MEMORANDUM FOR: The Honorable Admiral Robert J. Papp, Jr.
Commandant
United States Coast Guard

FROM: Carlton I. Mann
Acting Deputy Inspector General

SUBJECT: Re-issuance of Audit Report OIG-12-73, U.S. Coast Guard’s Maritime Patrol Aircraft

August 31, 2012

I am writing to inform you that the Department of Homeland Security (DHS) Office of Inspector General (OIG) has recalled the subject report and is now re-issuing it to modify the statement of compliance with generally accepted government auditing standards (GAGAS). We took these actions because it recently came to our attention that the family member of a senior OIG official was employed by an entity associated with this audit.

To ensure that this impairment did not affect our findings and conclusions, we thoroughly reviewed our work on this audit, as well as the results. Through this review, we verified that the impairment did not affect our results; our evidence is sound and fully supports our findings and conclusions. Therefore, we are re-issuing this report and re-posting it on our website. The report is unchanged except for the statement of compliance with GAGAS found on page 9 of Appendix A – Purpose, Scope, and Methodology.

We remain committed to assisting the Department in improving its effectiveness and efficiency to better carry out its mission, and we appreciate your support of our work. Please do not hesitate to call me or your staff may contact Anne L. Richards, Assistant Inspector General for Audits, at (202) 254-4100 if you have any questions or concerns.

Attachment
Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the Homeland Security Act of 2002 (Public Law 107-296) by amendment to the Inspector General Act of 1978. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the Department.

This report addresses whether the United States Coast Guard effectively awarded the 2010 Ocean Sentry Maritime Patrol contract. It is based on interviews with employees and officials of relevant agencies and institutions, direct observations, and a review of applicable documents.

The recommendation herein has been developed to the best knowledge available to our office, and has been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

Anne L. Richards
Assistant Inspector General for Audits
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### Abbreviations

<table>
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<th>Abbreviation</th>
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<tr>
<td>DCAA</td>
<td>Defense Contract Audit Agency</td>
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<td>DHS</td>
<td>Department of Homeland Security</td>
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<tr>
<td>EADS CASA</td>
<td>European Aeronautic Defense and Space Company/Construcciones Aeronáuticas</td>
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<tr>
<td></td>
<td>Sociedad Anónima</td>
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<tr>
<td>EADS NA</td>
<td>European Aeronautic Defense and Space Company North America Company</td>
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<tr>
<td>FAR</td>
<td>Federal Acquisition Regulation</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal year</td>
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<tr>
<td>HC-144A</td>
<td>Ocean Sentry Maritime Patrol Aircraft</td>
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<tr>
<td>OIG</td>
<td>Office of Inspector General</td>
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<td>USCG</td>
<td>United States Coast Guard</td>
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Executive Summary

The Ocean Sentry Maritime Patrol Aircraft is a medium-range surveillance aircraft purchased by the United States Coast Guard to replace its aging HU-25 Falcon fleet. In July 2010, the United States Coast Guard awarded its latest contract to the European Aeronautic Defense and Space Company North America for three aircraft with a value of about $117 million, excluding any option periods. The United States Coast Guard has taken delivery of 13 HC-144A aircraft since the program began in 2003. We performed this audit to determine whether the United States Coast Guard effectively awarded the 2010 Ocean Sentry Maritime Patrol Aircraft contract.

The United States Coast Guard generally awarded the Ocean Sentry Maritime Patrol Aircraft contract effectively. However, it could have improved its oversight of the contract. The United States Coast Guard was aware of extensive work and conclusions made by the Defense Contract Audit Agency regarding the presence of non-chargeable costs and noncompliance with the Federal Acquisition Regulation by the subcontractor, European Aeronautic Defense and Space Company/Construcciones Aeronáuticas Sociedad Anónima. Despite this knowledge, United States Coast Guard personnel did not follow up with the subcontractor to ensure that it had implemented recommendations made by the Defense Contract Audit Agency and did not obtain sufficient support to ensure the exclusion of non-chargeable costs when awarding the current contract. The Coast Guard partially concurred with our recommendation to improve the award and oversight of this acquisition and future acquisitions.
Background

In 2003, the United States Coast Guard (USCG) contracted with Integrated Coast Guard Systems to procure the initial Ocean Sentry Maritime Patrol Aircraft (HC-144A). Originally, as part of the Integrated Deepwater Program, the USCG procured the HC-144A to replace its aging HU-25 Falcon aircraft with 36 aircraft by 2025. The HC-144A is the largest aircraft acquisition program in the USCG’s Acquisition Directorate. The USCG received its first HC-144A in December 2006 and to date has accepted delivery of 13 aircraft.

Following multiple congressional hearings, audit reports, and investigations, the USCG ended its contractual relationship with Integrated Coast Guard Systems and became the lead systems integrator for the HC-144A program in January 2011. The USCG issued the current firm fixed-price HC-144A contract to European Aeronautic Defense and Space Company North America (EADS NA) in July 2010 for aircraft numbers 12, 13, and 14. EADS NA issued a subcontract to European Aeronautic Defense and Space Company/Construcciones Aeronáuticas Sociedad Anónima (EADS CASA), the original equipment manufacturer.

Photo of a HC-144A. Source: USCG.

The USCG’s Acquisition, Construction, and Improvements budget was about $1.3 billion for fiscal year (FY) 2010. The USCG budgeted about $299 million for its aviation department, and about $138.5 million for the HC-144A program. The USCG awarded the 2010 HC-144A base contract, excluding any option periods, for
about $117 million. According to the USCG’s FY 2012 Congressional Justification, the total cost for the HC-144A program, through aircraft number 11, was about $795.1 million. We conducted this audit to determine whether the USCG effectively awarded the 2010 HC-144A contract.

Results of Audit

The USCG generally awarded the HC-144A contract effectively. It followed federal regulation, Department, and USCG guidance when awarding the 2010 HC-144A contract. With one proposal received for the HC-144A solicitation, the USCG worked to ensure that the proposal went through the award process correctly. It standardized the HC-144A fleet to meet mission needs, appointed a source selection organization to oversee and approve the process, and obtained Department-level approval for its actions when required.

However, the USCG could have improved the oversight of the 2010 HC-144A contract. It was aware of extensive work and conclusions by the Defense Contract Audit Agency (DCAA) regarding the presence of non-chargeable costs and non-compliance with the Federal Acquisition Regulation (FAR) by EADS CASA. Despite this knowledge, USCG personnel did not follow up with EADS CASA to ensure that it had implemented recommendations made by DCAA and did not obtain sufficient support to ensure that non-chargeable costs were excluded when awarding the current HC-144A contract.

Additional Follow up Needed on Prior Subcontractor Deficiencies

The USCG should have conducted more follow up on deficiencies noted by the DCAA relating to EADS CASA and its accounting systems. The contract file did not contain sufficient documentation for USCG personnel to ensure that the subcontractor calculated all costs correctly. However, USCG personnel determined that the contractor’s price proposal met the requirements of the proposal evaluation plan and that price risk was not an evaluation factor. Although the USCG performed additional steps regarding price risk, such as comparison of proposed prices to historical prices, USCG personnel determined that the risk identified was not significant. USCG personnel could have followed up with DCAA on the status of prior report recommendations regarding noncompliance with the FAR.

We reviewed eight reports issued by DCAA between February 2004 and April 2010 on EADS CASA. The multiple DCAA reports identify numerous instances between 2004 and 2010 where EADS CASA included non-chargeable costs and costs that did not comply with FAR Part 31 in its cancellation and price proposals. FAR Part 31.205 identifies 18 costs that are generally non-chargeable in federal government contracts, such as...
interest, costs for bad debts, and advertising. Non-compliance with FAR Part 31 occurs when contractors do not follow its guidelines when determining whether costs are allowable, reasonable, and allocable when calculating costs.

DCAA provided detailed analyses and conclusions in its audit reports. Table 1 summarizes the non-chargeable costs and costs not in compliance with FAR Part 31, as identified in DCAA audit reports.

Table 1

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<th>DCAA Report Analysis</th>
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Source: DHS OIG.

*Supplemental Report.

In one audit report, DCAA concluded that about $11,019,750 of the total $154,884,795 proposal costs were questionable and about $269,129 were unsupported. In another audit report, DCAA noted deficiencies with timekeeping, living expenses, travel costs, cost of money, and the inclusion of other non-chargeable costs. In that report, DCAA also detailed that Airbus Military, a business unit of EADS CASA, incorrectly included costs in its proposals. For example, employees’ timesheet entries recorded amounts greater than a normal working day because of EADS CASA’s inadequate internal controls over its timekeeping system. One employee charged what appeared to be 1 full week (45.08 hours) to 1 day. DCAA determined that there was a significant risk of potential labor overcharges because employees may work on multiple contracts and

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projects, but do not record the labor hours on a daily basis. EADS CASA had policies and procedures to address daily timekeeping; however, EADS CASA stated that it never implemented them.

DCAA recommended that the management of EADS CASA take immediate action to ensure that future comprehensive price proposals comply with FAR Part 31. EADS CASA concurred with the report’s conclusions and acknowledged certain deficiencies in its estimating and accounting systems. However, according to DCAA, EADS CASA’s audit response was not fully responsive to the report’s recommendations. DCAA stated that EADS CASA’s decision not to implement timekeeping procedures until the award of a cost-based contract with the U.S. government would continue to prevent the determination of the validity and reliability of recorded labor hours used as a basis for future labor estimates.

USCG personnel acknowledged EADS CASA’s response to the DCAA findings in their contract file documentation; however, there was no documentation to show that USCG personnel took the necessary steps to ensure that EADS CASA implemented any corrective action. With only 2 months between the issuance of DCAA’s audit report and the award of the current HC-144A contract, EADS CASA did not have enough time to make the recommended changes before entering into another U.S. government contract.

The multiple DCAA reports demonstrate that EADS CASA included non-chargeable costs and costs not calculated in accordance with federal regulation in prior contracts. The USCG could have conducted additional follow up, such as verifying that the subcontractor addressed the DCAA report recommendations, which would have provided the USCG more assurance that the contractor and subcontractor did not include costs not allowed per the FAR.

**Other Reportable Matters**

**Delay in Initiating Equipment Modification**

The USCG awarded the current HC-144A contract with equipment known not to meet operational requirements, such as launch and arrival time, radar detection capability, and sensor performance. USCG personnel were aware of the equipment problems at least 14 months before they awarded the 2010 HC-144A contract.

Operational Assessments identify system enhancements and significant areas of risk to the program’s successful completion. The Operational Assessment dated May 2009 revealed operational problems with certain
equipment on the HC-144A. In December 2009, the sponsoring unit for the HC-144A made a recommendation to the USCG’s Acquisition Directorate to stop further purchase of the equipment and perform additional analysis. In March 2010, the program manager also recommended that the USCG stop purchase of the equipment. Despite these recommendations, USCG personnel stated they could not make any changes without the Executive Oversight Council’s approval. The USCG continued to follow its existing procedures by issuing the solicitation in April 2010 and awarding the contract with this equipment in July 2010. USCG personnel did not take action to stop the purchase of the equipment or remove this equipment until October 2010. The USCG’s Executive Oversight Council did not approve the removal of this equipment until later in October 2010.

Although the USCG identified these issues early in the acquisition process, it did not take the necessary steps to ensure that the contract excluded this equipment. The USCG has now amended the contract twice to address this equipment problem. Removing the equipment will decrease the cost by about $400,000 per aircraft, or a total of about $1.2 million for aircrafts 12, 13, and 14. However, according to USCG personnel, the USCG will incur additional costs for updating the technical designs, reconfiguration costs, aircraft recertification costs, and about $57,000 for labor costs just to remove this equipment. Until the USCG selects a replacement for this equipment, the total financial impact to the HC-144A program cannot be determined.

**Guidance for One-Bid Contracts**

DHS has issued additional procedures to promote full and open competition when the Department and its components award contracts based on receipt of only one proposal for a competitively issued solicitation. DHS’ Chief Procurement Officer issued a memorandum, *Procedures for Improved Competition*, dated February 2011, which provides historical data and additional procedures for awarding one-bid contracts over $700,000.

The USCG issued a Chief of Contracting Office Alert, 11-20, *New DHS Procedures for competitive negotiated contacts where only one offer is received*, dated February 23, 2011, to communicate the Department’s process change requirements and direct immediate adherence to the procedures. As of October 2011, the USCG has not created any component-level guidance to follow when awarding a contract that receives only one proposal. During the audit, USCG personnel stated that they were in the process of creating USCG-level guidance to address this area. However, at the end of the audit, USCG personnel informed us that
the Chief of Contracting Office Alert, 11-20, is the only guidance USCG will issue.

We believe that it may be beneficial for the USCG to issue additional specific component-level guidance for its contracting officers to follow when awarding contracts for which only one proposal is received.

**Recommendation**

We recommend that the Assistant Commandant for Acquisitions, USCG:

**Recommendation #1:** Ensure that the subcontractor has satisfactorily addressed and implemented DCAA report recommendations.

**Management Comments and OIG Analysis**

The USCG provided comments on the draft of this report. A copy of the comments in their entirety is included in appendix B. The USCG also provided technical comments and suggested revisions to our report in a separate document. We reviewed the USCG’s technical comments and made changes throughout our report where appropriate, but have not included the actual comments in this report.

**Management Comments to Recommendation #1**

**Partially Concur.** The USCG agreed with the spirit of the recommendation. The USCG agreed that for sole source contract actions, it is imperative that the USCG give full consideration to the findings in the DCAA audit report. However, the USCG maintains that actions taken to award the initial HC-144A contract were in accordance with applicable regulations.

The USCG maintains that it was not required to, and therefore did not, obtain certified cost or pricing data and did not perform cost analysis in accordance with FAR 15.404-1(a). The Scope of FAR Part 31 contains cost principles and procedures for the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed. Therefore, the DCAA audit findings were not relevant to award of this contract or to the exercising of options 2, 3, or 4 for contract HSCC23-10-C-2DA020.
OIG Analysis. As discussed in our report, the USCG was aware of extensive work conducted and conclusions made by the DCAA regarding the presence of non-chargeable costs and non-compliance with the FAR by EADS CASA. Whether a contract is sole source or competed should not determine whether USCG personnel give full consideration to previous report findings regarding the inclusion of non-chargeable costs by EADS CASA. FAR Part 15.403-1(b) allows the contracting officer to require data other than certified cost or pricing data, which include types of data identical to certified cost or pricing data without the certification. Therefore, the USCG could have obtained information to ensure that the subcontractor calculated all costs correctly.

The DCAA report findings show that EADS CASA included non-chargeable costs for more than 5 years, from 2004 to 2010. According to a USCG employee, the discounts given for the 2010 HC-144A contract would have outweighed any non-chargeable costs that EADS CASA could have included in its cost. Although USCG personnel used price analysis when evaluating the 2010 HC-144A contract, it did not preclude them from ensuring that EADS CASA addressed DCAA’s report recommendations prior to contract award. FAR Part 15.403-3(b) states that when there are unusual circumstances where it is concluded that additional data are necessary to determine the reasonableness of price, the contracting officer shall, to the maximum extent practicable, obtain additional data from sources other than the offeror. We believe that the numerous DCAA reports and findings warranted an unusual circumstance that should have caused the contracting officer to obtain additional information from sources other than the offeror. The price analysis techniques the contracting officer applied included information from the offeror to determine price reasonableness.

We modified our recommendation to ensure that the USCG will meet its mission needs and not delay further production of the HC-144A aircraft in production, but addressing the EADS CASA issues noted by DCAA should be a priority.
Appendix A
Purpose, Scope, and Methodology

We initiated this audit to determine whether the USCG effectively awarded the 2010 HC-144A contract. To achieve our objective, we reviewed the HSCG23-10-C-2DA020 contract file and its supporting documentation. We also reviewed federal regulation, DHS policies, DHS USCG FY 2012 Congressional Justification, and USCG guidance. We interviewed DHS officials in the Office of the Chief Procurement Officer and USCG officials in the Acquisition Directorate, Intelligence and Criminal Investigations Directorate, Capability Directorate, and the Office of Planning, Resources, and Procurement. We conducted onsite work at USCG headquarters in Washington, DC.

We relied on computer-processed data provided by the USCG for program costs and one-bid contract data provided by DHS from the Federal Procurement Data System-Next Generation. We did not perform any internal control testing of this information, as it was not the basis for our report findings and recommendations. To minimize costs and avoid duplication of work, we did not conduct an analysis of accounting and cost documents because those documents were located in Barcelona, Spain.

To accomplish our objective, we relied on the body of work already conducted by DCAA, and on the audit findings and conclusions in DCAA’s published reports. Two of these reports contained modified generally accepted government auditing standards statements. We did not review DCAA’s work, audit plans, or audit documentation, nor did we perform tests of DCAA’s work.

We conducted this performance audit between May 2011 and November 2011 pursuant to the Inspector General Act of 1978, as amended, and according to generally accepted government auditing standards (GAGAS), except that we identified an impairment to our independence in appearance. Following completion of our audit, it came to our attention that a family member of a senior OIG official was employed by an entity associated with this audit. We took steps to re-evaluate the evidence supporting our findings and conclusions. In our opinion, the impairment to our independence in appearance did not affect the findings and conclusions developed during this audit.

GAGAS requires that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based upon our audit objectives. We believe that the evidence obtained provides a reasonable basis for
Appendix A
Purpose, Scope, and Methodology

our findings and conclusions based upon our audit objectives, and that the impairment to our independence in appearance did not affect this evidence or any findings and conclusions.

We appreciate the assistance and cooperation of USCG personnel throughout this audit.
MEMORANDUM

From: RDML S.F. Metrick
COMDT (CG-8)

To: Anne L. Richards
Assistant Inspector General for Audits

Subj: DHS OIG DRAFT REPORT ON UNITED STATES COAST GUARD’S MARITIME PATROL AIRCRAFT (11-116-AUD-USCG)

Ref: (a) DHS OIG Draft Report dated January 31, 2012

1. This memorandum transmits the Coast Guard’s response to the findings and recommendations identified in reference (a).

2. If you have any questions, my point of contact is Mr. Mark Kulwicki who can be reached at (202) 372-3533.

#

Enclosure: (1) USCG Response

Copy: Brooke Bebow, Director
    Linda Howard, Audit Director
    LaParacina Williams, Lead Audit Manager
    Andrea Rambow, Audit Manager
    Tiffany Bellinger, Auditor
    Thomas Bobrowski, Program Analyst
    Victoria Phan, Program Analyst
    Cory Upmeyer, Program Analyst
    Marissa Weinshel, Program Analyst
    Maureen Duddy, Referencer
UNITED STATES COAST GUARD STATEMENT ON DEPARTMENT OF HOMELAND SECURITY OFFICE OF INSPECTOR GENERAL

U.S. COAST GUARD'S MARITIME PATROL AIRCRAFT (11-116-AUD-USCG)

INTRODUCTION
Thank you for the opportunity to review and comment on Department of Homeland Security (DHS) Office of Inspector General’s (OIG’s) Draft Report 11-116-AUD-USCG entitled, “U.S. Coast Guard’s Maritime Patrol Aircraft.”

RECOMMENDATION AND USCG RESPONSE
Recommendation #1: We recommend that the Assistant Commandant for Acquisitions, USCG, ensure that the subcontractor has satisfactorily addressed and implemented DCAA report recommendations prior to exercising options 2, 3, or 4 for contract HSCG23-10-C-2DA020.

USCG Response: Partially Concur. The Coast Guard agrees with the spirit of the recommendation. The Coast Guard agrees that for sole source contract actions, it is imperative that we give full consideration to the findings in the DCAA audit report. Thus, for any future modifications to the contract that require certified cost data, Coast Guard will perform cost analysis that utilizes the DCAA findings, as well as any updates DCAA may have regarding contractor corrective action, at the time the modifications are negotiated. Coast Guard agrees that this will help ensure that the Government receives a fair and reasonable price, in accordance with the Federal Acquisition Regulation (FAR).

While the Coast Guard agrees that future modifications to the contract will consider DCAA findings (as discussed in the prior paragraph), it is also important to note that the Coast Guard action in not considering the DCAA findings for the initial contract award was in accordance with the applicable regulations. In the case of the initial award of the MPA contract, submission of certified cost or pricing data was not required or permitted under the FAR given that the Contracting Officer appropriately determined, in accordance with FAR 15.403-1(c)(1)(ii), that the proposed price was based on adequate competition. Accordingly, the Coast Guard fully complied with FAR 15.404-1(a)(2) and performed a price analysis to determine whether the proposed price was fair and reasonable. The Coast Guard utilized multiple primary price analysis techniques suggested in FAR Part 15.404-1(b) to evaluate the prices proposed and determined the proposed prices, inclusive of options, were fair and reasonable.

In accordance with FAR 15.404-1(a), certified cost or pricing data was not obtained and cost analysis was not performed. DCAA audit findings regarding cost disallowances relate to individual cost elements (generally overhead items), and thus would only be relevant to a cost analysis (the evaluation of individual cost elements). This is further confirmed by FAR Part 31, Scope of Part, “This part contains cost principles and procedures for the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed.” Therefore, the DCAA audit findings were not relevant to award of this contract or to the exercising of options 2, 3, or 4 for contract HSCG23-10-C-2DA020.

ENCLOSURE (1)
Appendix C
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Appendix D
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