

**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE**

KELLOGG BROWN & ROOT SERVICES,
INC.

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

C.A. No.

COMPLAINT

Plaintiff, Kellogg Brown & Root Services, Inc. (“KBR”), by its attorneys, files its Complaint for damages against Defendant, the United States of America (“United States”), pursuant to the Federal Tort Claims Act (“FTCA”), 28 U.S.C. §§ 2671-2680. For its Complaint, KBR alleges as follows:

JURISDICTION

1. This Court has federal question jurisdiction over this action pursuant to 28 U.S.C. § 1331 because it involves a claim arising under 28 U.S.C. § 1346(b) and the FTCA, 28 U.S.C. §§ 2671-2680. KBR has exhausted all administrative remedies available under the FTCA, 28 U.S.C. § 2675.

VENUE

2. Venue is proper under 28 U.S.C. § 1402(b) because KBR, being duly incorporated under the laws of the State of Delaware, resides in this judicial district.

PARTIES

3. Plaintiff, KBR, is a corporation incorporated under the laws of the State of Delaware and has its principal place of business at 601 Jefferson Street, Houston, Texas 77002.

4. Defendant is the United States, acting through the Department of Defense (“DoD”), a “federal agency” of the United States under 28 U.S.C. § 2671, and its employees, officers, and agents, including the Defense Contract Audit Agency (“DCAA”), a subcomponent agency of DoD that is under the direction, authority, and control of the Under Secretary of Defense (Comptroller). A further statement of DCAA’s role as a party appears in paragraphs 30 through 49 *infra*, and is expressly incorporated herein.

NATURE OF THE CASE

5. For many decades, dating back to the Vietnam War, KBR and its predecessor corporate entities have provided engineering, construction, and logistical and life-support services to the United States under government contracts with the DoD. Most recently, KBR performed a wide-range of combat-support services for the U.S. military in Iraq and Afghanistan under a competitively-awarded contract known as the “LOGCAP III contract.” In accordance with the terms of LOGCAP III, the United States and KBR assumed mutual obligations under the contract and applicable regulations and statutes.

6. The United States relies on DCAA to help ensure these mutual obligations are met. DCAA verifies the amount of payments a contractor is entitled to receive, and in turn, how much the government is required to pay under DoD contracts, particularly under cost-reimbursement contracts. DCAA also supports the government’s efforts to ensure that contractors maintain the appropriate type and quality of accounting and related systems. DCAA provides these services primarily to administrative contracting personnel, including Procuring

Contracting Officers (“PCOs”) and program managers, within other components of DoD, such as the Department of the Army (“Army”) and Defense Contract Management Agency (“DCMA”).

7. In carrying out its responsibilities, DCAA performs the type of services that otherwise would be performed by commercial, non-governmental accounting and auditing professionals. Like all professional accountants and auditors, DCAA is required to exercise due care and maintain its professional independence in delivering these services.

8. DCAA maintains a permanent, on-site staff of auditors and accounting professionals at KBR’s offices in Houston, Texas. Among other responsibilities, they are tasked with continuously reviewing and auditing KBR’s accounting, financial, and business systems. These individuals are purported experts in federal government contracts, even though they often have little or no experience with cost-type contracts performed in support of contingency operations abroad.

9. In February 2007, in an act intended to pander to an investigating Congressional committee, and at the behest of a similarly-minded PCO, DCAA took steps to enable the Army to recapture costs incurred by KBR in the performance of the LOGCAP III contract.

10. In August 2007, amid persistent political pressure from Congress, DCAA issued an audit report in which it concluded that KBR had billed approximately \$99.6 million in allegedly “unallowable” costs to the LOGCAP III contract. But the conclusions in the audit report were demonstrably false, and it is now clear DCAA performed this audit in a negligent manner.

11. Based on DCAA’s negligent actions, the government unilaterally recouped \$45,254,491.16 from KBR. Ultimately, the Armed Services Board of Contract Appeals

(“ASBCA”) determined that the government’s DCAA-inspired recoupments were improper, and KBR was entitled to recover those amounts.

12. The government also relied on DCAA’s negligent work to bring a \$103 million civil fraud action against KBR under the False Claims Act (“FCA”). But after the substantial flaws in DCAA’s audit were uncovered in discovery, the United States voluntarily dismissed the fraud suit in November 2012.

13. DCAA’s negligence caused KBR to incur \$12,507,051.76 in professional and internal administrative costs to litigate those actions. The facts and information underlying DCAA’s malpractice were, at all times, uniquely in the government’s possession, and therefore KBR was unable to discover that DCAA was the proximate cause of its injuries until January 6, 2012. KBR is entitled to recover \$12,507,051.76 as money damages under the FTCA, 28 U.S.C. §§ 1346(b), 2671-80, as a direct result of DCAA’s professional malpractice.

14. This particular audit is only one example of a larger pattern of professional malpractice to which KBR and other defense contractors have been subjected by DCAA. For nearly a decade, DCAA’s audit work has become increasingly belligerent and unprincipled, and the agency routinely has eschewed its professional obligations to satisfy members of Congress in search of a scapegoat for the wars in Iraq and Afghanistan. DCAA dutifully has assumed this role, despite its own substantial and well-documented resource and personnel shortages. But rather than address those pervasive organizational issues, DCAA has taken aim at companies like KBR, which literally accompanied our Troops onto the battlefield, as part of a concerted effort by some in the government to avoid the financial, legal, and political consequences of two unpopular wars. In the process, DCAA has frequently failed to comply with its own auditing standards, an approach that has led to unprecedented litigation between federal contractors and

the government, and the astronomical costs of which are ultimately revisited on the American taxpayer. DCAA's pattern of malpractice is unacceptable, and this lawsuit simply seeks to hold DCAA auditors to the same standards and rules of conduct as other professional accountants and auditors in their field.

FACTUAL ALLEGATIONS

The LOGCAP III Contract

15. On January 9, 2001, the Army issued Draft Request for Proposals ("DRFP") No. DAAA-09-01-R-0068 for the award of a contract in support of the Army's Logistics Civil Augmentation Program ("LOGCAP"). In late Spring 2001, the Army converted the DRFP into a formal Request for Proposals ("RFP"). On May 29, 2001, three offerors, including Brown & Root Services ("BRS"), submitted initial proposals in response to the RFP. Thereafter, the Army conducted discussions with each offeror.

16. The anticipated contract was similar in nature and scope to prior LOGCAP contracts under which BRS and other contractors had support limited military engagements involving relatively small numbers of U.S. troops.

17. On September 11, 2001, the United States was attacked by the Islamic terrorist group known as Al Qaeda ("9/11 terrorist attacks").

18. The Army did not revise the RFP after the 9/11 terrorist attacks. The offerors submitted final proposals to the Army on September 26, 2001. In early December 2001, after evaluating proposals, the Army informed BRS it had been selected for contract award. A primary basis for the Army's award to BRS was the company's ability to finance substantial portions of work under the contract.

19. On December 14, 2001, BRS and the Army signed Contract No. DAAA-09-02-0007, which became known as the "LOGCAP III Contract."

20. Under the contract, BRS agreed to provide the Army logistical and life-support services during military “contingencies and exercises” throughout the world. LOGCAP III was structured as an indefinite-delivery/indefinite-quantity (“ID/IQ”) contract. The contract period of performance was a base period of one year and nine one-year options.

21. The contract statement of work (SOW) required BRS to have the capacity to support up to 25,000 troops for up to 180 days. These troops were to be supported at a limited number of locations: (i) 4,000 personnel at one (1) “intermediate staging base,” and (ii) 3,000 personnel at up to seven (7) “base camps.” The contract SOW also required BRS to be able to provide support beyond 180 days and for up to 50,000 personnel “per event.” Under the contract, the maximum number of events was two (2) “Major Regional Contingencies” and one (1) small-scale contingency per year for the life of the contract. The SOW defined an “event” as “[c]ontingency conditions from heightened international tensions or states of military readiness through period of armed conflict up to and including a Congressional declared state of war.”

22. LOGCAP III was a “rated order” contract under the Defense Priorities Allocation System (“DPAS”) regulations and the Defense Production Act (“DPA”) of 1950. That provision has been interpreted to require contractors, like KBR, to continue to deliver timely performance even if the government breaches the contract. If a contractor fails to do so, they could be subject to criminal penalties under the DPA.

23. The contract contained the clauses at Federal Acquisition Regulation (FAR) 52.216-7, Allowable Cost and Payment (MAR 2000) and FAR 52.215-2, Audit and Records—Negotiation (JUN 1999).

24. Whenever the Army required services under the contract, it issued a “task order” that dictated, among other things, the detailed scope, requirements, location, and duration of the

services to be provided. The Army had the option of structuring LOGCAP III task orders on a cost-plus-award-fee (“CPAF”), cost-plus-fixed fee (“CPFF”), or fixed-price basis. Under FAR Part 16, where the anticipated work involved significant cost or performance risk, the Army was required to utilize a CPAF task order. Where such risks were even more substantial, the Army was required to issue a CPFF task order.

25. On March 20, 2003, the U.S. military invaded Iraq and commenced Operation Iraqi Freedom (“OIF”).

26. On August 1, 2003, the Army signed a novation agreement that transferred the performance responsibilities under the LOGCAP III Contract from BRS to KBR.

27. During OIF, the Army issued hundreds of CPAF task orders to KBR, including Task Orders 44, 59, 61, and 89, to provide “base life support” services at U.S. military bases and U.S. diplomatic sites located throughout Iraq. These task orders required KBR to perform a wide variety of functions, including construction and operation of military dining facilities (“DFACs”), laundry, welfare and recreation services, facilities maintenance, power generation and distribution, waste management, water supply, vector control, fire protection services, billeting, and equipment maintenance. KBR hired subcontractors to perform many of these functions using its government-approved purchasing system.

28. Under these CPAF task orders, the Army was required to reimburse KBR on a bi-weekly basis for costs the company incurred to provide LOGCAP support. The Army also agreed to pay KBR a “base fee” of 1% of the definitized cost estimate for each task order. KBR was eligible to earn an additional 2% in “award fee” based on periodic evaluations of its performance by the Army.

29. Because they are “cost-reimbursement” in nature, CPAF task orders are subject to the requirements in FAR Subpart 16.3 (Cost-Reimbursement Contracts). Among other things, FAR 16.301-3 (Limitations) requires the United States to ensure “adequate Government resources are available to award and manage [the] contract” before it awards a cost-reimbursement contract or task order.

The Defense Contract Audit Agency

History

30. The DCAA was established in 1965 by a DoD directive that required the agency to develop a single contract audit capability. Specifically, the purpose of the DCAA is to:

a. Perform all contract auditing for the DoD and provide accounting and financial advisory services, in connection with the negotiation, administration, and settlement of contracts and subcontracts to all DoD activities.

b. Furnish contract audit services to other Government agencies.

31. In FY 2012, DCAA had approximately 4,700 employees located in 116 field offices throughout the United States, Europe, the Pacific, and Southwest Asia. DCAA represents that approximately 4,500 of these employees are trained accounting and auditing professionals, as well as government-contract experts.

Organization

32. DCAA is headquartered in Fort Belvoir, Virginia. It has five regional offices located near Los Angeles, Dallas-Fort Worth, Atlanta, Philadelphia, and Boston.

33. Each DCAA regional office is headed by a director and deputy director. Those individuals are typically supported by five regional audit supervisors and approximately fifteen technical and administrative personnel. Regional directors are responsible for planning,

managing, and accomplishing DCAA's mission within their assigned geographical area. In some instances, regional directors will personally review and sign DCAA work-product such as final audit reports.

34. Field audit offices ("FAO") perform the actual auditing and other professional accounting services provided by DCAA. Companies that have a large number of government contracts, such as KBR, also have DCAA professionals (i.e., "resident auditors") permanently located at their facilities.

35. DCAA "resident offices" are usually established at principal locations of major defense contractors, such as KBR. DCAA professionals are assigned full-time to a resident office. The main criteria for establishing a resident office are whether: (i) the audit workload at the contractor is of a continuing nature, and (ii) is sufficient in significance, complexity, and volume to warrant the assignment of a full-time DCAA staff.

36. DCAA maintains a large resident office at KBR's offices in Houston, Texas. Since 2004, DCAA has assigned an average of 55-65 auditors, and more than 200 employees, to the KBR resident office. The resident DCAA office at KBR is a permanent part of KBR's daily operations. The resident DCAA auditors at KBR's Houston facility perform functions that are very similar to those provided by commercial, non-governmental accounting and auditing professionals.

Functions

37. DCAA conducts audits and provides accounting opinions in support of certain mutual obligations assumed by the United States and federal government contractors. These mutual obligations include payment and accounting-system requirements.

38. The accounting and financial advisory services provided by DCAA include, but are not limited to, rendering professional accounting opinions on virtually all aspects of government contracting, including: (i) periodic payments under government contracts; (ii) determination of financial responsibility of offerors and bidders for federal government contracts; (iii) approval of contractor accounting systems; (iv) approval of material purchasing systems; (v) approval of estimating systems; (vi) analysis of management functions; (vii) analysis of financial operations; (viii) “allowability” of particular cost items under the FAR Cost Principles (48 C.F.R. pt. 31), the Cost Accounting Standards (48 C.F.R. pt. 30), and generally accepted accounting principles (“GAAP”); (ix) interpretation of contract provisions; and (x) interpretation of statutes and regulations.

39. DCAA performs a wide-variety of audits, but the majority of its work is dedicated to examination engagements that provide positive assurance. DCAA also conducts agreed-upon procedure audits and a limited number of performance audits. Each type of audit must adhere to generally accepted government auditing standards.

40. In an examination audit, DCAA seeks to obtain sufficient and appropriate evidence to express an opinion on whether the subject matter conforms with the criteria in all material aspects.

41. DCAA can accept agreed-upon procedure engagements as long as it has meaningful measurement criteria (such as the FAR, DFARS, CAS, or GAAP), and the audit

requestor (e.g., the Army) and DCAA agree to the procedures that will be applied. In those cases, DCAA is required to establish a clear understanding with respect to the terms of the engagement.

42. DCAA professionals also perform a variety of professional auditing, accounting, and financial advisory services. For example, DCAA auditors perform contractor systems reviews that focus on the contractor's policies, procedures, internal controls, and systems relating to accounting and management. The purpose of these audits is to identify systems deficiencies.

43. DCAA resident offices also perform incurred cost audits under which they determine whether a contractor's incurred costs are (i) allowable; (ii) reasonable; (iii) applicable to the contract; (iv) incurred, accounted for, and charged in accordance with GAAP and CAS; and (v) not prohibited by the contract, statute, or regulation. DCAA conducts incurred-cost audits for cost-reimbursement contracts on an ongoing basis. If a DCAA resident office lacks the technical expertise it needs to render a reliable audit opinion, it is required to employ a technical expert to assist with the assignment.

Professional Standards

44. To perform the various audit and accounting services with which it is tasked, DCAA has developed and published the Defense Contract Audit Manual ("DCAM"). The DCAM provides technical audit guidance, audit techniques, audit standards, and technical policies to be followed by DCAA personnel in executing their audit responsibilities.

45. DCAA is required to comply with specific, mandatory contract auditing, reporting, and accounting standards set forth in the DCAM. Once DCAA has undertaken to perform an audit, DCAA does not have discretion to choose whether to comply with these standards.

46. The standards in the DCAM govern (i) the quality of the audit performance, including audit planning and supervision; (ii) the nature and extent of audit evidence to be obtained by means of audit procedures; and (iii) the nature and content of audit reports.

47. DCAA is also required to comply with the Government Auditing Standards (“GAS”) contained in the General Accountability Office’s (“GAO”) “Yellow Book.” These professional standards are typically referred to as generally accepted government auditing standards (“GAGAS”). GAGAS incorporate standards issued by the American Institute of Certified Public Accountants (“AICPA”) and the Office of Management and Budget.

48. DCAA and its employees owe a duty to contractors to conduct audits in accordance with the mandatory professional auditing standards in GAGAS. To that end, all DCAA audit reports represent and are required to state that the audit has been performed in accordance with GAGAS.

49. General auditing and accounting standards set forth in the DCAM and GAGAS include, but are not limited to:

a. Qualifications – “Only those engagements that can be completed with professional competence are undertaken by DCAA.” DCAA work can be performed only by personnel having professional audit and accounting training and proficiency.

b. Independence – Auditors and audit organizations must maintain their independence so that their findings, opinions, conclusions, judgments, and recommendations will be impartial and free from personal, external, and organizational impairments. Auditors also must be objective in discharging their professional responsibilities.

c. Planning – “Before beginning an audit assignment, it is essential to coordinate with contracting officials . . . to understand the purpose of the audit . . . and the type

of report to be prepared upon completing the assignment.” For agreed-upon procedure audits, “[a]uditing standards require that the auditor establish a clear understanding regarding the terms of the engagement.” Each auditor must be “fully aware of the purpose of the audit.”

d. Risk Assessment – Auditors must consider the risk level of each assignment. Auditors shall only perform an engagement if they believe the subject matter can be evaluated against criteria that are suitable. Criteria are considered “suitable” when they are objective, measurable, complete, relevant, and assured to meet the objectives of the audit plan.

e. Written audit program – Auditors must prepare a written audit plan for each audit. The written audit plan allows the audit team and management to ensure (i) that the proposed audit objectives will likely result in a useful report, (ii) the audit plan addresses any relevant risks, (iii) the audit scope and methodology are adequate, (iv) available evidence is sufficient and appropriate, and (v) there are sufficient staff, supervisors, and specialists with the required professional competence to perform the audit.

f. Briefing the contract – Auditors must review the contract to identify provisions that may affect the contract audit workload. They must also promptly notify the contracting officer of contract provisions that may impede effective contract audit or administration.

g. Field work – Auditors must understand the audited entity and its operating environment. Auditors are required to take all necessary steps “to gain assurance that the audit conclusions will be based on a complete understanding of all pertinent facts.”

h. Supervision – “Final responsibility for audit quality rests with the supervisory auditor and the FAO manager, who are expected both to know the relevant accounting and auditing standards and to familiarize themselves with significant aspects of the

contractor and submission being evaluated.” The supervisory auditor is ultimately responsible for ensuring that each audit is conducted in accordance with GAGAS and the DCAM.

i. Sufficient evidence – the auditor must examine and develop sufficient evidence to provide a reasonable basis for his/her audit conclusions and recommendations.

j. Audit Report – Audit reports present the scope and results of the audit in an objective, concise, and complete manner. Before expressing any opinion, an auditor must obtain and review the available facts and perform a searching and analytical review of the contractor’s representations and supporting data.

Government Reports Indicating DCAA’s Professional Malpractice is Widespread

DoD IG Report

50. In March 2013, the Department of Defense Inspector General (“DoD IG”) issued “DoD IG Report—2013-044,” which examined whether certain DCAA attestation engagements and performance audits had complied with the GAGAS, DoD policies, and DCAA policies and procedures. The report stated that all independent audit and attestation engagements of DoD organizations must be conducted in accordance with GAGAS, “which provides the framework for auditors to perform high-quality audit work with competence, integrity, objectivity, and independence.”

51. The DoD IG report found a number of deficiencies in DCAA’s audit work, including:

- a. A failure by DCAA to maintain its professional independence.
- b. A failure by DCAA to employ audit personnel who possessed adequate professional competence and knowledge of the applicable AICPA attestation standards.

c. A failure by DCAA to comply with the GAGAS requirements for planning, which included DCAA's (i) reliance on inadequate or non-existent risk assessments, (ii) failure to identify relevant criteria, and (iii) lack of understanding of internal controls.

d. A failure by DCAA to obtain sufficient evidence to address engagement objectives or support judgments and conclusions.

e. A failure to effectively supervise and to ensure that the work of lower-level DCAA auditors complied with GAGAS and the DCAM. In this regard, the DoD IG found that DCAA's "pattern of multiple noncompliances with planning, communication, evidence, documentation, and fraud-related standards clearly indicates that supervision was inadequate."

f. A failure by DCAA to comply with GAGAS reporting standards.

g. A failure by DCAA to exercise sound professional judgment in planning and performing agreed-upon procedure audits.

GAO Reports

52. From 2008-2009, GAO published two reports that found similar deficiencies in DCAA's audit work. These reports evaluated DCAA's performance on particular audits that were conducted at the same time DCAA performed the audit at issue here.

53. A July 2008 report titled "Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated," GAO-08-857, described GAO's investigation of alleged failures by DCAA to comply with GAGAS on audits performed between 2003 and 2007. GAO determined that DCAA failed to comply with numerous GAGAS requirements on at least thirteen (13) different audits. Specifically, GAO found that:

a. Contractor officials and the DoD contracting community improperly influenced the audit scope, conclusions, and opinions of several audits, in violation of the GAGAS requirement that auditors maintain professional independence.

b. DCAA auditors failed to perform sufficient work and/or generate adequate work papers (i.e., documentation) to support their audit opinions.

c. DCAA supervisors changed audit report findings and dropped conclusions without adequate support.

54. A September 2009 report titled “Widespread Problems with Audit Quality Require Significant Reform,” GAO-09-468, described GAO’s review of sixty-nine (69) DCAA audits and cost-related assignments conducted during fiscal years 2004 through 2006. GAO found that DCAA failed to comply with professional auditing standards on sixty-five (65) of these engagements, including several audits involving KBR. Specifically, this report highlighted the following deficiencies:

a. DCAA auditors failed to exercise professional independence because they were improperly influenced by outside entities.

b. DCAA auditors failed to develop sufficient evidence to support their conclusions and opinions.

c. DCAA audit reports often failed to identify the subject matter being reviewed and the criteria against which it was being evaluated. Instead, DCAA frequently used vague, boilerplate language to represent that it had audited for compliance with high-level regulations.

d. DCAA's audit quality assurance program was not properly implemented, and as a result, the agency accepted audit assignments that were non-compliant with GAGAS and the DCAM.

e. DCAA has experienced chronic resource and staffing shortages, which have contributed to significant quality and performance problems. These shortages have been exacerbated by a substantial increase in the volume of federal procurements that require DCAA's services.

f. DCAA failed to provide sufficient support for the majority of the audit opinions reviewed by GAO. DCAA repeatedly issued unreliable opinions in support of agency decisions on (i) contract awards, (ii) direct billing privileges, (iii) reliability of cost estimates, and (iv) direct and indirect cost rates.

55. DCAA continues to experience significant problems conducting and completing required audits of the LOGCAP III Contract, including audits related to "contract close out" that should have been completed within six months of the end of each fiscal year's period of performance.

56. Timely fiscal-year closeout were even more critical under LOGCAP III because the task orders primarily were cost-reimbursement in nature, and the contract largely was funded using "one-year funds." As a result of DCAA's systemic staffing, training, and supervision issues, the agency has not completed close-out activities for the last seven (7) years of contract performance under LOGCAP III and remains ten (10) years behind in its work.

Operation Iraqi Freedom and the LOGCAP III Contract

57. Clause H-16 of the LOGCAP III contract required the Army to provide "force protection" to KBR and its subcontractors "commensurate with that" provided to DoD civilians.

This provision appeared in the contract under a heading titled “Special Provisions for Peacetime Contracts.”

58. Several of the CPAF tasks orders issued by the Army for performance in Iraq required the government to provide KBR and its subcontractors “force protection” that was “commensurate with the threat.”

59. Established DoD and Army doctrine required the military to provide adequate force protection to all civilian personnel who accompanied the force, including civilian contractors like KBR and its subcontractors.

60. By the time the United States declared “Mission Accomplished” in Iraq on May 1, 2003, KBR and its LOGCAP III subcontractors were performing work in a hostile, asymmetric war environment where insurgent attacks on civilian contractors were frequent, unpredictable, and lethal. Transporting supplies and personnel on the roads in Iraq was particularly dangerous, and KBR and its subcontractors were specifically targeted by insurgents who ambushed their trucks and employees using improvised explosive devices, rocket-propelled grenades, small arms, and sniper fire.

61. Between 2003-2006, seventy-five (75) KBR and KBR-subcontractor employees were killed as a result of hostile actions in Iraq while performing work under the LOGCAP III Contract. During that same period, approximately four-hundred eighty one (481) KBR and KBR-subcontractor employees sustained injuries as a result of hostile actions while performing work in Iraq under LOGCAP III.

62. As a result of the hostilities in Iraq, and the government's failure to provide adequate force protection, KBR and certain of its subcontractors hired private security contractors ("PSCs") between 2003-2006.

Undue Political Influence on DCAA's Activities

63. Beginning in 2004, various members and committees of the United States Congress ("Congress") requested documents and information from the Army and DoD regarding the use of PSCs in Iraq under the LOGCAP III contract. These requests were largely unanswered until July 2006.

64. Following several Congressional hearings in late 2006, the House Committee on Oversight and Government Reform ("HCGR") informed Ms. Tina Ballard, the Army's Deputy Assistant for Policy and Procurement, that she was required to appear before the HCGR on February 7, 2007 to testify about the use of PSCs in Iraq by KBR and one of its LOGCAP III subcontractors, Eurest Support Services ("ESS"). ESS constructed and operated numerous military DFACs in Iraq under LOGCAP III.

65. In preparation for Ms. Ballard's testimony, contracting officials from Army Sustainment Command in Rock Island, Illinois ("ASC-RI") sought and obtained information from ESS regarding its use of PSCs in Iraq. On January 30, 2007, ESS confirmed it periodically had used PSCs to protect its truck convoys and employees whenever military force protection was unavailable or refused. ESS also explained that it did not assign PSC costs to particular contracts, but that such costs were collected and charged against its total operating revenue.

66. On February 1, 2007, ESS provided ASC-RI an internal company memorandum reflecting that, as of March 9, 2005, ESS's proposed LOGCAP III subcontract prices included a factor for "security" that was 12.55% of its total labor costs.

67. Based on this information, an ASC-RI price analyst was tasked with calculating the amount of PSC costs allegedly included in eleven LOGCAP III subcontracts between KBR and ESS (the “ESS eleven” subcontracts). The pricing analyst ultimately concluded that ESS had included \$19,652,815 of PSC costs in these particular subcontracts.

68. On February 6, 2007, the day before Ms. Ballard was to testify before the HCGR, the ASC-RI contracting officer informed KBR by letter that the Army was “adjusting payments under the LOGCAP III contract [in the amount of \$19,652,815] associated with providing security services which appear to have been incurred and paid improperly.” The only basis for this adjustment was Clause H-16 of the LOGCAP III contract, which ASC-RI claimed prohibited the use of PSCs. Later that day, ASC-RI officials notified Ms. Ballard of the \$19,652,815 adjustment.

69. The next morning, on February 7, 2007, Ms. Ballard appeared before the HCGR, which at the time was chaired by Representative Henry Waxman (D-CA). During Ms. Ballard’s testimony, Congressman Waxman asked “may I assume that [ASC-RI’s \$19 million adjustment of costs] has to do with the fact that you were going to be coming before this hearing today, and therefore punitive action was warranted and you took it?” When Ms. Ballard attempted to describe the Army’s efforts to gather the “facts” before recouping funds from KBR, Representative Waxman stated: “[E]ven if you don’t want to acknowledge this, I think the fact we are holding this hearing today might have saved the Government \$20 million.”

70. Later that day, the ASC-RI contracting officer requested that DCAA issue a “Form-1” suspending \$19,652,815 (“Form-1, No. 127”) in PSC costs based on the agency’s conclusion that such costs were prohibited by Clause H-16 of the contract. DCAA did so without any independent review of the contract or the circumstances under which the costs were

incurred, and even though it is the only government entity that has authority to issue a Form-1. The Army ultimately recouped the \$19,652,815 from KBR by offsetting amounts otherwise owed to KBR under LOGCAP III.

DCAA and the LOGCAP III Contract

71. Following the February 7, 2007 HCGR hearing, KBR produced 17 to 20 binders of documentation to ASC-RI regarding the use of PSCs in Iraq by KBR and certain KBR subcontractors under LOGCAP III.

72. ASC-RI verbally requested that DCAA review this information, calculate the total amount of PSC costs charged to the LOGCAP III contract, and issue an audit report containing DCAA's findings and conclusions. A DCAA employee, Mr. Patrick Faul, was assigned to carry out these tasks. A DCAA resident auditor assigned to KBR, Ms. Teresa Lawson, was responsible for overseeing Mr. Faul's work.

73. DCAA's audit work suffered from many of the same deficiencies that GAO and the DoD IG found in their reviews of the agency's work during the same time period.

74. Mr. Faul has admitted under oath that DCAA never sought or obtained the required formal written request from ASC-RI to prepare an audit report.

75. Mr. Faul has admitted under oath that DCAA did not determine at the outset of the audit engagement, as is required, whether it was performing an "agreed-upon procedure" ("AUP") audit or issuing an audit opinion.

76. Ms. Lawson has testified under oath that DCAA first decided to issue an audit opinion in July 2007, several months after it began its work, and only one (1) month before DCAA issued the final audit report.

77. Ms. Lawson has admitted under oath that DCAA did not perform all the mandatory steps required by professional accounting standards to render an audit opinion.

78. Ms. Lawson has testified under oath that DCAA did not comply with the mandatory requirement to prepare written audit program. She further testified that DCAA “overlooked” the requirement to prepare a written audit program “because the situation was so fluid.”

79. Mr. Faul has testified under oath that DCAA did not prepare the required written audit program because ASC-RI had already determined that PSC costs were “unallowable” costs under the LOGCAP III contract. He further testified that he “looked at [ASC-RI’s audit request] as a clerical assignment, not necessarily in the scope of an audit.”

80. Mr. Faul has testified under oath that DCAA did not prepare an audit “risk assessment,” even though he acknowledged it is a requirement of “normal audits.”

81. Mr. Faul has admitted under oath that DCAA did not independently review or “brief” the terms and conditions of the LOGCAP III contract, as is required. He further testified that DCAA deferred to ASC-RI’s interpretation of Clause H-16 under LOGCAP III.

82. Mr. Faul has testified under oath that, unlike “a typical audit,” he did not “determine the scope” or “direction” of the audit, nor did he conduct an “independent review and analysis” of facts and circumstances that may have changed the outcome of the audit.

83. Ms. Lawson has testified under oath that DCAA never sought or obtained information from military personnel in Iraq regarding the adequacy of the military force protection provided to KBR and its subcontractors under LOGCAP III.

84. Mr. Faul has admitted under oath that DCAA never contacted any KBR LOGCAP III subcontractors to verify the accuracy of the information submitted to ASC-RI by KBR.

85. During the course of the audit, Ms. Lawson informed the ASC-RI contracting officer that DCAA could not “determine a reasonable estimate of the cost of armed security in the subcontractor’s billings.”

86. Mr. Faul has testified under oath that DCAA “didn’t have a precise number for the armed-security costs of some subcontractors.” He further testified that DCAA “would have liked to had more information.”

87. In a July 2007 email to his superiors, Mr. Faul stated that he did not know how to calculate the amount of PSC costs incurred under various LOGCAP III subcontracts. He added, “except for the ESS memo we have with the 12.xx% labor cost identified as security, we really have no information.”

88. DCAA ultimately calculated the amount of PSC costs included in the “ESS eleven subcontracts” using the 12.55% factor identified in the March 9, 2005 memorandum, even though those subcontracts were all priced and awarded in 2004. DCAA also utilized the 12.55% factor to calculate PSC costs on other ESS subcontracts that pre-dated the March 9, 2005 memorandum. The factor was also used to develop PSC cost estimates for LOGCAP III subcontractors other than ESS.

89. On August 29, 2007, DCAA issued DCAA Audit Report No. 3321-2007K17900008 (the “DCAA audit report”). The DCAA audit report estimated that approximately \$99.6 million in “unallowable” PSC costs were “billed to the government either directly or indirectly on the LOGCAP III Contract.”

90. Despite Ms. Lawson’s and Mr. Faul’s knowledge of the significant defects in their work, the DCAA audit report stated erroneously that DCAA had “conducted [its] examination in accordance with generally accepted government auditing standards.” The report also noted

“[t]hose standards require that [DCAA] plan and perform the examination to obtain reasonable assurance that the data and records examined are free of material misstatement.”

DCAA Revised Form-1, No. 127 and Additional Recoupments from KBR

91. On August 3, 2009, almost two (2) years after the DCAA audit report was completed, DCAA issued a revised “Form-1” (“Revised Form-1, No. 127”), which disapproved \$103,397,086 in alleged PSC costs incurred under the LOGCAP III contract. The increase from the \$99,678,695 in the DCAA audit report to \$103,397,086 in the Revised Form-1, No. 127 was due to the application of burdens by DCAA. Revised Form-1 No. 127 replaced the February 7, 2007 Form-1 “in its entirety.” DCAA again cited Clause H-16 of LOGCAP III as the sole basis for its disapproval.

92. On or about September 1, 2009, the government withheld an additional \$22,279,679.49 in alleged PSC costs incurred under the LOGCAP III contract based on Revised Form-1, No. 127.

93. On November 2, 2009, the Director of DCAA, April G. Stephenson, appeared before the Congressional Commission on Wartime Contracting and testified that the government was “in the process of initiating action to recoup the remaining [PSC] costs” identified in Revised Form-1, No. 127. Ms. Stephenson’s testimony demonstrates that the most senior leadership at DCAA knew and approved of DCAA’s defective work.

94. On November 6, 2009, Senator Claire McCaskill, the Chairman of the Senate Subcommittee on Contracting Oversight, sent a letter to the Secretary of Defense, Robert M. Gates, in which she expressed “concern[] that the Department [of Defense] [was] not moving quickly enough to recover the remaining \$61 million” in alleged PSC costs incurred under the LOGCAP III contract.

95. In March 2010, the government withheld an additional \$2,126,531 in alleged PSC costs incurred under the LOGCAP III contract based on Revised Form-1, No. 127.

96. In 2011, the government withheld an additional \$1,195,466.67 in alleged PSC costs incurred under the LOGCAP III contract based on Revised Form-1, No. 127.

The False Claims Act Litigation

97. On April 1, 2010, the government filed a complaint against KBR in the U.S. District Court for the District of Columbia. The complaint alleged KBR had violated the civil False Claims Act (“FCA”), 31 U.S.C. § 3729 *et seq.*, by billing costs associated with use of armed private security under the LOGCAP III Contract.

98. The government pursued the FCA suit against KBR on the basis of the August 29, 2007 DCAA audit report.

99. In September 2010, shortly after the case was filed, the United States moved to stay discovery and also filed a series of motions that substantially delayed discovery for more than a year.

100. After years of delay, KBR deposed Mr. Faul on January 6, 2012, which revealed for the first time that DCAA had conducted a defective audit.

101. Following Mr. Faul’s deposition, the government obtained the services of another DCAA employee, Roy Nelson, to develop a revised damages calculation in support of the government’s FCA case.

102. Mr. Nelson is not a certified public accountant.

103. Mr. Nelson prepared a revised damages calculation by reviewing the same 17 to 20 binders of documentation that Mr. Faul reviewed to prepare the August 29, 2007 DCAA audit report.

104. Mr. Nelson has admitted under oath that he did not perform his work in accordance with mandatory professional accounting standards.

105. Mr. Nelson has testified under oath that he permitted government attorneys and investigative agents to have input into the “assumptions” he used to determine the “numbers” for the revised damages calculation.

106. Based on Mr. Nelson’s work, the United States changed the damages it was seeking in the FCA litigation from \$103,397,086 to \$62,359,134.51.

107. In November 2012, the United States voluntarily dismissed the FCA case, one day before the government was required to start producing relevant documents under the court’s discovery schedule.

KBR Appeals at the Armed Services Board of Contract Appeals

108. Following the government’s cost withholdings based on the DCAA audit report, KBR filed appeals at the Armed Services Board of Contract Appeals (“ASBCA”) seeking to recover \$44,059,024.49 in amounts recouped by the government. These proceedings were largely stayed by the ASBCA for several years pending the government’s FCA investigation and during the pendency of the FCA suit.

109. On January 30, 2013, the ASC-RI contracting officer for the first time issued an administrative “final decision” addressing the “allowability” of PSC costs under LOGCAP III. The final decision claimed that KBR owed the government \$55,620,591.55. The decision was based on the August 29, 2007 audit report and Mr. Nelson’s revised damages calculation.

110. Ms. Lawson and Mr. Nelson testified during a six-week trial at the ASBCA.

111. In an opinion dated June 17, 2014, the ASBCA found that “during the years 2003-2006 the force protection provided by the government for Contract 0007 was not commensurate with the threat or with the force protection provided to DoD civilians.” The ASBCA added “there is no real question that the government did not provide force protection on a consistent basis. Our findings reveal this lack of force protection was a constant problem and the commanding generals testified they did not have the resources to provide it.”

112. Based on those findings, the ASBCA held “that the use of PSCs by KBR[] and its subcontractors to supplement government force protection during those years was reasonably necessary for accomplishment of the logistical support mission of Contract 0007 and the task orders thereunder.” The ASBCA further held “that the cost of PSC services used by KBR[] and its subcontractors . . . were reasonable as to amount.”

113. The ASBCA sustained the appeals filed by KBR. The ASBCA held that PSC costs were “allowable” under the LOGCAP III Contract and determined KBR was entitled to be reimbursed \$44,059,024.49. These amounts have not yet been paid to KBR.

COUNT I
DCAA’s Negligent Audit Caused KBR to
Incur Damages Defending Itself in Litigation at the ASBCA

114. Paragraphs 1 through 113 are incorporated herein by reference.

115. Under the Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2671-2680, the United States is liable in tort where a private party would be liable under applicable state law.

116. A private party acting as a professional may be liable for professional malpractice. The elements of a cause of action for professional malpractice are: (1) the duty of the professional to use the skill, prudence, and diligence as other members of his or her profession and comply with applicable mandatory professional standards; (2) a breach of that

duty; (3) a proximate causal connection between the negligent conduct and the resulting injury; and (4) actual loss or damage resulting from the professional's negligence.

117. At all times relevant to this complaint, DCAA maintained a resident office within KBR's facility for purposes of providing professional auditing and accounting services. DCAA's audit conclusions often provide the basis for the DoD to assert contractual and administrative remedies, such as the government withholding or offsetting funds owed to KBR.

118. DCAA had a duty to KBR to conduct audits according to professional standards because its actions are intended to affect KBR. Because the audit function is central to the relationship between the government and its contractors, it is reasonably foreseeable that a contractor will incur damages as a result of DCAA's failure to perform audit activities with appropriate care.

119. DCAA audited, reviewed, and expressed opinions concerning the use of PSCs from 2003 to 2006 under LOGCAP III. The mandatory standards for DCAA's audit and accounting functions found in GAGAS and the DCAM establish the minimal level of professional due care that DCAA was required meet. Among other requirements: (1) DCAA must assign only individuals having professional audit and accounting training and proficiency; (2) auditors and audit organizations must maintain their independence from external influences; (3) auditors must adequately plan the audit; (4) auditors must conduct a risk assessment and only audit if they have reason to believe the subject matter is capable of being evaluated against suitable criteria; (5) auditors must develop a written audit program; (6) auditors must review and brief the contract at issue in the audit; (7) auditors must understand the audited entity and its environment; (8) DCAA must properly supervise its personnel at all times; (9) the auditor's work

must be supported by sufficient evidence; and (10) the audit reports must satisfy GAGAS and DCAM.

120. The mandatory standards in the DCAM and GAGAS establish the applicable standard of professional due care for DCAA professionals.

121. During its audit of PSC costs under LOGCAP III, DCAA breached its duty to perform its services with professional due care by consistently failing to comply with the mandatory professional standards set forth in the DCAM and GAGAS. DCAA, *inter alia*:

- a. failed to adequately plan and understand the purpose of the audit;
- b. failed to prepare a written audit program or audit plan at the beginning of the audit;
- c. failed to exercise independent judgment;
- d. failed to perform a risk assessment to identify the contract provisions that might affect the audit workload;
- e. failed to obtain, review, or brief the LOGCAP III contract and other appropriate documents relating to the contract;
- f. failed to understand the relevant regulations and contract provisions regarding whether PSC costs were allowable and properly charged;
- g. failed to conduct the proper field work or seek technical assistance from subject matter experts, such as military personnel in the field about whether the actual force protection was being provided;
- h. failed to develop or examine sufficient evidence to issue an audit opinion;

i. issued an audit opinion even though Mr. Faul admitted that he “really ha[d] no information” and Ms. Lawson concluded that DCAA did not have enough data to determine the reasonable estimate of the cost of PSCs;

j. failed to adequately supervise its personnel and adopted their flawed and unsupported findings.

122. As a result of DCAA’s failure to use professional skill, prudence, and diligence and to comply with the mandatory auditing standards in the GAGAS and DCAM in the performance of its audit related to the LOGCAP III contract, DCAA provided erroneous professional advice and conclusions regarding the use and costs of PSCs under LOGCAP III.

123. Because DCAA failed to exercise due care in performing its auditing function, DCAA erroneously concluded that KBR had charged approximately \$99.6 million in allegedly unallowable PSC costs to the LOGCAP III contract. DCAA’s erroneous conclusion was the proximate cause of the government’s decision to disapprove \$103,397,086 of KBR’s incurred costs and to recapture \$45,254,491.16.

124. As a direct and proximate result of DCAA’s negligent audit, KBR was subjected to protracted litigation at the ASBCA to recover the amounts withheld and recouped from KBR based on DCAA’s audit. KBR incurred a total of \$10,514,116.35 in professional and internal administrative costs to defend itself in those actions.

125. KBR is entitled under the FTCA to recover the \$10,514,116.35 as money damages caused by DCAA’s negligence.

COUNT II

**DCAA's Negligent Audit Caused KBR to Incur
Damages Defending Itself Against the Government False Claims Act Claim**

126. Paragraphs 1 through 113 are incorporated herein by reference.

127. Under the Federal Tort Claims Act, 28 U.S.C. §§ 1346(b), 2671-2680, the United States is liable in tort where a private party would be liable under applicable state law.

128. A private party acting as a professional may be liable for professional malpractice. The elements of a cause of action for professional malpractice are: (1) the duty of the professional to use the skill, prudence, and diligence as other members of his or her profession; (2) a breach of that duty; (3) a proximate causal connection between the negligent conduct and the resulting injury; and (4) actual loss or damage resulting from the professional's negligence.

129. At all times relevant to this complaint, DCAA maintained a resident office within KBR's facility for purposes of providing professional auditing and accounting services. DCAA's audit conclusions often provide the basis for the DoD to assert contractual and administrative remedies, such as the government withholding or offsetting funds owed to KBR.

130. DCAA had a duty to KBR to conduct audits according to professional standards because its actions are intended to affect KBR. Because the audit function is central to the relationship between the government and its contractors, it is reasonably foreseeable that a contractor will incur damages as a result of DCAA's failure to perform audit activities with appropriate care.

131. DCAA audited, reviewed, and expressed opinions concerning the use of PSCs from 2003 to 2006 under LOGCAP III. The mandatory standards for DCAA's audit and accounting functions found in GAGAS and the DCAM establish the minimal level of professional due care that DCAA was required meet. Among other requirements: (1) DCAA

must assign only individuals having professional audit and accounting training and proficiency; (2) auditors and audit organizations must maintain their independence from external influences; (3) auditors must adequately plan its audits; (4) auditors must conduct a risk assessment and only audit if they have reason to believe the subject matter is capable of being evaluated against suitable criteria; (5) auditors must develop a written audit program; (6) auditors must review and brief the contract at issue in the audit; (7) auditors must understand the audited entity and its environment; (8) DCAA must properly supervise its personnel at all times; (9) the auditor's work must be supported by sufficient evidence; and (10) the audit reports must satisfy GAGAS and DCAM.

132. The mandatory standards in the DCAM and GAGAS establish the applicable standard of professional due care for DCAA professionals.

133. During the its audit of PSC costs under LOGCAP III, DCAA breached its duty to perform its services with professional due care by consistently failing to comply with the mandatory professional standards set forth in the DCAM and GAGAS. DCAA, *inter alia*:

- a. failed to adequately plan and understand the purpose of the audit;
- b. failed to prepare a written audit program or audit plan at the beginning of the audit;
- c. failed to exercise independent judgment;
- d. failed to perform a risk assessment to identify the contract provisions that might affect the audit workload;
- e. failed to obtain, review, or brief the LOGCAP III contract and other appropriate documents relating to the contract;

f. failed to understand the relevant regulations and contract provisions regarding whether PSC costs were allowable and properly charged;

g. failed to conduct the proper field work or seek technical assistance from subject matter experts, such as military personnel in the field about the actual force protection that was being done or not done;

h. failed to develop or examine sufficient evidence to issue an audit opinion and issued the opinion even though the Mr. Faul admitted that he “really ha[d] no information” while Ms. Lawson concluded that DCAA did not have enough data to determine the reasonable estimate of the cost of PSCs;

i. failed to adequately supervise its personnel and adopted their flawed and unsupported findings.

134. As a result of DCAA’s failure to use professional skill, prudence, and diligence in the performance of its audit and accounting functions related to the LOGCAP III contract, DCAA provided erroneous professional advice and conclusions regarding the use and costs of PSCs under LOGCAP III.

135. Because DCAA failed to exercise due care in performing its auditing function, DCAA erroneously concluded that KBR had charged approximately \$99.6 million in allegedly unallowable PSC costs to the LOGCAP III contract. DCAA’s erroneous conclusion was the proximate cause of the government’s decision to disapprove \$103,397,086 of KBR’s incurred costs and to recapture \$45,254,491.16.

136. The United States obtained the services of another DCAA auditor, Mr. Roy Nelson, to perform a subsequent review of DCAA’s audit findings and calculation of alleged PSC costs.

137. As a DCAA auditor, Mr. Nelson was subject to the same professional standards as all DCAA auditors, namely the requirement to comply with the GAGAS and DCAM.

138. Mr. Nelson had a duty to KBR to perform his work in accordance with these professional standards.

139. Mr. Nelson breached this duty by failing to comply with the mandatory professional standards in the DCAM and GAGAS. Mr. Nelson:

a. failed to maintain his independence from external influence by allowing government lawyers, DCIS investigators, and FBI agents to influence the calculation of alleged damages;

b. failed to develop or examine sufficient evidence to issue an audit opinion;

c. failed to review or brief the contract provisions or other relevant documents applicable to the use of PSCs;

d. failed to develop a written audit plan to direct his work or gain an understanding of the subject matter of his work;

e. failed to understand KBR, the audited entity, and its environment, such as whether PSCs were needed in Iraq;

f. failed to obtain professional technical assistance from knowledgeable persons in the field about the need for PSCs in Iraq.

140. The United States relied on the DCAA audit to initiate and conduct a civil fraud investigation of the use of PSCs under the LOGCAP III Contract.

141. The United States relied on the DCAA audit to file a complaint against KBR alleging that KBR had violated the FCA by billing costs associated with the use of armed private security to the LOGCAP III Contract.

142. The United States relied on the DCAA audit and the work of Mr. Roy Nelson to maintain the FCA suit until it was voluntarily dismissed in November 2012.

143. As a direct and proximate result of DCAA's and Mr. Nelson's negligence, KBR was subjected to protracted litigation at the U.S. District Court for the District of Columbia. KBR incurred \$1,992,935.41 in otherwise unrecoverable professional and internal administrative costs to defend itself in those actions.

144. KBR is entitled under the FTCA to recover the \$1,992,935.41 as money damages caused by DCAA's and Mr. Nelson's negligence.

PRAYER FOR RELIEF

Wherefore, plaintiff, Kellogg Brown and Root Services, Inc. demands as follows:

145. Judgment against the defendant United States of America in the amount of \$12,507,051.76, including post-judgment interest and attorneys' fees to the extent permitted by law; and

146. Such other relief as the Court may deem appropriate

OF COUNSEL:

Herbert L. Fenster
Raymond B. Biagini
Alejandro L. Sarria
John W. Sorrenti
McKenna Long & Aldridge LLP
1900 K Street, NW
Washington, D.C. 20006
(202) 496-7500

/s/ William J. Wade
William J. Wade (#704)
Wade@rlf.com
Kelly E. Farnan (#4395)
Farnan@rlf.com
Richards Layton & Finger, P.A.
One Rodney Square
920 N. King Street
Wilmington, DE 19801
(302) 651-7718

*Attorneys for Plaintiff Kellogg Brown &
Root Services, Inc.*

Dated: September 17, 2014