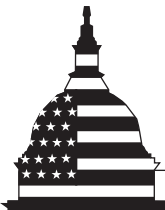


May 2011

SECURE BORDER INITIATIVE

Controls over Contractor Payments for the Technology Component Need Improvement



G A O

Accountability * Integrity * Reliability

SECURE BORDER INITIATIVE

Controls over Contractor Payments for the Technology Component Need Improvement

Why GAO Did This Study

In 2005, the Department of Homeland Security (DHS) initiated a multibillion-dollar contract to secure part of the nation's borders, the Secure Border Initiative (SBI). At that time, SBI was to include a single solution technology component; SBInet. DHS assigned the U.S. Customs and Border Protection (CBP) responsibility for overseeing the SBI contract, including SBInet. In January 2011, DHS announced that it was ending SBInet, and replacing it with a new technology portfolio. GAO was asked to (1) assess CBP's controls over payments to the prime contractor under the original SBInet program, and (2) provide information about the SBI program prime contractor's reporting against small business subcontracting goals. GAO assessed CBP controls against federal standards for internal control and relevant federal regulatory provisions, and summarized data on contractor performance against small business contracting goals.

What GAO Recommends

GAO makes five recommendations to improve CBP controls over prime contractor payments under the SBInet and the successor technology portfolio, including actions to strengthen invoice review procedures, provide more detailed support, and to better focus closeout audits. DHS concurred in principle with all recommendations, but for some, DHS also commented on the cost-effectiveness or others' role in implementation. GAO addresses these comments in the report.

View [GAO-11-68](#) or key components. For more information, contact Susan Ragland at (202) 512-9095 or raglands@gao.gov.

What GAO Found

GAO's review of CBP's controls over payments to the prime contractor under the original SBInet program identified the need to improve controls in two critical areas. Specifically, GAO found that CBP's design of controls for SBInet contractor payments did not (1) require invoices with sufficiently detailed data supporting billed costs to facilitate effective invoice reviews or (2) provide for sufficiently detailed, risk-based invoice review procedures to enable effective invoice reviews prior to making payments. Although CBP's established procedures were based on the Federal Acquisition Regulation (FAR), GAO identified numerous instances of CBP contracting officers lacking detailed support in the SBInet contractor invoices they received for review.

Excerpt of a SBInet Prime Contractor September 12 through 25, 2008, Invoice Showing Cost Data Submitted for CBP Review and Payment.

OTHER DIRECT COST	107,889.73
TRAVEL	108,148.57
OVERTIME PREMIUM	52.00
DIRECT LABOR	1,518,873.38

Source: GAO analysis of CBP records of contractor invoice.

Because CBP's preventative controls were not fully effective, the agency will continue to (1) be impaired in providing assurance that the reported \$780 million it already paid to the contractor under the original SBInet program was allowable under the contract, in the correct amount, and only for goods and services provided, and (2) rely heavily on detective controls (such as timely, effective contract closeout audits) for all SBInet funds disbursed. Further, timely action to improve CBP's preventative controls is critical for the estimated \$80 million in original SBInet program funds yet to be disbursed. Also, in light of the recent DHS announcement that it is replacing the originally conceived SBInet program with a new technology portfolio-based approach, GAO's findings concerning weaknesses in CBP's design of controls over payments to the prime contractor under the recently ended SBInet program can serve as "lessons learned" to be considered in designing and implementing controls as part of the newly announced portfolio-based approach to providing technological support to border security.

With respect to performance against small business contracting goals, the prime contractor reported that it met two of the six small business subcontracting goals for the overall SBI program. Specifically, it reported that it met subcontracting participation goals for Historically Underutilized Business Zone and Veteran-Owned small business categories, but was unable to meet the other four small business goals because a large steel purchase significantly reduced the subcontract dollars available for small businesses to participate in the SBI contract.

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Abbreviations

CBP	U.S. Customs and Border Protection
CO	contracting officer
COTR	contracting officer's technical representative
DCAA	Defense Contract Audit Agency
DHS	Department of Homeland Security
FAR	Federal Acquisition Regulation
HSAM	Department of Homeland Security Acquisition Manual
HSAR	Department of Homeland Security Acquisition Regulation
HUBZone	Historically Underutilized Business Zone
IDIQ	Indefinite Delivery/Indefinite Quantity
NFC	National Finance Center
OTIA	Office of Technology Innovation and Acquisition
SBA	Small Business Administration
SBI	Secure Border Initiative
SBI _{net}	Secure Border Initiative Network
SOP	standard operating procedures

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GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

May 25, 2011

The Honorable Bennie G. Thompson
Ranking Member
Committee on Homeland Security
House of Representatives

The Honorable Michael T. McCaul
Chairman
The Honorable William R. Keating
Ranking Member
Subcommittee on Oversight, Investigations, and Management
Committee on Homeland Security
House of Representatives

The Honorable Mike D. Rogers
House of Representatives

The Department of Homeland Security's (DHS) Secure Border Initiative (SBI), begun in November 2005, was intended as a multiyear effort to secure the nation's borders. At that time, the Secure Border Initiative-network (SBInet) component of SBI was intended to provide a single technology-based solution for the nation's entire Southwest border using a highly integrated set of fixed sensor towers. The U.S. Customs and Border Protection (CBP), a component of DHS, was assigned responsibility for monitoring and overseeing the prime contractor, including contractor payments, for both the overall SBI and SBInet programs.

Since its inception, we have issued a number of reports highlighting issues concerning technical problems, cost overruns, and schedule delays with the SBI program.¹ In March 2010, the Secretary of Homeland Security announced a freeze on all SBInet program disbursements, with the exception of SBInet contractual agreements to support technology-based

¹See, for example, GAO, *Secure Border Initiative: DHS Needs to Strengthen Management and Oversight of Its Prime Contractor*, [GAO-11-6](#) (Washington, D.C.: Oct. 18, 2010); *Secure Border Initiative: DHS Needs to Address Testing and Performance Limitations That Place Key Technology Program at Risk*, [GAO-10-158](#) (Washington, D.C.: Jan. 29, 2010); and *Secure Border Initiative: DHS Needs to Address Significant Risks in Delivering Key Technology Investment*, [GAO-08-1086](#) (Washington, D.C.: Sept. 22, 2008).

security for a 53-mile section along the Arizona border. In January 2011, the Secretary directed CBP to terminate the SBInet program as originally conceived, and instead focus on developing terrain- and population-based solutions utilizing existing proven technologies. The Secretary also provided that while the new technology approach should include elements of the former SBInet program where appropriate, DHS did not plan to use the current contract to procure any of the technology systems under the new approach, but rather would solicit competitive offers. Since the inception of the SBI program, for which Congress has appropriated a total of about \$4.4 billion through fiscal year 2010, about \$1.5 billion of that amount has been available for the original SBInet program. As of January 2011, CBP reported it had paid the prime contractor a total of about \$780 million under the original SBInet program, and had obligated, but not yet disbursed, almost an additional \$80 million.

In response to your request, this report provides (1) our assessment of CBP's controls over payments to the prime contractor related to the original SBInet program and (2) information about the overall SBI program prime contractor's reporting on the extent to which it met small business subcontracting goals. In addition, this report provides our analysis of the implications of the January 2011 DHS SBInet termination decision on our findings and conclusions related to prime contractor payment controls under the original SBInet program.

To accomplish our first objective, we assessed the original SBInet program's internal controls over prime contractor payments in comparison with our *Standards for Internal Control in the Federal Government*² and other relevant criteria, including relevant provisions of the Federal Acquisition Regulation (FAR), the Department of Homeland Security Acquisition Regulation (HSAR), DHS policies, and CBP procedures. We conducted structured interviews with CBP officials and a walk-through of CBP's prime contractor invoice review, approval, and processing procedures under the original SBInet program.³

²GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

³Throughout this report, we use the term invoice (consistent with FAR 2.101) to refer to a contractor's bill or written request for payment under a contract using standard form 1034 "Public Voucher for Purchases and Services Other Than Personal."

We also selected five task orders issued by CBP under the prime Indefinite Delivery/Indefinite Quantity (IDIQ) contract to review.⁴ These task orders represented 84 percent of all payments made to the prime contractor and 79 percent of the total value of all task orders from the original SBIInet program's inception in November 2005 through the end of fiscal year 2009. The selected task orders included types priced on both a fixed price and cost reimbursement basis and included both open and closed task orders. For each of the five task orders selected for review, we obtained and reviewed available contract documentation, including individual task orders, task order modifications, statements of work, and invoices. We also obtained available information related to all 99 invoices submitted under the five task orders for the purpose of assessing the extent to which they complied with the original SBIInet contract and were properly supported.⁵

To address our second objective of providing information about DHS's prime contractor's reporting on the extent to which it met small business subcontracting goals for the overall SBI program, we obtained and summarized information from the prime contractor's Subcontractor Plan, the prime contractor's five semiannual Small Business Subcontracting Review Summit reports from November 2007 through May 2010, and documentation supporting the prime contractor's small business subcontracting award reports. We did not assess or validate the accuracy or reliability of the contractor's reporting and supporting data.

We also gathered and assessed information DHS provided concerning its January 2011 decision to terminate the original SBIInet program. Specifically, we assessed information provided in terms of its implications for the remaining funds yet to be disbursed under the original SBIInet program, SBIInet contract closeout audits, and the limited information available as to the contractor and related contractor payment controls under the new technology portfolio approach.

⁴IDIQ contracts are used when the government cannot predetermine, above a specified minimum, the precise quantities of supplies or services that the government will require during the contract period. Under IDIQ contracts, the government can issue delivery orders (for supplies) and task orders (for services).

⁵While the prime contractor submitted a total of 101 invoices for these five task orders during this time frame, 2 invoices were rejected and included in a subsequent invoice.

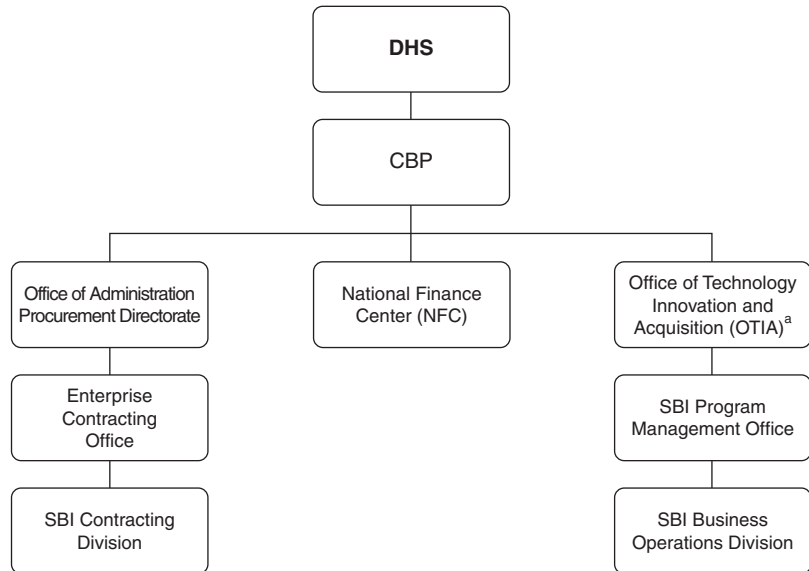
We conducted this performance audit from June 2009 to May 2011⁶ in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Figure 1 provides an overview of CBP organizational components that had prime contractor invoice review, approval, and payment responsibilities under the original SBIInet program.

⁶During this time frame we also issued [GAO-11-6](#) in response to this congressional request.

Figure 1: DHS and CBP Organizational Components That Had SBI Contract Oversight Responsibilities



Source: GAO analysis of SBI documentation.

^aThis office was created in November 2010. According to DHS officials, SBI was eliminated under the OTIA reorganization.

CBP’s Contracting Division, which is part of the Office of Administration Procurement Directorate’s Enterprise Contracting Office, was assigned SBIInet program prime contractor management and administrative responsibilities, including receiving and approving or rejecting invoices. The Office of Technology Innovation and Acquisition within CBP was assigned responsibility for managing key program and contractor oversight acquisition functions associated with SBIInet, such as verifying and accepting contract deliverables. This office was also to work closely with CBP’s SBI Contracting Division. Contracting officers (CO)⁷ and contracting officer’s technical representatives (COTR)⁸ in the SBI

⁷COs are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. COs have authority to enter into, administer, or terminate contracts.

⁸A COTR is delegated authority by the CO to monitor the contractor’s progress, including the surveillance and assessment of performance and compliance with project objectives.

Contracting Division were assigned responsibility for reviewing invoices and maintaining contract files. The SBI Business Operations Division was responsible for providing CO-approved invoices to CBP's National Finance Center (NFC) for processing contractor invoices for payment.

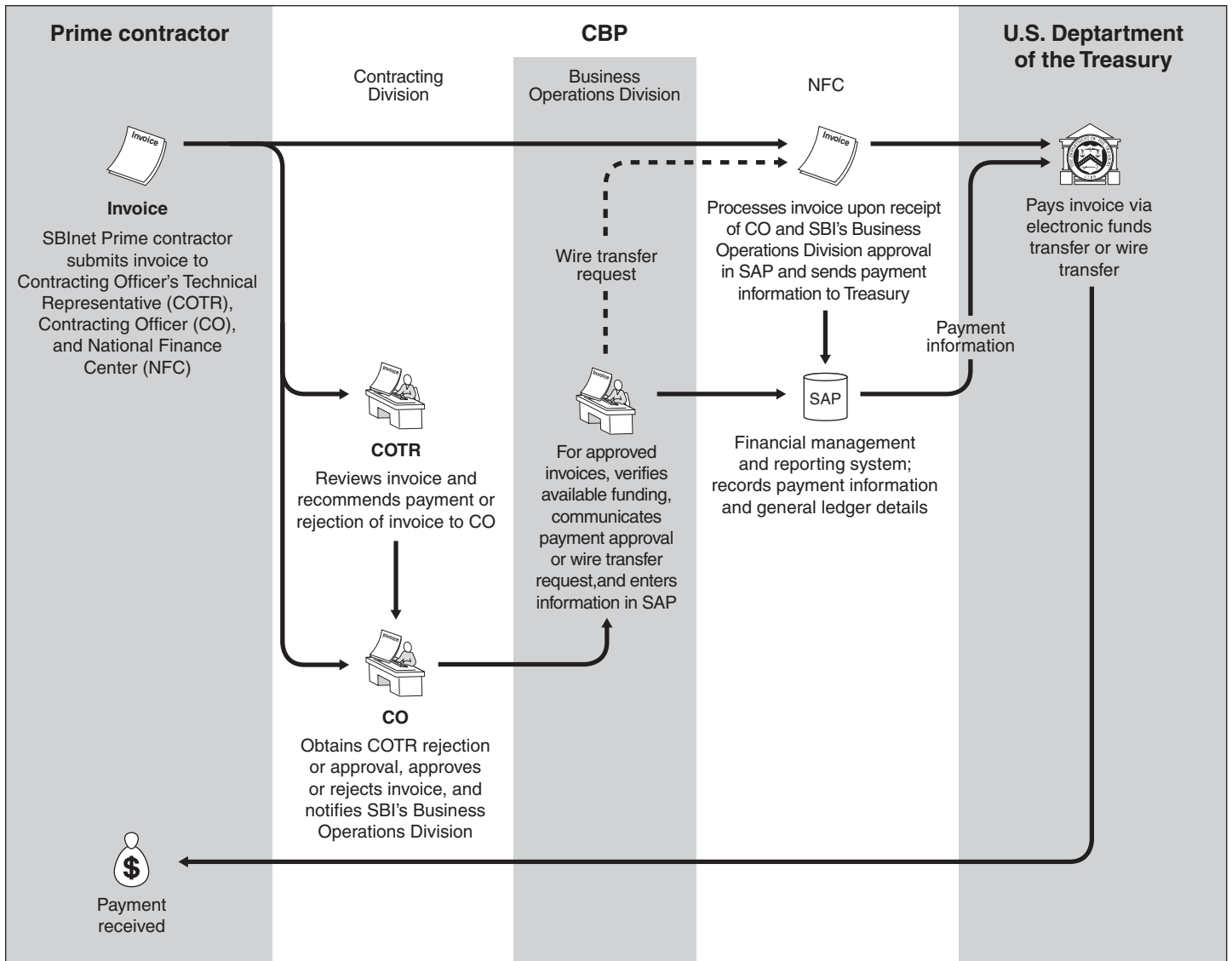
In carrying out its assigned prime contractor invoice-related responsibilities under the original SBI program, CBP relied on the FAR, HSAR, as well as DHS, CBP, and SBI program policies and procedures. The overarching policy for federal contracting is the FAR. DHS issued a supplemental regulation, HSAR, an acquisition manual for DHS contracting and, in October 2008, CBP's SBI Contracting Division⁹ issued standard operating procedures (SOP) setting out required review, approval, and processing steps for all SBI prime contractor invoice processing.¹⁰

Figure 2 provides an overview of CBP's process for reviewing, approving, and paying prime contractor invoices under the original SBI program.

⁹These SOPs were issued by the SBI Acquisition Office which was consolidated into the CBP Office of Administration Procurement Directorate as the SBI Contracting Division in November 2009.

¹⁰SBI Acquisition Office, SBI Community-400-01 (Oct. 31, 2008).

Figure 2: Process for Paying SBNET Invoices



Source: GAO analysis of SBI documentation.

CBP's process for reviewing, approving, and paying prime contractor invoices under the original SBIInet program relies on both preventative and detective controls.¹¹ Generally, preventative controls are more efficient and effective than detective controls. CBP's detective controls began with SBIInet's prime contractor submitting an invoice to the SBI Contracting Division's CO, COTR, and CBP's NFC for review. After reviewing the invoice, the COTR was responsible for recommending whether the CO should approve or reject the invoice. If the CO and COTR approved an invoice, the CO was to notify the SBI Business Operations Division within the Program Management Office to check for fund availability.¹² If funds were available, CBP's NFC was to be notified to process the invoice for payment. Further, while not required, CBP's COs may request the Defense Contract Audit Agency (DCAA), a defense agency within the U.S. Department of Defense, to conduct an invoice review or rate verification for any invoice. In addition, CBP officials told us that the CO will always request DCAA to conduct a closeout audit (a detective control) for any task order, although this is not required.¹³ DHS's Office of Procurement provides that the CO submit a memorandum to request a final audit for the entire IDIQ contract, or any of its delivery order, or task order components.

Controls over Prime Contractor Payments for SBI Technology Component Need Improvement

Under the original SBIInet program, CBP took actions intended to establish internal controls over contractor payments. CBP established SOPs setting out required contractor invoice review, approval, and processing steps for CBP's COs and COTRs to follow. These procedures were based on requirements in the FAR. We identified the need to improve CBP's controls in two important areas. Specifically, we identified the need to improve CBP's preventative controls over payments to the SBIInet program contractor with respect to requiring

- invoices with sufficiently detailed data supporting billed costs to facilitate effective invoice review and

¹¹Preventative controls are designed to prevent improper payments, or waste, before the payment is made. Detective controls are designed to identify improper payments, or waste, after the payment is made.

¹²DHS officials commented that more recent guidance calls for the Project Manager to confirm the COTR's recommendation to approve the invoice.

¹³The Homeland Security Acquisition Manual (HSAM) and a memorandum of understanding between DHS and DCAA included in the HSAM establish contract audit relationships between DHS and DCAA.

-
- specific, sufficiently detailed, risk-based invoice review procedures to enable full, effective, and documented reviews prior to making payments.

Because CBP's preventative controls were not fully effective, the agency will continue to (1) be impaired in its ability to provide assurance that the estimated \$780 million already paid the prime contractor under the original SBInet program was proper and allowable, in the correct amount, and only for goods and services provided and (2) rely heavily on detective controls (primarily contract closeout audits) for assurance concerning the propriety of SBInet program disbursements. Further, until CBP takes action to improve its preventative controls, it will continue to be impaired in its ability to effectively review the estimated \$80 million obligated, but yet to be disbursed, to the prime contractor under the original SBInet program. In addition, our findings have implications as possible "lessons learned" for DHS to consider and address as appropriate in designing and implementing contract payment controls for its new technology portfolio approach.

Detailed Data Supporting Invoiced Costs Not Required

Standards for Internal Control in the Federal Government and related guidance provide that an entity's internal controls should enable it to verify that ordered (invoiced) goods and services were proper and met the government's specifications.¹⁴ CBP's policies and related SOPs applicable to the original SBInet program required the prime contractor to submit invoices showing total costs incurred by cost element (i.e., direct labor, direct materials, major subcontracts, other direct costs, overtime premium, overhead, travel, and general and administrative expenses). However, CBP's policies and procedures did not require the invoices to include any additional supporting detail. Not requiring such detail not only precluded us from testing whether invoiced costs complied with the SBInet contract and were properly supported, but, more important, resulted in numerous instances in which CBP's COs and COTRs did not have the detailed support they needed to effectively review the SBInet contractors' invoices. For example, in one instance a CO requested additional detailed information such as travel dates and travel destinations to review the reasonableness of a lump sum invoiced cost amount for travel.

¹⁴GAO, *Internal Control: Streamlining the Payment Process While Maintaining Effective Internal Control*, [GAO/AIMD-21.3.2](#) (Washington, D.C.: May 2000).

Figure 3 shows an example of a SBInet prime contractor invoice submitted and paid for costs incurred for the period from September 12 through 25, 2008. Figure 3 also highlights lump sum invoiced costs for the “Direct Labor” and “Travel” cost elements.

Figure 3: Example of SBinet Prime Contractor Voucher with Lump Sum Amounts by Cost Element Submitted for CBP Review and Payment

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INCENTIVE FEE	0.00	0.00																																																											
TOTAL	3,705,718.70	45,571,243.06																																																											
TOTAL		3,705,718.70		45,571,243.06																																																									

Source: GAO analysis of CBP's records of contractor vouchers

In this example, the SBIInet prime contractor billed, and CBP paid, a total of \$3,705,718.70, including \$1,518,873.38 for the period for direct labor without any supporting details such as the hours worked and labor rate category. Supporting details are necessary to allow reviewing officials to determine, for example, whether the appropriate rate was charged and to assess the reasonableness of the hours charged.

Similarly, for the \$108,148.57 billed for travel for the period, the contractor did not provide supporting details necessary for a reviewing official to assess the amount claimed, such as the purpose of the trip and travel destination. Supporting details help CBP's COs and COTRs assess the propriety of invoice cost elements billed to the government, and effectively review the prime contractor's invoices.

Lacking sufficiently detailed data supporting the original SBIInet contractor's invoiced costs, we were unable to determine whether the 99 invoices we sampled for review were proper and in compliance with original SBIInet program contract provisions. Our review identified numerous instances of CBP CO and COTR frustration when they were unable to obtain detail to support SBIInet contractor lump sum invoiced costs, despite repeated requests. The SBIInet prime contractor denied these requests on the basis that CBP's policies did not require supporting detail. CBP paid the invoiced amounts in all cases.

In November 2009, CBP requested, and the SBIInet prime contractor began providing, some additional information with its invoices submitted under the original SBIInet program task orders. For example, the prime contractor included additional information on work performed for the invoice period. However, the additional information the contractor provided did not include sufficient additional detail needed to support an effective review of invoiced costs, such as hours worked, labor rate category, purpose of travel, or travel destination.

CBP could have relied on a provision of the contract to obtain additional support for lump sum invoiced costs. That is, as authorized by the contract's Allowable Cost and Payment Clause (FAR 52.216-7 (a) (1)), CBP could have required the SBIInet contractor to provide, in such form and with reasonable details, support for lump sum invoiced cost element claims. CBP and SBI Contracting Division management officials told us they were aware of their ability to obtain supplemental detailed supporting cost information under the FAR Allowable Cost and Payment clause. However, they also told us that CBP made a business decision for the overall SBI program (including the original SBIInet program) not to request such detailed supporting data from its prime contractor, but rather to rely

on other oversight mechanisms (such as closeout audits) to help identify any contractor billing issues.

Closeout audits are less effective as a control to identify or correct any contractor payment issues because they may not be conducted until a number of years after completion of a contract. The contractor's ability to repay any improper payments may deteriorate, responsible prime contractor officials may change, their memories may fade, or needed supporting data may be lost.

Design of Procedures for Review and Approval of Original SBInet Contractor Invoices Was Not Sufficiently Detailed

As provided by *Standards for Internal Control in the Federal Government*, well-developed and consistently implemented policies and procedures are critical in providing reasonable assurance that management's directives are carried out and program risks, such as the risk of improper payments, are minimized.

CBP's SOP applicable to COs' and COTRs' reviews of SBInet contractor invoices provided general guidance that COs and COTRs were to "evaluate invoices to certify receipt of the product or service in accordance with the terms of the contract or order, as well as the accuracy and validity of the elements in the invoice." However, CBP's procedures for reviewing prime contractor invoices submitted under the original SBInet program were not sufficiently detailed and appropriately risk based to enable consistent, effective, and documented invoice reviews.

CBP's prime contractor invoice review procedures under the original SBInet program did not identify the specific review steps required for COs and COTRs to carry out and document effective, risk based reviews that could reasonably ensure that the SBInet contractor's invoices were in the correct amount and accurately reflected all and only allowable goods and services as provided for under the original SBInet program. For example, CBP's SOP for reviewing payments to the prime contractor under the original SBInet program did not reflect such specific review steps as how to consider the relative risks and review invoice cost elements (including major subcontracts, direct materials, direct labor, and other direct costs); what qualifies as sufficient supporting evidence for amounts invoiced by the prime contractor; and how to review invoice credit amounts and contract reserve adjustments.¹⁵

¹⁵Contract reserve adjustments are amounts that represent prime contractor charges in excess of available funds for a specific contract line item. These amounts are adjusted after funding availability is confirmed.

SBI's Prime Contractor Reported That It Met Two of Its Six Small Business Subcontracting Goals

SBI's prime contractor reported to CBP that it met two of its six small business¹⁶ subcontracting goals that were identified in the prime contractor's subcontracting plan for the reporting period ended March 31, 2010. The prime contractor reported that it was unable to meet the remaining small business goals primarily as a result of non-small business contract awards necessitated by the Secure Fence Act of 2006, as amended. Specifically, to obtain the material needed to meet the 2006 statutory directive, in December 2007, the prime contractor entered into a large-scale steel purchase of approximately \$242 million that it told us was only available from a large business. Consequently, the SBI prime contractor reported that this steel purchase reduced the subcontract award dollars available such that it was unable meet all of its small business contract award goals for the SBI program.

The SBI's prime contractor reported on its performance against small business subcontracting goals that were identified in its subcontracting plan and aligned with the categories used by the Small Business Administration (SBA) for prime contracts. That is, consistent with SBA definitions, the SBI prime contractor established five socio-economic subcategories for its SBI program: (1) Small Disadvantaged Business,¹⁷ (2) Woman-Owned Small Business,¹⁸ (3) Historically Underutilized Business Zone (HUBZone),¹⁹ (4) Veteran-Owned Small Business,²⁰ and

¹⁶The Small Business Act defines a small business as a business concern that is independently owned and operated and is not dominant in the field of operation. The act states that the definition of a small business shall vary from industry to industry to the extent necessary to reflect industry differences. Small business size standards define the maximum size that a concern, together with all of its affiliates, may be if it is to be eligible for federal small business programs.

¹⁷A small disadvantaged business is a small firm owned and controlled by one or more individuals who are socially and economically disadvantaged.

¹⁸A Woman-Owned Small Business is a small business concern in which one or more women have 51 percent or more stock ownership.

¹⁹HubZone Small Business is a small business that must be at least 51 percent controlled by U.S. Citizens, or a Community Development Corporation, or an agricultural cooperative or an Indian tribe. The principal office must be located within a HUBZone and at least 35 percent of its employees must reside in a HUBZone.

²⁰A Veteran-Owned Small Business is a small business that is at least 51 percent unconditionally owned by one or more veterans (as defined at 38 U.S.C. 101(2)) and whose management and daily business operations are controlled by one or more veterans.

(5) Service-Disabled Veteran-Owned Small Business.²¹ The SBI prime contractor-established goals for each subcategory ranged from 1 to 5 percent of the total SBI program contract dollars awarded. Additionally, the SBI prime contractor also established an overall small business goal of awarding 40 percent of the total SBI program contract dollars to small businesses, which included, but was not limited to socio-economic small business goals.

As shown in table 1, as of March 31, 2010, the SBI contractor reported that it met subcontracting participation goals for the HUBZone and Veteran-Owned small business categories. Further, the prime contractor reported that while it had awarded a total of over \$262 million in SBI program funds to small businesses, its overall small business participation rate of approximately 33 percent from November 2005 through March 31, 2010, fell short of the 40 percent subcontracting goal.

Table 1: Summary of Prime Contractor’s Reporting on Small Business Participation Awards versus Goals for the SBI Program

Category of business	Planned percentage participation goal	Actual percentages reported as of March 31, 2010	Subcontracting dollars awarded as of March 31, 2010
Small Disadvantaged	5	3.77	\$29,874,672
Woman-Owned	5	1.70	13,491,664
HUBZone	1	2.35	18,615,635
Veteran-Owned	3.5	4.02	31,917,214
Service-Disabled Veteran-Owned	3	1.13	8,978,247
Overall small business	40	33.05	262,221,614

Source: Prime Contractor’s Supplier Diversity Roundtable Report, March 31, 2010.

SBI prime contractor officials told us they relied on self reported subcontractor data to report on the extent to which it met established small business participation targets.

²¹A Service Disabled Veteran-Owned Small Business is a small business that is at least 51 percent unconditionally and directly owned by one or more service-disabled veterans. The veteran must have a service-connected disability that has been determined by the Department of Veterans Affairs or his or her respective military branch of service.

Implications of January 2011 Decision to End the Original SBIInet Program

DHS's January 2011 decision to end the original SBIInet program has implications for contractor payments controls under both the original SBIInet program and its successor program. That is, our SBIInet contractor payment findings apply to the remaining residual original SBI program funds, to SBIInet contract closeout audits, and as "lessons learned" for the successor SBI technology program.

In January 2011, the Secretary directed CBP to end SBIInet as originally conceived as a single technology solution, and instead to implement a new border security technology portfolio approach utilizing existing technologies tailored to specific sectors of the Southwest border and their varying terrains and population densities. DHS announced that it intends to acquire all the technologies for the new approach through full and open competitions. The Secretary also directed that while the new technology approach should include elements of the former SBIInet program where appropriate, DHS did not plan to use the current SBIInet prime contract to procure any of the technology systems under the new plan. Therefore, our SBIInet contractor payment findings are directly relevant to the remaining \$80 million in original SBI program funds obligated but not yet disbursed. As discussed previously, CBP has an opportunity to improve the design of its preventative controls with respect to the remaining funds to be paid to the original SBIInet program prime contractor.

Further, our findings have implications for the contract closeout activities associated with the contract and task orders under the original SBIInet program. Given our findings on the design of prime contractor payment controls under the original SBIInet program, prompt action to complete closeout audits related to payments to the prime contractor under the original SBIInet program contract and task orders is imperative.

While CBP has the authority to do so as of February 2011, it had not yet requested that DCAA to conduct closeout audits on any of the original SBIInet program contracts and related task orders. CBP actions to timely request and monitor effective completion of these audits are important because it may take several years for a contractor to close its books and additional time for DCAA to review the final rates applicable in each calendar year. Also, in requesting and monitoring contract closeout audits, it will be important that CBP also provide information on our findings so that DCAA can adjust its planned review and testing procedures accordingly. However, CBP has not yet established a monitoring mechanism to follow up on the status of any DCAA closeout audits.

Internal control standards provide that any previously identified deficiencies related to an entity or program should be considered in

planning future audits of the entity or program.²² They also state that an entity should establish performance monitoring activities. Such monitoring represents an essential internal control activity that can be used to help assess the effectiveness of CBP controls over contractor payments (including vulnerability to, and recovery of, any improper payments), and whether any additional follow-up actions are necessary.

Finally, our findings concerning payments to the prime contractor under the recently ended SBInet program are useful as “lessons learned.” Our findings related to DHS controls over prime contractor payments under the original SBInet program will be applicable to designing procedures and controls for future technology portfolio contracting efforts. Our findings related to the design of current SBInet prime contractor payment policies and procedures represent important “lessons learned” for designing and implementing appropriate controls over contractor payments under the new technology portfolio approach.

Conclusions

Effective controls over contractor payments are essential to helping provide assurance that SBInet program funds were disbursed only for authorized goods and services, and in the correct amounts. Because preventative controls are generally more cost-efficient and effective than detective controls, timely actions to strengthen controls in this area are particularly important with respect to the remaining \$80 million in original SBInet program funds not yet disbursed. Furthermore, given the nearly \$800 million in contract payments CBP already disbursed, full and timely completion of detective controls, particularly closeout audits, will also be essential in providing reasonable assurance that SBInet program funds were disbursed only for authorized goods and services and in the correct amounts. As such it will be important for CBP to take prompt actions to (1) request that DCAA design and conduct closeout audits recognizing the need to strengthen detective controls and (2) establish a mechanism to coordinate and track completed closeout audits to ensure that such audits are fully effective, and completed in time to effectively address to any errors or improper payments identified. Further, our findings concerning the design of CBP’s controls over payments to the prime contractor under the recently ended SBInet program serve as “lessons learned” to be considered in designing and implementing controls as part of the newly announced technology portfolio approach.

²²[GAO/AIMD-00-21.3.1.](#)

Recommendations for Executive Action

We recommend that the Secretary of Homeland Security direct CBP's SBI Contracting Division Director to take the following five actions.

With respect to the remaining funds not yet disbursed under the original SBInet contract:

- Revise CBP's SBI SOPs to require the SBInet contractor to submit data supporting invoiced costs to CBP in sufficient detail to facilitate effective CO and COTR invoice review.
- Revise CBP's SBI SOPs to include specific, risk-based steps required for COs and COTRs to properly review and approve contractor invoices to ensure that they accurately reflect all program costs incurred, including specifying required documentation of such review and approval.

With respect to closeout audits under the original SBI prime contract and any task orders that receive closeout audits under DHS's SOPs:

- Request that DCAA to perform closeout audits as expeditiously as possible, including providing information on the contractor payment control findings concerning the original SBInet program that we identified for consideration in determining the extent and nature of DCAA testing required as part of such audits.
- Establish procedures for coordinating with DCAA to monitor the status of closeout audits related to the original SBInet program.

With respect to the new technology portfolio approach:

- Document the consideration and incorporation as appropriate, of lessons learned based on our findings on the design of controls over payments to the original SBInet contractor in designing and implementing contract provisions and related policies and procedures for reviewing and approving prime contractor invoices. Such provisions should provide for obtaining sufficiently detailed data supporting invoiced costs to support effective invoice reviews and include the specific, appropriately risk-based steps required for COs and COTRs to carry out an effective contractor invoice review.

Agency Comments and Our Evaluation

In commenting on a draft of this report, DHS concurred with two of our recommendations and concurred in principle with the remaining three. DHS agreed that the government needs to perform adequate review of contractor requests for interim and final payments and that the government should maintain effective and repeatable processes for risk-based reviews to provide effective "preventative" management controls.

With respect to the two recommendations for which it concurred, DHS cited actions under way to provide more focused, risk-based invoice review procedures, and incorporate lessons learned from past contractor invoice review experience into policies and processes for invoice review under the new technology portfolio approach.

For the three recommendations with which it concurred in principle, DHS expressed concerns with respect to the cost-effectiveness or appropriateness of the recommended actions. Specifically, regarding our recommendation to revise CBP's procedures to require the SBInet contractor to submit data supporting invoiced costs to CBP in sufficient detail to facilitate effective CO and COTR invoice review, CBP stated that it plans to enhance its current required review process by June 30, 2011, to provide copies of all contractor invoices directly to DCAA. However, DHS commented that requiring the prime contractor to submit substantial supporting documentation data where controls are already in place is not cost-effective. In this regard, we modified our recommendation by deleting examples of details to accompany invoices in order to allow CBP flexibility to decide specifically what detailed supporting data are needed. Nonetheless, as evidenced by numerous CO and COTR requests for more detailed data to support their invoice reviews discussed previously in our report, we continue to believe that the contractor should be required to provide information in sufficient detail to facilitate invoice reviews that can function as effective preventative controls in this area.

DHS also concurred in principle with our recommendations to request and monitor the expeditious completion of DCAA closeout audits. DHS agreed that there is a need to close out contracts as soon as practical and plans to continue to discuss with DCAA the importance of completing annual incurred cost audits so that contracts can be closed. However, DHS commented that DCAA management, not DHS, ultimately determines the completion of these audits. As discussed in our draft report, the focus of our recommendations was on DHS assisting DCAA in efficiently and effectively carrying out its responsibilities. Specifically, we recommended that DHS provide DCAA with information on our findings concerning the SBInet contractor's invoices to help focus its audit work and coordinate with DCAA to monitor the status of closeout audits. We continue to believe that DHS and CBP need to establish a mechanism to monitor completed closeout audits to ensure that such audits are fully effective and completed in time to effectively address to any errors or improper payments identified. By strengthening their monitoring of the status of DCAA closeout audits, DHS and CBP officials could better help ensure that corrective actions and lessons learned are effectively implemented and adopted, as appropriate. We therefore believe that these two

recommendations remain valid. We also made changes as appropriate throughout the draft in response to DHS technical comments. DHS comments are reprinted in appendix I.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate and House Committees on Appropriations and other Senate and House committees and subcommittees that have authorization and oversight responsibilities for homeland security. We will also send copies to the Secretary of Homeland Security, the Commissioner of U.S. Customs and Border Protection, and the Director of the Office of Management and Budget. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

Should you or your staff have any questions on matters discussed in this report, please contact me at (202) 512-9095 or at raglands@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix II.



Susan Ragland
Director, Financial Management and Assurance

Appendix I: Comments from the Department of Homeland Security



**Homeland
Security**

May 18, 2011

Susan Ragland
Director, Financial Management and Assurance
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: Draft Report GAO-11-68 "SECURE BORDER INITIATIVE: Controls over Contractor Payments for the SBI Technology Component Need Improvement"

Dear Ms. Ragland:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) and the U.S. Customs and Border Protection (CBP) appreciate the U.S. Government Accountability Office's (GAO's) work in planning and conducting its review and issuing this report.

DHS agrees that the government needs to perform adequate review of contractor requests for interim and final payments. DHS also agrees that the government should maintain effective and repeatable processes for risk-based reviews to provide effective "preventive" management controls. While we are in general agreement with the report's recommendations, some of the detailed conclusions in the draft report – specifically statements regarding documentation sufficiency for cost reimbursement type orders and recommendations for performance of "closeout audits" – require additional discussion and clarification, which we provide here and incorporate into our responses to the report's recommendations.

During the first year and half of the contractor's performance, CBP worked to ensure appropriate management controls were in place to oversee contractor performance, including controls for interim payments (public vouchers). Controls established as a result of these activities have enabled CBP officials to review and approve (and reject) contractor public vouchers and ultimately provide assurance the government is reimbursing the contractor only for allowable costs on public vouchers and at final payment.

The master contract with the Boeing Company allows CBP to award two general types of task orders: firm fixed-price and cost reimbursement. The former type of order provides the government with the least cost risk, the latter with far more risk. Accordingly, payment terms for each type of contract vary significantly:

- Firm fixed-price orders are paid when goods or services are delivered (note that the cost allowability rules in FAR Part 31 apply to pricing of firm fixed price contracts when cost analysis is performed, but not to payments under those contracts). Payment on such contracts are not based on actual costs incurred, and as such do not require a review of whether the costs are allowable. As such, these contracts do not require the contractor to submit supporting cost data regarding actual costs incurred.
- Cost type orders are paid on the basis of actual allowable costs incurred and are considered provisional – or interim – payments. At the end of contract performance, a final invoice request is received and a final “adjustment payment” is made, which reflects the difference between the interim amounts reimbursed and the final total amount due. The final total amount due is determined thru Defense Contract Audit Agency (DCAA) annual incurred cost audits. These audits review all costs incurred on contractor cost type contracts for a particular fiscal year, i.e., they are not performed on a contract by contract basis. The results of the audit, including the allowable direct and indirect costs for each contract, are provided to all of the contracting officers that have costs incurred on cost type contracts for that fiscal year.

Given the developmental nature of the initial Secure Border Initiative Network (SBInet) technology, CBP awarded cost-reimbursement type task orders for the SBInet Block 1 developmental phase of the program.

DISCUSSION

The unique nature of payments under cost reimbursement type orders is defined by Federal Acquisition Regulations (FAR) at Subpart 32.001:

*“Commercial interim payment” means any payment that is not a commercial advance payment or a delivery payment. These payments are **contract financing payments** for prompt payment purposes (i.e., not subject to the interest penalty provisions of the Prompt Payment Act in accordance with Subpart 32.9). A commercial interim payment is given to the contractor after some work has been done...”*

*“Contract financing payment” means an authorized Government disbursement of monies to a contractor **prior to acceptance of supplies or services** by the Government.*

(1) Contract financing payments include—

*(vi) **Interim payments under a cost reimbursement contract**, except for a cost reimbursement contract for services when Alternate I of the clause at 52.232-25¹, Prompt Payment, is used.”*

¹ Alternate I of the Prompt Payment clause is applicable to most cost type orders under Boeing’s master contract. This provision allows for the payment of interest under cost reimbursement type orders for services.

Interim payments under cost reimbursement contracts are subject to final audit, i.e., the amount paid on an interim basis are adjusted at the end of the contract to reflect the final amounts owed. Once the final amounts owed are determined, the difference between the interim and final payments is computed, and the difference is paid to the contractor (if the final payment exceeds the interim payment, which occurs in most instances) or the contractor provides a refund to the government (in those instances where the interim payments exceed the final amount due). Thus, although costs claimed for both interim and final payments must be allowable, government review for final payment is performed at a more detailed level, since this is the final determination of how much the government will ultimately pay. However, the government also reviews interim payments using risk-based procedures, and has additional protections to assure there are no overpayments during contract performance. These protections include the following:

- The amounts billed during each contractor fiscal year are adjusted on a regular basis to reflect any significant differences between the indirect rates being charged and the actual rates being incurred. DCAA monitors the indirect rates to assure the contractor complies with this requirement.
- The government withholds 10 percent of the contractor's fee to mitigate any potential interim overbillings.
- The government generally does not pay the interim payments if the contractor has significant deficiencies in their accounting or billing systems. In the subject instance, the SBInet contractor has accounting and billing systems that have been deemed acceptable by DCAA.

For the SBInet contract, Boeing has adhered to the general guidance promulgated by DCAA regarding interim and final payment requests, including the format and content required for its vouchers.² In particular, CBP is following the FAR requirement for withholding a percentage of the contract fee, which provides further protection to the government should an instance arise where an unallowable cost is included and paid in an interim payment request. Furthermore, the annual incurred cost audit, which DCAA performs in accordance with Generally Accepted Government Auditing Standards, provides assurance that final payments to the contractor will only include allowable costs in accordance with the provisions of FAR Part 31.

This general construct serves as the foundation for CBP's management and review of interim payment requests under its orders with Boeing. To augment these robust controls, CBP relies on a series of management controls and supporting information necessary to properly oversee and process interim payment requests. These controls typically include CBP reviewing the contractor's detailed cost account plans – derived originally from their cost proposal – that identify planned labor hours, labor rates, travel estimates (i.e., numbers of trips, locations, etc), as well as indirect and other allocated costs. Moreover, monthly contractor cost reporting

² Reference DCAA's guide: *DCAAP 7641.90 January 2005 - Information For Contractors*, found at <http://www.dcaa.mil/dcaap7641.90.pdf>

identifies actual labor hours expended, actual labor costs incurred, actual travel events and costs incurred, as well as indirect and other allocated costs. The government and contractor management teams collectively review this information jointly at least monthly, and usually weekly, in Integrated Product Teams (IPTs). As part of these management controls, CBP also receives monthly status reports from Defense Contract Management Agency (DCMA) that include Defense Contract Audit Agency's (DCAA's) assessment of the overall health of Boeing's accounting system.

This recurring management activity is normally sufficient for CBP officials to develop a detailed understanding of the work the contractor performed, costs the contractor incurred, products the contractor delivered, travel the contractor completed, and whether the actual performance is consistent with the negotiated contract terms and rates. Therefore, armed with the cost performance information and insights from management discussions regarding the actual contractor's performance, CBP officials are well postured each month to conduct a review of the contractor's interim payment requests and to determine whether the request conforms to the contractor's actual performance.

When situations have arisen where interim payment requests are questioned or rejected, additional information is requested of the contractor. On occasion, CBP has also requested DCAA conduct spot audits on individual payment requests. DCAA's tests determined that the contractor invoices were accurate, invoice preparation procedures were adequate, the billing system was reliable, and actual invoiced costs were reasonable and accurate.

Finally, CBP acknowledges the potential value and opportunity for continued process improvement and is establishing and aligning invoice approval procedures based on "lessons learned," a recent reorganization, and the need to manage prescribed time lines to avoid late payment interest penalties. Also, CBP is improving Contracting Officer (CO) and Contracting Officer Technical Representative (COTR) awareness of the relative risks associated with the various contract types through its new COTR Management Program, announced in April 2011.

CBP and the Department as a whole share the GAO concern for assuring there are effective controls. This is reflected by the recent revision to the DHS-DCAA Memorandum of Agreement. This agreement now provides for DCAA to receive copies of all interim payments on cost type DHS contracts. DCAA will conduct a review of all interim payments in excess of \$1 million, and will include all other interim payments as part of their periodic sampling universe. This process will ensure that (a) DHS is included in the regular monitoring by DCAA of the indirect rates, and (b) assist identifying any significant costs that were not reimbursable under the provisions of the FAR and/or the contract. CBP will include the requirement for the contractor to submit a copy of the public voucher directly to DCAA in all ongoing and future cost type contracts.

RECOMMENDATIONS

The report contained five recommendations. As discussed below, DHS concurs or concurs in principle with all of the recommendations. Technical comments on the draft report have been provided under separate cover.

Specifically, GAO recommended that the Secretary of the U.S. Department of Homeland Security, direct CBP's SBI Contracting Division Director to take the following actions:

RECOMMENDATION #1: With respect to the remaining funds not yet disbursed under the original SBI^{net} contract, revise CBP's SBI SOPs to require the SBI^{net} contractor to submit data supporting invoiced costs to CBP in sufficient detail to facilitate effective CO and COTR invoice review (for example, requiring invoice support to include hours worked and labor rates used for invoiced lump sum direct-labor cost charges).

RESPONSE: Concur in principle. DHS agrees that it is imperative for a contractor to provide sufficient information to support an effective government CO and/or COTR review and approval. CBP will continue to exercise robust invoicing review activities that rely on (1) extensive performance and cost information routinely furnished by the contractor, and (2) the Defense Contracting Audit Agency (DCAA) reviews of the contractor's accounting and billing systems, as well as vouchers, for continued assurance of invoice accuracy and reliability. In addition, as part of our efforts for continuous improvement, CBP will enhance the current review process by incorporating the recently revised DHS Memorandum of Agreement with DCAA to conduct detailed examinations of all contractor requests for interim payments that exceed \$1 million and all first vouchers under its cost type orders and contracts.

While DHS concurs in principle with the GAO recommendation, requiring the contractor to submit substantial supporting data as part of the public voucher submission is not cost-effective where controls such as those implemented by CBP are in place. In fact, the Department of Defense has recognized, via two memorandums to contracting personnel, the duplication in effort that results from requiring contractors to submit detailed supporting data with each interim voucher. This approach results in extensive additional data submitted (which is done at a significant cost to the government, since the contractor charges those costs to government contracts). Such additional data could include a multi-hundred line item report each month, for each invoice, identifying hours worked, hourly rates, by prime contractor and by subcontractor, by employee and work site, with travel claims, etc. This additional detail would not be a cost-effective improvement for the recurring interim payment review and is contrary to established best practices for interim payment reviews³.

³ Reference memorandum from the Principal Deputy Undersecretary for Defense, Acquisition and Technology, of October 2001, *Public Vouchers*.

By June 30, 2011, CBP will take the following actions:

- (1) Modify all existing cost reimbursement contracts to include a requirement for the contractor to send a copy of all public vouchers (requests for interim payment) directly to the cognizant DCAA field office; and
- (2) Modify standard operating procedures to require that any new cost reimbursement contracts/orders include a requirement for the contractor to send a copy of the public vouchers directly to the cognizant DCAA field office.

RECOMMENDATION #2: With respect to the remaining funds not yet disbursed under the original SBInet contract, revise CBP's SBI SOPs to include specific, risk-based steps required for COs and COTRs to properly review and approve contractor invoices to ensure that they accurately reflect all program costs incurred, including specifying required documentation of such review and approval.

RESPONSE: Concur. CBP's Office of Technology Innovation and Acquisition (OTIA) Program Management Office and Procurement Directorate are updating the invoice review and approval process, to include identifying risk-based steps that accommodate various contract types (e.g., cost-type invoice risks and procedures are different than fixed-price contracts), focusing on timeliness for invoice approval and improving awareness and utilization of numerous contract data sources to facilitate invoice approvals (Estimated Completion Date: June 30, 2011).

RECOMMENDATION #3: With respect to closeout audits under the original SBI prime contract and any task orders that receive closeout under DHS's SOPs, request that DCAA perform closeout audits as expeditiously as possible, including providing information in the contractor payment control findings concerning the original SBInet program that we identified for consideration in determining the extent and nature of DCAA testing required as part of such audits.

RESPONSE: Concur in principle. DHS agrees that there is a need to close contracts as soon as practical after contract performance is complete. As part of this process, DHS will work closely with DCAA to try to facilitate the required audits. However, as previously noted in our response, the key to closing the contract is completion of the DCAA annual incurred cost audits. The contracts cannot be closed until these audits are completed. DHS notes that completion of these audits is ultimately determined by DCAA management, not DHS. However, DHS will continue to discuss with DCAA senior officials the importance of completing the annual incurred cost audits so that the contracts can be closed.

CBP will close contracts within 90 days after receipt of the DCAA annual incurred cost audits that cover all contract years for the particular contract/task order at issue. As previously noted, such close out is contingent upon DCAA completion of the annual incurred cost audits (DCAA audits final incurred costs based on contractor fiscal years, not individual contracts).

RECOMMENDATION #4: With respect to closeout audits under the original SBI prime contract and any task orders that receive closeout under DHS's SOPs, establish procedures for coordinating with DCAA to monitor the status of closeout audits related to the original SBInet program.

RESPONSE: Concur in principle. DHS agrees with the GAO on the importance of having procedures for coordinating with DCAA on the status of closeout audits. However, such procedures are already in place. A current Interagency Agreement exists for the CBP contracting team to request DCAA support with financial controls and closeout audits. We currently receive from the Administrative Contracting Officer, on a monthly basis, a system status matrix (update) used to monitor Boeing's systems status (i.e., accounting, billing, budget compensation, information technology, estimating, indirect, labor, material, purchasing and control environment); the status of forward pricing; the status of Incurred Cost Audits; and the status of disclosure statement and Cost Accounting Standards issues. In addition, our resident DCAA Financial Liaison Advisor has access to the Boeing Contract Audit Coordinator network, and the staff of DCAA Field Office in Huntsville, AL, to remain apprised of the status of Boeing contract audits and Boeing corrective action progress. However, as previously noted, contract closeout audits cannot be performed until DCAA has conducted its annual incurred cost audits for the contractor business segment.

RECOMMENDATION #5: With respect to the new SBI technology plan, document the consideration, and incorporation as appropriate, of lessons learned based on GAO's findings on the design of controls over payments to the original SBInet contractor in designing and implementing contract provisions and related policies and procedures for reviewing and approving prime contractor invoices. Such provisions should provide for obtaining sufficiently detailed data supporting invoiced costs to support effective invoice reviews and include the specific appropriately risk-based steps required for COs and COTRS to carry out an effective contractor invoice review.

RESPONSE: Concur. As discussed in response to Recommendation #2, the OTIA Program Management Office and Procurement Directorate are updating policies and processes for reviewing and approving contractor invoices on the basis of lessons learned from the past, as well as enhancements now available through a new DCAA support agreement for expanded invoice review support. CBP will continue to rely on extensive periodic program cost and status reporting information to review and approve interim payment invoices on cost-type contracts. In the future, CBP's processes will highlight both (1) risk-based steps required by COs and COTRS, and (2) appropriate use of all available performance and cost information to approve interim contract payments (Estimated Completion Date: June 30, 2011).

Please note that CBP has no new SBI technology plan. There is, however, a new technology portfolio approach that replaces the obsolete SBInet program. The acquisition strategy for the current portfolio of procurements includes limited cost-type contracting.

Again, thank you for the opportunity to review and comment on this draft report. We look forward to working with you on future Homeland Security issues.

Sincerely,



Jim H. Crumpacker
Director
Departmental GAO/OIG Liaison Office

Appendix II: GAO Contact and Staff Acknowledgments

GAO Contact

Susan Ragland, (202) 512-9095 or raglands@gao.gov

Staff Acknowledgments

In addition to the contact named above, Chanetta Reed, Assistant Director; Kwabena Ansong; Heather Dunahoo; Nicholas Epifano; Aaron Livernois; and Stephen Lowery made key contributions to this report.

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