

memorandum

DATE: August 21, 2006 Audit Report No.: OAS-L-06-18
REPLY TO
ATTN OF: IG-32 (A06YT024)
SUBJECT: Audit of "Performance Based Incentives for BWXT Y-12, LLC"
TO: Director, Policy and Internal Control Management, NA-66

INTRODUCTION AND OBJECTIVE

The Department of Energy began to incorporate performance based incentive fees into its major management contracts after the 1994 Contract Reform report recommended the use of performance based contracting. Performance-based management contracts use appropriate incentives to reward superior performance and discourage substandard performance.

Accordingly, the Department of Energy's National Nuclear Security Administration's Y-12 National Security Complex (Y-12) is managed and operated under a performance-based contract. The contract, which is effective through September 2010, was awarded in August 2000.

We conducted this audit to determine if BWXT is meeting performance objectives established at the start of the performance period.

CONCLUSIONS AND OBSERVATIONS

During our audit, we noted minor weaknesses in the National Nuclear Security Administration's (NNSA's) preparation and approval of BWXT's performance based incentives (PBIs). Specifically, of the 34 PBIs that we judgmentally selected and reviewed, we identified two instances where BWXT received full fee for technically accomplishing PBI requirements although the purpose of the incentive was not met. We also identified one PBI which did not reward superior performance.

For example, NNSA incentivized the turnover of Purification Facility Project systems from the construction contractor to BWXT. The purification project will reestablish production capability for one of the materials used in nuclear weapons. Although management's purpose for incentivizing systems turnover was to assure that BWXT completed the project as scheduled, certain project activities were completed behind schedule. For instance, BWXT completed systems testing and readiness activities more than five months later than planned. Since the system testing and readiness activities were not included in the PBI grading criteria, NNSA paid BWXT the full \$400,000 incentive fee although management's purpose for the PBI was not met.

In another example, a PBI for Enriched Uranium Operations (EUO) incentivized the production of one metal button of acceptable quality to demonstrate the restart of EUO production capabilities. EUO operations recover and purify uranium for use in nuclear weapons. While BWXT produced a metal button, it did so from existing inventory rather than from material generated by restarted EUO processes. This fact was noted by local NNSA management who initially denied payment of the PBI. According to management, this decision was later reversed due to legal counsel's determination that the PBI grading criteria was not specific enough to withhold payment. Thus, although EUO production capabilities were not fully operational, NNSA paid BWXT the full \$50,000 incentive fee.

NNSA management agreed that PBIs had not always been properly written and the PBI for the production of a metal button exemplified this. Officials stated that resource constraints, particularly time and personnel, did not always allow for careful PBI development and made the PBI process difficult. Management also stated that while it and BWXT may agree on a PBI deliverable, in some cases, it was not specifically documented. Therefore, if BWXT completes the work as written in the PBI, NNSA is required to pay the full fee even if the purpose of the incentive was not met.

In addition, we found at least one instance where BWXT was rewarded for completing backlogged maintenance work. Specifically, NNSA paid BWXT over \$132,000 to address backlogged corrective maintenance job requests. We noted that the majority of these requests (89 percent) were written after BWXT was awarded the contract, therefore, BWXT was paid to reduce its own backlog. In our opinion, incentivizing a contractor to eliminate maintenance backlogs rewards less than superior performance and is contrary to Departmental guidance, which requires PBIs to be challenging and to motivate contractors to meet and exceed higher levels of performance.

SUGGESTED ACTION

We suggest that NNSA ensure that PBIs are clearly written to achieve their purposes. Specifically, NNSA should (1) ensure that the intent of the incentive is agreed upon and expressly stated in the PBI grading criteria; (2) include all of the appropriate Federal and contractor personnel (legal, program, administrative) in meetings where PBIs are developed; and (3) ensure that PBIs pertain to activities that challenge the contractor.

SCOPE AND METHODOLOGY

The audit was performed between January 2006 and April 2006, at the Y-12 National Security Complex in Oak Ridge, Tennessee.

To accomplish the audit objective, we reviewed PBI documentation for Fiscal Years 2003 through 2005, except for security-related and classified PBIs. We also reviewed Department policies regarding PBIs and interviewed key personnel.

The audit was conducted in accordance with generally accepted Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. During the audit, we assessed

the Department's compliance with the Government Performance and Results Act of 1993. We found that NNSA had established specific performance incentives. As noted above, however, we determined that these incentives did not always reward superior performance or discourage substandard performance. We did not rely extensively on computer processed data to support our analyses.

We verbally discussed the contents of this letter with the Director, Policy and Internal Control Management on August 3, 2006, and he waived an exit conference. Since no formal recommendations are being made in this Letter Report, a formal response is not required. We appreciated the cooperation of your staff throughout the audit.


George W. Collard, Acting Director
National Nuclear Security Administration
Audits Division
Office of Inspector General

cc: Team Leader, Audit Liaison Team, CF-1.2
Audit Liaison, Y-12 Site Office