



United States Government Accountability Office
Washington, DC 20548

April 29, 2005

The Honorable John Warner
Chairman
The Honorable Carl Levin
Ranking Minority Member
Committee on Armed Services
United States Senate

The Honorable Duncan Hunter
Chairman
The Honorable Ike Skelton
Ranking Minority Member
Committee on Armed Services
House of Representatives

Subject: *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues*

Since the Iraq conflict began in March 2003, the Departments of Defense (DOD) and State, the U.S. Agency for International Development, and other federal agencies have issued contracts to perform reconstruction activities in Iraq. The large number of contractors working amid continued violence has raised concerns over the use of contractors to support U.S. military and civilian operations overseas, including the cost of workers' compensation insurance provided to contractor employees in Iraq under the Defense Base Act (DBA).¹ We have received requests from over 100 members of Congress asking us to review a number of Iraq-related issues, including issues associated with DBA insurance.

Because of the level of interest in issues dealing with Iraq, the Comptroller General initiated this review under his statutory authority. The objectives of our review were to identify the cost to the U.S. government of insurance coverage purchased under DBA and to assess the act's implementation. DBA provides disability and medical benefits for contractors' and subcontractors' employees injured on the job and death benefits to survivors when those employees are killed.

We are limited at this time in what we can conclude about the cost of DBA insurance. Recent investigations by several states into a number of insurance companies and brokers during the

¹ 42 U.S.C. 1651-1654.

course of our review raise questions over the reliability of information that we obtained from the insurance industry, a primary source of data in our review.

Additionally, we found that it is difficult to aggregate reliable data on the cost of DBA insurance due in part to the large number of contractors and the multiple levels of subcontractors performing work in Iraq. Lacking reliable aggregate data, we were unable to calculate the total cost of DBA insurance to the government or the impact of DBA insurance costs on reconstruction activities in Iraq.

This report explains DBA requirements; discusses DBA insurance rates, which are higher for DOD than for other agencies; identifies challenges and concerns that federal agencies face when implementing DBA; and suggests that Congress consider requiring that the Director of the Office of Management and Budget (OMB) determine, in coordination with DOD, the Departments of Labor and State, and the U.S. Agency for International Development, what actions should be taken to address issues that came to light during our review. We provided a draft of this report to OMB; DOD; the Departments of State, Justice, and Labor; and the U.S. Agency for International Development. OMB agreed with our assessment of the challenges agencies face, and DOD took no exception to the factual information in our report, but neither agency agreed with our recommendation. State had no comments. Justice and Labor provided technical comments. Labor and the U.S. Agency for International Development expressed willingness to work with other agencies to identify needs, options, and risks associated with DBA insurance.

DBA Overview

Congress enacted DBA in 1941 to provide workers' compensation protection to employees of government contractors working at U.S. defense bases overseas. If employees incur injuries during the course of employment, DBA provides them with uniform levels of disability and medical benefits or—in the event of death—provides death benefits to their eligible dependents. Workers' compensation insurance had previously been unavailable or deemed inadequate in some countries where the employees performed work. Subsequent amendments to DBA extended coverage to other classes of employees, such as those working under public work contracts.² The Department of Labor administers DBA. Labor's role is to ensure that workers' compensation benefits are provided for covered employees.

² Under DBA, the term "public work" means "any fixed improvement or any project, whether or not fixed, involving construction, alteration, removal, or repair for the public use of the United States or its allies, including but not limited to projects or operations under service contracts and projects in connection with the national defense or with war activities, dredging, harbor improvements, dams, roadways, and housing, as well as preparatory and ancillary work in connection therewith at the site or on the project."

Under DBA, contractors working in Iraq, including all levels of subcontractors, are required to obtain DBA insurance for all employees, including foreign nationals.³ The cost of DBA insurance premiums is passed on to the government. Under the War Hazards Compensation Act,⁴ the government also reimburses insurance carriers for DBA benefits paid if the injury or death is caused by a “war-risk hazard,”⁵ provided that the insurance carrier did not charge its customer a war-risk hazard premium. In addition to disability and death payments, war-risk hazard benefits include funeral and burial expenses, medical expenses, and reasonable costs necessary to process the claims.

Increasing Use of Contractors and Continued Concerns over Cost Pose Challenges for Agencies Implementing DBA

When Congress passed DBA, the military’s reliance on contractors for direct support was not as great as it is today. Contractors have been involved in every major U.S. military operation since the Persian Gulf War in 1991,⁶ and military officials believe there has been a significant increase since then in the use of contractors to support a downsized military using more sophisticated weapons. While agencies have made some changes in implementing DBA over the years, large numbers of contractors in Iraq and conditions in that country have renewed concerns over the cost and administration of DBA.

Large Numbers of Contractors in Iraq Have Led to Concerns over the Cost of DBA Insurance

The number of employees required to be covered under DBA while working in Iraq is significant. Work performed under U.S. contracts and subcontracts in Iraq includes rebuilding clinics, schools, and other institutions; restoring oil infrastructure; restoring electricity, water, and other essential services; providing security; and strengthening local governance institutions. We could not locate any reliable U.S. government agency estimate of the total number of U.S. or foreign nationals employed under U.S. government contracts in

³ DBA covers the following types of contractor employment: work for U.S. government contractors on U.S. military bases or on any land used by the U.S. for military purposes outside the United States, work on public work contracts with any U.S. government agency, work on contracts approved and funded by the United States under the Foreign Assistance Act, and work for American employers providing welfare or similar services outside the United States for the benefit of the armed services.

⁴ 42 U.S.C. 1701-1717.

⁵ “War-risk hazard” means any hazard from certain specified causes that arise “during a war in which the United States is engaged; during an armed conflict in which the United States is engaged, whether or not war has been declared; or during a war or armed conflict between military forces of any origin, occurring within any country in which a person covered by the Act;” See 42 U.S.C. 1711.

⁶ GAO, *Military Operations: Contractors Provide Vital Services to Deployed Forces but Are Not Adequately Addressed in DOD Plans*, GAO-03-695 (Washington, D.C.: June 24, 2003).

Iraq. Additionally, while State reported that as of March 16, 2005, over 150,000 Iraqis were performing work in Iraq on U.S. government-administered projects, we could not validate these numbers, and agency officials told us there is no consistent or coordinated method for tracking employment figures.

We reported on concerns over the cost and implementation of DBA and related insurance in 1971 and 1980.⁷ Since that time, the Department of State and the U.S. Agency for International Development have instituted single-insurer programs that require all contractors performing work overseas for these agencies to purchase DBA insurance from a specified insurance carrier at a set rate negotiated by the agencies. During the course of our review, contractors working for the Department of State and the U.S. Agency for International Development paid approximately \$2 to \$5 for every \$100 of salary cost for DBA insurance in all locations.

In contrast, DOD contractors must independently acquire their own insurance. The eight DOD prime contractors we contacted reported that they were paying DBA insurance rates between approximately \$10 and \$21 per \$100 of salary cost for work in Iraq during the period of our review. While the government has limited visibility into how DBA insurance rates are set, agency officials at the Department of State and U.S. Agency for International Development told us the lower rates under their single-insurer programs are due to such factors as the pooling of work done in Iraq with work done in other places in the world, the less risky nature of the work they perform, and a low number of claims.

DOD completed a congressionally directed study in 1996 on the feasibility and desirability of initiating a single-insurer program. While DOD concluded at that time that such a program would not lead to cost savings, the DBA insurance rates defense contractors are now paying have led to concerns among DOD officials over the cost of DBA insurance. To address these concerns, DOD, through the U.S. Army Corps of Engineers, issued a solicitation on March 7, 2005, for a 1-year pilot contract to a single insurer for DBA insurance for all Army Corps of Engineers contractors performing work overseas. The solicitation originally required offers be submitted by April 7, 2005. The deadline was extended indefinitely to allow DOD to prepare responses to questions received from prospective offerors.

Agencies Face Challenges Implementing DBA in Iraq

According to agency officials, conditions in Iraq, such as mixed-funding sources for contracts and language barriers, have led to complications in implementing DBA. Implementation challenges include clarifying when DBA applies, providing adequate and accurate

⁷ GAO, *Opportunity for Savings in Providing War Risk Insurance for Contractor Property and Employees*, B-72699 (Washington, D.C.: November 1971) and GAO, *AID Needs Clarification on Defense Base Act Insurance Requirements*, B-162408 (Washington, D.C.: October 1980).

information to companies and workers, monitoring compliance, and processing claims. Despite actions taken by agencies, many challenges remain unresolved.

Department of Labor officials have reported, and GAO has observed, confusion among federal agencies and contractors over DBA.⁸ One source of confusion relates to when DBA is required. Some agency officials initially believed they could apply existing waivers granted by Labor for DBA insurance in Iraq, but Labor officials clarified that waivers do not apply in that country because of the absence of a local workers' compensation system. Subsequently, in December 2004, the Department of State issued a proposed change to its acquisition regulation to clarify when DBA insurance coverage is and is not required. However, new questions about when DBA applies have arisen. For example, while Labor has taken the position that DBA requirements do not cover work performed under grants, officials from other agencies recently expressed confusion over what benefits would be provided if grantees purchase DBA insurance. In addition, it is unclear to many agency officials whether DBA applies in cases where non-U.S. appropriated funds are mixed with U.S. appropriations.

In addition to questions over DBA, a number of other implementation challenges have surfaced. Labor and State officials told us that language and literacy barriers present a challenge when providing DBA information to companies and workers in Iraq. Labor officials told us that enhancing enforcement of DBA would require reports of coverage to be sent to Labor on every contract and subcontract in Iraq. Labor officials also informed us that the department is limited in the actions it can directly take for noncomplying contractors. Adding to the implementation challenges, Labor officials told us that the processing of claims has been slowed by difficulty in obtaining medical and other personal information because of conditions in Iraq and the need to respect local customs. Additionally, at a recent Department of Labor seminar, attorneys involved in DBA issues reported difficulty in obtaining necessary documentation, including contracts and marriage records, to file and report claims.

Conclusion

It is difficult to determine whether all DBA insurance is purchased in a cost-effective manner or if agencies' implementation challenges hinder their effectiveness in providing workers' compensation coverage under DBA. Lack of reliable information on numbers of contractors and cost of DBA insurance restricts the ability of agencies to make informed decisions on purchasing strategies for DBA. Additionally, confusion over when DBA applies and difficulty in enforcing DBA and processing claims remain largely unresolved problems, despite actions taken by agencies. Finally, new challenges, such as growing numbers of contractors, have arisen since 1941, when DBA was passed. These factors highlight the need for a coordinated effort among affected agencies to identify actions that can address such challenges.

⁸ We previously reported on the confusion over when DBA is applicable in 1980 (GAO, B-162408).

Matter for Congressional Consideration

To ensure that DBA cost and implementation issues are adequately addressed, we suggest that Congress consider requiring the Director of OMB to determine, in coordination with DOD, the Departments of Labor and State, and the U.S. Agency for International Development, current and future needs, options, and risks associated with DBA insurance. The agencies involved in this coordinated effort should identify actions, including any necessary legislative changes, to address the following issues:

- identifying cost-effective options for acquiring DBA insurance;
- developing methods for coordinating data collection efforts among agencies and contractors on the cost of insurance and other relevant information to make informed decisions;
- facilitating consistent, collective, and collaborative application of DBA across agencies by
 - developing and disseminating guidance on when and to whom DBA applies,
 - improving communication within and among agencies about the implementation of DBA and associated difficulties through such means as an informal network, interagency working groups, conferences, forums, or Web sites;
- identifying actions to address difficulties with administering DBA, such as
 - identifying potential means to address enforcement challenges,
 - collecting data from contractor employees to facilitate claims processing,
 - collecting and reporting to Labor information on contractors performing overseas and whether they have DBA insurance.

Agency Comments and Our Evaluation

DOD and OMB provided written comments on a draft of this report. Both disagreed with our recommendation, which is now included in the report with minor clarifications as a matter for congressional consideration. OMB agreed with our assessment of the challenges agencies face but points to actions already taken by the administration. OMB states that our recommendation is overly broad and said a targeted approach would be preferable in light of the need to give immediate attention to specific issues in Iraq. DOD took no exception to the factual information contained in our report but said that ongoing actions address the issues in our report. DOD also contends that the cost of undertaking an interagency effort will outweigh potential benefits.

We agree that agencies are taking actions to address some of the challenges discussed in our report. However, it was clear during our review that increased coordination among all affected agencies will be needed to identify actions to address DBA cost and implementation challenges. For example, we found that the conditions in Iraq make it difficult to enforce DBA and process claims. We also found that an informal interagency working group addressing insurance issues was not focused on issues related to DBA. And the working group did not include Labor officials, who play a key role in claims processing and

administration of DBA insurance. Furthermore, at a Labor seminar on DBA held in April 2005, we observed confusion among attendees over when DBA applies.

Our review also revealed the agencies lacked reliable data on how many contractors and subcontractors are in Iraq, costs to the government of DBA coverage for contractors, and whether all contractors operating in Iraq provided their employees required DBA insurance coverage. Without such information, the agencies are not in a position to make informed decisions about implementing DBA. DOD stated that it believes costs of interagency efforts will outweigh potential benefits. DOD officials told us, however, they do not have cost estimates or other data to support their statement, but that they believe challenges with implementing DBA in Iraq are being addressed and data collection and reporting efforts would be expensive and would divert limited resources. We do not believe our recommendation is overly broad; rather it provides flexibility to agencies to deal with the full range of issues we identified and allow them to proactively address the government's growing use of contractors in overseas situations now and in the future. We continue to believe a more coordinated and comprehensive approach, involving all of the affected agencies, is necessary to address DBA cost and implementation issues. OMB's and DOD's comments are included in enclosures I and II, respectively.

Labor indicated its willingness to work with other agencies and provided technical comments that are incorporated as appropriate (see enclosure III). Justice also provided technical comments, which were incorporated as appropriate. State had no comments. The U.S. Agency for International Development indicated, via e-mail, that it looked forward to working with OMB and the other agencies on the recommendation.

Scope and Methodology

To address our objectives, we obtained rates spent on DBA insurance for 21 contracts held by 13 prime contractors performing work in Iraq under cost-reimbursable contracts. These contracts represent 69 percent of U.S.-appropriated contracting dollars awarded for ongoing work as of May 2004. We selected companies of different sizes performing a range of services for DOD, the Department of State and the U.S. Agency for International Development. We did not obtain DBA rates from subcontractors in our review. We conducted interviews with officials from the selected contractors and DOD, the Departments of State, Labor, and Justice, and the U.S. Agency for International Development, as well as representatives from 11 insurance companies and brokers. We were unable to verify numbers provided by the Department of State for the total numbers of Iraqi employees working on U.S. government-administered reconstruction projects. Additionally, in light of recent investigations into the insurance industry, we did not rely on information obtained previously from insurance industry representatives. We performed our review between May 2004 and April 2005 in accordance with generally accepted government auditing standards.

If you have any questions, please contact me at (617) 788-0555 or at cooperd@gao.gov or John K. Needham, Assistant Director, at (202) 512-5274 or needhamjk1@gao.gov. Other major contributors to this report include Lily Chin, Christina Cromley, Jeff Hartnett, Bill McPhail, Lisa Simon, and Shannon G. Simpson.

Sincerely,

A handwritten signature in black ink that reads "David E. Cooper". The signature is written in a cursive style with a large, prominent initial "D".

David E. Cooper
Director
Acquisition and Sourcing Management

Enclosure I: Comments from the Office of Management and Budget



EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

APR 06 2005

Mr. David E. Cooper
Director
Acquisition and Sourcing Management
United States Government Accountability Office
Washington, DC 20548

Dear Mr. Cooper:

Thank you for this opportunity to comment on the GAO draft correspondence entitled "Defense Base Act Insurance: Review Needed of Cost and Implementation Issues."

We appreciate GAO's careful review of Defense Base Act (DBA) implementation and the many challenges faced by both contractors and agencies as they seek to meet their responsibilities under the law.

As noted in your letter, the recent increase in the use of contractors to support U.S. military and civilian operations overseas, particularly in Iraq, has presented numerous challenges with respect to DBA administration. The Administration has taken a number of steps to address these challenges. These include an interagency workgroup, comprised of staff from the Departments of State and Defense, the Office of Management and Budget, and the U.S. Agency for International Development, which has met to examine issues surrounding the cost and availability of DBA insurance coverage. In early April the Department of Labor (DOL) held its fourth seminar on DBA for contractors, agency contracting personnel, and other interested parties to provide information on coverage and requirements. Responding to confusion about DBA waiver authority, the State Department last December published a proposed rule intended to clarify when DOL waivers apply and when State may waive DBA requirements for contractors performing work on an intermittent basis. Lastly, as your correspondence notes, the Army Corps of Engineers has begun work on a pilot single-insurer program for DBA, which if effective may be expanded Department of Defense-wide.

While we agree with the assessment that challenges remain, we do not concur with GAO's recommendation that the Office of Management and Budget "determine . . . current and future needs, options, and risks associated with DBA insurance." In our view, this recommendation is overly broad. We believe a targeted approach to DBA issues would be preferable in light of the need to give immediate attention to our specific needs in Iraq. The Administration will continue the efforts it has begun, and work to solve specific issues as they arise.

**Thank you for your efforts to improve the implementation of the DBA and the
opportunity to comment.**

Sincerely,

A handwritten signature in black ink, reading "Dean F. Clancy". The signature is fluid and cursive, with the first name "Dean" being particularly prominent.

**Dean F. Clancy
Associate Director
Human Resource Programs**

Enclosure II: Comments from the Department of Defense



ACQUISITION
TECHNOLOGY
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

MAR 15 2005

Mr. David E. Cooper
Director, Acquisition and Sourcing Management
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Cooper:

This is the Department of Defense (DoD) response to the GAO draft report, "Defense Base Act Insurance: Review Needed of Cost and Implementation Issues," dated February 28, 2005 (GAO Code 120377/GAO-05-280R). While we take no exception to the factual information contained therein, it is not necessary "that the Director of the Office of Management and Budget determine, in coordination with the Departments of Defense, Labor, and State and the U.S. Agency for International Development, current and future needs, options, and risks associated with DBA insurance." In fact, the costs of undertaking such a substantial interagency effort to address the issues listed with this recommendation will outweigh any potential benefits.

For example, the various new DBA data collection and reporting efforts suggested for federal agencies and contractors would be expensive and would divert already limited resources, without any clear benefit for the procurement process. Similarly, the recent communications initiatives of the Department of Labor (DOL) in this area should be given sufficient time to achieve their anticipated results before chartering any additional interagency DBA working groups, conferences, forums, and/or web sites.

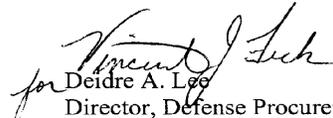
In addition, a number of the issues identified in the recommendation for an OMB sponsored review are already being addressed by the appropriate government entities. Clearly, the longstanding DBA insurance programs at the U.S. Agency for International Development and the Department of State have been effective in helping control the cost of this mandatory insurance. Also, as explained in the report, the U.S. Army Corps of Engineers has an ongoing initiative to examine whether such a DBA insurance program might also be advantageous for DoD at this time. Moreover, in the last year and a half, DOL, which has the statutory responsibility for administering the DBA, has been very active in sponsoring a series of highly informative seminars and roundtable meetings on



this subject. This DOL initiative has greatly increased awareness of DBA requirements within both the government procurement and contractor communities.

I appreciate the opportunity to comment on this draft report.

Sincerely,


for Deidre A. Lee
Director, Defense Procurement
and Acquisition Policy

Enclosure III: Comments from the Department of Labor

U.S. Department of Labor

Assistant Secretary for
Employment Standards
Washington, D.C. 20210



March 21, 2005

Mr. David E. Cooper
Director, Acquisition and
Sourcing Management
United States Government Accountability Office
Washington, D.C. 20548

Dear Mr. Cooper:

This responds to your request for comments from the U.S. Department of Labor on the draft report, *Defense Base Act Insurance: Review Needed of Cost and Implementation Issues*.

We have reviewed the Defense Base Act (DBA) report and our comments are as follows:

1. The draft report states that "... DBA is administered by the Department of Labor..." (page 1). This is only partially true, as our administration and oversight is limited to the claims side of the system, monitoring timely and accurate benefit payments, and resolving disputes related to those matters. The department has no authority over the business side of the system, including insurance availability, pricing, or purchasing arrangements.

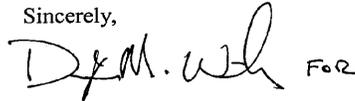
2. The draft report states that "Labor officials also informed us that they would need enforcement teams in Iraq to monitor compliance..." (page 5). This statement misconstrues the department's view. Although a comment to this effect may have been made as part of the general discussion regarding insurance enforcement, it was made to illustrate the impossibility of assuring that all contracted employees have insurance coverage without having someone in Iraq to actually demand to see proof of coverage for every level of subcontracted work, an impossible task. In fact, it is the department's perspective that enforcement of DBA coverage needs to take place before workers are sent overseas, with reports of coverage sent to the department on every contract and subcontract let. This is the only way in which accurate and useful records of insurance coverage can be maintained.

2

3. The Department of Labor is willing to work with any other agencies on matters of DBA coverage.

The Department appreciates the opportunity to provide comments on this report.

Sincerely,

A handwritten signature in black ink, appearing to read "Victoria A. Lipnic" with a stylized flourish at the end.

Victoria A. Lipnic

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