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United States Department of State
and the Broadcasting Board of Governors
Office of Inspector General

Office of Audits

Independent Accountants' Report Agreed-Upon Procedures on Kellogg, Brown & Root Services, Inc.'s, Revised Termination Settlement Proposal Contract No. S-FBOAD-99-D-0016

Report Number AUD/CG-06-25, May 2006

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Contract No. S-FBOAD-99-D-0016**

Report Number: AUD/CG-06-25, April 2006

Leonard G. Birnbaum and Company, LLP, Certified Public Accountants, performed the agreed-upon procedures under Department of State, Office of Inspector General, Contract No. SAQMPD04D0033, and by acceptance the report becomes a product of the Office of Inspector General.


Howard J. Krongard
Inspector General

4-26-06
Date

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Summary

At the request of the Department of State (Department), Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management, the Office of Inspector General (OIG) contracted with Leonard G. Birnbaum and Company, LLP, to perform agreed-upon procedures on Kellogg, Brown & Root Services, Inc.'s (KBR) March 17, 2005, revised termination settlement proposal under Contract No. S-FBOAD-99-D-0016, Task Order 57. The objective was to determine whether the revised proposal conformed to the requirements of a standard settlement proposal.

We found that the KBR revised termination settlement proposal included claims for unsupported and inappropriate costs concerning services provided by its subcontractor, Morrison International Construction, Inc. (Morrison). Specifically, in its termination settlement proposal of February 24, 2005, Morrison included \$53,173 covering "the costs associated with our management personnel for the time spent preparing, revising, discussing, negotiating our proposal and working with the government auditors in their review of the same." The amounts presented are estimates unsupported by any other documentation. We have, accordingly, questioned these amounts in their entirety.

In addition, we found that Morrison included \$527,753 in its termination settlement proposal, which it identified as unabsorbed overhead on the direct cost of terminated work. The law is well settled that post-termination unabsorbed overhead is not recoverable in a termination claim.

Although the total questioned amount associated with the management personnel and the unabsorbed overhead costs is \$580,926, after adjustments for overhead, G&A, and fee, the full amount of the questioned costs totals \$795,034. We recommend that the Department disallow the full amount. A summary of the claimed and questioned amounts and related comments is included in Exhibit A.

Background

On April 23, 1999, the Department awarded an indefinite-delivery, indefinite-quantity contract to KBR to provide worldwide security upgrade construction services on a task order basis. On September 29, 2001, the Department issued a \$5.5 million fixed-price task order to KBR for security upgrade construction at the Department's compound in Havana, Cuba. The Department subsequently increased the task order to \$9.03 million. On April 11, 2003, the Department notified KBR that it had terminated the task order effective April 9, 2003.

On October 22, 2003, KBR submitted a termination settlement proposal in the amount of \$4.4 million. OIG reviewed the KBR proposal and reported in March 2005¹ that KBR had not submitted its proposal on a total cost basis and it had not submitted certified

¹ *Review of the Kellogg, Brown & Root Termination for Convenience Proposal for Contract S-FBOAD-99-D-0010 Task Order 57 Havana, Cuba* (AUD/CG-05-22, Mar. 2005)

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pricing information. The Department's review of this resulted in KBR's submitting a revised settlement proposal, in the amount of \$4.2 million, on March 17, 2005.

Purpose, Scope, and Methodology

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

1. We reviewed the structure of KBR's proposal to assess whether it conformed to the structure of Standard Form 1436, Settlement Proposal (Total Cost Basis).
2. We reviewed OIG audit report AUD/CG-05-22 on KBR's termination settlement proposal dated February 25, 2004.
3. We reviewed the work papers supporting the OIG audit report.
4. We reviewed the comments by the Bureau of Administration, Office of Logistics Management (A/LM) on the OIG audit report.
5. We reviewed the comments by the A/LM Office of Acquisitions on the OIG audit report.
6. We reviewed supporting documentation provided by KBR and its subcontractor, Morrison, to OIG.

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

Agreed-Upon Procedures Results

Our review of the KBR revised termination settlement proposal dated March 17, 2005, found questionable items associated with claimed costs submitted by KBR's subcontractor, Morrison, including unsupported management personnel costs and unabsorbed overhead costs on terminated work. The total questioned costs, including adjustments for overhead, G&A, and fee, amounts to \$795,034. A summary of the claimed and questioned amounts and related comments is included in Exhibit A.

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Recommendation 1: We recommend that the Department's Bureau of Administration, Office of Logistics Management, Office of Acquisitions Management disallow \$795,034 for the reasons detailed in Exhibit A.

Leonard G. Birnbaum and Company, LLP



Leslie A. Leiper, Senior Partner

**Kellogg, Brown & Root
Termination Settlement Proposal
Under Contract No. S-FBOAD-99-D-0016, Task Order 57
Summary of Claimed and Questioned Amounts**

	<u>Claimed</u>	<u>Questioned</u>	<u>Notes</u>
KBR Labor	(b) (4)(b) (4)(b) (4)		
KBR Burden and Benefits	(b) (4)(b) (4)(b) (4)		
Subcontract	(b) (4)(b) (4)(b) (4)		
Subcontract Management	(b) (4)(b) (4)(b) (4)	\$ 53,173	1
Subcontract Unabsorbed Overhead	(b) (4)(b) (4)(b) (4)	527,753	2
Other Direct Costs	(b) (4)(b) (4)(b) (4)	_____	
Subtotal	(b) (4)(b) (4)(b) (4)	580,926	
Overhead	(b) (4)(b) (4)(b) (4)	_____ 3,544	3
Subtotal	(b) (4)(b) (4)(b) (4)	584,470	
G&A	(b) (4)(b) (4)(b) (4)	_____ 11,630	4
Subtotal	(b) (4)(b) (4)(b) (4)	596,100	
Fee	(b) (4)(b) (4)(b) (4)	_____ 198,934	5
Total	(b) (4)(b) (4)(b) (4)	\$ 795,034	

Notes

1. In its revised termination settlement proposal of February 24, 2005, KBR's subcontractor, Morrison International Construction, Inc., included "the costs associated with our management personnel for the time spent preparing, revising, discussing, negotiating our proposal and working with the government auditors in their review of the same." The amounts presented are estimates unsupported by any other documentation. We have, accordingly, questioned these amounts in their entirety.
2. KBR's subcontractor, Morrison International Construction, Inc., included in its termination settlement proposal, an amount of \$527,753, which it identified as unabsorbed overhead on the direct cost of terminated work. The law is well settled over many years that post-termination unabsorbed overhead is not recoverable in a termination claim. See *Walsky Construction Company*, ASBCA No. 52772, 01-02 BCA ¶31,557; *Nolan Brothers, Inc. v. United States* [16 CCF ¶80,119] 437 F.2d 1371 (Ct. Cl. 1971); *J.W. Cook & Sons, Inc.*, ASBCA No. 39691, 92-3 BCA ¶25,053; *Chamberlain Manufacturing Corp.*, ASBCA No. 16877, 73-2 BCA ¶10,139; *Technology, Inc.*, ASBCA No. 14083, 71-2 BCA ¶8956. We have, accordingly, questioned the amount claimed in its entirety.

**Kellogg, Brown & Root
Termination Settlement Proposal
Under Contract No. S-FBOAD-99-D-0016, Task Order 57
Summary of Claimed and Questioned Amounts**

- 3. Questioned overhead represents application of KBR’s proposed overhead rate of 0.61 percent to questioned base costs.
- 4. Questioned G&A represents application of KBR’s proposed G&A rate of 1.99 percent to questioned base costs.
- 5. Fee is a matter under the purview of the contracting officer. KBR has claimed fee at the rate of (b) (4)(b) (4) of total costs. We have questioned fee solely for purposes of comparability and adherence to the principles articulated in Part 49 of the Federal Acquisition Regulation (FAR). Questioned fee was calculated as follows:

(b) (4)(b) (4) of questioned costs (\$596,100 X (b) (4))	\$ 47,688
(b) (4)(b) (4) of subcontract costs not questioned (b) (4) X (b) (4)	_____ (b) (4)
Total	\$ (b) (4)

^a FAR § 49.202 provides that profit “shall not be allowed the contractor for material or services that, as of the effective date of termination, have not been delivered by a subcontractor, regardless of the percentage of completion.”

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