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ANTI-DRUG MEDIA CAMPAIGN

Aspects of Advertising Contract Mismanaged by the Government; Contractor Improperly Charged Some Costs

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our report entitled *Anti-Drug Media Campaign: Aspects of Advertising Contract Mismanaged by the Government; Contractor Improperly Charged Some Costs* (GAO-01-623, June 25, 2001), which contains the findings from our most recent report regarding our review of the Office of National Drug Control Policy's (ONDCP) advertising contract for Phase III of the National Youth Anti-Drug Media Campaign. We first reviewed certain programmatic aspects of the media campaign in a July 2000 report.[1] During that review, allegations were made that the government was not adequately managing aspects of the Phase III contract relating to costs incurred by the contractor (the advertising agency of Ogilvy & Mather) and that the contractor was overbilling the government. In October 2000, at the request of former Chairman Mica, we testified before this Subcommittee about our initial investigation of ONDCP's actions after it received allegations that Ogilvy was overbilling the government.[2] We reported that the former ONDCP Director knew about these allegations, including possible fraudulent conduct, in April 2000. We also reported that the Director agreed with the need to audit the contract after ONDCP transferred contracting responsibilities from the Department of Health and Human Services (HHS) to the Navy.

Our June 2001 report discussed whether Ogilvy properly charged the government for labor costs incurred under this contract, and whether the government adequately managed aspects of the contract award and administration related to costs incurred by the contractor. We focused on labor charges submitted by Ogilvy because the allegations pertained to labor costs. We reviewed these costs by examining the labor invoices that were submitted to the government for work done under the ONDCP contract, and then interviewing a sample of Ogilvy employees whose time sheets were revised regarding the amount of time that was charged to the government. We asked these employees about why the time sheets were revised and who made the changes. We collected other information by conducting interviews and reviewing contract-related documentation at HHS, which awarded and administered the contract during the first 2 years

[1] *Anti-Drug Media Campaign: ONDCP Met Most Mandates, but Evaluations of Impact Are Inconclusive* (GGD/HEHS-00-153, July 31, 2000).

[2] *Anti-Drug Media Campaign: Investigation of Actions Taken Concerning Alleged Excessive Contractor Cost* (GAO-01-34T, Oct. 4, 2000).

for ONDCP; the Navy, which assumed responsibility for administering the contract for ONDCP in November 2000; the Defense Contract Audit Agency (DCAA), which was asked by the Navy to review Ogilvy's accounting system and audit the contract; ONDCP; and Ogilvy. We did not determine the contractor's actual costs incurred under this contract. Although we did not focus on the technical aspects of Ogilvy's performance, ONDCP officials said that they were very satisfied with Ogilvy's technical performance regarding the anti-drug media campaign.

Background

Phase III of ONDCP's National Youth Anti-Drug Media Campaign was initiated in January 1999 as a 5-year effort to reduce youth drug use. The campaign consists of nationwide print and broadcast advertisements that are to run through December 2003. Although paid advertisements are the centerpiece of the campaign, they are part of a broader ONDCP effort that includes partnerships with community groups, corporate participation, public information and news media outreach, collaboration with the entertainment industry, and use of interactive media. Paid advertisements for the campaign are to be supplemented by matching advertisements donated by media outlets.

In December 1998, on behalf of ONDCP, HHS competitively awarded a cost-reimbursement contract to Ogilvy, with performance to begin in January 1999. That contract has a base year and 4 option years, for a total estimated value of $684 million. Of the $128.8 million value of the contract award for the first year, $18.9 million was for Ogilvy's labor costs, and the remainder was for media and subcontractor costs. According to HHS, a cost-reimbursement contract was used primarily because ONDCP's specific needs for the advertising campaign could not be determined in advance and the cost of performing the work could not be forecast with a reasonable degree of accuracy, and therefore a fixed-price contract was impractical.

According to ONDCP officials, because the Executive Office of the President, of which ONDCP is a part, did not have the procurement resources to award and administer a large contract, ONDCP arranged for HHS' Program Support Center (PSC) to serve as its contracting agent. This arrangement gave HHS overall responsibility for awarding and administering the Phase III contract in return for a fee, and ONDCP was to monitor technical aspects of the contractor's performance.

In November 2000, attorneys representing Ogilvy disclosed to the Justice Department's Civil Division that they had conducted a preliminary review

of Ogilvy's ONDCP contract costs, and found certain "slices of unreliability" in the company's accounting system and employee time sheets. The attorneys said that they disclosed to the Justice Department deficiencies in the company's timekeeping systems, which they said resulted in possible underbilling of labor costs from January through June 1999, and possible overbilling of labor costs for the last quarter of 1999. Also, in November 2000, ONDCP transferred contracting responsibilities from HHS to the Navy after a breakdown in ONDCP's working relationship with HHS regarding the contract. In December 2000, the Navy asked DCAA to review Ogilvy's accounting system and conduct an historical audit of costs incurred under the contract. In January 2001, the Navy exercised the option to Ogilvy for the third year of the contract (Option Year 2), with an estimated value of $137 million.

Findings

Ogilvy Improperly Charged for Some Labor Costs

We found that Ogilvy did not properly charge the government for some of the labor costs claimed under the contract, and did not have an adequate accounting system that could support a cost-reimbursement government contract of this value. Although the government disallowed nearly $7.6 million out of about $24.2 million in total labor charges submitted by Ogilvy during the first 19 months of the contract, attorneys for the company have proposed that about $850,000 be disallowed for that period. The amount of money that the government overpaid or should reimburse the contractor for labor costs incurred cannot be determined until DCAA audits the costs claimed by Ogilvy. The Navy has asked DCAA to audit the media campaign costs for 1999 and 2000, which it plans to start soon.

Some of Ogilvy's labor invoices included charges for time that its employees did not work on the contract. According to Ogilvy officials and an internal company E-mail, after learning in the summer of 1999 that revenue on the ONDCP contract was about $3 million lower than projected, certain Ogilvy managers instructed some employees to review and revise their time sheets. Ogilvy's attorneys provided documents indicating that these revisions added about 3,100 hours to the ONDCP contract, which increased charges to the government by about $238,000. We interviewed some of these employees, who told us that they initially did not record all of the time that they worked on the ONDCP contract, and that they revised their time sheets to increase the number of hours that they claimed to have worked. However, some of the employees also told us that they did not work the amount of additional time that was

added to their time sheets, or they could not fully explain why they increased the number of hours to the ONDPC contract. For example, one of the employees said that she did not work the 485 hours that she added to the ONDCP contract, and another employee generally could not recall the work that he did for ONDCP with respect to most of the 402 hours that he added to his time sheets.

In another audit step, we reviewed time sheets that Ogilvy submitted to ONDCP as support for the labor invoices in 1999, and found hundreds with scratch-outs, white-outs, and other changes to the amount of time billed to the ONDCP contract. These changes all lacked the employees' initials. We interviewed 12 Ogilvy employees whose time sheets were changed to add time to the ONDCP contract about why the changes were made.[3] Four of the 12 employees said that they did not make the changes indicated on their time sheets regarding ONDCP and did not know who made the changes, which added at least 55 hours to the ONDCP contract.[4] The other 8 employees said that they made the changes for various reasons, such as making corrections for mathematical errors, charging time to the wrong account, and recording the wrong office departure times.

We found other problems associated with Ogilvy's billing the government for its ONDCP work. Ogilvy inconsistently charged the government for paid absences and training and incorrectly billed fringe benefits for temporary contract employees. In June 2000, a consultant retained by Ogilvy to review the company's billing on the ONDCP contract reported that employee timesheets contained problems such as erasures, scratch-outs, and white-outs without the employees' initials on the changes. The next month, Ogilvy suspended billing the government for its labor and has not submitted another labor bill to the government from July 2000 to the present. We referred our findings regarding Ogilvy's improper billing under this contract to the Justice Department.

The Government Mismanaged Aspects of the Contract

The government did not adequately manage aspects of the contract award. HHS awarded a cost-reimbursement contract to Ogilvy before sufficiently determining whether Ogilvy had an adequate accounting system to support this type of contract. HHS also did not obtain a required statement from

[3]These were not the same employees who revised their time sheets after certain Ogilvy managers instructed them to do so.

[4]More hours may have been added, but it was not possible to determine what numbers had been whited-out or marked-out on some time sheets.

Ogilvy that would have disclosed the cost accounting practices that the company planned to use. The disclosure statement would have increased the likelihood that deficiencies in Ogilvy's cost accounting practices would have been identified and addressed earlier.

The government also did not adequately administer the contract by resolving billing problems when they arose or by auditing the contractor, despite clear indications that Ogilvy's cost accounting system and timekeeping procedures were deficient. The HHS contracting officer followed the technical representative's recommendations to disallow nearly one-third of the labor charges that Ogilvy submitted during the first 19 months of the contract without reviewing the appropriateness of those disallowances or arranging to audit the contract.

As we reported to this subcommittee last October, ONDCP's technical representative wrote a memorandum in April 2000 to the then-ONDCP Director about Ogilvy's billing irregularities, including a former Ogilvy employee's suspicions of fraudulent conduct. In this memorandum, the technical representative recommended an immediate audit of the base year of the contract. However, the HHS contracting officer informed us that ONDCP did not provide her with a copy of this memorandum or any other credible evidence of improper time charges and, therefore, an audit was not needed. The technical representative said that it was an ONDCP management decision not to share the unsubstantiated allegations of improper time charges with HHS contracting officials. ONDCP said that it lacked evidence substantiating the allegations and that an audit of the questioned billings was expected to occur immediately after the responsibility for contract administration was transferred from HHS to the Navy.

Contract administration was also impeded because the HHS contracting officer and the ONDCP technical representative did not have an effective working relationship, which eventually led to the transfer of contracting responsibilities from HHS to the Navy. The contracting officer said that the technical representative did not work within the boundaries of his appointment. However, ONDCP indicated that the technical representative started performing duties normally done by the contracting officer only because the contracting officer was not actively engaged in the administration of the contract, gave the technical representative permission, or acquiesced to the technical representative's performing the duties. Further, the technical representative said that his working relationship with HHS contracting officials deteriorated because he refused pressure from the contracting officer to recommend payment for

costs that he believed to be questionable or unsupportable. In some instances, we found documentary evidence to support the different parties' accounts of events, although with regard to other incidents, we found no documentation to resolve the differing views.

Actions Taken Since the October 2000 Hearing

In November 2000, Ogilvy hired PricewaterhouseCoopers to restructure its accounting system to meet government contracting standards. This included developing a disclosure statement regarding Ogilvy's accounting system, which was required to be submitted at the beginning of the contract. On March 9, 2001, more than 2 years after the contract award, Ogilvy submitted a disclosure statement. Ogilvy was also required to submit an incurred cost proposal to establish final costs incurred for 1999, which was originally due no later than June 30, 2000, and an incurred cost proposal for 2000, by June 30, 2001. On March 2, 2001, Ogilvy provided an "advance copy" of an incurred cost proposal to the Navy, which was not certified, for 1999. On July 11, 2001, Ogilvy provided a certified incurred cost proposal for 1999 and 2000.

Ogilvy also indicated that it has taken actions to improve the preparation of employee time sheets. In January 2001, Ogilvy issued its employees revised time sheet guidance prepared by PricewaterhouseCoopers containing detailed time sheet procedures and penalties for falsifying them. Also in January 2001, PricewaterhouseCoopers began providing time sheet training to Ogilvy employees.

For its part, ONDCP indicated that it has taken actions to improve the administration of the contract with Ogilvy, such as transferring the contracting responsibilities from HHS to the Navy. ONDCP also indicated that it split the technical representative's duties so that the Media Campaign Office will have various technical representatives, rather than having one technical representative, handling all of the media campaign contracts. In addition, ONDCP said that its media campaign staff have been trained and certified as technical representatives. According to ONDCP, since contracting responsibilities were transferred to the Navy, communication has been substantially enhanced between the technical representatives and the contracting officer, and regular meetings are scheduled with the technical representatives, the contracting officer, and the contractor to resolve issues.

With regard to the next contract option year, which begins in January 2002, ONDCP officials said that they are considering options and contingencies. In late July 2001, ONDCP officials said that they are

conducting market research with the Navy to determine whether the contract should be resolicited, are developing a statement of work for a possible new contract, and are considering whether any new contract should be fixed-price. ONDCP expects to decide by August 30, 2001, whether to exercise the next option year or whether reprocurement should be initiated.

DCAA, which began reviewing Ogilvy's accounting system in March 2001, determined last week that the company's accounting system was adequate with regard to the ONDCP contract. DCAA also plans to routinely review Ogilvy's future labor invoices when the company resumes submitting them, and soon will begin to audit Ogilvy's 1999 and 2000 costs.

Conclusions

Ogilvy did not properly charge the government for some of its labor costs incurred under this contract. Its submission of time sheets claiming hours that some employees said they did not work on the anti-drug media campaign was clearly improper. In addition, the company did not make substantial progress toward restructuring its accounting system to meet government requirements until nearly 2 years after the contract was awarded.

The government poorly managed aspects of the award and administration of the contract. HHS should not have awarded this cost-reimbursement contract without determining whether the contractor had an adequate cost accounting system. In addition, HHS should have reviewed the appropriateness of the large amount of money that the technical representative recommended be disallowed from the contractor's invoices, or arranged for an audit of the contract. The technical representative appropriately brought allegations of improper billing to the attention of ONDCP management, but ONDCP management did not take prompt action to investigate the allegations.

Because the contract has not yet been audited, the appropriateness of the disallowed charges and Ogilvy's actual incurred costs under this contract remains unknown. In assuming contracting responsibilities for the ONDCP contract, the Navy must determine the allowability of costs charged to the contract, including Ogilvy's nonbillable hours. We believe that the government should not exercise the next contract option year with Ogilvy unless substantial progress has been made toward resolving these issues and ONDCP has considered both Ogilvy's administrative and technical performance under the contract to date.

Recommendations

In our June 2001 report, we recommended corrective action to ONDCP and HHS to address the problems we identified. We recommended that the ONDCP Director should direct ONDCP staff to work with the Navy to

- review the appropriateness of the disallowed costs and temporary contract employee labor charges from Ogilvy's invoices and determine the amount of money that the government overpaid or should reimburse the contractor regarding these invoices;
- ensure that Ogilvy has an adequate cost accounting system for continued performance under the contract;
- coordinate the roles and responsibilities of the contracting officer and the technical representative and ensure that these roles and responsibilities are effectively carried out.

Further, we recommended that ONDCP request that the Navy not exercise the next contract option year with Ogilvy until the company has adequately restructured its accounting system to meet government requirements and ONDCP has considered the contractor's administrative, as well as technical performance, under the contract to date. In this regard, ONDCP and the Navy should immediately begin to plan contracting alternatives for the subsequent Phase III media campaign should they decide not to exercise the next contract option year with Ogilvy.

To improve HHS' compliance with contracting procedures and prevent the awarding of cost-reimbursement contracts covered by the Cost Accounting Standards (CAS) to companies lacking adequate accounting systems to support that type of contract, we recommended that the Director of the HHS Program Support Center (PSC) direct that PSC's controls over contracting procedures be assessed to ensure that they are adequate for awarding and administering CAS-covered cost-reimbursement contracts. These controls would include ensuring the adequacy of potential contractors' cost accounting systems, obtaining the required disclosure statements, arranging for audits of contracts when significant billing problems arise, and resolving billing disputes involving substantial disallowances on a timely basis.

Agency Comments

In providing comments on our draft report, ONDCP agreed with our recommendations and said that significant progress has been achieved toward resolving the problems that we identified. The HHS Program Support Center agreed with our recommendation that controls over contracting procedures should be reexamined, particularly with respect to

assessing an offeror's accounting system. Ogilvy's attorneys did not comment on the recommendations.

Recent Actions Taken on Recommendations

We met with ONDCP officials on July 25, 2001, to discuss additional progress made since our report was issued and incorporated in this statement what ONDCP officials told us. ONDCP officials indicated that they are working to implement our recommendations and provided a July 20, 2001, letter from the ONDCP Acting Director to the Navy stating that ONDCP and the Navy should jointly conduct market research as a basis for deciding whether to exercise the next option year with Ogilvy or resolicit the contract. The letter also indicated that unless market research indicates that the contract should remain cost-reimbursable, either in full or in part, the contract should be fixed-price. In addition, ONDCP informed the Navy that Ogilvy cannot be retained under a cost-type contract unless it has an accounting system that complies with the Federal Acquisition Regulation.

Although ONDCP is working to implement our recommendations, much remains to be done to settle the problems existing with this contract. The 1999 and 2000 costs need to be audited, the amount of labor costs to be paid for those years must be determined and possibly negotiated, and labor costs incurred since July 2000 have to be billed and determined. Moreover, the government has to decide if it is prudent to continue this contract or seek other contractual means to carry out the media campaign.

Contacts and Acknowledgments

For information about this testimony, please contact Bernard Ungar, Director, Physical Infrastructure Issues, on (202) 512-8387. Individuals making key contributions to this testimony included Bob Homan, John Baldwin, and Adam Vodraska.

This concludes my prepared statement. I will be happy to respond to any questions you or other Members of the Subcommittee may have.