DOE/IG-0510

AUDIT REPORT

USE OF PERFORMANCE-BASED INCENTIVES AT SELECTED DEPARTMENTAL SITES

JULY 2001

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

Department of Energy
Washington , DC 20585

July 9, 2001

MEMORANDUM FOR THE SECRETARY

FROM: Gregory H. Friedman (Signed)
Inspector General

SUBJECT: INFORMATION: Audit Report on "Use of Performance-Based Incentives at Selected Departmental Sites"

BACKGROUND

The Department of Energy (Department) began to incorporate performance-based incentive fees into its major management contracts after the 1994 Contract Reform report recommended the use of performance-based management contracts. The performance-based incentive approach ties elements of the contractor's profits to the achievement of specific technical performance objectives, delivery schedules, or cost control objectives. Thus, fees paid to contractors should bear a direct relationship to performance and require that each incentive have objective performance metrics and an objective evaluation of contractor performance. Successful use of performance-based incentives should also result in improved contractor performance.

The objective of the audit was to determine whether the Department's use of performance-based incentives has resulted in improved contractor performance at selected Departmental field sites.

RESULTS OF AUDIT

The Department did not utilize performance-based incentives in a manner that would consistently result in improved contractor performance. Twelve of nineteen performance-based incentives selected for review at the Savannah River Site and the Kansas City and Oak Ridge Y-12 Plants were not clearly designed to facilitate such improvement. Some performance incentive fees were increased without a corresponding increase in performance expectations. In other cases, the "challenge" to the contractor in the form of the performance standard was lowered while the monetary incentive remained unchanged. In all cases, these actions were taken without satisfactory explanation. Further, some incentives were established after the expected outcome had been achieved.

We determined, based on available documentation, that field sites were not fully evaluating past performance when negotiating recurring incentives and were not using appropriate processes to modify performance metrics. Furthermore, the Department had not established a formal review and approval process for Program Offices to ensure that negotiated performance-based incentives would improve contractor performance. As such, we question whether the Department could have better used $5.3 million provided from 1997 to 2000 for the 12 performance-based incentives with which we found problems.

To address this condition, we recommended that the *Department's Acquisition Guide* be revised to address the conditions noted in the audit report. We also recommended that parallel program-specific guidance be developed by the Offices of Environmental Management and Defense Programs.

The Office of Inspector General has previously reported problems in implementing performance-based management contracting practices. In addition, my office has identified the issue of contract administration as one of the top ten management challenges facing the Department today.

MANAGEMENT REACTION AND AUDITOR COMMENTS

Department officials disagreed with our finding and recommendations, asserting that no requirement existed for individual incentives to improve contractor performance. Management believed that the goal of performance-based incentives was to motivate the contractor to achieve specific work scope and potentially help to improve contractor operations over the entire spectrum of the contract. Furthermore, management did not believe that it was appropriate to evaluate the overall success of performance-based incentive contracts by looking at individual incentives. Management also believed that the issues identified during the audit were solely documentation issues.

The Office of Inspector General has a fundamental disagreement with management on this issue. To illustrate where our positions differ, management expressed the view that it is inappropriate to draw general conclusions on the effectiveness of the performance-based contracting scheme based on a review of individual performance incentives. Yet, under the approach that the Department has adopted, individual performance incentives and the potential fees associated with those incentives, are the only performance-based management contracting mechanism to reward contractors for their performance. Thus, it seems that any pattern of concern regarding the efficacy and application of individual performance incentives, such as that raised in our report, goes to the core of the Department's current program.

To its credit, the Department has incorporated performance measures in its major contracts. However, the more important question is whether the Department can demonstrate that the current system of performance-based contracting has resulted in improvements in contractor performance and that the benefits resulting from these improvements are worth the additional cost. Despite concerted efforts by procurement officials, based on this and other recent reviews, we believe that more needs to be done in this area. We reach this conclusion with the recognition that executing an effective performance-based contracting program in the Department of Energy setting is a challenging task.

Management comments and the Office of Inspector General response are more fully discussed on page 11 of the report.

Attachment

cc: Deputy Secretary
Administrator, National Nuclear Security Administration
Under Secretary for Energy, Science and Environment

USE OF PERFORMANCE-BASED INCENTIVES AT SELECTED DEPARTMENTAL SITES

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Overview

INTRODUCTION AND OBJECTIVE

The Department of Energy (Department) contract reform effort began in 1993 with the establishment of a team to review the Department's contracting practices and provide recommendations for improvement. In its February 1994 report, the team recommended the use of performance-based management contracting for future contract awards. It also recommended the use of an incentive fee approach in which an identified element of the contractor's profit would be tied to the achievement of specific technical performance objectives, delivery schedules, or cost control objectives. Under such "performance-based incentives," the fees paid to the contractor should bear a direct relationship to contractor performance and require that each incentive have objective performance metrics and an objective evaluation of contractor performance.

Office of Inspector General (OIG) reports issued since 1997 have identified problems in implementing performance-based management contracting practices. Specifically, incentive fees were paid for work that had already been completed and performance expectations were established that did not encourage and reward superior performance. More recently, an audit of *Incentive Fees for Bechtel Jacobs Company LLC* (DOE/IG-0503, May 2001) identified problems with objectives not being established prior to the start of the performance period and existing objectives not being met. A complete listing of related OIG reports is included in Appendix 1.

In May 2000 the Secretary announced renewed efforts to improve contractor performance. In accordance with this initiative and earlier reforms, the Department expanded its use of incentive fees. Between 1998 and 2000, total available incentive fees increased from $43 million to $62 million at the three field sites visited. This increase included, in some cases, a reallocation of the total available fee from base and award fees to performance-based incentive fees.

Given the importance of proper performance-based contract management to the Department, the objective of the audit was to determine whether the Department's use of performance-based incentive fees has resulted in improved contractor performance at selected Departmental field sites.

CONCLUSIONS AND OBSERVATIONS

The Department did not utilize performance-based incentives in a manner that would consistently result in improved contractor performance. Problems were identified with 12 of 19 performance-based incentives selected for review at the Savannah River Site, the

Kansas City Plant, and the Y-12 Plant located in Oak Ridge, TN. The dollar amounts of certain performance incentives were increased while the corresponding performance metrics remained the same. Other performance metrics were lessened, while the monetary incentive was left unchanged. Finally, some performance measures were established after the incentivized action had been completed. In each case, the Department was not able to provide a clear, documented rationale, based on past performance and changes in operating conditions, as to why the conditions occurred.

Our review also indicated that field sites were not fully evaluating past contractor performance when negotiating recurring performance-based incentives and were using processes for modifying performance-based incentives that were originally designed to address award fee performance rather than incentive fee projects. Furthermore, the Department had not established a formal Program Office review and approval process to ensure that negotiated performance-based incentives would improve contractor performance. For the 12 performance-based incentives with which we had concerns, the Department provided an additional $5.3 million from 1997 to 2000. Because these measures were not clearly structured to improve performance and because the Department's rationale for the measures was not evident, we questioned whether the $5.3 million could have been better used to incentivize other work.

The OIG fully recognizes the difficulty in implementing performance-based management contracting practices, including the shift away from base and award fees to the increased use of incentive fees. Department managers deserve credit for changes resulting in improvements to contract management. However, more remains to be done. The Office of Procurement and Assistance Management acknowledged, in a March 1999 report to the Secretary[1], that the use of performance-based incentives has not always led to improved performance at all sites. In addition, the Secretary of Energy Advisory Board recently reported [2] that "while substantial progress has been made with performance-based management and other DOE management initiatives, there is no comprehensive corporate approach to implementation, and as a result, policies and methods are not consistently implemented DOE-wide."

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[1] Follow-Up Assessment of the Effectiveness of Actions Taken to Improve Performance-Based Incentives in Performance-Based Management and Management and Integration Contracts, March 31, 1999.
[2] White Paper on Performance-Based Management, December 8, 2000.

To further enhance the implementation of the Department's performance-based contracting approach, management should consider the issues discussed in this report when preparing the yearend assurance memorandum on internal controls.

(Signed)
Office of Inspector General

Performance-Based Incentives

Performance-based incentives for Department contractors were not clearly structured in a manner that would result in improved contractor performance. Problems were identified with 12 (63 percent) of the 19 performance-based incentives reviewed at the Savannah River Site, the Kansas City Plant, and the Oak Ridge Y-12 Plant. There was not a clear rationale to support the fee amounts associated with certain performance metrics considering past performance and changes in operating conditions.

Recurring Performance-Based Incentives

Recurring performance-based incentives relate to those areas or activities that are incentivized from one year to the next. Because performance-based incentives are a tool for achieving improved contractor performance, recurring incentives should be structured to realize that goal. For example, where a contractor has historically performed at an acceptable level and in the absence of changes in operating conditions, an increase in available incentive fee should be accompanied by an increase in performance metrics. Conversely, a decrease in performance metrics should be accompanied by a decrease in available incentive fee.

However, our analyses indicated that some recurring performance-based metrics remained the same or decreased, while available incentive fee either increased or remained the same. In these cases, there was no evidence associated with the performance-based incentive, to show that there was a need to provide additional incentives to either improve contractor performance or compensate for changes in operating conditions. To illustrate:

- The Savannah River Site incentivized the production of high-level waste canisters at the Defense Waste Processing Facility. The annual performance metric since Fiscal Year (FY) 1998 had been the production of 250 canisters. In FY 2000, the Savannah River Operations Office (Savannah River) increased the available incentive fee by $500,000 for this activity, but did not increase the corresponding performance metric.

- The Kansas City Area Office (Kansas City) incentivized the timely delivery of non-First Production Unit weapon components. Kansas City increased the available incentive fee by $1.5 million from

FYs 1997 to 2000, even though the performance metric remained essentially the same (an on-time delivery rate of at least 99.6 percent).

- At Y-12, the Department's Area Office incentivized the off-loading of Safe-Secure Transport vehicles. From FYs 1999 to 2000, the Area Office increased the available incentive by $213,000, while loosening the performance metric from 4 days to 5 days. This occurred despite the contractor's demonstrated past performance of unloading the vehicles in an average of 2.1 days in FY 1999.

Additional examples of recurring performance-based incentives that we questioned are included in Appendix 2.

During our review, the field sites identified various factors that affected the changes in incentive fee. These factors included difficulty and complexity of weapons component production, risks associated with treatment of undetermined chemical types, and reductions in staffing. For example, the Y-12 Area Office stated that a deliberate decision was made by the Department to relax the performance-based incentive for the Safe-Secure Transport project from 4 days to 5 days due to the anticipated need to place resources on the off-loading of a new type of transport vehicle arriving with the Safe-Secure Transports. In other cases, field sites explained that the increase in available incentive fees was created by a reallocation of the contractor's base fee to incentive fee projects and the Department's campaign to transfer fee dollars from the award fee pool to the incentive fee pool.

We recognize that certain operating conditions for individual projects can affect the achievement of performance objectives. However, the supporting documentation provided by the field sites did not substantiate that these factors were carefully considered and evaluated during incentive fee negotiations with the contractor prior to approving their Performance Evaluation and Measurement Plans. Specifically, the rationale and explanation provided for individual performance-based incentive fees did not explain why the field sites negotiated an increased incentive fee for the contractor without a change in performance metrics, what impact the probable operating conditions would have on achieving the performance metrics, and how the increased fee amount was calculated for individual performance-based incentives. In addition, none of the responses supported a field site evaluation and comparison of the contractor's previous performance metrics and incentive fee when the new incentive fees were negotiated. Moreover, in our judgment, a simple reallocation from base fee and award fee pools to individual performance-based incentives is not, by itself, a sufficient basis for increasing the available fee associated with those incentives. Rather, management should determine, through a rational, analytic, and documented process, the best way to allocate fee with the express goal of improving performance.

Reductions in Performance Expectations

In some cases, performance expectations were reduced during the year without an adjustment to the available incentive fees. Performance-based incentives consist of certain variables, including schedule and scope of work. The initial estimates for these variables become the project performance expectations. Increasing the time allowed to complete a project or decreasing the scope of work to be performed is considered a reduction in project performance expectations. We would, therefore, expect a corresponding reduction in the available incentive fee. Alternatively, the record should include a documented rationale for not adjusting the available incentive fee. However, this was not always the case. For example:

- The Savannah River Site issued a baseline change proposal that eliminated two milestones from a performance-based incentive for capital equipment and general plant projects. The original performance metric required that at least 90 percent of milestones be completed in order to earn the total available incentive fee of $500,000. Completing less than 90 percent of milestones would earn the contractor $300,000. Even though the baseline change proposal eliminated two milestones, there was no adjustment to the available incentive fee.

- Kansas City changed a performance metric subsequent to the delivery date for Safeguard Transport vehicles. In July 1999, Kansas City approved a change to the performance evaluation plan that extended the delivery dates for three Safeguard Transport vehicles. The original delivery dates ranged from December 1998 to April 1999. The information provided by Kansas City did not involve a documented rationale for the adjustments to performance metrics. Even though the extension was approved after the original delivery dates had passed, there was no adjustment in the available incentive fee of $240,000 ($80,000 per vehicle).

- At Y-12, the Area Office negotiated a performance-based incentive that required a laboratory purification facility be established by completing two required milestones. The performance-based incentive was established through a baseline change proposal approved in July 1999. However, the contractor actually completed the two required milestones in April and May 1999, respectively. Thus, the Department paid $144,000 in incentive fee for work that was already completed.

Additional examples of modified performance expectations are included in Appendix 2.

Performance-Based Management Policy

The Department's policy is to maximize contractor performance. In 1998, the Office of Procurement and Assistance Management (Procurement) issued a *Performance-Based Contracting Guide*, which stated that incentives can be used to motivate a contractor to achieve higher levels of performance. Similarly, Procurement issued a 1999 report to the Secretary of Energy stating that the true measure of the effectiveness of performance-based incentives is in improvements in contractor performance. In addition, the Department's *Acquisition Guide*, which incorporated the *Performance-Based Contracting Guide*, identifies the roles and responsibilities of both Headquarters Procurement and field site managers for reviewing and approving performance-based incentives.

In responding to this report, Procurement officials emphasized that, in their view, the goal of performance-based incentives is to improve contractor operations over the entire spectrum of the contract. Further, they believe that an evaluation of overall contract performance cannot be made by looking at individual incentives. While we acknowledge that no specific policy requires recurring incentives to facilitate improved performance, the overall purpose of performance-based contracting is to enhance the operations of the Department's contractors over time. The performance-based incentives that are incorporated into major contracts provide the primary mechanism for achieving that goal. In the absence of a compelling alternative means of encouraging and evaluating performance, we would expect that each performance-based incentive would be structured in a manner that would facilitate long-term improvements in contract operations.

Performance-Based Incentive Review and Approval

In conducting the audit, we found that field sites did not fully evaluate past contractor performance when negotiating recurring performance-based incentives. In addition, modifications to performance expectations were controlled through baseline change proposal processes originally designed to address award fee performance rather than incentive fee projects. Also, at Headquarters, Program Offices had not established a formal review and approval process to ensure that negotiated performance-based incentives would improve contractor performance.

Evaluation of Past Contractor Performance

Each year field sites negotiate Performance Evaluation and Measurement Plans which contain contractor performance objectives, expectations, and incentive fees. Field site personnel indicated they consider various factors when negotiating performance metrics and available fee for recurring performance-based incentives. Such factors included changes in budget and resources and the level of difficulty in achieving the performance expectation. However, none of the documentation supporting the recurring performance-based incentives described any evaluation or consideration of improvements in contractor performance from one year to the next. Also, the performance-based incentive documentation did not identify and explain year-to-year changes of the performance metrics and the incentive fee available to the contractor.

In some cases, contractors successfully resisted Department attempts to strengthen performance metrics. For example, Kansas City officials stated that they were unsuccessful in trying to reduce the available incentive fee while keeping the performance metrics the same on a recurring performance-based incentive because they had to negotiate with the contractor and the contractor would not agree to it. Kansas City officials also stated that as a “concession” to the contractor agreeing to the elimination of base fee from the Kansas City Plant contract, the Albuquerque Operations Office reallocated approximately 75 percent of the base fee to incentive fee. Some of the reallocated base fee was applied to recurring performance-based incentives where the metrics were not increased to improve contractor performance.

Field Site Change Proposal Processes

At all three locations, modifications to performance expectations by field site personnel were controlled through baseline change proposal processes. These processes were designed to address award fee performance rather than incentive fee projects, and they did not address the impact of work scope changes on incentive fee when individual performance expectations were modified. It should be noted that changes to award fee performance expectations do not affect the available award fee because of the subjective nature of the evaluation process. In contrast, performance-based incentives involve an objective evaluation of contractor performance, and a reduction in project performance expectations should result in a corresponding reduction in the available incentive fee. Despite this inherent difference, none of the field sites assessed the impact on available incentive fee when modifying performance metrics. In addition, there appeared to be no standard, documented means by which approved modifications were incorporated into the performance-based incentive system.

Headquarters Program Office Review and Approval

Headquarters Program Offices also were not actively involved in ensuring that field site recurring performance-based incentives improved performance. Review requirements were not established for Program Offices, and the reviews that were conducted did not consider past contractor performance.

The Department's *Acquisition Guide* instructs field sites to submit performance-based incentives to Headquarters Procurement for their review and approval. However, there was no such requirement for review and approval by Headquarters Program Offices even though they fund the Department's field activities. While Procurement has requested that Program Offices participate in these reviews, many were not performing formal reviews of Performance Evaluation and Measurement Plans. Program Offices utilized an informal process to evaluate individual performance-based incentives and orally conveyed review comments. Field site personnel acknowledged that they had not received formal Program Office comments on their performance-based incentives, with one site characterizing its Program Office as being disengaged and having very little communication and ownership of the performance-based incentives.

While Program officials agreed that performance-based incentives should be used to improve contractor performance, their reviews did not formally evaluate this aspect of performance. Headquarters Program Office personnel acknowledged that they were not aware of past fees paid to contractors when they evaluated draft Performance Evaluation and Measurement Plans. Their reviews instead were limited to ensuring that field site performance-based incentives specifically addressed annual Program Office project priorities. Thus, Program officials could not provide assurances that proposed performance-based incentives were structured in a manner that would result in contractor improvement.

Achieving the Benefits of Performance-Based Management

Increasing available fee without a corresponding increase in the contract performance expectations, or decreases in the expectation without an adjustment of the fee, in our judgment, is contrary to the express goal of the Department's contract reform effort. Through this effort the Department has sought to motivate contractors to employ innovative business practices and reduce or avoid costs where possible. However, performance incentives that do not raise performance expectations (i.e., raise the bar) undercut the goal of fostering improvement in Departmental operations.

For particular performance-based incentives examined as a part of this audit, $4.4 million was provided without a demonstrated reciprocal benefit of improved contractor performance. In addition, Department contractors were provided incentive fees of $911,000 for FYs 1999 and 2000 for performance-based incentive expectations that had been eliminated or substantially reduced through baseline change proposal modifications.

RECOMMENDATIONS

We recommend that the Acting Director, Management and Administration, in consultation with the Program Offices, revise the Department's *Acquisition Guide* to:

1. Require that field sites evaluate:

    (a) Year-to-year changes in the available incentive fee in relation to negotiated performance metrics for improving contractor performance, including:

- Identifying what, if any, changes in operating conditions will impact incentive fees or performance metrics; and

- Documenting the analytical support for how those operating conditions affect the achievement of negotiated performance-based incentive fees and performance metrics.

(b) The impact on available incentive fee resulting from modifications to performance expectations. The evaluation should be included on a formal performance-based incentive change-control document.

2. Require the Headquarters Program Offices to:

(a) Review field site performance-based incentives, including a determination that individual incentives, especially those of a recurring nature, are structured in a manner that will improve contractor performance; and

(b) Approve field Performance Evaluation and Measurement Plans prior to providing the final negotiated plan to the contractor.

We recommend that the Acting Assistant Secretary for Environmental Management and the Acting Deputy Administrator for Defense Programs develop and implement Program Office specific guidance that incorporates the above recommended revisions to the *Acquisition Guide*.

MANAGEMENT REACTION

Management provided written comments to a draft of this report. We also met with management representatives to further discuss the issues raised and the examples cited.

Management disagreed with the premise supporting the objective of this audit, which was to determine whether the Department's use of performance-based incentive fees had resulted in improved contractor performance at selected sites. Specifically, they asserted that it is not the Department's policy to require that individual performance-based incentives improve contractor performance. Management stated that in many cases the performance-based incentive fee amount is used to compensate the contractor for performance of baseline level work.

Further, they believed that the reallocation of base and award fee to performance incentive fees was adequate justification for increasing the incentive fee without increases in performance metrics. They also asserted that we took their statements regarding improved contractor performance out of context. Specifically, management believes that the goal of performance-based incentives is to improve contractor performance over the entire spectrum of the contract. Management does not believe that it was appropriate to evaluate the overall success of performance-based incentive contracts by looking at individual incentives.

Accordingly, management did not concur with the audit recommendations. Essentially, they believed that the problems this audit identified were documentation issues and that the recommendations should focus only on improving documentation. Specifically, management did not believe that it was necessary at this time to revise the *Acquisition Guide*. They believed that the field sites were already required to conduct the evaluations we recommended. Management did, however, state that they would review existing policy and determine whether it adequately ensured that field sites documented their evaluations of contractor performance, shifting priorities, and year-to-year changes in available incentive fee and performance metrics. They also disagreed with the conclusion that there is no requirement for Headquarters Program Office participation in the performance-based incentive process. They believe that Program Office review and concurrence with the plans is a routine policy and practice.

AUDITOR COMMENTS

As evidenced by management's comments, there was a fundamental disagreement regarding the purpose of performance-based incentives. The use of performance-based incentives was a product of Performance-Based Management Contracting, which resulted from Contract Reform. All of these efforts sought to improve contractor performance.

We recognize that the Department's policy does not specifically require each specific performance-based incentive to improve contractor performance. However, because contract reform sought to use performance-based incentives as a tool for improving overall contractor performance, we believed that it was relevant to determine whether this tool was being used effectively to improve contractor performance over a span of time. Accordingly, we focused our efforts on determining whether contractor performance was improving in recurring performance-based incentives, i.e., whether it was apparent that contractors were improving their performance from a baseline in the first year over succeeding years of performance.

During this audit, management acknowledged that they have not identified a way to determine whether or not performance-based incentive fees are improving contractor performance over the spectrum of the entire contract effort. We believe that a reasonable approach is to review how the performance fees and metrics have evolved over a period of time for a specific body of work. However, we also recognize the possibility that a given performance metric may be subject to unusual circumstances. We would expect that such circumstances would be fully explained and documented.

In order to achieve the overall goal of Performance-Based Management Contracting – improved contractor performance – changes to metrics and incentive fees should, in our opinion, be supported by an analysis that shows an evaluation of changes in operating conditions and past contractor performance. Further, such analyses should be completed prior to negotiations with the contractor. We noted that analytical support of this type was not evident during our fieldwork for the examples we cited in our report.

Regarding management's position pertaining to the reallocation of base and award fees, we believe that such reallocations should consider how the available fee can be used to improve performance. For example, management should consider whether the contractor is already functioning at an acceptable baseline level. If the contractor is, then the available fee could be used as an incentive to reduce the cost of baseline work, or be applied to other work. In conducting our fieldwork, we did not see evidence that these aspects were considered.

RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Inspection of Selected Aspects of the Office of River Protection Performance-Based Incentive Program, (DOE/IG-0506, June 2001). Performance-based incentives awarded by the Office of River Protection (1) did not always challenge the contractor to achieve higher levels of performance; (2) did not specify formal quality acceptance criteria; and (3) did not document the rationale for establishing these fees.

Incentive Fees for Bechtel Jacobs Company LLC, (DOE/IG-0503, May 2001). The Oak Ridge Operations Office eliminated performance objectives in FY 1998, did not finalize performance objectives before the start of FY's 1999 and 2000, and modified performance objectives to reduce expectations during each year.

Performance Incentives at the Idaho National Engineering and Environmental Laboratory, (WR-B-00-05, April 2000). Performance-based incentives at the Idaho National Engineering and Environmental Laboratory resulted in: (1) performance that either declined or was unchanged or could not be directly linked to actions taken by the contractor, and rewarded process rather than outcome; and (2) improvement that was overstated or was compensated twice.

Inspection of the Fiscal Year 1996 Performance Based Incentive Program at the Savannah River Operations Office, (INS-0-98-03, May 1998). The Savannah River Operations Office had incentives that were not clearly stated and paid excessive fees.

Contractor Incentive Program at the Nevada Operations Office, (DOE/IG-0412, October 1997). The Nevada Operations Office performance incentives were vague, could not be validated, and were implemented after the performance period had been completed.

Contractor Incentive Program at the Rocky Flats Environmental Technology Site, (DOE/IG-0411, August 1997). DOE's performance incentives at Rocky Flats did not always include clearly defined criteria, were not structured to encourage superior performance, and were often process-oriented.

Inspection of Performance Based Incentive Program at the Richland Operations Office, (DOE/IG-0401, March 1997). The DOE Richland Operations Office paid excessive incentive fees; paid fees for work that was accomplished prior to the establishment of the incentive program; paid fee for work that was easily achieved by the contractor; and paid fee in an instance where quality and safety were compromised by the contractor in order to achieve an incentive fee.

ADDITIONAL EXAMPLES OF RECURRING PERFORMANCE-BASED INCENTIVES AND MODIFIED PERFORMANCE EXPECTATIONS

Recurring Performance-Based Incentives

- Savannah River incentivized the treatment (incineration) of Plutonium/Uranium Extraction Solvent (PUREX) waste at the Consolidated Incineration Facility. Savannah River increased the available incentive fee by $350,000 from Fiscal Year (FY) 1998 to 1999, even though the performance metric decreased from treating 2.7 million pounds of PUREX waste to treating 2.6 million pounds of waste.

- Savannah River incentivized the processing of low-level radioactive waste in storage (legacy waste). Processing this legacy waste provided the contractor with the opportunity to earn $600,000 in available incentive fee each year. However, in FY 2000 the quantity of legacy waste required to be processed decreased by 1,400 cubic meters (41 percent), while the available incentive fee remained the same. The available incentive fee could have been reduced by $246,000 to correspond with the same percentage reduction in the performance metric.

- Kansas City incentivized the achievement of a specific number of First Production Unit weapon component milestones. Kansas City increased the available incentive fee by $975,000 from FY 1999 to 2000, even though the performance metric remained virtually the same (the achievement of eight milestones in FY 1999 versus nine in FY 2000).

- Kansas City incentivized the contractor to maintain a high level of safety performance. Kansas City provided $610,000 of available incentive fee from FY 1998 to 2000 while loosening the performance metrics or keeping them the same for selected components of the performance-based incentive. This occurred despite the contractor's demonstrated performance of having one of the best safety records in the Department. A total available incentive fee of $350,000 was questioned for those areas where performance metrics were loosened while the incentive fees remained the same ($190,000) and where the performance metrics remained the same but the incentive fees increased ($160,000).

- Kansas City incentivized the on-time delivery of special production weapon components. Kansas City increased the available incentive fee by $240,000 from FY 1999 to 2000 without a corresponding increase in the performance metric (of at least 99.6 percent for on-time delivery).

Performance Expectation Modifications

- The Kansas City Area Office changed a performance-based incentive that incentivized the achievement of a specific number of First Production Unit weapon component milestones. The change extended the delivery date for the W87 component's new build qualification from August to September 2000. There was no adjustment in the available incentive fee of $300,000 for this milestone.

- The Y-12 Plant Area Office established a performance-based incentive that required the contractor to produce two W87 Joint Test Assemblies (Assemblies). The performance-based incentive was established through a baseline change proposal approved by the Area Office in July 1999. However, the contractor actually completed the two assemblies in October 1998, nine months prior to the change proposal. As a result, the Area Office paid the contractor $27,000 in incentive fee for work that was already completed and without any adjustment to the incentive fee amount.

Appendix 3

SCOPE

The audit was performed from July 2000 to February 2001 at Department Headquarters in Washington, DC and Germantown, MD. Field site visits were made to the Savannah River Site in Aiken, SC; the Kansas City Plant in Kansas City, MO; and the Y-12 Plant in Oak Ridge, TN.

METHODOLOGY

To accomplish the audit objective we:

- Reviewed prior OIG reports related to performance-based management contracting, specifically those relating to performance-based incentives, at the Department's for-profit contractors;

- Reviewed Departmental policy on performance-based management contracting, specifically that relating to performance-based incentives;

- Held discussions with Headquarters personnel from the Office of Management and Administration, Office of Environmental Management, and the Office of Defense Programs.

- Selected three Departmental field sites based on contract value and the substantial number of performance-based incentives.

- Selected a judgmental sample of performance-based incentives for FYs 1997-2000.

- Examined field site Performance Evaluation and Measurement Plans, performance-based incentive documents and related information for FYs 1997-2000.

- Held discussions with field site contracting and program personnel.

- Evaluated the Department's implementation of the *Government Performance and Results Act of 1993* related to the establishment of performance standards or measures for performance-based incentives.

We conducted the audit 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. The Department had not established performance standards or measures specifically relating to performance-based incentives. Therefore, we were unable to assess the effectiveness of the performance measures that might have been used. We did not rely on computer-processed data to accomplish the audit objective. Therefore, we did not assess the data reliability.

We held an exit conference with officials on July 2, 2001.

IG Report No. : DOE/IG-0510

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