

GAO

Report to the Chairman, Committee on
Governmental Affairs, U.S. Senate

October 1991

ENERGY MANAGEMENT

Tightening Fee Process and Contractor Accountability Will Challenge DOE



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**Resources, Community, and
Economic Development Division**

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The Honorable John Glenn
Chairman, Committee on Governmental
Affairs
United States Senate

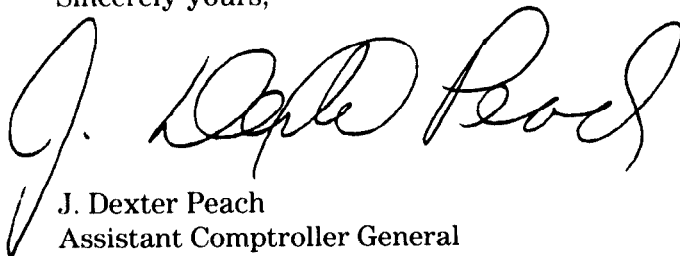
Dear Mr. Chairman:

In response to your January 24, 1991, request, this report discusses the Department of Energy's (DOE) appraisal process for management and operating contractors. The issues discussed include (1) the effectiveness of DOE's use of performance objectives to set expectations and evaluate contractor performance, (2) the effectiveness of DOE's use of data from on-site reviews to evaluate contractor performance for award fee purposes, and (3) the effect of DOE's new award fee regulations on the performance evaluation and award determination process.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Secretary of Energy; the Director, Office of Management and Budget; and other interested parties.

This work was performed under the direction of Victor S. Rezendes, Director, Energy Issues, who may be reached at (202) 275-1441. Other major contributors are listed in appendix I.

Sincerely yours,



J. Dexter Peach
Assistant Comptroller General

Executive Summary

Purpose

GAO has recently implemented a special audit effort to help ensure that areas vulnerable to fraud, waste, abuse, and mismanagement are identified and that appropriate corrective actions are taken. This effort focuses on 16 areas, one of which is the Department of Energy's (DOE) contracting practices. As part of this special audit effort, the Chairman, Senate Committee on Governmental Affairs, requested that GAO examine DOE's process for formally reviewing and assessing the performance of management and operating (M&O) contractors. Specifically, GAO examined (1) the effectiveness of DOE's use of performance objectives to set expectations and evaluate contractor performance, (2) the effectiveness of DOE's use of data from on-site reviews to evaluate contractor performance for award fee purposes, and (3) the effect of DOE's new award fee regulations on the performance evaluation and award determination process.

As agreed with the requester, GAO focused specifically on those contractors operating under cost-plus-award-fee contracts with DOE's Albuquerque Field Office. This office was selected because it administers contracts for four large defense materials production plants—Kansas City, Mound, Pantex, and Pinellas—as well as the contract for the Waste Isolation Pilot Plant (WIPP), in which DOE plans to store radioactive waste.

Background

DOE's M&O contracts with profit-making companies are generally cost-plus-award-fee contracts. Twenty-nine of DOE's 52 M&O contracts are cost-plus-award-fee contracts. The fee consists of a fixed amount (called the "base fee") and an award amount (called the "award fee pool") that is available to the contractor for performance above minimally acceptable levels. DOE evaluates the contractor's performance every 6 months to determine the amount of the award, if any. In fiscal year 1990, the potential award amounts ranged from \$4.5 million for the WIPP contractor to \$12.1 million for the Kansas City Plant contractor.

Results in Brief

The Albuquerque Field Office's (Albuquerque) use of performance objectives does not result in effective evaluations of contractor performance or effectively communicate DOE's expectations to the contractors. Albuquerque's contractor performance objectives are often very broad and provide no criteria or standards against which to evaluate contractor performance. As a result of this lack of specificity, judgments about performance are subjective. A February 1991 DOE report on a task

force study of the award fee process recommended building more objectivity into the performance evaluation plans and including performance indicators that are as specific as possible. To successfully implement such changes, however, DOE must change its traditional philosophy of establishing broad objectives and relying on its contractors to plan and carry out the programs.

Albuquerque does not have procedures and controls in place to ensure that all contractor performance data are appropriately evaluated as part of the award process. Although various on-site reviews of specific contractor functions, such as procurement or financial management, are periodically performed, the results of the reviews have sometimes been discounted in performance evaluations and award determinations. Furthermore, the evaluations and award determinations do not consistently reflect the contractors' lack of responsiveness to review findings, even those findings that are long-standing. Finally, even though DOE requires contractors to prepare self-assessments that include the status of previously identified deficiencies, Albuquerque has not enforced contractor compliance with this requirement.

DOE's new award fee policy is designed to both penalize contractors for avoidable costs such as the loss or destruction of property and provide substantially higher compensation for good management practices. Successful implementation of the policy on use of penalties will be difficult until DOE develops new management procedures and provides technical training for its staff so that it can identify and hold contractors accountable for these costs. As a consequence, contractors may realize substantial increases in compensation before DOE is able to enforce the rule's provisions.

Principal Findings

Broad Objectives Hamper the Effectiveness of Contractor Evaluations

Specific and measurable performance objectives are important to decrease the subjectivity of the evaluation process. Many objectives that Albuquerque has established for its M&O contractors, however, are very broadly stated and contain no criteria, standards, or milestones against which to measure contractor performance. For example, one performance objective for the Mound Plant was to "enhance the Industrial Hygiene Program." With such broad objectives, evaluations of contractor performance are highly subjective, causing disagreements and

confusion on the part of DOE units as well as the contractors about how to assess performance.

Although DOE is moving toward requiring more specific objectives, developing and enforcing these objectives constitutes a major change in the way DOE has done business with its contractors. The February 1991 DOE task force report to the Assistant Secretary for Defense Programs, which recommended more specificity in performance evaluation plans, stated that some DOE officials continue to believe that performance objectives need to be general to allow contractors the flexibility to apply their management expertise and respond to changing events. This belief reflects the traditional way that DOE has managed its contractors—that is, by establishing broad objectives and relying on contractors to plan and carry out the programs.

Albuquerque Lacks Procedures to Ensure That Deficiencies Are Considered and Promptly Corrected

In preparing contractor evaluations, DOE officials are to consider all pertinent information, such as findings from previous evaluations and on-site reviews. However, GAO found that significant findings that Albuquerque noted in some on-site reviews were discounted in the contractors' performance evaluation reports. For example, a fiscal year 1989 Contractor Purchasing System Review at WIPP revealed significant weaknesses, but these were not cited as deficiencies in the contractor's performance evaluation report.

In addition, Albuquerque does not ensure that contractors take prompt action to correct identified deficiencies. Three of the 10 Albuquerque divisions whose review procedures we examined have not established procedures specifying when and how contractors are to address review recommendations. Six of the divisions have not established central systems to track contractors' corrective actions. Accordingly, a contractor's failure to implement recommendations not only may go unnoticed by Albuquerque officials but also may not affect the contractor's performance evaluation. For example, although Albuquerque had not ensured that corrective action had been taken on 14 of 15 recommendations made 5 years earlier in a personal property review of the Pinellas contractor, this fact was not considered in the contractor's performance evaluation for the first half of fiscal year 1990. In fact, Albuquerque considered the contractor's performance in the personal property area to be a "significant achievement."

DOE established a new process in fiscal year 1990 to help monitor contractors' corrective actions. Contractors are required to submit self-

assessments that include the status of all prior deficiencies. DOE can reduce the awards if contractors do not submit adequate self-assessments. Although the Albuquerque contractors' self-assessments have generally not reported the status of previous deficiencies, Albuquerque officials have not yet penalized any contractors.

DOE Faces Major Challenges in Implementing Its New Accountability Rule

DOE's new rule to increase contractor accountability is designed to make the contractors, rather than the government, accountable for costs that could have been avoided by prudent contractor action. However, DOE faces formidable challenges in implementing this requirement. For example, to identify contractor accountability for loss or destruction of government property, DOE will need to develop procedures for such things as verifying the accuracy of the physical inventories conducted by the contractors.

Furthermore, to compensate the contractors for their increased risk, the rule also provides for substantially higher compensation. Because of the magnitude of the changes needed, contractors may be eligible for the increased compensation long before DOE is able to fully implement the accountability requirements.

Recommendations

GAO, among other things, recommends that the Secretary of Energy take actions to ensure the development of (1) specific, measurable performance objectives; (2) procedures that appropriately reflect the results of on-site reviews in performance evaluations and that track contractors' responses to previously identified deficiencies and consider these responses in the evaluations; and (3) procedures and staff training needed to implement the new accountability rule as a prerequisite for implementing the planned increase in contractor compensation.

Agency Comments

As requested, GAO did not obtain written agency comments on this report. However, the information in this report was discussed with agency officials, who agreed with the factual information. Their views were included where appropriate.

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Abbreviations

CPSR	Contractor Purchasing System Review
DOE	Department of Energy
ES&H	environment, safety, and health
GAO	General Accounting Office
M&O	management and operating
WIPP	Waste Isolation Pilot Plant

Introduction

The Department of Energy (DOE) uses management and operating (M&O) contracts for the operation, maintenance, or support of DOE-owned research, development, production, and testing facilities. All of DOE's M&O contracts are fully reimbursable, cost-type contracts. A few of these contracts provide for a fixed fee, while the contracts with nonprofit organizations are generally no-fee contracts. However, the majority of DOE's M&O contracts—29 out of 52 M&O contracts—are cost-plus-award-fee contracts.

A cost-plus-award-fee contract is a cost-reimbursement contract with special fee provisions consisting of a fixed amount (called the "base fee") and an award amount (called the "award fee pool"). The base fee does not vary with performance; rather, it is meant to compensate the contractor for factors such as risk, investment, and the nature of the work performed.¹ The award fee pool is the amount of money potentially available to the contractor for performance above minimally acceptable levels. The amount of the award, if any, is determined by DOE's evaluation of the contractor's performance. DOE uses award fee contracts, among other things, to encourage effective work by contractors and improve the quality of their performance.

DOE's Albuquerque Field Office (Albuquerque), where we concentrated our review, is central to the management of the nuclear weapons complex. Through cost-plus-award-fee contracts, Albuquerque manages and operates four of the nation's seven nuclear weapons production plants: the Kansas City Plant; Mound Plant (in Miamisburg, Ohio); Pantex Plant (near Amarillo, Texas); and Pinellas Plant (near St. Petersburg, Florida). Albuquerque also administers the cost-plus-award-fee contract for the management and operation of the underground Waste Isolation Pilot Plant (WIPP) (near Carlsbad, New Mexico), in which DOE plans to store radioactive waste.

¹As discussed in ch. 4, under DOE's revised regulations, half of the base fee is at risk if contractor performance is not satisfactory.

GAO and DOE Have Recognized the Need to Improve DOE Contractor Management

DOE's oversight of its contractors is 1 of 16 areas we have identified as being highly vulnerable to mismanagement, fraud, and abuse. We included DOE's contract oversight as a high-risk area in part because DOE had provided awards to contractors in questionable situations. For example, our October 1989 report on awards paid to the Rocky Flats, Colorado, contractor disclosed that the contractor received millions of dollars in awards despite significant problems in its environment, safety, and health (ES&H) programs.²

The Secretary of Energy has also recognized the need to improve DOE's contractor oversight process. In a September 1989 memorandum to all DOE personnel, the Secretary stated that contract management within the Department needed special corrective action. Specifically, he noted that DOE needed to modify and significantly strengthen existing contracting strategies, particularly in the area of compensation management. Among the contract management improvements that the Secretary said were needed were (1) expanded incentives for contractors to achieve excellence and cost effectiveness in their performance, (2) an enhanced understanding of performance expectations and performance criteria by both federal and contractor employees, and (3) tighter controls to ensure that DOE line managers take corrective action when contractors do not perform to standards.

In addition, in DOE's fiscal year 1989 and 1990 reports, required by the 1982 Federal Managers' Financial Integrity Act, the Secretary disclosed contract management as a material weakness. Both reports stated that performance expectations and performance criteria needed to be better defined and that oversight of both prime contracts and subcontracts needed to be improved.

DOE Has Taken Actions to Improve the Award Process

DOE has recently taken several actions to improve the award process. DOE (1) increased its emphasis on ES&H problems, (2) formalized a policy to withhold a contractor's entire award if performance in any one major functional area is unsatisfactory, and (3) issued new regulations holding contractors accountable for certain costs that have historically been borne by the government.

Since June 1989, at the direction of the Secretary of Energy, DOE has based at least 51 percent of the contractors' award fees on compliance

²Nuclear Health and Safety: DOE's Award Fees at Rocky Flats Do Not Adequately Reflect ES&H Problems (GAO/RCED-90-47, Oct. 23, 1989).

with ES&H regulations. This new emphasis on ES&H has already resulted in reduced award fees for Albuquerque's five award fee contractors. Awards decreased for all five contractors; for some the decrease was substantial. Table 1.1 compares the percent of available award fee pools paid to the Albuquerque contractors in fiscal years 1989 and 1990.

Table 1.1: Percent of Available Award Fee Pools Paid to Albuquerque Contractors, Fiscal Years 1989 and 1990

Facility	Fiscal year 1989		Fiscal year 1990	
	1st half	2nd half	1st half	2nd half
Kansas City Plant	81.3	68.5	61.6	78.4
Pantex Plant	79.2	59.5	53.6	56.0
Mound Plant	76.4	67.4	56.8	49.5
Pinellas Plant	89.7	85.5	57.2	64.4
WIPP	87.7	85.3	54.3	57.6

DOE has also formalized its policy that allows the fee determining official to withhold a contractor's entire award for the evaluation period when the contractor's performance is unacceptable in any one of the major performance areas. Since the policy was formalized in November 1989, no Albuquerque contractor has been rated unacceptable in any one of the major performance areas, and Albuquerque has not imposed this penalty.

In February 1991 DOE published interim regulations to hold the contractors, rather than the government, liable for certain costs that could have been avoided by prudent contractor action (for example, the costs of property damage caused by contractor negligence or fines levied for ES&H violations caused by contractor negligence).³ The contractor's maximum liability for avoidable costs will be the fee earned—both the base fee and the award fee—for the evaluation period during which the contractor negligence or noncompliance occurred. The new regulations, which will apply to all new or renewed for-profit M&O contracts, represent a significant departure from DOE's historical practice of indemnifying its contractors against virtually all costs incurred. At the same time, to compensate contractors for the increased risks involved, the regulations substantially increase the total compensation for which contractors will be eligible. The implications of the new regulations are discussed further in chapter 4.

³The final regulations adopting and modifying the interim regulations were promulgated on June 19, 1991.

Assessment of Contractor Performance to Determine Awards

Contractor performance is assessed for award purposes every 6 months according to a performance evaluation plan. The plan is to contain the criteria to be considered under each performance area evaluated. Various DOE offices prepare and review the evaluation report upon which the award amount is calculated.

Performance Evaluation Plans

The performance evaluation plans for the Albuquerque award fee contractors include performance objectives and evaluation criteria for six broad functional performance groups: (1) general management; (2) operations and weapons; (3) waste management, operational surety, and environmental restoration; (4) environment, safety, and health; (5) safeguards and security; and (6) resources and business management. Weights are assigned to each group to reflect the emphasis that DOE wants to place on that aspect of performance in the award determination. Each of these groups contains two to eight functional performance areas. The performance evaluation plans are sent to the contractors before the start of each evaluation period.

Albuquerque has area offices located at each site managed by award fee contractors.⁴ Area office staff gather and assess information on contractor performance on a continuing basis. These offices prepare the initial draft performance evaluation plan with input from the Albuquerque divisions and DOE headquarters. Staff from the Albuquerque divisions have more expertise in specialized areas of contractor performance and provide a broader perspective on issues related to contractor performance. Over 30 Albuquerque divisions are involved in the award fee administration process.

The plan is reviewed by the Albuquerque Award Fee Board, which is chaired by the Albuquerque deputy manager and composed of senior Albuquerque officials and the area office managers. The fee determination official—the Albuquerque manager—then concurs with the plan and submits it to DOE headquarters for final approval. Before fiscal year 1989, DOE headquarters did not participate in the award process.

Award Determination

At the end of each 6-month evaluation period, Albuquerque area offices prepare a draft performance evaluation report to determine award

⁴The office located at the WIPP site is called a "project office," but because it performs functions similar to those of an area office, in this report we refer to all the on-site offices as "area offices."

amounts. As with the performance evaluation plan, these offices consider input from the Albuquerque divisions and DOE headquarters in preparing the report, which describes contractor performance in each of the functional performance groups. Albuquerque uses five categories in describing contractor performance. "Significant deficiencies" or "significant achievements" are those that are judged to represent major events or sustained levels of performance of sufficient importance to affect the award determination. "Notable deficiencies" or "notable achievements" are those that are judged to be noteworthy but of lesser significance.⁵ "Observations" are positive or negative comments judged to be worth mentioning but not significant enough to affect the award determination.

Contractor performance in each functional performance group is assigned a numerical score and a rating based on the number and nature of achievements and deficiencies. The performance scale in the new award fee rule consists of "outstanding" (numerical scores of 96 to 100 points), "good" (86 to 95 points), "satisfactory" (76 to 85 points), "marginal" (66 to 75 points) and "unsatisfactory" (65 points or less). "Outstanding" performance, for example, substantially exceeds expected levels, with several significant or notable achievements and no deficiencies. An overall rating is calculated by multiplying the numerical score for each performance group by the assigned weight for that performance group and totaling the results.

The performance evaluation reports are to address contractor performance under each performance objective. If warranted, however, performance in areas other than those covered by performance objectives is also to be addressed. For example, even though DOE had not established a performance objective requiring strategic planning, in rating the WIPP contractor's performance for the first half of fiscal year 1991, DOE cited the contractor's lack of strategic planning as a deficiency.

Once the reports are drafted, they are reviewed by the Albuquerque Award Fee Board. The board reaches consensus on a contractor's rating and award amount. The Albuquerque manager makes the final award determination. Since fiscal year 1989, DOE headquarters has also reviewed and approved the award determination.

⁵Before fiscal year 1991, Albuquerque referred to performance in this category simply as "achievements" and "deficiencies."

Current Award Fee Structure

The maximum fee—both base amount and award fee—that a contractor can earn is derived from the estimated contract costs and the amount of risk involved. Table 1.2 shows the contract costs, base fees, available award fee pools, and actual awards paid to Albuquerque contractors in fiscal year 1990.

Table 1.2: Contract Costs, Base Fees, Award Fee Pools, and Actual Awards Paid to Albuquerque Contractors, Fiscal Year 1990

Facility	Costs	Base fee	Awards	
			Fee pool	Paid
Kansas City Plant	\$527	\$2.6	\$12.1	\$8.5
Pantex Plant	182	1.2	5.7	3.1
Mound Plant	195	1.0	8.3	4.4
Pinellas Plant	139	0.6	6.3	3.8
WIPP	68	1.1	4.5	1.9

Objectives, Scope, and Methodology

We recently implemented a special audit effort to help ensure that areas vulnerable to fraud, waste, abuse, and mismanagement are identified and that appropriate corrective actions are taken. This effort focuses on 16 areas, one of which is DOE's contracting practices. As part of this examination of DOE contracting practices, the Chairman, Senate Committee on Governmental Affairs, requested that we examine (1) the effectiveness of DOE's use of performance objectives to set expectations and evaluate contractor performance, (2) the effectiveness of DOE's use of data from on-site reviews to evaluate contractor performance for award fee purposes, and (3) the effect of DOE's new award fee regulations on the performance evaluation and award determination process.

As agreed with the requester, we concentrated our review on the contractors operating under cost-plus-award-fee contracts with DOE's Albuquerque Field Office. We selected this office because it is responsible for administering several large cost-plus-award-fee contracts, including those for four defense materials production plants, as well as the cost-plus-award-fee contract for WIPP. We have included references to award fee activities and initiatives at other DOE offices where appropriate.

We obtained the views of DOE officials and analyzed documents from the Albuquerque Field Office's divisions; the Amarillo, Kansas City, Dayton, and Pinellas area offices; the WIPP Project Office; and DOE headquarters.

To determine the effectiveness of DOE's use of performance objectives, we reviewed, analyzed, and discussed with DOE officials (1) the fiscal year 1991 performance evaluation plans for the Albuquerque award fee contractors, (2) a February 1991 report on DOE award fees submitted by DOE officials to DOE headquarters, (3) criteria related to cost-plus-award-fee contracts in the Federal Acquisition Regulations, Department of Energy Acquisition Regulations, and other DOE documents, and (4) the Albuquerque award fee performance evaluation reports for fiscal year 1990 and the first half of fiscal year 1991.

To evaluate the effectiveness of DOE's use of contractor performance data from on-site reviews, we reviewed a judgmentally selected sample of these reviews to (1) determine whether their findings affected subsequent award fee performance evaluation reports and (2) identify instances in which contractors had not corrected deficiencies contained in the reviews. We also reviewed contractors' self-assessments for fiscal year 1990 to determine whether they had addressed previously identified deficiencies.

To determine the effect of DOE's new award fee regulations, we examined the regulations (published as an interim final rule on Feb. 7, 1991, and as a final rule on June 19, 1991) and the published notices that preceded them. We discussed the effect of the new regulations with DOE officials at headquarters and Albuquerque.

We conducted our review between July 1990 and July 1991 in accordance with generally accepted government auditing standards. We discussed the contents of this report with responsible agency officials, who agreed with the factual information. We have incorporated their comments where appropriate. As requested, we did not obtain written agency comments.

DOE Performance Evaluation Plans Do Not Adequately Convey Expectations

Many of the objectives contained in Albuquerque's performance evaluation plans are so broad and subjective that they do not effectively communicate what is expected of the contractor. The performance objectives do not specify measurable expectations, standards, or milestones against which to judge contractor performance. As a result, the contractor may not have a clear understanding of what level of performance would be considered successful, and DOE units often disagree about how specific performance—either bad or good—should be assessed for the award determination. While DOE appears to be moving toward requiring more specific objectives, questions remain about whether DOE's actions will be sufficient to overcome its long-standing approach of establishing broad goals and relying on its contractors to plan and carry out the specific programs.

Many Performance Objectives Are Not Specific Enough

About half of the Albuquerque performance objectives do not tell the contractors specifically what is expected of them and what significance will be attached to specific accomplishments or failures. Because the objectives contain no criteria, standards, or milestones against which to measure the contractors' performance, the level and significance of their performance are open to interpretation.

In writing performance objectives, Albuquerque often uses broad terms such as "improving programs" or "fulfilling conceptual goals" but does not specify what is to be accomplished or how it will be measured. For example, in the first half of fiscal year 1991, three of the six performance objectives established for the Mound Plant contractor in the critical ES&H area were: (1) "enhance the Industrial Hygiene Program," (2) "enhance the Health Physics Program," and (3) "enhance and accelerate the Safety Analysis Program."

Other performance objectives represent broad conceptual goals. For example, for the first half of fiscal year 1991, an objective established for the Kansas City Plant contractor was to "ensure that sound business management and resources are being directed and utilized on those projects and activities most critical to DOE's mission." Such an objective conveys no criteria or standards against which performance can be measured.

Lack of Specificity Results in Confusion in Judging Contractor Performance

Some DOE officials have recognized the problems caused by the lack of specificity in performance expectations. In a February 1991 report to the Assistant Secretary for Defense Programs, a DOE task force recommended improvements to the award determination process largely because of the misunderstandings caused by the subjectivity of the process.

The February report resulted from a study of the award fee process by a DOE group composed of representatives from contractors, DOE headquarters, and DOE field offices. The report noted that because DOE's performance evaluation plans are essentially subjective, there is a low level of understanding between DOE field offices and the contractors and between field offices and headquarters on the meaning and intent of performance objectives. The lack of specificity frequently leads to disagreements both on what constitutes an accomplishment and on what significance the accomplishment has. The report also noted that contractors see the expectation setting and evaluation processes as arbitrary and ambiguous and often complain that they do not know what DOE perceives as successful performance. As a result, the process often does not effectively provide DOE's contractors with an incentive to excel.

The report noted that DOE personnel who determine the contractor's rating and award at the end of the evaluation period often disagree on how the contractor's performance should be interpreted and reflected in the rating. For example, some headquarters reviewers put different emphases on certain events that occurred during the rating period than field reviewers did. The report stated that contractors would have a greater opportunity to be responsive if DOE directions were clear and consistent.

Our analysis also indicated frequent disagreement among DOE officials about what constitutes a contractor deficiency for award determination purposes. Performance judgments that the Albuquerque division officials, who have technical expertise in specific areas of contractor performance, provided as input to the contractors' evaluation reports were often not upheld by area office or Award Fee Board officials. For example, in fiscal year 1990, fewer than half of the contractors' actions described by Albuquerque division officials as "significant deficiencies" were reflected as such in the final performance evaluation reports. Most of the remainder were downgraded to "deficiencies"; a few were omitted altogether. Likewise, fewer than half of the contractors' actions described by Albuquerque division officials as "deficiencies" appeared as such in the performance evaluation reports. A small percent of the

remainder were downgraded to “observations”; the rest were omitted. The area offices made most of the decisions to downgrade or omit these deficiencies.

Furthermore, views differed between DOE headquarters and Albuquerque officials. For example, Albuquerque officials considered the WIPP contractor’s progress on the Final Safety Analysis Report during the first half of fiscal year 1990 to be an “achievement”; DOE headquarters officials judged the contractor’s performance on the report to be a “deficiency.”

To resolve such differences, the February 1991 task force report identified the need for: (1) more specificity in performance evaluation plans and (2) advance agreement between DOE organizations and contractors on how the achievement of objectives will affect performance ratings. The report also recommended building more objectivity into the performance evaluation plans and including performance indicators that are as specific as possible.

Albuquerque is also taking actions to improve performance objectives. In a June 1991 memorandum on the development of performance objectives for the first half of fiscal year 1992, Albuquerque officials called for objective performance requirements to the extent possible. As an example, they said that “enhance safety program” would be an unacceptable objective, suggesting instead an objective such as “demonstrate material improvement in the safety program by providing two weeks’ training in fire protection per person. Certificates of training completion will evidence accomplishment of this [objective].”

Improved Performance Objectives Will Be Difficult to Achieve

While DOE is endorsing the use of more specific performance objectives, this improvement will be difficult to achieve without a change in DOE’s historical relationship with its contractors—a change in DOE’s basic culture. As noted, top DOE officials agree that more specific performance objectives are needed, but some DOE officials continue to believe that performance objectives should be subjective. This view reflects DOE’s traditional philosophy with regard to contractor activities—that is, DOE establishes broad objectives and relies on the contractors to plan and carry out the programs with little DOE oversight. We have characterized this philosophy as one of “least interference” in contractor operations.

According to the February 1991 task force report, some DOE officials believe that DOE should not rely too heavily on specific performance

objectives because doing so would reduce the flexibility the contractors need to effectively manage DOE facilities. If DOE were to establish specific, measurable performance requirements, the officials contend, the contractors might focus most of their efforts on these requirements, at the expense of broader goals such as maintaining basic systems and processes and responding to unanticipated events. This view was represented in a December 1990 memorandum from a Deputy Assistant Secretary for Defense Programs, who concluded that the use of broader goals and standards had resulted in the contractors' initiating and implementing several valuable programs at the sites.

The task force report noted that a second argument for broader goals is that DOE hires the contractors in part for their management expertise. Accordingly, part of the evaluation must address how well the contractor establishes priorities to best use the resources available to accomplish the range of requirements under the contract. DOE must subjectively assess the contractor's performance in accomplishing this. One Albuquerque division director, for example, commented that broad objectives are appropriate. If DOE had to develop more specific objectives for the program, he said, DOE would not need the contractor—it could run the program itself. An area office branch chief made similar comments.

Conclusions

The broad performance objectives DOE currently uses to assess the performance of its award fee contractors lead to disagreements among DOE units on how contractor performance should be rated. Contractors are also dissatisfied because they view the process as arbitrary and ambiguous.

While DOE has recently endorsed the need for more specific and measurable objectives, implementing this change will be difficult because of philosophical differences within DOE about the appropriate relationship with the contractors. Proactive and strong leadership will be needed to overcome institutional resistance to changing the historical relationship between DOE and its contractors.

Recommendations

We recommend that the Secretary of Energy ensure continued improvement in the performance evaluation and award determination processes by (1) requiring that specific, measurable performance objectives be developed, (2) developing procedures to communicate to the contractor

Chapter 2
DOE Performance Evaluation Plans Do Not
Adequately Convey Expectations

what is expected and how it will be measured, and (3) establishing procedures to ensure that these requirements are implemented consistently by all DOE organizations that take part in the award fee process.

Evaluation Process Does Not Always Give Appropriate Consideration to Deficiencies or Contractors' Actions to Address Them

Although Albuquerque considers a voluminous amount of information from every office involved, questions remain about whether all of the serious performance deficiencies identified during routine oversight are appropriately evaluated as part of the award fee process. In addition, DOE's performance evaluations do not routinely consider the timeliness and thoroughness of a contractor's actions to address review findings or deficiencies identified in previous performance evaluations. Further, DOE has not effectively used a new award fee requirement—the contractor's self-assessment—to evaluate the contractor's response to deficiencies identified in previous performance evaluations.

Some Performance Information Not Appropriately Reflected in Performance Evaluation Reports

In compiling award fee performance evaluation reports, DOE uses contractor reports, performance indicators for various programs, evaluations of contractor products, and on-site reviews of specific contractor functions. According to DOE officials, management must evaluate the significance of such information in deciding whether the performance information warrants inclusion in the performance evaluation. The periodic on-site reviews—such as the reviews of the contractors' procurement systems, property management systems, and financial systems—are key because they are based on direct observation and evaluation by functional experts.

In determining the award amount, Albuquerque managers consider how many achievements and deficiencies the contractor has received. Our analysis showed that some on-site reviews disclosed deficiencies that did not appear to be treated appropriately in the contractor's performance evaluation report. One example comes from a Contractor Purchasing System Review (CPSR) at WIPP. CPSRs are on-site reviews conducted periodically by Albuquerque personnel to ensure that contractors' purchasing systems comply with DOE and federal acquisition regulations. These purchasing systems and the periodic reviews are important because, in total, the five Albuquerque award fee contractors annually award subcontracts totaling nearly \$400 million.

A 1989 CPSR found deficiencies in WIPP's purchasing system. Because of the seriousness of these deficiencies, DOE reduced the contractor's threshold for procurement actions needing prior DOE approval from \$25 million (the threshold given to most Albuquerque contractors) to \$150,000. In the contractor's performance evaluation for that period, however, the only mention of the CPSR was an observation that "while the procurement function has supported the program, preliminary indications show that there are a number of areas needing improvement,

such as: lack of advance procurement planning; deficiencies in updating and implementing procedures; and small business set-aside reporting practices." Because observations in the award fee report do not affect the overall rating or the award determination, the contractor was not penalized for these serious procurement management problems.

Not only was the WIPP contractor not penalized, it received an "achievement" in its performance evaluation the following year after a follow-up CPSR showed significant improvements. According to the evaluation report, "considerable effort had been applied to respond to the previous 34 recommendations and to increasing the overall effectiveness of the procurement systems." In effect, because "achievements" increase the award amount, the WIPP contractor actually benefited from having a deficient procurement system.

Albuquerque officials, however, assert that they have to view the contractor's performance in total. According to an Albuquerque official, individual deficiencies such as the problems with the WIPP contractor's procurement system did not merit greater significance when compared with the contractor's overall performance in other areas of procurement management such as progress in socioeconomic goals.

Contractors' Actions to Address Deficiencies Not Always Considered in Award Determinations

Although DOE procedures require that performance evaluations consider a contractor's responsiveness to on-site reviews and performance evaluations, Albuquerque's evaluations have not done so consistently. First, because not all divisions have developed procedures and systems for tracking contractors' responses to review findings, a contractor's failure to respond might not be reflected in the award determination. Second, Albuquerque has not ensured that contractors' self-assessments systematically report actions taken on deficiencies cited in previous performance evaluations.

Contractors' Lack of Action on Review Findings Not Reflected in Performance Evaluations

Six of the 10 Albuquerque divisions whose review procedures we examined have not established central systems to track contractors' responses to review findings. Three of the divisions have not established written procedures specifying when and how contractors should address recommendations from the on-site reviews. Consequently, because a contractor's failure to respond to review findings may not be noted in a timely manner, the contractor's failure to address previous recommendations might not be considered in the award determination.

For example, on the basis of a March 1990 personal property review, the Pinellas contractor received a "significant achievement" in its performance evaluation for the second half of fiscal year 1990 to recognize its development of an effective, automated equipment tracking system. But neither the property review nor the performance evaluation report revealed that Albuquerque had not ensured that corrective action had been taken on 14 of 15 recommendations it made during the contractor's 1985 personal property review. At that time, the Albuquerque property management program did not have a central tracking system to monitor actions on outstanding recommendations. Such a tracking system has since been developed.

Similarly, the Kansas City contractor's award determination for performance during the first half of 1990 was not affected by the contractor's failure to implement recommendations made over 3 years earlier. According to a 1990 follow-up financial systems review, the contractor had not yet taken action to correct a problem identified in a review conducted in 1987. In response to the earlier review, the contractor had agreed to develop written procedures to ensure that costs for projects being done for other governmental agencies were not incurred before the funds were received. Albuquerque's financial management program does not have a central tracking system to monitor action on outstanding recommendations.

Albuquerque Has Not Ensured That Contractors Systematically Report the Status of Previous Deficiencies

Albuquerque has not ensured that contractors systematically report actions taken to correct each "significant deficiency" and "deficiency" cited in previous performance evaluations. Although DOE instituted, in fiscal year 1990, a new self-assessment procedure in which contractors are to report the status of previously identified deficiencies, contractor self-assessments have generally not included this information.

Albuquerque officials can raise or lower the contractor's overall rating as a result of their evaluation of the adequacy of the contractor's self-assessment. Although the Albuquerque contractors' self assessments have generally not reported the status of previous deficiencies, Albuquerque has not penalized the contractors. According to an Albuquerque official, they wanted to give contractors time to understand the new self-assessment requirement. In contrast, Albuquerque did reward the Pantex Plant contractor for its self-assessment for the first half of fiscal year 1990. Albuquerque considered the self-assessment to be especially well structured, realistic, and candid. As a result, Albuquerque

increased the contractor's overall rating by one point, which increased the contractor's award by about \$125,000.

Conclusions

Because on-site reviews are based on direct observation and evaluation by functional experts, such reviews are a key tool for evaluating contractor performance. Albuquerque discounted serious deficiencies revealed by some reviews, however, in determining the contractor's award fee. Because of the value of the information provided by these on-site reviews, appropriate consideration should be given to review findings in making award determinations.

In addition, Albuquerque does not always consider a contractor's response to review findings in performance evaluations and award determinations. Procedures specifying when and how the contractors should address review recommendations and systems to track contractors' corrective actions are needed to ensure that the contractor's responsiveness is monitored and evaluated as part of the performance evaluation for determining the award fee.

Similarly, Albuquerque lacks a system to monitor contractors' corrective actions for "deficiencies" identified in previous performance evaluations. The contractor's self-assessments cannot be relied on for this purpose because Albuquerque has not fully enforced the requirement to ensure that all deficiencies identified in performance evaluations are appropriately addressed.

Recommendations

We recommend that the Secretary of Energy (1) ensure that the results of on-site reviews are given appropriate consideration in the award determination process, (2) establish procedures for requiring and tracking contractor responses to all review findings, (3) ensure that contractor responses to previous review findings are considered in all on-site reviews, and (4) establish procedures for ensuring that all deficiencies identified in performance evaluations are addressed in contractor self-assessments.

Major Effort Will Be Needed to Implement New Accountability Requirements

Because of recognized deficiencies in its contractor management procedures, DOE has issued a new rule to make the profit-making contractors accountable for certain costs previously borne by DOE and, at the same time, to significantly increase the potential award amounts that contractors can earn. All new or existing contracts that are extended after March 11, 1991, are subject to the new rule.

Implementing the rule, however, will be a formidable task, as illustrated by the large number and scope of the issues DOE itself has said must be addressed to effectively implement the rule. Questions remain about whether DOE will be in a position to hold the contractors accountable for avoidable costs. The potential exists, therefore, for contractors to receive considerable increases in fees without actually being subject to the increased accountability requirements of the new rule.

New Rule Issued to Increase Contractor Accountability

Historically, DOE has indemnified its profit-making management and operating (M&O) contractors against nearly all risks and costs; DOE has rarely disallowed any costs incurred by the contractors. For example, DOE reimbursed its contractors for fines and penalties imposed for violations of federal and state environmental regulations unless the fines or penalties were the result of willful misconduct or lack of good faith on the part of a few key contractor personnel.¹

To improve its fiscal controls over its contractors, DOE developed a new accountability rule. Under this rule, DOE will (1) hold the contractors, rather than the government, responsible for costs that could have been avoided by proper contract performance and (2) increase contractors' potential fees to offset the increase in their financial risk.

The rule will apply to all new profit-making M&O contracts. Under the rule, the contractor's liability is no longer limited to the willful actions of a few key employees, but covers the negligence and misconduct of all employees. Contractors will be liable for all negligence and misconduct that result in civil fines and penalties, destruction or loss of government property, and other avoidable costs. The rule allows the DOE contracting officer to make the final decision on whether or not to reimburse the

¹Under DOE regulations, costs incurred in defense of any civil or criminal fraud proceeding brought by the government against a contractor are unallowable if the proceeding results in a conviction.

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contractor for such costs. The contractor's total financial liability, however, is limited to the amount of the fee actually earned during the evaluation period in which the contractor's negligence or misconduct occurred.

To compensate the contractors for their potential increased liability, the new rule substantially increases the total fee available to the contractors. Table 4.1 compares the Albuquerque contractors' fiscal year 1991 base fees and available award fee pools with the amounts that would have been available under the new award fee provisions.² As shown, the total fees available to the contractors would have increased substantially, particularly for the base fee portion. The increases in the base fee are intended not only to adjust for inflation since the last revision in 1983, but also to reflect the increased accountability and risk related to operating a facility.

Table 4.1: Comparison of Fiscal Year 1991 Fees Available to Albuquerque Contractors With Potential Fees Available Under New Rule

Facility	Dollars in Millions						Percent increase
	Current fee			New fee			
	Base	Award	Total	Base	Award	Total	
Kansas City Plant	\$1.26	\$14.17	\$15.43	\$8.40	\$12.60	\$21.00	36
Pantex Plant	1.41	6.57	7.98	4.70	9.40	14.10	77
Mound Plant	.58	10.47	11.05	5.82	8.73	14.55	32
Pinellas Plant	.61	6.89	7.50	4.05	6.08	10.13	35
WIPP	1.20	3.60	4.80	3.00	4.50	7.50	56

Although the base fee has historically been considered the contractors' primary compensation for satisfactory performance, receipt of the entire base fee is no longer guaranteed. Under the new rule the contractors will have to refund up to 50 percent of the base fee if their overall performance is rated "marginal" or "unsatisfactory."

²To avoid confusion, we use the term "base fee" to refer to the fixed portion of the fee. Under the new rule, however, this portion of the fee is called the "basic" fee.

DOE Faces a Major Challenge in Effectively Implementing the New Accountability Rule

To achieve the intended increase in contractor accountability, DOE must (1) incorporate the new requirements into DOE's 29 cost-plus-award-fee contracts, (2) develop day-to-day operational procedures by which to identify all avoidable costs and hold the contractors accountable for them, and (3) train the staff to implement the accountability procedures in a timely manner. If DOE's efforts in these areas are not effective, the contractors may receive the larger award fees without actually incurring any additional liability.

Two areas pose particular challenges to DOE: identifying contractor accountability for loss or damage to government property and identifying avoidable costs. Accountability for lost or damaged property will be difficult and time-consuming to determine because procedures will have to be developed to (1) determine the condition of existing equipment, (2) identify whether and how much property was lost or damaged, (3) determine that damage was caused by negligence or misconduct rather than routine wear and tear, and (4) identify the value of the property in question. DOE does not currently perform any of these functions as part of its routine operations. For example, property loss or damage would normally be identified by comparing physical inventories with property records. To implement the accountability rule, DOE would have to periodically verify the accuracy of the physical inventories conducted by the contractors. Without such verification, DOE would rely totally on information provided by a contractor to determine the contractor's liability for lost or damaged property. Albuquerque's current reviews of contractors' property management systems (which at best are scheduled every 2 years), however, focus on the contractors' policies and procedures; the reviews do not include verification of physical inventories. Similarly, Albuquerque currently has no process for determining what damage results from routine wear and tear or for identifying the current value of the contractor property.

The issue of avoidable costs—costs incurred as the result of negligence or willful misconduct by a contractor or its subcontractors—is even less well defined. In addition to the difficulty of identifying instances in which funds were not used effectively, DOE would also have to decide how much of the costs incurred were actually avoidable.

DOE Efforts to Implement Accountability Requirements

DOE has initiated efforts to implement the new rule. DOE's March 1991 contract for the operation of the Oak Ridge plants and facilities incorporates the provisions of the new rule but specifies that the new accountability and increased compensation provisions would not go into effect until October 1, 1991. DOE had much to accomplish by that date. DOE is also negotiating to incorporate provisions of the new rule in several contracts that were extended while the rule was being finalized. DOE will incorporate the provisions in the contracts with the other profit-making contractors when their current contracts expire.

DOE has identified the following three major issues that will have to be addressed in implementing the accountability requirements:

- The way DOE's instructions are communicated to the contractors. Because contractors would be able to deny accountability for actions undertaken at DOE's direction, DOE officials have recognized that they must clarify who has the authority to give instructions and how these instructions are to be communicated to the contractor.
- Responsibility for identifying avoidable costs. According to DOE officials, this identification must become a key responsibility of the DOE program staff, rather than solely an administrative function, because only the program staff will have the knowledge to identify instances in which costs could have been avoided.
- The need for extensive training of DOE staff. For several years DOE has recognized the need to improve the technical capabilities of its staff. DOE believes training is even more important under the new accountability rule, because implementing the rule effectively will require more precise instructions to the contractors and the technical capability to identify avoidable costs.

Although these issues are all critical to the effectiveness of the new accountability rule, DOE has a limited number of staff to monitor and verify contractor actions. According to Albuquerque officials, their current level of staffing will make it very difficult to properly perform duties related to implementing the accountability rule without a severe impact on other work load requirements. Although supplemented by some area office staff members, Albuquerque divisions have limited staff to enforce the accountability requirements. For example, Albuquerque has only four property management positions dedicated to overseeing an estimated \$5 billion worth of government-owned personal property being held by nine different M&O contractors. Additionally, to implement the accountability rule, DOE would have to ensure that the contractors perform appropriate maintenance on government-owned

equipment to prevent unnecessary damage. But Albuquerque has only three positions dedicated to overseeing contractor compliance with DOE maintenance requirements. Albuquerque does not yet know what equipment needs to be maintained or what maintenance schedules are appropriate because contractors were only recently required to document what equipment they have and to develop maintenance schedules. Further, Albuquerque has only five positions dedicated to overseeing nearly 300,000 procurement actions, representing nearly \$2 billion, performed by its nine M&O contractors annually. With such a small staff it will be very difficult for Albuquerque to determine whether contractors' procurement actions incurred avoidable costs.

The changes required for DOE to identify and communicate its requirements and hold the contractors accountable cannot be accomplished quickly. For example, a current DOE effort to use task orders to identify specific tasks and milestones to be accomplished with authorized funds is one way to better communicate DOE's instructions to the contractors and hold them accountable for specific results. Officials responsible for developing this approach, however, say that full implementation at all DOE contractors should take from 3 to 5 years. This effort will also require extensive training for the DOE staff involved.

In response to the accountability rule, task order administration, and other DOE business management initiatives, Albuquerque has requested a total of 92 additional staff for fiscal years 1992 and 1993.

Conclusions

DOE's efforts, including the issuance of the new rule to hold contractors accountable for actions within their control, are commendable but substantial additional effort will be required to achieve DOE's goals. DOE has coupled the increased accountability with increased award fees and capped the potential financial accountability of the contractors to make the new requirements more acceptable to the contractors.

To actually achieve this increased contractor accountability, however, DOE must develop day-to-day operational procedures that will identify avoidable costs and hold the contractors accountable for them. Two areas in particular will be difficult and time-consuming to implement: accountability for loss or damage to government property and avoidable costs. These will require the development of new procedures, additional training for DOE staff, and possibly the addition of more staff.

The scope of the changes needed in DOE procedures and operations to implement the accountability requirements raises the possibility that contractors will be eligible for the increased compensation before DOE is in position to impose the accountability requirements.

Recommendations

We recommend that the Secretary of Energy ensure that procedures for determining contractor liability for lost or damaged property and avoidable costs are in place and that sufficiently trained staff are available to implement the new accountability requirements, or delay the planned increase in award fees until DOE is ready to hold the contractors accountable.

Major Contributors to This Report

Resources,
Community, and
Economic
Development Division,
Washington, D.C.

Judy England-Joseph, Associate Director
Richard A. Hale, Assistant Director
Joanne E. Weaver, Assignment Manager

Denver Regional
Office

John D. Gentry, Regional Management Representative
David O. Bourne, Evaluator-in-Charge
Sarah A. Narvaez, Staff Evaluator

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