TESTIMONY

STATEMENT OF JOHN C. LAYTON

INSPECTOR GENERAL

DEPARTMENT OF ENERGY

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

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SUMMARY OF STATEMENT
BY
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The Office of Inspector General, Department of Energy (DOE), has identified deficiencies in the administration of performance-based contracts. For example, we found:

Incentive fees were excessive in relation to the cost of the work.

- An incentive fee of $225,000 was paid to replace a ventilation fan when the cost of this work for the year was only $25,000.

Incentive fees were paid for work completed before the establishment of the performance objective.

- A $776,000 incentive fee was paid for work completed on experiments before the performance objective was established.

Incentive fees were paid for work that was not completed by the contractor.

- An incentive fee of $225,000 was paid for the upgrading of alarm panels in 7 tank farms. However, alarm panel upgrades were completed in only two tank farms.
- A cost reduction award of $4.3 million was paid for a work force reduction that took place prior to the contract creating the cost reduction program.

Incentive fees were paid for work that was easily achieved.

- An incentive fee of $150,000 was paid for the pumping of 1,500 gallons of solution from a tank. However, the work was completed only six days after the contractor proposed the incentive, and two days after the incentive was established.

Performance measures were not results oriented.

- An incentive fee of $301,000 was paid for a claimed savings of a $1.5 million reduction in labor costs associated with the elimination of 1,000 internal contractor procedures. However, DOE could not document any baseline change analysis which demonstrated where labor costs had actually been reduced. Nor could DOE demonstrate where the claimed savings had been made available for reuse.

I believe that if contracts have incentives, they should encourage superior performance and discourage substandard performance. They should also be structured to ensure that safety is not compromised. We have made recommendations to help assure that incentive fees paid under performance based contracts represent actual achievement by the Department's contractors, and that real and measurable benefits are obtained by the Department and the American taxpayer.

Mr. Chairman and Members of the Subcommittee, I am here at your request to testify on the Department of Energy's (DOE) implementation of performance-based contracting.

BACKGROUND

The Department of Energy is the U.S. Government's largest non-military contracting agency. In Fiscal Year 1996, $14 billion of DOE's $16 billion budget was obligated for management and operating (M&O) or similar type contracts. In Fiscal Year 1996, the 15 largest DOE contracts accounted for $10.6 billion. I have attached an exhibit showing the 15 largest contracts.

I have testified on numerous occasions before Congress that DOE has not, in general, done an adequate job of contract administration. Office of Inspector General work has documented deficiencies in the way DOE administers its contracts. These deficiencies have led to excessive funding for personnel benefits, the use of taxpayer funds for purposes not intended, wasteful energy management practices, and excessive project costs. I have testified that improved contract administration, regardless of the specific provisions of the contract, is necessary. Since 1989, in accordance with the requirements of the Federal Managers' Financial Integrity Act, DOE has reported contract administration as a material weakness.

The National Performance Review Report for the Department of Energy stated that, relative to the size of the contracts being managed and the complexity of the work being performed, the Government oversight staff was considered small and inadequately trained. This report also stated that oversight at the Department was hampered by a lack of specificity in the description of products of Management and Operating Contracts and performance requirements, expectations, and measurement criteria.

This report discussed alternative management and contracting arrangements, and stated that the then Secretary was well aware of the weaknesses in the Department's contracting systems. This report stated that in testimony before the House Committee on Energy and Commerce on May 26, 1993, the then Secretary summarized her concerns and announced a series of initiatives to improve the Department's contract management, including the formation of a Contract Reform Team to perform a top-to-bottom review of the Department's contracting mechanisms and practices.

In June 1993, the then Secretary of Energy established a Contract Reform Team to review the Department's contracting practices and to make recommendations to improve them. The need for contract reform was driven by a recognition that DOE was not in adequate control of its contractors, that contractors were not sufficiently accountable to DOE, and that there was an absence of well-defined performance measures and criteria for DOE contractors. The Contract Reform Team found that many of the Department's award fee contracts suffered from the absence of well-defined performance criteria and measures, and that, under the DOE award fee structure, contractors were not sufficiently motivated to identify cost-reductions or cost-avoidance approaches and apply them to their operations.

The Contract Reform Team recommended Performance-Based Management Contracting as a contract reform initiative. The Contract Reform Team Report identified the key elements of the Department's Performance-Based Management Contracts, including: (1) clearly stated, results-oriented, performance criteria and measures; (2) appropriate incentives for contractors to meet and exceed the performance criteria effectively and efficiently; and (3) specific incentives for cost savings.

As discussed in the Contract Reform Team Report, Performance Based Contracting was intended to transition the Department from broad, subjective statements of work in traditional Management and Operating contracts, to well defined, objective performance criteria and measures for program activities, environment, and health and safety requirements. Simply put, the performance based contract was intended to clearly state what the Department expects from its contractors, establish financial incentives that would motivate the contractors to perform, and provide ways for the Department to measure their performance.

Performance based contracts are designed to motivate contractors by applying incentive fee payments for the accomplishment of specific performance objectives, and to provide financial rewards for reducing the cost of operations. According to the Contract Reform Team Report, the design of proper incentives to reward superior performance and discourage substandard performance is a critical component of the new performance-based contracting concept. The Contract Reform Team Report stated that DOE should reward cost-effective, superior technical performance, and overall management excellence, and discourage substandard performance.

The thrust of the Contract Reform Team's efforts was consistent with the August 1993 Government Performance Results Act which focused on improving the management of federal programs and activities by establishing program goals and measuring the achievement of these goals.

On July 5, 1994, the then Secretary gave direction in a "Decision Memorandum" that "Throughout the complex, negotiations will commence immediately to incorporate contract reform provisions into existing contracts, and preparations will begin to develop negotiation strategies for new and extended contracts." On the following day, July 6, 1994, the Deputy Assistant Secretary for Procurement and Assistance Management sent a memorandum to eight Operations Offices and two Field Offices which stated that the Secretary had authorized the renewal and extension of selected Management and Operating contracts subject to the conditions stated in the memorandum, which included the incorporation of contract reform provisions into existing contracts.

In July 1994, my office issued a report on the “Inspection of the Cost Reduction Incentive Program at the Department of Energy’s Idaho Operations Office.” We found the Idaho Operations Office was not adequately validating cost savings claimed. We recommended that the Deputy Assistant Secretary for Procurement and Assistance Management and the Acting Associate Deputy Secretary for Field Management establish written cost reduction incentive program policies and procedures; and that these policies and procedures should also address the manner in which cost savings should be validated.

In April 1995, Department officials issued Cost Reduction Incentives Program (CRIP) guidance to the Operations Offices. However, as of March 31, 1997, there has not been agreement within the Department as to which organization has responsibility to develop and implement policy for the CRIP program. As a result, policies and procedures have not been issued.

The Department instituted a Business Management Oversight Pilot Project to change the way it administered contracts. Key features of the pilot project were reliance on self-assessments by the Department’s contractors as well as the establishment of management systems needed to meet performance expectations.

In May 1995, I wrote the then Deputy Secretary to express my concern that this program appeared to reduce the authority and capability of DOE to perform adequate contract administration. I was concerned that the Department was moving too aggressively to reduce the level of contract administration before the required supporting performance measurement systems were in place.

My office has since conducted several reviews of the Department's implementation of Performance-Based Contracting. We have issued reports covering performance measures and cost savings programs in contracts at the Richland Operations Office, the Rocky Flats Field Office, and the Nevada Operations Office. Our reports have documented deficiencies in the Department's development and administration of performance based contracts and the associated incentives used to improve contractor performance. These deficiencies include:

- Incentive fees were paid that were excessive in relation to the cost of the work.
- Incentive fees were paid for work completed before the establishment of the contract incentive.
- Incentive fees were paid for work that was not completed.

- o Incentive fees were paid for work that was easily achieved.
- o Performance measures were not clearly defined or results oriented.

I will now discuss the results of our work at each of these locations.

PERFORMANCE BASED INCENTIVES

I will first discuss the Inspection of the Performance Based Incentive Program at the Richland Operations Office. The Fiscal Year 1995 Performance Based Incentive (PBI) Program at Richland was initiated as one part of the broader Contract Reform Initiatives being implemented at Richland's Hanford Site.

In July 1994, DOE's Contract Reform Executive Committee recommended, and the then Secretary of Energy approved, that the full range of contract reform provisions should be incorporated into the Westinghouse Hanford Company (Westinghouse) contract by October 1994, the start of Fiscal Year 1995. However, Richland's Deputy Manager said it was recognized by September 1994 that the Richland team established to implement the PBI Program at Richland had reached an impasse, and that DOE Headquarters had returned the first round of 13 draft PBIs from the Richland Operations Office as being insufficient for a contract incentive program effort, considering the dollar size of the Richland

PBI program and the number of individual PBIs. DOE Headquarters directed changes to the Richland PBI Program, requiring that the dollar size of the program be raised and that the number of individual PBIs be increased. The Assistant Secretary for Environmental Management stated that this direction to Richland was to allocate more of the fee pool to objectively measured performance based incentives, and to reduce the amount of the subjective award fee portion of the fee pool. DOE Headquarters also required that the PBI Program be in place at Richland by December 1994. Westinghouse's contract was modified to include performance-based incentives on January 25, 1995.

By the end of Fiscal Year 1995, the PBI Program at the Richland Operations Office included 34 PBIs with 86 separate performance objectives issued to Westinghouse. The project costs incentivized by the 34 PBIs comprised $162 million of Westinghouse's $1.38 billion budget in Fiscal Year 1995.

Under the Fiscal Year 1995 PBI Program, Westinghouse earned $11.5 million out of a possible $14.2 million in incentive fees. For Fiscal Year 1995, the first year of the PBI program, Westinghouse was paid a total of $19 million in base, award, and PBI fees. In addition, Westinghouse also was paid an additional $27.6 million in cost reduction and solid waste incentive fees for a total Fiscal Year 1995 fee of $46.6 million. In contrast, for the three prior Fiscal Years, 1992, 1993, and 1994, Westinghouse was paid $12.7 million, $15.4 million and $21.9 million respectively in base, award, and cost reduction incentive fees.

The PBI incentive fees available to Westinghouse for each of the 34 PBIs ranged from $50,000 to $1.8 million. One PBI was subdivided into eight separate performance objectives, with each objective having an available fee of $225,000. The Manager of the Richland Operations Office stated that an objective methodology to determine the incentive fee was not available and the incentive fee of $225,000 per performance objective was calculated by dividing the $1.8 million incentive fee available by the eight performance objectives.

We reviewed 15 of the 34 PBIs in detail. Our review found that the Richland Operations Office paid PBI fees to Westinghouse that were excessive when compared to the cost of labor and material to perform the PBI work. For example:

o The Richland Operations Office paid the Contractor a Fiscal Year 1995 PBI fee of $225,000 to replace a ventilation fan in a waste storage tank. However, the total Fiscal Year 1995 project cost for the ventilation fan replacement was only about $25,000.

We also found that the Richland Operations Office paid PBI fees for work that was either partially accomplished or that was completed prior to the PBI Program being established at Richland. For example:

- A PBI was established for completing the shutdown of 21 systems at a Hanford facility with a maximum fee of $300,000. Westinghouse reported that the work was completed and the Richland Operations Office paid the maximum fee of $300,000. However, we found that one-third of the work representing the shutdown of 7 of the 21 systems was completed between September 28, 1994, and January 12, 1995, prior to the establishment of the PBI Program at Richland.

- In another case, a PBI with a fee of $100,000 was established for the completion of four activities associated with implementation of a computer software program even though all four activities were completed prior to the establishment of the PBI Program at Richland. We found that Westinghouse was paid the $100,000 fee even though documentation available to the Richland Operations Office and Westinghouse personnel indicated that three of the four activities were completed in October and November 1994, and the fourth was completed 12 days prior to the January 25, 1995, establishment of the PBI Program at Richland.

The Richland Operations Office also paid PBI fees of $910,870 to Westinghouse for work that was not complete. In several cases, Westinghouse reported that the work had been completed, but follow-up reviews by Richland, after the commencement of our inspection, showed that the work was not completed in accordance with the provisions of the PBIs. For example:

o A PBI was established to upgrade alarm panels in 7 tank farms with a maximum fee of $225,000. Westinghouse reported that the work was completed approximately one month after the PBI was established and the Richland Operations Office paid the maximum fee of $225,000. However, Richland subsequently determined that the alarm panel upgrades were completed in only two of the seven tank farms prior to Westinghouse's stated PBI completion date.

o In another case, a PBI was established to replace compressed air systems in 10 tank farms with a maximum fee of $225,000. Westinghouse reported that the work was completed and the Richland Operations Office paid a pro-rated incentive fee of $185,870. However, documentation available to Richland and Westinghouse personnel indicated that the replacement of compressed air systems in 7 of the 10 tank farms had been completed between January 1993 and August 1994, prior to the establishment of the PBI Program at Richland.

In addition, the compressed air system in one of these tank farms had not been completed at the time the PBI fee was paid and acceptance testing of the system had not been completed. The system required the use of a temporary compressor for more than a year after Westinghouse reported that the work was completed. Also, quality and safety were compromised in this case by Westinghouse's failure to follow required procedures for the testing and acceptance of the system. While contractor personnel were attempting to conduct a preventive maintenance operation on the cooling system fans, two fans started that the contractor personnel believed had been locked out, resulting in a “near miss” incident. Subsequent investigation of this incident by the Richland Operations Office found that DOE requirements were not properly implemented during startup and acceptance of the system, and that several deficiencies led to the “near miss” incident, including improper acceptance testing and inadequate safety and quality oversight.

We believe that, in the establishment of performance objectives and measures at DOE sites, careful attention needs to be given to ensure that safety is not compromised in the contractor’s efforts to earn an incentive fee.

We also found that the Richland Operations Office paid PBI fees for Performance Objectives which appeared to have been easily achieved and represented little challenge to Westinghouse. In many cases, Westinghouse already had scheduled completion dates before the PBI Program was established. Richland documentation shows that, in these instances, Westinghouse was in the process of completing these objectives ahead of schedule without any incentive, or had completed these objectives within days of the establishment of the PBIs. For example:

o A PBI was established for Westinghouse to provide a final high-level waste melter assessment report. Westinghouse provided the report and was paid the maximum fee of $200,000. However, Westinghouse completed this report just 19 days after the incentive fee was established, and only two weeks in advance of the report's originally scheduled completion date where the contractor would not have received an incentive payment.

- In another case, a PBI was established with an incentive fee of $150,000 to pump the contents of a storage tank. The PBI required Westinghouse to begin pumping the tank within four days of the PBI establishment date, and to pump at least 1,500 gallons within 30 days of when the pumping started to achieve the $150,000 maximum incentive fee. However, Westinghouse was able to complete the pumping of the tank six days after they proposed the PBI, and two days after the PBI was established, and was paid $150,000. The DOE Richland Program Manager for this project said he could not recall anything special or unique about pumping 1,500 gallons of the 10,000 gallons.

Our inspection found that the PBI Program at the Richland Operations Office was established without any specific written policies or procedures for the management and administration of an incentive fee program. As a result:

- the rationale for selecting PBI Performance Objectives was unclear;
- the justification for specific PBI fee amounts could not be determined;
- the scope of PBI work and the criteria for acceptance were not always clearly defined; and,

- o the expected financial and operational benefits of the PBIs selected under this incentive program were undefined in most cases.

We recommended the recovery of approximately $2 million in various Fiscal Year 1995 PBI fees and penalties. We also recommended that the Manager, Richland Operations Office, and the Assistant Secretary for Environmental Management, develop policies and procedures for the management and administration of an incentive fee program, with particular emphasis on: (1) the rationale used for the selection of performance objectives to be included under an incentive fee program; (2) the determination of incentive fee amounts; (3) the definition of the scope of work to be accomplished in order to achieve an incentive fee; (4) the identification of acceptance criteria for incentivized work; and (5) the verification of incentivized work prior to the payment of incentive fees.

The Department agreed with the report recommendations. The Department has reached a final settlement with Westinghouse as of June 27, 1997, which included reimbursement to the Department of about $910,000 in Fiscal Year 1995 fees and $450,000 in Fiscal Year 1995 penalties for incomplete work; and an additional $1.1 million in penalties for Fiscal Year 1996 PBIs, for a total recovery of about $2.5 million in fees and penalties.

In response to our recommendations, the Assistant Secretary for Environmental Management incorporated our comments into the “Environmental Management Guidelines for Fee and Incentives Development” which was distributed on July

11, 1997, to all Operations and Field Offices that support Environmental Management Programs. In addition, the Richland Operations Office issued a procedure for Performance-Based Contract Incentives on September 17, 1997.

Secretary Peña expressed concern about contracting within the Department shortly after our report was issued. The Secretary announced that he had directed the Department’s Procurement Executive to develop and coordinate a plan to review the use of performance-based management incentives in contracts at Department of Energy sites and facilities; and initiate a comprehensive review of all performance-based management contracts to ensure that contract incentives are rational, appropriately constructed, tied to reasonable fees, and properly administered.

My office also conducted an audit on “Contractor Incentive Programs at the Rocky Flats Environmental Technology Site.” The audit report was issued on August 13, 1997.

On July 1, l995, Kaiser-Hill Company, LLC (Kaiser-Hill) became the contractor responsible for management of the Rocky Flats Environmental Technology Site (Rocky Flats). As the managing contractor, Kaiser-Hill assembled a team of subcontractors responsible for specific areas of operations. Consistent with contract reform, the Department’s contract with Kaiser-Hill included incentive fee provisions.

For Fiscal Year l996, the first full fiscal year of its operations at Rocky Flats, estimated costs for Kaiser-Hill and its primary subcontractors totaled $530 million. For this period, base fees for the contractors were about $8.7 million and available performance measure incentive fees totaled $39.1 million. In addition, through Fiscal Year 1996, Kaiser-Hill had submitted 20 cost reduction proposals with claimed savings of $33.3 million. Under the contract's terms, Kaiser-Hill would be entitled to 35 percent of savings approved by the Department.

For Fiscal Year 1996, Kaiser-Hill and its team received the base fee of $8.7 million and $29.2 million of the available performance measure incentive fees. As of November 1996, cost reduction proposals, valued at $16 million, were approved and Kaiser-Hill was awarded almost $5.6 million in cost savings incentives.

The purpose of our audit was to determine whether cost reduction awards and performance fees paid to Kaiser-Hill were appropriate and justified. We found that the Rocky Flats Field Office rewarded the contractor for cost reduction proposals that were not innovative and that these proposals generally did not result in savings that had been returned to the Department's control. We also found that the performance measures at Rocky Flats rewarded performance expectations that were not clearly defined and were not always structured so as to encourage and reward superior performance.

COST REDUCTION INCENTIVES

According to Departmental guidance issued in April 1995, contractors should be rewarded for innovative cost reduction incentive proposals that reference appropriate baselines and which return claimed savings to the Department's control. However, the Rocky Flats Field Office approved three of Kaiser-Hill's proposals, with savings valued at $16 million, that did not meet the criteria included in the Department's guidance. The most significant of these was a "proposal" to accelerate a planned reduction in the contractor work force.

In November 1995, Kaiser-Hill submitted a cost reduction proposal in which it claimed that it accelerated by about three months a planned reduction in the contractor work force at Rocky Flats. Kaiser-Hill stated that during the transition period, "...on its own initiative and using its own funds...", it took "...immediate and decisive steps..." to reduce its work force on July 1, 1995, and thereby saved the Department about $14.9 million. The Department accepted the proposal. As a result of its financial review, the Rocky Flats Field Office reduced the claimed savings from $14.9 million to $12.3 million and awarded a $4.3 million incentive fee to Kaiser-Hill for the claimed savings. Our audit disclosed, however, that the proposal would have been rejected had the Department applied its own guidance for accepting contractor cost savings proposals. Specifically, we determined that the employees had been separated on June 28, 1995, by the predecessor contractor, EG&G Rocky Flats, Inc. (EG&G). This was prior to the July 1, 1995, effective date of the Department's contract with Kaiser-Hill, in which Kaiser-Hill became responsible for managing Rocky Flats.

Furthermore, we found that Kaiser-Hill had already been compensated for work force restructuring activities under a fixed-price transition contract. This contract, for which Kaiser-Hill was paid $9.9 million, was in effect from May 1, 1995, through June 30, 1995. It included a Human Resources clause requiring, among other activities, that Kaiser-Hill:

- o Develop a Labor Relations and Workforce Restructuring Plan,

- o Prepare for the hiring and transferring of employees, and

- o Initiate procedures required by the rightsizing process, such as identifying the number of employees in effected classifications, coordinating appropriate retraining, and promptly submitting a rightsizing plan to the Department.

We also found that the cost reduction proposal was not innovative as required by Departmental guidance. Specifically, the Department anticipated that work force reductions would be part of Rocky Flats' transition from a defense mission to an environmental cleanup mission. Further, the reduction-in-force was driven by a declining budget over which the contractor had no control. Finally, the Department had anticipated the work force reductions months before Kaiser-Hill was selected as the new contractor.

An analysis of the related sequence of events at Rocky Flats supports our conclusions. Specifically,

- In a July 1992 report to Congress on the Rocky Flats transition, the Department described prospective work force reductions to about 4,500 persons between Fiscal Years 1992 and 1995.

- In a December 1994 memorandum to Headquarters officials, the then Rocky Flats Field Office Chief Financial Officer discussed the need to accelerate contractor downsizing to achieve Fiscal Year 1996 budget expectations.

- In a February 1995 media advisory, the Department announced the need to eliminate 1,700 employees by November 1, 1995.

- In a May 9, 1995, memorandum to senior Headquarters' officials, the then Rocky Flats Field Office Manager requested approval for employee terminations designed to allow the Kaiser-Hill team a "running start" on July 1, 1995. Headquarters approved these actions a day later.

- In a news release dated May 11, 1995, the Department announced the schedule for implementing the previously anticipated reduction-in-force, indicating that the reduction was budget-driven.

Under Department guidance, acceptable cost reduction proposals must return "hard dollar," or measurable, near-term savings to the Department's direct control. In this instance, there was no support for the claim that the savings had been returned to the Department. As stated in Department guidelines, a revised baseline of cost, schedule, and work scope should have been prepared and compared to the existing baseline to demonstrate actual cost savings. An analysis of baseline changes provides confirmation that the savings have actually been made available to the Department. Kaiser-Hill did not establish a new baseline in its cost savings claim. Similar concerns about Departmental acceptance of "soft," unsupported contractor claims of savings have been raised during Office of Inspector General reviews at other Department facilities.

In responding to our draft report, Rocky Flats Field Office management stated that it did consider Departmental guidance but believed that applying the guidance would have been inappropriate for the following reasons:

o The guidance was issued by Headquarters in April 1995, and was not available to the Rocky Flats Field Office when the Kaiser-Hill contract was signed April 4, 1995.

o The guidance had not been incorporated into Departmental Orders and was therefore not mandatory.

We did not find the arguments set forth by the Rocky Flats Field Office compelling. First, the April 1995 guidance and the basic principles for accepting contractor cost reduction proposals had been under development for many months prior to formal issuance. Second, Rocky Flats Field Office personnel should have been familiar with the Departmental guidance since a senior Rocky Flats Field Office contracting official participated in its development. Third, the principles contained in the guidance were part of the recommendations for contractor cost savings incentive programs in the 1994 Contract Reform effort. Finally, even the contractor, Kaiser-Hill, recognized the applicability of the April 1995 guidance. In transmitting its cost savings proposal to the Department, it referred directly to selected portions of the April 1995 guidance in support of its proposal.

We concluded that Kaiser-Hill received a cost reduction award of $4.3 million for a reduction in work force which took place prior to the contract creating the cost reduction program becoming effective.

PERFORMANCE MEASURE INCENTIVES

One of the underlying principles of contract reform is to reward and encourage superior performance. The Department and Kaiser-Hill agreed to performance measures and related incentive fees for Fiscal Years 1995 and 1996. Our audit examined 15 measures in detail. For these 15 measures, incentive fees of $13.9 million were available and Kaiser-Hill and its primary subcontractors were awarded $11.7 million.

We concluded that 9 of the 15 measures, with related incentive awards of $6.9 million, were questionable. The measures we questioned defined expectations without objective data to support the definition and were, therefore, not structured to encourage and reward superior performance. For example:

o Kaiser-Hill and its team received $2.3 million as an incentive fee for entering line items of property into the Government's property system. However, the performance measures used were not derived from objective data, were easy to achieve and did not, therefore, represent a challenge to the contractor. The audit disclosed that Kaiser-Hill processed from 2 to almost 4 times the number of data entries envisioned under the measures. The contractor’s actual performance confirmed that the original performance levels were not realistic. In responding to our report, Department management agreed that the performance measures could have been more challenging.

o Kaiser-Hill and its team also received an incentive award of about $61,000 ostensibly for reducing safety violations by 10 percent against the prior period’s level of safety violations in a specific building at Rocky Flats. We found, however, that there had not been any safety violations in the building in the prior period. It was clear that objective data was not used to establish a realistic measure.

o Another performance measure was designed to encourage Kaiser-Hill and its team to self-identify safety violations. Under this measure, the contractors were not to receive a fee if more than two safety violations were brought to their attention during the measurement period. The theory supporting the measure was that if the Department had to report more than two safety violations, the contractors were not doing an adequate job of self-identification. The Rocky Flats Field Office, however, identified three unreported safety violations during one period. Despite the specific terms of the measure, which should have nullified a performance incentive under the circumstances, the Department paid Kaiser-Hill and its team almost $600,000.

We concluded that the conceptual change from the Department's traditional management and operating contracts to performance-based contracts was significant and that it required a substantial amount of preparation time and additional experience. We observed that the ambitious implementation schedule for performance-based contracting at the Rocky Flats Field Office may not have been adequate. The Rocky Flats Field Office, in essence, had to implement performance-based contracting at the same time that it was learning the fundamentals of the process, including the development of meaningful measures.

Department management concurred with our recommendations to strengthen requirements for cost reduction proposals and to clarify guidance on performance measures. The Department also agreed to review the transition contract, and the July 1, 1995 contract, to ensure that no redundant compensation associated with the accelerated work force reduction proposal occurred. However, the Department stated that there were no legal grounds for recovery of funds after approval of a cost reduction proposal which met all other contract terms and conditions.

My office also conducted an audit of the “Contractor Incentive Program at the Nevada Operations Office.”

In January 1996, Bechtel Nevada Corporation became the management contractor for the Department’s Nevada Test Site and associated activities. Consistent with Contract Reform, the Department’s contract with Bechtel included performance measures and incentive fee concepts.

For Fiscal Year 1996, performance measures covered the first nine months of the contract -- January 1, 1996, through September 30, 1996. For this period, Bechtel’s operating budget was $347 million. Total performance incentive fees of $19 million were available in Fiscal Year 1996, of which Bechtel received $14.6 million. Bechtel’s operating budget for Fiscal Year 1997 was $259 million and the maximum available fee was $16.7 million. The purpose of this audit was to assess the effectiveness of performance-based contracting at Nevada. We examined 6 of 27 Fiscal Year 1996 performance measures in detail and made a limited review of the 25 performance measures for Fiscal Year 1997.

We found that performance measures associated with the Bechtel contract included milestones that were established after the work had actually been completed and criteria that was vague and non-specific. As a result, the Nevada Operations Office rewarded performance that could not be objectively validated. For example:

o The Nevada Operations Office established 31 performance measurement milestones for certain subcritical and laboratory readiness experiments. Twelve of the 31 milestones, for which Bechtel received about $776,000 in incentive fees, were added after the milestones had already been completed. For instance, Bechtel was required to replace a hoist and to perform a “safety walkdown.” These tasks were to be completed by February 5, 1996, and April 1, 1996, respectively. However, the milestones associated with these tasks were added to the contract on June 25, 1996, months after the work had already been accomplished. Bechtel billed the Nevada Operations Office for these tasks on July 18, 1996. The Nevada Operations Office acknowledged that there were delays in getting milestones formally approved. It contended, however, that sufficient evidence existed to demonstrate that the milestones were developed and agreed to before accomplishing the work. However, the Nevada Operations Office did not provide, nor could we locate, any documentation to support this position. In fact, we noted that 60 percent of the incentive fees available for the subcritical and laboratory readiness experiments were associated with milestones that were labeled “To Be Determined” as of February 7, 1996, in Nevada documents.

o Another performance measure required Bechtel to reduce indirect and fringe benefit costs at the Nevada site and make the savings available to the Department. Available incentive fees for this measure totaled $3.2 million. Of this amount, Bechtel received $1.8 million for claimed indirect cost reductions of $10.2 million. We reviewed 5 of 31 claimed reductions, representing 79 percent of the $1.8 million paid. In one instance, Bechtel claimed that it eliminated 1,000 unnecessary internal procedures and saved, as a result, $1.5 million in labor costs annually because the procedures no longer needed to be maintained. For this claim, the Nevada Operations Office paid Bechtel an incentive fee of $301,000. Bechtel could not provide any baseline change analysis which demonstrated where labor costs at Nevada had been reduced through employee reductions or transfers, or where employees had assumed additional duties as a result of this change. In addition, neither the Nevada Operations Office nor Bechtel could demonstrate that the claimed savings had been made available for Departmental reuse either through a deobligation to the contract or a reprogramming of funds.

o Also as part of the indirect cost reduction measure, Bechtel claimed a savings of $2.8 million because employee fringe benefit costs were less than those of the previous site operating contractors. The Department paid Bechtel an incentive fee of $343,500 for this action. Neither the Nevada Operations Office nor Bechtel could demonstrate that the claimed savings had been deobligated from its contract or reprogrammed for other use. Therefore, the incentive fee of $343,500 paid to Bechtel appeared questionable. In responding to our report, the Nevada Operations Office management acknowledged that its validation of claimed savings was subjective because of the difficulty in establishing measurement baselines.

o We found that, as was the case with the performance measures for Fiscal Year 1996, many of the Fiscal Year 1997 measures were subjective and process-oriented. For instance, one of the key measures described expected performance, in part, as reducing the cost of doing business through business development, more efficient processes and practices, and the identification of innovative problem solving solutions. This measure carried with it a potential incentive fee of $2.5 million. However, we found that its vague language makes it nearly impossible for the Department to objectively evaluate contractor performance.

We recommended that the Department enhance future performance measures consistent with Contract Reform. We also recommended that the Department seek recovery of incentive fees paid where the work was accomplished prior to setting the performance measure, where the performance measure was not met, or where the savings cannot be demonstrated.

The problems experienced by the Department in establishing and administering performance-based contracts at Richland, Rocky Flats, and Nevada were generally attributed by local DOE managers to the challenges associated with the transition from traditional management and operating contracts to performance-based contracts. Department managers, in fact, expressed frustration at the difficulty in defining performance measures and setting performance targets within limited timeframes without sufficient procedures and policies in place.

The reports I have discussed show, I believe, that the Department had not developed adequate performance measurement systems to ensure the prudent expenditures of taxpayer dollars.

This concludes my statement and I would be happy to answer any questions you may have.

Department of Energy
FY 1996 Obligations for 15 Largest Contracts

Contractor		Obligations (000's)[1/]
Lockheed Martin Energy Systems	$	1,353,644
Lockheed Martin-Sandia Corp.		1,285,800
Westinghouse Savannah River Co.		1,178,533
University of California (Los Alamos)		1,125,735
University of California (Livermore)		938,189
Westinghouse Hanford Co.		918,547
Lockheed Martin Idaho Tech.		599,616
Kaiser Hill Co., LLC		565,731
University of Chicago		490,887
Lockheed Martin Energy Res. Corp.		419,811
Associated Universities, Inc		399,681
Battelle Memorial Institute		374,589
Bechtel Nevada, Inc.		341,000
University of California (Berkeley)		328,138
Allied Signal, Inc.		317,018
Total	$	10,636,919

[1/] Source: Adjusted DOE Annual Procurement and Financial Assistance Report FY 1996