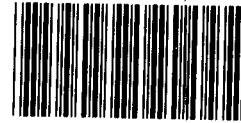


July 1992

ENERGY
MANAGEMENT

Entertainment Costs
Under DOE's Uranium
Enrichment
Production Contract

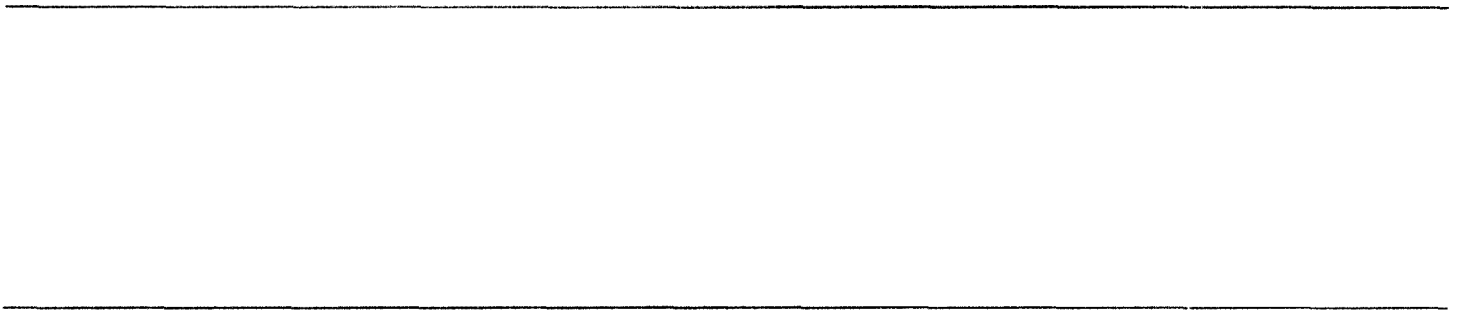


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**Resources, Community, and
Economic Development Division**

B-249103

July 30, 1992

The Honorable John D. Dingell
Chairman, Subcommittee on
Oversight and Investigations
Committee on Energy and Commerce
House of Representatives

The Honorable Howard Wolpe
Chairman, Subcommittee on
Investigations and Oversight
Committee on Science, Space, and
Technology
House of Representatives

In response to your request and subsequent discussions with your offices, this fact sheet provides information on the entertainment costs, including the cost of alcoholic beverages, that the Department of Energy (DOE) allowed under its contract with Martin Marietta Energy Systems (MMES)—the management and operating (M&O) contractor—to produce enriched uranium. MMES has two contracts with DOE—one for DOE facilities at Paducah, Kentucky, and Portsmouth, Ohio, and another for DOE facilities at Oak Ridge, Tennessee. The contract for the facilities at Paducah and Portsmouth is for producing enriched uranium.

We examined costs allowed under both contracts; however, as you requested, this fact sheet discusses only the entertainment and alcoholic beverage costs incurred for marketing activities under the uranium enrichment production contract. Our examination of entertainment and alcoholic beverage costs is part of a larger request from your offices to examine whether the costs that MMES charges the government for operating DOE's facilities are allowable and reasonable. We plan to provide you with a separate report on this broader effort at a later date.

In summary, we found the following:

- MMES marketing costs totaled about \$25 million for fiscal years 1986 through 1991. Of this amount, about \$554,000 was spent on entertainment costs which, in addition to alcoholic beverage costs, included costs for such things as golf outings, musical performances, dinners, luncheons, receptions, tours, and a charter boat ride. The cost per activity ranged from a few hundred dollars to thousands of dollars.

- The total cost of alcoholic beverages allowed under the contract could not be determined from the records DOE and MMES kept for marketing activities. However, in some instances, we were able to identify the cost paid for alcoholic beverages for an individual activity or event—usually involving a dinner meal or a reception. In those instances, the cost ranged from a few hundred dollars to over \$1,000 for each individual activity. In addition, DOE and MMES officials participated in these functions where alcoholic beverage costs were incurred, and these officials sometimes constituted more than one-third of the participants. The cost for DOE and MMES officials to participate in these functions was included in the marketing expenses of the uranium enrichment production contract.
- As a part of its marketing program to sell enriched uranium, DOE allowed MMES to charge entertainment and alcoholic beverage costs to the uranium enrichment production contract. We have requested an opinion from DOE's Office of General Counsel to clarify DOE's legal basis for allowing these costs. At the time this fact sheet was completed, we had not received DOE's response. Because you requested to have the other information in this fact sheet as soon as possible, we will report to you separately on this issue after we receive DOE's response to our inquiry.
- Although DOE allowed entertainment and alcoholic beverage costs to be incurred under the uranium enrichment production contract, it recognized that the providing of alcoholic beverages in a U.S. government-sponsored activity is not a general practice. DOE further recognized that the use of alcoholic beverages in such marketing activities should be minimized and sound judgment must be exercised in determining circumstances appropriate for such use. As a result, DOE developed written criteria to manage and monitor entertainment costs and the cost and consumption of alcoholic beverages.
- DOE and MMES did not adhere to some of the criteria DOE established to manage and monitor entertainment and alcoholic beverage costs. For example, the hours that alcoholic beverages are to be available during marketing events were not specified in any of the requests for approval of marketing activities that we examined. Furthermore, none of the required quarterly reports on marketing activities mentioned the consumption or the cost of alcoholic beverages associated with these activities. However, beginning in April 1992, DOE took steps to have alcoholic beverages more specifically addressed in MMES' requests for advance approval of marketing costs to be incurred under the contract and in the marketing reports. In fact, DOE has directed MMES to specifically set forth how the use of alcohol and entertainment is consistent with DOE's established criteria. In addition, DOE also directed MMES to include in future marketing activity reports

specific information on whether entertainment expenses at marketing events are reasonable and effective.

Section 1 of this fact sheet discusses entertainment and alcoholic beverage costs incurred under DOE's uranium enrichment production contract and describes several examples.

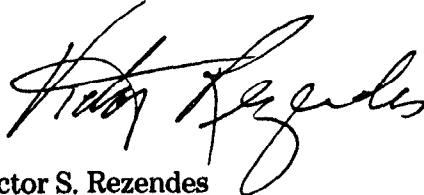
Scope and Methodology

We reviewed the history of and guidelines for the marketing activities. To examine the entertainment and alcoholic beverage costs associated with marketing activities for DOE's uranium enrichment production contract, we (1) determined the total marketing and entertainment costs incurred for fiscal years 1986 through 1991 and (2) selected for more detailed review all required quarterly reports prepared by MMES on marketing costs incurred for the most recent 3-year period—fiscal years 1989 through 1991. Then we judgmentally selected 25 marketing events from fiscal years 1989 through 1991 for a detailed examination of the entertainment and alcoholic beverage costs, and we reviewed MMES' documentation for each of the events. We also discussed with DOE and MMES officials the (1) information contained in their marketing files and the quarterly reports on entertainment and alcoholic beverage costs, (2) details involving DOE's decision to allow entertainment and alcoholic beverage costs under the contract, and (3) legal analysis performed that justified the charging of entertainment and alcoholic beverage costs under the contract.

We discussed the information presented in this fact sheet with DOE and MMES officials at DOE's Oak Ridge, Tennessee, Operations Office and DOE officials from the Office of the Deputy Assistant Secretary for Uranium Enrichment in Germantown, Maryland, and the Office of General Counsel in Washington, D.C. We incorporated their comments where appropriate. As requested, we did not obtain written agency comments on this fact sheet. We conducted our review from November 1991 to June 1992 in accordance with generally accepted government auditing standards.

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

If you have any questions about this fact sheet, please call me at (202) 275-1441. Major contributors to this fact sheet are listed in appendix I.



Victor S. Rezendes
Director, Energy and
Science Issues

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Abbreviations

DOE	Department of Energy
GAO	General Accounting Office
M&O	management and operating
MMES	Martin Marietta Energy Systems

Entertainment Costs Incurred Under DOE's Uranium Enrichment Production Contract

Background

In 1974, the United States was the sole supplier of enriched uranium to the non-Communist world. By 1983, foreign suppliers had made major inroads into the world market, reducing the Department of Energy's (DOE) share of the foreign market to approximately one-third of its previous level. More significantly, there were indications that utilities in the United States, which had been previously considered totally committed as DOE customers, were beginning to seriously examine foreign sources for their long-term requirements. The ability of foreign suppliers to penetrate DOE's previously exclusive market was due principally to price differences and more favorable contract terms.

DOE's New Marketing Strategy

In early 1984, DOE announced that it was embarking on a major initiative to restore the competitive position of the United States in the world uranium enrichment market. The elements of the Department's initiative were to (1) stabilize DOE's market share through the issuance of a new, more flexible enrichment contract, (2) reduce prices, (3) enhance DOE customer services and marketing activities, and (4) reduce program costs in all major areas.

Entertainment Costs Allowed Under DOE's New Marketing Strategy

In February 1988, DOE agreed to allow its contractor, Martin Marietta Energy Systems (MMES), to incur entertainment costs—including the cost of alcoholic beverages—under the uranium enrichment production contract. This agreement was made retroactive to November 1985. Between fiscal years 1986 and 1991, the agency incurred about \$24.8 million in marketing costs—which included about \$554,000 in entertainment and alcoholic beverage costs. About 55 percent of the total entertainment costs, or about \$305,000, were incurred during fiscal years 1989 through 1991—the period we examined for specific marketing events. Table I.1 summarizes the marketing and entertainment costs for uranium enrichment marketing activities for the 6-year period.

Table I.1: Uranium Enrichment Marketing Activities—Marketing and Entertainment Costs for Fiscal Years 1986-91

Fiscal year	Marketing costs	Entertainment costs
1986	\$3,877,000	\$61,336
1987	3,589,000	72,688
1988	3,900,000	114,949
1989	4,121,000	86,695
1990	4,811,000	103,073
1991	4,520,000	115,555
Total	\$24,818,000	\$554,296

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Entertainment costs, which include alcoholic beverage costs, have been charged for items such as golf outings, musical performances, dinners, luncheons, receptions, tours, and a charter boat ride. The cost per activity ranged from a few hundred dollars to thousands of dollars. DOE defines entertainment as "any activity in which food and beverages are provided or which primarily occurs outside of a normal office environment." According to DOE's Assistant Manager for Enriching Operations in Oak Ridge, the cost of entertainment provided for marketing activities are recovered by including those costs in the price of enriched uranium sold to DOE's customers.

Examples of Alcoholic
Beverage Costs Incurred

The total cost incurred for alcoholic beverages under the contract could not be determined because neither MMES nor DOE maintains records that would identify such information. For example, MMES' quarterly reports on the marketing activities for the fiscal year 1989-91 period did not contain any information about the cost of alcoholic beverages at any of the numerous marketing activities that took place during that period. In reviewing files for an individual domestic activity or event, however, we identified costs paid for alcoholic beverages in some instances. The files we reviewed on foreign marketing activities did not provide any information on the cost of alcoholic beverages incurred. DOE and MMES officials informed us that alcoholic beverages would normally be charged as part of the foreign marketing activities. The following examples from MMES' domestic marketing activity files illustrate costs incurred for alcoholic beverages:

- At a September 29 to October 3, 1991, activity planned for 51 people—29 of whom were either DOE or contractor employees—that took place in Paducah, Kentucky and Livermore, California, MMES charged about \$12,640 for meals, of which at least \$2,200, or 17 percent, was for alcoholic beverages. The actual alcoholic beverage costs may have been more because for some meals the available documentation did not specify whether any alcoholic beverage costs were incurred. The total entertainment cost for all activities involved in this event was over \$27,000. The purpose of this activity was to (1) provide Japanese customers with a tour of the Gaseous Diffusion Plant in Paducah, Kentucky, and the Atomic Vapor Laser Isotope Separation facilities at Lawrence Livermore National Laboratory, (2) discuss enrichment contract issues, (3) discuss the status of uranium enrichment activities, and (4) promote customer relations.

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- At a January 15, 1991, dinner in Oak Ridge, Tennessee, planned for 17 people—7 of whom were either DOE or MMES employees—about \$120, or 22 percent, of the total dinner bill of about \$550 was for alcoholic beverages. The total cost of entertainment for this event was about \$700. The purpose of this activity was to meet with nuclear fuel managers of selected domestic utilities to discuss the Atomic Vapor Laser Isotope Separation feed and product form selection.
- At a June 21-22, 1990, activity in Washington, D.C., planned for 83 people—32 of whom were either DOE or MMES employees—we could identify that MMES charged, at a minimum, about \$1,500 for alcoholic beverages during the first day of this activity. For example, of the \$1,100 charged for a reception, about \$600, or 55 percent, was for alcoholic beverages. From the \$3,300 cost for dinner, about \$800, or 24 percent, was for alcoholic beverages—49 bottles of wine. During an after dinner charter boat ride costing \$4,800, about \$70 was spent for special order liquor. Another \$1,400 was spent for catering on the boat for desserts and liqueurs, according to MMES' Director, Marketing Support Division. This official could not recall how much of the \$1,400 was associated with costs for alcoholic beverages, and the available MMES documentation did not show such information. In total, over \$16,000 was charged as entertainment costs. From the amount that could be documented, about \$1,500, or 9 percent, of the \$16,000, was for alcoholic beverages. The purpose of this activity was to discuss new market developments and DOE's future plans.
- For a March 25-28, 1990, function planned for 115 people—20 of whom were either DOE or MMES employees—at Opryland in Nashville, Tennessee, about \$1,200, or 28.5 percent, of the total activity cost of about \$4,200, was charged for alcoholic beverages. At this same function, about \$2,500 was also paid for suites and refreshments. The actual cost of the refreshments could not be determined, but the amount that MMES budgeted for refreshments was \$950, or 38 percent, of this activity's total cost. The amount of alcoholic beverages associated with the refreshment cost could not be determined from the documentation in the marketing files. The total entertainment cost charged for this event was almost \$8,000. The purpose of this activity was to promote customer relations by providing a relaxed atmosphere in which to listen to customer concerns and discuss future requirements.
- At a December 5, 1989, luncheon in Washington, D.C., planned for 23 people—15 of whom were either DOE or other government employees (no MMES employees were included)—about \$600, or 26 percent, of the total luncheon bill of about \$2,300 was for alcoholic beverages. The total cost of entertainment for this event was about \$2,500. The purpose of this activity

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was to discuss Korea's future uranium enrichment needs and to convince them of DOE's credibility and reliability in the future.

- At a June 19, 1989, wine tasting reception at a wine museum in Monterey, California, planned for 85 people—18 of whom were either DOE or MMES employees—\$3,675 was paid for the reception that included all wines at the museum, a Spanish guitarist for 2 hours, and an hors d'oeuvre menu. The total was based on a cost of \$49 per person. The purpose of this activity was to promote customer relations by providing a relaxed atmosphere in which to listen to customer concerns and discuss future requirements. This reception took place during the International Enrichment Conference held in Monterey, California, June 18-21, 1989.
- At meetings with representatives of DOE's domestic enrichment customers in Livermore, California, planned for about 66 people—27 of whom were DOE or contractor employees—on February 15-16, 1989, MMES spent about \$1,900, or 25 percent of the total, for alcoholic beverages at two dinners that cost about \$7,400, excluding tax and gratuities. The total entertainment cost for this event was over \$10,000. The purpose of this meeting was to provide a comprehensive tour of the Atomic Vapor Laser Isotope Separation enrichment facilities at the Lawrence Livermore National Laboratory and to discuss 1988 activities and DOE's plans for the coming year.
- On a number of occasions, several thousand dollars were charged as entertainment expenses incurred as part of MMES-sponsored overseas marketing activities. Unlike the files for some domestic activities, the documentation in MMES' files for these overseas trips was not very specific in describing—beyond statements like “dinner” and “reception”—what the expenses were for and how many people actually attended. Even though DOE and MMES officials stated that costs for alcoholic beverages would have occurred on such trips, the files did not provide any details at all. For example, on a Far East marketing trip from March 31 to April 11, 1991, to visit Japanese customers to discuss marketing activities and enhance business relationships, over \$25,000 was spent for meals, meetings, and receptions, but no further information was available on the details of this cost.

Other Entertainment Costs

In addition to the cost of alcoholic beverages, MMES' uranium enrichment marketing activities involved a variety of other entertainment costs, such as tours, a charter boat ride, golf outings, dinners, luncheons, receptions, musical performances, and overseas entertainment. The following examples illustrate the types of other entertainment expenses charged to the uranium enrichment contract.

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- At the previously mentioned activity that took place September 29 - October 3, 1991, in Paducah, Kentucky, and Livermore, California, MMES paid about \$1,000 for golf club rentals, green fees, and golf cart rentals for 12 Japanese customers—about \$80 per person—at Half Moon Bay, California.
- At a June 23-26, 1991, activity in Washington, D.C., planned for 80 people—24 of whom were either DOE or MMES employees—MMES spent \$5,500 for a performance during a dinner. The dinner cost was an additional \$7,200. The performance was the production of a play, according to the MMES official who signed the petty cash voucher requesting approval to pay for the performance. During this same activity, after participating in a MMES-sponsored dinner on June 23, 1991, an MMES employee and a DOE employee took several customers to a restaurant and spent an additional \$200—the bill was paid after midnight. In addition, on June 24, 1991, an MMES employee, a DOE employee, and a utility customer spent over \$200 in a local restaurant, after a MMES-sponsored banquet costing over \$2,000. The bill did not specify if any of the \$200 was for alcoholic beverages. The total entertainment cost for this 4-day event was about \$19,000. The purpose of this activity was to discuss the customers' pending decisions on the new price offer and the current market status and to demonstrate DOE's new computer program to enter reactor data.
- At the previously mentioned June 21-22, 1990, activity in Washington, D.C., planned for 83 people—32 of whom were either DOE or MMES employees—MMES paid \$1,250 for an after hours tour of Mt. Vernon and \$500 for entertainment during the charter boat ride, in addition to the \$4,800 for the charter boat ride and the \$1,400 for catering discussed earlier.
- At the previously mentioned December 5-6, 1989, activity in Washington, D.C., planned for 23 people—15 of whom were DOE and other government employees (no MMES employees were included)—about \$2,300, including about \$600 for alcoholic beverages, was spent for a luncheon, an average of almost \$100 per person.
- At an October 24-28, 1988, meeting in Washington, D.C., and Paducah, Kentucky, planned for about 45 and 42 people—25 and 22 of whom were either DOE or MMES employees, respectively—MMES paid for a variety of entertainment events at a cost of over \$4,500. The entertainment amount included costs for such things as golf, fishing, floral arrangements, a concert, gifts, and unspecified favors. The purpose of this activity was to discuss enrichment contract issues and to promote customer relations.
- On a number of occasions, several thousand dollars were charged as entertainment expenses incurred on overseas uranium enrichment marketing activities. Unlike the domestic activities' files, the MMES' files for

these overseas trips were not very specific in describing—beyond statements like “dinner” and “reception”—what the expenses were for and how many people actually attended. For example, on a Far East marketing trip to visit customers in Korea, Taiwan, and Japan from October 25 to November 17, 1990, MMES spent over \$27,000 for entertainment. The marketing files only identified the cost incurred in the Orient for business meals in the currency of the host country—which was the bulk of the entertainment cost. The MMES marketing officials subsequently translated the cost into U.S. dollars. The purpose of this trip was also to discuss marketing activities and enhance business relationships with customers.

DOE's Basis for Allowing Entertainment and Alcoholic Beverage Costs

As part of its marketing program to sell enriched uranium, DOE allowed MMES to charge entertainment and alcoholic beverage costs to its uranium enrichment production contract. However, entertainment and alcoholic beverage costs were statutorily prohibited in DOE contracts by section 1534 of Public Law 99-145, dated November 8, 1985.¹ When the law was enacted it allowed the Secretary of Energy 150 days to prescribe regulations to implement section 1534 of this law. Such regulations could establish appropriate definitions, exclusions, limitations, and qualifications to the law. In 1990, a DOE Board of Contract Appeals decision held that after April 7, 1986, alcohol is considered a statutorily precluded cost.²

DOE believes that the alcoholic beverage cost prohibitions contained in section 1534 of Public Law 99-145 are not applicable to MMES uranium enrichment marketing activities directed by DOE because the MMES marketing activities, including the occasional providing of alcoholic beverages, are solely conducted in support of and for the benefit of DOE. According to DOE, section 1534 was enacted to preclude government reimbursement for costs that indirectly help contractors market their products when marketing government products.

We requested in mid-June and early July 1992, an opinion from DOE's Office of General Counsel to clarify the basis upon which DOE has concluded that the costs for entertainment and alcoholic beverages are allowable under the uranium enrichment production contract. At the time this fact sheet was finalized, we had not received DOE's response. Therefore, because you requested to have the other information in this fact sheet as soon as

¹Section 1534 of the Department of Energy National Security and Military Applications of Nuclear Energy Authorization Act of 1986, Public Law 99-145.

²Cotton and Company, EBCA No. 426-8-89.

possible, we will report to you separately on this issue after we receive DOE's response to our inquiry.

DOE's Allowable Cost Criteria for Alcoholic Beverage Costs

DOE, in deriving its policy that entertainment and alcoholic beverage costs could be incurred under the contract with MMES, recognized that "the providing of alcoholic beverages in a U.S. government-sponsored activity is not a general practice, and because of this sensitivity and not because of its unallowability, the use of alcoholic beverages in such marketing activities should be minimized and sound judgment must be exercised in determining circumstances appropriate for such usage." As a result, DOE developed written criteria to manage and monitor entertainment costs and the cost and consumption of alcoholic beverages.

Prior to the obligation or expenditure of any funds for entertainment in connection with marketing activities for uranium enrichment services, MMES is required to obtain the advance written approval of the Contracting Officer or the Contracting Officer's Representative, unless otherwise provided.

Under DOE's criteria, the following guidelines apply to the approval of alcoholic beverages as an allowable cost at a marketing activity:

Structured Events. Alcoholic beverages may be approved in connection with structured events directed by DOE, such as receptions for enrichment customers associated with either DOE-sponsored conferences or nuclear industry conferences. These activities should have limited hours in which alcoholic beverages are available, and those hours should be specified in the request for approval.

Business Meetings. Alcoholic beverages are not generally considered necessary for business meetings and will not ordinarily be approved for reimbursement, unless they are a customary beverage accompanying a meal. In general, the type of meal and cultural setting should be considered in determining what is customary. The considerations, according to the criteria, would include whether the (1) setting is formal or informal or (2) customers are domestic or foreign.

In the Far East, in situations where a post-dinner location is the traditional setting for business interaction, alcoholic beverages may be approved on the basis of deliberate consideration of (1) selected attendance, (2) limited

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Uranium Enrichment Production Contract**

frequency, and (3) meeting minimum expectations of tradition and courtesy.

DOE's guidelines did not specify what the limited hours should be in which alcoholic beverages may be made available at structured events. However, DOE's Assistant Manager for Enriching Operations, who is responsible for approving in advance all MMES entertainment expenses, stated that the hours are usually limited from 5:30 to 9 p.m. for hospitality suites. He pointed out that even though the specific hours are not included in the request, he is aware of what goes on at these activities and how they are run. None of the requests for advance approval of the cost for alcoholic beverages that we examined in MMES files specified hour limitations, as required by the guidelines.

According to DOE's criteria, DOE supervision should be assigned during all structured events when alcoholic beverages are available to assure compliance with DOE's policy and applicable law. Even though DOE established that supervision should be provided, DOE has not established any prohibition against its employees fully participating in MMES' entertainment activities, including the consumption of alcohol. Both DOE and MMES officials told us that there has been no excessive consumption of alcohol at MMES-sponsored activities by either DOE or MMES employees.

In reviewing the data in the files for several marketing activities where we could identify that alcoholic beverages were purchased, the files did not include any documentation to show how the activity was complying with DOE's cost criteria concerning alcoholic beverages. Furthermore, the advance approval required for the use of alcoholic beverages in connection with marketing activities was not specific enough to identify whether an approval for the use of alcoholic beverages was being requested or for the events in which alcoholic beverages will be used. For example, in the estimated cost section of the approval document, the following statement was included in the requests for approval.

"This request for approval is made to assure compliance with the September 21, 1987, 'Allowable Cost Criteria Entertainment—Advertising Expenses' and, in particular, to request advance approval in accordance with Item No. 7 of these criteria."

Item No. 7 of the criteria deals with alcoholic beverages.

New DOE and MMES
Actions to Address
Alcoholic Beverage
Cost Issues

As a result of our review, on April 7, 1992, DOE's Assistant Manager for Enriching Operations directed MMES' Vice President for Uranium Enrichment to prepare future quarterly reports to include

- the reasonableness of expenses, such as alcohol and entertainment, based on the estimates;
- the effectiveness of the customer function; and
- whether the activity served its purpose and should be continued in the future.

In response to DOE's direction, MMES officials told us that the following expanded note will be a part of the request for approval of marketing events on future requests involving entertainment activities that might include alcohol.

"Note: There is the possibility that alcoholic beverages will be consumed at the DOE hosted event (depending on the location of and/or menu selection at the proposed meal). This is being noted on this request for approval to assure compliance with the September 13, 1990, 'Allowable Cost Criteria Entertainment—Advertising Expenses' and, in particular, to request advance approval in accordance with Item No. 7 of these criteria which specifically addresses the use of alcoholic beverages."³

The MMES officials said they also planned to address the effectiveness and reasonableness of the activity and whether the event served its useful purpose. The officials said they did not plan to summarize the cost of alcoholic beverages or the number of people served alcohol at these events because, in essence, they did not believe it could be practicably done. However, the DOE official responsible for approving requests for entertainment activities stated that he plans to have MMES summarize these data in some manner.

³The criteria were revised in September 1990 to increase the allowable cost of gifts to foreign nationals from under \$25 to under \$75.

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