



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

Special Review

Cost Incentives for the Department's Cleanup Contract in Idaho



OAS-RA-13-20

May 2013



Department of Energy
Washington, DC 20585

May 13, 2013

MEMORANDUM FOR THE MANAGER, IDAHO OPERATIONS OFFICE

A handwritten signature in black ink, appearing to read "Rickey R. Hass".

FROM: Rickey R. Hass
Deputy Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Special Review of "Cost Incentives for the
Department's Cleanup Contract in Idaho"

BACKGROUND

In Fiscal Year 2005, the Department of Energy (Department) awarded a Cost-Plus-Incentive-Fee contract to CH2M ♦ WG Idaho, LLC (CWI) to lead environmental cleanup of its Idaho National Laboratory site. The contract originally ran from May 1, 2005 through September 30, 2012, and has been extended for 3 years to September 30, 2015. The contract had a target cost of \$2.7 billion and a target fee of \$196 million (7.36 percent of target cost). The contract includes an additional incentive if work is completed under target cost, in which the fee will be increased by 30 cents for every dollar that the total allowable cost is less than the target cost.

In addition to the target work to be completed within the contract, additional non-target work was allowed under Section B.5 of the contract. When the contract was originally approved, the contractor anticipated that the amount of additional non-target work would be approximately \$89 million. However, the amount of non-target work completed ultimately increased to about \$510 million, with the largest increase attributable to work funded under the American Recovery and Reinvestment Act of 2009 (Recovery Act). The Department and CWI are now negotiating to close out the agreed upon scope of work covered by the contract performance period that ended September 30, 2012, and to calculate fee based upon the cost to complete this work. In that connection, the Department requested that we perform this review. Our objective was to examine the appropriateness of the contractor's allocation of General and Administrative (G&A) costs to the entire scope of non-target work.

RESULTS OF AUDIT

During our review, nothing came to our attention to indicate that G&A costs had not been properly allocated to the non-target work. In accordance with its Cost Accounting Disclosure Statement, CWI allocated about \$128 million in G&A expenses to its non-target work, which was about \$88 million more than originally planned for the contract. This allocation reduced the G&A expense allocated to CWI's target work, thereby reducing the total costs of target work.

The contractor contends the allocation served to reduce the actual cost of target work scope, and as a consequence, it is entitled to earn fee at the target work scope rate on the allocated amount. During the audit, however, we learned that the Department disagreed with impact of the G&A allocation on the incentive fee and was in a dispute with CWI regarding its overall fee.

G&A Expense Allocation

We did not identify any concerns with CWI's allocation of G&A expense to its non-target work. The allocation appeared to comply with the terms of the contract and was consistent with Cost Accounting Standards and CWI's disclosure statement regarding how it manages indirect costs. Although we did not examine all elements or components of the G&A pool in detail, the types of charges allocated appear, at the surface, to be ones that are generally considered allowable and allocable under the Federal Acquisition Regulation. In addition, the Department has acknowledged that CWI's allocations of G&A expenses were done in accordance with generally accepted accounting principles and Cost Accounting Standards.

Undefinitized Fee Structure

The Department had taken some action to protect its interests with regard to fee on Section B.5 work, however, Federal officials had not definitized terms of the contract in this area. While contracting officials communicated to CWI that the fee structure was not final pending decisions regarding G&A allocations early on — in April 2010 — they did not take action to rule on the fee until January 2012, about 5 months after CWI submitted a proposal for fee associated with G&A allocation. The following key facts we noted during our review provide a timeline of the activities associated with the series of contracting actions and contractor claims that took place:

- The original contract estimated that the non-target work was to be approximately \$89 million.
- The actual amount of non-target work was \$510 million, with Recovery Act work being the largest contributor to the increase.
- The Recovery Act related major increase meant that a greater portion of G&A costs would be allocated to the non-target work than was contemplated in the original contract. Given the structure of the cost reduction incentive, the more G&A costs allocated to the non-target work, the higher the potential cost incentive fee.
- Recognizing this, the Department added a clause to its contract modifications beginning in April 2010, shortly after Recovery Act Section B.5 work began, stating that "this modification is subject to adjustment upon the determination whether or not to include G&A costs in the Section B.5 out of target work scope fee calculation."
- CWI accepted these modifications along with the funding provided subject to this new language in the contract that the fee calculation would be definitized at a later date.
- In August 2011, CWI communicated to the Department's Contracting Officer that it believed it was entitled to fee based on its allocation of G&A costs to non-target work.

- In January 2012, the Contracting Officer notified CWI that the Department would not pay cost incentive fee for cost allocations because the Department viewed the allocation as redistribution of contract costs rather than a realization of savings to the Department.
- CWI refused to accept the Department's position, asserting in February 2012, that its claim for fee was appropriate and consistent with the objectives of the contract.
- Shortly afterward, according to CWI, the discussion over the fee was postponed so CWI and the Department could concentrate on negotiating a 3-year contract extension.
- The original contract period ended September 30, 2012, and CWI sent a letter to the Department's Contracting Officer on December 13, 2012, claiming final fee, which included the claim for the entire amount of the fee in dispute attributable to the G&A allocation.

Based on the totality of the information we reviewed, we concluded that the contract modifications accepted by CWI disclosed that its fee earning potential in this area was undefinitized. While the Department did not act to definitize the contract promptly, it asserted that it preserved its right to do so by including instructions regarding fee determination in the modification to the contract that provided Recovery Act funding. We also noted that the contractor accepted the modification and performed the work it was tasked to do. The Department's notice to the contractor regarding the fee was, in effect, ultimately definitized when it rendered its decision not to pay an incentive fee related to the allocation of G&A costs to Section B.5 work scope funded by the Recovery Act. The definitization in this case was consistent with the contract with CWI, which states that "final fee determination will be calculated by the Contracting Officer."

RECOMMENDATION

To conclude this issue, we recommend that the Manager, Idaho Operations Office, direct the Contracting Officer to review and finalize CWI's final contract claim.

MANAGEMENT COMMENTS

Management concurred with the report's recommendation and indicated that corrective action has been initiated. Management's formal comments are included in their entirety in Attachment 2.

Attachment

cc: Deputy Secretary
Acting Under Secretary for Nuclear Security
Senior Advisor for Environmental Management
Assistant Secretary for Nuclear Energy
Chief of Staff

OBJECTIVE, SCOPE AND METHODOLOGY

OBJECTIVE

We performed this review to examine the appropriateness of the contractor's allocation of General and Administrative (G&A) costs to the entire scope of non-target work.

SCOPE

This review was performed from November 2012 through April 2013. We conducted the review at the Idaho Operations Office and CH2M ♦ WG Idaho, LLC (CWI) offices in Idaho Falls, Idaho. The scope of our review was limited to the issue in dispute between CWI and the Department of Energy (Department) concerning the allocation of G&A costs from the target cost to Section B.5 of the contract, and the effect upon fee.

METHODOLOGY

To accomplish the objective of this assessment, we:

- Reviewed applicable laws and regulations related to incentive fee;
- Interviewed Department and contractor personnel at the Idaho National Laboratory site; and
- Reviewed CWI's contract and modifications.

We conducted this review in accordance with generally accepted Government auditing standards for attestation engagements. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our review objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our review objectives. We did not assess all the costs of the project and can therefore give only limited assurance on these costs. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our assessment. We did not rely on computer-processed data to satisfy our objective.

Management waived an exit conference.

MANAGEMENT COMMENTS

United States Government

Department of Energy

memorandum

Idaho Operations Office

Date: April 25, 2013

Subject: Office of Inspector General Draft Report on the Special Review of "Cost Incentives for the Department's Cleanup Contract in Idaho" (AS-IR&A-13-039)

To: Rickey R. Hass
Deputy Inspector General for Audits and Inspections
Office of Inspector General

The Idaho Operations Office appreciates the opportunity to review the Office of Inspector General's draft report, "Cost Incentives for the Department's Cleanup Contract in Idaho." The report contained the following recommendation:

Recommendation: The Manager Idaho Operations Office, direct the Contracting Officer to review and finalize CH2M ♦ WG Idaho, LLC's (CWI) final contract claim.

Idaho Operations Office concurs with the recommendation. We are in the process of finalizing CWI's final contract claim and expect to issue a final fee determination by June 30, 2013.

If you have any questions concerning this response, please contact Mr. Michael L. Adams, Director, Contract Management Division, at (208) 526-5277.



Richard B. Provercher
Manager

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