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SUPERFUND

EPA Action Could Have
Minimized Program
Management Costs

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss program management costs associated with the Environmental Protection Agency's (EPA) hazardous waste cleanup contracts under Superfund. Critics have raised concerns about Superfund contractors' spending excessive amounts of public funds on activities that do not advance the cleanup of hazardous waste sites. These concerns have focused on high administrative and management costs (program management costs) incurred by EPA's Alternative Remedial Contracting Strategy (ARCS) contractors.

Mr. Chairman, as you are aware, over the years we have reported on numerous contract and fiscal management problems in the Superfund program.¹ This work has repeatedly identified serious deficiencies in EPA's management of contractors and in the agency's efforts to recover costs from responsible parties. With billions of dollars at stake, EPA's effective management of these contracts is critical if we are to maximize scarce federal resources for cleanup activities at these hazardous waste sites. For years, however, the agency tolerated deficiencies in contract management and failed to follow through on planned corrective measures. Recently, under pressure from the Congress and others, EPA has taken steps to remedy these long-standing contract management problems. EPA will need to sustain this effort under the new administration to correct these problems.

Our testimony today focuses on one particular aspect of EPA's contract management--high program management costs on cost-reimbursable ARCS contracts. As a result of the criticisms about EPA's high program management costs, you and two other Subcommittee Chairmen requested that we assess (1) the extent of and reasons for high Superfund program management costs and EPA initiatives to reduce these costs and (2) EPA's plans to control program management costs on future Superfund cleanup contracts. This testimony summarizes the resulting report that we are releasing at this hearing.²

In summary, lack of EPA action has contributed to high ARCS program management costs. As of September 1992, ARCS contractors had incurred \$465 million in costs, of which one quarter (\$105

¹See app. I for a list of our reports pertaining to Superfund contracting.

²Superfund: EPA Action Could Have Minimized Program Management Costs (GAO/RCED-93-136, June 7, 1993).

million) was for program management.³ The percentage of costs expended for program management ranged from almost 70 percent in fiscal year 1988 to 15 percent in fiscal year 1992. These high costs resulted in part because EPA awarded a large number of contracts and built in excess work load capacity into the contracts to allow EPA to terminate contractors that performed poorly and to prevent future capacity shortages. However, the cleanup work load EPA anticipated never materialized, in part because of changes in EPA policy, including a decision to have private parties responsible for site contamination manage and pay for cleanups. Also, EPA delayed in terminating contractors and effecting other contracting changes to avoid additional costs to the government. Furthermore, ARCS contractors have included costs that either are not allowable or are questionable under the Federal Acquisition Regulation (FAR) in their indirect costs--a portion of which is charged to program management. Subsequent increases in cleanup work load and recent EPA initiatives to control program management costs have eased the work load overcapacity problem to some degree, but the problem persists in some regions, and EPA has yet to adequately study whether further terminations are warranted.

EPA is currently developing new contracts to replace ARCS contracts and is, once again, also considering policy changes that could affect the volume and type of work available to Superfund contractors. EPA staff are aware that these policy changes and Superfund's upcoming reauthorization could affect the cleanup work load. For this reason they are attempting to incorporate enough flexibility into the new contracts to allow for sufficient contract capacity and to minimize future program management costs. EPA's ability to respond to program changes as they occur and, if needed, coordinate prompt and appropriate actions could help minimize future program management costs.

In the report released today, we have made recommendations designed to control program management and other contracting costs.

Before we begin a more detailed discussion of our findings, let me provide you with some background information on EPA's ARCS contracts.

BACKGROUND

The Superfund program was created in 1980 to clean up the nation's most dangerous hazardous waste sites. The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) created a trust fund (Superfund), financed primarily through taxes on crude oil and chemicals, to pay for site cleanups.

³Our report and this testimony incorporate EPA program management cost data through fiscal year 1992, the latest data available at the time we conducted our audit.

The Congress reauthorized Superfund in 1986 and in October 1990 increased its authorization to a total of \$15.2 billion.

EPA first awarded contracts to private ARCS contractors in 1988 to perform or oversee the cleanup of Superfund hazardous waste sites. These contractors perform remedial studies, design cleanup remedies, and manage the cleanup under ARCS contracts. Actual site cleanups can be performed by other private contractors or by the U.S. Army Corps of Engineers.

Prior to 1988, under EPA's previous contracting strategy, contracts were awarded only to five relatively large contractors. To increase the level of competition and to encourage smaller firms to participate, EPA awarded a total of 45 ARCS contracts to 23 contractors in 1988 and 1989, each for a period of 10 years. The total cost of the 45 contracts, if all options are exercised, is \$6.6 billion. This includes \$2.4 billion for cleanup design and oversight by the 23 ARCS contractors and \$4.2 billion for subcontractors that would perform the actual cleanups.

The work performed under ARCS contracts is divided into two elements--program management and remedial planning. EPA incorporated the program management concept into ARCS contracts as a means of providing oversight for non-site-specific costs. Costs that support multiple sites are also charged to program management. Costs incurred for a specific site are charged to remedial planning. Program management costs include such costs as the salary of contract managers, the cost of reporting and billing, and the cost of purchasing equipment used at multiple sites.

Before turning to program management costs, we'd like to place today's hearing in the broader context of our prior work on problems with fiscal mismanagement of EPA's contracting and cost recovery efforts.

PROBLEMS WITH SUPERFUND CONTRACT MANAGEMENT AND COST RECOVERY EFFORTS

Over the years, we have repeatedly reported that serious contract management problems exist in the Superfund program. As you know, EPA makes extensive use of cost-reimbursable contracts to clean up hazardous waste sites. These contracts require special agency oversight because they reimburse the contractor for all allowable costs and therefore give the contractor little incentive to control costs. However, we have repeatedly reported that EPA has not overseen its cost-reimbursable contracts as necessary to prevent contractors from overcharging the government. For example, EPA has not satisfactorily estimated the cost of work before approving contractors' budgets. In addition, EPA has not effectively used two other basic cost control techniques--invoice reviews and audits--to ensure the reasonableness of contractor charges. For example, we testified in March 1992 that over

\$2.5 million in unallowable and questionable costs were improperly included in the overhead accounts by one ARCS contractor, including providing clients with tickets to professional sporting events, alcohol at company parties, and nonemployee travel by spouses.⁴

We also previously reported that EPA has recovered only a small fraction of the Superfund resources that it has spent. Parties responsible for contaminating Superfund sites are required by CERCLA to clean them up or to reimburse EPA for a government-funded cleanup. As of September 30, 1992, EPA had collected just 10 percent of the \$5.7 billion that it had classified as recoverable from responsible parties. Because it lacks complete data on its past recovery efforts, EPA cannot explain this low rate of repayment. Among other problems we identified, EPA does not fully recover its indirect costs and interest.

Under mounting pressure from the Congress, EPA's Inspector General, and GAO, EPA began in 1992 to address its contract management and cost-recovery problems, including the root causes. EPA senior management has started to focus attention on contracting and has recently initiated efforts to exercise greater financial control over its Superfund contracts. For example, since early 1992, EPA has required its staff to develop independent government cost estimates for Superfund contracts and is working to help its staff develop cost-estimating expertise. EPA has also requested funding to increase the number of auditors in its Office of Inspector General to help reduce the audit backlog. To improve its cost-recovery efforts, in August 1992, EPA proposed regulations to change its approach for recovering indirect costs. Under this proposal, the agency would seek to recover the previously excluded categories of indirect costs and would revise its method for distributing indirect costs so that almost all indirect costs would be recoverable. EPA is currently reviewing comments on this proposal. If adopted, the agency estimates this proposal would almost triple the indirect costs recoverable from responsible parties, and would allow EPA to seek recovery of some of the over \$1 billion now excluded.

With this as background, we'd like to focus the balance of our statement today on another area of contracting--program management. Specifically, we will describe the extent of and reasons for high Superfund program management costs and EPA's initiatives to reduce these costs and its plans to control program management costs on future Superfund cleanup contracts.

⁴Federally Sponsored Contracts: Unallowable and Questionable Indirect Costs Claimed by CH₂M Hill (GAO/T-RCED-92-37, Mar. 19, 1992).

LACK OF EPA ACTION CONTRIBUTED TO HIGH
ARCS PROGRAM MANAGEMENT COSTS

Lack of EPA action has contributed to excessive program management costs in Superfund's ARCS cleanup contracts. Nearly halfway through the life of these 10-year contracts, contractors have spent \$105 million, which represents almost one of every four dollars (23 percent), on program management activities. EPA anticipated that program management costs would represent a higher proportion of contractors' costs in the early years of the contract--because of start-up costs the ARCS contractors were expected to incur--and would then diminish in the latter years of the contracts as the remedial work load increased. Although the yearly percentage of these costs has declined--from 69 percent in fiscal year 1988 to 15 percent in fiscal year 1992--program management costs have been much greater than anticipated, primarily because the expected cleanup work load either never materialized or went to others.

Mr. Chairman, we'd like to highlight a few of the factors that contributed to the high ARCS program management costs. First, in awarding the contracts, EPA deliberately built in excess contract capacity and increased the number of contracts involved from 5 to 45 to avoid future capacity shortages and to allow for the termination of poor performers. Simply put, EPA hired too many contractors for the work they eventually were given to do. Second, the anticipated cleanup work load for ARCS contractors never materialized, in part because of policy changes that EPA did not consider in its original work load estimates. For example, soon after the ARCS contracts were awarded, EPA implemented a new enforcement-first policy that compels parties responsible for site contamination to manage and pay for cleanups. This and other policies effectively reduced the amount of work available for ARCS contractors. Finally, although EPA was aware of high ARCS program management costs as early as October 1989, it did not initiate action to avoid additional costs to the government and to correct the problem, such as terminating contractors as originally planned, until the beginning of fiscal year 1992.

Of the \$465 million in ARCS costs, nearly \$161 million was for indirect costs--costs that are particularly subject to waste and overcharging. Our December 1991 review of indirect costs claimed by one ARCS contractor and similar reviews of other ARCS contractors by the Defense Contract Audit Agency (DCAA) and EPA's Inspector General found that contractors had claimed costs that are either not allowable or are questionable under the FAR.⁵ These

⁵See Federally Sponsored Contracts: Unallowable and Questionable Indirect Costs Claimed by CH₂M Hill (GAO/T-RCED-92-37, Mar. 19, 1992) and EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-

past reviews showed that the primary cause of these charges to the government were inadequate contractor internal controls and the excessive backlog of audits.

Because of these prior findings, our most recent work included a review of a sample of indirect costs that two additional ARCS contractors had included in their overhead claims. We found instances in which unallowable and questionable expenses were being claimed by these contractors. For example, one contractor included about \$2,000 for alcoholic beverages in its overhead account, costs that are clearly unallowable under the FAR. Similarly, the other contractor included about \$4,400 for tickets to sports events and sports apparel in its overhead costs. Both contractors also included expenses in their indirect costs accounts that we consider questionable. The FAR requires that indirect costs that are allowable must also be reasonable but does not illustrate what a prudent person would consider a reasonable cost. While the FAR allows reasonable expenses designed to improve employee morale, we question one contractor's inclusion of about \$70,000 for various entertainment and employee welfare activities, including \$23,000 for an alumni dinner and \$25,000 for Christmas parties. While the prudent person standard is admittedly a subjective one, we question whether these expenses are reasonable.

EPA has taken a number of actions to improve contract management and to minimize program management costs and wasteful indirect costs, such as strengthening guidance to and oversight of contractors. EPA has also increased the ARCS work load by shifting work from other contracts. These actions have helped reduce the percentage of program management costs to about 15 percent for fiscal year 1992.

Although EPA's actions have lowered the percentage of program management costs, they have not entirely resolved the problem. Significant excess contract capacity remains in some regions that, if left unresolved, may ultimately cost the government millions of dollars in unnecessary program management costs that will otherwise continue to accrue over the life of these contracts. Moreover, nearly one of every five ARCS contracts continues to charge program management costs in excess of 20 percent of total contract costs. In regions that still have excess contract capacity, terminating one or more contracts could save millions of dollars in program management costs over the remaining life of the ARCS contracts.

Let me now shift my attention to EPA's efforts to control program management costs on the new Superfund cleanup contracts.

RCED-91-5, Dec. 11, 1990). On Apr. 9, 1992, DCAA testified on ongoing audit issues with 17 of the 35 largest Superfund contractors before the Environment, Energy, and Natural Resources Subcommittee of the House Committee on Government Operations.

EPA's NEW CLEANUP CONTRACTS ARE MORE FLEXIBLE

EPA is currently developing new cleanup contracts, known as Response Action Contracts (RACS), that will supplement and eventually replace the ARCS contracts as their capacity is exhausted. The regions will begin to run out of ARCS capacity in 1994, according to EPA. EPA has prepared work load forecasts to estimate contracting needs, ensure the continuity of cleanup work upon expiration of the ARCS contracts, and help control program management costs.

EPA is designing the new RACS contracts with features to address key deficiencies of the ARCS contracts, especially features to help avoid excess capacity and high program management costs. For example, EPA plans to reduce the overall number of contracts from 45 to between 20 and 30. EPA also plans to reduce the contract duration from 10 years to 5 years, with an option for the government to renew the contract for an additional 5 years. Because the RACS contracts will be procured over the next 4 to 5 years as needed for each region, EPA will also be able to adjust the RACS design as needed for future procurements. Finally, detailed cost breakdowns and a new award fee process should make it easier for EPA to monitor and control costs.

Major policy initiatives now being developed at EPA, such as the Superfund Accelerated Cleanup Model (SACM) to help expedite cleanups, and Superfund's upcoming reauthorization may affect RACS' contracting needs. To avoid the types of problems that have occurred under previous cleanup contracts, EPA will need contracts flexible enough to avoid excessive costs under a variety of possible scenarios. The ultimate usefulness of the flexibility built into RACS contracts depends, however, on EPA's ability to utilize these features wisely and decisively in response to changing contracting needs and to coordinate the development and implementation of SACM.

CONCLUSIONS

In conclusion, as the number of Superfund hazardous waste sites and the corresponding costs to clean them continues to escalate, EPA has the dual responsibility to eliminate the human health and environmental dangers posed by these sites quickly and cost-effectively. With scarce federal resources and competing federal demands, it is important that EPA maximize the use of available funds for hazardous waste cleanup activities at specific sites. To date, EPA's performance in this area is poor, with a high proportion of Superfund dollars being spent on program management and indirect costs.

Four years after becoming aware of this problem, EPA has taken some actions to reduce program management costs but has failed to adequately address the problem's root cause--too many ARCS

contractors and too much ARCS contract capacity. In designing the new RACS cleanup contracts, EPA has included key features that should help control program management costs and maintain appropriate levels of contractor capacity. The ultimate usefulness of the flexibility being built into RACS contracts depends, however, on EPA's ability to effectively coordinate new policy initiatives and program changes and to utilize the flexible features wisely and in a timely manner in response to changing Superfund contracting needs.

As we recommended in the report being released today, there are a number of actions that EPA can take to minimize program management costs. Specifically, we recommended that EPA analyze ARCS contracts to determine whether terminating some contracts would be more cost-effective than continuing to pay program management costs for the remaining life of underutilized contracts. We also recommended that EPA coordinate the development and implementation of SACM and other policy initiatives, as well as major program changes that may occur during Superfund's reauthorization, and modify the RACS contract design as needed to avoid unnecessary government costs once they go into effect.

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Mr. Chairman, this concludes my prepared statement. I will be glad to respond to any questions that you or Members of the Subcommittee may have.

RELATED GAO PRODUCTS
ON EPA CONTRACTING

Federal Contracting: Cost-effective Contract Management Requires Sustained Commitment (GAO/T-RCED-93-2, Dec. 3, 1992).

Superfund Program Management (GAO/HR-93-10, Dec. 1992).

Superfund: EPA Cost Estimates Are Not Reliable or Timely (GAO/AFMD-92-40, July 1, 1992).

Federally Sponsored Contracts: Unallowable and Questionable Indirect Costs Claimed by CH₂M Hill (GAO/T-RCED-92-37, Mar. 19, 1992).

Superfund: EPA Has Not Corrected Long-Standing Contract Management Problems (GAO/RCED-92-45, Oct. 24, 1991).

Superfund: More Settlement Authority and EPA Controls Could Increase Cost Recovery (GAO/RCED-91-144, July 18, 1991).

EPA's Contract Management: Audit Backlogs and Audit Follow-up Problems Undermine EPA's Contract Management (GAO/T-RCED-91-5, Dec. 11, 1990).

Superfund: Contractors Are Being Too Liberally Indemnified by the Government (GAO/RCED-89-160, Sept. 26, 1989).

Superfund Contracts: EPA's Procedures for Preventing Conflicts of Interest Need Strengthening (GAO/RCED-89-57, Feb. 17, 1989).

Superfund Contracts: EPA Needs to Control Contractor Costs (GAO/RCED-88-182, July 29, 1988).

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