DOE/IG-0559

AUDIT REPORT

PRIVATIZATION OF SAFETY MANAGEMENT SERVICES AT THE SAVANNAH RIVER SITE

JUNE 2002

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

U. S. DEPARTMENT OF ENERGY
Washington, DC 20585

June 18, 2002

MEMORANDUM FOR THE SECRETARY

FROM: Gregory H. Friedman (Signed)
Inspector General

SUBJECT: INFORMATION: Audit Report on "Privatization of Safety Management Services at the Savannah River Site"

BACKGROUND

In January 1997, Westinghouse Savannah River Company, the management and operating contractor at the Savannah River Site, submitted a privatization proposal requesting approval to form a "spin-off" company to perform safety management services. The new company, Westinghouse Safety Management Solutions, Incorporated (WSMS), would be a wholly owned subsidiary of Westinghouse and would be largely comprised of Westinghouse personnel already performing safety management services at the site. To justify the spin-off, the management and operating contractor prepared a make-or-buy analysis indicating that by using WSMS the Department would save at least $11.5 million over 5 years. The Department approved the proposal and allowed Westinghouse to enter into a sole-source, cost-reimbursable agreement with WSMS beginning in Fiscal Year 1998.

The objective of this audit was to determine whether the privatization of safety management services at the Savannah River Site has reduced the Department's cost.

RESULTS OF AUDIT

Rather than reducing costs as expected, the privatization effort has actually increased the Department's safety management operating costs by, on average, $2 million per year. We found that the Westinghouse privatization proposal contained an inaccurate make-or-buy analysis, that it was not thoroughly evaluated by responsible Federal managers, and that the Department did not require competitive bids for the safety management services. In fact, we were told that a desire to avoid layoffs, not reducing cost, was the primary factor in the decision to approve the establishment of WSMS. As a result, from 1998 through 2001, the Department incurred about $8 million in unnecessary costs. Based on the average annual cost for the last three fiscal years, an additional $6.3 million in unnecessary costs could accrue during the remainder of the contract, which extends through Fiscal Year 2006.

We recommended a series of specific actions intended to enhance the Savannah River Operations Office's analyses and decision-making process with respect to its continuing privatization initiatives.

MANAGEMENT REACTION

The Manager, Savannah River Operations Office did not agree with our conclusions that privatizing safety management services increased the Department's costs. He stated that our analysis did not include all relevant factors and that we relied on judgmental variables in estimating the cost of retaining the services in-house. The Manager also believed that the creation of WSMS met its stated objective, preservation of technical capability for use by Department sites. Management comments have been included in their entirety at Appendix 1.

Based on the Manager's concerns, we revisited our financial analysis and modified it to include additional cost factors. In particular, we added back costs associated with certain post-retirement benefits the Department could have accrued had Westinghouse (rather than WSMS) continued to perform the safety management services. Even with those adjustments, however, we found that the WSMS proposal would not have been the favored alternative from a cost standpoint. In every reasonable scenario we analyzed, privatizing safety management with WSMS was more costly than keeping the services with Westinghouse. A summary of our comparative estimates is included as Appendix 2. Additionally, we concluded that the Department had not demonstrated that technical capabilities provided by WSMS were so unique as to justify the non-competitive process used to create the new venture.

Given the importance the Department has placed on safety issues, we respect efforts to retain talented personnel with specialized safety expertise and experience. However, the Westinghouse proposal was based, in large measure, on a commitment to reduce safety management costs. Available documentation confirms, as well, that the Department regarded cost savings as a factor influencing its decision to allow Westinghouse to enter into a sole source subcontract with WSMS for such services. Based on the record to date, the WSMS operation has not met the anticipated cost reduction objective.

Attachment

cc: Chief of Staff
Under Secretary for Energy, Science, and Environment
Manager, Savannah River Operations Office

PRIVATIZATION OF SAFETY MANAGEMENT SERVICES AT THE SAVANNAH RIVER SITE

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OVERVIEW

INTRODUCTION AND OBJECTIVE

The Department of Energy (Department) has encouraged the privatization of activities with commercial sources as a means to reduce the cost of doing business and shift greater performance and financial risk to the private sector. The Department's Contract Reform Team issued a report in 1994, *Making Contracting Work Better and Cost Less*, which recommended a decreased reliance on management and operating (M&O) contractors to accomplish required activities. The report also recommended that the Department improve its make-or-buy decision-making process and explore more cost-effective contracting strategies. The make-or-buy analysis helps to determine whether it is more desirable to make a good or provide a service, rather than acquire the good or service from outside sources.

In January 1997, Westinghouse Savannah River Company (Westinghouse), the Department's M&O contractor at the Savannah River Site, submitted a privatization proposal to the Department requesting that it be allowed to form a spin-off company to perform safety management services at the site. These services include engineering and consulting in safety analysis and safety documentation, as well as preparing health and safety plans and developing regulatory positions. The new company, Westinghouse Safety Management Solutions, Incorporated (WSMS), would be a wholly owned subsidiary of Westinghouse largely comprised of Westinghouse personnel already performing safety management services at the site. To justify the spin-off of safety management services, Westinghouse prepared a make-or-buy analysis that concluded the Department would realize a savings of at least $11.5 million over 5 years by having WSMS perform the services. The Department approved the proposal and allowed Westinghouse to enter into a sole-source, cost-reimbursable agreement with WSMS to perform safety management services at the site beginning in Fiscal Year (FY) 1998. The current agreement is to have WSMS continue to perform these services as long as Westinghouse is the M&O contractor. The contract extends through FY 2006.

The objective of this audit was to determine whether the privatization of safety management services at the Savannah River Site has reduced the Department's cost.

CONCLUSIONS AND OBSERVATIONS

Contrary to expectations, privatization of safety management services with WSMS has cost the Department about $2 million more per year than if the services had remained in-house. Westinghouse's privatization proposal contained an inaccurate make-or-buy analysis and the Department did not thoroughly evaluate the merit of the proposal. In addition, the Department did not require that the work be competitively bid to minimize costs. In fact, Department officials stated that cost was not a deciding factor in approving the establishment of WSMS. Rather, the decision was based primarily on a desire to avoid layoffs of safety management engineers. As a result, from FY 1998 through FY 2001, the Department incurred about $8 million in unnecessary costs and based on the average annual cost for the last three fiscal years, could incur about $6.3 million in additional unnecessary costs during the remainder of the contract.

Prior Office of Inspector General audits also identified problems concerning the Department's make-or-buy decision-making process. In our audit on *Central Shops at Brookhaven National Laboratory* (ER-B-00-01, May 2000), we determined that Brookhaven did not prepare a make-or-buy analysis for its Central Shops services and may have missed opportunities to reduce fabrication costs. Also, our report on *The Department's Management and Operating Contractor Make-or-Buy Program* (DOE/IG-0460, February 2000) noted that three of the four contractors reviewed had either not included all functions in their make-or-buy plans or had not scheduled cost-benefit analyses for many functions that were candidates for outsourcing. Finally, our audit of *Architect and Engineering Costs at Los Alamos and Sandia National Laboratories* (DOE/IG-0424, August 1998) disclosed that Los Alamos incurred higher costs for architect and engineering services, in part, because it did not use competition in selecting contractors for some projects.

This audit identified issues that management should consider when preparing its year-end assurance memorandum on internal controls.

(Signed)
Office of Inspector General

COSTS WERE NOT REDUCED

Cost of Safety Management Services

The privatization of safety management services at the Savannah River Site has resulted in increased safety management costs. We estimated that the privatization of these services was costing the Department an average of $2 million more per year with WSMS than if the services had remained in-house with Westinghouse. As illustrated in the following table, the average annual cost to the Department of having WSMS perform safety management services, for FYs 1998 through 2001, was $22.9 million. We determined that the average annual cost that the Department would have incurred had Westinghouse performed the same services in-house with the same level of effort would have been about $20.9 million.

Comparison of WSMS Actual Costs to Westinghouse Reconstructed Costs

Fiscal Years

(Rounded in millions)

	1998	1999	2000	2001	Annual Average
WSMS	$23.0	$21.6	$20.4	$26.7	$22.9
Westinghouse	$18.9	$19.9	$19.1	$25.9	$20.9
Cost Difference	$4.1	$1.6	$1.3	$0.8	$2.0

The cost difference was primarily attributable to WSMS having a higher combined labor and overhead rate than Westinghouse. A detailed comparison of WSMS actual costs to Westinghouse's reconstructed costs for FYs 1998 through 2001 is in Appendix 2.

During our audit, we discussed our preliminary finding and the methodology used to estimate Westinghouse costs with representatives from the Savannah River Operations Office. At that time, management did not take exception to the methodology used to reconstruct costs. In a written response to our draft report, however, management disagreed with our conclusion that privatizing safety management services had increased the Department's costs. Specifically, management stated that our analysis was not precise enough to be relied upon because it did not include annual costs of about $300,000 in Post Retirement Benefits Other Than Pensions (PRBOTP) and used judgmental variables in estimating the cost of retaining safety management services in-house. Management asserted that if the variables were reasonably adjusted, our analysis would provide an essentially neutral reconstructed cost comparison. In particular, management contended that the productivity factors we used were higher than the former Westinghouse Safety Analysis organization experienced.

Based on management's response, we revised our cost estimate to include PRBOTP, which we estimated to be about $300,000 annually. However, including these costs still does not make WSMS cost effective. Also, the Office of Inspector General disagrees with management's assertion that using higher productivity factors would have shown that contracting with WSMS was cost effective. The values used in estimating the cost of retaining the services in-house were either the costs actually expensed by Westinghouse or were conservative values chosen from a range we considered reasonable. In making our estimates we used actual Westinghouse productivity factors. It should be noted that raising the productivity factor would have caused Westinghouse's costs to be even lower.

Department Policy and Westinghouse Contract Requirements

Department policy requires that privatization initiatives be supported through make-or-buy analyses that establish a preference for providing goods or services on a least-cost basis. In addition to the Contract Reform Team's recommendations, the Department's Privatization Working Group issued a report in 1997, *Harnessing the Market: The Opportunities and Challenges of Privatization*, with similar recommendations. The working group concluded that successful privatization depends on the Department's ability to move from cost-reimbursement contracts with broad statements of work to narrowly defined, fixed-price or incentive-based contracts that are competitively awarded.

In addition, the Department's contract with Westinghouse requires that privatization initiatives be supported through the development of a make-or-buy program emphasizing efficient performance on a least-cost basis. The contract also requires Westinghouse to maximize the use of competition and fixed-price subcontracting to reduce operating costs for the site.

In keeping with Department policy and contractual requirements, Westinghouse established an internal policy to require that make-or-buy analyses be performed to determine whether to provide specific services in-house or to purchase the services from another contractor.

The analysis is to provide the Department with the most unbiased selection of procurement or internal resources for performance of services at the lowest estimated cost. When conducting cost comparisons, Westinghouse is to ensure that all costs are considered and that these costs are realistic and fair.

Westinghouse Analysis, the Department's Evaluation, and Competition

Westinghouse's privatization proposal was based on an inaccurate make-or-buy analysis that the Department did not thoroughly evaluate. In addition, the Department did not require that safety management services be competitively bid to further minimize costs.

Proposal Analysis

The Westinghouse make-or-buy analysis contained unrealistic cost data and omitted certain categories of cost from consideration. For example, the analysis used inflated fringe benefit rates to estimate the cost for keeping the services in-house. Westinghouse's average annual fringe benefit rate for exempt employees was 22 percent from FY 1994 through FY 1996 and 20 percent from FY 1997 through FY 2001. However, the analysis used an average rate of about 31 percent. The Westinghouse manager responsible for the analysis was unable to provide support for this percentage. This overstated the cost of keeping the services in-house by about $1.2 million per year. In addition, the analysis omitted costs of about $300,000 per year for Westinghouse employees who provide oversight of the WSMS subcontract. Including these two categories of cost would have increased the relative cost of subcontracting the work to WSMS.

Department Evaluation

The Department did not thoroughly evaluate the merit of the Westinghouse proposal to ensure that privatizing safety management services would actually reduce operating costs. In fact, the Department's contracting officer stated that cost was not a deciding factor in approving the establishment of WSMS. According to the contracting officer, the decision to establish WSMS to perform safety management services was based primarily on a desire to avoid layoffs of safety management engineers at the site in order to preserve a technical capability for use by other Department sites. Also, the Department did not believe that a precise cost estimate could be constructed for a newly formed company. Thus, from the Department's perspective Westinghouse was not required to formally correct the make-or-buy analysis that supported the decision to establish WSMS. In addition, management was not aware of the additional costs incurred after WSMS was established because the Department did not follow-up to evaluate the cost impact of its decision to privatize.

In written comments on our draft report, management stated that it mandated inclusion of a provision in the agreement between Westinghouse and WSMS that would allow Westinghouse, at the Department's direction, to withdraw work from WSMS if it failed to perform in a cost-effective or technically proficient manner. Also, management stated that it has and will continue to monitor privatization activities and that it monitors the performance of WSMS and the costs paid to WSMS.

During our review, we noted that the provision management cites was included in the agreement, but we also observed that the Department had only recently initiated an analysis of the reasonableness of WSMS costs. Monitoring efforts to date consisted only of ensuring that WSMS costs were consistent with the requirements set forth in the Annual Operating Plan and did not compare WSMS costs to what it might cost to acquire the services from another source.

Consideration of Competition

The Department also did not require Westinghouse to solicit competitive bids for safety management services to ensure minimal operating costs. Instead, Westinghouse was allowed to enter into a sole-source, cost-reimbursable agreement with WSMS to perform these services. Prior to privatization, Westinghouse identified five competitors that could have performed similar services and may have competed for the contract. Competition would have been an effective way to ensure that the Government obtained the best value for its investment.

Management stated that special expertise was being acquired in this procurement action through an affiliate transfer process and there was not a requirement for competition, nor for obtaining the services on a "least cost" basis. Nevertheless, according to management, both the structure of the Westinghouse contract and the agreement with WSMS clearly provide that the Savannah River Operations Office may promptly seek competition if management determines such action is appropriate. The agreement between Westinghouse and

WSMS stipulates that the services will be purchased from WSMS only if the technical quality is acceptable and the costs are reasonable.

The Office of Inspector General recognizes that competition may not be possible when purchasing a special expertise. However, Westinghouse has acknowledged that other competent safety management firms existed. In fact, WSMS currently subcontracts a portion of its work to other firms. Furthermore, this expertise did not need to be acquired because it already existed in-house. Although management was performing a market analysis and evaluating the reasonableness of WSMS costs, management has not indicated if it would obtain competition if the results of the review support it.

Unnecessary Costs

From FY 1998 through FY 2001, the Department incurred approximately $8 million more for safety management services by using WSMS than it would have had the services remained in-house. Additionally, based on the average annual cost for the last 3 fiscal years, the Department could incur about $6.3 million in unnecessary costs during the remaining 5 years of the contract.

Unless more is done to evaluate proposals submitted by Westinghouse, future decisions regarding privatization at the site may not ensure that the Department selects the least-cost alternative. The Department is considering the privatization of two additional services at the site in the near future—medical services, with annual costs of about $4.8 million; and maintenance of administrative facilities, including fire protection, with annual costs of about $7.5 million. Decisions regarding privatization of these services could have a significant impact on future costs.

RECOMMENDATIONS

We recommend that the Manager, Savannah River Operations Office:

1. Competitively acquire safety management services at the Savannah River Site as soon as practical;

2. Require that Westinghouse prepare thorough and accurate make-or-buy analyses for privatization initiatives;

3. Ensure that Westinghouse seeks competitive bids when qualified bidders are available for future procurements unless there is a compelling reason for using another contracting method;

4. Direct the Contracting Officer to thoroughly evaluate make-or-buy analyses prepared by Westinghouse prior to selecting least-cost alternatives; and,

5. Direct Operations Office personnel to perform follow-up reviews of privatization initiatives to determine whether the initiatives actually reduce overall costs, and initiate timely corrective action when appropriate.

MANAGEMENT REACTION

Management agreed with recommendations 2 through 4 and has initiated corrective action. Management partially concurred with the first recommendation, indicating that under the Westinghouse contract and WSMS agreement, the Department has the option to seek competition for safety management services or to reduce fees if costs for these services are deemed unreasonable. With regard to recommendation 5, management again partially concurred, noting that while the Department was, in fact, monitoring WSMS cost and performance, not all privatization activities are implemented solely to generate cost savings. Overall, management believed that the creation of WSMS met its stated objective, preservation of a technical capability for use by Department sites.

Management's verbatim comments are included as Appendix 1.

AUDITOR COMMENTS

Based on our audit, we concluded that WSMS was not providing services so unique to justify a sole-source procurement, especially when, by our estimate, the services now cost substantially more than when they were provided by Westinghouse. As noted, management disagrees with our assessment of the uniqueness of services and with our cost estimate. In our judgment, the most logical way to resolve these matters is for the Department to hold an open competition as soon as practical. Only when such a competition occurs can the Department be assured that its requirements for safety management services at the site are being met in the most cost-effective manner.

DOE F 1325.8

United States Government

Department of Energy (DOE)

Savannah River Operations Office (SR)

memorandum

DATE: APR 0 1 2002

REPLY TO ATTN OF: CMD (T. E. Reynolds, 803-725-1680)

SUBJECT: Draft Audit Report on "Privatization of Safety Management Services at the Savannah River Site" (IG-30)

TO: Gregory H. Friedman, Inspector General (IG-1), HQ

The Savannah River Operations Office (SR) has agreed in part with the recommendations made in this draft report; however, SR is not in total agreement with the findings that prompted the recommendations. Subject draft audit report asserts: SR approved the audited transaction without performing a thorough review of the Make-Or-Buy (MOB) analysis performed by the contractor; the MOB analysis prepared by the contractor was flawed; the decision to approve the transaction was based primarily on a desire to avoid layoffs of safety management engineers at the site; the transaction was not competitively awarded; and, SR incurred about $9 million in unnecessary costs. The documentation in the case files provided to the Office of the Inspector General (OIG) does not support the OIG's findings. Further, SR does not agree with the conclusion SR incurred $9 million in unnecessary costs or will incur approximately $8 million in future unnecessary costs. SR's review of the reconstructed cost analysis referenced in the report reveals the OIG did not take into consideration all relevant cost information.

The case file shows that SR performed a thorough review of the initial MOB analysis presented by the contractor and disagreed with it. SR did not require a formal correction of the analysis because the "Buy" side of the analysis was based upon projected costs of a yet to be formed organization. It was apparent that a precise cost estimate could not be constructed for a newly forming company. The concept proposed by the contractor was to preserve the function's capabilities by creating a commercial subsidiary to perform the services it was required to perform under its contract with SR, while preserving a special capability for availability to other DOE sites. As discussed below, the approved business arrangement inherently provided for the control of costs. Under the arrangement approved by DOE, the contractor took considerable financial risk in developing the commercial subsidiary without a guarantee that it would receive work.

The file documentation clearly shows that the primary reason for approval of this initiative was not simply to avoid the layoff of safety management engineers at the site, but to avoid layoffs of these personnel in order to preserve a technical capability for use by other sites in the complex. SR was the first site in the complex to have an approved Integrated Safety Management System. The capabilities of the WSRC safety management engineering function were recognized within the DOE complex, and SR believed it would be beneficial to the Department to preserve the capabilities of the organization for the benefit of other DOE sites. After lengthy negotiations with Westinghouse Savannah River Company (WSRC), SR approved the transaction based upon the concepts outlined under the Purchasing From Contractor-Affiliated Sources provisions of the Department of Energy Acquisition Regulation (DEAR) 970.4402-3. These provisions permit purchasing technical services from a company affiliate without competition where the affiliate has a special expertise. Because there was a special expertise being acquired, there was neither a requirement for competition, nor a requirement that the services be obtained on a "least cost" basis.

To ensure DOE costs for the services would be reasonable, SR mandated inclusion of a provision in the agreement between WSRC and its subsidiary which states: "Should Westinghouse Safety Management Solutions, Inc. (WSMS) fail to perform the assigned work in a cost effective or technically proficient manner, WSRC, at the direction of the Department of Energy, shall have the right to withdraw work assigned under this Interworks Requisition" (IWR – a WSRC purchasing document used to acquire services from affiliates). Further, under the terms of the agreement, the new company assumed the severance pay liability for all former WSRC personnel at the end of the contract term. SR projected that costs charged to the site would decrease because WSMS intended to

Mr. Friedman, (IG-1) 2 APR 0 1 2002

increase the ratio of technicians to engineers, and through absorption of overhead costs by other potential customers. Further, approving the establishment of a commercial subsidiary would also provide economic transition assistance to the local community, which had already been affected by the downsizing at the site.

SR extensively discussed with OIG representatives the OIG's reconstruction of WSRC costs. The OIG's cost analysis demonstrates a trend that WSMS continues to become more efficient (relative to the reconstructed in-house WSRC costs) with each year. This trend confirms the Department's initial belief that costs should decrease under the approved arrangement. However, in at least one major respect, the OIG cost comparison did not consider all costs that the Department would be liable for if safety management services had remained within WSRC. The OIG chose not to include Post Retirement Benefits Other Than Pensions (PRBOTP) in its cost comparison. PRBOTPs include retiree medical costs which are substantial for M&O contractors who reach retirement age. PRBOTPs will never be paid to WSMS personnel under the Department's contractual arrangement with WSMS, but would have been paid upon retirement to WSRC retirees had they not transferred to WSMS. The OIG chose not to include PRBOTPs costs in its in-house cost comparison because PRBOTPs are not funded until retirement (in other words, PRBOTPs are funded on a "pay as you go" basis). Excluding these costs, however, dramatically understates certain future Departmental costs that can be actuarially determined today. There are a number of acceptable methods for pro-rating (or amortizing) future PRBOTP costs to current operations, but a very conservative calculation results in annual PRBOTP costs of about $300,000 not considered in the OIG calculations. Because the Department was relieved forever of these future PRBOTP costs, such costs should be included in the calculations and amortized over a reasonable life (i.e., 30 years). It is noted that the OIG's decision to ignore PRBOTP costs is inconsistent with Office of Management and Budget (OMB) Circular A-76 guidance which requires federal agencies to include unfunded federal retirement costs when performing a cost comparison analysis.

Furthermore, the OIG's reconstructed cost estimate for WSRC performance included other judgmental variables. Reasonable adjustments to the variables provides an essentially neutral, reconstructed cost comparison. For example, the OIG used employee productivity factors that were higher than the former WSRC Safety Analysis organization experienced ("productivity factors" represent the per cent of any employee's time devoted to direct work tasks vice "nonproductive" time such as training, general meeting attendance, and so on). Using a defensibly higher productivity factor would have shown in-house costs to be higher than WSMS costs. Accordingly, using other productivity factors, including PRBOTP costs, and recognizing the positive cost trends identified in the audit report, the cost reconstruction would show a benefit to the Government.

Since SR's approval of the creation of WSMS, the company has provided assistance to virtually every site in the complex, many of which were supported through the IWR approved by SR. Thus, the primary basis for approval of the transaction has met its stated objective – preservation of a technical capability for use by other sites in the complex. Further, additional benefits, as discussed above, have accrued to DOE at no material increase in cost.

Responses to the Recommendations in the draft audit report are set forth in Attachment 1.

As instructed in your office's March 11, 2002, memo, I have limited my comments to two pages in order for this document to be incorporated verbatim into the report to provide an accurate portrayal of the management response to this draft audit. Please contact me or T. E. Reynolds, 803-725-1680, if you or your staff have any questions.

Greg Rudy
Manager

CMD:TER:kao

SB-02-0089
Attachment:
SRS Response to OIG Draft Report

Comparison of Actual Cost to Reconstructed Cost

	1997	1998	1999	2000	2001	1998-2001 Total	Annual Average	Notes
		Fiscal Years						
		(Millions)						
WSMS Actual Cost								
Direct Labor		$8.2	$8.1	$8.4	$10.3	$35.0	$8.8	1
Indirect Cost		10.9	9.9	10.0	11.8	42.6	10.7	1
WSRC Support		0.3	0.3	0.3	0.4	1.2	0.3	2
Subcontract Cost		3.6	3.3	1.8	4.2	12.8	3.2	1
Total Cost		$23.0	$21.6	$20.4	$26.7	$91.7	$22.9	
Westinghouse Cost for In– House Performance								
	Actual Costs	Reconstructed Estimate						
Direct Labor	$10.2	$8.4	$9.2	$9.9	$12.4	$39.9	$10.0	3
Indirect Labor	2.7	2.2	2.3	2.3	2.8	9.6	2.4	4
Benefits	2.3	2.1	2.3	2.3	3.0	9.8	2.5	5
Other Indirects	2.7	2.2	2.4	2.5	3.2	10.3	2.6	6
Subcontract Cost	1.8	3.6	3.3	1.8	4.2	12.8	3.2	1
PRBOTP		0.3	0.3	0.3	0.3	1.2	0.3	8
Total Cost	$19.7	$18.8	$19.9	$19.1	$25.9	$83.7	$20.9	
Cost Difference		**$4.1**	**$1.6**	**$1.3**	**$0.8**	**$8.0**	**$2.0**	7

(Figures in chart are rounded based on original calculations.)

Notes:

1. These are the actual costs billed by WSMS from FYs 1998 through 2001.

2. We estimated the cost Westinghouse incurred to administer the WSMS contract based on the actual pay rates and time spent by some Westinghouse employees, and a percentage of time as estimated by other employees.

3. Direct labor was estimated assuming that Westinghouse would have worked the same number of hours as WSMS, and the ratio of exempt to non-exempt personnel would have been the same as in FY 1997. Also, we adjusted the salary estimates for non-exempt and exempt personnel using the actual general and merit-pay increases applied to the actual FY 1997 average salaries.

4. Indirect labor includes training, leave, and other labor not directly chargeable to a specific scope of work. These costs were calculated by using the average of the actual annual productivity rates of the three Westinghouse divisions with the most engineers at the site.

5. Benefits costs include Westinghouse's portion of Federal and state unemployment taxes, FICA, pensions, and life and health insurance. Westinghouse's exempt and non-exempt personnel have different benefits rates; therefore, their benefits costs were calculated separately and added together. The actual benefits rates for Westinghouse's exempt and non-exempt personnel were used.

6. Other indirect costs include items such as computer hardware and software, indirect support subcontracts, rents/leases, travel, division overhead, and facilities and utilities cost. The other-indirect-cost rate was derived by dividing the actual FY 1997 other indirect cost by the total labor and benefits cost. This rate was then applied to the total labor and benefits cost for each year.

7. Costs increased $8 million, or an average of $2 million per year, between FYs 1998 and 2001. The annual cost difference for FYs 1999 through 2001 may be a better indicator of future patterns because FY 1998 may have included some start-up costs. The average annual cost increase for these three fiscal years is $1.3 million.

8. Post Retirements Benefits Other Than Pensions (PRBOTP) are health, dental, and life insurance benefits that are provided to employees that retire from Westinghouse. These costs were added to the reconstructed cost estimate because they represent a future liability that would be incurred by Westinghouse if it continued to perform the services in-house. The estimated $300,000 annual cost is based on the FY 1997 present value PRBOTP obligation per a Westinghouse actuarial study.

SCOPE

The audit was performed from July 2, 2001, to February 7, 2002, at the Savannah River Site in Aiken, South Carolina. The audit covered the activities associated with the privatization of safety management services at the site from October 1997 through September 2001.

METHODOLOGY

To accomplish the audit objective, we:

- Evaluated Westinghouse's make-or-buy analysis prepared to support the privatization of safety management services;
- Compared the actual cost of safety management services after WSMS was in place to an estimate of the cost had the services remained in-house at Westinghouse;
- Interviewed Savannah River Operations Office and Westinghouse officials regarding privatization initiatives pursued at the site from October 1995 through July 2001;
- Reviewed Federal regulations regarding the make-or-buy decision-making process and the competitive award of contracts; and,
- Evaluated the Department's and Westinghouse's policies and contractual requirements concerning privatization initiatives.

The audit was performed 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. In addition, we reviewed the implementation of the Government Performance and Results Act of 1993 as it related to the privatization of safety management services. No specific performance measures were established for privatization efforts because privatization was not a recurrent activity. In performing this audit, we did not rely significantly on computer-generated data.

We held an exit conference with representatives of the Savannah River Operations Office's Chief Financial Officer on May 17, 2002.

IG Report No.: DOE/IG-0559

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4. What additional actions could the Office of Inspector General have taken on the issues discussed in this report which would have been helpful?

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