

GAO

Report to the Chairman, Subcommittee
on Treasury, Postal Service, and
General Government, Committee on
Appropriations, House of
Representatives

June 2001

ANTI-DRUG MEDIA CAMPAIGN

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



G A O

Accountability * Integrity * Reliability

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United States General Accounting Office
Washington, DC 20548

June 25, 2001

The Honorable Ernest J. Istook, Jr.
Chairman, Subcommittee on Treasury, Postal Service,
and General Government
Committee on Appropriations
House of Representatives

Dear Mr. Chairman:

This report discusses the Office of National Drug Control Policy's (ONDCP) advertising contract for Phase III of the National Youth Anti-Drug Media Campaign. Phase I of the media campaign was a 12-city pilot featuring paid local television and radio advertisements that ran from January through July 1998. Phase II was a nationwide campaign that included all media types and ran from July through December 1998. Phase III was a continuation of the paid advertising campaign that incorporated additional campaign components, such as partnerships with community groups. Phase III started in January 1999 and is planned to run through December 2003. The Phase III advertising contract is a cost-reimbursement type with a base year and 4 option years, for a total estimated value of \$684 million. The government awarded the Phase III contract to the Ogilvy & Mather (Ogilvy) advertising agency in New York, and Ogilvy is currently performing the third year of the contract.¹

We reviewed certain aspects of the media campaign in a July 2000 report.² During that review, allegations were made that the government was not

¹ A separate contract was awarded to the public relations firm of Fleishman-Hillard to provide public relations services for ONDCP regarding the campaign. This report does not discuss that contract.

² *Anti-Drug Media Campaign: ONDCP Met Most Mandates, but Evaluations of Impact Are Inconclusive* (GGD/HEHS-00-153, July 31, 2000). That report discussed (1) whether ONDCP provided timely financial reports to Congress, how funds for paid advertising were managed and disbursed, and whether ONDCP complied with certain statutory requirements regarding the obligation of funds; (2) what ONDCP did to develop and implement guidelines in response to statutory program requirements; and (3) whether the evaluation designs for Phases I, II, and III were appropriate; how well the Phase I and II evaluations were implemented; and how effective Phases I and II of the campaign were in influencing group awareness of different types of paid anti-drug media messages and drug attitudes.

adequately managing aspects of the Phase III contract relating to costs that Ogilvy incurred and that the company was overbilling the government. Former Subcommittee Chairman Jim Kolbe requested that we assess the validity of those allegations. Further, Rep. John Mica, the former Chairman of the House Government Reform Subcommittee on Criminal Justice, Drug Policy and Human Resources, asked us to review, in addition to the overbilling allegations, the former ONDCP Director's role in deciding whether to audit the Phase III contract. At an October 2000 hearing before that subcommittee, we testified about those issues on the basis of our initial investigation.³ We reported that the former ONDCP Director knew in April 2000 about allegations of improper billing, including possible fraudulent conduct, concerning ONDCP's contract with Ogilvy and that he agreed with the need to audit the contract after contracting responsibilities were transferred later from the Department of Health and Human Services (HHS) to the Navy.

This report provides information on the following questions: Did the advertising contractor for Phase III properly charge the government for labor costs incurred under this contract, and did the government adequately manage aspects of the contract award and administration related to costs incurred by the contractor?

Our review focused on labor charges that Ogilvy submitted because the allegations that were raised pertained to labor costs. We reviewed these costs by examining labor invoices that were submitted to the government for work done under the ONDCP contract and then interviewed a sample of Ogilvy employees whose time sheets were revised regarding the amount of time charged to the contract. 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; the Navy, which assumed responsibility for administering the contract 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

³ *Anti-Drug Media Campaign: Investigation of Actions Taken Concerning Alleged Excessive Contractor Cost* (GAO-01-34T, Oct. 4, 2000).

Ogilvy's technical performance regarding the anti-drug media campaign. A detailed scope and methodology is contained in appendix I.

Results in Brief

The contractor for the advertising portion of the Phase III anti-drug media campaign 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. Ogilvy believes that it may have both underbilled and overbilled the government for portions of its work on the campaign for 1999 and 2000, and has disclosed this to the Department of Justice. The government disallowed nearly \$7.6 million out of about \$24.2 million in total labor charges that Ogilvy submitted during the first 19 months of the contract. Attorneys for the company, who retained consultants to review time charges submitted under this contract, have proposed that about \$850,000 be disallowed for that period. However, because the contract has not yet been audited, the amount of money that the government overpaid or should reimburse the contractor for labor costs incurred currently cannot be determined. The Navy asked DCAA to audit the costs for 1999 and 2000, but DCAA does not plan to begin the audit until Ogilvy certifies its incurred cost proposal (required to establish final costs incurred), which the company has not yet done. Ogilvy's attorneys said that the company expects to certify the incurred cost proposal after it completes the disclosure process on direct labor charges or reaches an agreement with the government.

We found that some of Ogilvy's labor charges to the government were not reliable and included charges for time that its employees did not work on the contract. According to Ogilvy officials and an internal company E-mail, after revenue on the ONDCP contract did not meet projections in the summer of 1999, certain Ogilvy managers instructed some employees to review and revise their time sheets. Some Ogilvy employees told us that they initially did not record all of the time 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 Ogilvy employees also told us that they did not work the amount of additional time that was added to their time sheets or could not fully explain why they increased the number of hours billed to the ONDCP contract. Time sheets for some other employees (not those who revised their time sheets after certain Ogilvy managers instructed them to) also showed changes that increased the number of hours charged for the ONDCP work; however, some employees said that they did not make those changes to their time sheets and could not explain who made the changes and why.

We found other problems associated with Ogilvy's billing the government for its ONDCP work. For example, Ogilvy inconsistently charged the government for employees' nonbillable hours, such as paid absences and training, in its invoices. In addition, we found that Ogilvy incorrectly billed fringe benefits for temporary contract employees. A June 2000 consultant's report also found problems with Ogilvy's accounting system and time sheets submitted in support of invoices submitted under the contract. Ogilvy is taking steps to restructure its accounting system and improve its timekeeping procedures.

The government did not adequately manage aspects of the contract award. The HHS Program Support Center, under an agreement with ONDCP, provided a contracting officer to award and administer the contract and awarded a cost-reimbursement contract to Ogilvy before sufficiently determining, as required, that the contractor had an adequate accounting system to support this type of contract. HHS also failed to obtain a required statement from the contractor that would have disclosed the cost accounting practices that the company planned to use under this contract. 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. Moreover, the contracting officer and the technical representative did not have an effective working relationship, which impeded contract administration.

We are recommending corrective action to ONDCP and HHS to address the problems we identified and have referred our findings regarding improper billing by the contractor to the Department of Justice. We recommend that ONDCP work with the Navy to review the appropriateness of the disallowed costs and other labor charges and determine the amount of money that the government overpaid or should reimburse the contractor, ensure that Ogilvy has an adequate cost accounting system for continued performance under the contract, and effectively coordinate the roles and responsibilities of the contracting officer and the contracting officer's technical representative (COTR). In

providing comments on a draft of this report, ONDCP said that the report fairly and accurately portrays the complexities of the contracting issues regarding the advertising portion of the media campaign, and agreed with our recommendations. ONDCP also said that significant progress has been achieved toward resolving the problems that we identified. The HHS Program Support Center (PSC) said that it agreed with our recommendation that controls over contracting procedures, particularly with respect to assessing an offeror's accounting system, should be reexamined. In their comments, the Navy and DCAA discussed the actions that they plan to take regarding the recommendations that we made to ONDCP.

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, it is part of a broader ONDCP effort that also 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 on a matching basis. In discussions with Ogilvy's attorneys regarding billing issues, the attorneys asserted that the government received more value than the company was required to provide under the contract. For example, the attorneys said that Ogilvy matched 115 percent of the paid advertisements with pro bono advertisements, compared to the contract's 100 percent matching requirement.⁴

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 a contracting officer from the PSC to serve as its contracting officer. 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. ONDCP paid

⁴ The matching of paid and pro bono advertisements was not part of this review, and we did not verify this assertion.

HHS \$452,000 to award and administer the Phase III advertising contract in 1999 and 2000.

The request for proposals (RFP) issued by HHS for the Phase III contract contemplated the award of a type of cost-reimbursement contract known as a cost-plus-fixed-fee contract. Under this type of contract, in addition to being reimbursed for costs properly incurred, the contractor is paid a negotiated fee that is fixed at the inception of the contract. HHS indicated that the awarding of a cost-reimbursement contract was a joint decision of ONDCP and the HHS contracting office. 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 this work could not be forecast with a reasonable degree of accuracy, and therefore a fixed-price contract was impractical.

The RFP notified competitors that the resulting cost-reimbursement contract would be subject to federal government Cost Accounting Standards (CAS) and applicable regulations governing the accounting for costs by the contractor. The RFP required each competitor to submit a disclosure statement (in a format established by the government) of its cost accounting practices that would be used by the government to determine the adequacy of the prospective contractor's cost accounting system. During the competition for the contract, Ogilvy submitted to the government a cost proposal in June 1998 and a best and final offer in November 1998, but not the required disclosure statement.

Three offerors had submitted proposals for the advertising portion of the Phase III contract and Ogilvy made the lowest-priced offer. In December 1998, HHS competitively awarded the cost-reimbursement contract to Ogilvy, with performance to begin in January 1999. 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 rest was for media and subcontractor costs.

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. According to the attorneys, the initial review began in response to the October 2000 hearing before the House Government Reform Subcommittee on Criminal Justice, Drug Policy and Human Resources. 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 for the period January through June 1999, and possible overbilling of labor costs for the last quarter of 1999. We also referred our findings regarding Ogilvy's improper billing under this contract to the Department of Justice. Ogilvy has hired consultants to help determine the amounts that should have been billed and to implement an acceptable cost accounting system with improved timekeeping procedures.

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, which is discussed in more detail later in this report. In January 2001, the Navy exercised the option (Option Year 2) to Ogilvy for the third year of the contract, with an estimated value of \$137 million. On December 6, 2000, the Navy asked DCAA to review Ogilvy's accounting system and conduct an historical audit of costs incurred under this contract.

Ogilvy's Labor Cost Charges Were Not Reliable

The contractor for the advertising portion of the Phase III anti-drug media campaign 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. Ogilvy believes that it may have both underbilled and overbilled the government for portions of its work on the campaign for 1999 and 2000. We found that some of Ogilvy's labor charges to the government were not reliable and included charges for time that its employees did not work on the contract. Attorneys for the company, who retained consultants to review time charges submitted under this contract, have proposed that the government disallow about \$850,000 out of about \$24.2 million in labor charges submitted during the first 19 months of the contract. However, because the contract has not yet been audited, the amount of money that the government overpaid or should reimburse the contractor for labor costs incurred currently cannot be determined.

Some of Ogilvy's Charges Were for Time Employees Did Not Work

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 employees' time sheets for the ONDCP contract, which increased charges to the government by about \$238,000. Some of these Ogilvy employees told us that they initially did not record all of the time 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 could not fully explain why they increased the number of hours billed to the ONDCP contract. Time sheets for some other employees that we reviewed (which were not included among those for the employees who added 3,100 hours to their time sheets) also showed changes that increased the number of hours that were charged for the ONDCP work; however, some of those employees said they did not make those changes to their time sheets and could not explain who made the changes and why.

A July 28, 1999, E-mail sent by Ogilvy's former government contracts manager to the company's finance director, and copied to the project director⁵ and media director, explained the revenue shortfall on the contract and the time sheet revision effort. The E-mail stated that, on the basis of an April 1999 staffing plan, Ogilvy had projected an income of \$15.7 million on the ONDCP contract, but that revenue was about \$3 million less than that. In the E-mail, the former government contracts manager stated the following:

"As we've progressed through the year, with real 'new hires' taking somewhat longer to accomplish than originally estimated, staffing needs fluctuating, and actual labor numbers coming in under those projected on an individual-by-individual basis, we have gotten somewhat away from that number. (We are currently approximately \$3,000,000 under.) Nevertheless, [the project director] is confident that we can reach the number we committed to as long as we take some specific steps as soon as possible."

The E-mail detailed positions to be filled that would increase revenue on the contract. The E-mail from the former government contracts manager continued:

"Lastly, a significant contributing factor to our low actuals are [sic] that much of our existing staff (primarily in media) are spending much less time that [sic] projected. All of these time sheets are being reviewed (primarily by...[the project director, the media director, and the former government contracts manager]) and are subject to revision.

⁵ Ogilvy had two project directors working on the ONDCP contract until the first project director left the company in March 2000. The E-mail cited above and this report refer to the current project director.

Again...[the project director] still believes that we can hit our projection of \$15,700,000 but only if we put into effect all of the above-detailed measures at a minimum.”

We asked Ogilvy’s media director, project director, and finance director about the issues and actions described in this E-mail. The media director said that the company’s finance department provided him with the time sheets for about 50 media department employees who were working on the ONDCP contract, representing hundreds of individual time sheets, which he passed on to the media department’s four group heads for them to distribute to their employees for review. The media director said that he continually received employee time sheets to be revised, but mainly in September 1999. He also said that, if the amount of time that employees had charged to the ONDCP contract was not consistent with what they were projected to work, the group heads were to ask their employees to reexamine their time sheets to determine their accuracy.

The project director explained that employees spent less time working on the account at the beginning of the contract than expected because some tasks were still being performed by the previous media campaign contractor and because employees were still being hired for the work.⁶ However, the project director said that she was not involved in revising time sheets, and that she only asked her secretary and one other employee to review their time sheets with regard to the time billed against the ONDCP contract. According to a document provided by Ogilvy’s attorneys, the project director’s secretary added 375 hours to her time sheets for the ONDCP contract for time worked from January through May 1999. This document indicated that the revised time sheets were entered into Ogilvy’s accounting system on September 2, 1999. The other employee whom the project director asked to review her time sheets reduced the amount of time she billed to the ONDCP contract by 3 hours, according to the company document.

The project director said that the time sheet revision effort mentioned in the E-mail referred to an ongoing effort to track time worked accurately, and was not a single review task. She also provided a memorandum dated June 17, 1999, that she had prepared for Ogilvy staff working on the ONDCP contract, which stressed the importance of accurate and timely preparation of time sheets. She added that in a meeting held in the late

⁶ ONDCP’s media director said that a fully integrated media campaign did not begin until July 1999, even though the contract began in January 1999.

summer of 1999 involving Ogilvy's president, finance director, former government contracts manager, former co-project director, and herself, the company's president was "angry" about low revenue on the ONDCP contract, but that he did not instruct anyone to do anything regarding employee time sheets. In an interview with our Office of Special Investigations, the company president said that he had conversations with the finance director and project director about the low forecasts of revenue on the ONDCP contract, but that he never told anyone at the company to review or revise his or her time sheets.

Regarding the July 28, 1999, E-mail, Ogilvy's finance director said that the government contracts manager, along with other managers, was reviewing whether employees had charged the correct account for time spent working for ONDCP. He said that some employees had initially charged the wrong account for work on the ONDCP contract. The finance director added that the company did not place a high priority on employees' preparation of time sheets because the company is paid by other clients primarily on the basis of commissions and fixed fees, rather than on a cost-reimbursement basis. In providing comments on a draft of this report, Ogilvy's attorneys said that this comment attributed to the finance director does not fully capture his perspective. The attorneys said that, while the subject matter of timekeeping was discussed during this interview, the finance director does not believe that he discounted the importance of timekeeping accuracy in the manner ascribed to him. Instead, the attorneys said, the finance director believes he was describing a practice by some employees that emphasized the importance of achieving accuracy within quarters and yearly, rather than on a daily time sheet basis.

Ogilvy's attorneys provided documents indicating that 28 employees had prepared revised time sheets, primarily in September and October 1999,⁷ thereby adding a total of 3,127 hours to the ONDCP contract. Ogilvy's attorneys provided an estimate of the value of those additional hours, which was calculated by their consultants, of \$87,536, which, when overhead and fringe benefits costs were included, amounted to \$237,733.⁸ We interviewed 3 of those 28 employees about when and why they revised

⁷ According to the document, some revised time charges were also added for work done in May, June, November, and December 1999.

⁸ We used the provisional rates of 126 percent for overhead costs and 20 percent for fringe benefits costs.

their time sheets.⁹ One of the 3 employees said that she did not work the 485 hours that she added to the ONDCP contract; 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; and the third employee, who was the media director, said that he added 67 hours to the ONDCP contract after reviewing his calendar and finding that he had worked more hours on ONDCP than he originally reported on his time sheets. Details regarding our interviews with these three employees and how we selected them to interview are contained in appendix II.

We also reviewed time sheets that Ogilvy submitted to ONDCP as support for the labor invoices in 1999 and found hundreds¹⁰ containing scratch-outs, white-outs, and other changes to the amount of time billed to the ONDCP contract, all lacking 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. (These were not the same employees who revised their time sheets after certain Ogilvy managers instructed them to do so.) 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.¹¹ The other 8 employees said that they made the changes for various reasons, such as mathematical errors, charging time to the wrong account, and recording the wrong office departure times. Details regarding our interviews with the supervisors of the four employees who said they did not make the changes made on their time sheets, as well as how we selected these time sheets for review, are contained in appendix III.

We were unable to determine whether Ogilvy billed the government or if the government paid for all of the hours that were added to the ONDCP contract as a result of the time sheet revision effort because, in some cases, we could not determine whether the invoices reflected the original or revised time sheets. We also recognize that we questioned employees

⁹ We chose to interview a sample of these employees because of resource limitations. According to an Ogilvy attorney, 15 of the 28 employees were no longer employed at the company in January 2001, including one who transferred 435 hours and another who transferred 322 hours from other company accounts to the ONDCP contract.

¹⁰ About 12,000 time sheets were submitted to ONDCP for work done during 1999.

¹¹ 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.

about their work activities up to 2 years after they occurred and that the passage of time may have affected their recollections.

Ogilvy's Labor Invoices Incorrectly Billed Certain Costs

Ogilvy submitted labor invoices to the government that were calculated on the percentage of time that employees worked on the ONDCP contract, compared to all time worked for the company during each month. However, in applying that methodology, the company inconsistently charged the government for paid absences and training. In addition, Ogilvy incorrectly billed fringe benefits for temporary contract employees. Moreover, although the contract required the contractor to bill monthly, Ogilvy did not submit a labor invoice to the government until 5 months after the beginning of the contract. The company later voided its first labor invoice and submitted another invoice to the government 4 months later. The company also submitted multiple versions of invoices covering the same time periods.

Ogilvy's cost proposal and best and final offer were not clear about how the company planned to bill the government for its labor costs. The company's June 1998 cost proposal indicated that the government would be billed on the basis of the number of hours that employees worked on the ONDCP contract multiplied by their hourly salary rates, assuming a 40-hour work week. However, the company's response to the government's question about uncompensated overtime in its November 1998 best and final offer, which modified the initial proposal, indicated that Ogilvy would bill the government on the basis of the percentage of time that employees worked for ONDCP multiplied by their salaries during that month.¹² Despite the lack of clarity regarding how Ogilvy planned to bill the government, it appears that billing on the basis of the percentage of time that employees worked on the ONDCP contract can be an acceptable method under the Federal Acquisition Regulation (FAR) and CAS cost allocation principles and DCAA audit guidance for employees who work uncompensated overtime and work on more than one account. However, we note that, although Ogilvy stated in its cost proposal that its employees work a 40-hour work week, the company's actual work week is 35 hours and 32 hours in the summer. Because working less than 40 hours a week may increase the cost of the government's pro-rata share for Ogilvy's

¹² The contract required Ogilvy to report direct labor costs by providing "...all persons, listing the person's name, title, number of hours or days worked, hourly rate, the total cost per person and a total amount for this category."

employees working on the ONDCP contract, the government will need to determine the acceptability of this practice with regard to the ONDCP contract.

In March 2001, after completing an internal review of billing practices, Ogilvy's attorneys and consultants told us that they had found the percentage of time billing methodology was not always properly implemented. For example, they said that Ogilvy failed to add paid absences to the base of total hours worked, which resulted in an increase in the percentage of time Ogilvy's employees worked on the ONDCP contract. In addition, attorneys and consultants said that the company misclassified some costs, such as bonuses, by charging them as part of direct labor rates to individual cost objectives (client accounts), rather than including them as overhead, but that the misclassifications would be corrected in a "true-up" of the contract. Ogilvy's attorneys defined a "true-up" as the process contemplated by the contract to determine the final actual incurred costs through which the government and the contractor ultimately settle the amount of costs reimbursable to the contractor for the contract year.

We found that Ogilvy inconsistently charged the government for nonbillable hours, such as paid absences and training, in its invoices. Ogilvy's calculation of the percentage of time that employees worked on the ONDCP contract at times included, and at other times excluded, paid absences (sick leave, holidays, and vacations) and training in the denominator representing the total number of hours that employees worked. In its cost proposal, Ogilvy did not indicate that paid absences (sick leave, holidays, and vacations) were included in the company's overhead. However, in a required disclosure statement that Ogilvy submitted to the Navy in March 2001 regarding the company's accounting practices, which was prepared to be effective January 1, 1999, Ogilvy indicated that sick leave, holidays, and vacations would be included in its overhead. In addition, when Ogilvy billed employees' entire monthly salaries without deducting the value of time that they spent on training, it may have resulted in double counting, because training was already included in Ogilvy's overhead. In administering this contract, the Navy will need to determine how nonbillable hours should be charged to the government, including resolving the proper charges for these costs during the first 2 years of the contract.

We also found that Ogilvy's invoices included labor charges for temporary contract employees, which, when the percentage of time methodology was applied, appeared to result in overbilling. The company's September 1999

invoice, for example, billed 15.5 hours for a temporary employee's work, all of which was dedicated to the ONDCP contract. The invoice also indicated that the company paid this employee \$11,000 that month.¹³ When Ogilvy applied its percentage of time billing methodology, this temporary contract employee's entire monthly salary was allocated to the 15.5 hours he worked, resulting in a direct labor bill of \$11,100 (or an effective labor rate of \$716 per hour) to the government. After adding overhead and fringe benefit costs to this invoice, Ogilvy charged the government a total of \$30,146 for 15.5 hours of work performed by this employee in September 1999. ONDCP records indicated that the salary for this employee could not be substantiated by a payroll register, and therefore the contracting officer's technical representative (COTR) recommended disallowing charges for this employee.

In explaining the billing for this temporary contract employee, attorneys for Ogilvy said that the \$11,100 billed was not for the 15.5 hours of work indicated on the September 1999 invoice, but for 133 hours that the employee worked in July and August 1999. The attorneys stressed that Ogilvy did not disguise this bill to ONDCP and that there should be no inference that the company attempted to "sneak" this charge past the government. The attorneys also said that the cumulative billing to ONDCP for the employee (the 15.5 hours billed in September 1999 and the remainder of the 133 hours billed in the next invoice) would not have any material differences, and that any actual errors, such as misallocation of costs, would be adjusted in the true-up of the costs incurred under the contract that is currently under way.

Ogilvy's attorneys also said that Ogilvy billed the government for a total of 22 employees who worked for the firm that provided the temporary contract labor in the foregoing example. We found that the same overhead and fringe benefit costs were charged for the temporary contract employees as they were for Ogilvy employees.¹⁴ In commenting on a draft of this report, Ogilvy's attorneys said that the company did not correctly apply the permissible fringe rate to this group of contract employees. The

¹³ Other than the 15.5 hours recorded as worked on the ONDCP contract, the time sheets submitted to ONDCP did not indicate what this employee worked on during the rest of the month. The time sheets were approved by a supervisor.

¹⁴ We found that the government paid for 19 of these 22 temporary employees. It appeared that the remaining three temporary employees were not paid because of missing time sheets or payroll data.

attorneys added that, according to PricewaterhouseCoopers and a reasonable reading of the FAR, charging the same overhead for regular and temporary contract employees is proper. In a required disclosure statement that Ogilvy submitted to the Navy in March 2001 (to be effective January 1, 1999), the company indicated that it would charge the same overhead for temporary contract and regular employees. This issue is expected to be resolved between the government and Ogilvy. As of May 2001, this disclosure statement had yet to be approved by the government.

Ogilvy also delayed in submitting its first labor invoice to the government. The contract required the company to submit its labor invoices monthly, starting with January 1999. Ogilvy's finance director said that the company submitted its first labor invoice to the government in May 1999, but that the COTR rejected it because the invoice was not in the correct format. The finance director also said that it was unclear what the COTR wanted regarding the invoice and that the COTR did not provide a sample format until June 1999. Ogilvy did not submit another labor invoice until September 1999—9 months after the contract began.

The COTR said that ONDCP did not cause Ogilvy's billing delay and that ONDCP did not reject Ogilvy's first labor invoice. Instead, the COTR said that Ogilvy's delay in submitting the first labor invoice was the result of the company's lack of government contracting experience and because Ogilvy did not hire a government contracts manager until 5 months after the contract began. The COTR added that after he met with Ogilvy's government contracts manager in mid-June 1999 about the invoice, the former government contracts manager sent the COTR an E-mail on June 21, 1999, voiding the invoice. In that E-mail, the former government contracts manager said that "[a]fter our meeting, based on info [sic] received at that time, we voided those invoices and have been preparing new ones in accordance with your payroll and time sheet needs."

Ogilvy also regularly submitted two or more invoices for the same period, with the subsequent invoices charging time for additional employees and adding more hours for employees previously billed. For example, the company submitted a total of four invoices for labor charges incurred during July and August 1999. According to ONDCP, the COTR recommended that duplicative billings contained in multiple invoices be disallowed. Ogilvy did not stop billing for 1999 until June 2000, and had not submitted any labor invoices from July 2000 to the present, as of March 2001.

Consultant Found Problems With Ogilvy's Accounting System

In April 2000, Ogilvy retained American Express Tax and Business Services to analyze its accounting systems and procedures and overhead rates with respect to the ONDCP contract. In June 2000, American Express reported that it had reviewed Ogilvy's December 1999 invoice for ONDCP and found, among other problems, that time sheets contained erasures, scratch-outs, and white-outs without the employees' initials on the changes; in one instance, a supervisor's approved signature was rubber-stamped on the time sheet; and employees were not completing their time sheets and submitting them to the accounting department on a timely basis. American Express recommended that Ogilvy establish written time sheet policies and procedures and inform employees of these policies and procedures, both orally and in writing, as well as the penalties for not complying.

American Express also reported in June 2000 that Ogilvy's accounting system segregated direct costs from indirect costs as required, and identified and accumulated direct costs by contract, but that Ogilvy's general ledger did not provide for a segregation of unallowable expenses from allowable expenses and the company's reporting system did not allow for it to have a full and complete profit and loss statement. Using an overhead model it had developed, American Express also concluded that Ogilvy significantly overbilled ONDCP for overhead in 1999, and that upon audit and final determination of the rates, Ogilvy would be required to return the overbilled funds to the government. In discussions with Ogilvy's attorneys about the American Express report, they pointed out that American Express's use of the word "overbilling" in this context was misleading because Ogilvy billed its overhead costs pursuant to a contractually agreed upon provisional rate that the parties understood was subject to revision after the actual rate was determined. Ogilvy's uncertified incurred cost proposal for its New York office for 1999 contained lower overhead and fringe benefits rates than the provisional ones contained in the contract.

The Government Did Not Adequately Manage Aspects of the Contract Pertaining to Costs Incurred by the Contractor

The government awarded a cost-reimbursement contract to Ogilvy before sufficiently determining, as required, that the contractor had an accounting system able to support this type of contract. In addition, the government did not obtain from the contractor the required disclosure statement regarding its cost accounting practices until 27 months after the contract began and has not obtained the company's certified incurred cost proposal for 1999.¹⁵ HHS and ONDCP did not resolve billing disputes between the COTR and the contractor, and failed to perform an audit after allegations that the contractor was submitting improper time charges were raised. Moreover, the contracting officer and the COTR did not have an effective working relationship, which impeded contract administration.

The Government's Analysis of the Contractor's Accounting System Was Insufficient

Under the FAR, a cost-plus-fixed-fee (cost-reimbursement) contract is not to be awarded unless the contracting officer determines that the contractor's accounting system is adequate for determining costs of the contract. Further, at the time the RFP for the Phase III contract was issued, an entity selected to receive a federal contract of \$25 million¹⁶ or more covered by the Cost Accounting Standards (CAS) was required to submit a CAS disclosure statement, which is a description of its accounting practices and procedures. A disclosure statement would have shown whether Ogilvy could meet the government's cost accounting standards.¹⁷

¹⁵ In March 2001, Ogilvy provided the Navy with an incurred cost proposal for 1999, but it was not certified. The incurred cost proposal is required to be certified, by statute and the FAR, before the proposal will be accepted by the government (unless certification is waived by the government). Specifically, a contractor official no lower than the level of a vice president or chief financial officer is to certify that, to the best of his or her knowledge and belief, all costs included in the proposal are allowable in accordance with the FAR cost principles and that the proposal does not include any costs that are expressly unallowable. Ogilvy's attorneys indicated that the required certification is delayed pending the completion of the disclosure process on direct labor charges, on which the incurred cost proposal for 1999 must be based.

¹⁶ This amount has since been increased to \$50 million.

¹⁷ HHS officials believed that CAS did not require a disclosure statement to be submitted until 90 days after the contract award because this would be Ogilvy's first CAS-covered contract awarded at the beginning of the company's current fiscal year. However, we believe, on the basis of our review of the CAS regulation, that this 90-day extension was not applicable here. In any event, Ogilvy did not submit its disclosure statement until March 2001, which was about 2 years after the 90-day extension.

The FAR requires that the contracting officer ensure that the offeror has submitted the required disclosure statement.¹⁸ As a general matter, a contracting officer is not to award a CAS-covered contract until a written determination (by the administrative contracting officer) has been made that the required disclosure statement is adequate.¹⁹ The cognizant auditor is responsible for conducting reviews of disclosure statements for adequacy and compliance, and the cognizant administrative contracting officer is responsible for determinations of adequacy and compliance of the disclosure statement. The HHS contracting officer said that she verbally asked Ogilvy's former government contracts manager for the disclosure statement once or twice in May or June 1999 (about a half-year after the contract award), and then repeated the request to the subsequent government contracts manager three or four times starting in January 2000, but did not receive one. In March 2001, more than 2 years after the contract award, Ogilvy submitted a CAS disclosure statement to the Navy and DCAA.

HHS contracting officials said that they relied on the work of an HHS cost analyst in determining the adequacy of Ogilvy's accounting system before awarding the contract. The contracting officer said that the cost analyst verbally informed her before the contract was awarded that Ogilvy had an adequate accounting system, but the cost analyst told us that he did not recall that. The contracting officer also said that the cost analyst should have documented his determination about Ogilvy's accounting system in writing before the contract award. In March 2000, an HHS cost analyst sent an E-mail to HHS contracting officials stating that Ogilvy had an accounting system that could "estimate, accumulate, and record costs on a job-by-job basis." The cost analyst also said in his E-mail that the financial documentation that Ogilvy supplied demonstrated that the company used generally accepted accounting principles, that its accounting system provided for the segregation of direct and indirect costs, and that the "identification and accumulation of direct costs by contract is taking place and there is a logical and consistent method for the allocation of indirect costs to a final cost objective." The cost analyst told us that he did not prepare this E-mail until March 2000, which was 15 months after the

¹⁸ FAR 30.202-6.

¹⁹ Under FAR 30.202-6, the contracting officer may waive the requirement for an adequacy determination before award in order to protect the government's interest. However, there is no indication that such a waiver was made here. Where a waiver is made, the determination of adequacy is required as soon as possible after the award.

contract award, because the HHS contracting officer did not ask him to until then.

In November 2000, in connection with our review of the award and administration of this contract, the HHS cost analyst prepared a memorandum to HHS contracting officials providing additional information about his basis for concluding that Ogilvy had an acceptable accounting system to support a cost-reimbursement contract. In his memorandum, the cost analyst indicated that the analysis of the proposal to award a cost-reimbursement contract to Ogilvy involved a cursory review of the offeror's accounting system and that neither a pre-award survey nor a complete audit of Ogilvy's methods and processes was done. The analyst stated that he considered Ogilvy to have an acceptable accounting system on the basis of the company's (1) statement in its proposal that it used an accounting system that could estimate, accumulate, and record costs on a job-by-job basis; (2) provision of a detailed schedule of indirect cost expenditures and a financial statement for the company that corresponded with the schedule of indirect costs; (3) statement in its proposal that it had full access to the company's public relations office in Washington, D.C., which had managed major government contracts since 1987; and (4) the fact that Ogilvy's public relations office²⁰ had been audited by DCAA, which demonstrated that its accounting methods and procedures met government standards.

However, even if the cost analyst informed the contracting officer that Ogilvy's accounting system was adequate prior to award, we believe this limited analysis was an insufficient basis for determining that Ogilvy's cost accounting system was adequate to support a cost-reimbursement contract of this magnitude. Because this was the first federal contract received by Ogilvy's New York office, the company's schedule of indirect costs and its statement that it was using an accounting system that could estimate, accumulate, and record costs for this contract warranted further in-depth review. Such an analysis should have included a review of Ogilvy's accounting system and timekeeping procedures in its New York office. Further review should have also been triggered by the clear indications in Ogilvy's proposal that the company thought the contract

²⁰ ONDCP noted that Ogilvy public relations is not an entity that was involved in the ONDCP advertising contract award. Ogilvy's attorneys confirmed that Ogilvy public relations, which was an unsuccessful bidder on another portion of the solicitation that was awarded as a separate contract, did not have any involvement with the ONDCP advertising contract post-award.

was not subject to the CAS regulations and that Ogilvy was not submitting a disclosure statement even though the RFP itself established that the resulting contract would be subject to full CAS coverage. Because these issues were not resolved, the government's determination regarding the adequacy of Ogilvy's accounting system and its compliance with CAS was insufficient.

The government's award of the Phase III advertising contract to Ogilvy without sufficiently determining whether the company had an adequate cost accounting system and without performing the required review and determination of the adequacy of the required CAS disclosure statement contributed to the unresolved labor billing problems. Had the requirement for Ogilvy to submit the necessary disclosure statement been enforced in a timely manner, it is likely that the company's cost accounting practices already would have been subject to review and scrutiny by the government. Such scrutiny would have increased the likelihood that deficiencies in Ogilvy's cost accounting practices would have been identified and addressed earlier.

Further, the HHS cost analyst's reliance on DCAA's audits of Ogilvy's Washington, D.C., public relations office to validate the cost accounting practices of Ogilvy's New York office under this contract was misplaced. Full access by the contractor to the Washington, D.C., office of another business unit within the same firm does not mean that the New York office would be using the same accounting and timekeeping systems that had been approved under the other federal contracts with the Washington, D.C., office. No specific information was provided in the cost proposal regarding the similarity or compatibility of Ogilvy's cost accounting systems in its New York and Washington, D.C., offices.

Finally, HHS contracting officials also referred to a September 21, 1998, cost analysis of Ogilvy's proposal as support for the adequacy of the contractor's accounting system. However, that analysis noted cost discrepancies within the proposal and did not indicate that Ogilvy had an adequate accounting system to support a cost-reimbursement contract. Given that the RFP for Phase III contemplated the award of a high-dollar value CAS-covered contract, the fact that Ogilvy's New York office did not already have government approval of its cost accounting practices and did not submit the required CAS disclosure statement should have been viewed as a significant risk by government contracting officials.

The Government Did Not Resolve Billing Disallowances or Audit the Contract

The government has not paid nearly one-third of the labor costs that Ogilvy billed for work performed under the ONDCP contract. However, HHS did not review the appropriateness of these disallowances, which were recommended by the COTR. Further, the government did not audit the contract, despite the large amount of money that was being disallowed from the contractor's invoices or after allegations of improper time charges were raised. Attorneys for Ogilvy said that they believe that about \$6.8 million of the \$7.6 million disallowed under the contract was improperly disallowed.

The labor invoice that Ogilvy submitted in September 1999 covered charges back to the beginning of the contract. In that and subsequent invoices, the COTR routinely recommended that HHS' contracting officer disallow portions of them for payment. As part of his review of the contractor's labor invoices, the COTR recalculated them and made disallowance recommendations on the basis of his adjustments.²¹ The COTR said that he made these adjustments in an attempt to ensure that the government only paid the contractor's actual costs under the contract.

The COTR recommended disallowing payment for labor costs claimed where (1) time sheets were not provided in support of labor invoices; (2) employee salary data were not provided; (3) employee salaries exceeded those proposed by the contractor; (4) bonuses or other unallowable compensation, such as car allowances and health club fees, were claimed; (5) salaries exceeded allowable limits; and (6) computational errors were made by the contractor. In addition, the COTR recalculated the invoices to include nonbillable hours in the base of hours that employees worked at the company, which Ogilvy's attorneys and consultants told us in March 2001 was, they believed, an appropriate adjustment to the percentage of time billing methodology. The contracting officer generally followed the COTR's recommendations and disallowed payment of about \$7.6 million out of about \$24.2 million, or about 31 percent, in labor charges from Ogilvy during the first 19 months of the contract.

In April 2000, the COTR wrote a memorandum to the ONDCP Director reporting "irregularities" with Ogilvy's billing under the contract, including "suspicions of fraudulent conduct" relayed by a former Ogilvy employee. The COTR recommended an immediate audit of the base year of the

²¹ ONDCP paid an accounting firm \$300,000 per year to review Ogilvy's invoices. The accounting firm reported to the COTR.

contract in his memorandum and reported several problems, including a substantial increase in the number of Ogilvy employees working on the contract; the submission of multiple invoices for the same billing period; time sheets that were illegible or contained many changes that increased the number of hours charged to ONDCP; billing for pro bono work, excessive salaries, and unallowable compensation; and the use of an erroneous billing methodology. In addition, the COTR indicated that he had asked HHS for documentation regarding the acceptability of Ogilvy's accounting system, but that he had only received a statement in response from HHS that the company used generally accepted accounting principles.

The memorandum also indicated that a former Ogilvy employee informed ONDCP about suspicions of fraudulent conduct regarding the contract. According to this former Ogilvy employee (who was a former senior manager and wished to remain anonymous), after Ogilvy's president complained in the summer of 1999 about a lack of revenue on the ONDCP contract, Ogilvy employee time sheets were altered to increase the number of hours billed to the contract. The COTR also indicated in this memo that he asked the HHS contracting officer for an audit, but that HHS responded that its policy was to conduct an audit at the end of the contract (which, if all of the option years were exercised, would have been in December 2003) and that ONDCP would have to pay for an audit conducted prior to then. A copy of the memo containing the ONDCP Director's handwritten notes indicated that he agreed with the need for an external audit. However, ONDCP officials told us that they did not arrange for an audit at that time because HHS wanted ONDCP to pay for it, which ONDCP declined to do, and that ONDCP planned to transfer contracting responsibilities from HHS to the Navy and have the Navy arrange for an audit after taking over the contract.

We asked the HHS contracting officer when she first heard allegations of improper charges being submitted on the contract, what she learned, and what action was taken. The contracting officer said that, after Ogilvy began submitting labor invoices in September 1999, the COTR verbally informed her that the contractor might be overbilling the government and possibly engaged in fraudulent conduct. However, the contracting officer said that the COTR did not elaborate or provide any support for his suspicion. The contracting officer said that she did not believe the allegations were credible because no evidence of improper time charges was provided and that, therefore, an audit was not needed.

HHS contracting officials also said that, if they had had credible allegations of improper charges being submitted by the contractor, they could have referred the matter to the HHS Inspector General, who they said could have ordered an immediate audit of the contract. HHS contracting officials said, for example, that ONDCP did not provide them with a copy of the COTR's April 2000 memo to the ONDCP Director regarding improper time charges. However, ONDCP officials said that they believed an audit should have been done, even without specific knowledge of evidence of fraudulent charges, because of the large amount of money that was being disallowed from the contractor's invoices. The COTR said that it was an ONDCP management decision not to share the unsubstantiated allegations of improper time charges with HHS contracting officials and not to refer the matter to the HHS Inspector General. ONDCP indicated that its actions were based on the lack of evidence substantiating the allegations and the fact that an audit of questioned billings was expected to occur immediately after the responsibility for contract administration was transferred from HHS to the Navy, which ONDCP expected would occur in the near future. Further, ONDCP indicated that it believed that ONDCP's request to HHS to withhold payment of Ogilvy's underlying claim protected the government until the audit could occur.

Contracting Officer and COTR Did Not Have an Effective Working Relationship

At the beginning of the contract, HHS appointed an ONDCP employee as the COTR to handle contractual technical issues. However, the HHS contracting officer and the COTR did not have an effective working relationship, which impeded contract administration and led to the transfer of contracting responsibilities from HHS to the Navy.²² The contracting officer said that the COTR did not work within the boundaries of his appointment. However, ONDCP indicated that the COTR started performing duties normally performed by the contracting officer only because the contracting officer was not actively engaged in the administration of the contract, gave the COTR permission, or acquiesced to the COTR's performing the duties. Further, the COTR said that the working relationship with HHS contracting officials deteriorated because he refused pressure from the contracting officer to recommend payment for costs that the COTR believed to be questionable or unsupported by the

²² HHS officials said that they initiated the transfer of contract responsibilities to the Navy. However, ONDCP officials said that they began exploring the transfer of contracting responsibilities, unbeknownst to HHS, after meeting with HHS in November 1999.

contractor. 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.

In December 1998, the HHS contracting officer issued the COTR an appointment letter authorizing him to (1) correspond and hold conferences with the contractor on matters of a technical nature, (2) conduct inspections and perform evaluations permitted by the contract, (3) approve technical data required by the contract, and (4) maintain the official technical file. In addition, the appointment letter indicated that all significant actions taken by the COTR would be documented and a copy provided to the contracting officer, including trip reports, memorandums for the file, and correspondence with the contractor. Moreover, the letter indicated that the appointment did not authorize the COTR to issue or approve changes or enter into any agreement, modification, or any other matter affecting the cost or terms and conditions of the contract.

The contracting officer said that the COTR did not comply with his duties and responsibilities in certain instances. For example, the contracting officer said that the COTR did not provide contractor performance reports, which under the contract were required to be submitted 9 months after the contract award and yearly thereafter. The COTR said that he did not provide contractor performance reports because the contracting officer never asked him for them. We found that the contract files contained an April 16, 1999, fax from the contracting officer to the COTR providing a form for measuring the contractor's performance. We also found an October 27, 1999, letter from the contracting officer to the COTR indicating that the contractor performance report was due and that, because the report was required by the contract, either the report needed to be prepared or the contract had to be modified to delete the requirement. The contracting officer asked the COTR how he wanted to proceed on this issue, but we did not find evidence that the COTR responded in writing. When we asked the COTR about these documents, he said that ONDCP provided the contractor with an assessment of its performance on an ongoing basis and was unable to wait until the end of the performance period to provide this type of assessment.

The contracting officer also said that the COTR allowed the contractor to bill four times a month, rather than once a month, without asking HHS to amend the contract. However, the COTR said that he allowed the contractor to bill more than once a month because he wanted to segregate first and second year costs, as well as media and nonmedia costs. We found in the contract files a June 6, 2000, letter from Ogilvy's government

contracts manager to the contracting officer, informing her that a meeting had been held with the COTR during which it was agreed that Ogilvy would submit four invoices per month. The letter indicated that billing four times monthly would help track and identify travel costs, media and nonmedia billing, and labor costs for 1999 and 2000. We did not find any correspondence from the contracting officer to the COTR or the contractor that disagreed with this billing plan.

A November 11, 1999, E-mail that Ogilvy's former government contracts manager sent to HHS contracting officials addressed the company's concerns about the administration of the contract. In the E-mail, Ogilvy's former government contracts manager described "relationship issues with the COTR creating difficulty in the management of the contract," including the COTR's "reluctance to involve HHS/Procurement in any contract issues" and "inability to supply [the] agency with adequate direction or explanation of needs." (The COTR, however, said that he never told Ogilvy staff that they could not contact HHS.) Ogilvy sent this E-mail to HHS after the company's project director, finance director, and former government contracts manager met with HHS contracting officials on October 21, 1999, to discuss concerns they had regarding the contract. During that meeting, HHS officials asked Ogilvy officials to put their concerns in writing. However, Ogilvy's finance director said that HHS officials took no action in response to the E-mail, and Ogilvy's project director said that payments on the contract did not begin until after the company contacted ONDCP's General Counsel in November or December 1999. ONDCP's General Counsel told us, however, that he was not responsible for expediting payments to Ogilvy as the payment process took its normal course and that he did not discuss this issue with Ogilvy's project director. According to ONDCP, it took several weeks to sift through the invoice that Ogilvy submitted on September 27, 1999, and that ONDCP was able to authorize payment of a substantial portion of the claimed costs by November 11, 1999.

Recent and Planned Actions

In response to the October 2000 hearing before the House Government Reform Subcommittee on Criminal Justice, Drug Policy and Human Resources, Ogilvy hired PricewaterhouseCoopers in November 2000 to restructure its accounting system to meet government contracting standards for a CAS-covered cost-reimbursement contract. This included developing a disclosure statement regarding Ogilvy's accounting system, which was required to be submitted at the beginning of the contract, and an incurred cost proposal for 1999, which was originally due no later than June 30, 2000.

In March 2001, attorneys for Ogilvy met with us to discuss an estimate of charges that they proposed be disallowed from the amounts already billed under the contract. The estimate, which had been developed by PricewaterhouseCoopers, was for about \$850,000, including overhead and fringe benefits, out of about \$24.2 million that was billed for ONDCP work during the first 19 months of the contract. According to Ogilvy's attorneys, PricewaterhouseCoopers did not conduct an audit of all of the ONDCP time charges to determine what charges were or were not appropriate. However, the attorneys said that PricewaterhouseCoopers reviewed all of Ogilvy's time charges regarding ONDCP to complete three distinct tasks: (1) assist Ogilvy and its attorneys in developing statistical confirmation of anecdotal reports of overcharging or mischarging, (2) quantify areas identified with the attorneys as being "clearly suspect," and (3) "conservatively estimate charges in areas identified as being probably suspect that could not otherwise be precisely quantified." The attorneys said that these "conservative assumptions were made in the government's favor." Further, the attorneys said that they did not find \$850,000 to be "improper," but rather developed an "overestimate of erroneous charges." A PricewaterhouseCoopers manager told us that his firm reviewed time charges in selected areas directed by Ogilvy's attorneys. We did not verify the information that Ogilvy's attorneys or consultants provided to us regarding the amount of money that they proposed be disallowed, including the methodology that PricewaterhouseCoopers used in developing the \$850,000 estimate, because our scope of work did not include determining the total actual costs incurred under this contract. We expect that DCAA will address the appropriateness of Ogilvy's time charges as part of the audit that Navy asked DCAA to conduct.

On March 2, 2001, Ogilvy provided an "advance copy" of an incurred cost proposal to the Navy, which was not certified. An Ogilvy attorney said that the FAR requires a contractor to include all direct labor costs in the base used to determine the indirect rates claimed in the incurred cost proposal. According to the attorney, such inclusion benefits the government even when the company does not expect to be paid for all of the direct labor costs used for the base, as in this case. The attorney said that, in this circumstance, the company is unable to certify the incurred cost proposal for indirect rates until the contracting officer and the company agree on the allowable direct labor. He added that certifying the incurred cost proposal at this point theoretically could be viewed as wrongly certifying direct labor charges that the company does not intend to collect. Further, the attorney said that Ogilvy fully expects to certify an incurred cost proposal that can be audited by DCAA pending completion of the

voluntary disclosure process or through agreement with the Navy, DCAA, and the Department of Justice.

In addition to retaining consultants to restructure its accounting system to meet government contracting requirements, Ogilvy 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 COTR's duties so that the Media Campaign Office will have various technical representatives, rather than having one COTR handling all of the media campaign contracts. In addition, ONDCP said that its media campaign staff have been trained and certified as COTRs. According to ONDCP, since contracting responsibilities were transferred to the Navy, communication has been substantially enhanced between the COTRs and the contracting officer, and regular meetings are scheduled between the COTRs, the contracting officer, and the contractor to resolve issues.

In March 2001, DCAA began reviewing Ogilvy's accounting system but does not plan to start an historical cost audit until the company certifies its incurred cost proposal. DCAA also plans to routinely review Ogilvy's future labor invoices.

Conclusions

The contractor for the advertising portion of the Phase III anti-drug media campaign did not properly charge the government for some of the labor costs incurred under the contract. Ogilvy's submission of time sheets claiming hours that some employees said they did not work on the anti-drug media campaign was clearly improper. Moreover, Ogilvy should not have been awarded a CAS-covered cost-reimbursement government contract until the company had an adequate cost accounting system to support this type of contract. Ogilvy did not comply with FAR and CAS requirements regarding its accounting system for this cost-reimbursement contract. Although ONDCP is pleased with the technical aspects of Ogilvy's work, 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 that met CAS standards. In addition, HHS should have reviewed the appropriateness of the large amount of money that the COTR recommended be disallowed from the contractor's invoices or arranged for an audit of the contract. The COTR appropriately brought allegations of improper billing to the attention of ONDCP management, but ONDCP management did not take prompt action to investigate the allegations. Moreover, contract administration was impeded because the COTR and contracting officer did not have an effective working relationship.

Because the contract has not yet been audited, the appropriateness of the disallowed charges and the actual costs incurred is currently unknown. In assuming contracting responsibilities for the ONDCP contract, the Navy must determine whether Ogilvy has adequately restructured its accounting system to meet government requirements and the allowability of costs charged to the contract, including Ogilvy's nonbillable hours and temporary contract employee labor charges. 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 for Executive Action

The Director of ONDCP should direct ONDCP staff to work with the Navy to (1) 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, (2) ensure that Ogilvy has an adequate cost accounting system for continued performance under the contract, and (3) coordinate the roles and responsibilities of the contracting officer and COTR and ensure that these roles and responsibilities are effectively carried out. Further, ONDCP should request that the Navy not exercise the next option year of the contract 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 CAS-covered cost-reimbursement contracts to companies lacking adequate accounting systems to support that type of contract, the Director of the HHS Program Support Center (PSC) should 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 (including auditor approval), 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 and Ogilvy Comments

We provided copies of a draft of this report for comment to the Acting ONDCP Director; the PSC Director; the Director of Contracts for the Navy's Fleet and Industrial Supply Center, Norfolk Detachment, in Washington, D.C.; DCAA's Branch Manager in New York City; and the President of Ogilvy in New York City. On May 22, we received written comments from attorneys representing Ogilvy, which are reprinted in appendix V; on May 23, we received written comments from the Deputy Director of ONDCP, which are reprinted in appendix IV; and on May 24, we received written comments from the PSC Director, which are reprinted in appendix VI. We received oral comments from the Department of Defense (DOD), which included comments from the Navy and DCAA.

ONDCP Comments

The Deputy Director of ONDCP said that ONDCP believes that, in general, the report fairly and accurately portrays the complexities of the contracting issues regarding the advertising portion of the anti-drug media campaign. The Deputy Director also said that ONDCP agrees with the recommendations in the report and offered some additional comments to clarify actions taken by ONDCP. He said that action already has been under way for some time and significant progress has been achieved regarding our recommendations to (1) resolve the appropriateness of the disallowed costs and subcontractor labor charges and determine amounts overpaid for which the contractor should be reimbursed; (2) certify Ogilvy's cost accounting system for continued performance under the contract; and (3) coordinate contracting officer and COTR responsibilities, ensuring effective contract administration.

The ONDCP Deputy Director also said that an excellent working relationship has been established with the Navy, that all media campaign staff have been trained and certified as COTRs, and that the Navy has

agreed to have a full-time contracting officer on-site at ONDCP's Media Campaign office. The Deputy Director said that these changes will greatly facilitate communication and resolution of problems, as well as speed implementation of the program. The Deputy Director also said that the Navy, DCAA, and the Department of Justice are actively pursuing a solution to Ogilvy's certification of its costs incurred under the contract.

The ONDCP Deputy Director also said that ONDCP has notified the Navy that the next year option of the contract should not be exercised unless Ogilvy's cost accounting system has been approved, and that ONDCP will coordinate with the Navy on determining whether to exercise that option. The Deputy Director said that ONDCP has notified the Navy that acquisition planning is under way to prepare for offering a new contract for bid should the decision be made not to exercise the next year option on the contract. Further, the Deputy Director said that a statement of work is being prepared for a possible new contract offering and that a timeline has been proposed to the Navy that would provide for a new contract award prior to the current contract's option date.

Although ONDCP indicated that significant progress has been achieved toward resolving the appropriateness of the disallowed costs and resolving subcontractor labor charges, we note that DCAA's audit of the contract has not yet begun. As also noted in the report, the Navy has asked DCAA to audit the costs that Ogilvy incurred under the contract in 1999 and 2000, but that DCAA does not plan to begin the audit until the company certifies its incurred cost proposal, which Ogilvy has not yet done. Further, although Ogilvy's attorneys said that the company expects to certify the incurred cost proposal after it completes the disclosure process on direct labor charges or reaches an agreement with the government, we are not a party to these negotiations and cannot comment on their status. With regard to "subcontractor" labor charges, which we referred to in our draft report, after consulting with Ogilvy's attorneys and reviewing an agreement that Ogilvy had made with a firm that provided temporary contract labor to the company, we agreed to refer to "temporary contract" employees, rather than "subcontractor" employees, in the report.

With regard to ONDCP's comments that significant progress has been made toward certifying Ogilvy's cost accounting system for continued performance under the contract, we recognize, as noted in the report, that DCAA began reviewing Ogilvy's accounting system in March 2001, but we have not assessed the progress of that work.

Regarding ONDCP's comments that significant progress has been made toward coordinating contracting officer and COTR responsibilities, we recognize, as noted in the report, the efforts that ONDCP indicated have been made to train and certify its employees as COTRs.

ONDCP also suggested some technical clarifications to the report, which we incorporated where appropriate.

Ogilvy Comments

Ogilvy's attorneys provided comments on many issues addressed in this report. In general, Ogilvy's attorneys said that the report was fair; that the company regrets the billing errors that were made and is making extensive efforts to correct the problems; and that, despite the billing problems, the government ultimately benefited from the company's extraordinary performance under the contract. Our specific responses to the attorneys' comments are included in appendix V. The attorneys did not make any comments on the recommendations. They also suggested specific technical changes to clarify our report, which we have made where appropriate.

PSC Comments

The PSC Director said that, while PSC believes that adequate contracting procedures are in place to ensure that awards of CAS-covered cost-reimbursement contracts are made to companies with adequate accounting systems, it concurs that the PSC controls over contracting procedures, particularly with respect to assessing an offeror's accounting system, should be examined. The Director said that PSC has initiated such a review and will strengthen procedures whenever possible.

Navy Comments

DOD provided a summary of oral comments from the Navy and DCAA. In their comments, the Navy and DCAA discussed the actions that they plan to take regarding the recommendations that we made to ONDCP. DOD indicated that, since taking over the ONDCP contract administration from HHS, the Navy has requested that DCAA perform audits of Ogilvy's cost accounting system and historical audits of all past invoices to determine what, if any, money the government has overpaid or should reimburse Ogilvy. DOD also said that, until Ogilvy's cost accounting system is approved by DCAA and the contracting officer, DCAA is providing audit support for all invoices to determine the appropriate amount to reimburse the contractor. In addition, according to DOD, the respective roles of the contracting officer, the Navy contracting officer's technical representative, and DCAA have been coordinated and clarified between the Navy and ONDCP to ensure that these roles and responsibilities are effectively carried out.

DOD also indicated that the Navy is working with Ogilvy and ONDCP to restructure the contract to better track the funds to appropriate categories under the contract. However, DOD indicated that Ogilvy has not provided a certified copy of its indirect costs, which prevents DCAA from conducting that portion of the requested audit and will delay the resolution and payment of the outstanding invoices. DOD also indicated that DCAA is working with Ogilvy to ensure that its cost accounting system meets government requirements. Moreover, DOD indicated that, should ONDCP and the Navy decide not to exercise the next contract option year, alternative plans are being made with ONDCP to cover Phase III of the media campaign.

We are sending copies of this report to the Chairman and Ranking Minority Member, House Committee on Appropriations; the Ranking Minority Member, House Appropriations Subcommittee on Treasury, Postal Service, and General Government; the Chairman and Ranking Minority Member, Senate Committee on Appropriations; and the Chairman and Ranking Minority Member, Senate Appropriations Subcommittee on Treasury and Postal Service. We are also sending copies of this report to the Acting Director of the Office of National Drug Control Policy; the Director of HHS' Program Support Center; the President of Ogilvy and Mather in New York; and the Administrator of the Office of Federal Procurement Policy in her capacity as Chairman of the Cost Accounting Standards Board. Copies will also be made available to others upon request.

Major contributors to this report were Bob Homan, John Baldwin, Jason Bair, Seth Taylor, Adam Vodraska, Jim Higgins, and Mark Connelly. If you have any questions, please contact me on (202) 512-8387 or at ungarb@gao.gov

Sincerely yours,



Bernard L. Ungar
Director, Physical Infrastructure Issues

Appendix I: Scope and Methodology

In conducting this review, we interviewed HHS, Navy, and ONDCP officials involved in awarding and administering the Phase III media campaign contract. We also reviewed relevant documentation, including the contractor's cost proposal and best and final offer; the contract; invoices and supporting documentation, including time sheets and payroll registers; correspondence between HHS, ONDCP, and the contractor; consultant reports; and previous GAO reports and testimony on the media campaign.

To determine whether the government and the contractor followed the FAR and CAS requirements in awarding and administering the contract related to ensuring the acceptability of the contractor's accounting system, we compared the actions taken, as evidenced in the contract documentation and interviews that we conducted, with the actions that should have been taken under FAR and CAS. We also interviewed DCAA officials about their audit plans and procedures regarding the ONDCP contract.

To determine whether the contractor properly billed the government, we analyzed the invoices that were submitted, the cost proposal, contract, and the FAR and CAS, and we interviewed contractor officials and employees, including those who prepared the cost proposal and invoices. In addition, we met with Ogilvy's attorneys and consultants who reviewed the contractor's invoices and accounting practices. We interviewed 3 of 28 employees who were identified by an Ogilvy attorney as having revised their time sheets for the ONDCP contract. We chose two of those three employees for our sample because they added the largest number of hours to the ONDCP contract on their time sheets, according to a company document. We chose the third employee because he was the media director who supervised many of the employees who worked on the ONDCP contract. We did not interview the rest of the employees who were identified as having revised their time sheets because of resource limitations and because 15 of the 28 employees were no longer employed at the company as of January 2001.

We also identified employees with changes on their time sheets for the ONDCP contract by reviewing copies of the time sheets that were submitted to ONDCP as supporting documentation. From this set of time sheets with changes, we judgmentally selected a sample of 20 employees with the largest number of hours added to the ONDCP contract. An Ogilvy attorney told us that 12 of those 20 employees were still working at the company in December 2000, and we interviewed those 12 employees in December 2000 and January 2001. We also interviewed the supervisors for

the four employees who said someone else made the changes that were shown on their time sheets.

Our review objective did not include determining the amount of money that the government overpaid or should reimburse for labor costs. In addition, other problems with employee time sheets could have existed that we or the company (or its attorneys and consultants) did not identify. We did not verify the information that the company or its attorneys and accountants provided. We also did not review the costs of media that Ogilvy incurred for the government. Further, although we reviewed Ogilvy invoices that included charges for temporary contract employees and discussed the billing of a temporary contract employee in this report, we did not review the billing for all of the temporary employees. We also did not review the overall award process used for the initial contract award.

We did our work from September 2000 through April 2001 in Washington, D.C., and New York City in accordance with generally accepted government auditing standards. We provided a draft of this report to ONDCP, HHS, the Navy, DCAA, and Ogilvy. Their comments and our evaluation are provided at the end of our letter and in appendix V.

Appendix II: Interviews With Ogilvy Employees Who Revised Their Time Sheets

Ogilvy's attorneys provided documents indicating that 28 employees prepared revised time sheets, primarily in September and October 1999, and added a total of 3,127 hours to the ONDCP contract. We judgmentally selected a sample of 3 of those 28 employees to interview about when and why they revised their time sheets.¹ We chose two of the three employees for our sample because they had added the largest number of hours to the ONDCP contract, according to the document that Ogilvy's attorneys provided to us. We chose the third employee because he was the media director who supervised many of the employees who worked on the ONDCP contract.

One of the three employees in our sample prepared revised time sheets for 16 weeks, covering time from January through May 1999, and added 485 hours to the ONDCP contract. However, this employee said that she did not work an extra 485 hours on the anti-drug media campaign and revised her time sheets because an Ogilvy manager instructed her to do so. This employee said that the manager told her to add the extra hours to the ONDCP contract because her original charges did not reflect the amount of time that she was projected to work on the anti-drug media campaign. The employee could not recall which Ogilvy manager gave her those instructions, but said it was either the former government contracts manager or the project director. (The former government contracts manager, through his attorney, declined to comment on this matter. The project director said that she did not instruct this employee to add the 485 hours to her time sheets.²)

Ogilvy's finance department did not retain the original versions of the time sheets that this employee prepared before adding the 485 hours to the ONDCP contract. However, the employee kept copies of her original and revised time sheets, which showed that time charges were transferred from other company accounts in the first set of time sheets to the ONDCP contract in the second set. In the original set of time sheets, no time had been charged to the ONDCP contract in 8 of the 16 weeks. In addition, the total number of hours claimed as worked during particular weeks

¹ We chose to interview a sample of these employees because of resource limitations. According to an Ogilvy attorney, 15 of the 28 employees were no longer employed at the company in January 2001, including one who transferred 435 hours and another who transferred 322 hours from other company accounts to the ONDCP contract.

² These revised time sheets were signed by the employee's supervisor, who is also Ogilvy's project director for the ONDCP contract.

remained unchanged in both sets of time sheets. The employee could not recall when she revised her time sheets, but a document provided by Ogilvy's attorneys indicated that the revised time sheets were entered into the company's timekeeping system on September 2, 1999. Ogilvy's consultants calculated the value of these 485 hours to be \$6,199, which, when we added overhead and fringe benefits costs, totaled \$16,836.

Another of the three employees in our sample prepared revised time sheets for 14 weeks, covering time from January through May 1999, and added 402 hours to the ONDCP contract. This employee said that his supervisor asked him to revise his time sheets because the employee's original time charges did not reflect the number of hours that he was projected to work on the ONDCP contract. The employee said that he added the 402 hours to his time sheets in the summer of 1999 on the basis of his memory of time worked. He also said that he believed the revised time sheets were more accurate than the originals. When asked why he added time to the ONDCP contract, this employee said that, early in 1999, he was doing tasks for multiple clients that involved gathering information about the media market in general, but that also benefited ONDCP. (This employee originally did not charge any time to ONDCP in January and February 1999, but added 238 hours to the ONDCP contract in his revised time sheets for those 2 months.) This employee also said he was working for ONDCP in mid-April 1999 in preparation for a presentation, but could not recall why he added more time to the ONDCP contract for the other weeks.

Ogilvy's finance department retained this employee's original and revised time sheets for 5 of the 14 weeks for which he added 402 hours to the ONDCP contract. In addition, Ogilvy sent copies of original and revised time sheets for 4 other weeks (among the 14 weeks) to ONDCP as support for its labor invoices, which we reviewed. Those time sheets showed that time charges were transferred out of other company accounts in the first set of time sheets to the ONDCP contract in the revised set, while the total number of hours worked during individual weeks was generally left unchanged in both versions.³ A document provided by Ogilvy's attorneys indicated that the revised time sheets were entered into the company's timekeeping system on September 14, 1999. Ogilvy's consultants

³ For one week, the total number of hours worked was reduced by 1 hour in the revised time sheet, while the total number of hours worked was reduced by 2 hours in another week's revised time sheet.

calculated the value of these 402 hours to be \$13,403, which, when we added overhead and fringe benefits costs, totaled \$36,401.

The third employee in our sample, Ogilvy's media director,⁴ prepared revised time sheets for 7 weeks, covering time from January through June 1999, and added 67 hours to the ONDCP contract. This media director said that he added the time after reviewing his calendar and finding that he had worked more hours on ONDCP than originally claimed. Ogilvy's finance department retained copies of this employee's original and revised time sheets, which showed that time charges were transferred from other company accounts in the first set of time sheets to ONDCP in the second set of time sheets. The total number of hours worked during individual weeks remained unchanged in both versions. A document provided by Ogilvy's attorneys indicated that the revised time sheets were entered into the company's timekeeping system on September 14, 1999. Ogilvy's consultants calculated the value of these 67 hours to be \$5,147, which, when we added overhead and fringe benefits costs, totaled \$13,978.

⁴ The media director was also the supervisor for the employee who added 402 hours to his time sheets for the ONDCP work.

Appendix III: Interviews With Ogilvy Employees and Supervisors Regarding Time Sheets Containing Changes

We reviewed time sheets that Ogilvy submitted to ONDCP as support for the labor invoices in 1999 and found hundreds¹ containing scratch-outs, white-outs, and other changes to the amount of time billed to the ONDCP contract, all lacking the employees' initials. We judgmentally selected a sample of 20 employees' time sheets with such changes that added time to the ONDCP contract and asked to interview the employees about why the changes were made. These time sheets were selected for our sample because, after reviewing all of the time sheets that were submitted to ONDCP, they appeared to have the most time added for the ONDCP contract.² In some cases, Ogilvy had submitted to ONDCP two versions of time sheets for the same employee, and, in those instances, we questioned those employees about the reasons for the differences between the two sets of time sheets. In other cases, we only had copies of the time sheets containing the changes, and we questioned the employees about why the revisions were made. Attorneys representing Ogilvy indicated that 12 of those 20 employees whose time sheets were included in our sample were still employed at the company as of December 2000.

During our interviews with those 12 employees, 4 said that they did not make the changes indicated on their time sheets for ONDCP work and did not know who made the changes, which added at least 55 hours to the ONDCP contract.³ The other eight employees said that they made the changes for various reasons, such as mathematical errors, charging time to the wrong account, and recording the wrong office departure times.

We interviewed the three supervisors of these four employees who said that they did not make the changes indicated on their time sheets regarding the ONDCP contract. (One supervisor approved the time sheets for two of the four employees.) The supervisor for two of the four employees said that he changed one employee's time sheets, adding at least 14 hours⁴ charged to ONDCP, after his supervisor instructed him to

¹ About 12,000 time sheets were submitted to ONDCP for work done during 1999.

² Our sampling methodology was similar to that prescribed in the DCAA Audit Manual (January 2001) for reviewing labor costs. Paragraph 6-404.8 (Pre-interview Analysis) of the manual advises that once high-risk areas are identified, such as labor charge adjustments that are more than normal corrections, and the corresponding employee population identified, employees with the most questionable labor charges are normally interviewed.

³ 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.

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

make the changes. This supervisor said that he did not change the time sheets of his other employee in our sample. According to an Ogilvy attorney, the supervisor who was identified by this supervisor as instructing him to make the changes is no longer employed at the company.

The supervisor for the third employee said that she did not make the changes to her employee's time sheet and did not know who did. In that case, the employee originally recorded that she did not work on a particular day, but that the "0" hours had been written over with "7" hours. That employee said that she was returning from a personal foreign trip and was not doing work for Ogilvy that day.

The supervisor for the fourth employee said that she did not add to her employee's time sheet the number of hours worked on the ONDCP contract on a certain day. However, she thought that the change made was appropriate because the employee had recorded on the time sheet when she arrived and departed that day, but apparently had forgotten to record the number of hours that she worked. The supervisor said that it would have "made sense" for the accounting department to have made that change.

Appendix IV: Comments From the Office of National Drug Control Policy



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF NATIONAL DRUG CONTROL POLICY
Washington, D.C. 20503

May 23, 2001

Mr. Bernard L. Ungar
Director, Physical Infrastructure Issues
U.S. General Accounting Office
441 G. Street, N.W.
Washington, D.C. 20548

Dear Mr. Ungar:

The Office of National Drug Control Policy (ONDCP) has reviewed the draft GAO report on the "Anti-Drug Media Campaign: Aspects of Advertising Contract Mismanaged by the Government; Contractor Improperly Charged Some Costs." In general, ONDCP believes that the report fairly and accurately portrays the complexities of the contracting issues.

ONDCP agrees with the recommendations contained in the draft report; however, we offer some additional comments to clarify actions already taken by ONDCP. We have offered recommended technical changes under separate cover.

ONDCP agrees with the recommendations that ONDCP work with Navy (1) to resolve the appropriateness of disallowed costs and subcontractor labor charges and determine amounts overpaid or which the contractor should be reimbursed, (2) certify Ogilvy's cost accounting system for continued performance under the contract, and (3) coordinate contracting officer and COTR responsibilities, ensuring effective contract administration. In fact, action in each of these areas has been underway for some time, and significant progress has been achieved.

Resolution of disallowed charges is well underway by the Navy, working with the Defense Contract Auditing Agency (DCAA). We have been pleased with the transfer of the contract to the Navy and an excellent working relationship has been established. The Navy contracting officer and contract administration staff work harmoniously and effectively with ONDCP's Media Campaign program staff. As stated in the report, all media campaign staff have now been formally trained and certified as the contracting officer's technical representatives (COTRs). Reassignment of responsibilities among COTRs has been initiated to ensure that each COTR has additional time to devote to the contract for which he or she is responsible. Additionally, the COTR for the Ogilvy contract is being supported by Alternate and Assistant COTRs who are integrally involved in the advertising component of the Campaign. Further, the Navy has agreed to a full-time Contracting Officer on site in the Media Campaign office. These changes will

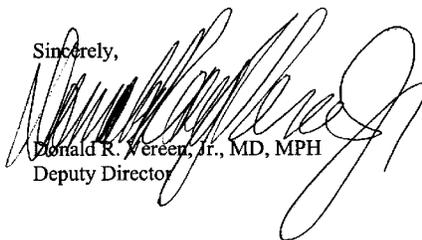
greatly facilitate communication and resolution of problems, as well as speed implementation of the program.

The second recommendation by GAO is to ensure that Ogilvy has an adequate cost accounting system for continued performance under the contract. DCAA began an accounting system review in March, 2001, and expects to receive Ogilvy input to support a determination in the near future. Additionally, DCAA cannot start to audit Ogilvy's past billings until Ogilvy certifies its costs. Ogilvy has stated that it cannot certify its costs because it did not have sufficient controls to accurately track its labor. At present, Navy, DCAA and the Department of Justice are actively pursuing a solution to the problem.

ONDCP has notified the Navy that the next year option of the Ogilvy contract should not be exercised unless Ogilvy's cost accounting system has been approved. ONDCP will coordinate with Navy on the determination as to whether to exercise the next year option. In the meantime, ONDCP has notified the Navy that acquisition planning is underway to prepare for offering a new contract for bid should the decision be made not to exercise the next year option on the Ogilvy contract. A statement of work is being prepared for a possible new contract offering and a timeline has been proposed to Navy that would provide for a new contract award prior to the current contract's option date.

ONDCP appreciates this opportunity to review the draft report and to provide formal comment.

Sincerely,



Donald R. Vereen, Jr., MD, MPH
Deputy Director

Appendix V: Comments From Ogilvy and Mather

Note: GAO comments supplementing those in the report text appear at the end of this appendix.


O'MELVENY & MYERS LLP

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May 22, 2001

VIA HAND DELIVERY

Mr. Bernard Ungar
Director, Physical Infrastructure Issues
United States General Accounting Office
441 G Street, N.W.
Room 2A10
Washington, D.C. 20548

OUR FILE NUMBER
633,306-001

WRITER'S DIRECT DIAL
202-383-5359

WRITER'S E-MAIL ADDRESS
iraphaelson@omml.com

Re: Comments on May 2001 Draft Report on Anti-Drug Media Campaign

Dear Mr. Ungar:

Let us begin by thanking you and your co-workers on behalf of our client, Ogilvy & Mather ("Ogilvy"), for your open-minded efforts at developing a fair report on the issues addressed in your Draft Report. As you know, the billing errors that Ogilvy has voluntarily made known to the government are a source of profound disappointment within the company. As a novice government contractor, Ogilvy implemented an unprecedented pro bono match program using donated celebrity endorsements and leveraging its leadership in the industry to create and implement a substantively extraordinary advertising program for the ONDCP. That program has been widely praised as you generously noted in the Draft Report. Yet, despite the breadth and excellence of the effort, Ogilvy did not have an accounting system that met the detailed technical specifications required of government contractors. The ensuing mistakes are unacceptable. By the following observations, Ogilvy does not intend to excuse them. We appreciate your willingness to balance the justifiable criticism of what occurred with the context you have noted, including the company's extensive efforts at self-disclosure, self-correction, and self-improvement. For instance, Ogilvy has already taken significant steps to ensure prospective compliance with the government's unique and complicated billing structure. Nonetheless, there are a few observations that we think we must make on behalf of the client, however, though they may not rise to the level of what you might ordinarily expect as "comment" on a report of this nature.

See comment 1.

O'MELVENY & MYERS LLP

Mr. Bernard Ungar, May 22, 2001 - Page 2

As we noted in the discussions during the audit, notwithstanding the billing irregularities, we believe that the government ultimately benefited from Ogilvy's extraordinary performance of the contract. As a novice government contractor¹, Ogilvy took on a difficult contract as low-bidder and outperformed the contract objectives providing extraordinary results and client service. This commitment to client service included, but was not limited to, the company's retention of outside lawyers and accountants to conduct far-reaching reviews of the billing missteps that were detailed in real time not only for the executive branch agencies involved but to the Justice Department and the GAO auditors on-site. Indeed, we believe it fair to say that every aspect of the GAO audit was assisted by the company and its outside experts. As to the substantive contract work, by every objective measure analyzed by PricewaterhouseCoopers (PWC), they were able to confirm that the government received more value under the contract than the four corners of the contract provided.

- **Ogilvy provided more advertising per labor dollar than contracted for.**
 - Though this was not exclusively a media contract, PWC confirmed ONDCP received \$28.45 of media for every dollar of labor currently booked rather than the rate of \$23.73 anticipated in the BAFO (more than 20%).
- **Applying a hypothetical effective commission rate analysis², ONDCP contracted for a lower rate than Ogilvy's commercial clients and received a lower rate than it contracted for, halved if one considered the pro bono match.**
 - PWC confirmed an internal Ogilvy analysis that developed a hypothetical effective commission rate on the contract. They found that the government actually received a lower effective commission rate (8.15%) than its commercial customers received (11.19%-15.4%) AND received a lower rate than could have been anticipated in the BAFO (10.91%).

¹ Attached at Tab A is a photocopy of a summary chart from a study by Jones-Lundin Associates which did a study for advertisers and advertising agencies that shows that while labor-based fees have evolved into the dominant form of compensation in the industry today, they have not been so historically. This study confirms one of our core points of discussion with you regarding the relative inexperience of Ogilvy and like-situated businesses in timekeeping in an industry that historically was compensated on the basis of commissions. Again, this context is not offered to excuse the missteps but rather to explain the backdrop against which they occurred.

² As reflected in the chart at Tab A, it is the commission rate that formerly drove compensation for Ogilvy and other ad agencies.

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Mr. Bernard Ungar, May 22, 2001 - Page 3

- **Ogilvy saved ONDCP additional sums by controlling overhead to reduce the overhead rate to be applied in the true-up.**
 - PWC has worked with Ogilvy to present the incurred cost submission to DCAA and the Navy for purposes of confirming the overhead rate. The submitted rate of 111% represents a significant savings to the government over the agreed provisional rate of 126%.
- **Ogilvy outperformed the contract's requirement of a 100% pro bono match.**
 - PWC has confirmed that Ogilvy secured matching pro bono advertising of 115%, significantly in excess of the contract's requirement of a 100% match.
- **Ogilvy provided many high quality intangibles under the contract.**
 - There is ample evidence of Ogilvy's subjectively extraordinary performance of the various tasks it received to the satisfaction of the client. There is also ample evidence that Ogilvy performed numerous assigned tasks requiring significant effort not clearly anticipated by the contract.
- **Ogilvy recorded millions of dollars less in direct labor than the government thought it would, given the contract and additional tasks in 1999.**
 - PWC confirmed that Ogilvy recorded almost \$3 million less than the amount described to the government for the expanding work in the summer of 1999.

What the foregoing means is that even if the government had paid every questionable dollar in the Ogilvy system (billed and unbilled), and it has not, and even if the contract had been true up, which it has not, the government would have gotten more than it has bargained for in its contract with the low bidder. Of course, as your Draft Report notes, we do not propose that the government pay for direct labor charges or overhead that Ogilvy's outside accounting consultant has identified as potentially inconsistent with FAR. Now, almost a year and a half after the close of the first year of the contract, we remain anxious to true-up the contract as per the terms to be paid for the work fully performed notwithstanding the weaknesses in the company's record-keeping. Put another way, the government is not "out of pocket" on this contract. Ogilvy is. Indeed, at this time, there is almost \$19 million in uncompensated labor for 1999-2001 and more than \$100 million in uncompensated media and production expenses on Ogilvy's books. Obviously, the company is anxious to complete the true-up process contemplated by the contract.

That said, let us turn to some specific points within the Report that we believe ought fairly be amplified.

O'MELVENY & MYERS LLP

Mr. Bernard Ungar, May 22, 2001 - Page 4

Page 15 and the Draft American Express Tax and Business Services Division ("AmExServices") Report (also referenced elsewhere beginning at Page 4, par. 1 Summary)

We believe that GAO's treatment of the draft AmExServices' Report, that the company obtained in June 2000, should be expanded. While the Draft Report certainly captures some of the AmExServices' observations and context we had previously offered, it does not address some of the other key aspects of that draft report. Those aspects fall essentially into two categories. First, there are a number of observations by AmExServices that would (and did) lead reasonable financial managers to believe that the Ogilvy accounting system and billing to the government was essentially sound and could reasonably be relied upon by both the company and the government.

- AmExServices "performed an analysis of O&M's labor charging system" and found "[f]rom an overall standpoint, with the exception of recording time daily and failure to submit timesheets timely to accounting, there appears to be no other material issues relating to the labor charging system."
- The company's "method of accounting for vacation, sick and holiday time (paid absences) is consistent with the industry...[and]...the way the company has bid the ONDCP contract."
- The company should consider "challenging" the government [COTR] proposal to change the method of accounting for paid absences.
- With regard to these expenses, AmExServices concluded that "except in certain unique circumstances, [the accounting variances] should not vary significantly from the methodology the government is proposing. In fact, the methodology that O&M utilizes has the effect of producing a better matching of the cost with the effort, which is consistent with the intent of the government regulations."
- "Not all indirect rates are being captured by the accounting system."
- "The books and records are closed on a monthly basis satisfying the need of the government regulations."

The AmExServices Draft Report was wholly consistent with the feedback the company had received from the government (some of which is noted at page 17 of your Draft Report) and other feedback that was understood by virtue of a review conducted by government auditors at the Finance Department in December 1999. Indeed, in light of the foregoing, it was reasonable for the company to take an iterative approach to systems enhancement until the late summer of 2000, when it learned of the more serious matters raised regarding billing reliability at which time the company stopped billing the government altogether. Thus, the inference that the

Now on p.16.
See comment 2.

See comment 3.

O'MEIVENY & MYERS LLP

Mr. Bernard Ungar, May 22, 2001 - Page 5

company is "late" in sending bills seems unfair when the delay is intentional and the reasons for the delay have been explained to the government as being motivated by a desire to ensure accurate and FAR-compliant billing. (See page 15, final sentence of the second paragraph of the Draft Report)

See comment 2.

Second, the AmExServices' Report reinforced the company's view that a CAS Disclosure Statement was not required in the first year of the contract.³ If this observation is correct, then neither the government nor Ogilvy's failure to have one in place is critical to what occurred here. Having said that, Ogilvy and its counsel and consultants do believe that CAS-compliant accounting should have been in place and that having such a statement would have provided a basis not only for preventing many of the issues but in ensuring open dialogue with the COTR-something that Ogilvy does not believe exists even today.⁴

Page 3, paragraph 2, reference to revenue shortfall

See comment 4.

While there is no question that some managers were aware of shortfalls in time-recording and therefore revenue on the ONDCP contract in the late summer and fall of 1999, two important contextual elements should be noted. First, the shortfall was perceived as being clerical insofar as the hours seemingly devoted to the project were not being captured by those seemingly under-reporting time on the project. Second, and perhaps more important in assessing overall corporate motivation, Ogilvy New York was ahead of the office-wide performance budget by the third quarter and eventually exceeded those projections by more than 20%. The ONDCP contract did not affect that positive performance.

See comment 5.

Page 6, second full paragraph

See comment 6.

While it may be of little moment to the readers of the Draft Report, it may also be noted that attorneys for the company made disclosures in November to the ONDCP, HHS, Navy, and OSI, in addition to those made to the Justice Department. We continue to discuss these issues with all of those agencies in an effort to ensure a fair true up of 1999-2000 billings and appropriate prospective billing.

Now on p.10.

Page 9, paragraph 3

See comment 7.

The Draft Report attributes a comment to the Financial Director that we do not believe fully captures his perspective. While the subject matter of timekeeping was discussed, he does not believe that he discounted the importance of timekeeping accuracy in the manner ascribed to him. Rather, he believes he was describing a practice by some employees that emphasized the

³ AmExServices stated with seeming approval that: "In its original proposal, O&M was able to claim exemption from compliance with the Cost Accounting Standards."

⁴ Indeed, there has been neither the "ongoing" assessment of Ogilvy's performance attributed to the COTR at page 23 of the Draft Report nor have there been the "regular" meetings that the COTR reports to have arranged at page 25.

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importance of achieving accuracy within quarters and yearly rather than on a daily timesheet basis.

Page 10, first full paragraph

We believe the reader would benefit from having the 3127 hours viewed in the context of the more than 150,000 hours worked on the project in 1999.

Page 11, Labor Invoices

The repetitive submission of invoices for the same months was necessitated by the COTR's direction to only bill individual employees who had submitted all timesheets for a particular month and the difficulty Ogilvy had in securing timely submission of timesheets by its employees. Such repetitive billing does not appear to have resulted in double-billing for the same labor time.

The Draft Report also discusses the fact that Ogilvy billed overhead and fringe benefits for certain temporary contract laborers. As disclosed to GAO during the audit, Ogilvy did not correctly apply the permissible fringe rate to this group of contract employees. Nonetheless, according to PWC and a reasonable reading of the FAR, charging the same overhead for regular and temporary employees is proper. Though fringe should be maintained on a separate rate for full-time and temp-type employees, the failure to do so here was not material according to PWC and is expected to be resolved in the true-up.

Page 12, Labor Invoices

While we recognize that there is a genuine cost-accounting issue under the FAR with regard to the 35 hour corporate work week, it should also be noted that there were hundreds of hours of uncompensated and unbilled overtime devoted to the ONDCP project by company employees dedicated to the success of the project. Moreover, some of the cost-allocations questioned in this section of the Draft Report, though rejected by the COTR were nonetheless verbally approved by HHS. Moreover, some of the costs which are described as "incorrectly billed" are more properly described as "misclassified" as some charges that may not belong in the direct labor bill would nonetheless have an offsetting affect to the overhead rate under the FAR.

Page 14, second paragraph

Ogilvy's first invoice in May 1999 followed numerous consultations with the COTR and was accomplished with the help of an outside consultant as to format. The bill was withdrawn when the COTR made additional formatting demands as a condition of payment.

See comment 8.

Now on p.12.

See comment 9.

See comment 10.

See comment 11.

Now on p.15.

See comment 12.

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Page 15, paragraph 2 and Page 21, paragraph 1 & 3 subsequent billing for prior months

See comment 13.

Though not ideal from either the government or Ogilvy's perspective, the practice of backbilling as complete sets of timesheets for employees were received and entered into the billing system was done with the approval of the COTR.

Page 19, Reliance on Public Relations Sister Company

See comment 14.

Though we cannot comment on HHS' motivations, once the public relations contract was awarded to another company, Ogilvy New York did not have the benefit of the Washington Public Relations firm's government cost accounting expertise as it anticipated in submitting the BAFO.

Now on p. 21.

Page 20, Contracting Officer Reliance on COTR on disallowances

See comment 15.

While the contracting officer approved the COTR's disallowances as noted pending provision of additional documentation, numerous decisions by the COTR to withhold payment were overruled by the contracting officer. Indeed, as you noted in the Draft Report, it remains Ogilvy's position that the withholding of the referenced payments were done for largely erroneous reasons.

Now on p. 27.

Page 26 (first para)

See comment 16.

The Draft Report concludes that Ogilvy did not "begin making serious efforts to restructure its accounting system to meet government requirements until nearly 2 years after the contract was awarded." We respectfully disagree with this assessment. While the efforts may not have produced the desired system within the timeframe referenced, the seriousness of the effort in the intervening time cannot be seriously questioned. In 1999, the company hired a government contracts specialist, an accounting consultant, and a government contracts lawyer, none of whom are currently in those positions. The company promulgated timesheet policies and attempted to dialogue with the COTR on contract requirements. Though none of these efforts prevented the billing problems we identified to the government, they were nonetheless good faith efforts to create a system by a novice government contractor.

Now on p. 35.

Page 31 (middle para)

See comment 17.

Though there was clearly a failure of recollection by the employee regarding which manager instructed her to change her time, there is strong, if not conclusive, extrinsic evidence that the manager who gave the instruction was the Ogilvy contract coordinator. He admits as much and the account manager denied doing so. Moreover, the contemporaneous handwritten instructions to move the time are in his and not the account manager's handwriting.

Other Issues

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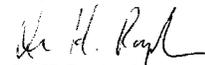
See comment 18.

The discussion of the audit activity regarding white-out and extraneous markings should include two contextual observations. First, as the interview appendix makes clearer, most of the markings were explained as innocent self-correction with some of the unidentified changes being correction of obvious math errors. Second, such extraneous markings, though viewed as auditing red-flags, are not all uncommon in government and private time-sheet reviews.

See comment 19.

Finally, we believe that the final Report should reflect some of the positive comments you and others from GAO were kind enough to make during the informal review process regarding the company's admirable openness during the audit process. It was, after all, the company that helped substantially broaden the focus of your auditors work beyond the extraneous marking analysis to the billing missteps described in the appendices and text. It was in that spirit of openness and fairness that you have dealt with us as well. As noted above, none of the above excuses the errors Ogilvy brought forward and which it regrets. Yet, as you have endeavored to do, those errors should be understood in the context of the manner in which the contract was administered and ultimately assessed in light of the value of the service delivered. We recognize, of course, as noted at page 30 of the Draft Report, that GAO did not audit the efficacy of the media campaign that Ogilvy was hired to provide. By all independent and reported measures, that campaign was a success. The accounting issues, though presently not fully audited by GAO, have been the subject of a review by PWC on a timesheet by timesheet basis and the results of that review have been shared with the various government agencies involved. We thank you for the opportunity to amplify on our earlier discussions.

Very truly yours,



Ira H. Raphaelson
of O'MELVENY & MYERS LLP

IHR:mfs

cc: Mr. Robert Homan
DC1:467539.5
05/24/01

The following are GAO's comments on the letter from attorneys representing Ogilvy & Mather dated May 22, 2001.

GAO Comments

1. Ogilvy's attorneys said that the billing errors that the company voluntarily made known to the government are a source of profound disappointment to Ogilvy, but that notwithstanding the billing irregularities, the government ultimately benefited from the company's "extraordinary performance." Ogilvy's attorneys cited several examples of how they believed the government received more value under the contract than the contract required. The attorneys indicated that the company (1) provided more advertising per labor dollar than the contract required; (2) gave ONDCP a lower effective commission rate than its commercial clients, after applying a hypothetical effective commission rate analysis; (3) saved ONDCP additional sums by controlling overhead to reduce the overhead rate to be applied in the true-up; (4) outperformed the contract's requirement of a 100 percent pro bono match; (5) provided many high quality intangibles under the contract; and (6) recorded millions of dollars less in direct labor costs than the government thought it would, given the contract and additional tasks undertaken in 1999. However, Ogilvy's attorneys said that despite these observations, the company does not intend to excuse the billing errors that were made.

Although we cannot comment on the company's claims regarding its technical performance under this contract because the scope of our review was limited to aspects of the award and administration of the contract and Ogilvy's billing practices, as noted in this report, ONDCP is pleased with Ogilvy's technical performance regarding the anti-drug media campaign. We agree with Ogilvy's attorneys that the company's claims of extraordinary performance do not excuse the billing problems that were found to have occurred.

2. Ogilvy's attorneys suggested that our treatment of the report by American Express Tax and Business Services be expanded in our report. The attorneys said that American Express made a number of observations that "would (and did) lead reasonable financial managers to believe that the Ogilvy accounting system and billing to the government was essentially sound and could reasonably be relied upon by both the company and the government." We did not attempt to provide a comprehensive summary of the American Express report, but chose to report problems that American Express found that corroborated some of our findings. We also did not agree with some of American Express' findings. For example, Ogilvy's attorneys asked us

to include in our report that American Express had found that Ogilvy's method of accounting for paid absences (vacation, sick, and holiday time) was consistent with industry practice. However, we found that the company inconsistently charged the government for paid absences.

Ogilvy's attorneys also noted that the American Express report "reinforced the company's view that a CAS disclosure statement was not required in the first year of the contract." The attorneys also said that, if American Express was correct, "then neither the government nor Ogilvy's failure to have a disclosure statement in place is critical to what occurred under this contract." In addition, the attorneys said that Ogilvy and its counsel and consultants believe that a CAS-compliant accounting system should have been in place and that having a disclosure statement would have provided a basis not only for preventing many of the issues, but also for ensuring open dialogue with the COTR, which Ogilvy does not believe currently exists. Ogilvy's attorneys continued that "there has been neither the 'ongoing assessment' of Ogilvy's performance attributed to the COTR in the report, nor have there been the 'regular' meetings that the COTR reports to have arranged."

We believe that, because the ONDCP contract was a CAS-covered contract over a certain value, Ogilvy was required to provide a disclosure statement at the time of the award. We were unable to verify whether the COTR provided an "ongoing assessment" of Ogilvy's performance because, as noted in the report, the COTR said that he did not prepare a formal contractor performance report. We also did not verify whether regular meetings have recently been scheduled and taken place between the COTR and Ogilvy.

3. Ogilvy's attorneys also indicated that the American Express report was "wholly consistent with the feedback that the company received from the government...and other feedback that was understood by virtue of a review conducted by government auditors at the Finance Department in December 1999." We understand from discussions with Ogilvy's attorneys that this review refers to work conducted by us in connection with our July 2000 report regarding the anti-drug media campaign. However, the scope of that review, which is detailed in footnote 2 of this report, did not include determining the adequacy of Ogilvy's accounting system with respect to the ONDCP contract. As indicated in the July 2000 report, we did not conduct a financial audit of the campaign's fiscal operations or review the related internal controls to determine the accuracy of the campaign's obligations and

expenditures. Our records do not indicate that we met with Ogilvy financial staff in December 1999, but rather that we met with Ogilvy media staff in September 1999, and the discussion focused on billing media, rather than labor costs. Further, our record of that meeting does not indicate that we provided feedback regarding the adequacy of Ogilvy's accounting or timekeeping systems.

Ogilvy's attorneys also said that, in light of the review conducted by government auditors in December 1999, it was reasonable for the company to take an "iterative approach" to systems enhancement until the late summer of 2000, when it learned of the more serious matters raised regarding billing reliability, at which time the company stopped billing the government altogether. Therefore, they said, the inference that the company is "late" in sending bills seemed unfair when the delay was intentional and the reasons for the delay have been explained to the government as being motivated by a desire to ensure accurate and FAR-compliant billing. We did not mean to imply that the company had been late in billing the government after problems were raised in late summer 2000. We understand that Ogilvy has stopped billing for labor until it has completed restructuring its accounting system to meet government contracting requirements. However, we did intend to indicate that Ogilvy was late in billing the government for labor at the beginning of the contract. Ogilvy did not provide the government with its first labor invoice until May 1999, even though the contract, which began in January 1999, required the company to bill the government on a monthly basis. Ogilvy should have had the processes and staff in place to bill the government in accordance with the contract terms at the beginning of the contract.

4. Ogilvy's attorneys said that the revenue shortfall on the ONDCP contract was "perceived as clerical insofar as the hours seemingly devoted to the project were not being captured by those seemingly under-reporting time on the project." However, if the revenue shortfall was perceived solely as a recordkeeping problem, the actions that some Ogilvy employees took in response, which included adding time charged against the contract that some employees said they did not work, was not the proper solution. Further, we were not able to comment on the perceptions of Ogilvy management at the time or whether their perceptions, whatever they were, were accurate.
5. Regarding the low revenue that Ogilvy realized on the ONDCP contract in the late summer and fall of 1999, the company's attorneys said that Ogilvy New York was ahead of its officewide performance budget by

the third quarter and eventually exceeded those projections by more than 20 percent. Ogilvy's officewide performance in 1999 was outside of the scope of our review of the ONDCP contract.

6. Ogilvy's attorneys noted that they made disclosures regarding the company's billing practices under this contract not only to the Justice Department, but also to ONDCP, HHS, the Navy, and GAO's Office of Special Investigations. We did not verify Ogilvy's disclosures to all other government agencies.
7. Ogilvy's attorneys said that a statement attributed to the financial director (referred to in our report as the "finance director") did not fully capture his perspective regarding Ogilvy's timekeeping procedures. The attorneys provided an additional statement regarding his perspective, which we added to the report.
8. Ogilvy's attorneys said that the 3,127 hours that employees added to the ONDCP contract should be viewed in the context of the more than 150,000 hours worked on the project in 1999. Because we found that some of the time sheets that Ogilvy submitted to the government in 1999 were not reliable, we did not calculate the total number of hours that Ogilvy's employees worked on the ONDCP contract in 1999.
9. Ogilvy's attorneys said that the company's submission of repetitive invoices for the same months was necessitated by the COTR's direction to bill only individual employees who had submitted all time sheets for a particular month and by the difficulty Ogilvy had in securing timely submission of time sheets by its employees. The attorneys also said that such repetitive billing does not appear to have resulted in double-billing for the same labor time. We did not determine whether any double-billing for the same labor time occurred, but expect that issue will be examined as part of the contract "true-up" and DCAA audit.

Ogilvy's attorneys also said that, with regard to the billing of overhead and fringe benefits for certain temporary contract workers, Ogilvy did not correctly apply the permissible fringe rate to this group of employees, but that the failure to maintain separate rates was not material and is expected to be resolved in the true-up. The attorneys also said that charging the same overhead for regular and temporary contract employees is proper. This issue is expected to be resolved between the government and Ogilvy.

10. Ogilvy's attorneys said that, although there is a genuine cost-accounting issue under the FAR with regard to a 35-hour corporate work week, it should be noted that company employees worked hundreds of hours of uncompensated and unbilled overtime on the ONDCP project. The government will need to resolve whether a 35-hour work week is appropriate under this contract. We also note that Ogilvy's billing methodology contemplated uncompensated overtime and the company's timekeeping system should have captured all hours worked on the contract.

In addition, the attorneys said that some of the cost allocations questioned in the draft report, although rejected by the COTR, were nonetheless verbally approved by HHS. We were unable to determine which cost allocations were verbally approved by HHS. However, in response to questions that we posed to the HHS contracting officer regarding the contract administration, the contracting officer wrote us in November 2000 that a determination had not been made about whether bonuses and perquisites were allowable or allocable costs under the contract and that no payments were made to Ogilvy for these costs.

11. Ogilvy's attorneys also said that some of the costs that were described as "incorrectly billed" are more properly described as "misclassified" because some charges that may not belong in the direct labor bill would nonetheless have an offsetting effect in relation to the overhead rate under the FAR. Accordingly, we revised a statement contained in the draft report attributed to Ogilvy's attorneys to indicate that certain costs were "misclassified" rather than "incorrectly allocated."

12. Ogilvy's attorneys said that the company's submission of its first labor invoice in May 1999 followed numerous consultations with the COTR and was accomplished with the help of an outside consultant on the format. They also said that the bill was withdrawn when the COTR made additional formatting demands as a condition of payment. A June 21, 1999, E-mail that Ogilvy's former government contracts manager sent to the COTR, which is described in the report, appears to corroborate Ogilvy's assertion that the COTR provided direction on how the invoices should be prepared. In that E-mail, the former government contracts manager indicated that the original invoices had been voided and that they were preparing new ones "in accordance with your [the COTR's] payroll and time sheet needs."

13. Ogilvy’s attorneys said that, although not ideal from the perspective of either the government or Ogilvy, the practice of backbilling as complete sets of time sheets for employees were received and entered into the billing system was done with the approval of the COTR. However, it appears that labor charges could not have been properly calculated until an employee’s entire set of time sheets for that billing period were submitted when applying the methodology that was used to prepare labor invoices under this contract—the percentage of time that each employee worked on the ONDCP contract during that billing period. Further, in his April 2000 memorandum to the then ONDCP Director, the COTR expressed concern about Ogilvy’s delays in billing. In the memorandum, the COTR said that, as of April 2000, the company had billed only 58 percent of the estimated value of the first year of the contract.

14. Ogilvy’s attorneys said that, once the public relations contract for the anti-drug media campaign was awarded to another company, Ogilvy New York did not have the benefit of Ogilvy’s Washington, D.C., public relations firm’s government cost accounting expertise, as anticipated when submitting the best and final offer. However, once this was realized by Ogilvy, it should have obtained any needed expertise from other sources, which it apparently did not do until 16 months after the contract began. We did not examine the relationship, if any, between the accounting systems of Ogilvy’s Washington, D.C., public relations and its New York City advertising offices.

15. Ogilvy’s attorneys said that, while the contracting officer approved the COTR’s disallowances, as noted, pending the provision of additional documentation, numerous decisions by the COTR to withhold payment were overruled by the contracting officer. However, HHS contracting officials told us that they generally followed the COTR’s disallowance recommendations. We were unable to determine how frequently the contracting officer followed the COTR’s disallowance recommendations regarding labor costs because the payment records combined both media and labor costs.

The attorneys also said that it is Ogilvy’s position that the withholding of payments for labor costs claimed was done largely for erroneous reasons. The appropriateness of the disallowed costs is expected to be examined and resolved in an audit of the contract.

16. Ogilvy’s attorneys said that they disagreed with our conclusion in the draft report that the company “did not begin making serious efforts to

restructure its accounting system to meet government requirements until nearly 2 years after the contract was awarded.” They also said that, while the efforts may not have produced the desired system within the time frame referenced, the seriousness of the effort in the intervening time cannot be seriously questioned. The attorneys noted that in 1999 the company hired a government contracts specialist, an accounting consultant, and a government contracts lawyer, none of whom are currently in those positions, and that it promulgated timesheet policies and attempted to have a dialogue with the COTR on contract requirements. The attorneys added that, although none of these efforts prevented the billing problems that they reported to the government, the efforts were nonetheless good faith efforts to create an accounting system acceptable to the government by a novice government contractor.

We recognize, as indicated in the report, that Ogilvy retained American Express Tax and Business Services in April 2000, which was 16 months after the contract award, to review billing and accounting system issues related to the ONDCP contract. However, although American Express reported in June 2000 that it had found several problems regarding the company’s accounting and timekeeping systems, our review indicated that significant progress toward restructuring Ogilvy’s accounting system to meet government contracting requirements did not occur until after the company retained PricewaterhouseCoopers in November 2000, which was nearly 2 years after the contract award. We also believe that Ogilvy should have had an accounting system in place to meet government contracting requirements at the beginning of the contract. Therefore, we revised our statement to indicate that “Ogilvy did not make significant progress toward restructuring its accounting system to meet government requirements until nearly 2 years after the contract was awarded.” The report indicated that Ogilvy had issued new time sheet guidance in January 2001. As noted in comment 2, we did not verify whether regular meetings have recently been scheduled and taken place between the COTR and Ogilvy.

17. Ogilvy’s attorneys said that, although there was a clear failure of recollection by the employee who added 485 hours to her time sheets regarding which manager instructed her to add that time, there is “strong, if not conclusive, extrinsic evidence that the manager who gave the instruction was the Ogilvy contract coordinator” (who is referred to in the report as the “former government contracts manager”). The attorneys said that the former government contracts manager “admits as much and the account manager [who is referred to

in the report as the “project director”] denied doing so.” In addition, the attorneys said that “the contemporaneous handwritten instructions to move the time are in his and not the account manager’s handwriting.” However, we could not substantiate these statements made by Ogilvy’s attorneys because we were unable to ask the former government contracts manager whether he instructed this employee to add the 485 hours or whether the handwritten instructions to add the time to the ONDCP contract on this employee’s time sheets were his. As indicated in the report, the former government contracts manager, through his attorney, declined to discuss this matter with us. The report also indicated that the project director denied that she had instructed this employee to add the 485 hours to the ONDCP contract.

18. Ogilvy’s attorneys said that the discussion of the audit activity regarding white-outs and extraneous markings on time sheets should include two contextual observations. First, the attorneys said, as appendix II makes clear, most of the markings were explained as innocent self-correction with some of the unidentified changes being corrections of obvious math errors. In addition, the attorneys said that such extraneous markings, though viewed as auditing red-flags, “are not all uncommon in government and private time sheet reviews.” However, the fact that 4 of 12 employees in our sample, or one-third, said that they did not make the changes shown on their time sheets adding time charged to the ONDCP contract, raises serious questions about the reasons why the changes were made and who made them, as well as about the accuracy of the time billed to the government. (We note that one of the four employees and her supervisor provided a possible explanation for the change that was made to the employee’s time sheet, as described in appendix III.) We had no data that would confirm whether these types of “extraneous markings...are not all uncommon in government and private time sheet reviews,” as indicated by Ogilvy’s attorneys. We also note that Ogilvy’s recently revised timekeeping policy requires employees and their immediate supervisors to initial all changes made to their time sheets, which was not done for the changes made to the time sheets in our sample. Further, we note that guidance contained in DCAA’s audit manual (Section 5-909.1) requires that corrections to timekeeping records be “made in ink, initialed by the employee, properly authorized, and provide a sufficient and relevant explanation for the correction.”
19. Finally, Ogilvy’s attorneys said they believed that the report should reflect some of the positive comments we made during the informal review process regarding the company’s “admirable openness during

the audit process.” The attorneys noted that the company helped broaden the focus of our work beyond our initial extraneous marking analysis of the time sheets, and that the accounting issues have been the subject of a review by PricewaterhouseCoopers on a time sheet by time sheet basis and shared with the various government agencies involved. The attorneys also said that, although Ogilvy does not intend to excuse the billing errors that were made, they should be understood in the context of the manner in which the contract was administered, and ultimately assessed in light of the value of the service delivered. Further, the attorneys said that although they recognized that we did not review the efficacy of the campaign, by all independent and reported measures, the anti-drug media campaign was a success.

As noted in the report, we recognize that Ogilvy, with the assistance of PricewaterhouseCoopers, has made significant recent efforts to restructure the company’s accounting system to meet government contracting requirements and that the company voluntarily provided us data on the 28 employees who prepared new time sheets, revising the amount of time that they charged to the ONDCP contract. However, as stated in the report, we cannot comment on the efficacy of the anti-drug media campaign.

Appendix VI: Comments From the Program Support Center



DEPARTMENT OF HEALTH & HUMAN SERVICES

Program Support Center

Rockville MD 20857

MAY 24 2001

Mr. Bernard L. Ungar
Director, Physical Infrastructure Issues
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Ungar:

The Program Support Center (PSC) thanks the General Accounting Office (GAO) for the opportunity to review and comment on GAO's draft report, "Anti-Drug Media Campaign: Aspects of Advertising Contract Mismanaged by the Government; Contractor Improperly Charged Some Costs."

GAO Recommendation

To improve HHS' compliance with contracting procedures and prevent the awarding of CAS-covered cost-reimbursement contracts to companies without adequate accounting systems to support that type of contract, the Director of the HHS Program Support Center (PSC) should 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.

PSC Comment

While we believe that adequate contracting procedures are in place to ensure that awards of CAS-covered cost-reimbursement contracts are made to companies with adequate accounting systems, we concur that the PSC controls over contracting procedures, particularly with respect to assessing an offeror's accounting system, should be reexamined. PSC has initiated such a review and will strengthen procedures wherever possible.

The PSC appreciates the opportunity to comment on this draft report before its publication.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Curtis L. Coy".

Curtis L. Coy
Director

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