

DOE F 1325.8
(08-93)

United States Government

Department of Energy



Memorandum

DATE: March 17, 2004 Audit Report No. OAS-L-04-11

REPLY
TO IG-36 (A04DN003)
ATTN OF:

SUBJECT: Audit of "Requests for Equitable Adjustment at the Rocky Flats Environmental Technology Site"

TO: Frazer R. Lockhart, Manager, Rocky Flats Project Office

INTRODUCTION AND OBJECTIVE

Effective February 1, 2000, the Department of Energy's (Department) Rocky Flats Project Office (RFPO) and Kaiser-Hill Co., LLC (Kaiser-Hill), entered into a cost-plus-incentive-fee contract to close the Rocky Flats Environmental Technology Site (Rocky Flats) by December 15, 2006. Under the contract terms, Kaiser-Hill's final incentive fee earned will be based on how well it meets established cost targets. For example, Kaiser-Hill would earn a target fee of \$340 million if final costs fall within the target cost range of \$3.96 billion to \$4.16 billion. If costs fall below that target cost, Kaiser-Hill's fee could increase to as much as \$460 million. If costs increase due to factors beyond its control, Kaiser-Hill can submit individual Requests for Equitable Adjustment (REAs) for incorporation into the contract by modification. Each approved REA increases the target cost and target fee. To date, the Department has approved 10 REAs that have added approximately \$10.2 million to target cost, and several other REAs are pending.

During the audit, we learned that the Department's Office of Environmental Management (EM) is considering an RFPO proposal to incentivize Kaiser-Hill to further reduce costs. If adopted, Kaiser-Hill's maximum fee would increase up to \$560 million if it could significantly reduce costs below the current minimum cost target of \$3.56 billion. Also, the Department's proposal would automatically approve approximately \$40 million in pending REAs without formal modifications to the contract. Kaiser-Hill would be reimbursed for the REAs, but those costs would not be added to target cost. Therefore, Kaiser-Hill would not have the opportunity to earn incentive fees on those REAs. However, Kaiser-Hill would retain the right to submit future REAs for costs incurred beyond its control. The new REAs would be incorporated in the contract by modification, as is currently being done.

Due to the importance of the REA approval process in establishing Kaiser-Hill's final earned fee, the objective of this audit was to determine whether Kaiser-Hill's REAs were justifiable and supportable.

CONCLUSIONS AND OBSERVATIONS

The REAs submitted by Kaiser-Hill and approved by RFPO appear to be justifiable and supportable. However, we identified two concerns with RFPO's REA approval process that could result in the Department paying more than necessary. First, despite a Department of Energy Acquisition Regulation requirement for an external Federal audit agency to review any contract modification in excess of \$1 million, such reviews were not performed on three approved REAs that exceeded that threshold. The combined cost of the three REAs totaled \$9.7 million. Second, RFPO's current policies and procedures require internal RFPO reviews for each REA submitted. However, under the new proposal awaiting EM's approval, RFPO does not plan to perform an internal review on any of the pending REAs.

In discussing these concerns with RFPO, we found that it either overlooked the requirements or felt that they were not necessary. Regarding the three REAs larger than \$1 million, RFPO officials stated that they were initially unaware that such external audits should be conducted. However, RFPO stated that internal reviews are not necessary because the costs will be included in the annual cost-incurred audit conducted by the Defense Contract Audit Agency (DCAA). The purpose of an internal review, nevertheless, is not to establish the allowability of costs. Rather, it is intended to establish whether or not the costs were justified in relation to the contract. Further, internal reviews by RFPO are REA specific, while the DCAA audits encompass all costs incurred by Kaiser-Hill during the year. Past internal and external reviews have resulted in significant reductions to the amount of the REAs and accompanying fee savings to the Department. Thus, if the reviews are not performed, the Department risks paying more than necessary.

SCOPE AND METHODOLOGY

The audit was performed at Rocky Flats between December 2003 and February 2004. The audit examined the justification and support of those REAs that were submitted by Kaiser-Hill and approved by RFPO since inception of the contract.

To accomplish the audit objective, we reviewed the REAs; the REA approval process; laws and regulations surrounding REAs; and discussed past, current, and new REA activities with EM, RFPO, and Kaiser-Hill personnel.

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. Accordingly, we assessed internal controls and performance measures established under the *Government Performance and Results Act of 1993* related to

REAs. 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. We generally did not rely on computer-processed data to accomplish our audit objective.

We discussed the results with RFPO personnel on February 18, 2004. Since no formal recommendations are being made in this letter report, a formal response is not required. However, to assure that future costs are both allowable and justifiable, we suggest that RFPO ensure that internal and external reviews are performed prior to approving REAs.

We appreciated the cooperation of your staff throughout the audit.


Phillip L. Holbrook, Director
Environmental Audits Division
Office of Inspector General

cc: Assistant Secretary for Environmental Management
Team Leader, Audit Liaison Team, ME-1.1
Audit Liaison, Rocky Flats Project Office

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memorandum

DATE: March 17, 2004

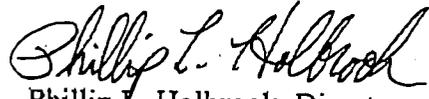
REPLY TO
ATTN OF: IG-36 (A04DN003)

SUBJECT: Letter Report on Requests for Equitable Adjustment at the Rocky Flats Environmental Technology Site

TO: Team Leader, Audit Liaison Team (ME-1.1)

Attached is the subject report. Since no recommendations are being made, a Management Decision is not required for this report. Therefore, it does not need to be tracked in the Department's Audit Report Tracking System.

We appreciated your cooperation during the audit.


Phillip L. Holbrook, Director
Environmental Audits Division
Office of Inspector General

Attachment

cc: Manager, Rocky Flats Project Office

DOE F 1075.8
(08-93)

United States Government

Department of Energy

memorandum

DATE: March 17, 2004

REPLY TO
ATTN OF: IG-36 (A04DN003)

SUBJECT: Final Report Package for Letter Report on "Requests for Equitable Adjustment at Rocky Flats Environmental Technology Site"

TO: Director, Planning and Administration

Attached is the required final report package on the subject audit. The pertinent details are:

1. Staff days: Programmed N/A Actual N/A
2. Elapsed days: Programmed 92 Actual 97
3. Names of OIG audit staff:

Assistant Division Director: Fred Pieper
Team Leader: Mark Mickelsen
Auditor-in-Charge: Christine Nehls
Audit Staff: Destiny Halpin

4. Coordination with Investigations and Inspections: Inspections and Investigations were notified on 3/4/04 of planned issuance of letter report. No actual or potential compromise of an investigation or inspection was noted. This report will not impact any ongoing investigations or inspections.
5. Matters to be brought to attention of the IG or AIGAS: None.


Phillip L. Holbrook, Director
Environmental Audits Division
Office of Inspector General

Attachments:

1. Final Report
2. Monetary Impact Report
3. Audit Project Summary Report
4. Transmittal Memorandum

MONETARY IMPACT OF REPORT NO.: OAS-L-04-11

- 1. Title of Audit: Requests for Equitable Adjustment (REA) at the Rocky Flats Environmental Technology Site
- 2. Division: Environmental Audits Division
- 3. Project No.: A04DN003
- 4. Type of Audit:

Financial: _____ Performance: X
 Financial Statement _____ Economy and Efficiency X
 Financial Related _____ Program Results _____
 Other (specify type): _____

5.

FINDING		COST AVOIDANCE		QUESTIONED COSTS				MGT. POSITION	POTENTIAL BUDGET IMPACT
(A)	(B) Title	(C) One Time	(D) Recurring Amount Per Year	(E) Questioned	(F) Unsupported	(G) Unresolved	(H) Total (E)+(F)+(G)	(I) C=Concur N=Noncon U=Undec	(J) Y=Yes N=No
		\$0	\$0	\$0	\$0	\$0	\$0	N/A	Y
TOTALS-ALL FINDINGS		\$0	\$0	\$0		\$0	\$0		

6. Remarks:

We identified two internal control weaknesses in the Rocky Flats Project Office's (RFPO) REA approval process, relating to external and internal reviews. First, despite a Department of Energy Acquisition Regulation requirement for an external federal audit agency to review any contract modification above \$1 million, audits were not performed on three RFPO-approved REAs that exceeded that threshold and had combined costs of \$8.9 million. Second, even though RFPO's current policies and procedures require internal RFPO reviews of the REAs, it does not plan to perform such reviews on the REAs identified for inclusion in a proposal to restructure Kaiser-Hill's incentive fee. Since past reviews have resulted in significant reductions to the amount of REAs with accompanying savings in fees paid to Kaiser-Hill, we suggested that RFPO ensure that internal and external reviews are performed, prior to approving REAs.

- 7. Contractor: _____
- 8. Contract No.: _____
- 9. Task Order No.: _____

10. Approvals:
 Division Director/Date: [Signature] 3/15/04
 Technical Advisor & Date: [Signature] _____

Audit Project Office Summary (APS)

Page 1

Report run on: March 18, 2004 10:22 AM

Audit#: A04DN003 Ofc: DNA Title: REQUESTS FOR EQUITABLE ADJUSTMENT AT ROCKY FL

**** Milestones ****

	Planned	End of Survey	Revised	Actual
Entrance Conference:.....	01-OCT-03		11-DEC-03	11-DEC-03
Survey:.....			24-FEB-04	24-FEB-04
Draft Report:.....				
Completed (With Report):..	30-SEP-04		12-MAR-04	17-MAR-04 (R)
-----Elapsed Days:	365		92	97

Elap. Less Susp:

Date Suspended:

Date Terminated:

Date Reactivated:

Date Cancelled:

DaysSuspended(Cur/Tot):

() Report Number: OAS-L-04-1

Rpt Title:

Report Type: LTR LETTER REPORT

REQUESTS FOR EQUITABLE ADJUSTMENT AT THE ROCKY FLATS ENVIRONMENTAL TECHNOLOGY SITE

**** Audit Codes and Personnel ****

Class: PER PERFORMANCE

Program: WT Not Found

MgtChall: 103 PERFORMANCE MANAGEME

Site: MSA MULTI-SITE AUDIT

AD: 496 PIEPER

SecMiss: ENV ENVIRONMENTAL QUALIT

AIC: 793 NEHLS

PresInit: Not Found

Team Ldr: 342 MICKELSEN

Tech Adv: 421 SCHULMAN

**** Task Information ****

Task No:

Task Order Dt:

CO Tech. Rep:

Orig Auth Hrs:

Orig Auth Costs:

Current Auth:

Current Auth Cost:

Tot Actl IPR Hr:

Tot Actl Cost:

**** Time Charges ****

Emp/Cont Name	Numdays	Last Date
TERRY, R	0.5	20-MAR-04
MICKELSEN, M	8.9	06-MAR-04
HALPIN, D	18.8	07-FEB-04
NEHLS, C	51.1	06-MAR-04
Total:	79.3	

Audit Project Office Summary (APS)

Report run on: March 18, 2004 10:22 AM

**** Keywords ****

CONTRACT MODIFICATIONS
 DEFENSE CONTRACT AUDIT AGENCY
 EXTERNAL REVIEWS
 INCENTIVE FEE
 INTERNAL REVIEWS
 KAISER-HILL CO., LLC
 MAXIMUM FEE
 MINIMUM FEE
 REQUEST FOR EQUITABLE ADJUSTMENT
 ROCKY FLATS ENVIRONMENTAL TECHNOLOGY SITE
 ROCKY FLATS PROJECT OFFICE
 TARGET COST
 TARGET FEE

**** Location Information ****

<u>Loc Code</u>	<u>Description</u>
RFA	ROCKY FLATS OFFICE
RFA	KAISER-HILL COMPANY LLC
RFA	ROCKY FLATS OFFICE
RFA	KAISER-HILL COMPANY LLC
RFC	ROCKY FLATS PLANT, ROCKY

**** Finding Information ****

<u>Find#</u>	<u>Title</u>	<u>Type</u>	<u>Amount</u>	<u>Yrs</u>	<u>Bud Imp</u>	<u>Mgt Pos</u>	<u>Dept Pos</u>	<u>Dept Amount</u>	<u>Dept Date</u>
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Audit Project Office Summary (APS)

Report run on: March 18, 2004 10:22 AM

Audit History

Audit No: A04DN003

History Date: 18-MAR-04

History Text:

PB/ ENTERED COMPLETED WITH REPORT DATE.

AUDIT DATABASE INFORMATION SHEET

1. Project No.: A04DN003
2. Title of Audit: Requests for Equitable Adjustment at Rocky Flats Environmental Technology Site
3. Report No./Date OAS-L-04-11; March 17, 2004
4. Management Challenge Area: Contract Administration
5. Presidential Mgmt Initiative: Improved Financial Performance
6. Secretary Priority/Initiative: Corporate Management
7. Program Code: EM-2
8. Location/Sites: Rocky Flats Environmental Technology Site, Golden, CO
Rocky Flats Project Office, Golden, CO
9. Finding Summary:

We found that the Requests for Equitable Adjustment (REAs) submitted by Kaiser-Hill Co., LLC (Kaiser-Hill) and approved by the Department of Energy's (Department) Rocky Flats Project Office (RFPO) appear to be justifiable and supportable. However, we identified two internal control weaknesses in the RFPO's REA approval process, relating to external and internal reviews. First, despite a Department of Energy Acquisition Regulation (DEAR) requirement for an external Federal audit agency to review any contract modification in excess of \$1 million, audits were not performed on three RFPO-approved REAs that exceeded that threshold. Combined costs for the three REAs totaled \$8.9 million. Second, even though RFPO's current policies and procedures require internal RFPO reviews of the REAs, it does not plan to perform such reviews on the REAs identified for inclusion in a proposal to restructure Kaiser-Hill's incentive fee. Since past reviews have resulted in significant reductions to the amount of REAs with accompanying savings in fees paid to Kaiser-Hill, we suggested in a letter report that RFPO ensure that internal and external reviews are performed, prior to approving REAs.

10. Keywords: Rocky Flats Environmental Technology Site
Rocky Flats Project Office
Kaiser-Hill Co., LLC
Requests for Equitable Adjustment
Internal Reviews
External Reviews
Contract Modifications
Defense Contract Audit Agency
Incentive Fee
Target Cost
Target Fee
Minimum Fee
Maximum Fee