



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

Audit Report

Use of Noncompetitive
Procurements to Obtain Services at
the Savannah River Site



Department of Energy
Washington, DC 20585

April 10, 2012

MEMORANDUM FOR THE SECRETARY

FROM:


Gregory H. Friedman
Inspector General

SUBJECT:

INFORMATION: Audit Report on "Use of Noncompetitive Procurements to Obtain Services at the Savannah River Site"

INTRODUCTION AND OBJECTIVE

Savannah River Nuclear Solutions, LLC (SRNS), assumed management and operating responsibility for the Department of Energy's Savannah River Site located near Aiken, South Carolina, in August 2008. Under its contract, SRNS is responsible for environmental cleanup, national security activities and operation of the Savannah River National Laboratory. SRNS is a limited liability corporation whose parent companies include Fluor Federal Services, Inc.; Newport News Nuclear, Inc.; and, Honeywell International, Inc. The Savannah River Operations Office provides Department oversight for all Office of Environmental Management operations for the site.

To help ensure that procurements from affiliates are free from conflicts of interest, adequately competed and reasonable in cost, the Department's contractors are required to obtain approval of related party procurements from Federal officials. For the SRNS contract, the Department established a requirement that procurements from the parent or an affiliate, regardless of type or amount, be submitted for approval prior to award. As we reported in our Inspections report on *Organizational Conflicts of Interest Program at Sandia National Laboratories* (DOE/IG-0853, July 2011), such reviews are essential to ensure that potential or actual Organizational Conflicts of Interest (OCI) are identified, prevented, and/or mitigated.

In 2009, SRNS awarded two noncompetitive contracts for personnel services to two of its three parent companies, Fluor and Newport News. During the period June 2009 through August 2010, SRNS released 126 purchase orders against these contracts valued at approximately \$26 million. Given the significant level of activity in this area, we initiated this audit to determine whether the Department had ensured that SRNS appropriately applied contracting requirements when noncompetitively acquiring services from affiliates or related parties.

RESULTS OF AUDIT

We found that SRNS had not always met its contractual obligations when acquiring services from its affiliates. Specifically, SRNS had not:

- Obtained required Department approval for the two noncompetitive contracts it awarded to Fluor and Newport News during 2009. Although specifically required under the terms of its contract, SRNS also did not obtain approval for subsequent modifications

that increased the budget ceilings for those contracts from \$5 million to \$40 million in one case, and, from \$500,000 to \$15 million in the other;

- Demonstrated, in most cases, that the affiliates were the only sources capable of providing the expertise necessary to perform the needed services, a pre-requisite for noncompetitive awards to affiliate companies; and,
- Performed cost analyses to ensure the reasonableness of the cost of affiliate personnel services, as required.

Our review of a statistical sample of noncompetitive acquisitions made under the two affiliate personnel services contracts disclosed that in 34 of 42 (81 percent) acquisitions sampled, SRNS had not demonstrated that an affiliate source was the only source of the needed expertise. Additionally, we were unable to obtain evidence that the required cost reasonableness analysis of affiliate personnel services was performed. For example, SRNS issued noncompetitive purchase orders to obtain the services of an internal auditor and a project controls scheduler from a parent company, Fluor. In the first order, the period of performance was approximately 21 months, at an estimated cost of \$400,412, which included \$310,013 in labor and \$90,399 in estimated travel related to temporary living expenses and periodic trips home. In the second order, the period of performance was approximately 24 months, at an estimated cost of \$408,515, which included \$285,406 in labor and \$123,109 in estimated travel. In neither case did SRNS demonstrate that the individuals solely possessed special expertise or that the acquisitions were reasonable in cost.

The noncompetitive acquisitions occurred and persisted because the Department did not effectively administer the SRNS contract as it pertains to the procurement of affiliate personnel services. For example, Department contracting officials were apparently unaware that they had approved, in June 2010, an exemption from Federal requirements for the acquisition of affiliate personnel services as part of a multiple modification initiative to SRNS' procurement manual. Furthermore, Department contracting officials stated that they were aware that SRNS had proposed using affiliate personnel services, but they were unaware of how extensively the services were being used. Additionally, the Department was not notified of a potential OCI because SRNS' General Counsel determined that SRNS did not need to submit a representation regarding such a potential conflict to the Department for these two noncompetitive contracts with parent companies. According to senior contractor officials, SRNS had tacit approval to use affiliate personnel services because the intention had been disclosed in the contract proposal prior to award of the management and operating contract. As a result, even though specifically required under the terms of its contract, SRNS never submitted its affiliate personnel service contracts with Fluor and Newport News to the Department for approval.

SRNS sought to rely on inclusion of its intent to acquire personnel services as tacit approval for the process, yet violated a major condition of its original proposal. Specifically, the SRNS proposal stated that "Should the availability of critical skills become an issue ... we will fill any short-term gaps by drawing from the qualified personnel of our member companies." SRNS defines short-term assignments as work expected to last less than 12 months. However, of the 42 purchase orders in our sample, 22 contain assignments that have lasted 12 months or longer.

We also noted that SRNS officials directly involved in the overall management and administration of the two affiliate contracts had what we considered to be an apparent conflict of

interest in that they were assigned to SRNS but remained employees of the parent companies. The relationship of these SRNS employees to the affiliates, coupled with their responsibilities associated with administering the two affiliate contracts, calls into question SRNS' ability to provide assurance that it was performing objectively and without bias, and, as a result, preventing the affiliates from receiving an unfair competitive advantage. No instance of personal enrichment came to our attention during the course of our review. In our opinion, however, the appointment of affiliate personnel to key management positions, whose roles include administering the two affiliate contracts, creates a potential conflict of interest that had not been evaluated by SRNS, had not been brought to the attention of the Department, and was contrary to the very explicit terms of the master contract.

In the absence of effective Department oversight of SRNS' acquisition of affiliate personnel services, the Department lacked assurance that due consideration was given to acquiring these services via competitive means, that the services were obtained at fair and reasonable prices, and, as a consequence, the best interests of the U.S. taxpayers were protected. The significance of this is demonstrated by the fact that, at the time of our review, SRNS had released purchase orders against the two noncompetitive contracts with Fluor and Newport News totaling approximately \$26 million and had raised the contractual budget ceilings for these contracts from \$5.5 million to \$55 million.

During the audit, the Savannah River Operations Office initiated a review to determine the reasonableness of the cost of affiliate personnel services that were acquired. While this action is commendable, we believe that additional action is necessary. As such, and to further address the issues identified in this report, we made a number of recommendations designed to strengthen the Department's oversight of SRNS' acquisitions from affiliates and address deficiencies associated with SRNS' acquisition of affiliate personnel services.

MANAGEMENT REACTION

Management partially concurred with the report's recommendations and cited certain planned, initiated or completed actions. In one important aspect, management did not agree with our conclusions regarding procurements from affiliates and outlined actions that are not completely responsive to our recommendations. Notably, management expressed its opinion that the transactions we reviewed should have been classified as human resource actions that did not amount to procurements. Management, however, acknowledged the risks associated with improper use of affiliate personnel services. We believe that regardless of how the actions are described, there is still a compelling need to ensure that SRNS obtains services from corporate affiliates at fair and reasonable prices. Management's comments and our responses are summarized and more fully discussed in the body of our report. Management's formal comments are included in Appendix 3 of the report.

Attachment

cc: Deputy Secretary
Associate Deputy Secretary
Under Secretary for Nuclear Security
Chief of Staff
Director, Office of Management

REPORT ON USE OF NONCOMPETITIVE PROCUREMENTS TO OBTAIN SERVICES AT THE SAVANNAH RIVER SITE

TABLE OF CONTENTS

Use of Noncompetitive Procurements

Details of Finding	1
Recommendations and Comments	6

Appendices

1. Objective, Scope and Methodology	8
2. Prior Report	10
3. Management Comments	11

USE OF NONCOMPETITIVE PROCUREMENTS TO OBTAIN SERVICES AT THE SAVANNAH RIVER SITE

Requirements for Contractor Purchasing Systems

The Department of Energy's (Department) Management and Operating (M&O) contract with Savannah River Nuclear Solutions, LLC (SRNS) establishes basic requirements for purchasing products and services. Specifically, SRNS is required to develop, implement and maintain formal policies, practices and procedures that meet Federal acquisition regulations. SRNS is required to ensure, among other things, the acquisition of quality products and services at fair and reasonable prices and the use of effective competitive procurement techniques. SRNS' contract also provides that it can purchase goods and services from affiliate sources when the acquisition is consistent with Federal contracting officer approved policies and procedures designed to permit effective competition. SRNS can acquire technical services on a sole-source basis from affiliate entities where those entities have a special expertise, provided the basis for such acquisition is documented. SRNS' approved Procurement Practices Manual which documents its policies, practices and procedures for purchasing goods and services, was effective April 2009.

The Savannah River Operations Office provides Department oversight for all Office of Environmental Management operations for the Savannah River Site, including those conducted by SRNS. In addition, to help ensure that procurements from affiliates are free from conflicts of interest, SRNS' contract required the development of an Organizational Conflict of Interest (OCI) Management Plan, including a requirement for SRNS to inform the Savannah River Operations Office's Chief Counsel and Contracting Officer as soon as a determination is made of the existence of a potential conflict that cannot be immediately resolved. Further, the OCI Management Plan stipulates that once a potential issue has been raised, it will not be considered resolved until the Contracting Officer determines that no further action is required.

Use of Noncompetitive Procurements to Obtain Services

SRNS had not fully implemented procurement procedures designed to ensure effective competition when acquiring personnel services from affiliate sources. Specifically, in 2009 SRNS awarded noncompetitive contracts for personnel services to its parent companies Fluor Federal Services, Inc. (Fluor) and Newport News Nuclear, Inc. (Newport News). Further, during the period June 2009 through August 2010, SRNS released 126 purchase orders under these 2 contracts to obtain services totaling approximately \$26 million. In making the awards, SRNS did not obtain prior approval of the noncompetitive awards, as required by the Department. We also noted that between May 2009 and October 2010, SRNS significantly increased the affiliate contracts'

budget ceilings for obtaining affiliate personnel services without obtaining the required Department approval. The contracts with Fluor and Newport News contained initial budget ceilings of \$5 million and \$500,000. After several increases, these budget ceilings were raised to \$40 million and \$15 million, respectively. As previously discussed, neither the initial contracts nor the contract modifications increasing the budget ceilings were submitted to the Department for approval, as required.

Additionally, SRNS, in noncompetitively acquiring personnel services under the contracts, had not demonstrated that either the sole-source acquisition was justified or that costs were reasonable, as required by its contract. Specifically, we reviewed a statistical sample of 42 of the 126 noncompetitive purchase orders issued under the 2 affiliate contracts by SRNS to obtain affiliate personnel services from the period June 2009 through August 2010. In 34 of 42 (81 percent) purchase orders reviewed, totaling approximately \$6.1 million, the file did not clearly define or document the specific special expertise needed to perform the required service and that the affiliate source solely possessed the specific special expertise. Also, we found no documentation to support any effort to obtain the services from a source other than an affiliate source. For the remaining eight purchase orders reviewed, the file contained documentation to support the need for special expertise that would only reasonably be available from an affiliate source. Further, in all 42 sample items, we found no documentation supporting the cost reasonableness of affiliate personnel services provided. Although SRNS obtained a cost estimate for the personnel service prepared by the affiliate source, no attempt was made to compare the estimated cost to the cost of other potential sources. We also noted that the 34 purchase orders mentioned above included over \$1.3 million in estimated travel costs, 21 percent of the total cost of the purchase orders. These travel costs included temporary living expenses and periodic trips home.

For instance, SRNS issued a noncompetitive purchase order to obtain the services of an internal auditor from its parent company, Fluor. The scope of work description included planning and performing fieldwork, testing processes and procedures, identifying issues, and providing solutions in clear concise audit reports. Although two similar audit positions had previously been filled using staff augmentation services¹, the requestor stated that only the corporate affiliate had the special expertise required for

¹ Staff augmentation is a mechanism for temporarily increasing staffing on an as needed basis by subcontracting for individuals with specific labor skills.

the internal audit position. However, the procurement file did not document the special expertise required for the position or demonstrate that the needed expertise could only be obtained using the corporate affiliate. Although the individual selected for the position had an audit background, the employee was not serving as an auditor at Fluor, but instead held a position as a Senior Accounting Manager. Further, the SRNS procurement file contained a cost estimate for the services provided by Fluor, but did not document cost comparisons to establish the reasonableness of the estimate. The period of performance was January 14, 2010, through September 30, 2011, at an estimated cost of \$400,412, which included \$310,013 in fully burdened labor (3,275 hours) and \$90,399 in estimated travel. As an aid in judging the reasonableness of such cost, the fully burdened cost for a journeyman level Federal auditor for the same number of labor hours, excluding travel, would be \$224,403 (approximately 44 percent less than the total estimated cost for the internal auditor).

In another instance, SRNS issued a noncompetitive purchase order to obtain the services of a project controls scheduler from Fluor. Although the individual appeared to possess the necessary education and experience to successfully perform the service, the procurement file contained no evidence that this employee was the only source possessing the experience necessary to perform the service. In fact, the procurement file contained no position description or employee resume. Further, the statement of work in the procurement file did not clearly define or document the specific level of special expertise that was necessary to perform the required service. Discussions with SRNS officials revealed that a number of similar positions had been filled using staff augmentation services. The period of performance was October 5, 2009, through September 30, 2011, at an estimated cost of \$408,515, which included \$285,406 in labor and \$123,109 in estimated travel.

**Department's
Oversight of
Purchases from
Affiliate Sources**

The Department had not provided effective oversight of SRNS' procurement of affiliate personnel services. For example, in June 2010, the Department approved an SRNS request to modify its procurement manual to, among other things, exempt affiliate personnel services from effective competition and remove the requirement to have all affiliate contracts approved by the Department. However, the contracting official that approved the modifications indicated not being aware of the specific modifications that related to procurements with affiliate sources. We noted that the Department approved the exemption and removal of Department approval thresholds as part of an 18 page

proposal that made multiple modifications to the procurement manual. Department contracting officials also told us that while they were aware that SRNS had proposed using affiliate personnel services, they were unaware of how extensively it was being used. The supervisory contracting official explained that, despite the exemption, any cost incurred by SRNS must ultimately meet the tests of allowability, allocability and reasonableness in order to be reimbursed by the Department. The official stated that future procurement file audits or reviews could assess the appropriateness of costs incurred. In response to our review, on April 29, 2011, the Department's Contracting Officer initiated a review of the reasonableness of costs related to all affiliate personnel services charged to the contract.

Additionally, the Department's ability to provide effective oversight was impeded because SRNS did not notify it of a potential OCI. Specifically, potential OCIs are required to be evaluated when contractors make purchasing decisions with affiliate sources. If a potential conflict of interest is determined to exist that cannot be immediately resolved, the contractor is required to inform the Department's Chief Counsel and Contracting Officer. In those instances, the issue is not considered resolved until the Contracting Officer determines that no further action is required. However, SRNS' General Counsel determined that an OCI representation need not be submitted for these two noncompetitive contracts with its parent companies. According to contractor procurement and general counsel officials, SRNS had tacit approval to use affiliate personnel services because the intention was disclosed in its proposal prior to contract award.

Furthermore, in its formal proposal seeking contract award, SRNS stated that it intended to use affiliate personnel to fill short-term gaps in critical skills. Specifically, the proposal stated that "Should the availability of critical skills become an issue ... we will fill any short-term gaps by drawing from the qualified personnel of our member companies." However, we determined that a number of affiliate employees at SRNS were not used to fill short-term gaps in critical skills, as defined by SRNS in its proposal. Although SRNS defined short-term assignments as work durations expected to last less than 12 months, we identified affiliate employees who exceeded the 12 month duration defined by SRNS as short-term. Based on our statistical sample of 42 purchase orders, 22 (52 percent) of the purchase orders covered 26 individual employees with assignments for affiliate personnel services that have lasted longer than 12 months, thus not considered short-term.

Finally, while SRNS' General Counsel determined that it did not need to submit an OCI representation to the Department for approval, we noted that SRNS officials in key management positions who were assigned to SRNS remained employees of the affiliate companies and were in decision making positions affecting contracts with their parent companies. Specifically, SRNS officials in the offices of Chief Counsel, Contract Management, Chief Financial Officer and Workforce Services were directly involved in the overall management and administration of the two affiliate contracts. These officials had direct oversight concerning issuance of the two affiliate contracts and they provided oversight associated with releasing individual purchase orders against the affiliate contracts, reviewing affiliate invoices for payment and increasing the affiliate contracts' budget ceilings. The senior officials for each of these offices remained employees of their affiliate companies, although they were assigned to SRNS for an indefinite period of time greater than 12 months. The relationship of these employees, assigned to SRNS from the affiliates, coupled with their responsibilities associated with administering the two affiliate contracts, calls into question SRNS' ability to provide assurance that it is performing objectively and without bias, thus preventing the affiliates from receiving an unfair competitive advantage. While we did not identify any actual conflicts of interest during our review, in our opinion, this creates an appearance of an OCI which has not been evaluated by SRNS or brought to the attention of the Department.

Reasonableness of Cost for Services

While the Department's previously discussed review to determine the reasonableness of costs related to affiliate personnel services is commendable, the Department faces significant challenges because it will be difficult to determine whether SRNS is obtaining these services at fair and reasonable prices. Specifically, without appropriate documentation to justify the noncompetitive selection of personnel from affiliate sources to perform needed services and a determination of the reasonableness of the price paid for such services, the Department cannot determine whether the services could have been performed by entities outside the parent companies or whether the services were performed by the parent companies at fair and reasonable prices.

The use of affiliate personnel services also adds a burden of substantial travel-related costs that may have been avoided through competitive procurements of necessary personnel services. All affiliate personnel services obtained from SRNS' affiliate companies required travel. Based on our analysis of 34 of the 42 sampled purchase orders that had sufficient documentation on

travel costs, SRNS estimated that it may incur at least \$1.3 million in travel-related costs related to temporary living expenses and periodic trips home. These travel costs consist mainly of transportation and per diem costs for affiliate personnel temporarily assigned to the Savannah River Site. Therefore, the Department is at increased risk of incurring unnecessary costs if it does not ensure that competitive procurements are used to the extent practical and that procurements from affiliate companies comply with contract terms.

RECOMMENDATIONS

To ensure that SRNS is appropriately applying contracting requirements for acquiring affiliate personnel services and to avoid any appearance of potential or actual conflicts of interest, we recommend that the Senior Advisor for Environmental Management ensure that the Manager, Savannah River Operations Office, directs the Contracting Officer to:

1. Reconsider the approval of changes to SRNS' Procurement Practices Manual which exempted SRNS from Federal competition requirements applicable to affiliate source acquisitions and removed Departmental approval threshold requirements associated with affiliate transactions;
2. Require SRNS to conduct OCI reviews when issuing contracts to its affiliates;
3. Enforce requirements for SRNS to submit its contracts for affiliate personnel services with Fluor and Newport News to the Department for approval; and,
4. Ensure SRNS follows procurement requirements when noncompetitively acquiring affiliate personnel services, to include determining that the affiliate is the sole-source of needed expertise and that the services are obtained at fair and reasonable prices.

MANAGEMENT REACTION

Management partially concurred with the report's findings and recommendations. Environmental Management (EM) agreed that the acquisition of affiliate personnel services, which management refers to as corporate reachback, should not be used as a means to avoid or circumvent appropriate use of subcontractors or to undermine prime-subcontractor competitive procurement methods as set forth in the contract and applicable law. EM also agreed that corporate reachback should be appropriately limited to specific areas of expertise and in duration. However, EM concluded that

corporate reachback is not a procurement action, and asserted that it is a human resource (HR) action that is not subject to the restrictions that apply to procurements from affiliate sources. Rather than addressing the need to reconsider the approval of changes to the SRNS Procurement Practices Manual as indicated in Recommendation 1, EM stated that as of October 2011, SRNS implemented an HR business process for corporate reachback that is not subject to the SRNS Procurement Practices Manual.

EM also did not envision the need for the Manager, Savannah River Operations Office, to provide direction relating to determining that the affiliate is the sole-source of needed expertise and that the services are obtained at fair and reasonable prices as indicated in Recommendation 4. Specifically, EM concluded that corporate reachback is not a procurement action and is not subject to a determination that the affiliate is the sole-source of needed expertise. Finally, EM stated that corporate reachback costs are subject to the same requirements for reimbursement as any other costs and only reimbursed to the extent that the costs are allowable and reasonable.

**AUDITOR
COMMENTS**

We consider management's comments not fully responsive to our recommendations. Specifically, as indicated in Recommendation 1, we believe that there is a need for EM to address exemptions and revisions to the SRNS Procurement Practices Manual, which among other things, effectively removed Departmental approval threshold requirements associated with all affiliate transactions. While management concluded that the use of corporate reachback is not a procurement action and is not subject to the restrictions that apply to procurements from affiliate sources, the removal of Departmental approval threshold requirements associated with affiliate transactions will limit oversight of all other procurements from affiliate sources. In addition, we believe, as outlined in Recommendation 4, that it is necessary for EM to ensure that SRNS obtains corporate reachback services at fair and reasonable prices. For instance, our work demonstrated that no documentation existed to support the cost reasonableness for the 42 corporate reachback files we reviewed. Without addressing these areas, the Department would have difficulty ensuring that SRNS is adhering to requirements and that costs to the Department are reasonable.

OBJECTIVE

To determine whether the Department of Energy (Department) had ensured that Savannah River Nuclear Solutions, LLC (SRNS) appropriately applied contracting requirements when noncompetitively acquiring services from affiliates or related parties.

SCOPE

The audit was performed from April 2010 to February 2012, at the Savannah River Operations Office and the offices of SRNS in Aiken, South Carolina. The scope of the audit was limited to a review of statistically selected samples of noncompetitive purchase orders for services issued by SRNS during the period June 1, 2009 through August 30, 2010.

METHODOLOGY

To accomplish the audit objective, we:

- Obtained and reviewed Department guidance and requirements for contractor purchasing systems and contractor purchases from affiliate sources;
- Obtained and reviewed SRNS procurement procedures;
- Interviewed key personnel at the Savannah River Operations Office;
- Obtained and reviewed SRNS procurement files associated with noncompetitively acquired services at the Savannah River Site; and,
- Obtained and reviewed additional information provided by SRNS officials concerning affiliate personnel services.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Accordingly, the audit included tests of controls and compliance with laws and regulations to the extent necessary to satisfy the objective. Specifically, we reviewed SRNS procurement files for noncompetitively acquired services issued during the period June 1, 2009, through August 30, 2010, to determine the extent to which SRNS followed its prescribed procurement practices. We also assessed the Department's implementation of the *Government Performance and Results Act of 1993* and determined that the

Department had not established performance measures specifically related to the use of affiliate personnel services. 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. Finally, we relied upon computer-processed data to a limited extent to accomplish our audit objective and performed appropriate tests to validate the results.

An exit conference was held with the Office of Environmental Management on February 23, 2012.

PRIOR REPORT

- Inspection Report on [*Organizational Conflicts of Interest Program at Sandia National Laboratories*](#) (DOE/IG-0853, July 2011). The inspection revealed a number of areas where Sandia National Laboratories (Sandia) could improve its Organizational Conflict of Interest (OCI) process to prevent potential or actual occurrences. Although specifically required by Federal Regulation and contractual provisions, Sandia had not completed a number of OCI-related activities. Specifically, appropriate OCI reviews were not always conducted in the areas of Technology Transfer License Agreements, Work for Others projects, Cooperative Research and Development Agreements, and subcontracts between Sandia and Lockheed Martin Corporation. These weaknesses occurred, in part, because Sandia failed to provide adequate direction to staff and management officials on the implementation of the OCI process. Further, Sandia had not provided all essential personnel with the necessary OCI training to assist them in identifying and mitigating OCI issues or concerns when encountered. Also, no specific performance measures related to Sandia's OCI Program had been established by the National Nuclear Security Administration (NNSA). Finally, NNSA had not conducted periodic assessments of the OCI Program to ensure that Sandia had satisfied its OCI responsibilities. Because the required OCI reviews were not performed for the items tested, the inspectors and responsible Department of Energy (Department)/NNSA Federal officials could not discern whether actual conflicts of interest existed. Such OCI determinations would have enabled the Department to better ensure that Lockheed Martin Corporation was not given an unfair competitive advantage. Management generally agreed with the report and the recommendations, and indicated that Sandia had already initiated improvement efforts in several areas to strengthen its OCI Program.

MANAGEMENT COMMENTS



Department of Energy

Washington, DC 20585

January 30, 2012

MEMORANDUM FOR RICKEY R. HASS
DEPUTY INSPECTOR GENERAL
FOR AUDITS AND INSPECTIONS
OFFICE OF INSPECTOR GENERAL

FROM:  DAVID HUIZENGA
ACTING ASSISTANT SECRETARY FOR
ENVIRONMENTAL MANAGEMENT

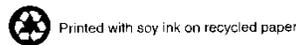
SUBJECT: Draft Audit Report on "Use of Non-Competitive Procurements
to Obtain Services at the Savannah River Site"

The Office of Environmental Management (EM) appreciates the opportunity to have reviewed the Inspector General's draft audit report on "Use of Non-Competitive Procurements to Obtain Services at the Savannah River Site."

In reviewing the draft audit report, EM observes that the document equates human resource personnel actions conducted under corporate reachback to non-competitive procurements. The concepts are not equivalent. It is important to understand the use of corporate reachback in this contract, and distinguish it from the normal meaning of procurement actions.

The Department of Energy (DOE) issued Request for Proposal (RFP) No. DE-RP09-06SR22470 in March 2007 for Management and Operation (M&O) of the Savannah River Site (SRS). The RFP required each proposal team to describe its overall management approach to safely and effectively execute the general scope of work, and specifically instructed that the offeror describe its approach for ensuring that the workforce maintains the appropriate mix of critical skills and qualifications. In response to that instruction, Savannah River Nuclear Solutions, LLC (SRNS) proposed the use of corporate reachback as part of its management approach. The Source Evaluation Board found corporate reachback a favorable attribute in determining strengths for SRNS in evaluating its Organizational Structure and Management Approach.¹

¹ The information about what was proposed by SRNS is nonpublic information that, to the extent it is not incorporated into the contract, is prohibited from disclosure under Freedom of Information Act and may be proprietary information subject to the Trade Secrets Act. The information about DOE's evaluation of the proposal is Source Selection Information, which also is nonpublic information that, to the extent it has not already been made public, is prohibited from release and from disclosure under FOIA.



Corporate reachback is a method of readily accessing individuals with critical skills and bringing them on board effectively and economically. It frequently has been used by DOE EM contractors for more than a decade, if not longer.

In an M&O contract, such as this one, the prime contractor normally is an entity newly created for the sole purpose of performing this single contract. The parents of the M&O contractor invariably have a depth of human resource (HR) skills superior of the M&O contractor. It is therefore expected, and usually advantageous to the Government, that the M&O contractor use corporate reachback as a human resource action to obtain necessary personnel skills. Personnel are loaned pursuant to a cost transfer agreement, not a procurement (sub)contract. Unlike a subcontract, no additional fee is charged, and the salaries of certain employees transferred under these corporate reachback actions are covered under the Secretary of Energy's salary freeze policy. Therefore, corporate reachback is not a procurement, and not subject to the restrictions that apply to procurements from affiliated sources.

Although corporate reachback may be an acceptable HR technique and thus does not constitute a procurement, it should not be used as a means to avoid or circumvent appropriate use of subcontractors or undermine prime-subcontractor competitive procurement methods as set forth in the contract and applicable law. In addition, corporate reachback should be appropriately limited to specific areas of expertise and in duration. Upon consideration of the Inspector General's (IG) inquiry, DOE recognizes the need for guidance in this area. In consultation with Office of Management (MA), EM is willing to work with MA as they prepare guidance on the use of corporate reachback to ensure its proper use.

With regard to the recommendations, EM provides the following responses:

Recommendation 1: Reconsider the approval of changes to the SRNS Procurement Practices Manual which exempted SRNS from Federal competition requirements applicable to affiliate source acquisitions and removed departmental approval threshold requirements associated with affiliate transactions.

EM's Response: The practice utilized by SRNS consisted of an intra-company HR cost transfer, rather than a subcontract with an outside source. These HR actions were entered into the SRNS approved procurement system instead of an appropriate HR system, which has created unnecessary confusion and should not have happened. This created the appearance that a subcontract competition occurred and that advance DOE approval was required. We note that even though there was a mischaracterization of the action, that the employee transfers were functionally treated as employee transfers and not subcontractor employees (*e.g.*, no additional fee/overhead was charged, and the salaries of the employees transferred under these corporate reachback actions were covered under the Secretary of Energy's salary freeze policy applicable to certain prime M&O contractor employees under DOE Order 350.1, *Contractors Human Resource Management Programs*, but not subcontractors). To avoid this mischaracterization in the future, as of October 2011, SRNS implemented an HR business process to accommodate an intra-

company HR cost transfer that is not subject to the contractor's purchasing manual under Contract DE-AC09-08SR22470.

EM will collaborate with the SRS Contracting Officer (CO) to validate and verify that the indirect costs were applied appropriately, such as to ensure that the personnel charges were transferred properly. In addition, EM will work with MA to ensure that future corporate reachback actions will not be used as a means to avoid or circumvent appropriate use of subcontractors or to undermine prime-subcontractor competitive procurement methods and to ensure that corporate reachback is limited to specific areas of expertise and for an appropriate duration.

Recommendation 2: Require SRNS to conduct Organizational Conflict of Interest (OCI) reviews when issuing contracts to its affiliates.

EM's Response: Section H, clause H-26, of the current SRNS contract requires SRNS to submit an OCI Management Plan to the CO for approval. It specifically requires the plan to include "procedures for identifying and evaluating past, present, and anticipated contracts" of the Contractor and its related entities. In accordance with that clause, SRNS provided the SRS CO a copy of its OCI Management Plan on November 3, 2008. The plan was deemed acceptable.² Moreover, H-26 holds SRNS accountable and requires the plan be updated periodically over the term of its contract.

Therefore, although the SRNS contract provides for OCI reviews with regard to "contracts" with affiliates, this clause does not appear to encompass corporate reachback, since those human resource actions are not "contracts."

The concept that corporate reachback transfers do not create OCIs was discussed by the Government Accountability Office (GAO) in a protest of the SRNS award. The protester contended that 11 out of 14 of SRNS's proposed key personnel had "divided loyalty" because they were employed by SRNS's member companies and not SRNS itself. In denying this protest issue, the GAO found "no significant potential for OCIs arising out of the fact that 11 of SRNS's key personnel will remain employees of team member companies rather than become direct employees of SRNS." It also agreed with DOE that there was no likely divergence of interest since "the employers [parent companies] are team members of SRNS working together to perform the site work." Furthermore, GAO noted that key personnel in the previous contract also were employed by team members, not the prime contractor, and OCIs had not arisen under that situation. *See Savannah River Alliance, LLC*, B-311126 *et seq.*, Apr. 25, 2008, 2008 CPD ¶ 88 at 23-24. Consequently, while this issue merits scrutiny by EM and MA since it is not directly addressed in the current contract, the use of affiliates to provide critical skills to the prime contractor via corporate reachback does not itself create an OCI.

² The CO required inclusion of the following statement to define affiliation: "For the purpose of this clause, affiliation occurs when a business concern is controlled by or has the power to control another or when a third party has the power to control both. Services from an approved Contractor affiliate will be at cost without additional fee or profit."

Even though the H-26 clause of the SRNS contract does not require that the Management Plan address potential OCIs for corporate reachback, to avoid the potential of an OCI with respect to corporate reachback, EM will coordinate with MA as it develops a corporate reachback policy to ensure, to the extent necessary, that the applicable laws with respect to OCI in the context of future corporate reachback transfers from affiliates are discussed.

Recommendation 3: Enforce requirements for SRNS to submit its contracts for affiliate personnel services with Fluor and Newport News to the Department for approval.

EM's Response: The SRNS contract requires CO approval of changes in positions identified as Key Personnel. However, it does not require the contractor to obtain CO approval of appropriate corporate reachback actions. As discussed above, these are not procurement contract actions; DOE does not require that corporate reachback actions be preapproved. However, EM will work with MA to ensure that guidance is provided to ensure CO approval of corporate reachback where appropriate.

Recommendation 4: Ensure SRNS follows procurement requirements when non-competitively acquiring affiliate personnel services, to include determining that the affiliate is the sole source of needed expertise and that the services are obtained at fair and reasonable prices.

EM's Response: As stated in EM's response under Recommendation No. 1, the actions performed by SRNS were for an intra-company HR cost transfer, which were in alignment with the SRNS Cost Transfer Agreements between SRNS and the SRNS parent organizations. SRNS has implemented an HR business process to accommodate intra-company HR actions. This will avoid any future appearance of a procurement action when SRNS is obtaining personnel services from parents via corporate reachback.

As discussed above, when utilized properly, corporate reachback is not a procurement action, and therefore not subject to a determination that the parent is the sole source of needed expertise. Costs incurred for services obtained through corporate reachback are subject to the same requirements for reimbursement as any other costs. Therefore, SRNS is already reimbursed for such costs only to the extent that the CO finds them allowable and reasonable. EM is committed to proper implementation of its contracts and transparency of its contracting actions.

cc: D. Moody, SRS
T. Harms, EM-4.1
A. Stephenson, CF-50
A. Williams, EM-2.1

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