

ER-B-99-05

AUDIT
REPORT

WESTINGHOUSE SAVANNAH
RIVER COMPANY'S
WITHDRAW OF FEES



U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES

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DEPARTMENT OF ENERGY

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April 8, 1999

MEMORANDUM FOR THE MANAGER, SAVANNAH RIVER OPERATIONS OFFICE

FROM: Terry L. Brendlinger, Manager (Signed)
Eastern Regional Audit Office
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Westinghouse Savannah River Company's
Withdrawal of Fees"

BACKGROUND

As the operator of the Department's Savannah River Site, Westinghouse Savannah River Company (Westinghouse) receives three types of fees: (1) award fees commensurate with the overall performance rating, (2) Performance Based Incentive (PBI) fees for achieving measurable goals or defined tasks as specified in annual operating plans, and (3) Cost Reduction Incentive Program (CRIP) fees for making improvements in site operations that reduce total contract costs. The Department's Contracting Officer notifies Westinghouse when fees are earned, and Westinghouse withdraws the authorized amounts from the Department's letter-of-credit account.

The audit objective was to determine whether Westinghouse withdrew the appropriate amount of fees from the letter-of-credit account in Fiscal Years (FY) 1997 and 1998.

RESULTS OF AUDIT

Westinghouse correctly withdrew \$51 million in award fees and \$47 million in PBI fees in FYs 1997 and 1998. However, it withdrew \$170,400 more in CRIP fees than authorized by the Department. Westinghouse made mistakes in 13 of 19 CRIP fee withdrawals, and withdrew fees that were not authorized by the Department for at least 21 cost reduction proposals. The errors and unauthorized withdrawals occurred because Westinghouse did not have formal procedures for processing and recording CRIP fee withdrawals. The Department did not detect the errors and unauthorized withdrawals because the Savannah River Operations Office (Operations Office) did not reconcile Westinghouse's withdrawals to the amounts authorized by the Contracting Officer. At the completion of our audit, Westinghouse returned \$170,400 to the Department.

We recommend that Westinghouse establish formal procedures to ensure withdrawals of CRIP fees are processed and recorded accurately and restricted to the amounts authorized by the Contracting Officer. In addition, we recommend that the Operations Office enforce contract requirements and establish procedures to reconcile CRIP fees withdrawn by Westinghouse to ensure withdrawn amounts are accurate and approved by the Contracting Officer; and reconcile CRIP fee withdrawals made between FYs 1992 and 1996, and recover amounts determined by the Contracting Officer to be unallowable, plus interest.

Also, we found that contrary to the terms of the contract, Westinghouse did not share its CRIP fees with senior managers who suggested or implemented cost reductions. Westinghouse determined that it was inappropriate for senior managers to receive incentive pay for suggesting or implementing improvements in operations for which they were directly responsible. As of January 1999, Westinghouse had accrued a liability of \$109,300 in CRIP fees which had not been distributed to senior managers. As a result, Westinghouse retained control of Department funds to which it was not contractually entitled. At the conclusion of our audit, Westinghouse returned control of the \$109,300 withheld from the senior managers to the Department. However, Westinghouse did not return its share of the fees, totaling \$970,700.

We recommend that the Operations Office discontinue the practice of awarding fees to Westinghouse for CRIP proposals suggested by senior managers and recover \$970,700 from Westinghouse.

MANAGEMENT REACTION

Management concurred with the findings and four of the six recommendations. However, Management did not concur with recommendations to discontinue awarding fees to Westinghouse for CRIP proposals suggested by senior managers and to recover \$970,700 from Westinghouse. Management stated that the intent of the CRIP was to award Westinghouse for approved cost saving suggestions that met the CRIP criteria, regardless of the source of the suggestion.

AUDITOR COMMENTS

We determined that by returning only the senior managers' share of CRIP fees to the Department, Westinghouse did not comply with the terms of its contract and undermined the primary objective of the CRIP, which is to provide an incentive for employees to make one-time improvements that reduce contract costs. Also, we consider Westinghouse's return of the senior managers' share of the fees to be an admission that the fees received for the proposal were inappropriate for the CRIP. Therefore, Westinghouse should return its share of the fees as well as the senior managers' share.

WESTINGHOUSE SAVANNAH RIVER COMPANY'S WITHDRAWAL OF FEES

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Overview

INTRODUCTION AND OBJECTIVE

Under the current contract, Westinghouse receives three types of fees for managing and operating the Savannah River Site. It receives (1) award fees commensurate with its overall performance rating, (2) PBI fees for achieving measurable goals or defined tasks as specified in annual operating plans, and (3) CRIP fees for making improvements in site operations that reduce total contract cost.

The Department authorized Westinghouse to withdraw \$500,000 per month from the letter-of-credit account in anticipation of earning award fees. The Contracting Officer used the *Award Fee Performance Evaluation Plan* to determine the amount of fees actually earned, and notified Westinghouse, in writing, semiannually. Westinghouse then made a withdrawal, or deposit, to adjust the previous monthly withdrawals to the total authorized amount. Westinghouse received \$21 million in award fees in FY 1997 and \$30 million in FY 1998.

To receive PBI fees, Westinghouse notified the Operations Office when specific tasks were completed and the PBI goals were achieved. The Operations Office verified that the tasks were completed satisfactorily and, if so, the Contracting Officer notified Westinghouse, in writing, that it had permission to withdraw PBI fees from the letter-of-credit account. Westinghouse received \$23 million in PBI fees in FY 1997 and \$24 million in FY 1998.

Westinghouse earned CRIP Fees by making improvements in site operations that reduced the total cost of the contract. Proposals for improving site operations were initiated by employees and submitted to the Contracting Officer for approval. When CRIP proposals were approved, the Contracting Officer notified Westinghouse, in writing, that it had permission to withdraw the appropriate fee from the letter-of-credit account. The contract required Westinghouse to give at least 10 percent of the total CRIP fees withdrawn from the account to the employees who suggested or implemented the improvements. Over 3,100 payments were made to Westinghouse employees during FYs 1997 and 1998. Westinghouse received \$5 million in CRIP fees in FY 1997 and \$8 million in FY 1998.

The Office of Inspector General recently issued two reports regarding fees at the Savannah River Site. Inspection Report INS-0-98-03, *The Fiscal Year 1996 Performance Based Incentive Program at the Savannah River Operations Office*, determined that the PBI program

was established without any written policies or procedures for program management and administration, and the *FY 1996 Performance Evaluation Plan* was not approved until 4.5 months into the performance period. Also, the inspection identified three instances of questionable fee payments. Audit Report ER-B-98-08, *The Cost Reduction Incentive Program at the Savannah River Site*, determined that the Operations Office had not taken appropriate action in response to a Headquarters/field assessment of the CRIP program; therefore, Westinghouse was still receiving CRIP fees for non-innovative proposals. The audit concluded that most of the savings identified under the CRIP Program occurred through greater management focus on reducing costs, working smart, or the results of budget constraints, as opposed to innovative changes.

The objective of this audit was to determine whether Westinghouse withdrew the appropriate amount of fees from the letter-of-credit account in FYs 1997 and 1998.

CONCLUSIONS AND OBSERVATIONS

Westinghouse correctly withdrew \$51 million in award fees and \$47 million in PBI fees in FYs 1997 and 1998. This represented 88 percent of the fees withdrawn by Westinghouse during the 2-year period.

However, Westinghouse withdrew more CRIP fees than authorized by the Department. Westinghouse made mistakes in 13 of 19 CRIP fee withdrawals, and withdrew fees that were not authorized by the Department for at least 21 cost reduction proposals. The errors occurred because Westinghouse did not have formal procedures for processing and recording CRIP fee withdrawals. The Department did not detect the errors and unauthorized withdrawals because the Operations Office did not reconcile the amounts withdrawn by Westinghouse to the amounts authorized by the Contracting Officer. As a result, Westinghouse withdrew \$170,400 more than authorized by the Department in FYs 1997 and 1998. At the completion of our audit, Westinghouse returned \$170,400 to the Department. (Details of this finding start on page 4 of the report.)

Also, contrary to the terms of the contract, Westinghouse did not share its CRIP fees with senior managers who suggested or implemented cost reductions. Westinghouse determined that it was inappropriate for senior managers to receive incentive pay for suggesting or implementing improvements in operations for which they were directly responsible. As

of January 1999, Westinghouse had accrued a liability of \$109,300 in CRIP fees, which had not been distributed to senior managers. As a result, Westinghouse retained control of Department funds to which it was not contractually entitled. At the conclusion of our audit, Westinghouse returned control of the \$109,300 withheld from the senior managers to the Department. However, Westinghouse did not return its share of the fees totaling \$970,700. (Details of this finding start on page 8 of the report.)

The audit identified issues that management should consider when preparing its yearend assurance memorandum on internal controls.

(Signed)

Office of Inspector General

COST REDUCTION INCENTIVE PROGRAM FEES

Withdrawals Exceeded Authorizations

Westinghouse withdrew more CRIP fees than authorized by the Department in FY 1997 and 1998. Westinghouse made errors in 13 of 19 CRIP fee withdrawals in the subject fiscal years. Five withdrawals exceeded authorized amounts, and eight were less than authorized. In one instance, the Contracting Officer authorized a CRIP fee withdrawal of \$2,686,500. Westinghouse withdrew \$2,837,400 which exceeded the total amount approved by \$150,900. In another example, the Contracting Officer authorized a CRIP fee withdrawal of \$494,000, and Westinghouse withdrew only \$356,700. In this example, Westinghouse discovered that an error was made and attempted to correct it by withdrawing an additional \$132,200. However, the total withdrawal was still \$5,100 less than the authorized amount. Neither Westinghouse nor the Operations Office detected these errors.

In addition, Westinghouse often withdrew money from the letter-of-credit account to pay employees their share of CRIP awards prior to obtaining the Department's approval. The employees were paid based on Westinghouse's estimate of savings claimed in the cost reduction proposals. We examined payments to 25 employees who received large awards in FYs 1997 and 1998 and determined that 13 of the 25 employees were paid a total of \$72,500 before the Contracting Officer authorized the CRIP fee withdrawal. One employee was paid \$40,500 nearly a year in advance of the Contracting Officer's approval.

Westinghouse made at least 132 payments to contractor employees for savings claimed in 21 cost reduction proposals that were disapproved by the Contracting Officer. For example, after the Department's technical review process recommended disapproval for one cost reduction proposal, Westinghouse appealed the disapproval and withdrew \$3,900 from the letter-of-credit account to pay its employees in March 1998. As of January 1999, the Operations Office had not ruled on the appeal, and the employees' share was never returned to the letter-of-credit account.

Department Policy Limited Fees to Amounts Authorized by the Contracting Officer

Clause I.85 of Westinghouse's contract requires that Westinghouse obtain the Contracting Officer's approval before withdrawing fees from the letter-of-credit account. Also, Departmental Order 534.1 requires that the Department and its integrated contractors maintain records with sufficient details to account for all Departmental funds, assets, liabilities and costs. The Field Element Chief Financial Officer is required to establish and maintain the official accounting records, which must be supported with valid documents and periodically reconciled to detect and correct recording errors.

Westinghouse Did Not Have Formal Procedures

Errors occurred because Westinghouse did not have formal procedures for withdrawing, distributing and recording CRIP fees. In FY 1997, Westinghouse used several informal methods for withdrawing CRIP fees. One method was to withdraw the total amount authorized in the Contracting Officer's determination letters and then determine the correct share to be paid to suggesting or implementing employees. Later, another method was adopted in which Westinghouse withdrew fee payments separately for the employees' and Westinghouse's shares. When this method was used, the sum of both payments rarely equaled the total amount authorized by the Contracting Officer.

Also, Westinghouse did not have formal or consistent methods for recording its employees' share of savings. Between April and October 1996, payments were made to employees prior to obtaining the Contracting Officer's authorization and recorded in the accounting records as allowable costs, even though many of the CRIP proposals were never approved. Between November 1996 and July 1997, payments were made to employees prior to obtaining the Contracting Officer's authorization and recorded as unallowable costs. If the proposals were approved, the payments were transferred to an allowable account in accordance with the Contracting Officer's authorization. Between July 1997 and December 1998, Westinghouse recorded payments made to employees prior to approval as allowable costs, then transferred the payments to an unallowable account upon disapproval.

Department Did Not Reconcile Amounts Authorized or Enforce Contract Requirements

The Department did not detect Westinghouse's errors and unauthorized withdrawals because the Operations Office did not reconcile the amounts withdrawn by Westinghouse to the amounts authorized by the Contracting Officer or force Westinghouse to follow contract requirements. The Operations Office attempted to reconcile Westinghouse's withdrawals using data obtained from Westinghouse, but was unable to do so. At least one Departmental manager suspected that the data provided by Westinghouse for CRIP fee withdrawals were erroneous. However, the manager could not determine where individual errors occurred.

As a result of these conditions, Westinghouse withdrew \$170,400

**Westinghouse Withdrew
More Than Authorized**

more than authorized in FYs 1997 and 1998. Westinghouse withdrew \$157,100 more than authorized as the result of errors, and \$13,300 as the result of withdrawals for employees' shares of CRIP proposals that were disapproved by the Contracting Officer. At the completion of our audit, Westinghouse returned \$170,400 to the Department.

We recommend that the Manager, Savannah River Operations Office:

RECOMMENDATIONS

1. Direct Westinghouse to establish formal procedures to ensure withdrawals of CRIP fees are processed and recorded accurately, are not withdrawn before approval by the Contracting Officer, and are restricted to the amounts approved by the Contracting Officer;
2. Enforce contract requirements for Westinghouse to obtain the Contracting Officer's approval before withdrawing fees from the letter-of-credit account;
3. Establish procedures for the Operations Office to reconcile CRIP fees withdrawn by Westinghouse to ensure withdrawn amounts are accurate and approved by the Contracting Officer; and
4. Require the Operations Office to reconcile CRIP fee withdrawals made between FYs 1992 and 1996 and recover amounts determined by the Contracting Officer to be unallowable, plus interest.

**MANAGEMENT
REACTION**

Management concurred with the finding and recommendations. The Operations Office stated that it will direct Westinghouse to establish formal procedures to ensure that withdrawals of CRIP fees are processed and recorded accurately and are not withdrawn before approval by the Contracting Officer, and that CRIP fees authorized are reconciled with letter-of-credit drawdowns. The revised procedures will require Westinghouse to establish a new general ledger account to be used exclusively for CRIP fees. When fees are withdrawn, Westinghouse will deposit them into this account. Distributions will be made from this account to corporate partners and to payroll for employees. This should provide a verifiable record of all fee transactions. The procedures will be completed by June 30, 1999. In addition, the Operations Office will direct Westinghouse to reconcile CRIP fees withdrawn during FYs 1992 through 1996, correct any error(s) discovered, and complete this reconciliation by June 1, 1999.

The Operations Office will review the reconciliation and recover any amounts determined to be unallowable with appropriate interest.

AUDITOR COMMENTS

Management's reaction to the finding is fully responsive. When implemented, management's intended actions should reduce the risk of future errors in CRIP fee transactions.

FEES SHARED WITH SENIOR MANAGERS

Westinghouse Did Not Share CRIP Fees With Senior Managers

Westinghouse withheld CRIP fees owed to some senior managers for suggesting or implementing cost reduction proposals. Westinghouse generally withheld CRIP fees owed to exempt employees in pay grades 40 and above. Senior managers in these pay grades typically included program managers and department heads. Many of the senior managers in these pay grades were "incentive grade" employees and may have submitted suggestions that directly impacted the programs and activities for which they were directly responsible, and for which they received incentive pay.

For example, one of the CRIP proposals for which the suggestors' share was not distributed was submitted by an inventory manager and a principle material engineer. The proposal affected the department under the inventory manager's direct control. The proposal suggested that Westinghouse eliminate nonessential inventory items, such as styrofoam cups, aluminum foil, napkins, and calendars. Westinghouse was awarded \$18,800 for the proposal, of which the suggestors' share was \$1,900. Neither the inventory manager nor the principle material engineer received their share of the CRIP fee award.

In September 1998, Westinghouse established a "Management Driven Hard Dollar Savings Account" to accumulate the undistributed CRIP fees. Westinghouse stated that it intended to pay the funds collected in the account to all employees after the account had accumulated an undetermined amount. As of January 1999, the undistributed CRIP fees totaled \$109,300 for 8 CRIP proposals.

Contract Requires Distribution to Suggesting/Implementing Employees

Contract terms require Westinghouse to distribute not less than 10 percent of the CRIP fee award to the employees involved in identifying or achieving the causal cost reduction. Not distributing the suggestors' share, or distributing it to employees not involved in identifying or achieving the cost reduction, is contractually unallowable.

Westinghouse Believed It Was Inappropriate to Pay Senior Managers

Despite contractual requirements, Westinghouse believed it was inappropriate to pay senior managers for submitting suggestions to reduce the cost of operations for which the managers were directly responsible. One manager stated that Westinghouse was embarrassed to allow its senior managers to receive incentive pay for suggestions that resulted in CRIP savings.

**Westinghouse
Improperly Retained
Funds**

As a result, Westinghouse retained Department funds to which it was not contractually entitled. At the conclusion of the audit, Westinghouse returned \$109,300 to the Department for the CRIP fees withheld from senior managers. However, Westinghouse did not return its portion of the CRIP fees, totaling \$970,700.

We believe it is inappropriate for Westinghouse to return only the senior managers' share of the fees to the Department. The terms of the contract require Westinghouse to distribute at least 10 percent of all CRIP fees to the employees who suggested or implemented the cost reductions. By returning only the senior managers' share of the fees, Westinghouse is in noncompliance with the contract terms. Also, Westinghouse has undermined the primary objective of the CRIP, which is to provide an incentive for employees to make one-time improvements that reduce contract costs.

Further, we consider Westinghouse's actions to be an admission that the fees received for the senior managers' proposals were inappropriate for reimbursement under the CRIP. We concluded in Audit Report ER-B-98-08 that the Department provided CRIP awards to Westinghouse for non-innovative proposals that were typical of the types of actions taken by managers in the Government and private industry to avoid waste and inefficiency. We recommended that the Operations Office discontinue the practice of paying CRIP fees for non-innovative proposals, because cash incentives should not be required to motivate Westinghouse to implement business practices that are commonly used by other Government contractors and private industry. The Operations Office stated that the recommendation could not be implemented without first modifying the contract or obtaining Westinghouse's concurrence. We consider Westinghouse's return of the senior managers' share of the fees to be an admission that the fees received for the proposals were inappropriate. The Department should consider Westinghouse's share of the fees to be inappropriate for the same reason Westinghouse determined the senior managers' share to be inappropriate.

We recommend that the Manager, Savannah River Operations Office

RECOMMENDATIONS

1. Discontinue the practice of awarding fees to Westinghouse for CRIP proposals suggested by senior managers, and
2. Recover Westinghouse's share of CRIP fees associated with the \$109,300 in fees withheld from senior managers.

**MANAGEMENT
REACTION**

Management concurred with the finding that Westinghouse improperly retained CRIP fees withheld from senior managers. However, Management did not concur with the recommendations. The Operations Office stated that the intent of the CRIP was to reward Westinghouse for approved cost saving suggestions that met the CRIP criteria, regardless of the source of the suggestion. Nevertheless, the Operations Office accepted the Westinghouse position that senior managers are already compensated under special incentive programs and, therefore, providing additional payments to these employees under the CRIP is not appropriate. The Operations Office stated that it will direct Westinghouse to establish formal procedures to reaffirm the practice of not awarding fees to senior managers. The procedures will be completed by April 30, 1999.

AUDITOR COMMENTS

We determined that by returning only the senior managers' share of CRIP fees to the Department, Westinghouse did not comply with the terms of its contract and undermined the primary objective of the CRIP, which is to provide an incentive for employees to make one-time improvements that reduce contract costs. Also, we consider Westinghouse's return of the senior managers' share of the fees to be an admission that the fees received for the proposals were inappropriate for the CRIP. Therefore, Westinghouse should return its share of the fees as well as the senior managers' share.

Appendix

SCOPE

The audit was performed between November 16, 1998, and January 22, 1999, at the Savannah River Site near Aiken, South Carolina. The audit covered award fees, PBI fees, and CRIP fees withdrawn by Westinghouse in FYs 1997 and 1998.

METHODOLOGY

To accomplish the audit objective, we:

- Reviewed Westinghouse's contract clauses relating to fees;
- Identified and reviewed accounting systems used by Westinghouse for recording fees;
- Assessed controls over the approval and payment of fees;
- Examined supporting records such as fee determination letters, invoices to the letter of credit, and payroll data; and
- Held discussions with officials from the Operations Office and Westinghouse regarding the administration of and accounting for fees.

The audit was performed in accordance with generally accepted Government auditing standards for financial 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.

The Operations Office had not established any measurable performance goals relating to the handling or recording of fee withdrawals, therefore, we were unable to assess the effectiveness of the performance measures that might have been used.

We relied on computer-generated data provided by the Operations Office and Westinghouse regarding fees. We did not separately evaluate general and application controls for this computer-generated data. Instead, we relied upon previous evaluations of computer-generated data performed during annual audits of the Operations Office's financial statements.

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