



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

Inspection Report

Approval of Contractor Executive
Salaries by Department of Energy
Personnel

DOE/IG-0882

March 2013




Department of Energy
Washington, DC 20585

March 22, 2013

MEMORANDUM FOR THE SECRETARY

FROM:


Gregory H. Friedman
Inspector General

SUBJECT:

INFORMATION: Inspection Report on "Approval of Contractor Executive Salaries by Department of Energy Personnel"

INTRODUCTION AND OBJECTIVE

In April 2011, the Department of Energy awarded a nearly \$2.2 billion contract to URS|CH2M Oak Ridge, LLC, (UCOR) for the environmental cleanup at the East Tennessee Technology Park, Oak Ridge, Tennessee. As a support provider for the Office of Environmental Management (EM), the Oak Ridge Office (ORO) is responsible for oversight of the UCOR contract, including analyzing and performing market analyses to assess the reasonableness of the proposed contractor executive salaries.

The Department is the largest civilian contracting agency within the Federal government consisting of a contractor workforce of about 100,000, with some receiving executive salary. In August 2007, the Office of Inspector General issued five reports on executive salaries and fringe benefits for contractors working for the Office of Science, the National Nuclear Security Administration and EM. These reports concluded that there were questioned and unallowable salary and fringe benefit costs of about \$386,000 at two Department national laboratories. Management took corrective actions in response to our reports.

The Office of Inspector General received a complaint alleging that an ORO senior management official approved salaries for UCOR executives that were higher than the ORO Human Resources (ORO HR) calculated market rates without proper authority. We initiated this inspection to examine the facts and circumstances surrounding the allegation.

RESULTS OF INSPECTION

Our inspection confirmed the essence of the complaint. The review revealed that a former ORO senior management official deviated from requirements established in the awarded contract by approving UCOR contractor executive salaries that were higher than the market rates calculated by ORO HR officials. Specifically, we found that:

- Without proper authority, a former ORO senior management official approved 10 contractor executive salaries that exceeded market salary rates calculated by the ORO HR office. In the two most extreme cases, one executive's annual base salary determination

was 82 percent higher than the ORO HR calculated market rate, from \$164,889 to \$299,800; and the other was 74 percent higher than the ORO HR calculated market rate, from \$194,400 to \$337,581.

- During the course of our inspection, and after we questioned the initial salary approvals, ORO rescinded these approvals. Subsequently, a senior ORO procurement official approved salary increases for all 10 contractor executives at the same level UCOR requested in its original contract proposal, without regard to established ORO HR calculated market rates. The annual salary difference ranged from \$5,741 to \$143,181 per executive over the ORO HR recommended market rates for the Oak Ridge area.

Our inspection identified uncertainty and a number of significant missteps related to the process for reviewing and approving proposed contractor executive salaries when new contracts were awarded. For example, ORO and Headquarters officials mistakenly assumed that the executive salary amounts submitted by UCOR were found to be reasonable by the Source Evaluation Board (SEB) officials during the contract pre-award phase. After we questioned the process, a procurement official at ORO even went so far as to prepare a document certifying that an executive salary reasonableness determination had been made during the SEB process. We determined, however, that despite ORO's assurances and a signed certification, the SEB responsible for reviewing UCOR's proposal had not actually performed such a review. Instead, SEB officials told us that they expected that UCOR executive salaries would be set based on the ORO HR market analysis.

We discussed the salary setting procedures with Headquarters program officials, who told us they were under the impression that a new process for setting contractor executive salaries had been adopted by ORO procurement officials. As such, they did not believe that the Department Acquisition Letter 2007-02, *Contractor Executive Compensation*, applied. Acquisition Letter 2007-02 provides guidance on the compensation of contractor senior executives under all contracts and references the sections of the Federal Acquisition Regulation needed to determine reasonableness. We ultimately determined that the market analysis, referenced in the Federal Acquisition Regulation and Department Order 350.1, *Contractor Human Resource Management Programs*, had actually been performed by ORO HR staff; however, both ORO management and procurement officials elected not to use the calculated market salary rates completed by ORO HR when establishing UCOR executive salaries. The former ORO senior management official who ultimately approved the salary increases explained that ORO approved them because it believed that it had the authority to do so. The former official acknowledged that in doing so, ORO had inadvertently circumvented the Department's prescribed approval process. Therefore, approving officials did not specifically evaluate the proposed executive salaries nor could they provide information indicating that the salary increases were reasonable.

During a subsequent discussion of an initial draft of this report, ORO and EM officials told us that they used the SEB pre-award process to determine reasonableness of executive salaries. As such, ORO and EM officials asserted that they had not circumvented the Department's prescribed approval process. The officials also indicated that the SEB obtained audit services from an independent consulting firm to assess the reasonableness of the salaries. However, we were told by the consulting firm that an assessment of the reasonableness of a contractor's salary was

outside of its scope of work. The consulting firm officials indicated that their assessment focused on determining whether the proposed total compensation of UCOR key personnel exceeded the per executive total compensation benchmark (\$693,951 at the time of the assessment) established by the Office of Federal Procurement Policy. We discussed the results with ORO senior management officials and they acknowledged the fact that the consulting firm did not perform a reasonableness assessment of contractor executive salaries.

In light of current budgetary pressures, we concluded that the Department needs to implement and execute measures to ensure that contractor executive salaries are: (i) reasonable; (ii) consistent with local market compensation rates; and (iii) developed using established Departmental procedures. Anything less could adversely impact ORO missions by diverting funds from other pressing mission needs. In this particular case, the Department could incur approximately \$3.45 million over the market rate salaries for 10 UCOR contractor executive salaries over the life of the 5-year contract.

To help clarify contractor salary setting requirements and prevent recurrence of the events described in our report, we made several recommendations.

MANAGEMENT REACTION

Management generally concurred with the recommendations in the report. Specifically, the Director, Office of Acquisition and Project Management agreed to take action to update Department policy. ORO and EM management committed to provide guidance and develop policies and procedures consistent with the updated policy. ORO, in conjunction with EM, will render a reasonableness determination regarding the UCOR contractor executive salaries. As appropriate, we modified our report to address other technical comments from management.

The comments provided by the Office of Acquisition and Project Management, Office of Environmental Management, and ORO are included in Appendix 3.

Attachment

cc: Deputy Secretary
Deputy Assistant Secretary, Acquisition and Project Management for
Office of Environmental Management
Chief of Staff
Director, Office of Acquisition and Project Management
Manager, Oak Ridge Office

**REPORT ON APPROVAL OF CONTRACTOR EXECUTIVE SALARIES
BY DEPARTMENT OF ENERGY PERSONNEL**

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APPROVAL OF CONTRACTOR EXECUTIVE SALARIES BY DEPARTMENT OF ENERGY PERSONNEL

CONTRACTOR EXECUTIVE SALARIES

Generally, the Department of Energy (Department) requires that a reasonableness determination be made when setting contractor executive salaries. Such requirements were established in Federal Acquisition Regulation (FAR) 31.205-6, *Compensation for Personal Services*, and FAR 31.201-3, *Determining Reasonableness*, and Department Order 350.1, *Contractor Human Resource Management Programs*. Federal procurement officials charged with oversight of the contract must perform a market analysis and/or make a determination that contractor proposed salaries are reasonable. The Department's Acquisition Letter 2007-02, *Contractor Executive Compensation*, published on April 3, 2007, provides guidance on the compensation of contractor senior executives under all contracts and the salary of the top contractor management official under management and operating contracts and other contracts designated by the Senior Procurement Official. Acquisition Letter 2007-02 references sections of the FAR applicable to making such reasonableness determinations. Acquisition Letter 2007-02 also sets a threshold for executive salaries to the lesser of 10 percent above the candidate's current salary or 6 percent above the prior contractor's executive reimbursed salary. Further, Acquisition Letter 2007-02 mandates that any salaries higher than the thresholds require approval from the Senior Procurement Executive.

We substantiated the allegation that a former Oak Ridge Office (ORO) senior management official approved contractor executive salaries for URS|CH2M Oak Ridge, LLC, (UCOR) without proper authority. The events leading up to the UCOR salary approvals involved Headquarters and ORO officials taking a number of actions that were inconsistent with existing policy and were not well coordinated. These actions resulted in higher UCOR salaries that, if left unmodified, could cost the Department an additional \$3.45 million over the life of the 5-year contract.

Review and Approval of Salaries

Our inspection revealed that responsible Federal officials at Oak Ridge did not use the Department's procedures for setting contractor executive salaries. During the post-award process in June 2011, UCOR submitted proposed salaries for its executives. The UCOR proposal called for salaries ranging from \$229,250 to \$360,000, which exceeded ORO Human Resources (ORO HR)

comparison of salaries paid under the previous contractor to current market rates. As specified by the Department's Request for Proposal, 30 days after contract award, UCOR's Prime Contract Manager submitted a formal request to ORO for approval of the salaries of its top 10 executives.

After submission, and based on the results of a market analysis, ORO HR officials made a reasonableness determination that salary increases should not exceed 6 percent above the prior contractor's executives reimbursed salary. Following the advice provided by ORO HR, an ORO procurement official approved the recommended salaries. While the approved salaries were in line with those recommended by ORO HR, they were significantly lower than those proposed by UCOR. ORO procurement officials told us that UCOR did not agree with the lower salaries and in August 2011, UCOR provided ORO HR additional supporting documentation that it believed justified the higher proposed executive salaries. After analyzing the UCOR submitted data, ORO HR officials took action to increase the salaries for 7 of the 10 UCOR executives. The second round of executive salary approvals were still significantly less than those originally requested by UCOR. We noted that the Acquisition Letter 2007-02 was referenced in each of the approval letters signed by the ORO procurement official and the former ORO senior management official.

In spite of the increases provided in August 2011, UCOR remained unsatisfied with executive compensation levels and requested reconsideration of its originally proposed salary levels. UCOR noted that it believed the requested salary levels were justified because it was able to recruit the high caliber 10 key executives based on salary proposals it had made in its original proposal. Various ORO officials told us that they examined the renewed request by UCOR but did not believe that the increases could be approved by anyone other than the Headquarters Senior Procurement Executive. We were told that even though ORO management officials were aware of the opinions expressed by various members of the professional staff, in November 2011, a former ORO senior management official approved the salaries for the 10 key executives as originally proposed by UCOR. We could not determine whether the former ORO senior management official specifically considered the market analysis or salary recommendations made by ORO HR prior to making the decision

to approve the salary increases. In addition to approving the higher salaries, the former ORO senior management official, without explanation, also indicated in the letter to UCOR that the proposed salaries were retroactive from August 1, 2011.

The following table details the various contractor executive salary setting actions taken by ORO.

Proposed and Approved Contractor Executive Salaries

<u>UCOR Executives</u>	<u>Prior Contractor Executive Salaries</u>	<u>UCOR's Proposed Executive Salaries Ultimately Approved by a Former ORO Senior Official</u>	<u>ORO HR Calculated Market Rates for UCOR Executive Salaries (June 24, 2011)*</u>	<u>Percent Above ORO HR Market Rate UCOR Executive Salaries</u>	<u>Difference between ORO HR Market Rate and UCOR Proposed Executive Salaries</u>
1	\$155,556	\$299,800	\$164,889	82	\$134,911
2	\$183,396	\$337,581	\$194,400	74	\$143,181
3	\$149,292	\$249,000	\$158,250	57	\$ 90,750
4	\$151,596	\$242,000	\$160,692	51	\$ 81,308
5	\$152,424	\$230,000	\$161,570	42	\$ 68,430
6	\$163,884	\$229,250	\$173,717	32	\$ 55,533
7	\$182,556	\$246,210	\$193,509	27	\$ 52,701
8	\$305,004	\$360,000	\$323,300	11	\$ 36,700
9	\$240,000	\$274,200	\$254,400	8	\$ 19,800
10	\$213,924	\$232,500	\$226,759	3	\$ 5,741

*Note: Although we did not validate the market rates calculated for UCOR, these figures were provided to the Office of Inspector General by ORO HR subject matter experts responsible for determining appropriate executive salary compensation. Therefore, for the purposes of this report we relied upon the market analysis provided to and used by the Contracting Officer.

CONTRIBUTING FACTORS

The issues identified in this report were the result of several contributing factors, including inconsistently applied guidance related to the process for setting salaries. The details are discussed below.

Inconsistently Applied Guidance

Our inspection revealed that the former ORO senior management official approved the UCOR executive salaries without ensuring that the action conformed to Department guidance. In particular, the former official did not comply with Acquisition Letter 2007-02 that specifies that Heads of Contracting Activities can approve an increase to salaries only after obtaining approval from the

Headquarters Senior Procurement Executive. Acquisition Letter 2007-02 also requires the Senior Procurement Executive to consult with the cognizant Program Secretarial Officer prior to granting approval for the higher salaries. However, we learned that these steps were not taken prior to approval of UCOR's executive salaries.

On December 7, 2011, we brought this matter to the attention of the former ORO senior management official who approved UCOR's executive salaries. We were told that immediate corrective actions would be initiated to ensure the proper process was executed to provide support for the higher salaries for the 10 UCOR executives. The former ORO senior management official also informed us that although a letter approving the increases had been signed, the process was not final because Form 3220.5, *Application for Contractor Compensation Approval*, was not signed and processed through ORO HR, as required. The same ORO senior management official acknowledged that prior to our meeting, an ORO HR official had explained that because the Heads of Contracting Activities had not been consulted, the ORO senior management official did not have authority to sign the approval letter or the Form 3220.5.

On December 10, 2011, shortly after our meeting with the former ORO official who had taken action to approve the salaries, ORO issued a letter rescinding the UCOR executive salaries, which had been approved on November 10, 2011, until further notice. The letter stated that "UCOR is only authorized to charge to the government the salary amounts approved in the letter dated June 24, 2011. Any amount higher than the salaries approved in June 24th letter are unallowable."

In spite of this action, the higher salaries were billed to the Government and drawn directly against the Department's letter of credit retroactive from August 1, 2011, except for the period between December 10, 2011, and January 23, 2012.

On January 23, 2012, the senior ORO procurement official subsequently approved the full amount of the UCOR requested salaries for all 10 contractor executives. During our discussions with this senior ORO procurement official in January 2012, the official took responsibility for making the reasonableness determination and independently approving the higher salaries.

Although requested, the official did not provide us documentation to demonstrate how the reasonableness of the salaries was determined.

Salary Setting Process

The issues we identified were the result of two contributing factors— confusion regarding what guidance was operative and the failure of field officials to consistently apply existing Department guidance. Senior Headquarters program officials informed us that they assumed that ORO, as well as other sites, was no longer using Acquisition Letter 2007-02, and were using a new process to establish contractor executive salaries. Specifically, officials from the Office of Environmental Management (EM), and ORO senior officials indicated that the process for setting contractor executive salaries was based on a reasonableness determination made during the Source Evaluation Board (SEB) process (the pre-award phase).

After we made inquiries regarding guidance on contractor executive salary determinations, senior Headquarters EM officials, as well as specific ORO senior officials, specifically told us that reasonableness for UCOR executive salaries had been determined during the SEB process. Further, a senior ORO procurement official stated that according to senior Headquarters Office of Acquisition and Project Management (OAPM) and EM officials, Acquisition Letter 2007-02 did not apply. Specifically, and again after the fact and after our inquiry began, Headquarters officials notified the senior ORO procurement official that the SEB process would have already determined reasonableness for the UCOR salaries and that the senior ORO procurement official's signature for approval would suffice.

In February 2012, another ORO procurement official (not previously discussed) prepared and signed a document identifying the contractor executive salaries process used during the pre-award phase. The document included information stating that the ORO procurement official made the reasonableness determination during the SEB process for proposal evaluation. The document also noted that as part of the SEB's Cost Analysis, the "Cost Report evaluated the executive compensation levels of the Key Personnel for each offeror." Furthermore, "As part of the SEB evaluation, a cost analysis was performed of each offer, which included . . . a fair and

reasonable price or to determine cost realism." Despite the affirmation, we discovered that the SEB had not actually performed these steps.

Our inspection revealed that SEB officials had not made a reasonableness determination or performed a market analysis of the UCOR executive salaries. SEB members told us that they had instead deferred to the ORO HR official's assessment that was historically conducted during the post-award review. In fact, the senior SEB official and the financial SEB official explained that the members had not made a reasonableness determination and that they did not review any market data for comparison to the five offers as would have been necessary to reach a determination. These officials also stated that they did not have the training or the expertise to make a professionally-based reasonableness determination concerning UCOR's executive salaries. Further, the financial SEB official stated that there was not a reasonableness determination made during the SEB process because it was a long standing ORO practice that ORO HR makes this determination during the post-award phase of the contract.

We were informed by an EM official that a similar incident occurred last year at the Department's Environmental Management Consolidated Business Center (EMCBC) in Cincinnati, Ohio. EMCBC serves EM in providing contract award, administration and related services for 15 Department sites. The same EM official advised EMCBC that Acquisition Letter 2007-02 was not applicable and that a determination on the reasonableness of salaries had been made as part of the SEB process. As noted by this official, the direction provided to EMCBC and ORO was essentially the same; however, we did not assess EMCBC's executive salary determination process during this inspection.

On March 16, 2012, a senior EM official issued a memorandum requesting revisions of Acquisition Letter 2007-02, requiring SEB officials to perform the pre-award compensation analysis. The memorandum further indicated that the ORO procurement official verified that the UCOR executive salaries were determined to be reasonable in the contractor's proposal and contained in the contract. As mentioned previously, it was not until February 2012, approximately 10 months after the award of the contract, that the Contracting Officer signed and provided us a written document outlining salary reasonableness. We requested, but have not received, any additional evidence that a reasonableness determination was performed for UCOR's proposed and approved

executive salaries by the voting SEB members. Therefore, regardless of the guidance followed (Acquisition Letter 2007-02 or SEB Process), we were unable to obtain any evidence to support the final determination for UCOR's executive salaries.

In a subsequent discussion on the initial draft of this report and despite direct evidence to the contrary from SEB members, ORO and EM officials still contend that they used the SEB pre-award process to determine reasonableness of executive salaries. ORO indicated that Acquisition Letter 2007-02 does not apply to pre-award actions or to non-Management & Operating (M&O) contracts (UCOR contract is cost plus award fee). ORO and EM officials also indicated that the reasonableness determination was made based on conformity with compensation practices of other proposing firms of similar size in the same industry performing decontamination and decommissioning work, performing work in the same geographic area, and performing similar work under comparable circumstances. Moreover, we were told by ORO officials "as part of the reasonableness and realism determination," the SEB obtained audit services of an independent consulting firm. As such the officials asserted that they did not inadvertently circumvent the Department's prescribed approval process. The consulting firm informed us, however, that it focused on reasonableness as it pertained to whether the proposed total compensation of any UCOR key personnel exceeded the total compensation benchmark. The consulting firm also told us that it was outside of its scope of work to review contractor key personnel salary for reasonableness based on FAR Parts 31.205-06 and 31.201-3.

Further, ORO management has acknowledged that in transitioning to a new type of contract, Department officials inadvertently cited the requirements of Acquisition Letter 2007-02 in the contract. Associated process and procedural issues in this matter resulted in differing actions that should not have been taken. ORO is developing processes and protocols to preclude a repeat of the situation in the areas of training for all staff involved in acquisition matters, developing specific steps in assessing executive compensation and specifying roles of the SEB, Contracting Officer, etc.

OVERALL IMPACT

In light of current budgetary pressures, we concluded that the Department needs to implement executive measures to ensure that contractor executive salaries are: (i) reasonable; (ii) consistent with local market compensations rates; and (iii) established using Departmental procedures. Anything less could adversely impact ORO missions by diverting funds from other pressing mission needs. In this particular case, the Department could incur approximately \$3.45 million over the market rate salaries for 10 UCOR contractor executive salaries over the life of the 5-year contract.

RECOMMENDATIONS

Although the Department had taken a number of actions to address many of the deficiencies that we identified, we believe that additional actions are necessary. To help address the issues with inconsistently applied guidance, improve the contractor executive salary setting process, and better control salary costs in this area, we recommend that the Director, Office of Acquisition and Project Management:

1. Update the policy on contractor executive salaries to include the applicable methodology and the requirement to fully document reasonableness determinations (whether it is pre-award or post-award of the contract); and,
2. Ensure that the Department's contracts include the amended process for contractor executive salary reasonableness determinations based on revisions to the policy.

We also recommend that the Manager, Oak Ridge Office:

3. Ensure the policy and procedures are consistently applied for documenting a reasonableness determination of contractor executive salaries during pre-award or post-award of the contract; and,
4. Complete a reasonableness determination regarding the UCOR executive salaries and adjust rates as appropriate.

We also recommend that the Deputy Assistant Secretary, Acquisition and Project Management for Office of Environmental Management:

5. Ensure the policy and procedures are consistently applied for documenting a reasonableness determination of contractor executive salaries during pre-award or post-award of the contract.

**MANAGEMENT AND
INSPECTOR
COMMENTS**

Management generally concurred with each of the five recommendations in the report. Specifically, regarding recommendation 1, the Director, Office of Acquisition and Project Management agreed to update the acquisition letter to clarify the applicability to non-M&O contracts and emphasize the necessity of following Department Order 350.1 and FAR 31.205-6(b), when determining reasonableness of contractor salaries. Also, management concurred in principle with recommendation 2, stating that Department Order 350.1 provides sufficient language requiring the contractor to provide supporting justification for consideration of the initial and proposed changes to executive salary actions (see Department Order 350.1, Chapter IV, Attachment 1, page IV-4, paragraph 4a of the Contractor Requirements Document). However the Department is in the process of eliminating the referenced Contractor Requirements Document from Department Order 350.1 and incorporating the language directly into the applicable contracts. This revision is being carried out through a Departmental enterprise risk management initiative and will transfer language from the Contractor Requirements Documents of Chapters IV through VI of Department Order 350.1 to the Special H Clause of the applicable Department contracts. We believe that the planned corrective actions by OAPM for the two recommendations will emphasize and clarify the process needed for contractor executive salary reasonableness determinations and market analysis, whether it be pre-award or post-award.

The ORO Manager concurred with recommendations 3 and 4 in the report and indicated that ORO will ensure that local processes and procedures are in place to implement Departmental policy and guidance as it is developed. Also, ORO along with EM will conduct an analysis using all relevant data and information and will render a reasonableness determination regarding the UCOR salaries. Although the ORO Manager concurred, ORO is

maintaining the position that Acquisition Letter 2007-02 referenced in the report provides two paths for determining appropriate executive compensation — one for M&O contracts or those designated by the Senior Procurement Executive, and the other for non-M&O contracts. Further, ORO commented that the compensation stated as appropriate in the report appears to be based on the first contract path mentioned. We determined that if the Acquisition Letter 2007-02 did not apply, then all designated contractor executive salaries must be approved by the Senior Procurement Executive. However, we maintain that at the time of our review, the acquisition letter applied to all contracts. In addition, according to the Director, Office of Acquisition and Project Management, the office will make the acquisition letter clearer and will indicate its applicability to non-M&O contracts.

Further, ORO indicated that UCOR salary levels were in the middle of the competitive proposals received and that the salary levels parallel executive salaries of other Department cleanup contractors. According to FAR 31.201-3, *Determining Reasonableness*, there shall be no presumption of reasonableness attached to the incurrence of costs by a contractor. Also, the provisions set forth in Department Order 350.1 have to be met, which include the contract requirements to conduct a market analysis. In a subsequent meeting with senior ORO officials, they acknowledged that the SEB was not adequately trained, did not have the experience, and that ORO did not have a pre-award process in place to conduct reasonableness determinations and market analysis.

In addition, the Deputy Assistant Secretary, Acquisition and Project Management for Office of Environmental Management concurred with recommendation 5 and indicated that the office will provide guidance and develop policies and procedures consistent with the updated policy it receives from OAPM.

We have addressed management's comments and made technical changes to the report, as appropriate. The comments provided by the OAPM, EM, and ORO are included in Appendix 3.

Appendix 1

OBJECTIVE The objective of this inspection was to determine the facts and circumstances surrounding the allegation that an Oak Ridge Office (ORO) management official deviated from established Department of Energy (Department) guidance by approving higher contractor executive salaries for URS|CH2M Oak Ridge, LLC, (UCOR) without the proper authority.

SCOPE This allegation-based inspection was completed in March 2013, at the ORO in Oak Ridge, Tennessee.

METHODOLOGY To accomplish the inspection objective, we:

- Reviewed and analyzed Federal and Department regulations, Department contracts, orders, and documents;
- Reviewed market analysis provided by ORO HR but did not evaluate the validity of the market analysis performed by ORO subject matter experts; and,
- Interviewed ORO senior management officials, the Chief Counsel staff and procurement officials, as well as, senior management and policy officials at Headquarters.

We conducted this allegation-based inspection in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Inspection and Evaluation*. Those standards require that we plan and perform the inspection to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions and observations based on our inspection objective. We believe the evidence obtained provided a reasonable basis for our conclusions and observations based on our inspection objective. Accordingly, the inspection included tests of controls and compliance with laws and regulations to the extent necessary to satisfy the inspection 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 inspection. Finally, we relied on computer-processed data, to some extent, to satisfy our objective. We confirmed the validity of such data, when appropriate, by conducting interviews and analyzing source documents.

We held an exit conference with management on March 7, 2013.

PRIOR REPORTS

The following Department of Energy (Department) Office of Inspector General (OIG) reports are related to executive compensation and the amounts that can be reimbursed to Department contractors. Note: These reports cannot be found on the Office of Inspector General's public website.

- Audit Report on *Executive Compensation at Selected Office of Science Sites* (OAS-L-07-19, August 13, 2007). As part of a Department-wide audit of executive compensation, the OIG reviewed executive compensation at seven Office of Science sites: Argonne National Laboratory (Argonne), Brookhaven National Laboratory (Brookhaven), Lawrence Berkeley National Laboratory, Oak Ridge Institute for Science and Education, Oak Ridge National Laboratory, Princeton Plasma Physics Laboratory, and Thomas Jefferson National Accelerator Facility. For the Office of Science sites reviewed, it was found that executive compensation reimbursed to contractors did not exceed the annual cap determined by the Administrator, Office of Federal Procurement Policy, and the contractors complied with applicable provisions of procurement regulations, Department policies and guidance, and their contracts. As such, no recommendations were made in this report. At two sites, Argonne and Brookhaven, questioned costs were identified related to executive compensation and were addressed in separate reports (*Executive Compensation at Argonne National Laboratory*, OAS-L-07-17, and *Executive Compensation at Brookhaven National Laboratory*, OAS-L-07-18). Two recommendations were made in report OAS-L-07-18.
- Audit Report on *Executive Compensation at Argonne National Laboratory* (OAS-L-07-17, August 13, 2007). As part of a Department-wide audit of executive compensation, the OIG reviewed executive compensation at Argonne. Argonne executive compensation costs reimbursed to the University of Chicago did not exceed the annual cap and compensation generally complied with applicable provisions of procurement regulations, Department policies, and the Argonne contract. However, the review identified other questioned costs related to Argonne's executive compensation. Specifically, \$414,867 in questioned costs were identified, which consisted of \$60,346 for chauffeurs, \$253,632 for fringe benefit costs associated with unallowable salary costs, and \$100,889 for the salary and fringe benefits of an Argonne executive. The report made recommendations for responsible contracting officers to determine the allowability of questioned costs and recover costs determined to be unallowable. It was also recommended that the contracting officers determine whether costs, similar to those identified in the audit, were claimed after September 30, 2005, and recover costs determined to be unallowable.
- Audit Report on *Executive Compensation at Brookhaven National Laboratory* (OAS-L-07-18, August 13, 2007). As part of a Department-wide audit of executive compensation, the OIG reviewed executive compensation at Brookhaven. Brookhaven executive compensation costs reimbursed to Brookhaven Science Associates did not exceed the annual cap determined by the Administrator, Office of Federal Procurement Policy, and compensation generally complied with applicable provision of procurement regulations,

Appendix 2 (continued)

Department policies and guidance, and the Brookhaven contract. However, the review identified questioned costs related to Brookhaven's executive compensation. Specifically, \$31,472 in questioned costs was identified consisting of \$10,727 for an executive's salary in excess of the approved salary ceiling and \$20,745 for fringe benefit costs associated with unallowable salary costs. It was recommended that the responsible contracting officers determine the allowability of questioned costs and recover costs determined to be unallowable. It was also recommended that the contracting officers determine whether costs, similar to those identified in the audit, were claimed after September 30, 2005, and recover costs determined to be unallowable.

- Audit Report on *Executive Compensation at Selected Office of Environmental Management Sites* (OAS-L-07-20, August 13, 2007). As part of a Department-wide audit of executive compensation, the OIG reviewed executive compensation at two Office of Environmental Management (EM) sites: the East Tennessee Technology Park and the Savannah River Site. For the two EM sites reviewed, it was found that executive compensation reimbursed to contractors did not exceed the annual cap determined by the Administrator, Office of Federal Procurement Policy, and the contractors complied with the applicable provisions of procurement regulations, Department policies and guidance, and their contracts. No recommendations were made in this report.
- Audit Report on *Executive Compensation at Selected National Nuclear Security Administration Sites* (OAS-L-07-21, August 13, 2007). As part of a Department-wide audit of executive compensation, the OIG reviewed executive compensation at four National Nuclear Security Administration (NNSA) Sites: Los Alamos National Laboratory, Lawrence Livermore National Laboratory, Sandia National Laboratory, and the Y-12 National Security Complex. For the four NNSA sites reviewed, it was found that executive compensation reimbursed to contractors did not exceed the annual cap determined by the Administrator, Office of Federal Procurement Policy, and the contractors complied with the applicable provisions of procurement regulations, Department policies and guidance, and their contracts. No recommendations were made in this report.

MANAGEMENT COMMENTS



Department of Energy
Washington, DC 20585

FEB 07 2013

MEMORANDUM FOR SANDRA D. BRUCE
ASSISTANT INSPECTOR GENERAL FOR INSPECTIONS
OFFICE OF INSPECTOR GENERAL

FROM: *Paul Bosco* PAUL BOSCO
DIRECTOR
OFFICE OF ACQUISITION
AND PROJECT MANAGEMENT

SUBJECT: Inspection Report on "Approval of Contractor Executive Salaries
by Department of Energy Personnel"

The Office of Acquisition and Project Management has reviewed the subject draft report and has the following comments:

General Comment:

The Acquisition Letter (AL) 2007-02, Contractor Executive Compensation, does not limit increases in executive salaries to the lesser of 10 percent above the candidate's current salary or 6 percent above the prior contractor's executive reimbursed salary. It merely identifies the threshold above which approval by the Senior Procurement Executive of the top contractor official's salary is required.

Recommendation 1: We recommend that the Director, Office of Acquisition and Project Management, update the policy on contractor executive salaries to include the applicable methodology and the requirement to fully document reasonableness determinations (whether it is pre-award or post-award of the contract).

Management Response: Concur

Action Plan:

The Office of Acquisition and Project Management will update Acquisition Letter (AL) 2007-02 to: (1) clarify its applicability to contracts requiring Departmental approval of individual salary actions for the top contractor official; and (2) emphasize that DOE Order 350.1 and FAR 31.205-6, including FAR 31.205-6(b), Reasonableness, must be followed in evaluating executive salaries for reasonableness (see attached memorandum, dated January 29, 2013).

Estimated Completion Date: September 30, 2013



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Recommendation 2: We recommend that the Director, Office of Acquisition and Project Management, ensure that the Department's contracts include the amended process for contractor executive salary reasonableness determinations based on revisions to the policy.

Management Response: Concur in Principle

Action Plan: DOE 350.1 provides sufficient language requiring the contractor to provide supporting justification for consideration of the initial and proposed changes to executive salary actions (see DOE 350.1, Chapter IV, Attachment 1, page IV-4, paragraph 4a of the Contractor Requirements Document CRD). DOE is in the process of eliminating the referenced CRD from DOE 350.1 and incorporating the language directly into the applicable contracts. This revision is being undertaken through a Departmental enterprise risk management initiative and will transfer language from the CRDs of Chapters, IV, V, and VI of DOE 350.1 to the Special H Clause of the applicable DOE contracts.

Attachment



Department of Energy

Oak Ridge Office
P.O. Box 2001
Oak Ridge, Tennessee 37831

February 1, 2013

MEMORANDUM FOR SANDRA D. BRUCE
ASSISTANT INSPECTOR GENERAL FOR INSPECTIONS
OFFICE OF INSPECTOR GENERAL

FROM: LARRY C. KELLY *Larry C. Kelly*
MANAGER, OAK RIDGE OFFICE

SUBJECT: DRAFT INSPECTION REPORT ON "APPROVAL OF CONTRACTOR EXECUTIVE SALARIES
BY DEPARTMENT OF ENERGY PERSONNEL"

Thank you for the opportunity to comment on the subject draft Office of Inspector General (OIG) report. As documented in our responses to the OIG's recommendations, management will initiate actions to address areas for improvement. While we concur with the OIG's observations that the Department's policy governing contractor executive salary compensation was unclear, and that processes and procedures were not well coordinated, we do not concur with the OIG's conclusion that the salary determinations were inappropriate. The Acquisition Letter referenced in the OIG report provides two paths for determining appropriate executive compensation: one for management and operating (M&O) contracts or those designated by the Senior Procurement Executive, and the other for non-M&O contracts. The compensation stated as appropriate in the report appears to be based on the first contract path mentioned.

For non-M&O contracts, like the East Tennessee Technology Park (ETTP) cleanup contract, the provisions of Federal Acquisition Regulation (FAR) 31.205-6 in assessing contractor executive compensation apply, specifically that, "In determining the reasonableness of individual elements for particular employees or classes of employees, consideration should be given to all potentially relevant facts. Facts which may be relevant include general conformity with the compensation practices of other firms of the same size, the compensation practices of other firms in the same industry, and the compensation practices of other firms in the same geographic area...". Preliminary efforts to date have shown in the case of the ETTP cleanup contract competition, the proposed salary for the selected contractor's senior executive was in the middle of the competitive proposals received (two were higher and two were lower). In addition, by comparison, the URS|CH2M Oak Ridge LLC (UCOR) senior executive salary level parallels executive salaries of Department of Energy cleanup contractors at two other sites doing environmental cleanup work comparable to Oak Ridge. As stated in response to Recommendation 4, an additional analysis of the UCOR salary levels will be conducted, using additional data points that are provided for in the FAR, to include the compensation practices of other firms doing similar work in the same industry.

The Oak Ridge Office (ORO), in conjunction with the Headquarters Offices of Management's (MA's) Acquisition and Project Management, and Environmental Management's (EM's) Acquisition and Project Management, have reviewed the draft report. Detailed technical and general comments are provided as Appendix A. MA will provide a separate management response.

Sandra D. Bruce

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February 1, 2013

DRAFT INSPECTION REPORT ON "APPROVAL OF CONTRACTOR EXECUTIVE SALARIES BY DEPARTMENT OF ENERGY PERSONNEL"

With respect to the specific recommendations in the draft report addressed to ORO and EM:

Recommendation 3: We also recommend that the Manager, Oak Ridge Office, ensure the policy and procedures are consistently applied for documenting a reasonableness determination of contractor executive salaries during pre-award or post-award of the contract.

Management Response: Concur.

Action Plan: ORO will ensure that local processes and procedures are in place to implement Departmental policy and guidance as it is developed. In the interim, ORO will develop local processes and procedures that: a) define the processes used to conduct and document reasonableness determinations; and b) define the roles and responsibilities of all functional groups at ORO involved in contractor executive salary determinations.

Estimated Completion Date: February 28, 2013

Recommendation 4: We also recommend that the Manager, Oak Ridge Office, complete a reasonableness determination regarding the UCOR executive salaries and adjust rates as appropriate.

Management Response: Concur.

Action Plan: Consistent with the forthcoming defined processes (see the Action Plan in Recommendation 3), ORO will conduct an analysis which, using all relevant data and information, will render, in conjunction with the EM Program, a reasonableness determination regarding the UCOR salaries.

Estimated Completion Date: March 29, 2013

Recommendation 5: We also recommend that the Deputy Assistant Secretary for Acquisition and Project Management, Office of Environmental Management, ensure the policy and procedures are consistently applied for documenting a reasonableness determination of contractor executive salaries during pre-award or post-award of the contract.

Management Response: Concur.

Action Plan: Upon receipt of the updated policy by the Office of Acquisition and Project Management, we will provide guidance and develop policies and procedures consistent with the policy.

Estimated Completion Date: Implementation of the procedures will follow within 60 days of the completion of the updated policy.

Attachment

cc w/attachment:

John E. Surash, EM-50, FORS
Timothy C. Harms, EM-63, FORS
Paul Bosco, MA-60, LENF950
Berta L. Schreiber, MA-61, LENF950
Thomas P. Griffin, CF-50, FORS

John C. Shewairy, AD-40, ORO
Don F. Thress, CC-10, ORO
Mark Whitney, EM-90, ORO
Judith M. Penry, FM-70, ORO

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