance of NASA contracts they only look at previous performance on NASA contracts.

Shouldn't NASA take into account when it is considering a company like Boeing the overall past performance of the company with other Federal agencies such as the Department of Defense? In other words, if they will diddle the Department of Defense, why won't they do the same thing to NASA?

Ms. LEE. The way we do past performance—

Mr. DINGELL. Beg your pardon?

Ms. LEE. On the source selection in past performance evaluation, and this is also part of a new initiative from the administration, Office of Federal Procurement Policy, greater emphasis is on past performance evaluation. We look at the contractor, we tell them in



the RFP, the request for proposal, they must provide us data on their past performance. That includes relevant experience plus like work. We do look at both commercial work, Department of Defense work, and any other NASA work.

In looking at the NASA work, we would look at existing reports, the existing contracts, and we like to survey for ongoing work as well as work that has been completed, and we try to do likewise for other activities, both commercial and at other government agencies.

Mr. DINGELL. Are you telling me that Boeing was requested to make submissions with regard to their behavior in prior Federal contracts and apparently did not inform NASA about the problems that they had with the Defense Department with regard to the Defense Contract Audit Agency and other agencies that are inquiring into their performance?

Ms. LEE. On this particular evaluation, there wasn't a formal RFP out. The selection was made among the existing station prime contractors so it was based on a determination and finding which is a specific method that was notified so we didn't have a formal RFP out.

Mr. DINGELL. Are you telling me that you didn't inquire into the behavior of Boeing with regard to these matters or that you did? Or that you didn't do so very carefully? I am trying to understand what you are telling me because apparently Boeing didn't tell you because poor General Dailey is sitting down there and he doesn't know anything about these events.

Did you ask Boeing to tell you about these things or did you not? You appear to have a wonderful, trusting relationship with Boeing. I am impressed they must have done something to bring this kind of confidence on the part of NASA in Boeing into being because apparently you didn't inquire of Boeing when you put them in charge of this whole contract about their poor behavior in connection with other contracts.

What kind of an inquiry did you make with regard to Boeing when you put them in charge of these contracts?

Ms. LEE. This particular selection, which I believe we are going to go ahead and submit the analysis for the record, the prime emphasis was on the technical expertise, and, again, we were dealing with a small group of contractors, the prime contractors, so what we basically did was a comparative analysis.

Mr. DINGELL. What are you telling me, that you made the best pick of a sorry lot? You had four or five contractors and you obviously picked the best of the contractors. Did you pick Boeing because they were the best, or because you thought they were the best, or because you didn't bother to inquire? Why did you pick Boeing as the best?

General DAILEY. We will submit—

Ms. LEE. I believe we picked Boeing because we felt they had the most expertise on the Space Station.

Mr. DINGELL. You felt?

Ms. LEE. Had that expertise. That was a judgment and it was done by—

Mr. DINGELL. You are telling me you believed that?

Ms. LEE. Yes.

Mr. DINGELL. Did you have a reason for believing that?

General DAILEY. If you would like to pursue that we can bring Ms. Pam McInerney up to answer that; she is ready to lead us through the process.

Mr. DINGELL. I am content to let you do that if you want, General. Ms. Lee said she believed they were the best. I would just ask you on what basis did you believe they were the best? You know, I believe in the Holy Trinity, I never talked to any of them, never met the Holy Ghost, but I believe he is there. I don't know it but I believe it. I have great faith.

Apparently, you had great faith in Boeing. I get my great faith out of the scriptures. Where do you get your great faith in Boeing?

You say you had great faith in Boeing. You proceeded to put Boeing in as the prime contractor. They have demonstrated I think rather conclusively on the basis of the record here that they did not have a good cost containment record.

Other agencies, the Defense Department has eight ongoing criminal investigations, the Air Force has 13 criminal cases into the conduct of Boeing.

I am trying to find out what was the good information you got on Boeing that told you that Boeing people were the people that should handle the Space Station?

General DAILEY. That decision was based on the fact that Boeing had the responsibility for development of the core hardware for the station.

Mr. DINGELL. The responsibility for the element of core hardware?

General DAILEY. Yes.

Mr. DINGELL. That is wonderful. But what did they say about cost containment?

General DAILEY. The amount and complexities of integration necessary to provide the core hardware, past performance and demonstrated capability to produce or support the following Space Station program elements, pressurized elements, unpressurized elements, subsystems for human presence and others, logistics elements and analysis, and physical integration of experiments, capability to coordinate and integrate U.S. elements with those provided by international partners.

Mr. DINGELL. To give this to Boeing, you took it from another contractor?

General DAILEY. We took it away from several others, yes.

Mr. DINGELL. Four contractors. Now, Boeing in addition even pled guilty and had been suspended in the 1990's for contract irregularities. Were you aware of that?

General DAILEY. Yes, we were.

Mr. DINGELL. Well, what was it that caused Ms. Lee to have a belief that Boeing would do a good job here and that Boeing could control costs? Did you inquire into whether Boeing could control costs?

General DAILEY. The confidence that we had in Boeing was based upon their—

Mr. DINGELL. Pardon?

General DAILEY. The confidence we had in Boeing was based on their demonstrated performance in developing the elements that I mentioned before.

Mr. DINGELL. We have established that their demonstrated performance was—let me just quote. They had been rated unsatisfactory twice and poor the other two times on cost control.

Now, you said here, this, you said the very survival of the Space Station depends on how successful NASA and its contractors control and reduce costs proactively.

General DAILEY. And I—

Mr. DINGELL. Here you have yourself a contractor who has had all manner of difficulty with other agencies, including pleading guilty to criminal charges; unsatisfactory and poor two times each on cost control. What I am trying to find out is what is it that gives Ms. Lee and you, General Dailey, confidence that Boeing is going to be able to do these things for you in terms of containing costs which you tell us is so important that the entire survival of the Space Station depends on it.

What caused this confidence? What did you have in your files that says that Boeing has undergone a transformation which indicates they will deal honestly with the government and which indicates that Boeing is going to contain costs after a record of two reviews which say poor and two which say unsatisfactory?

What was it? There must have been something in your records that tells you that. Now please tell me what it was.

General DAILEY. It was the very fact that cost control is critical to the future of the Space Station. That is the—

Mr. DINGELL. And we are in cordial agreement. You are speaking to somebody who voted for this.

General DAILEY. I know.

Mr. DINGELL. I am beginning to wonder whether I should have voted for it; in fact, I am beginning to wonder if I ought to be attacking it.

I want to know what led you to believe that Boeing was the person or the corporation that should deal with this question. What of your records establishes that?

General DAILEY. Technical competence in their ability to build this system, their previous experience, and their realization that cost control is absolutely critical to the future of the station.

Mr. DINGELL. Aren't you saying you are taking this on faith, General, that they are going to—

General DAILEY. I think that is the case any time you let a contract.

Mr. DINGELL. Pardon?

General DAILEY. I think that is the case any time you let a contract, sir. You have to take it on faith that they can do what they propose.

Mr. DINGELL. I am asking you what it was in the records of your agency that justified the belief that Boeing was the best and that Boeing could meet the requirements?

Ms. Lee tells me you believe and I am a great believer, in belief. I think it is something we ought to believe. But belief requires faith and we should run the government on hard facts and I am trying to find out what hard facts did you have that justified this?

General DAILEY. Boeing is a very large corporation with a large commercial aircraft capability that is very successful and they have corporate capabilities that they can bring to bear to run programs. This is part of our discussion with them.

Mr. DINGELL. Their corporate ability they brought to bear had motivated NASA to find them poor and unsatisfactory in two instances each on four reviews.

Let me go on. Boeing just recently settled a mischarging case with the government for \$75 million involving other programs and the Space Station; and the press release says—this comes out of the U.S. Attorney's office—"Boeing Pays \$75 Million For Mischarging On Defense Contracts... the largest single monetary recovery in the history of the United States Attorney's Office for the Western District of Washington.

Such cost mischarging was particularly egregious in Boeing divisions that were exploring the application of Artificial Intelligence (AI) to computers. In the 1980's, Boeing aggressively pursued AI research and potential applications to space robots of the future, space station environmental systems, military aircraft command and control systems, and other computer applications."

Were you aware of this?

General DAILEY. We are now, yes, sir.

Mr. DINGELL. You are now? Were you at the time you awarded it to Boeing?

General DAILEY. I can't answer. I don't know whether we were or not. We received that information recently when it was released by Justice.

Mr. DINGELL. Did you have any personal awareness of it?

General DAILEY. I have no personal awareness of it.

Mr. DINGELL. You did not. Did anybody at the table have any awareness of this?

Ms. LEE. I was aware of several activities ongoing, just generally what was being discussed; I knew Justice Department was dealing with some activities.

Mr. DINGELL. Did you make any inquiry into it?

Ms. LEE. As far as this particular case, no; I just kept myself informed on that.

Mr. DINGELL. But you believed Boeing was the right contractor to do this work?

Ms. LEE. I personally did yes.

Mr. DINGELL. You personally believed it.

General, do you personally believe?

General DAILEY. Yes, sir, we as an agency—

Mr. DINGELL. I have asked you, Ms. Lee and you, General, to tell us about anything you had which would be of a factual character that would justify it. And here we have the regrettable situation where you and Ms. Lee both believe, but you have not got any hard data, and you keep having all these warnings coming in about Boeing.

Can you tell us on what basis the committee can make, come to this belief? There may be something out there that would justify me in having the same belief, or Mr. Schaefer.

Now, Mr. Schaefer is a much more charitable fellow than I so he will probably be easier to convince than I. But can you tell us anything?

General DAILEY. Sir, I think you have to have confidence in us that we can make this come in and bring the program in with the capabilities and with the money that is available to do it. We are committed to doing that and that is what we are here to tell you.

Mr. DINGELL. Well, now, General, the Defense Contract Audit Agency has questioned over \$100 million of the \$490 million that IBM submitted as a cost on the Space Station program. Are you aware of that?

General DAILEY. Yes, sir, we are.

Mr. DINGELL. What are you doing to collect that money?

General DAILEY. You want to go ahead and answer that, or Gene.

Mr. DINGELL. That is approximately 20 percent; 100 million out of 490 comes out to a shade more than 20 percent. What are you doing to collect that money?

Mr. EASLEY. I would like to answer that, Mr. Chairman.

When I became aware of it, there was, through the DCAA audit report where there was potential unallowable costs that a letter was sent from NASA to McDonnell Douglas, our prime contractor, IBM is a subcontractor, informing them that they are to make no more payments to that, to IBM, until it has all been resolved.

Mr. DINGELL. Have you withheld that money, then? When was the first money withheld?

Mr. EASLEY. To my knowledge no money has been withheld on the billable costs to date.

Mr. DINGELL. You say no money has been withheld. But you are paying them. You are not withholding. But if you are paying them you are not withholding, is that right?

Mr. EASLEY. That contract was terminated and there is a very low level of that activity going on at IBM, very few costs currently being incurred. There are some costs that have not been negotiated. It is undefinitized costs and there will be quite a bit of costs that IBM believes that McDonnell owes them and—

Mr. DINGELL. How much money are you withholding from IBM?

Mr. EASLEY. I don't have the specific number that IBM has not been reimbursed by McDonnell.

Mr. DINGELL. Well, will you look into it and inform the committee for inclusion in the record how much you are withholding from IBM?

Mr. EASLEY. Absolutely.

[The following information was received.]

As of June 26, 1994, NASA is withholding \$3.4 million from IBM. NASA is withholding an additional \$14.8 million from McDonnell Douglas.

Both companies also have pending fee claims which NASA has not yet analyzed. IBM is claiming \$6.3 million and McDonnell Douglas has claims totalling \$46.7 million.

Mr. DINGELL. I get the feeling you are not withholding much because you are telling us you have a low level of activity.

The sequence is you are paying McDonnell which is paying IBM, is that right?

Mr. EASLEY. We are not making any payments to McDonnell that relates to the IBM activity whatsoever.

Mr. DINGELL. Well, now, as I gather, McDonnell is in this portion of the contract the prime contractor, is that right?

Mr. EASLEY. That is correct.

Mr. DINGELL. IBM is a subsidiary contractor. Does the prime contractor have any responsibility or not? Is he able to say we got lots of money, fellows, have a good time? Or is he supposed to actually supervise expenditures as the agent of NASA?

Mr. EASLEY. Your latter point is correct. It is his subcontract and he is the responsible party to make sure it is all correct before the costs are billed to us.

General DAILEY. As you are aware, we are undergoing a termination. We have not received the final settlement proposal from McDonnell Douglas. We are making no further payments on this matter until it gets resolved.

Mr. DINGELL. Well, IBM has submitted their termination, is that correct?

Mr. EASLEY. Their termination proposal.

Mr. DINGELL. Okay. McDonnell Douglas has not, is that correct?

Mr. EASLEY. That is correct.

Mr. DINGELL. Why not?

Mr. EASLEY. McDonnell was waiting until they get the, all the termination activities from their subcontractors so they will be able to give us a better proposal.

Mr. DINGELL. Well—

Mr. EASLEY. All inclusive.

Mr. DINGELL. You are still paying McDonnell, is that correct?

Mr. EASLEY. No, sir. We have ceased payments to McDonnell on all activities.

Mr. DINGELL. You have ceased payments to McDonnell.

Mr. EASLEY. As relates to the Space Station Freedom contract.

Mr. DINGELL. How much is outstanding there?

Mr. EASLEY. I cannot give you a precise number. There are claims from some subcontractors that have not been paid that could come in.

Mr. DINGELL. So they are not paying their subcontractors?

Mr. EASLEY. There are some additional claims as a result of the termination that they—McDonnell in turn terminated a number of subcontractors.

Mr. DINGELL. Terminated a number of subcontractors?

Mr. EASLEY. They have terminated several subcontractors. McDonnell Douglas had a number under the Space Station Freedom program that had to be terminated.

Mr. DINGELL. I am trying to understand. McDonnell Douglas has been prime contractor. McDonnell Douglas has been making payments to IBM. McDonnell Douglas has made payments to other subcontractors. You are getting complaints about McDonnell Douglas terminating some subcontractors.

I am trying to understand, do you know what McDonnell Douglas is paying to whom for different portions of the contract that we are discussing?

Mr. EASLEY. I can certainly get you that information.

Mr. DINGELL. But you don't know it now?

Mr. EASLEY. We have incurred in total close to \$3 billion on that contract with McDonnell Douglas and somewhere on the order of half would be for subcontractors.

Mr. DINGELL. Can you tell us or can you, General, tell us today that McDonnell Douglas is making payments to the subcontractors according to the contract or that they are simply paying money?

Mr. EASLEY. Let me answer that, to my knowledge they are making payments in accordance with the terms of their subcontracts.

Mr. DINGELL. Do you know that? Have you had an audit that tells you they are doing that?

Mr. EASLEY. All our vouchers—we do not—

Mr. DINGELL. No, vouchers are nice, but when I submit a voucher I say I have done this and I sign my name. That is a voucher, right?

Mr. EASLEY. Yes.

Mr. DINGELL. So if people, for example, like Boeing have falsely billed, they submitted false vouchers, haven't they?

Mr. EASLEY. Correct.

Mr. DINGELL. DCAA caught them. You guys did not, did you?

Mr. EASLEY. Let me point out every voucher I have paid McDonnell Douglas has been provisionally approved by DCAA.

Mr. DINGELL. But they were paid before audit. What I am trying to say is there is a difference between an audit and a voucher.

Mr. EASLEY. That is correct.

Mr. DINGELL. An audit is where you validate, you certify the work has been correctly done and the amount is proper, is that correct?

Mr. EASLEY. Correct.

Mr. DINGELL. A voucher is somebody saying I did this and you pay them money, right?

Mr. EASLEY. Not unless it has been approved by DCAA. Every one of these to—

Mr. DINGELL. All of these were approved by DCAA?

Mr. EASLEY. To my knowledge all the money we paid McDonnell Douglas, the cost vouchers have been provisionally approved by the Defense Contract Audit Agency.

Mr. DINGELL. Have been provisionally approved?

Mr. EASLEY. Right.

Mr. DINGELL. There is an approval and provisionally approved approval? What is the difference?

Mr. EASLEY. The difference is that this—the provisional approval is what you need to make disbursements from the Federal Treasury. The final approval is after the contract work is complete or some segment in the process where DCAA has a final incurred cost audit to finally verify the costs previously provisionally approved were in fact correct or should be adjusted.

Mr. DINGELL. That has all been done?

Mr. EASLEY. The final incurred cost audit has not been done.

Mr. DINGELL. But the money has been paid?

Mr. EASLEY. The money has been paid up through a certain period of time.

Mr. DINGELL. It has been done at IBM, has it not? You paid IBM all except a few small items that have to be cleaned up according to what the General tells me.

Mr. EASLEY. There are quite a number of costs that IBM believes that is due them that has not been paid to them by McDonnell Douglas.

Mr. DINGELL. Would you want to debate that with the General because he told us there were only a few small items that have not been paid at IBM?

Mr. EASLEY. If you permit, Mr. Chairman, let me say there is a significant fee claim from McDonnell Douglas, and I am using the total cost in terms of cost and fee that is questionable whether or not the money will be fee bearing or not.

Mr. DINGELL. The basis of the audit, though, DCAA questioned \$107 of \$492 million. And what I am trying to figure out is how you are dealing with this matter.

Let's take a look at this. You are still paying McDonnell now through the new contract with Boeing and you paid them \$156 million to date.

Mr. EASLEY. Mr. Chairman, the Boeing contract is not the responsibility of the Johnson Space Center so—

Mr. DINGELL. General, can you tell us that? What I am trying to understand is you are still paying McDonnell Douglas. But you are paying them through Boeing now. You paid them \$156 million to date. What I am trying to understand is for what was that \$156 million paid?

Ms. McInerney, I guess I will have to swear you if you are going to testify. Do you have any objection to testifying under oath?

Ms. MCINERNEY. No, I don't.

Mr. DINGELL. Do you desire to be advised by counsel?

Ms. MCINERNEY. No.

Mr. DINGELL. I will inform you that copies of the rules of the House and the rules of the subcommittee are there on the table for your use.

[Witness Sworn.]

Mr. DINGELL. Would you give your name to the Reporter, please.

Ms. MCINERNEY. Pamela McInerney.

Mr. DINGELL. Mr. Reporter, would you read back the last question because this charming young lady is going to give us an answer.

[The Reporter read the record as requested.]

Ms. MCINERNEY. The dollar amount—

Mr. DINGELL. I am having a hard time hearing you.

Ms. MCINERNEY. Under the new Boeing contract, the letter contract was issued November 15, 1993, and at that time Boeing issued subcontracts to the other work package contractors. Initially, they supported transition activities down at the Space Station program office in Houston in order to transition from the old work package arrangements into the new single prime arrangement with the subcontractors.

On February 1, 1994, the letter contract was significantly modified to incorporate the hardware content associated with the formal work package contract. That is the hardware content that would be part of the forward going program.

So that \$150 million represents transition costs through February 1, and from February 1 to the current period it would rep-



resent the activities associated with the McDonnell Douglas portion of the forward going work under the Space Station program.

Mr. DINGELL. So I guess we can say simply that NASA is currently paying McDonnell Douglas, right?

Ms. MCINERNEY. That is correct. Through Boeing.

Mr. DINGELL. General Dailey, there is a criminal investigation regarding some \$20 to \$40 million that IBM has charged to the Space Station. Isn't that right? That is some of the \$107 million whose expenditure is questioned by DCAA. Isn't that right?

General DAILEY. I don't know what the amount is. I know there is an investigation under way but I don't have the details.

Mr. DINGELL. Well—

General DAILEY. I believe that is an ongoing investigation.

Mr. DINGELL. Beg your pardon? I know it is.

General DAILEY. We don't get that information when they are under way other than to be notified that—

Mr. DINGELL. Don't you think it would be useful if you did?

General DAILEY. Yes, sir but—

Mr. DINGELL. Then you wouldn't have to appear before some congressional subcommittee and say, we don't know anything about it. But it would be useful in your administration of the contract—

General DAILEY. It would.

Mr. DINGELL. [continuing] to know whether somebody is stealing from the till. Then poor Ms. Lee wouldn't have to come before us, Ms. Lee, and tell us what great people they are. We don't want that happening to her.

Now, is NASA currently negotiating a major contract with Boeing for Space Station Alpha?

General DAILEY. Yes, we are.

Mr. DINGELL. Now, we have got here a whole array of abuses found by the Department of Justice and by other Federal regulatory agencies and investigative agencies, including the Department of Defense.

Wouldn't it seem useful that NASA were to have some full and complete audits of Boeing's actual overhead submissions? Don't you need those so you can make a judgment? Here you have a company that ranks poor twice, unsatisfactory twice, is involved in a number of criminal prosecutions for serious misbehavior, and you don't have the vaguest idea of what is going on with regard to their overhead submissions because you haven't had any audits of the matter. Shouldn't you have some audits here, General?

General DAILEY. Yes, sir, but—

Mr. DINGELL. Pardon?

General DAILEY. But Boeing was prevented from providing that information at the request of the U.S. Government.

Mr. DINGELL. They were precluded from doing so because of previous bad conduct by Boeing.

General DAILEY. That is right.

Mr. DINGELL. But those criminal matters are now closed.

General DAILEY. Yes. They have provided some information. We have the 1993 overhead and the 1987, I believe, overhead costs.

Mr. DINGELL. Don't you think you ought to review the audit before you come in here and tell us they should be the people who should have this contract as the prime contractor? Poor Ms. Lee be-

believes they are the best but she does so without any audits on these matters.

General DAILEY. DCAA is currently auditing that information.

Mr. DINGELL. Well, why is it that the negotiations won't wait until after the audit is completed?

General DAILEY. I am not sure that it won't, but I don't know what the time frame is for the completion of the audit. We can get that information.

[The following information was received.]

The following represents the schedule agreed to by the government's Corporate Administrative Contracting Officer (CACO) and the Boeing Corporation for submission of Overhead Rate Packages to the government: FY 1986, Boeing submission September 1993, audit complete February 1994; FY 1987, Boeing submission January 1994, audit complete June 1994; FY 1988, Boeing submission September 1994, audit complete February 1995; FY 1989, Boeing submission January 1995, audit complete June 1995; FY 1990, Boeing submission September 1995, audit complete February 1996; FY 1991, Boeing submission January 1996, audit complete June 1996; FY 1992, Boeing submission September 1996, audit complete February 1997; and FY 1993, Boeing submission May 1994, audit complete October 1994.

Mr. DINGELL. Somebody else want to comment on that? Mr. Holz? Ms. Lee?

Here is where you are. You negotiate the contract and then you audit them. You might be saying, my word, how could we have ever done this—or maybe I should say, my word, how could you have ever done that. How could you ever have done this?

What I am saying is here you negotiate a contract but Ms. Lee tells us she believes they are the best people to do the work but they have not even been audited and you can't tell us anything in your record that would indicate to me that they have been behaving properly on these matters.

Ms. LEE. We are——

Mr. DINGELL. How are you telling us these are the best possible people? They are unaudited; your record of their behavior is bad.

Ms. LEE. We are negotiating cost reimbursement contracts so after the audit appropriate adjustments will be made and we will pay the right amount—so it is an estimating procedure as is forward pricing. We are using forward pricing rates to estimate the future rates that will be used to calculate the basis of that contract and those two after they are accumulated and become actuals and audited we make appropriate adjustments and pay only those allowable and applicable.

Mr. DINGELL. Here is where you are going to be, you are going to give them a contract you will audit in 4 or 5 years, you tell us, of the work done by the company, you are telling me that you believe this is the best company to do the work, then all of a sudden whenever the audits are completed you are going to find out—I won't say you are going to find out but I will say you might find out there are a whole mess of fresh new irregularities. Are you going to come back here under oath and tell me you still think they were the best choice?

Ms. LEE. I can't tell you at this time.

Mr. DINGELL. Well, can you tell us at this time? We have gone through this. You tell me you believed earlier, do you still believe they are the best people to get this work?

Ms. LEE. Yes, sir, I do.

Mr. DINGELL. You do. Do you have any sound basis on which you can tell the committee these are the best people to do the work?

Ms. LEE. My basis is mainly the discussions of their technical competence, knowledge of the Space Station. In order to be able to control costs and approach the business aspect, they have to have the technical competencies and those excellents—so I feel we have to have a contractor able to perform excellent in the technical arena and also bring in business management and cost controlling. They have to be coupled together and I think we have the best combination given the circumstances on this.

Mr. DINGELL. Am I in error in coming to the rather curious assumption that when one is going to select somebody they ought to audit first and negotiate second, rather than negotiate first and audit later?

Is there something wrong with my reasoning on that matter? You are negotiating with Boeing, you are going to audit them later. I am suggesting wouldn't it be a nice thing to try something innovative and audit first and negotiate later? Am I illogical in my approach to this thing?

Ms. LEE. No, sir.

Mr. DINGELL. What is wrong with my approach and why is it inferior to the approach you folks are taking at NASA?

Ms. LEE. It isn't. The current system that we do use in fact is used not only on these contracts but government-wide. You will see that as we negotiate, or as any other government agency basically, particularly on cost reimbursement contracts, what you negotiate is the forward pricing rates which are the best estimates and those are reviewed, et cetera, by DCAA. As mentioned to you earlier, they will go ahead and audit the forward pricing rates but then those rates as recommended by DCAA are what we used in the negotiation. But still because it is a cost reimbursement contract when DCAA does their second audit of actuals, we make additional adjustments. So we do use audited rates but they are forward pricing rates and then we subsequently use again the audited rates based on the actuals incurred based on after the fact data. So we use both.

Mr. DINGELL. How are you going to do accurate forward pricing if you don't know the overhead?

Ms. LEE. We get the forward pricing rates from DCAA.

Mr. DINGELL. Beg your pardon?

Ms. LEE. DCAA did that review and they recommended forward pricing.

Mr. DINGELL. DCAA has not audited since 1986.

Ms. LEE. They will continue and they are now auditing those actuals for those periods and they also, the contractor submits to them projections including overhead projections in their base, the business base, and from that we establish forward pricing rates.

Mr. DINGELL. DCAA has not completed the audits. Contractor statements of overhead and costs have proven to be egregiously bad, and you folks down there at NASA have said that 2 years they were poor and 2 years they were unsatisfactory. That is 4 out of 4. I am trying to understand how you are going to get any intelligent adjustment as to forward pricing until you know the overhead and how are you going to get that until you have done the

audit to find out how they have complied with the prior requirements.

Ms. LEE. DCAA is currently auditing those rates, both the forward pricing rates and the overhead rates for those past years. We are working with DCAA to get that data. In fact, we work with them many times on verbal and information and they give us and keep us updated on how it is progressing. So we are working with them on both ends, the forward pricing rates and the preestablished overhead rates for the past years.

Mr. DINGELL. Will the audits be done before the negotiations are done?

Ms. LEE. The work will be well under way. I would guess the final published audit probably won't be out, but they give us information and say, here is what is going to be and here is what we are finding, and they give us recommendations many times as the audits are ongoing. But as far as a final published audit in each case, it probably won't be completed by then.

Mr. DINGELL. How important are the submissions that the company is going to be making to you? Are they going to give you as much information, more information, or less information than DCAA is going to give you?

Ms. LEE. They generally will give us and propose the rates they have proposed to DCAA and they will tell us they are either approved DCAA rates and we are using the approved rates or these are the rates submitted to DCAA for audit. They will tell us where they are and what the status of the rates are for each of the years and then we act accordingly.

Mr. DINGELL. Now, will the information that will be submitted to NASA by Boeing be sufficient to, all by itself, to negotiate a contract with Boeing?

Ms. LEE. I hesitate—not all by itself because we will take that information and validate based on DCAA's knowledge and use DCAA recommendations in the rate activity.

Mr. DINGELL. Against what are you going to validate the information that will be submitted to you by DCAA?

Ms. LEE. Against their own audit. DCAA is our auditor. When they give us a finding, we generally accept their finding and that it is, in fact, an audited rate.

Mr. DINGELL. You are not going to have complete audits and you tell me that you are going to validate those audits against something else. I am trying to understand against what else are you going to validate the audits that will be performed by DCAA.

Ms. LEE. We will validate the information the contractor gives us with DCAA. So if the contractor comes in and says, my overhead rate is 92 percent, and for this year or whatever, we will go to DCAA and say, is that the rate you have recommended, and then they will tell us, yes or no. And what they have recommended. That recommendation, recommended rate from DCAA is based on their DCAA's audit of the contractors' information.

Mr. DINGELL. How am I to assume you will have enough information to negotiate a good contract? With Boeing on this matter? You are getting incomplete audit information, you are getting Boeing's submissions, and how are you going to know this before you examine, for example, allowables, the question of what is al-

lowable, what is allocable and what is reasonable? You got to do those three things. How are you going to do that?

Ms. LEE. DCAA and NASA work as a partnership and DCAA actually does the audit work. In fact, we reimburse them for that work. They perform—performed the audit and once they perform the audit we accept their recommendations. We, NASA, do not do a subsequent audit. That is to try and save government money and time.

The contractors' rates are only audited one time by DCAA and then we, the remaining government agencies, use that rate and that audit as the basis of their actions. So we don't have NASA and DCAA and Department of Defense all auditing the same rates. DCAA is the auditor.

Mr. DINGELL. I want to pursue this in a bit, Ms. Lee. I have to go to the Floor. There is another vote. We will reconvene in 15 minutes.

[Brief recess.]

Mr. DINGELL. The subcommittee will come to order. General Dailey, we have talked about a number of matters that have gone on in connection with this contract with regard to the Space Station with which you and Ms. Lee and Mr. Easley and the others there were unfamiliar.

Do you think you ought to go forward with this contract with Boeing before you have the answers to the questions and have the information that you need?

General DAILEY. I believe that the process that we have under way will not proceed at a rate faster than we have the necessary information to negotiate a contract with Boeing.

Mr. DINGELL. So you are saying you should go forward with the contract without having the answers to the questions?

General DAILEY. It may be that we go forward without all the answers. The other factor here is that we are operating off a letter contract and are trying to get a definitized signed contract with our prime contractor so that we can start fixing those costs and get increased control over the program and that is a very serious consideration at this point because of the funds that are involved.

Mr. DINGELL. You are telling us that you have come to the conclusion that you have made the best judgment you can?

General DAILEY. Yes, sir.

Mr. DINGELL. Do you feel that the other information discussed today or that has become available as a result of the DCAA audit indicates that it is something you ought not pay any particular heed to?

General DAILEY. No, sir, not at all. In my comment, I said that not only do we accept the recommendations of the DCAA audit, but we are, in fact, incorporating the recommendations, and that is the case with the other audits performed by GAO and the IG.

Mr. DINGELL. What about the civil and criminal problems that Boeing has had with the Justice Department?

General DAILEY. Boeing has not been declared an unqualified bidder.

Mr. DINGELL. They were suspended once. Am I to assume they were suspended for their good character or were they suspended for a different reason?

General DAILEY. No, sir. They are not suspended now. They are a qualified contractor that we are in negotiations with.

Mr. DINGELL. I will not say that they are not qualified to bid. I think that we are a long way from establishing that you have any information in your files which would justify selection of anybody at this time.

I have asked Ms. Lee that and I have asked you that and neither of you have been able to come forward with suggestions to us as to what that might be.

General DAILEY. The information that I gave, sir, I believe is very important, and that is their technical competence to bring expertise to bear in the financial management area. This hearing is focusing on the financial management aspect and that is a critical aspect of this program, as the chairman has noted.

But financial management is one factor. Technical competence is also a critical factor. We must have a contractor that can do the job. Under the previous arrangement, NASA was the integration contractor. We didn't have a single prime.

In this case now, we have Boeing and that is the reason we want them as our prime contractor is to provide the integration function for the Space Station. This is a critical aspect of the development. So financial management is a critical portion of this entire operation. It is one that is going to bring us the visibility that could be very detrimental to the program if we don't have it under control, but it was a careful consideration that we made in the selection process of Boeing along with all the other capabilities that they have.

In our discussions with them and with their leadership, we are convinced that they are going to bring the necessary controls in place to control costs.

Another important factor in the previous Space Station program that led to cost growth was the lack of control of changes and configuration modifications to the program. The thing that we have in place now with our new management structure is a much more rigorous process by which changes will be approved.

Mr. DINGELL. Of course, your new management structure is not yet in place either.

General DAILEY. It is in place. As a matter of fact, they have central responsibility in this case to make sure that we do have the financial management controls and they are a critical part of it.

As I mentioned, we have many of them with us here today participating in this hearing as part of their awareness and training to—

Mr. DINGELL. We will try to assist them in their continued awareness of these matters. As a matter of fact, your staff suggested we should visit with you again in 6 months so you should get your calendar set to get together some time early in March next year. That will be about as soon as I can get the subcommittee constituted.

The Chair's time has expired. The Chair recognizes the gentleman from Colorado.

Mr. SCHAEFER. I want to move off Boeing for a moment and go back to IBM.

Gentlemen and Ms. Lee, the chairman asked you what effort you were making to get back \$100 million from IBM. You stated you were authorized to withhold payments. However, you told us that due to the low level of activity, no payments were being made. So what efforts are you making to reclaim the \$100 million in question?

Ms. LEE. Right now, those costs are our questioned costs. There will be a final audit. DCAA will determine—if they are determined to be unallowable costs, we will disallow them which means that IBM will, through their prime, refund the money. So if they are determined to be unallowable costs, we will recoup the funds.

Mr. SCHAEFER. You don't anticipate any problems from IBM in returning the funds if they are not actual costs?

Ms. LEE. No, I don't.

Mr. SCHAEFER. I have a fax that came from you Mr. Easley dated July 25, 1994. Without going through the whole thing, it basically is saying we are unable to obtain any IBM data. The subcontractor was novated to Boeing under SSPO in February 1994 and neither the MCDAC officials who were prime to IBM or Loral officials who acquired the IBM Division were able to provide the data.

The question is—and this is rather distressing to me as I know it is to other members of the committee—but the fact that IBM refused to provide DCAA with information about their management costs, bonuses, award fees, et cetera—I know that IBM sold that division to Loral.

Do you intend to talk to Loral to ensure that this information is going to be provided to the DCAA?

Mr. EASLEY. Absolutely. The only piece of information that has not been received, to my knowledge, is the executive bonus fees. The other types of award fees and costs and things of that nature, to my knowledge, they had access to.

Mr. SCHAEFER. It says, "Any IBM data here as of July 25." It says "any." This was Monday. This is R.E. Easley.

Mr. EASLEY. That was the data relating—this was a response back to Mr. Dingell's staff that they had asked us last week to get the executive bonuses on all attendees' companies. We responded this week with nine and Loral, IBM refused to give the information regarding the executive bonuses, but we are going to pursue that through proper channels to obtain it.

Mr. SCHAEFER. What is the proper channel?

Mr. EASLEY. Pursuing it through their corporate office. There is a government official there who is called the Administrative Contracting Officer for the Federal Government. There is a person at IBM, but Loral has acquired that particular division, so we will walk it through the cognizant Administrative Contracting Officer, which in this case will now be at the Loral headquarters.

[The following information was received.]

**LORAL**

Space Information Systems

Marina Plaza, Suite 500  
 2450 South Shore Blvd  
 P O Box 58487  
 Houston, TX 77058  
 (713) 335-5001  
 Fax: (713) 335-5010

Clint H. Denny  
 President

August 3, 1994

TO: R. E. Easley, NASA  
 FROM: C. H. Denny, Loral Space Information Systems

The following additional information is being provided that addresses IBM Federal Systems Division-Houston employees. This data was supplied by the Federal Systems Group office which was responsible for executive compensation under IBM. These payments reflect year-end bonuses earned prior to the sale of Federal Systems to Loral. Also, please note that IBM used a calendar year performance period.

If you need further information, please advise.

CY 1993		CY 1992		CY 1991	
Number	\$\$\$	Number	\$\$\$	Number	\$\$\$
1	28,085	1	50,666	1	13,440
2	15,570				
2	13,840				
3	12,110				
5	10,380				
<hr/>		<hr/>		<hr/>	
TOTAL	175,135	1	50,666	1	13,440



Mr. SCHAEFER. If there are problems with the billing, as Ms. Lee indicated, you expect that you are going to get refunds. Would you get the refunds from IBM or Loral?

Mr. EASLEY. As far as I am concerned, from McDonnell Douglas. That is our prime contractor. If they are determined to be unallowable costs, they will have to pursue the recovery with Loral or IBM.

While the acquisition has taken place, I am not sure all the paperwork has yet been finalized between Loral and IBM, but I don't expect any problem with regard to that nature.

Mr. SCHAEFER. Is there any problem withholding the money going to McDonnell Douglas for bonuses until we get this data?

Mr. EASLEY. The bonuses that will be reimbursed to Loral?

Mr. SCHAEFER. Right.

Mr. EASLEY. No, there will be no problem doing that.

Mr. SCHAEFER. Why don't we do that until we get the proper data?

Mr. EASLEY. We have ceased payments on the McDonnell contract also.

Mr. SCHAEFER. That is not the question, sir.

Mr. EASLEY. We make payments for Loral through McDonnell Douglas.

Mr. SCHAEFER. So why make those until we get the proper data?

Mr. EASLEY. We can certainly do that, but I may add, Mr. Schaefer, since that contract with McDonnell Douglas has been terminated, we are not paying any vouchers to McDonnell Douglas subsequent to last month. So the issue would be do we pursue a recovery?

Mr. SCHAEFER. You are paying them through Boeing; right?

Mr. EASLEY. A separate contract by the Space Station Alpha Program Office which is a separate contractual arrangement with Boeing, not my responsibility.

Ms. MCINERNEY. Under the current Boeing contract, the letter contract on the Space Station Program Office, McDonnell Douglas is a first-tier subcontractor. IBM, through Loral, is not a subcontractor to McDonnell Douglas. That effort was deleted out of the work package to contract in October and it was not carried forward in the new program. The reason it was deleted, it was based on simplification of the DMS architecture.

Mr. SCHAEFER. I understand that, but we are talking about getting money back that has already been spent.

Ms. MCINERNEY. I understand.

Mr. SCHAEFER. So, therefore, who do we go to and how do we put the pressure on to get that money back for the taxpayers?

Ms. MCINERNEY. In this case, I would assume we would go through McDonnell Douglas, because it is under the Work Package 2 arena. We would not go to Boeing because Boeing does not have responsibility for the past liabilities on the Freedom program.

Mr. SCHAEFER. Have we gone to McDonnell Douglas?

Ms. MCINERNEY. I can't address that.

Mr. EASLEY. As far as recovering the IBM bonuses, the answer to that is no.

Mr. SCHAEFER. Why not?

Mr. EASLEY. I just found out—first of all, I just found out recently where the data from IBM had not been provided to the

DCAA. I don't know if the costs for the bonuses may or may not be appropriate, but I will take action to recover that.

Mr. SCHAEFER. I think, and would hope that NASA does, too, that it is a shocking display of arrogance for a contractor to refuse to provide to the government auditors data about what the government's own money has been buying.

Response?

Mr. EASLEY. I agree.

Mr. SCHAEFER. Well, we have been talking about this, what possibly can be done, and I would hope that NASA does intend to move forcefully to recover the monies that we have out there.

Do you agree?

Mr. EASLEY. Absolutely.

General DAILEY. We are going to do it. We found out very recently that this had not been recovered and we will take the action to get it back.

Mr. SCHAEFER. Why were you the last to know on this?

General DAILEY. My comment that I made about the fact that we need to have a closer working relationship with DCAA and our other audit agencies, that was one of the examples that I had in mind.

Mr. DINGELL. Would the gentleman yield?

Mr. Easley, the DCAA turned over its report on this matter with regard to withholding of the information by IBM in March. You, in response to a question from my good friend from Colorado, said you had just gotten that information and this is now nearly August.

March was 4 or 5 months ago. You just became aware of it or it was just turned over?

Mr. EASLEY. The March report was a draft report. Just a week or so ago, the final report was issued. The DCAA came to me during the process of the audit and asked my assistance to get a piece of information—I had never been asked to go assist them—related to another company.

Mr. DINGELL. Do you read these drafts when you get them?

Mr. EASLEY. Yes, sir.

Mr. DINGELL. Well, the original date is 7 March 1994, "Report On Audits Of The Budgeting And Financial Control Systems, NASA Johnson Space Center Major Contractors, Houston, Texas."

Without objection, this will be put in the record.

[The following information was received.]

DRAFT

21 June  
~~March~~ 1994AUDIT REPORT NO.  
3521-93D11020004  
TRON NO.REPORT ON AUDITS OF THE  
BUDGETING AND FINANCIAL CONTROL SYSTEMS  
NASA JOHNSON SPACE CENTER MAJOR CONTRACTORS  
HOUSTON, TEXAS

Under the provisions of Title 32, Code of Federal Regulations, Part 290.26(b)(2), any Freedom of Information Act requests for audit reports received by DCAA will be referred to the cognizant contracting agency for determination as to releasability and a direct response to the requester.

Contractor information contained in this audit report may be proprietary. The restrictions of 18 USC 1905 should be considered before this information is released to the public.

This report may not be released to any Federal agency outside the Department of Defense without the approval of Headquarters, DCAA, except to an agency requesting the report in negotiation or administering its contract.

CENTRAL REGION  
DEFENSE CONTRACT AUDIT AGENCY  
HOUSTON BRANCH OFFICE  
HOUSTON, TEXAS

FOR OFFICIAL USE ONLY

SUBJECT: Report on Audits of the  
Budgeting and Financial  
Control Systems  
NASA Johnson Space Center  
Major Contractors  
Houston, Texas

TO: Dr. Robert Easley  
Director of Procurement  
NASA, Johnson Space Center  
Mail Code BB  
Houston, Texas 77058

### 1. Purpose of Audit

As part of our comprehensive audit of contractors at the NASA Johnson Space Center, Houston, Texas, we reviewed the Budgeting and Financial Control systems of ten major NASA contractors. We performed these reviews to evaluate the policies, procedures, and practices for assuring the effectiveness of overall controls of Government contract costs. Our audits were conducted from 1 July 1993 through 30 September 1993 and covered contractor operations for the fiscal year ended 31 December 1992.

Our primary objective in reviewing these budgetary systems was to establish that sound budgetary systems are operating for each company's planning and cost control purposes. Additional objectives were to determine whether:

- a. Costs estimated and/or incurred for government work are developed, recorded, and controlled on a consistent basis with management's most recent and probable plans.
- b. Direct and indirect costs for government contracts are estimated and performed efficiently and economically.
- c. Any significant changes in the contractor's plans and circumstances are promptly reflected through controlled and documented revisions to budgets and estimates to complete.
- d. Reports to the Government on performance of contract effort are consistent with the contractor's latest budgetary data.

We conducted our audit in accordance with generally accepted government standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the data and records reviewed are free of misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records reviewed. An audit also includes assessing the accounting principles used and significant estimates made by the contractors, as well as evaluating the overall data and records presentation. We believe our audit provides a reasonable basis for our opinion.

### 2. Scope of Audit

To accomplish our objective and provide the maximum coverage of the NASA major contractors, we identified ten contracts which represent the most significant Government dollars as a basis for our review of these budgetary

systems and financial controls. The specific contracts and other pertinent related data are presented below:

<u>CONTRACTOR</u>	<u>CONTRACT NO.</u>	<u>CONTRACT TYPE</u>	<u>PROJECT NAME</u>	<u>DATE OF 533</u>
IBM	87916006 (Prime NAS9-18200)	CPAF/LOE	Freedom WP-2	March 1993
Paramax	J8L4XCL-483201-H (Prime NAS9-18000)	CPAF/LOE	STSOC	July 1993
MDSSC	NAS9-18200	CPAF/LOE	Freedom WP-2	Aug. 1993
Bendix	J6L4XCG-485222-M (Prime NAS9-18000)	CPAF/LOE	STSOC	June 1993
LESC	NAS9-17900	CPAF/LOE	ESC	May 1993
Barrios	JOW4XXL-483210G (Prime NAS9-18344)	CPAF/LOE	OSC	June 1993
Loral	NAS9-18300 NAS9-18280	CPAF/LOE CPAF/LOE	MSC SRM&QA	Aug. 1993 Aug. 1993
Rockwell	NAS9-18000	CPAF/LOE	STSOC	Jan. 1993
CAR Link	NAS9-18181	CPAF/LOE	TSC	June 1993
Boeing	NAS9-17540	CPAF/LOE	FEPC	July 1993

Although the extent and depth of these audits varied depending upon the contractor size, amount of government business, and audit risk, in general the audit scope included reviewing the accuracy of budget preparation, testing assumptions used in developing the budget, and assessing the reasonableness of explanations in management reports for budget variances. In essence, are sound budgetary systems in existence within these NASA contractor organizations, and are these budgetary systems operating effectively as managerial tools to produce maximum efficiency and economy of operations? Generally, the audit scope was designed to determine the following:

- a. Do the contractors have functional organizations for preparing realistic budgets with written procedures prescribing the necessary mechanics, documentation, and controls?
- b. Are these procedures used to forecast the company's business volume and are estimates based on logical assumptions and reliable information?
- c. Do budgetary systems provide for a quantitative expression of management plans and define what is expected of each member of management at every level responsible for cost control?
- d. Is there an actual need for each function budgeted and is the projected cost level reasonable?
- e. Do the systems provide for advance notice of budget plan changes which may affect future workload and resources, such as increases/decreases in plant population, asset acquisitions and dispositions, and physical moves?
- f. Do budgetary systems include adequate cost monitoring techniques such as adequate benchmarks for determining direct and indirect staffing levels, guidelines for evaluating indirect cost projections, and requirements for performing adequate facility studies?

g. Do the contractors effectively control costs by verifying that management compares budgeted to actual costs, significant variances are noted, analyzed, and explanations are documented?

Specifically, our scope of audit attempted to determine how pro-active the contractors are in trying to control and reduce costs on the NASA programs. The contractor policies, procedures, and practices were reviewed to determine the following:

- a. Whether or not the contractor had detailed budgets established for its specific worktasks.
- b. Whether or not these contractors perform detailed cost analysis on specific worktasks which would indicate whether or not the contractors are pro-active and involved in the management of its costs.
- c. Whether or not these contractors reported accurate and complete information on its NASA Form 533 cost projections. Do the contractor's internal budgets and cost analysis compare to the information as reported to the Government?
- d. Whether these contractors had performed any recent internal reviews of (i) direct to indirect staffing requirements, (ii) utilization of facilities, and, (iii) utilization of equipment for the specific NASA contracts and programs. Are these contractors pro-active in the management of costs?

### 3. Background

The NASA Johnson Space Center (JSC) in Houston, Texas, already the Mission Control Center for the Space Shuttle flights, has recently been named the host NASA center for the Space Station Freedom effort with Boeing Corporation as the prime contractor. In addition to this effort, NASA JSC contracts include research and development type contracts, engineering design and/or maintenance and support contracts, logistic support contracts for other NASA programs, and contracts for the NASA JSC operations and functions which support NASA's mission and programs such as security and quality assurance.

To provide NASA management with a more effective evaluation of contractor cost performance, NASA designed and implemented the use of the NASA Contractor Financial Management Reporting System or NASA 533 reports. This NASA Form 533 report, a contractual reporting requirement by NASA on a monthly and/or quarterly basis is applicable to all NASA cost-type, price determination and fix-priced incentive contracts. These reports, along with the other required technical and schedule reports, are to provide NASA Project Managers necessary data for evaluating contractor cost performance. Specifically, the NASA Form 533 provides the following data to management:

- 0 An Estimate Cost/Hours-to-Complete or a projection of hours and costs which realistically supports the schedule of contract effort.
- 0 Cost Incurred/Hours Worked which reflect the contractor cost and technical performance on a monthly basis and cumulative basis.
- 0 A contractor's Estimated Final Cost/Hours which is to provide NASA management data for the estimate of cost/hours at contract completion.

Procedures for completion of the NASA Form 533 are contained in the NASA handbook, NHB 9501.2B. This Handbook, published in February 1985, is provided to all NASA project managers and contractors for the administration of the Contractor Financial Management Reporting System. Contractual data is submitted in a standard format, both summarized and detailed by WBS, for most contracts and is used by NASA to plan, monitor, and control the resources available through its awarded contracts.

Therefore, our budgetary review utilized this document, NASA Form 533 report, in performing our review of the contractor's budget. According to the policies, procedures, and instructions contained in this Handbook, the primary source of monitoring contractor performance is the NASA Form 533 report which must be correlated with required technical and schedule reports. It is also used by NASA for establishing the basis for the Agency's accrued revenue and expenditure accounting system. This is the fundamental reason for assuring that each contractor has an adequate budgetary system within its organization and that it is operating effectively and efficiently. Without adequate budgetary systems, contractor performance cannot be accurately determined nor NASA's mission be accomplished in the most efficient, effective, and successful manner.

#### 4. Summary of Audit Results

a. In our opinion, Contractor Financial Management Reports (Form 533) being prepared by the major contractors for submission to NASA for contract progress do not properly reflect costs needed for contract completion. This problem is a direct result of inadequate contractor involvement in the management of the costs needed to perform and complete NASA contracts.

Since the start of our audit significant changes have taken place concerning the restructuring of the Space Station and Space Shuttle programs. All Space Station work packages are being novated into one contract which will be managed by Boeing as the Prime contractor. This new contract is to be definitized by 31 August 1994. IBM, a major subcontractor to McDonnell Douglas under its (WPO2) workpackage, had its subcontract terminated in November 1993. Also, IBM announced in December 1993 that it sold its Federal Systems Division to Loral Corporation.

Based on this restructuring of the Space Station Program, funding and requirements for McDonnell Douglas, Rocketdyne (Rockwell), Lockheed and other subcontractors has been significantly reduced. This condition makes it critical that these contractors immediately review their staffing, equipment and facilities utilization in order to prevent excess and unreasonable costs from being incurred and billed to the Government due to these ongoing changes. It is also critical that these contractors develop systems which will enable them to monitor costs incurred, project accurate estimates to complete and be more involved in cost avoidance and worktask efficiency analysis.

To further emphasize the necessity for contractor pro-active management of contract cost, one must also consider the Government's expense for paid management cost, bonuses, and fees. The Government recognizes that contractors should be adequately compensated for their management expertise and realize a profit. By the same token, there must be a corresponding benefit received by the Government and evidenced by incentives for the control of cost within the contractor's organization. For without adequate control of contract cost, the incurred management costs, plus awards such as bonuses and fees, are not properly justified. Exhibit B illustrates an approximate level of annualized expense paid by the Government for this management knowledge and associated bonuses and profits.

On December 1-2, 1993, members of the cost proposal community representing NASA, DCAA, Rocketdyne (Rockwell) McDonnell Douglas and Boeing met to discuss an acceptable approach and plan for developing the Space Station Alpha Tier I cost proposal. One of the objectives was to establish a program baseline based on a detailed Work Breakdown Structure (WBS). Once the baseline and WBS's are established and agreed to, each contractor and subcontractor involved should adapt its system to monitor its costs and project accurate estimates to complete around the specific baseline structure. Establishing this objective is only the first of several solutions to correct major system deficiencies noted in our review and summarized below. The specific contractor budgetary deficiencies are summarized below, illustrated in Exhibit A, and detailed in the separately issued audit reports included as enclosures to this report:

MAJOR CONDITIONS

- (1) Contractors have inadequate detailed budgets and contract baselines to enable them to determine an accurate percentage of completion and project an accurate estimate to complete.
- (2) Contract baseline costs are constantly changed to reflect actual costs
- (3) There is little evidence of contractor cost analysis of budgetary variances and involvement to reduce or control cost growth.
- (4) Certain costs are incurred prior to the work being contractually authorized and adequately baselined.
- (5) Contractors expect to be automatically reimbursed for all costs it incurs because of the cost type contract environment at NASA.

b. Within each of the enclosed audit reports, specific contractor system deficiencies and recommendations are discussed in detail in the "Statement of Condition and Recommendation" appendices. However, we also want to emphasize needed overall system recommendations as follows:

COMPOSITE RECOMMENDATIONS

- (1) All contractors should establish detailed budgets and baselines from which to monitor and control costs.
- (2) These baselines should not be constantly changed to reflect actual costs. The baseline costs should only be changed if the specific contract scope of work is changed and contractually modified.
- (3) Cost growth should be proposed by the contractor and authorized under the contract prior to the incurrence by the contractor. Cost growth proposals should be based on the detailed budget analysis by contractors which adequately supports the need for additional funds.
- (4) The contractor needs to become more involved in the efficient management of its worktasks and in efforts to reduce or prevent costs and correct inefficiencies before costs are incurred. These efforts should be documented in the contractor's budgetary analysis process.
- (5) All contractors should perform an accurate percentage of completion and estimate to complete for each major work task performed. The estimate to complete is not the difference between incurred costs and contract target costs.
- (6) Contractors should provide NASA with specific schedules as to what it plans to review internally in regards to :
  - (a) indirect and direct staffing functions and processes
  - (b) utilization of equipment
  - (c) utilization of facilities
 The specific results of these reviews should be provided as well as corrective action plans and cost avoidance details.
- (7) The lead contractors for the Space Station Program (Boeing Corporation) and for the Space Shuttle Operations (Rockwell) should be made accountable for the accuracy of the 533 data. These contractors should be tasked by NASA to ensure that the contractors working under them are reporting accurate cost data and are actively involved in monitoring their contract performance and in controlling cost growth on these major NASA programs.
- (8) Contractors should establish specific goals each year as to contract performance and cost reduction objectives. Bonuses should



reflect the accomplishment of these specific goals. Bonuses should not be based on predetermined percentages based on employees just "showing up" for work.

(9) Each contractor should establish an account to accumulate idle or free time. A specific definition as to what constitutes idle or free time should be established by NASA and given to each contractor. Idle or free time can then be measured periodically to determine if it is reasonable or excessive.

#### CONTRACTOR'S SUMMARIZED REACTIONS

Because Boeing Aerospace Corporation was recently awarded the prime contract for the newly revamped Space Station, we specifically requested Boeing respond to our composite recommendations addressed in the body of this report. Boeing's response to this request is included below and corresponds to the above numbered recommendations. The formal written response is included as Attachment A to Enclosure 10.

- (1) BAO agrees and does provide NASA a detailed budget and baseline established to monitor and control costs.
- (2) BAO agrees that the baseline budgets should not change unless a specific contract scope of work is changed and contractually modified. Estimates to complete should change whether a task is added below the threshold amount which requires no contract modification or over the threshold amount which does require a contract modification.
- (3) The contractor agrees that cost growth should be proposed and authorized under the contract prior to any cost incurrence by the contractor. BAO currently works under this methodology.
- (4) BAO agrees that cost efficiencies and the correction of inefficiencies should be put in place prior to incurrence of costs. However, costs associated with preparing documentation in our budgetary analyses process may offset any benefit received; this must be considered.
- (5) If NASA feels that performing a Percentage-Of-Completion for each major work task performed would be beneficial, BAO would comply. However, cost associated with preparing a Percentage-Of-Completion and estimate to complete for each major work task may offset any benefit received; this must be considered.
- (6) If NASA feels that specific schedules as to what it plans to review internally in regards to (a) indirect and direct staffing functions and processes, (b) utilization of equipment, and (c) utilization of facilities would be beneficial, BAO would comply. Presently, FEPC has no contract requirement to provide reviews. Also, the costs associated with preparing these schedules and reviews may offset any benefit received; this must be considered.
- (7) This comment is not addressed to the FEPC.
- (8) BAO does establish goals each fiscal year as to contract performance and cost reduction objectives. Boeing currently does not provide bonuses to employees on FEPC.
- (9) If NASA feels that accumulating idle time would be beneficial, BAO would comply. Idle time, as BAO understands the definition in this audit report, means any down time of a task/area that results from some impact to the program. Down time meaning that employees cannot work on the task/area that was impacted and could not work on any other task/area of the program. The FEPC program does not experience down time under this definition. Currently, there is not a contract requirement to do so.

In addition, each contractor was presented the specific conditions and recommendations applicable to their organization and requested to submit a formal written response. These written responses are included and identified as an "Attachment A" to the applicable audit report enclosure.

#### AUDITOR'S COMMENTS

It is the intent of this audit that all contractor's have policies and procedures which would ensure that NASA 533 reports are being consistently and accurately prepared. While most of the contractors concurred in general with the above audit objective, the new space station contract gives contractor's the opportunity to strengthen their respective budgetary systems and establish work order baselines from which to monitor, review, and report costs. In fact, the new International Space Station proposal is being priced and put together based on an extensive work breakdown structure (WBS) from which to accumulate, monitor and report costs. This preaward process can have a major impact on future surveillance activities. The WBS established during preaward impacts application of the criteria, baselines management, estimates at completion, as well as analysis. A successful preaward process can be ensured when solicitation and contract requirements are structured to the needs of the program. Each contractor should submit a written summary of the management procedures it will establish, maintain and use in the performance of the contract.

Contractors should establish detailed baselines from their participation in each WBS, perform accurate estimates to complete based on a documented percentage of completion analysis, and report this progress accurately on their respective NASA 533's. Milestones must measure accomplishment of work necessary for program completion and not merely the passage of time. For example, the completion of monthly or quarterly program or staff meetings would not be considered milestones which demonstrate work accomplishment. Completion of critical design reviews or configuration audits would be measures of work accomplished.

Furthermore, breaking down of a task into smaller milestones whose budgets are objectively determined would be an acceptable earned value technique. The assumption is that percent complete methods must be objective. For example, a supervisor's monthly best guess of a percent complete would not be an acceptable earned value technique. However, a monthly calculation of percent complete based upon preset values for assessing progress in accomplishing a task is an acceptable earned value technique. The key question to ask is, "Do the techniques being used provide the best available measurement for determining objective accomplishments?"

Most contractors with Level of Effort (LOE) type contracts believe they should be excluded from doing an acceptable earned value technique. These contractors indicated that estimate to complete is merely the difference between negotiated budgeted hours and actual hours incurred. The budgeted hours are established at the beginning of the fiscal year based on the contractor's annual operation plan. These contractors stated that NASA controlled the hours after the establishment of the annual operating plan and they merely did what they are told to do. Certain contractors also felt that it is cost prohibitive to do acceptable earned value techniques, and the budget baseline is the object of misunderstanding between team members and therefore, variances are reported and analyzed at a top contract level.

It is the opinion of DCAA that the LOE contract method merely accumulates budgeted cost of work performed based on the passage of time. It is the least effective and desired of all earned value techniques. LOE work packages show no schedule variances and true program variances are masked as data is summarized to higher levels of the work breakdown structure. The LOE method should be used only for certain fixed levels of program support such as a program manager, contract manager, or technical manager. Other activities should be either discretely measured or apportioned to the effort they support. If the contractor and NASA technical take the time to negotiate hours for specific work tasks under LOE contracts, why shouldn't the contractor be held accountable for the baseline and do an accurate

estimate to complete and earned value analysis on the progress of that work task? The value of carefully scheduling, then monitoring the status of all necessary activities in each project is universally recognized.

It is also the objective of this audit that each contractor become more pro-active in the management of its contract costs. We were shown little evidence of contractor involvement in reviews of its functional areas or job processes. Performing a more accurate earned value analysis of job and project worktasks could give the contractors better visibility as to potential high cost and high risk jobs. The contractor may need to review this analysis in more detail in an effort to reduce cost growth and correct future schedule slippages. Contractor reviews of its operations should be scheduled each year in an effort to be as efficient as possible and prevent excessive costs from being incurred. Policies and procedures should be developed which establish periodic reviews of staffing, equipment and facility utilization. The objective should not be how much money has been appropriated to spend, but should be whether each dollar appropriated is being spent in the most cost efficient and effective manner.

DCAA will continue to test and report on the contractor's systems and the accuracy of the contractor's 533 reports. If the contractors fail to take effective corrective actions or fail to make acceptable progress in resolving the reported system deficiencies, contractual remedies should be considered such as withhold on public vouchers or disallowance of cost.

#### 5. Disposition of Audit Results

a. Accounting counsel and any additional audit service which you may require will be provided upon request. Requests for assistance may be directed to Mr. Michael McConnell, Branch Manager, Ms. Carol Darby, or Messrs. Gary Catt, Barry Copeland, Emil Kuropata, and Gary Mack, Supervisory Auditors at (713) 946-6595. Our telefax number is (713) 946-8480.

b. Please advise this office of the status of final disposition of audit recommendations as we intend to perform a follow-up review within one year of the report issuance date.

c. We wish to express our appreciation for the contractors' support and cooperation extended during the reviews. We also invite your comments and suggestions on this audit report and our related audit support.

d. We have attached to the original copy of this report a Contract Audit Follow-up Summary Sheet in accordance with reissued DoD Directive 7640.2 dated 12 February 1988.

DEFENSE CONTRACT AUDIT AGENCY

Michael S. McConnell, Branch Manager

RD/DRD  
RAMC-3  
RST-3

**DRAFT**BUDGETING AND FINANCIAL CONTROL SYSTEMS  
NASA JOHNSON SPACE CENTER MAJOR CONTRACTORSUNIT SYSTEM DEFICIENCIES BY CONTRACTOR

DEFICIENCY	CONTRACTORS									
	CONTRACTOR ENCLOSURE REFERENCE									
	AT	ATISYS	MOSSC	SENDIX	LESC	BARRICKS	LSRAL	ASOC	UNDA	JOEHO
NASA Form 833 is not properly completed.	x									
Inadequate formal written policies/procedures on completion of 833 & budgets	x									
Incompatible with formal written procedures										
Inventory ETC	x									
a) No detail budgets										
b) Lump sum actuals; not detail support										
c) Percentage of completion not detailed by element										
d) Inadequate #BS variance analysis by element										
e) Forward pricing rates based on long range budgets are not used or NASA 533 projections.										
Inadequate audit trail from the 533 to a specific #BS.	x									
a) #BS's do not total to 533 budgets.										
b) #BS's do not total to actuals or % of completion on 533.										
Unauthorized/unnegotiated cost included in reported incurred cost and/or projected ETC cost	x									
Delays in recording actual costs.									x	

x Denotes deficiency found at this contractor

**DRAFT**BUDGETING AND FINANCIAL CONTROL SYSTEMS  
NASA JOHNSON SPACE CENTER MAJOR CONTRACTORSBUDGET SYSTEM DEFICIENCIES BY CONTRACTOR

DEFICIENCY	CONTRACTORS											
	CONTRACTOR	ENCLOSURE	REFERENCE	CONTRACTOR	ENCLOSURE	REFERENCE	CONTRACTOR	ENCLOSURE	REFERENCE	CONTRACTOR	ENCLOSURE	REFERENCE
Prime contractor directs subs to improperly complete ETO on the SCS's	X											
EO's data is not incorporated into prime's ETO.												X
Financial budgets differ from operational budgets w/ ETO's												X
Budgets above with actuals, i.e. adjusted each month/year.	X											X
Actual hours are moved from an overrun #85 to another #85												X
Uncompensated hours not included in ETO hours.												X
Untimely update of budgets.												X
Either inadequate or non-existent indirect/direct analysis.	X	X		X	X		X	X		X	X	X
Either inadequate or non-existent utilization of equipment analysis.	X	X		X	X		X	X		X	X	X
Either inadequate or non-existent utilization of facility analysis.	X	X		X	X		X	X		X	X	X
Inadequate controls over bonuses and awards	X	X		X	X		X	X		X	X	X
Inadequate controls over idle and down time.	X	X		X	X		X	X		X	X	X

X denotes deficiency found at this contractor

**DRAFT**

BUDGETING AND FINANCIAL CONTROL SYSTEMS  
NASA JOHNSON SPACE CENTER MAJOR CONTRACTORS  
HOUSTON, TEXAS

MANAGEMENT COSTS, BONUSES, AND FEES

<u>CONTRACTOR</u>	<u>FY</u>	<u>MGM'T COSTS</u> (000'S)	<u>BONUSES</u> (000'S)	<u>FEES</u> (000'S)	<u>TOTAL</u> (000'S)
IBM	93	\$ *	\$ *	\$ *	\$ *
PARAMAX	93	4,793	233	5,073	10,099
MDSSC	93	3,664	1,394	—	5,058
BENDIX	93	5,797	482	1,423	7,702
LESC	92	15,921	237	8,537	24,695
BARRIOS	92	1,799	28	499	2,326
LORAL	93	9,878	630	10,065	20,573
RSOC	93	14,436	336	15,000	29,772
LINK	93	1,585	0	2,910	4,495
BOEING	93	<u>1,821</u>	<u>0</u>	<u>2,698</u>	<u>4,519</u>
GRAND TOTAL:		59,694	3,340	46,205	\$109,239

\* Contractor did not provide the requested data.

Mr. DINGELL. It says, "Contractor information contained in this audit may be proprietary. The restrictions of 18 U.S.C. 1905 should be considered before this information is released to the public."

That is the second paragraph. The first paragraph says, "Under provisions of Title 32, Code of Federal Regulations, Part 290.26(b)(2), any Freedom of Information Act request for audit reports received by DCAA will be referred to the cognizant contracting agency for determination as to releasability and a direct response to the requester." Then they go on down and if you look, you will find in the letter which was enclosed, or rather in the information which is enclosed with the report, you will see it says IBM—at the top, it says "FY 93, management costs in thousands."

There is an asterisk, bonuses; another asterisk, fees; another asterisk, total; another asterisk and then these words appear: "Contractor did not provide the requested data."

Now, you got this in March. What did you do about it when you got it in March?

Mr. EASLEY. We probably should have been more proactive to offer our assistance to DCAA—

Mr. DINGELL. When did you first find out that this information was withheld by the contractor?

Mr. EASLEY. In the draft report.

Mr. DINGELL. What did you do about it when you found out about it?

Mr. EASLEY. It was a draft report they had provided us for our comments. We didn't do anything regarding going to IBM.

Mr. DINGELL. Why not?

Mr. EASLEY. It was DCAA's report. It was not a final report. It was a draft report mainly for our editorial type of comments.

Mr. DINGELL. Don't you think you should have gotten the information? Do you agree that this information is proprietary and should be withheld or do you think that the government should have this information?

Mr. EASLEY. The government is entitled to it.

Mr. DINGELL. You think the government is entitled to it, but you got this in March and you didn't do anything about it. Why didn't you do something about it?

Mr. EASLEY. As I mentioned, it was a draft report—

Mr. DINGELL. It is a draft report, but it is true that IBM withheld the information. Now, you can say it was a draft report, but they wouldn't make the information available for a draft report. Couldn't they have made the information available for a draft report?

Mr. EASLEY. Yes, sir.

Mr. DINGELL. What did you do about it?

Mr. EASLEY. I should have or somebody on my staff should have immediately gone—

Mr. DINGELL. You didn't do anything about it, did you?

Mr. EASLEY. Not at that time. We have not gotten the information yet from IBM.

Mr. DINGELL. They claim it is proprietary. Do you agree with that?

Mr. EASLEY. Not in a typical classification sense. The other nine companies that gave me similar data stamped "this is confidential," mainly so it wouldn't be publicly disclosed to other companies.

Mr. DINGELL. So you have proceeded in entire ignorance during all this period? You still haven't gotten the information about what management costs, bonuses, fees and the total of these things were—and General Dailey and NASA don't have it either.

Do you find this acceptable, General?

General DAILEY. I am concerned that we did not take any action at that time. In discussing it during the break as to why we didn't, normally when a draft report comes out like that, it would be accompanied by a request from DCAA if they wanted us to pursue it.

As Mr. Easley has said, we should have been more proactive and that is what I meant by the requirement to develop a closer working relationship with our auditing agencies.

Mr. DINGELL. DCAA didn't get the information for the final report either, did it?

General DAILEY. No, sir.

Mr. DINGELL. DCAA works for NASA. Information that they submit to NASA is used by NASA in connection with its review of its contracts. NASA relies on DCAA for these reports. You let IBM go for 5 months without submitting the information to you.

Did you know about the fact that this information was not made available to you at headquarters, General?

General DAILEY. No, I did not.

Mr. DINGELL. What is the policy on production of information by your contractors? Are they supposed to do it or not?

General DAILEY. Yes, sir, they are. They are expected to do it.

Mr. DINGELL. Everybody else submitted it. IBM did not. Do you find that curious, Mr. Easley?

Mr. EASLEY. Yes, sir.

Mr. DINGELL. Did you find it curious, General?

General DAILEY. I do and I think that Mr. Easley has admitted that he made a mistake by not pursuing it when he was notified of it through the draft report in March.

Mr. DINGELL. I yield back to my good friend with apologies for taking so much time.

Mr. SCHAEFER. Mr. Easley, I want to make sure I got this correct. In my questioning about the IBM information, you said you just received the information. And "recently," I think, was the word.

Mr. EASLEY. The audit report, the final audit report just came in week before last.

Mr. SCHAEFER. The information in March was what we were talking about here, that IBM was not furnishing it, and if I am not mistaken in my prior question, it was asked and you responded that you had recently received it and the fact that IBM had not complied.

Mr. EASLEY. Still had not complied.

Mr. SCHAEFER. Just recently?

Mr. EASLEY. That they still had not complied.

Mr. SCHAEFER. In other words, you knew before about the March information?



Mr. EASLEY. I don't know the precise date. I knew about it because it was a very thick report.

Mr. SCHAEFER. Some time in early to mid-1993, NASA realized that things were wrong with Space Station Freedom and in response, NASA ordered a complete overhaul of both the physical configuration of the Space Station and of the contracting agreements for it.

What did NASA do at the time to stop as much work as possible so that there wouldn't be any more money wasted on the Space Station?

Ms. MCINERNEY. We started redesign. A policy was issued to the Work Package Centers that gave direction to the contracting officers, who in turn provided direction to the Space Station Freedom contractors not to incur overtime, not to have overtime expense, not to increase their staffing levels.

No options were to be exercised. No new task orders issued. No new modifications made against the contracts.

On a case-by-case basis, if a need arose to do any of those types of contractual actions, a request was put together and submitted to the Station Redesign Team and the team would evaluate each action on a case-by-case basis based on the design configuration that was being developed during that time period.

If they felt with absolute certainty that that work effort was not required, they would turn down the request and say, "Do not go forward with the contract action." If it was necessary because the Station Redesign Team felt that was significant technical content that would be carried forward in the design, then they gave approval for that contract action to continue.

After the Redesign Team action was over in June and the transition team picked up and the move was made to the host center at JSC, there was still a continual vigilance of this process. The contracting officers would forward their contract actions to the Program Office at JSC. When the design was further refined during the transition process, direction was provided from the Program Office to the respective contracting officers for the Work Package Contracts to delete work that was no longer needed for the forward-going design.

There was a series of letters that went out through the period of October and November. That activity was done in order to try to control, in order to conserve resources and have the contractors spend their resources in what would be considered the forward-going work under the new Space Station program.

Mr. SCHAEFER. So as soon as you made this movement knowing that the overhaul was going to be there, you informed, by letter, the individual contractors that were involved?

Ms. MCINERNEY. That is correct. Each contracting officer issued a letter to their contractor saying what was going on.

Mr. SCHAEFER. Mr. Chairman, I would like, without objection, to ask that they provide us with the letters in which they informed the contractors that this overhaul was taking place in order to stop the payment and the use of money.

Mr. DINGELL. We will pursue that on behalf of the gentleman.

[The following was received.]

See the attached memorandum from NASA Administrator to senior management regarding measures to be taken to minimize expenditures during the redesign process, followed by letters from the NASA contracting officers to the work package prime contractors.

National Aeronautics and  
Space Administration  
Office of the Administrator  
Washington DC 20546-0001



February 25, 1993

TO: Officials-in-Charge of Headquarters Offices  
Directors, NASA Field Installations  
Director, Jet Propulsion Laboratory

FROM: A/Administrator

SUBJECT: Space Station Freedom

NASA has been directed to redesign Space Station Freedom (SSF) as part of a program that is more efficient and effective and capable of producing greater returns on our investment. The revised Station program will strive to significantly reduce development, operations, and utilization costs while achieving many of the current goals for long duration scientific research. The redesigned Station will take advantage of, to the maximum extent possible, the investment we have made. It is important, however, to conserve our resources while the redesign effort is underway, and until it has progressed through its initial design phase. With this in mind, and in the interest of not expending any unnecessary funds, the following direction is effective immediately and will remain in effect until further notice:

a. No new awards (or new work modifications) which relate in whole or in part to the SSF, including support service contracts, should be issued nor should options under such contracts be exercised.

b. For existing contracts which address the SSF program in whole or in part, SSF-related activities should not be accelerated. New SSF-related change orders, task orders or task assignments, etc., should not be issued.

c. Change orders which have been issued may be definitized and incremental funding modifications may be executed; however

solicitations for new SSF-related contracts or new work modifications should not be issued.

d. All SSF contractors should be advised that no overtime is authorized and that staffing increases are prohibited. This direction does not, of course, preclude any previously planned staffing reductions. These reductions should be implemented judiciously to ensure no major disruptions in the workforce. Exceptions to this direction will be granted only in compelling cases. Such requests should be submitted to the Headquarters Office of Procurement (Code HS) who will process them to Code A for approval. (Requests may be transmitted to the Code HS fax machine at 202-358-4065.) Requests shall clearly identify and support the necessity for the proposed action and shall include, at a minimum, the information contained in the enclosure to this letter.

No further action should be taken until written approval to proceed is granted.

Questions should be directed to Carol Saric or Foster Fournier of Code HS at (202) 358-2080.



Daniel S. Goldin

Enclosure

ENCLOSURE

1. TITLE AND DESCRIPTION OF THE CONTRACT INVOLVED. (Include the name and a description of the contract under which the requested action would be performed. Indicate whether the contract covers only SSF activities or whether other programs are also supported.)
2. TYPE OF CONTRACT. (Including whether it is Level-of-Effort. Do not use abbreviations.)
3. CURRENT VALUE OF THE CONTRACT EXCLUDING THE PROPOSED ACTION. (Estimated cost and fee.)
4. TITLE AND DESCRIPTION OF THE PROPOSED ACTION IF DIFFERENT FROM ITEM 1. ABOVE. (Include the name and a clear, concise description of the specific work for which authority is requested.)
5. TYPE OF ACTION. (Indicate whether the proposed action is a new contract, new work under existing contract, option exercise, solicitation, change order, task order or task assignment, etc.)
6. DOLLAR VALUE OF THE PROPOSED ACTION. (Provide the estimated cost and fee of the specific action proposed. If this is a new contract, provide the value of the basic effort and any options separately.)
7. WHY AUTHORITY TO PROCEED IS NEEDED. (Provide clear, concise rationale to support the request (including, for example, whether a proposed change would reduce the cost of SSF-related activities). Identify whether there are any "drop dead" dates involved, the basis for such deadlines, and any impact for failure to meet those dates.)
8. NAME, TITLE, AND TELEPHONE NUMBER OF CENTER PROCUREMENT POINT OF CONTACT.
9. NAME, TITLE, AND TELEPHONE NUMBER OF CENTER TECHNICAL POINT OF CONTACT.

National Aeronautics and  
Space Administration

Lyndon B. Johnson Space Center  
Houston, Texas  
77058



BB-93-617

MAR 3 1993

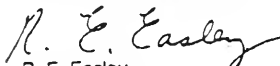
McDonnell Douglas Space Systems Company  
Attn: Mr. Larry P. Morata  
Vice President/General Manager  
5301 Bolsa Avenue  
A95-J800, 17-828  
Huntington Beach, CA 92647

Subject: Space Station Freedom

The NASA Administrator has advised that the Agency has been directed to redesign Space Station Freedom (SSF) as part of a program that is more efficient and effective and capable of producing greater returns on our investment.

Consistent with the Administrator's direction, you are hereby advised that for existing contracts which address the SSF program in whole or in part, SSF-related activities should not be accelerated. No paid overtime is authorized for SSF-related efforts, and any staffing increases which are a result of SSF-related activities are prohibited.

This direction is effective immediately and will remain in effect until further notice. If you have any questions, please contact the contracting officer that has cognizance over your contract.

  
R. E. Easley  
Director of Procurement

National Aeronautics and  
Space Administration

Lewis Research Center  
Cleveland, Ohio  
44135

NASA

*File*

copy to Attn of 1540

March 10, 1993

Rockwell International Corporation  
Rocketdyne Division  
Attn: Fred Dunn M/S LA-54  
6633 Canoga Avenue  
Canoga Park, CA 91303

Subject: Conservation of Resources

As you are aware, NASA has been directed to redesign Space Station Freedom to achieve a more efficient and effective program. The revised program will strive to significantly reduce development, operation, and utilization costs while achieving many of the current program goals and taking full advantage of the investment made to date. While this redesign activity is in process, it is imperative that the program conserve current resources.

Rocketdyne is therefore directed to take all necessary and prudent actions required to conserve available program resources while minimizing any adverse impact to the overall program schedule. To this end, Rocketdyne is directed to defer any increases to current staffing levels and prohibit paid overtime, unless it is required in an emergency situation, pending further program direction.

With respect to Rocketdyne's subcontractor team, Rocketdyne is authorized to proceed with subcontract/subcontractor actions that are currently planned and covered in the FY93 budget. However, prudent actions to conserve resources while minimizing schedule impact shall be observed by the subcontractor team.

Exceptions to this direction will be granted only in compelling instances. Such requests shall be submitted to this office and clearly support the circumstances surrounding the request. If additional information is needed, please contact me or Bob Schneider.

*(5)*

Ronald W. Sepesi  
Contracting Officer

bcc:  
6000/R. L. Thomas  
8100/R. A. Schneider  
- 1540/Official File

1540/RWSepesi:amn:03/12/93:A:CONSERVE

National Aeronautics and  
Space Administration



Lewis Research Center  
Cleveland Ohio  
44135

MAR 23 1993

1540

Rockwell International  
Rocketdyne Division  
Attn: Frederick D. Dunn  
6633 Canoga Ave. LA-54  
Canoga Park, CA 91303-2790

Subject: Conservation of Resources

As of March 19, 1993, the WP-04 Request for Overtime Authorization has been disapproved. Rocketdyne shall take immediate steps to comply with the direction as prescribed in my letter dated March 10, 1993. LeRC acknowledges and approves Rocketdyne's overtime usage during this transitional period while exceptions to the general overtime prohibition were being reviewed.

If additional information is needed, please contract me at 216-433-2792.

/s/ Ronald Sepesi,

Ron Sepesi  
Contracting Officer

bcc:

8000/R. L. Thomas  
1540/R. W. Sepesi  
1540/K. R. Brocone  
1540/L. J. Stauber  
1540/K. K. Martin  
1540/Official File

1540/RWSepesi:sms:3/22/93:K:\dunn.OT

National Aeronautics and  
Space Administration  
Lewis Research Center  
Cleveland, Ohio  
44135

NASA

1540

MAR 24 1993

Rockwell International Corp.  
Rocketdyne Division  
Attn: Fred Dunn M/S LA-54  
6633 Canoga Avenue  
Canoga Park, CA 91303

Subject: Conservation of Resources

Reference is made to my letters dated March 10, 1993, and March 23, 1993, and a Code D memorandum dated March 24, 1993.

Based on the latest program office correspondence which provided additional guidance and interpretation relative to the conservation of program resources, Rocketdyne is authorized to proceed with subcontractor actions and activities that are currently planned and supported by the Fiscal 1993 budget in order to maintain SSF program progress, cause minimal disruption in completing work package CDR actions, and to support the Program CDR schedule in June 1993.

Prudent management actions shall be adopted by Rocketdyne and its subcontractor team to minimize current year expenditures, avoid unnecessary hardware or program build-up, and discontinue actions beyond that needed to maintain the current schedule. Near term activities in support of post PMC requirements are not considered prudent in light of the current program redesign. These activities shall be discontinued.

Paid overtime at Rocketdyne is still prohibited under the latest program guidance.

Rocketdyne is requested to provide this Office with a copy of the guidance that is provided to your subcontractor team as the result of this direction.

*/s/*

Ronald W. Sepesi  
Contracting Officer

bcc:  
1540/R. W. Sepesi  
1540/L. J. Stauber  
8100/R. L. Thomas  
6100/B. A. Schneider  
1540/Official File

1540/RWSepesi:am:03/25/93

MAR 26 1993

AP52 (93-03-113-E)

Boeing Defense & Space Group  
 Missiles & Space Division  
 ATTN: Wayne R. Widener, Contracts Manager  
 Space Station Freedom Program  
 P. O. Box 240002  
 Huntsville, AL 35824-6402

SUBJECT: Contract NAS8-50000, Space Station Redesign Activity  
 Direction

Clarifications and directions have been received from NASA Headquarters relative to the current activities involving the Space Station Freedom redesign effort. Effective immediately, the following directions apply:

1. With respect to subcontracts, Boeing shall proceed with subcontracts that are currently planned and covered under the Fiscal Year 1993 budget so that there is minimal disruption to complete the project Critical Design Reviews (CDRs) and the system CDR scheduled to start in June 1993. The Government does not want to take any action that would prevent Boeing from making progress on the SSF program as currently contracted; however, prudent efforts on the part of Boeing to mitigate expenditures pending SSF redesign are encouraged.

2. Options contained in the WPO1 contract will not be exercised unless an exception is granted by NASA Headquarters. (See paragraph c., below.)

3. Change order direction previously issued against the contract will be negotiated and definitized. Configuration directives approving Engineering Change Proposals (ECPs) which reflect work previously authorized will be issued.

4. All new WPO1 change order direction will be handled as follows:

a. Configuration directives and/or contract change orders that do not affect any change to cost or schedule may be issued by the Contracting Officer. Such directives and/or change orders shall be actual "zero-dollar" changes and the documentation must include a statement indicating that zero dollars will result in complying with the change. Zero dollars are defined as meaning that there is no change to the contract value and does not include changes authorized pursuant to Clause H.3. "Special Provision for Contract Changes."

CONCUR	CODE				
	SIGNATURE				
	DATE				



b. Any configuration directive and/or change order direction that modifies program cost and affects direct labor resources will have to be approved by the Deputy Associate Administrator for Space Flight. This includes directive or change orders that would result in a reduction in the contract value.

c. In the event that approval must be requested for an action, as described in paragraph b., above, Boeing shall provide the following information to the Contracting Officer:

(1) A description of the effort.

(2) Enough information to enable full understanding of the compelling reasons for seeking the exception.

(3) The impact (dollars and narrative explanation) should the exception not be granted. The impact must identify the number of employees (prime and subcontract) that could be laid off due to disapproval of the exception request.

d. The Contracting Officer will expedite the request to Headquarters, on a case-by-case basis, for the requisite approval.

Any questions should be directed to John C. Cather, 205-544-1743, or A. S. Bunnell, 205-544-8024.

Original Signed By  
Stephen P. Beale

Stephen P. Beale  
Contracting Officer

CC:  
KA01  
KA01/CM  
KA10  
KA13  
KA30  
KA40  
MS-3  
KA61  
EJ11  
CP31

AP52 SS O/F Copy  
AP52 SS R/F Copy  
AP52 SS C/F Copy

DCAA  
DCMC

Mr. SCHAEFER. Can you provide the subcommittee with the before and after figures of how much NASA was spending before it realized that things were seriously out of control at the Space Station and how much NASA cut spending when it began cutting back in light of the huge overruns and the lack of control? Provide us those figures, too?

Ms. MCINERNEY. Unfortunately, I don't have that data here.

Mr. SCHAEFER. I understand. I mean to provide the committee that.

[The following information was received.]

Space Station Freedom contractors were on a gradual buildup as the program prepared for its Critical Design Review (CDR) in June 1993. NASA management recognized this buildup as absolutely critical to successfully completing CDR, which was important to both the Freedom program and the redesign effort. From September 1992 to June 1993, total Space Station monthly costs increased from an average of \$164 million to \$180 million. Of this amount, the previous three prime contractors' cost increased from \$109 million to \$124 million, accounting for most of the total monthly increase.

Since CDR in June 1993, costs have been reduced, reflecting the redesign efforts and the new management and contractor arrangements. Since October 1993, total monthly costs have averaged \$135 million, with the prime contractors representing \$100 million, or 75 percent, of that amount.

Mr. SCHAEFER. Since the time of the configuration of the contracting effort last year and the selection of Boeing as a prime contractor, has the Space Station had a baseline?

Ms. MCINERNEY. Do you mean Space Station Freedom or the new Space Station?

Mr. SCHAEFER. The new Space Station.

Ms. MCINERNEY. The Space Station program came out with a design at the end of the redesign activity, which was in June, endorsed by the Vest Committee, accepted by the White House.

There were two activities that the Space Station Program Office conducted. One was called a System Requirements Review in December which further defined the baseline and put it in place and then they recently had a System Design Review in March of this year this which established that as the baseline.

Mr. SCHAEFER. So you have a baseline?

Ms. MCINERNEY. That is correct; a technical baseline.

Mr. SCHAEFER. Is there a financial baseline, cost?

Ms. MCINERNEY. The cost baseline is under negotiation. The Space Station office has conducted two fact-finding sessions over the last 2 months with the contractors. It has included participation from DPRO and DCAA and this is leading into activities that will begin shortly with the final negotiations of the estimated cost and fee for the contracts.

Mr. SCHAEFER. So we do not have a financial baseline. That is being negotiated?

Ms. MCINERNEY. That is correct.

Mr. SCHAEFER. How much has been spent on the Space Station in the absence of the baseline?

Ms. MCINERNEY. We can provide that.

Mr. SCHAEFER. Thank you, Mr. Chairman.

[The following information was received.]

The Space Station Freedom contracts were novated on February 1, 1994, and NASA signed a Letter Contract with the Boeing Company. Since that date, the program has obligated \$580.7 million through June 30, 1994.

Mr. DINGELL. General, you are familiar with the fact that in 1992, NASA promised the President that it would correct deficiencies that GAO identified in NASA's financial management system, are you not?

General DAILEY. Yes, sir. I am.

Mr. DINGELL. And GAO at that time promised that it would correct the deficiencies through increased emphasis on the issue at headquarters level; is that right?

General DAILEY. I believe it is. Yes, sir.

Mr. DINGELL. And that initiative is designed to enhance the effectiveness and efficiency of post-contract award management, the improving of oversight and the utilization of contract administration services from DOD and by providing training in management; that these ends would be accomplished, is that right?

General DAILEY. I can't say for sure on that, sir.

Mr. DINGELL. We have here a situation where we find, first of all, that the centers in the case of the information we are talking about refused to make the information available to you. You never knew that IBM refused to tell you about their management costs, did you?

General DAILEY. No, I didn't know that.

Mr. DINGELL. And one of the problems that seems to be here is that the centers seem to act as if they don't work for you. Mr. Easley doesn't tell you what is going on down there.

General DAILEY. There are many things that Mr. Easley doesn't tell me with regard to what he does when he carries out his own duties. He is responsible for significant areas of management at the Johnson Space Center that he does not convey to me on a regular basis. He has been entrusted with the authority to do that.

Mr. DINGELL. I have a letter here from Johnson Space Center in response to the draft of the DCAA audit dated May 10. I would like to read a portion of it.

It says as follows: "The draft, in nearly all cases, indicates that the contractors are not complying with NASA Handbook 950.2b, Contractor Financial Management Reporting System, for preparing NASA Form 533. While this is true, NASA has directed each of the contractors on required reporting.

"The handbook, as written, is incorrect and is in the process of being rewritten to comply with the current requirements. Therefore, we disagree with the statement that contractors are not complying with the reporting requirements and that the 533 Handbook takes precedence over what NASA has directed the contractors to report. The fact that contractors could not provide a copy of a NASA deviation would not be a basis for a prime and/or sub-contractor to ignore contractual direction in terms of reporting."

This letter was written by the director of procurement at the Johnson Space Center. He has been in that job since 1989. I believe that is you, isn't it, Mr. Easley?

Mr. EASLEY. Yes.

Mr. DINGELL. Mr. Easley, I want to ask this question of the General and then I have a couple of questions.

General, do you agree with that letter?

General DAILEY. I don't and I don't believe Mr. Easley does either. I believe he wrote a letter subsequent to this and corrected the statement about the NASA Handbook; is that correct?

Mr. EASLEY. That is correct.

Mr. DINGELL. I am curious.

General DAILEY. This letter has been superseded.

Mr. DINGELL. Withdrawn?

General DAILEY. Yes, sir.

Mr. DINGELL. Why was it written in the first place?

Mr. EASLEY. Where it said that it was incorrect, it was subsequently, by changing the wording to where—the handbook itself is correct. We had augmented the handbook. At no time have we ever instructed, to my knowledge, a contractor to report differently from what the handbook required, but rather to augment and provide some additional information.

Mr. DINGELL. What does augment mean?

Mr. EASLEY. Additional; in addition to.

Mr. DINGELL. What form does this augmentation take?

Mr. EASLEY. It takes on a variety of different forms depending on which—

Mr. DINGELL. Does it mean that you write a new section which applies to all contractors or that you just write a letter to a contractor and say disregard this part of the handbook? Which do you do when you augment? Do you augment by adding a new paragraph or section or set up a new handbook or do you write a letter to the contractor and say, "Don't pay any heed to that part?"

Mr. EASLEY. No, sir. We comply with the handbook, but we have additional information depending on which type of contract and what kind of system that it provides. Some of our 533 reports may be a very few pages, 5 or 6 and others may be 15, 20, 30 pages long.

Mr. DINGELL. Are these part of an individual contract? Are they done for everybody in the industry? What form does it take? Does this become a section of the handbook?

Mr. EASLEY. No, sir. The additional reporting requirements, that is very key—it is in addition to what the handbook requires would be additional reporting requirements that might be needed for a project manager.

Mr. DINGELL. Do you clear these augmentations with General Dailey?

Mr. EASLEY. No. They are cleared between my organization and the Comptroller's organization at our center who has a major hand in evaluating the cost reporting for contractors.

Mr. DINGELL. General, what authority does Mr. Easley need to augment these requirements in the handbook? I am trying to understand, is the handbook something which gives instructions to Mr. Dailey and everybody else? Does Mr. Dailey control the editing of the handbook? What are his authorities to make changes in the handbook?

General DAILEY. The handbook is an agency level document that is produced by our headquarters.

Mr. DINGELL. Does Mr. Easley have the authority to change it whenever he feels the mood is upon him?

General DAILEY. It provides guidance for various activities and the centers are authorized to modify or to augment this in cases where it is necessary to do so. But it is done with the—I believe at the center director level. I am not sure where they do it within the center, but we have delegated that authority.

Mr. DINGELL. Is that done in writing or do you just say fellows, change it any way you like?

General DAILEY. It is part of the policy and it reflects that.

Mr. DINGELL. Is that written down somewhere?

General DAILEY. I think that—I don't know. I will have to check. [The following information was received.]

Attached is the portion of NHB 9501.2B where NASA Centers are authorized to modify or augment requirements set forth in the handbook.

#### CENTER AUTHORITY TO CHANGE COST REPORTING REQUIREMENTS CONTAINED IN NASA HANDBOOK 9501.2B

For relevant sections of NHB 9501.2, see the following:

1. Preface, paragraph 4
2. Paragraph 102.3 :
3. Paragraphs 103.3. and 103.4.
4. Paragraphs 104.1.a., 104.2.c. and 104.2.d.
5. Paragraph 300.4.
6. Paragraph 301.7.

In terms of the specific request, I believe it should be noted that, in every case, there is no stipulated NF533 reporting structure in the NHB; Chapter 2 provides guidance, but it is the intention of the system that a customized reporting structure be developed for each particular contract. In this sense, the NHB is "augmented" for every contract, because each one specifies the structure to be

used for reporting on that contract. The most direct response to the request would be to simply quote Paragraph 103.4:

"Exceptions to the requirements and procedures set forth in this Handbook are those variations to the system, which due to unique-reporting requirements or capabilities of the contractor's management system, require special attention (e.g., substitution of contractor's internal reports for specific data requirements, elimination of detailed long-range cost projections on support service contracts where NASA controls the application of labor to the contract, etc.). **These exceptions may be approved at the Installation level in accordance with the local management procedures.**"

Other instances in which authority is specifically given to "augment" the NHB are:

1. Paragraph 102.3. - "NASA contractors are expected to submit cost reports in which the cost information is fitted to the technical and schedule reporting structure. **The exact level and the detailed fitting of this data is based upon NASA project management requirements and the contractor's management system capability.**"

2. Re report due dates: Paragraph 104.1. - "In those instances where the contractor's internal management system precludes submission by the specified date, the submittal date will be negotiated."

3. Re substitution of contractor reporting formats: "Contractors' internal automated printout reports may be substituted for the 533 reporting formats, **with the contracting officer's approval**, so long as the substitute reports contain data elements equivalent to the corresponding 533's."

4. Re the initial report: Paragraph 300.4. - "An "Initial Report" in complete detail, time-phased for the expected life of the contract, will be submitted by the contractor within 10 days after authorization to proceed has been granted, **unless otherwise specified by the contracting officer.**"

5. Re reporting during contract close-out: Paragraph 301.7. - "During this time period, since no significant additional costs are being incurred, 533 reporting may be required on a quarterly basis only at a summary level, **by direction of the contracting officer.**"

Mr. DINGELL. Can you tell us, Mr. Easley, where is the authority that you have to change the handbook?

Mr. EASLEY. First of all, I don't recall changing the handbook. It would not be a deviation to augment if we have supplementary information.

Mr. DINGELL. Let's look at what you said here. You said, "The handbook, as written, is incorrect and is in the process of being rewritten to comply with the current requirements."

Do you agree with that, General?

General DAILEY. It turns out that the handbook is being rewritten.

Mr. DINGELL. Was that correct at the time this letter was written?

General DAILEY. May I pursue this for a moment, sir, because it is a fundamental issue to the way we operate the agency. We put out guidance at the headquarters level that provides overall direction to our centers as to how they are to do business. They have to have ability to adjust to specific cases, but they don't override the guidance that comes out from the headquarters—

Mr. DINGELL. They do in this specific case, do they not?

General DAILEY. This letter is no longer valid. It has been superseded by another transmission from the same individual indicating that he made a mistake when he wrote this letter.

[The letter referred to follows:]

8/14/94 15:42

NO. 615 PAGE 2

National Aeronautics and  
Space Administration  
Lyndon B. Johnson Space Center  
Houston, Texas  
77058



JUL 6 1994

copy to AEM of BD-94-41

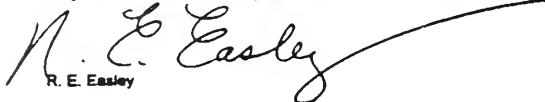
Defense Contract Audit Agency  
Houston Branch Office  
Attn: Mr. Michael S. McConnell, Branch Manager  
8878 Gulf Freeway, Suite 500  
Houston, TX 77017

Subject: Report on Audits of the Budgeting and Financial Control Systems

Reference my letter dated May 10, 1994, same subject, which provided our comments regarding the draft audit report.

It has come to my attention that we used a bad choice of words dealing with the NASA Handbook 9501.2B, Contractor Financial Management Reporting System. Accordingly, in paragraph 1 of General Comments, please delete the sentence beginning with the words, "The Handbook, as written, is incorrect...", and substitute the following: "The Handbook is correct and is the official document; however, in a number of cases the contract schedule has supplemented the Handbook requirements. Thus, the audit must consider reporting based upon the Handbook requirements as well as any supplemental contract requirements."

I regret any confusion this may have caused.



R. E. Easley

RECEIVED

94 JUL 8 P 1: 25

DCAA  
HOUSTON BRANCH



Mr. DINGELL. I wonder why Mr. Easley would write a letter in which he would say the handbook as written is incorrect. Why did you say that?

Mr. EASLEY. First of all, I signed the letter. My staff prepared the letter, but I take full responsibility for it.

Mr. DINGELL. Do you agree with your staff?

Mr. EASLEY. The intent was to say it is additional information over and above. It is an incorrect statement to say that the handbook is incorrect. That was not the intent.

Mr. DINGELL. The question to which this all refers is the reporting requirements that were imposed, that DCAA said were imposed by your handbook; isn't that right?

Mr. EASLEY. That is correct.

Mr. DINGELL. Now, why did you tell them that this was not proper, that the handbook was incorrect on the reporting? Do you still maintain the position that it was incorrect on reporting?

Mr. EASLEY. The handbook was not the single reporting requirement. We had other requirements in addition to the handbook.

Mr. DINGELL. But your letter was about a disagreement that people had with DCAA, yourself and contractors, right, over the reporting requirements. Were you trying to amend the reporting requirements?

Mr. EASLEY. I think the real disagreement was not on the reporting requirements, but were the contractors complying with the contractual reporting requirements.

Mr. DINGELL. Were they complying with the reporting requirements?

Mr. EASLEY. Were the contractors complying? Not in all circumstances.

Mr. DINGELL. When you said that the handbook was incorrect, were you saying that the behavior of the contractors was correct or that the behavior of DCAA was correct?

Mr. EASLEY. I wasn't getting at the behavior. The behavior of the contractor was incorrect in that we were not getting the total information that the contract required them to submit in terms of the financial in all cases.

Mr. DINGELL. I am curious why you said that the handbook as written on this point of the reporting by the contractors was incorrect. Because you were essentially saying that the contractors didn't have to make the reports that DCAA said they had to make.

Mr. EASLEY. As I said earlier, the word incorrect is not a—

Mr. DINGELL. Let's address my question. It always makes me happier when people do that. It makes me unhappy when they don't and we don't want me to be unhappy today.

Why was it you told the contractors in this letter that DCAA was incorrect on the question of reporting? Why did you do that? The handbook says they have to make certain reports. The reports that were supposed to be made dealt with questions of management, compensation, fees, bonuses and so forth. Why did you write that the handbook was incorrect on this?

Mr. EASLEY. It was an extremely bad choice of words. It should have said that there were additional requirements.

Mr. DINGELL. Were the additional requirements that there was to be more reporting or less reporting?

Mr. EASLEY. More.

Mr. DINGELL. What were those additional requirements?

Mr. EASLEY. Many of our contracts depending on what they were would have additional requirements to report by certain types of work breakdown structure.

Mr. DINGELL. What are those requirements? Are they in writing somewhere?

Mr. EASLEY. Each of our major contracts typically will have a separate augmentation deliverable which will describe those which we can make available to you or your staff.

Mr. DINGELL. But nowhere in your letter did you say that they were to provide more information. You inferred that they did not have to provide the information which was required in the handbook; isn't that the clear inference of the language of your letter?

Mr. EASLEY. Unfortunately that can be interpreted that way.

Mr. DINGELL. Is there any other interpretation that I can assign to this?

Mr. EASLEY. I can't answer that.

Mr. DINGELL. So you are telling everybody that they don't have to submit all the information in this letter.

General Dailey I guess prudently said that you should withdraw the letter, but you didn't clear the letter with General Dailey.

When did you find out about it, General?

General DAILEY. I found out about it simultaneously with the correction that came out when the letter correcting the situation arrived also. It came in in the same package.

Mr. DINGELL. So somebody else wrote the correction; is that right?

General DAILEY. No. Mr. Easley wrote it also.

Mr. DINGELL. The correcting letter went out July 6. What was the date of your letter, Mr. Easley?

Mr. EASLEY. July 6th is the correcting letter.

Mr. DINGELL. July 6? Your letter was May 10, was it not? General Dailey's letter was July 6th.

General DAILEY. Then he wrote another letter on July 6 correcting it.

Mr. DINGELL. Why did you send the July 6th letter after you had sent the May 10th letter?

Mr. EASLEY. Due to the interpretation that had been put in the May 10th letter, that was being perceived as the handbook was incorrect and that was not intended—that was an error put in the May 10 letter.

Mr. DINGELL. When did DCAA brief headquarters as to their findings? You have two letters, May 10, your May 10 letter says you don't have to pay any heed to the handbook. Your July 6 letter says you do.

When did DCAA brief headquarters?

General DAILEY. I think it was around July 6, but I am not sure of the exact date.

Mr. DINGELL. So I note here that the document headed "NASA Johnson Space Center, Defense Contract Audit Agency, Budgeting & Financial Control System Audits, dated July 6, 1994." I assume that that is what triggered the withdrawal of the letter; is that

right? That was essentially the briefing paper I gather that DCAA used in briefing NASA on this particular point; is that right?

General DAILEY. I can't answer what triggered the letter.

Mr. EASLEY. May I address that? The thing that triggered me to revising the letter was the fact of a conversation between headquarters' financial people with members of my staff regarding the interpretation and that was why we clarified the letter.

Mr. DINGELL. I am trying to understand why the letter was withdrawn and let me ask you a question. Do you think you need the information that was sent out in the handbook?

Mr. EASLEY. Absolutely.

Mr. DINGELL. In the reporting?

Mr. EASLEY. And we never have—

Mr. DINGELL. Why did you write the letter of May 10?

Mr. EASLEY. The purpose of the letter of May 10 was two reasons. One, to provide any clarification; and second, we had—of the 10 companies that had been audited my staff working with DCAA and other business managers at the center—had provided comments back on the other 8 companies and the remaining 2 companies had not provided the comments.

Mr. DINGELL. You said the handbook as written is incorrect and is in the process of being rewritten to comply with current requirements. How was the handbook incorrect in what it told the contractors to report?

Mr. EASLEY. Probably Mr. Holz could address that.

Mr. DINGELL. The handbook set forth requirements that you are supposed to carry forward to get information from contractors. How were those information collecting and reporting sections incorrect?

Mr. EASLEY. As you have been told, there is a revision to the handbook that is in process now and I would defer that to someone from the office that is revising the handbook.

Mr. DINGELL. Well, let's come back here now. We seem to have disagreement with the Johnson Space Center disagreeing with the DCAA audit. Indeed, in a four-page letter, the Director of Procurement at Johnson attempted to dismiss and rationalize all the DCAA findings, and without objection, we will put that in the record.

[The letter referred to follows:]

National Aeronautics and  
Space Administration

Lyndon B. Johnson Space Center  
Houston, Texas  
77068



BD-64-30

MAY 10 1984

Defense Contract Audit Agency  
Houston Branch Office  
Attn: Mr. Michael S. McConnell, Branch Manager  
8878 Gulf Freeway, Suite 500  
Houston, TX 77017

**Subject:** Report on Audits of the Budgeting and Financial Control Systems

We appreciate the opportunity to review the subject draft audit report prior to its being published. Most of the contracting officers also had an opportunity to meet one-on-one with your lead auditor for the respective contractor. There are some issues or misunderstandings that need to be clarified prior to the document being published, and these were addressed in the meetings. The individual contractor-by-contractor details previously provided to you are not provided in this letter, however, we trust they will be given proper consideration. For further emphasis, some of the major issues are addressed below.

General Comments:

1. The draft, in nearly all cases, indicates that the contractors are not complying with NASA Handbook 9501.2B, Contractor Financial Management Reporting System, for preparing NASA Form 533. While this is true, NASA has directed each of the contractors on required reporting. The Handbook, as written, is incorrect and is in the process of being rewritten to comply with the current requirements. Therefore, we disagree with the statement that contractors are not complying with reporting requirements and that the 533 Handbook takes precedence over what NASA has directed the contractors to report. The fact that contractors could not provide a copy of a NASA deviation would not be a basis for a prime and/or subcontractor to ignore contractual direction in terms of reporting. This major difference of opinion has substantial ripple effect throughout the report and therefore needs to be addressed.
2. A number of your comments relevant to "estimate to complete" do not clearly relate to the "level-of-effort" (LOE) environment which is the predominant type under the audited contracts. The contracts are for a "LOE" (hours) to be provided during a set period of time, as opposed to a specific deliverable task or end item. These hours are then turned on through the issuance of individual task orders that typically contain an agreed to staffing level. The fundamental difference between LOE contracting versus "completion form" with defined deliverables needs to be addressed throughout your report.
3. A number of your comments dealing with the following terms "authorized," "definitized," and "undefinitized," as they relate to change orders, gives reason to believe there is some misunderstanding on the proper usage of these terms. NASA may issue direction to a contractor, pursuant to the changes clause, which "authorizes" the contractor to proceed and incur cost. These costs are then treated and reported as "authorized." They are "undefinitized" until such time as they are subsequently negotiated and "definitized" to the contract by the issuance of a bilateral supplemental agreement. This matter needs to be corrected in several areas in the report.

4. The report refers in numerous places to "inadequate controls over bonuses and awards," and implies throughout that they must be tied to "performance." Many companies, due to a shrinking aerospace market, are making management decisions to offer "lump sums" or bonuses as part of overall compensation packages, and therefore would not be a planned "performance based" award. A number of these, if not all, are in fact approved by the administrative contracting officer. This matter needs to be addressed throughout the report.
5. Regarding "idle time accounts," we believe that matter is most appropriately dealt with through floorchecks, which we both have responsibility for conducting.
6. Given that the audit began July 1993, time and circumstances (such as novation of several contracts/subcontracts) has caused several statements to be inaccurate today. This condition needs to be reviewed throughout the report.
7. Specific comments by contractor follows:

#### Appendix A - IBM

- a. The prime contractor, McDonnell Douglas Space Systems Company (MDSSC), flowed down the 533 reporting requirements that were on the prime contract.
- b. Page 1, first paragraph, questioned IBM subcontract value as containing "...significant amounts of undefinitized, unnegotiated work..." This dollar amount did include authorized work in the form of contract change orders. See general comments above.
- c. Page 1, last sentence of second paragraph, is not clear and appears to be contradictory.
- d. Page 2, fourth paragraph, next to last sentence states, "We have seen no evidence to show their costs were approved by NASA." NASA does not "approve these costs," and the fact that they are "definitized" or "undefinitized" does not create the requirement for Government approval. The undefinitized, unnegotiated costs will be negotiated.
- e. Page 8, second paragraph states, "...changing the method in which software is to be developed should be definitized and negotiated before it occurs." is our preferred method; however, this does not preclude NASA from issuing a change order when deemed appropriate that has not been definitized, and does not make the cost impact for the directed work as unallowable or inappropriate. In addition, part of the cost growth under this subcontract was directly attributable to the failure of the Government to provide Government Furnished Equipment at the required time. Negotiation in advance of the impact of not meeting the contract requirement by the Government was not practical.
- f. Page 8, last paragraph, is inconsistent with the changes clause when such direction is given by the prime contractor.

#### Appendix B - Paramax

Details already provided in meeting.

#### Appendix C - MDSSC

- a. Page 1, first paragraph, states that over \$1 Billion of undefinitized and unnegotiated cost results in misrepresentation of cost variances. The contractor was provided direction to report in this manner. Without the inclusion of these costs in the 533 report, our ability to monitor costs would have been significantly impacted. Only by including undefinitized changes in contract value can variances be identified, since undefinitized changes are included (and should be) in the contractor's estimate at completion.
- b. Page 2, first paragraph, states that "failure to comply with its own management reporting requirements has resulted in significant cost growths." It cannot reasonably be concluded that failure of MDSSC to comply with its own management reporting requirements resulted in significant cost growth. While we do not disagree that it would have been preferable to have had a more timely comprehensive estimate at completion, the reason for cost growth is more attributable to other factors.

- c. Page 2, sixth paragraph, Author's Comments, which states "...they could not locate documentation to support the government direction provided..." needs to be corrected since a copy of the direction is in fact a part of MDSSC's comments.
- d. Page 8, first paragraph, discusses cost growth process. Given that there is no practical way for the Government or prime contractor to precisely identify when it occurs, proposing and negotiating prior to incurrences of any cost growth is not practicable.
- e. Page 10 discusses problems concerning staffing levels. This issue deals with changes directed by the Government. In fact, a direct-vs-indirect analysis was conducted by DCAA with NASA participation and is also part of the 533 review activities. An indirect rate review was conducted for the Houston operations, and prior to redesign, a similar (annual) review was being scheduled for the Huntington Beach operations.

Appendix D - Bendix

Details already provided in meeting.

Appendix E - LFSC

Details already provided in meeting.

Appendix F - Burdick

Details already provided in meeting.

Appendix G - Loral

Details already provided in meeting.

Appendix H - BEOC

Details already provided in meeting.

Appendix I - CAE Link

Details already provided in meeting.

Appendix J - Boeing-FEPC

Details already provided in meeting.

In summary, we do appreciate the opportunity to review the draft report, and we trust the above comments and those furnished in the one-on-one meetings will be given proper consideration prior to publishing the report. For further discussions, feel free to contact John J. Thiel at 713-483-4109.

  
R. E. Easley

cc:  
LAW, Draper  
BE/S, Delp  
BC/G, Hyde  
BG/W, Bays

Mr. DINGELL. Nowhere in the letter does the director agree with any of the audit findings or indicate anything will be corrected. Do you agree with the DCAA audit or do you disagree?

General DAILEY. We agree with the audit, sir.

Mr. ABBEY. The Johnson Space Center agrees completely with the audit and we have initiated action to take into account all the recommendations and developed an action plan to fix it.

Mr. DINGELL. Mr. Easley, you wrote the letter.

Mr. EASLEY. I signed the letter, correct.

Mr. DINGELL. You signed the letter or you wrote the letter?

Mr. EASLEY. I did not write the letter. I signed the letter.

Mr. DINGELL. Do you agree with the letter?

Mr. EASLEY. The letter could have been better written. I fully agree and support the findings by DCAA. The purpose of the letter was not to disagree with the findings, but to find clarification prior to final publication of the report.

Mr. DINGELL. Here we have an unfortunate situation where headquarters has one policy and you, Mr. Easley, in Johnson Space Center, has a different policy.

Mr. ABBEY. The Johnson Space Center policy is the same as General Dailey's in headquarters.

Mr. DINGELL. Would you please inform Mr. Easley of that.

Mr. ABBEY. He has been informed.

Mr. DINGELL. It will help us all because it will probably prevent other hearings like this or at least help reduce their frequency.

Mr. ABBEY. I certainly agree and we have so informed all the people that are involved at the Johnson Space Center.

Mr. DINGELL. Don't you have sort of a historical problem that you have one set of policies in Washington that you are going to control costs and have adequate reporting and Mr. Easley and all the good folks who are working in the Space Center have a different policy. Every time DCAA comes forward with an audit, they have a letter saying that the handbook is incorrect or disregard the audit because we don't agree with it.

At the same time, Mr. Easley is not getting the data that he needs on things like fees, management costs and bonuses. Is this a problem, General?

General DAILEY. It could be a problem at the present time and it is one that we are working on actively in the management reforms that we have incorporated that I mentioned earlier. I think that this particular incident is an isolated case where we have had the individual involved has corrected the error with a subsequent letter showing that he acknowledges that he is aligned with the agency policy in this regard.

But this is part of the cultural change in the management discipline that we are instilling in the agency and I think that we have the structure in place to make sure that this change takes place. I do not view this particular incident as a serious breach of policy by a center. I think that it was in this case perhaps a misjudgment by one of our senior supervisors that has been corrected in writing.

Mr. DINGELL. Well, General, I was an infantry man back in World War II, I guess a little before you were in, but I have some recollection of how it was done in the military and I manage the

committee and administered a Congressional office and have run some businesses. It has always been my rule that when I told somebody we were going to do something, we did it.

I sense that the problem here is that you have to see to it that folks at NASA understand that when you say something is going to be done, it is going to be done. I think that perhaps is a critical question.

This is not the only example of where the Johnson Space Center failed to see serious management problems. Let's look at the performance evaluation given for McDonnell Douglas for the period October 1992 through March of 1993. The additional rating that the center gave for the cost control performance was "good," overall rating was "excellent." Then the NASA Inspector General released a report that criticized McDonnell Douglas's cost control management during the same period as the performance evaluation.

You are familiar with that, are you not?

General DAILEY. Yes, sir. I am.

Mr. DINGELL. And Johnson Space Center then revised both ratings downward and incorporated some of the IG's findings in its evaluation. Does Johnson Space Center communicate with or been communicated with by the IG? Can you tell us the answer to that Mr. Easley or Mr. Abbey?

Mr. ABBEY. Yes. We do take action on those recommendations and since that time, Mr. Chairman, we have taken action and really put into place a whole new team to administer that effort. Mr. Easley works for our new Director of Business Management, Terry Hesse, who is here today and we have taken action to implement all recommendations of the DCAA audit and other appropriate audits.

Mr. DINGELL. The Center is supposed to oversee the contractor's performance everyday; is that right?

Mr. ABBEY. Yes, sir.

Mr. DINGELL. And supervising and overseeing the performance of the contractors everyday means they ought to be knowing what they are doing; right?

General DAILEY. Right.

Mr. DINGELL. And how well they are doing?

General DAILEY. Yes.

Mr. DINGELL. But here they missed all the deficiencies that were found by the IG, so they had to reduce a cost control performance of "good" and an overall rating of "excellent" as a result of the Inspector General's findings on the matter. Does that indicate to you that the Center there is doing a good job of supervising costs or does it indicate that maybe we ought to fire them and put the IG in charge of business down there?

General DAILEY. In fact, we have made major personnel realignments in this program as a result of our restructuring.

Mr. DINGELL. But it has happened and we must assume that if this is the kind of performance review and supervision of the contractors that is given by the center, there is need for substantial change. Must we not make that assumption?

Mr. ABBEY. Mr. Chairman, we have taken action on the award fee structure and the way we administer the award fee structure and given emphasis on the right areas I believe and we are taking



area action to change that taking into account the DCAA audit. We will put the emphasis in the right area and judge the contractors in the right fashion.

Mr. DINGELL. Can you, General, or you, Mr. Abbey, explain to us how Johnson Space Center could have so easily missed all the definitions that were found by the Inspector General?

Mr. ABBEY. I think they tended to put—in our award fee evaluations, they didn't put the emphasis on the right area and we have taken action to put that emphasis in the right area.

Mr. DINGELL. Why is that?

Mr. ABBEY. I think they were perhaps putting emphasis more on drawing releases at that time in that there was a great deal of pressure trying to get McDonnell Douglas to release drawings at that point.

Mr. DINGELL. We have quoted on several occasions from the opening statement of General Dailey in which he says the very survival of the Space Station program depends on how successful NASA and its contractors control and reduce costs proactively.

Here you have a Center that can't find a whole plethora of things wrong with the behavior of one of your major contractors. They are working with them everyday, the Inspector General sees what has been done and comes to the conclusion it has been poorly done. Happily, the rating was corrected.

General, did you instruct that rating be corrected or did somebody else do that?

General DAILEY. That initiative was taken by the center as a result of the Inspector General report, I believe. This was a situation where it was not detected by—

Mr. DINGELL. I am trying to understand—here you have an agency that has a major subordinate institution. We have gone through a number of instances where we find that there have been significant failures by the subordinate institution. I am curious—what is to be done to correct this problem?

You have the Space Center not rating its people properly, having very large cost overruns, not auditing, not scrutinizing its contractors in a proper fashion. What do we do?

General DAILEY. I think we have already done it and that is what I have been talking about in the restructuring not only of the management structure, but—the Space Station does not report to Johnson Space Center. It reports to the program director here at headquarters. The center now provides support in personnel and facilities, but the management structure is direct from the Office of Space Flight through the Director of the Space Station program to the program manager, who is located at Johnson.

Mr. DINGELL. Well, your thesis is that you are correcting this by intensifying the review and the reporting and the disclosure and the control.

General DAILEY. That is right; and training.

Mr. DINGELL. In NASA here.

General DAILEY. No, this—

Mr. DINGELL. I am curious. You have come to this decision with regard to the Space Station. I wonder if Johnson Space Center is doing well enough that we can trust them to deal with other Space Stations without the same kind of intensive supervision?

General DAILEY. I think they are. The initiatives that we have instituted are agency-wide. They don't apply just to Johnson, but to the entire agency. We have made dramatic changes to the way we do business in terms of instilling and installing discipline into the system and responsibility and accountability. We know exactly who is responsible in each case and who does what. As I mentioned in my initial comment, we had an unwieldy management structure by which Johnson and the Space Station program were trying to operate, and we think we have corrected that through this consolidation to a single prime and a host center.

Mr. DINGELL. Let's talk about contractor employee bonuses. What is the purpose of a contractor employee bonus?

General DAILEY. To incentivize the individuals involved in the contract.

Mr. DINGELL. Can you make the statement that the contractor employee bonuses have provided an incentive or that they have only provided additional income? It is clear they have provided additional income. Can you tell us that they have also provided incentives?

General DAILEY. I can't say with certainty, but I assume that they have.

Mr. DINGELL. Let's come back to the Holy Ghost. I have great faith in him. I believe in him, but I never shook his hand or met him, never had a word with him, but that is belief. You and I have been talking for the best part of the day, so I know you are there.

Do you know that these bonuses are providing incentive or that they are simply providing additional income?

General DAILEY. I don't know with certainty, as I said, sir.

Mr. DINGELL. In some instances, it is related to the size of the salary on a company-wide basis. In some instances, it is related to the share of the contract. In some instances, it is bottomed on other things. But do you have any information whatsoever that would indicate that any of these bonuses were done on the basis of an incentive basis?

Is there any difference in award amongst the companies that would indicate that they are done on other than simply a salary augmentation basis?

Ms. LEE. The particular employee bonuses are again a compensation plan. Each company—

Mr. DINGELL. I agree with that. They are a compensation plan, but are they an incentive plan.

Ms. LEE. It depends on each company. Each company has a compensation plan—

Mr. DINGELL. Don't you scrutinize these things?

Ms. LEE. DCAA does our compensation plan review.

Mr. DINGELL. They do it pursuant to the rules. Apparently you have no rules that address this question, do you?

Ms. LEE. They would follow the cost accounting standards in the Federal Acquisition Regulation. That would be the guidance on what is and is not allowable on the compensation plan.

Mr. DINGELL. DCAA was here today saying that they are not complying.

Ms. LEE. We are reviewing those specific compensation plans. We have talked to DCCA about redoing it, but we have in hand two

compensation plans that have been reviewed and have been approved. We need tighten our relationship with DCAA and find out what the conflict is.

Mr. DINGELL. IBM just flat refused to provide the information, as we have discussed with Mr. Easley, who said that the handbook was wrong on this particular matter. The subcommittee has asked for this information, and we asked our dear Mr. Easley here; we said, "Can you give us that information?" He said: "We are unable to provide any IBM data. The subcontract was novated to Boeing under SSPO in February 1994. Neither the McDonnell Douglas officials who were Prime to IBM, nor the Loral officials who acquired the IBM Division were able to provide the data." IBM said that that information was proprietary.

I am trying to find out what controls you have and what policies you have on this and how you administer them and whether you have to wait until your affairs are audited by DCAA to know whether you are making correct payments or not.

Don't you have, General, any in-house system of checking these things out yourself?

Ms. LEE. We do have to wait until the DCAA audit is finished before we make complete and final payment. We do make adjustments based on that.

Mr. DINGELL. We are just talking about the bonuses. We are trying to find out how you control the bonuses. This is not apparently a new thing and it didn't start this week nor did it start in March when IBM refused to provide the information to Mr. Easley and he said they didn't need to because the handbook was wrong.

What are your policies of auditing these things as you go along so you know what is happening. For example, if they won't tell you the information on bonuses because it is proprietary, will they tell you the information on the cost of a particular part or component?

Ms. LEE. We can pursue that information, yes.

Mr. DINGELL. Pursue, but I am asking what current policy you have in place which deals with these questions, because unless you have policies to control the amount you pay to assure that you have adequate and full reporting by the contractors, you simply are not going to be able to get the information you need to control costs and costs will keep going right up just like they are.

Now what policies do you have to look at your contracts as they go on to know what is going on before this committee requests a DCAA audit?

Ms. LEE. On the bonuses, we have a compensation review plan that is in the NASA FAR supplement to the Federal Acquisition Regulations that requires our folks to, I believe every 3 years, ensure that there has been a current compensation review and that our contractors are complying with that.

Mr. DINGELL. But you and General Dailey are sitting down there and you don't know what there is in the way of an ongoing continuing program you have to assure that you are able to control these costs. As a matter of fact, you haven't even be able as of this minute to get the information from IBM and good Mr. Easley here says that the handbook is wrong and they don't have to submit it and you, General Dailey, had to get him to withdraw it.

What ongoing mechanisms do you have in there to supervise the behavior of the contractors, to know on what they are spending money and whether they are reporting to you properly?

We are having a vast discussion here today about the fact that they wouldn't deal with you properly on the subject of bonuses. This makes me suspicious that just possibly they are not dealing with you properly on other matters. On one contract, you have a \$492 million item and you have \$100 million the DCAA says is being improperly billed for, and you have criminal investigations ongoing, but you have no way to deal with these questions in hand.

Is it because you don't have adequate revenues to properly supervise your contracts? Is it that you lack the will to properly do it, that your regulations are inadequate—what is it that is wrong down there?

General DAILEY. I believe that we have all the controls and all the revenues necessary to do what it is that we need to do. We are talking about things that have happened in the past under a different structure under a different set of circumstances. We are talking about 1 contractor out of 10 that failed to provide information in a specific area of which there were many other elements that are provided, and we are going to pursue that contractor to get the information that is required.

DCAA provides us with the audit service as to the bonuses that are paid and we operate on their recommendations. That is the system. They provide us with that service. We hire them to do that.

Mr. DINGELL. Here you have one, April 29 of this year. You have Boeing paid \$75 million for mischarging on defense contracts. What I am trying to have you tell me is, what internal mechanisms do you have to assure that your contractors report properly, deal with you truthfully, bill you correctly and properly and are properly audited and supervised by your agency, not wait and say, "We don't have any responsibility for this. This is DCAA's chore."

What do you have that does this?

General DAILEY. Our program management system that is in place for each program.

Mr. DINGELL. You told us you are just training your managers now.

General DAILEY. Those are the managers of the future.

Mr. DINGELL. What changes have taken place between the time we had this fuss over the question of whether they submitted data on their management compensation and bonuses to assure you that the system is going to run differently?

General DAILEY. We are talking about since last March.

Mr. DINGELL. That is right. That is 5 months ago.

General DAILEY. It has been for the last 18 months that things have been happening. The information that we are dealing with today is based upon past performance that happens in periods prior to incorporation of some of the management reforms and also prior to the new structure being incorporated.

The fact that these events are taking place at this time are based upon previous activities that were not influenced by some of the new management schemes that we have in place. So I am predicting that we have the controls in place so that we will be able to properly manage in the future.

Mr. DINGELL. Can you tell us why you shouldn't disallow any and all charges where the contractor cannot or refuses to provide proper supporting data? IBM simply says we don't have to provide that.

General DAILEY. We have means by which we can penalize them for failing to respond.

Mr. DINGELL. The refusal antedates March, and it is now almost the first of August. Are you dealing with them on that matter Mr. Easley?

Mr. EASLEY. I have started action with McDonnell Douglas to deal with that.

Mr. DINGELL. Have you told them you are going to lay sanctions or penalties in place to procure the data.

Mr. EASLEY. They know we will pursue recovery of the cost if determined to be unallowable.

Mr. DINGELL. Have you told them you are going to lay any sanctions or penalties in place?

Mr. EASLEY. Not sanctions or penalties, but we will get full recovery.

Mr. DINGELL. The FAR strictly limits the basis for employee bonuses. Bendix has been paying bonuses based on the amount of time that employees were billing to your projects. Is that proper?

Is that proper, General, Ms. Lee? Is that correct? Is that what should be done?

Ms. LEE. Can you repeat it again?

Mr. DINGELL. The FAR strictly limits the basis for employee bonuses. Now, Bendix has been paying bonuses based on the amount of time employees were billing to your project. Does that comply with the requirements of the Federal Acquisition Regulation, FAR? This apparently is a practice that has been going on for awhile.

Mr. EASLEY. Let me address that. Based on the information—there are two components of the bonuses. One is a true bonus, which is incentive compensation; the second piece is in lieu of a salary increase, in lieu of getting a 2 percent, 3 percent, 4 percent raise, called a lump sum. It was categorized as a bonus.

Bendix and McDonnell Douglas were two companies that had done some of that with their employees, but it was in lieu of a salary increase.

Mr. DINGELL. Let's look at this. Bendix is paying bonuses based on the amount of time of billing a project. In other words, bonuses are not based on performance, but they are based on who is charging the most time to NASA: "Fellows work late; it will increase your pay because not only will you get overtime, but you will also a bonus based on your billing."

It goes back to the classical argument about working by the hour as opposed to working by the job. What comment do you have to make?

Mr. EASLEY. I would need to review that further to make an intelligent remark about exactly how it is set up.

Mr. DINGELL. You are familiar with the booklet on MORE prepared by the Mission Operations Space Team—that is MOST. The subcontractor indicated that most criterion for excellence in productivity is an increase in the number of man-hours that contributes directly to contract tasks, is that right?

I am quoting from DCAA's report on their audit.

Mr. EASLEY. I cannot verify that, no, sir.

Mr. DINGELL. Would it concern you if that were so?

Mr. EASLEY. You say in terms of the number of hours worked on the project.

Mr. DINGELL. Let me read you the language. It says, in its booklet MORE, prepared by the Mission Operations Space Team, MOST, the subcontractor indicated that the MOST criterion for excellence in productivity is the increase in the number of manhours that contribute directly to contract tasks.

MOST set the excellence standard at 92 percent of the available hours. We believe that instead of direct hours charged the measurement of productivity should be the objectives accomplished.

Do you agree with that or not?

Mr. EASLEY. I will agree with that.

Mr. DINGELL. In other words, what is the result of the higher percentage of direct hours charged? How much more productive are these additional hours? Can the same objective be accomplished with fewer hours?

The fact that 92 percent or more of the available hours were charged directly to the contract tasks does not prove that NASA received a higher return for its contract subcontract dollars. Do you agree with that?

Mr. EASLEY. I assume they are getting at the productive effort that is being accomplished.

Mr. DINGELL. That is the basis on which bonuses are paid. In other words, the more time they charge, the more they get in bonuses as opposed to greater productivity and efficiency.

Do you have any say at all on bonuses down there General?

General DAILEY. No, sir.

Mr. DINGELL. Do you have any say?

Mr. EASLEY. The way we handle those types of things is what Ms. Lee was saying, is in compensation reviews, and we have requested those over a year ago on 10 of our contracts which some have been completed—

Mr. DINGELL. You haven't got them yet, have you?

Mr. EASLEY. We have received two compensation reviews.

Mr. DINGELL. Two out of how many?

Mr. EASLEY. We probably requested fifteen or so.

Mr. DINGELL. Out of fifteen, you have gotten two. Was IBM one of them?

Mr. EASLEY. No, sir. DCAA gave us compensation reviews on Loral and Lockheed. They have others scheduled.

Mr. DINGELL. What did you find on that?

Mr. EASLEY. The DCAA report indicated that the reviews were in compliance with Federal Acquisition Regulation on total compensation, which includes bonuses. The FAR includes them.

The section cited of the FAR includes salary package as well as bonuses and other forms of incentive compensation. I will be glad to provide your staff with copies of those reports.

Mr. DINGELL. That would be appreciated.

General, we have kept you a long time. Thank you very much for your assistance to the committee today.

The committee stands adjourned.

[Whereupon, at 3:15 p.m., the subcommittee was adjourned.]  
[The following information was received.]

## FILE COPY

AUDIT REPORT NO.  
3521-93C13020001  
CHROM NO. 0418

20 September 1993

REPORT ON REVIEW OF CONTRACTOR EMPLOYEE  
COMPENSATION SYSTEM  
LOCKHEED ENGINEERING AND SCIENCES COMPANY, INC.  
HOUSTON, TEXAS

Under the provisions of Title 32 Code of Federal Acquisition Regulations, Part 290.26(b) (2), any Freedom of Information Act requests for audit reports received by DCAA will be referred to the cognizant contracting Agency for determination as to releasability and a direct response to the requestor.

Contractor information contained in this audit report may be proprietary. The restrictions of 18 USC 1905 should be considered before this information is released to the public.

This report may not be released to any Federal agency outside the Department of Defense without the approval of Headquarters, DCAA, except to an agency requesting the report in negotiation or administering its contract.

CENTRAL REGION  
HOUSTON BRANCH OFFICE  
DEFENSE CONTRACT AUDIT AGENCY  
HOUSTON, TEXAS

FOR OFFICIAL USE ONLY



## DEFENSE CONTRACT AUDIT AGENCY

CENTRAL REGION  
HOUSTON BRANCH OFFICE  
2876 GULF FREEWAY, SUITE 800  
HOUSTON, TEXAS 77017-6844



Audit Report No. 3521-93CL3020001

20 September 1993

SUBJECT: Audit Report on Contractor Employee  
Compensation System Review (CSCR)  
Lockheed Engineering and Sciences Company, Inc.  
Houston, Texas

TO: Defense Logistics Agency  
DCMRO, Houston Residency  
ATTN: Lloyd Billiter  
2320 LaBranch Street, Box 16  
Houston, Texas 77004-1082

### 1. Purpose and Scope of Audit

a. As part of our comprehensive audit of the Lockheed Engineering and Sciences Company, Inc. (LESC), we reviewed the contractor's employee compensation system. The purposes of our review were to (1) determine the adequacy of the contractor's compensation system for establishing and maintaining reasonable employee wages and salaries consistent with the services provided and in compliance with FAR 31.205-6; (2) determine the contractor's compliance with its compensation policies and procedures; (3) identify any unreasonable costs and system deficiencies that require contractor corrective action; and (4) report on the reliability of the contractor's compensation system to provide reasonable compensation costs.

b. Except as discussed in paragraph 2, we conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the data and records reviewed are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the accounts and disclosures in the data and records reviewed. An audit also includes assessing the accounting principles used and significant estimates made by the contractor, as well as evaluating the overall presentation. We believe that our audit provides a reasonable basis for our opinion.

c. We performed our review during the period from 7 December 1992 through 7 June 1993. The review included an evaluation of the contractor's policies/procedures, job descriptions, job evaluation plans, salary/wage structures, and employee personnel files. We compared specific job classifications to benchmarks contained in wage and salary surveys reflecting the competitive labor market.

### 2. Circumstances Affecting the Review

Our results of audit are qualified to the extent that subsequent reviews by DCMA, the contract administration office, or others, of insurance, pension, and other fringe benefits may supplement the findings of this review. Further, we

FOR OFFICIAL USE ONLY



Audit Report No. 3521-93CL3020001

did not test whether or not the contractor's labor skill mix was comparable to its skill mix initially proposed for contract performance. We will review this in the near future.

### 3. Background Information

Lockheed Engineering & Sciences Company is a subsidiary of the Lockheed Corporation, Culverhouse, California, and has been in existence since 1 January 1980. LESC is primarily engaged in providing engineering, scientific, technical, and management support services to the National Aeronautics and Space Administration (NASA) in the Space Shuttle program and the developing Space Station program. The contractor also has government contracts with the Army and Navy. LESC reorganized on 1 January 1993, to establish a new company Lockheed Environmental Systems and Technologies Company (LESTAT). LESTAT took over LESC's existing EPA contracts and future environmental effort.

LESC's corporate headquarter is located at 2625 Bay Area Boulevard, Houston, Texas where the accounting records are maintained on a calendar year basis.

LESC consists of eleven programs as follows:

- |                                |  |
|--------------------------------|--|
| 1. B870 Program                | NASA, Johnson Space Center/Houston, Texas    |
| 2. Washington Area Program     | Washington, D.C.                             |
| 3. Western Program             | NSA, Ames Research Center, Moffett Field, CA |
| 4. White Sands Test Facility   | NSA, White Sands Test Facility, New Mexico   |
| 5. White Sands Missile Range   | Army, White Sands Missile Range, New Mexico  |
| 6. Army/Dugway Proving Grounds | Utah   |
| 7. Intercompany Program        | Houston, Texas                               |
| 8. Marine Systems Program      | U.S. Navy, San Diego, CA                     |
| 9. Special Programs            | Classified                                   |
| 10. Langley Program            | NASA, Langley Research Center, Hampton, VA   |
| 11. Supercollider Program      | Dallas, Texas                                |

c. LESC's sales for CY1991 are \$387,788 million and for CY 1992 \$386,915 million. About 88 percent of LESC's sales for both years are to the U.S. Government as presented below.

	Sales			
	CY 1991		CY 1992	
	Amount (000's)	Percent ( % )	Amount (000's)	Percent ( % )
U.S. Government				
Defense	\$ 34,285	8.84	\$ 32,741	8.45
Non-Defense	306,678	79.08	309,993	80.12
Total	\$340,963	87.92	\$342,734	88.57

	Sales			
	CFY 1991		CFY 1992	
	Amount (000's)	Percent ( % )	Amount (000's)	Percent ( % )
Foreign Government-Direct	\$ 92	0.02	\$ 88	0.02
Commercial				
Domestic	\$ 1,190		\$ 5,961	1.54
Export	—		287	0.07
Total	\$ 1,190	0.31	\$ 6,228	1.61
Intercompany	\$ 48,545	11.75	\$ 37,868	9.79
Total Sales	\$387,788	100.00	\$386,915	100.00

d. In December 1991, the contractor had 1,918 salaried Houston located employees with associated gross annual compensation of about \$86,497,000. In December 1992, the number of salaried Houston-located employees dropped to 1,803 with associated gross compensation of about \$83,342,000.

#### 4. Summary of Audit Results

a. We qualified the results of audit as explained in paragraph 2 of this report. In our opinion, the contractor's employee compensation system is acceptable for generating reasonable costs. Based on a comparison of the contractor's average weighted wages and salaries to national and local industry compensation survey data, our review disclosed no compensation costs that would be considered unreasonable under FAR 31.205-6(b).

However, we identified a condition relative to benchmarking which, if corrected, would increase reliability on the results of the contractor's comparison of its salaries with external market surveys. This condition is detailed below:

##### (1) Condition

The salary data used by the contractor are not comparable to the Hughes Aircraft Company survey salary data used by LSC for benchmarking in two ways.

(a) The contractor compared its nonsupervisory engineering average salaries with results of the Hughes survey for supervisory and nonsupervisory engineering average salaries. The comparison of nonsupervisory engineer average salaries with both nonsupervisory and supervisory engineers is inappropriate because supervisory salaries are usually higher than nonsupervisory salaries.

Audit Report 3521-93C13020001

(b) The contractor compared its salary grades with the number of years experience since Bachelor's degree in the Hughes survey. For example, LESC compared its salary grade nine with the Hughes survey for nine years of experience. However, salary grade nine has employees with varying years of experience since his or her Bachelor's degree.

(2) Recommendation

To achieve reliable results for salary comparison with external market surveys, we recommend that the contractor sort its data in the same manner as the external survey used. If the contractor uses nonsupervisory engineers in its benchmarking, then the contractor should only compare with nonsupervisory engineers included in the external salary survey. Further, if the external salary survey uses years of experience since bachelor's degree to develop average salaries, the contractor should follow that same methodology for benchmarking.

(3) Contractor's Reaction

In future benchmarking, the contractor will compare its salaries in accordance with the comparative survey data. (See Appendix 1 of this report for the contractor's complete response.)

(4) Auditor's Reminder

Since the contractor in essence has concurred with our recommendation and during the audit provided the salary data in a manner which we could review, no further action is required at the time. We will review this condition in our next compensation review of LESC to ensure compliance.

b. Our review was limited to an examination of the contractor's compensation system. Accordingly, we express no opinion on the contractor's system of internal controls taken as a whole.

c. We discussed the results of our review and recommendation with Mr. Arthur Lenke, Human Resources Manager. The contractor's response to our recommendation is incorporated in the contractor's response section of this report, paragraph 4.a(3), above.

d. Use of this audit report information for purposes other than that intended should not be made without prior consultation with this office regarding its applicability.

5. Status of Corrective Action Taken On Prior Recommendations

From our prior review of the contractor's compensation system, reference Audit Report No. 3521-OC130060 dated 11 September 1990, we noted that the contractor had no formal benchmarking and inadequate supervisory job descriptions. To correct these conditions, we recommended that the contractor submit to DCMA every 15 January the following:

Audit Report 3521-93C1302001

a. an annual list of classifications, by program areas, reflecting the average wage and salary levels as an alternate to formal benchmarking; and

b. a schedule listing the minimum and actual qualifications, experience, and grade levels of each supervisory classifications as these supervisory qualifications are not specified in the position guide document.

The contractor has been complying with the above recommendations.

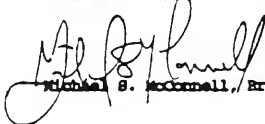
4. Disposition of Audit Results

a. Accounting counsel advice or additional audit service which may be required can be obtained by contacting Mr. Gary Catt, Supervisory Auditor, Houston Branch Office, at (713) 946-6595.

b. We would like to thank the contractor for their support and cooperation during the review, especially, Mr. Art Lemke who always responded to our requests on a timely manner.

c. This audit was performed by Ms. Tita M. Rabang, Auditor. We would appreciate your comments and suggestions for improving our audit services and/or related audit support.

DEFENSE CONTRACTS AUDIT AGENCY



Michael S. McConnell, Branch Manager

Copy furnished:  
See Distribution List

## DISTRIBUTION LIST

National Aeronautics and Space Admin  
Lyndon B. Johnson Space Center  
STS Engineering and Equipment Procurement Branch  
Contracting Officer  
ATTN: Ms. Laura Pepper/BC2  
Houston, Texas 77058

National Aeronautics and Space Admin  
Lyndon B. Johnson Space Center  
ATTN: Office of Inspector General  
Building 1, Room 161/W-J8  
Houston, Texas 77058


U.S. Environmental Protection Agency  
Southern Audit Division  
Office of the Inspector General  
ATTN: Dalton Leonard  
1375 Peachtree Street, N.E., Suite 276  
Atlanta, Georgia 30309

Lockheed Engineering and Sciences Co. (thru AOO)  
2628 Bay Area Boulevard  
Houston, Texas 77058

Defense Contract Audit Agency  
Lockheed Corporation  
ATTN: Resident Auditor  
4500 Park Granada Boulevard  
Calabasas, California 91399-0357

Defense Contract Audit Agency  
Central Region  
ATTN: RSO-3  
104 Decker Court, Suite 300  
Irving, Texas 75062-2795

Defense Contract Audit Agency  
ATTN: OPD  
Cameron Station  
Alexandria, Virginia 22304-6178

 **Lockheed**  
*Engineering & Sciences Company*  
 Two Corporate Plaza, 2625 Bay Area Blvd  
 P O Box 54999, Houston, Texas 77258-8999

Corporate Offices: (713) 283-4400  
 Fax: (713) 283-4660

August 23, 1993

Ms. Titi Rabenz  
 DEFENSE CONTRACT AUDIT AGENCY  
 2625 Bay Area Blvd.  
 Houston, Texas 77058

Subject: Draft Compensation System Review Audit Report (July 6, 1993)  
 Audit Report No. 3821-OC:30060

Dear Ms. Rabenz:

Per your request, this office has reviewed your "draft audit report" of July 6, 1993. I have found the report to be very thorough and complete.

I would like to respond to the two identified areas of benchmarking.

Item 1: The contractor compared its nonsupervisory engineering average salaries with results of the Hughes Survey for supervisory and nonsupervisory salaries.

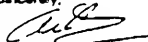
Response: It is the practice of LESC to benchmark several variations of its supervisory and nonsupervisory engineering work force enabling us to look at our salaried rate from diverse viewpoints. One of those variations is a comparison of all LESC's engineers (supervisory and nonsupervisory) to the engineers in the Hughes Survey. This office gave you that comparison rather than the one you were looking for (engineers nonsupervisory to engineers nonsupervisory) in error. This office will supply the appropriate benchmark variation for future audits.

Item 2: The contractor compared its salary grades with the number of years experience since Bachelors degree in the Hughes Survey.

Response: LESC's does several comparisons of it's engineers education/experience to the Hughes Survey. For future benchmarking this office will include a straight years since degree variation.

Thank you for the opportunity to review the "draft" and this office looks forward to receiving the final report.

Sincerely,



A. R. Lemke  
 Manager, Human Resources

**FILE**

AUDIT REPORT No. 3521-93DL3020002

1 July 1993

REPORT ON REVIEW OF CONTRACTOR EMPLOYEE  
COMPENSATION SYSTEM Review (COCR)  
LOCAL SPACE INFORMATION SYSTEMS  
HOUSTON, TEXAS

Under the provisions of Title 32 Code of Federal Acquisition Regulations, Part 290.26(b) (2), any Freedom of Information Act requests for audit reports received by DCAA will be referred to the cognizant contracting Agency for determination as to releasability and a direct response to the requestor.

Contractor information contained in this audit report may be proprietary. The restrictions of 18 USC 1905 should be considered before this information is released to the public.

This report may not be released to any Federal agency outside the Department of Defense without the approval of Headquarters, DCAA, except to an agency requesting the report in negotiation or administering its contract.

DEFENSE CONTRACT AUDIT AGENCY  
CENTRAL REGION  
HOUSTON BRANCH OFFICE  
HOUSTON, TEXAS



## DEFENSE CONTRACT AUDIT AGENCY

CENTRAL REGION  
HOUSTON BRANCH OFFICE  
8878 GULF FRIERWAY, SUITE 800  
HOUSTON, TEXAS 77017-6544



Audit Report No. 3521-93D1302002  
(0402)

1 July 1993

SUBJECT: Audit Report on Contractor Employee  
Compensation System Review (CHECK)  
Loral Space Information System  
Houston, Texas

TO: Distribution List

1. Purpose and Scope of Audit

a. As part of our comprehensive audit of the Loral Space Information System (LSIS), we reviewed the contractor's employee compensation system. The purposes of our review were to (1) determine the adequacy of the contractor's compensation system for establishing and maintaining reasonable employee wages and salaries consistent with the services provided and in compliance with FAR 31.205-6; (2) determine the contractor's compliance with its compensation policies and procedures; (3) identify any unreasonable costs and system deficiencies that require contractor corrective action; and (4) report on the reliability of the contractor's compensation system to provide reasonable compensation costs.

b. Except as discussed in paragraph 2, we conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the data and records reviewed are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the data and records reviewed. An audit also includes assessing the accounting principles used and significant estimates made by the contractor, as well as evaluating the overall presentation. We believe that our audit provides a reasonable basis for our opinion.

c. We performed our review during the period from 7 April 1993 through 10 June 1993. The review included an evaluation of the contractor's policies/procedures, job descriptions, job evaluation plans, salary/wage structures, and employee personnel files. We compared specific job classifications to benchmarks contained in wage and salary surveys reflecting the competitive labor market.

FOR OFFICIAL USE ONLY



Audit Report No. 1521-9301302007

2. Circumstances Affecting the Review

The results of audit are qualified to the extent that subsequent review by DCAA, the contract administration office, or others, of insurance, pension, and other fringe benefits may supplement the findings of this review.

3. Background Information.

a. The contractor receives most of its contracts through NASA/Johnson Space Center located in Houston. Approximately 96% is cost type. The work is virtually 100 percent government contracts. Services delivered are engineering with a small amount of manufacturing. Loral employs approximately 1200 people. LSIIS was previously part of the Loral Space Missions Group. On 1 January 1991 LSIIS became a stand alone division.

b. LSIIS's sales are \$180,816 million and \$136,857 million for CY 1992 and CY1993 respectively. The details are presented as follows:

	Sales			
	CY 1992 *		CY 1993	
	Amount (\$000)	Percent ( % )	Amount (\$000)	Percent ( % )
U.S. Government				
Defense	\$ 6,091	3.0	\$ 4,349	3.0
Nondefense	173,555	26.0	132,169	26.7
Total Govt. Sales	179,646	99.0	136,518	99.7
Commercial	1,170	1.0	340	0.3
Total Sales	180,816	100.0	136,857	100.0

\* The contractor's fiscal year 1992 was a fifteen month period, beginning 1 January 1991 and ending 31 March 1992.

4. Summary of Audit Results

a. We qualified the results of our audit as discussed in paragraph 2 of this report. The contractor's compensation cost is within acceptable guidelines compared to the average weighted wages and salaries of national and local professional and technical compensation survey data. The contractor's compensation policies and procedures are considered adequate for maintaining its compensation system. In our opinion, the contractor's employee compensation system for non executive personnel is acceptable for generating reasonable costs under FAR 31.205-6(b).

Audit Report 3521-93D1302002

b. Our review was limited to an examination of the contractor's compensation system for non-executive personnel. DCAA Corporate Office in New York is reviewing executive level salaries, (i.e. vice president and above). Accordingly, we express no opinion on the reasonableness of executive level salaries or the contractor's system of internal controls taken as a whole.

c. The results of our review were discussed with the contractor's representative, Mr. Sam Reed, Manager of Compensation and Benefits, on 17 June 1993.

d. The information contained in this report should not be used for other purposes without first discussing its applicability with our office.

4. Disposition of Audit Results.

a. Upon request, accounting counsel and additional audit services which may be required can be obtained by contacting Mr. Edil Ruzopeta, Supervisory Auditor, at commercial telephone (713) 946-6395, or Fax (713) 946-6480.

b. This audit was performed by Margaret Lindsey. We would appreciate your comments and suggestions for improving our audit services and/or related audit support.

c. We would like to commend the contractor for their support and cooperation during our review, especially, Mr. Sam Reed, Human Relations Manager, who always responded to our requests in a timely manner.

DEFENSE CONTRACT AUDIT AGENCY

*Michael S. McConnell*  
for Michael S. McConnell, Branch Manager

Copy furnished:  
Distribution List

Audit Report No. 3521-9301302002

DISTRIBUTION LIST

	<u>No. of Copies</u>
Defense Logistics Agency DCSAO - San Antonio ATTN: DCSAO-GS/CNE/Williter 2320 LaBranch, Box 1 Houston, Texas 77004	1
National Aeronautics and Space Administration Johnson Space Center ATTN: Virginia Willis/EGZ Houston, Texas 77058	1
National Aeronautics and Space Administration Johnson Space Center ATTN: Steve Cleland/EGZ Houston, Texas 77058	1
National Aeronautics and Space Administration Johnson Space Center ATTN: Jane Brandestien/EGZ Houston, Texas 77058	1
Director Office of Inspector General National Aeronautics and Space Administration Johnson Space Center ATTN: Code W-JB Houston, Texas 77058	1
Defense Contract Audit Agency Central Region ATTN: RST-W 106 Decker Ct., Ste. 300 Irving, Texas 77062-2795	1

National Aeronautics and  
Space Administration

Headquarters

Washington, DC 20546-0001



Reply to Attn of

Office of Inspector General.

The Honorable John D. Dingell  
Chairman  
Subcommittee on Oversight and  
Investigations  
Attn: Robert L. Roach  
2328 Senate House Office Building  
Washington, DC 20515-2216

Dear Mr. Chairman:

Enclosed are copies of the three reports issued by my office during July 1994. In addition, the following is a brief summary of the most significant report.

A survey of institutional support contracts at Johnson Space Center (JSC) found that JSC has not evaluated the feasibility and cost effectiveness of consolidating these contracts since 1973. In the past 10 years, four NASA Centers have achieved significant program improvements and cost savings through contract consolidations. The benefits of these consolidations included: (1) reduced contractor interface; (2) reduction in contract administration resources for contract award process; (3) more direct chain of command; (4) improved accountability; and (5) improved performance evaluation. Kennedy Space Center (KSC), for example, consolidated all institutional functions into one contract in the early 1980s. KSC officials estimated savings associated with the consolidation of \$13.1 to \$66.9 million for fiscal years 1984 to 1989.

JSC is contracting separately for institutional support functions based on problems experienced with the 1970 consolidated contract and to meet small and disadvantaged business goals. We recommended that JSC's Directors of Procurement and Center Operations: (1) evaluate the feasibility and cost effectiveness of consolidating part or all of the institutional support service contracts; and (2) provide supporting rationale for the contracting method selected to obtain the institutional support functions. JSC concurred with the recommendation and indicated that the results of their examination of the contracts should be available by the end of calendar year 1994. They indicated, however, that small disadvantaged business goals would be factored into this evaluation. JSC's corrective actions are responsive to our recommendation.

If you or your staff have any questions regarding any of the three enclosed audit reports, please call me at (202)358-1220.

Sincerely,

*Bill D. Colvin*  
Bill D. Colvin  
Inspector General

3 Enclosures to RR

ONE HUNDRED THIRD CONGRESS

ROOM 3313  
NATIONAL HOUSE OFFICE BUILDING  
PHONE 202-225-4441

JOHN D. DINGELL, MICHIGAN, CHAIRMAN

THEODORE BROWN, OHIO  
MARJORIE MARGOLIS BASHETZWEIG,  
PENNSYLVANIA  
HENRY A. WALLACE, CALIFORNIA  
CAROLIS COLLINS, ALABAMA  
RON HYDER, OREGON  
JOHN BENTLEY, TEXASDAN SCHAEFER, COLORADO  
CARLOS J. MOOREHEAD, CALIFORNIA  
JOE BARTON, TEXAS  
FRED LIPTON, MICHIGAN

**U.S. House of Representatives**  
**Subcommittee on Oversight and Investigations**  
 of the  
**Committee on Energy and Commerce**  
 Washington, DC 20515-6110

RED FF STURTE STAFF DIRECTOR/CHIEF COUNSEL

August 29, 1994

VIA FACSIMILE

The Honorable Daniel S. Goldin  
 Administrator  
 National Aeronautics and Space Administration  
 300 E Street, S.W.  
 Washington, D.C. 20546

Dear Mr. Goldin:

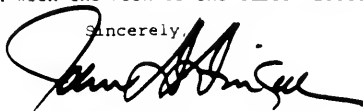
Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives, the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce is continuing its long-standing investigation of the adequacy of disclosures under the securities laws by government contractors. In particular, the Subcommittee is now examining the adequacy of those disclosures by major publicly held companies holding significant contracts for work on the space station. During the Subcommittee's hearing on problems with budgeting and financial control systems involving major publicly held contractors on the space station held on July 27, 1994, NASA's Deputy Administrator, General John R. Daily, agreed to provide various documents and data for the record. Those documents and data are listed in Attachment A.

To further the Subcommittee's review, we would also like additional information on the selection of the prime contractor for the new space station. Specifically, we request the documents listed in Attachment B.

Please furnish the requested documents no later than the close of business on Monday, September 12, 1994. The definitized contract with Boeing can be provided when it becomes available. If you have any questions concerning this matter, please contact Robert L. Roach or Hilary C. Sullivan of the Subcommittee staff at (202) 225-4441.

Thank you for your attention to this matter, as well as your agency's cooperation with the work of the Subcommittee.

Sincerely,



John D. Dingell  
 Chairman  
 Subcommittee on  
 Oversight and Investigations

Enclosures

cc: The Honorable Dan Schaefer  
 Ranking Republican Member  
 Subcommittee on Oversight and Investigations

## Attachment A

Material Requested of NASA During the Subcommittee Hearing

1. NASA's cost estimate of Space Station Freedom (SSF) before its termination.
- 2a. The date when SSF project management first knew of the project's cost overruns and the estimated project overrun at that time.
- 2b. The date the project was terminated and the estimated project overrun at that time.
3. The bases for and analyses of the Boeing selection. (This should cover all associated documentation including, but not limited to, the pre-negotiation and post-negotiation memoranda on the Boeing letter contract).
4. The amount of money being withheld from IBM.
5. The schedule of when DCAA's audits of Boeing's overhead submissions (1987-1993) will be completed.
6. NASA's letters to the SSF contractors informing them of the project's overhaul and directing them on how to minimize costs incurred during that period.
7. The space station's monthly expenditures before NASA notified its contractors of the overhaul and after such notification (six months of data for both periods).
8. The amount spent on the space station since Boeing received the letter contract. Include Boeing's expenses as well as other expenses incurred by NASA.
9. NASA's written policy on augmenting or modifying NASA Handbook 950.2b.
10. DCAA's compensation reviews of Lockheed and Loral.

## Attachment B

1. All correspondence between NASA and space station contractors regarding the selection of a single prime contractor.
2. The data each contractor provided to NASA for consideration in the prime contractor selection.
3. The Boeing letter contract.
4. The Boeing definitized contract, when available.

National Aeronautics and  
Space Administration  
**Headquarters**  
Washington DC 20546-0001



94 OCT -6 PM 4:42

U.S. AIR FORCE

OCT 5 1994

Reply to Attn of

LB:MDD:LA94-411f

Honorable John D. Dingell  
Chairman  
Subcommittee on Investigations  
and Oversight  
Committee on Energy and Commerce  
House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

Enclosed is the additional material requested subsequent to the July 27, 1994, hearing at which Gen. Dailey testified on space station contracting. This information completes the material requested during that hearing. As indicated, a copy of the definitized contract with the Boeing Defense and Space Group will be furnished to the Subcommittee as soon as it is available.

Sincerely,

Mary D. Kerwin  
Deputy Associate Administrator  
for Legislative Affairs

Enclosure



National Aeronautics and  
Space Administration

Lyndon B. Johnson Space Center  
2101 NASA Road 1  
Houston, Texas 77058-3696



Reply to Attn of:

BB-94-049

AUG 24 1994

Mr. Robert L. Roach  
Special Assistant  
Subcommittee on Oversight and Investigations  
Committee on Energy and Conservation  
2323 Rayburn House Office Building  
Washington, DC 20515

Dear Mr. Roach:

It was a pleasure to meet you at the pre-hearing meeting on July 21, 1994. On the following day, Ms. Hesse, Director of Business Management at the Johnson Space Center (JSC), met with you to review our action plan to address the Defense Contract Audit Agency (DCAA) audit findings of JSC's major contractors' budget and financial control systems. I have summarized the action plan below and want to inform you that individuals involved in these activities have been instructed to correct any other irregularities or deficiencies that surface during the implementation process.

Improved External Communication

- JSC and the Dallas regional office of the DCAA have agreed to work cooperatively in the disposition of all audit issues. Joint planning and strategy sessions are addressing verification of the implementation of corrective actions.
- JSC senior management, with DCAA participation, will brief the Chief Executive Officers and Chief Financial Officers of all JSC contractors on the results of the DCAA audit, as well as corrective actions being taken by JSC. Meetings will also be held with individual contractors to discuss outstanding audit issues.

Oversight and Review

- A JSC Oversight Committee has been established to review all JSC service contracts. The objective of the committee's work is to streamline and improve management practices and promote cost effectiveness in our procurement activities.
- All current NASA Form (NF) 533 deliverable contractor cost reports will be reviewed by a senior JSC working group to determine if the basic intents and



NASA financial requirements of the report are properly instituted, including: use of appropriate work breakdown structures, proper accounting methodologies, logical and well-defined methods of determining estimates-to-complete, accuracy of auxiliary financial and schedule reports, and compliance with the NASA handbook on contractor cost and performance reporting.

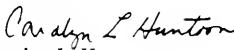
- JSC contracting officers are providing written direction to contractors that responds to specific DCAA audit recommendations (numbers 1 through 6), as well as requiring contractors to establish formal written NF533 cost reporting policies and procedures, proper internal financial controls, proper cost estimates, accurate budgeting baselines, and formal configuration management controls to eliminate unauthorized cost growth.
- Award fee evaluation procedures are being clarified and improved, including the development and application of a critical budgeting and financial control systems checklist.
- Government and private industry will be benchmarked to determine the “best practices” being employed in level-of-effort contracting. Continuous improvement metrics will then be developed.
- JSC will work closely with the DCAA to devise an optimal solution for contract management bonuses and “idle” time reporting.

#### Financial Training

- Within 90 days, all contracting officers, contracting officer technical representatives, and business managers at JSC will attend intensive contract administration training.
- The JSC Comptroller will develop a more comprehensive and expanded contractor NF533 training course which includes the DCAA’s recommended improvements.

Ms. Hesse is the JSC focal point for the overall coordination and disposition of the DCAA audit recommendations and implementation of JSC’s plan of action. She is placing key emphasis on providing verifiable results through audit trails, documentation, and substantiated evidence that we have met our objectives. I am confident that the proper processes and controls are being put into place to establish JSC as a model organization with high cost efficiency, contract administration, and business management standards and practices.

Sincerely,



Carolyn L. Huntoon  
Director



ISBN 0-16-046546-X



9 780160 465468