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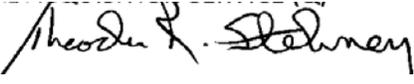
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MEMORANDUM FOR MARTHA JOHNSON  
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FROM:

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SUBJECT: Observations on IT support task order for the Department of Homeland Security Consolidation at Saint Elizabeths

This memo presents our observations relative to the recent award, protests, and cancellation of a \$2.6 billion Alliant task order for campus-wide information technology (IT) infrastructure design, implementation, operations, and maintenance at the Department of Homeland Security (DHS) Headquarters Consolidation project at the Saint Elizabeths campus. We are providing these observations for consideration in formulating any re-compete strategy. The procurement was managed by the FAS Assisted Acquisition Service Division out of the National Capital Region under the terms of an intra-agency agreement between PBS and FAS.

In summary, we noted that:

- (1) The director of the region's Assisted Acquisition Service served in multiple roles on the procurement management team, including project manager, chair of the technical evaluation panel, contracting officer's technical representative, and contracting officer's supervisor. As a result, the team composition lacked adequate separation of duties and compromised the contracting officer's ability to render independent determinations and ensure FAR compliance.
- (2) The contract was missing a profit sharing formula and a specified production point, both key elements needed in order to implement the cost sharing and price renegotiation features of the incentive contract type selected. This undercut the goal of ultimately negotiating a firm-fixed price for services.

- (3) The contract ceiling prices, and the cost estimates upon which they were based, did not include labor rate escalation. As a result, it is likely that labor costs were significantly understated over the 10-year performance period of the contract.
- (4) As structured, award of operations and maintenance prior to fully designing the infrastructure scope introduced an avoidable risk premium and likely increased costs.
- (5) In awarding broadly-scoped requirements spanning a 5-year base performance period, FAS created an obligation that exceeds its available funding. Incremental funding of these non-severable services violated the bona fide needs rule.

Our review was not an audit; fieldwork was limited to inquiries of PBS and FAS management and to a review of task order documentation. Neither a response nor formal action plan is required.

## **Observations**

### **(1) Procurement team composition compromised controls**

As composed, the procurement team did not preserve the independence of the contracting function, disturbing the necessary balance between program wishes, and the rules of procurement. The team included a project manager, contracting officer, and a five-member technical evaluation panel (TEP). The director of the region's Assisted Acquisition Service served in multiple roles, including: project manager; chair of the TEP; and contracting officer's technical representative. The director is also the contracting officer's supervisor. This arrangement defeats a necessary procurement internal control feature by compromising the contracting officer's ability to render independent determinations with respect to task order structure, source selection plan, results of technical evaluation, and ultimately the award decision itself. Possible cause: the requirements of this procurement appear to have exceeded the staffing capabilities of the performing office.

### **(2) Contract missing key elements needed to manage cost risk**

The task order omitted certain key elements necessary to implement the cost sharing and price renegotiation features that are the primary attributes of the contract type selected. Absent these elements, the contract takes on the characteristics of a cost-reimbursable arrangement, with all cost risk transferred to the Government.

The task order employed a contract type known as fixed-price incentive, successive targets. FAR 16.403 describes a fixed-price incentive contract as

*"...a fixed-price contract that provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost. The final price is subject to a price ceiling, negotiated at the outset."*

The “successive targets” is a subgenre of the type. Per FAR 16.403-2 *{emphasis added}*:

*“A fixed-price incentive (successive targets) contract specifies the following elements, all of which are **negotiated at the outset**:*

- i. An initial **target cost**.*
- ii. An initial **target profit**.*
- iii. An initial **profit adjustment formula** to be used for establishing the firm target profit, including a ceiling and floor for the firm target profit. (This formula normally provides for a lesser degree of contractor cost responsibility than would a formula for establishing final profit and price.)*
- iv. The **production point** at which the firm target cost and firm target profit will be negotiated (usually before delivery or shop completion of the first item).*
- v. A **ceiling price** that is the maximum that may be paid to the contractor, except for any adjustment under other contract clauses providing for equitable adjustment or other revision of the contract price under stated circumstances.”*

The task order as awarded omitted both the profit adjustment formula and a specified production point. Again per FAR 16.403-2, the production point is a trigger for additional price negotiation.

*“When the production point specified in the contract is reached, the parties negotiate the firm target cost, giving consideration to cost experience under the contract and other pertinent factors. The firm target profit is established by the formula. At this point, the parties have two alternatives, as follows:*

- i. They may negotiate a firm fixed price, using the firm target cost plus the firm target profit as a guide.*
- ii. If negotiation of a firm fixed price is inappropriate, they may negotiate a formula for establishing the final price using the firm target cost and firm target profit. The final cost is then negotiated at completion, and the final profit is established by formula, as under the fixed-price incentive (firm target) contract...”*

The procurement rules give the ordering agency broad latitude in structuring its procurement, but the result must reside within the regulatory framework. The omissions here not only produced a non-compliant contract structure, but created a disincentive to enter into final price negotiations.

The following discussion will help explain this issue. The table below presents the ceiling price for each of the contract line items. The base period is 5 years from date of award. The option periods are for 2 and 3 years respectively.

Contract Line Items (CLINs)	Ceiling Price (\$ millions)		
	Base	Option 1	Option 2
<b><i>FPI successive targets CLINs</i></b>			
1. Project management support	\$ 37.5	\$ 15.0	\$ 22.5
2. Requirements analysis and design	\$ 33.0	\$ 4.4	\$ 2.0
3. Implement and test approved solutions	\$ 140.0	\$ 46.6	\$ 8.0
4. Operations and maintenance on campus	\$ 169.0	\$ 299.0	\$ 546.0
5. Operations and maintenance off-site (optional)	\$ 480.0	\$ 240.0	\$ 360.0
6. Technical consulting	\$ 4.0	\$ 4.0	\$ 4.0
7. Engineering requirements	\$ 1.1	\$ 2.2	\$ 2.2
8. Logistics support (optional)	\$ 5.0	\$ 2.5	\$ 0.5
<b><i>Cost reimbursable, not-to-exceed CLINs</i></b>			
9. Travel	\$ 0.8		
10. Tools	\$ 282.0		
11. Other Direct Costs	\$ 2.0		

Contract line item numbers (CLINs) 1 through 4 are the foundational components (i.e. manage, design, implement, and operate) of this task. Project management is overarching and necessary irrespective of the final design selection. The composition of the proposed project management team is a critical evaluation factor, and relatively fixed under the contract. As such, a firm estimate of cost for this element appears calculable in advance. An estimate of the effort needed to accomplish requirements analysis and design should also be accessible, at least to the extent of the currently established construction project scope and schedule. What cannot be known at the point of award is which solution will ultimately win acceptance and be implemented. This means the specific equipment needs are not firm and there is no established implementation schedule. Accordingly, CLIN 3 (implementation and testing) and CLIN 4 (operations and maintenance) are contingent requirements and therefore not yet susceptible to a firm cost estimate.

If the above assessment is accurate, then the use of a fixed-price incentive is justified for CLINs 3 and 4, providing the key element deficiencies noted above are remedied. A logical production point for implementation and testing (CLIN 3) would be after some percentage of design work is complete. A logical production point for operations and maintenance (CLIN 4) would be after design is complete and equipment is specified. In contrast, CLINs 1 and 2 could have been solicited as firm-fixed price requirements, at least with respect to the first phase of campus construction which is already funded and underway. The assessment also shows that the selection of contract type and analysis of funding requirements are closely related, a notion discussed below in connection with bona fide needs.

**(3) Labor cost estimate excludes escalation**

The cost model which supports the Independent Government Cost Estimate does not incorporate labor rate escalation. Holding all other variables constant, this omission would significantly understate labor costs over the 10-year period of performance. In some applications, the model appears to use 2010 ceiling labor rates from the Alliant contract. In others, such as implementation and testing labor, the model applies a fixed percentage of equipment cost to arrive at a labor cost estimate. In either instance, there is no provision made for escalation.

**(4) Operations and maintenance acquisition approach creates unnecessary cost risk**

Awarding operations and maintenance (CLINs 4 and 5) without a definitized design, equipment selection, and an implementation schedule introduced an avoidable risk premium and likely increased costs to DHS. The benefit of price competition was unrealized. Ideally, a fixed price incentive contract compensates for this by asking the vendor to set an initial target price to be revisited when the requirement is known. In this instance, with no specified production point and no profit sharing formula, there is no event to trigger price re-negotiation. This defeats the principal advantage of using a fixed-price incentive contract. As a result, the operations and maintenance CLINs effectively become cost reimbursable, with all cost risk transferred to the Government.

An external risk analysis prepared for PBS estimated the risk premium for this task at 33 percent of estimated costs, which is to say a prudent contractor would need to make such an allowance in its proposal to cover uncertainties. The impact was made worse by a decision to amend the solicitation 12 days after issuance, expanding the scope of operations and maintenance services to include an additional 7,000 DHS employees housed in various locations off campus. By comparison, the Saint Elizabeths campus, when completed, is expected to house 14,000 employees. The estimated impact of this scope change was to add \$1 billion to the total IT contract cost. At 21,000 employees, this expansion still represents only a subset of DHS employees in the region

Whatever operational advantages are gained by using a single contract vehicle, the benefits must be measured against the risk premium it entails. Size and complexity of administration argue against this arrangement, as do the uncertainty of final housing locations and move schedules for the off-campus staff. This is because, concurrent with the consolidation of DHS headquarters components at Saint Elizabeths, a complementary project is underway to consolidate the DHS mission support components. The objective of the mission support consolidation is to reduce the number of DHS locations in the National Capital Region from about 60 down to 6. Project management of the mission support consolidation is separate from Saint Elizabeths. Combining the IT requirements related to

both of these projects under a single contract action subjects the IT contract to the substantial risks of both undertakings.

**(5) Incremental funding of non-severable services violates the bona fide needs rule**

In awarding broadly-scoped CLINs spanning a 5-year base performance period, FAS created an obligation that exceeds its available funding. At the time of award, FAS had about \$108 million in client funds, derived primarily from a DHS ARRA<sup>1</sup> reimbursable work authorization. It divided this amount between the first two CLINs, partially funding CLIN 1 (project management support) and CLIN 2 (requirements analysis and design). All future funding was expected (but not required) to occur in annual increments. To limit the Government's liability in the event of termination due to funding, and to preclude an Antideficiency Act violation, the contract incorporated a Limitation of Government's Obligation clause. The clause does not overcome the underlying requirement to fully fund a non-severable service.

The Comptroller General has held that contracts that cannot be separated for performance by fiscal year may not be funded on an incremental basis without statutory authority. (See *B-241415*, 71 *Comp.Gen.* 428.) The bona fide needs rule, upon which the holding of that decision was based, applies to all federal government funding activities carried out with appropriated funds. (See *B-240264*.) As the statute has been interpreted and applied, an appropriation is available only to fulfill a genuine or bona fide need of the period of availability for which it was made. Whether an agency should charge the full cost of contract services to the appropriation available on the date a contract for services is made or to the appropriation current at the time services are rendered depends upon whether the services are severable or entire.

Neither the acquisition plan nor the contract differentiates the severable from the non-severable components of the overall requirement. Non-severable services, i.e., those that constitute a single undertaking with a defined end-product that cannot be feasibly subdivided for separate performance in each fiscal year, require full funding at time of award. There is a statutorily authorized exception—multi-year funding (as implemented at *FAR 17.1*)—but that was not invoked nor would it suit this requirement. The (now cancelled) award violated the bona fide needs rule as it failed to identify and fully fund the non-severable components the DHS requirement.

To properly evaluate severability as it relates to this action, the IT requirement must be viewed within the context of the underlying bricks and mortar construction project. In this instance, there are three planned construction phases. Phase 1 construction is funded and

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<sup>1</sup> ARRA - American Recovery and Reinvestment Act of 2009

well underway. The IT infrastructure requirement associated with this phase is immediate. Occupancy is dependent upon it. There is no value in a partially designed network or a fractionally implemented design. This effort must be funded in its entirety. Phases 2 and 3 are contingent upon future congressional funding actions. IT support for these phases could be awarded under an optional CLIN, for example, with funding deferred until the construction is certain. Again, each option would require funding in the entirety when it is exercised.

Other CLIN structures are possible and there may be alternatives to aligning the CLINs with the construction phases. For example, IT requirements pertaining to perimeter security and the overall passive optical network may supersede construction phasing considerations, rendering those aspects non-severable and arguing for a different CLIN structure altogether. In any event, for purposes of acquisition planning, a reasonable conclusion is that consideration of severability is critical to contract design and CLIN structure. What is less obvious is that CLIN structure itself can impact the determination of severability, and hence the determination of the funding requirement at the time of award.

It appears that the task order cancellation has not placed the construction schedule in immediate jeopardy. The Clark Construction Group will be tasked with the requirement as it relates to the first phase of construction (U.S. Coast Guard Headquarters) through a provision already contained in Clark's design-build contract. Further, the original Phase 1 architect, Perkins & Will, will support this effort under its design contract which is still in effect. However, these are partial, short-term measures implemented by the PBS project team. A successful IT support contract remains an urgent but at least manageable need.

While we have not conducted an audit and accordingly make no formal recommendations, we hope that these observations will assist the new procurement team as it prepares a workable acquisition strategy. If we can be of further assistance, please contact me at 202-501-0374.