

**GAO**

**Testimony**

Before the Committee on Governmental Affairs  
United States Senate

For Release on Delivery  
Expected at  
9:30 a.m., EST  
Thursday  
March 17, 1994

**ENERGY MANAGEMENT**

**Inadequate DOE Monitoring  
of Contractors' Acquisitions  
From Affiliates**

Statement of Victor S. Rezendes,  
Director, Energy and Science Issues,  
Resources, Community, and Economic  
Development Division



059292 / 151059

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss the results of our work for you, Mr. Chairman, regarding the Department of Energy's (DOE) efforts to monitor its management and operating contractors' acquisitions of supplies and services from affiliated entities-- that is, any divisions or subsidiaries of the contractors or their parent companies. Our testimony today is based on a review of these efforts, the results of which are being released today in our report to you entitled Energy Management: Inadequate DOE Monitoring of Contractors' Acquisitions From Affiliates (GAO/RCED-94-83, Feb. 11, 1994). For today's hearing, you specifically asked us to discuss the adequacy of DOE's monitoring activities and regulations governing affiliated entities. As you know, our work focused on the acquisitions of the Westinghouse Savannah River Company (referred to as Westinghouse in our testimony) and Bechtel Savannah River, Inc. (referred to as Bechtel in our testimony), DOE's principal contractors at the Savannah River Site in South Carolina. At the end of our testimony we will also briefly discuss DOE's recent contract reform initiatives and some financial management issues.

In summary, DOE's monitoring of Westinghouse's and Bechtel's acquisitions from affiliates is inadequate to ensure that DOE pays fair and reasonable prices for such acquisitions. Our analysis of 60 selected Westinghouse and Bechtel acquisitions, totaling about \$48 million from the sample's overall universe of about \$100 million, identified various problems, such as inadequate cost controls and performance problems, unallowable and other questionable costs, and inappropriate contract approvals and contract payments. Factors contributing to these problems included weaknesses in Westinghouse's management systems and DOE's limited internal controls.

The manner in which DOE, at Savannah River, has chosen to implement its regulations on acquisitions from affiliates fails to adequately ensure that the government's interests are protected. DOE has not required that acquisitions from affiliates comply with the DOE Acquisition Regulation stating that competition must be obtained. Furthermore, Westinghouse and Bechtel have been able to obtain support and services from affiliates without undergoing the same level of scrutiny by DOE that would apply if the purchases were made from nonaffiliated third parties.

Various DOE studies show that problems with acquisitions from affiliates exist elsewhere in DOE. In fact, DOE headquarters officials emphasized to us in December 1993 that DOE, through reviews over the last 18 months, has recognized the need to ensure that adequate procedures are developed for determining whether acquisitions from affiliates are in the best interests of the government. These officials also agreed, however, that the information presented in our report demonstrates that acquisitions from affiliates need increased attention.

Before discussing these issues, we would like to provide some background information on the program.

#### BACKGROUND

In general, the DOE Acquisition Regulation permits a management and operating contractor to make acquisitions from affiliates as long as certain requirements are met--for example, that the award is made in accordance with DOE-approved policies and procedures designed to permit effective competition. DOE's contract with Westinghouse allows for the noncompetitive acquisition of necessary or desirable support from Westinghouse's affiliates.

During fiscal years 1990, 1991, and 1992, Westinghouse's acquisitions totaled over \$5 billion. This amount included nearly \$100 million in acquisitions from Westinghouse's affiliates and the affiliates of Bechtel. DOE considers Westinghouse and Bechtel a single entity for contracting purposes because Bechtel constitutes an integral part of Westinghouse's responsibility for the design, construction, management, operations, and maintenance of the Savannah River Site. Bechtel's contract also allows that company to noncompetitively obtain necessary or desirable support from affiliates.

#### DOE'S MONITORING ACTIVITIES ARE INADEQUATE

Our analysis of selected Westinghouse and Bechtel acquisitions identified various problems showing that some acquisitions were not in the best interests of the government. A discussion of several examples will help to highlight the major problem areas we found and to illustrate the consequences of inadequate monitoring. In the appendix to our report, we include a detailed discussion of each example plus some others to provide further information on the types of problems we uncovered and the complex issues involved. We also found that weaknesses in Westinghouse's management systems and DOE's limited internal controls were factors contributing to these problems.

#### Inadequate Cost Controls and Performance Problems

This example involves two Westinghouse noncompetitive, cost-plus-fixed-fee subcontracts that totaled about \$12.1 million when awarded for reactor restart support from the Westinghouse Nuclear Services Division. Westinghouse's contract files showed that employees continued to work on one of the cost-plus-fixed-fee subcontracts after it expired, which resulted in an unauthorized cost overrun of \$1.3 million. Without obtaining DOE's required

approval, Westinghouse transferred the cost overrun to another Westinghouse Nuclear Services Division cost-plus-fixed-fee subcontract that had sufficient funds obligated to cover the cost overrun. Furthermore, according to the contract files, it appears that some of the same people worked under both contracts, although there is no clear record of how this was handled in accounting for the costs charged to both contracts.

Unallowable and Other  
Questionable Costs

This example involves Westinghouse's and DOE's monitoring of several of Bechtel's noncompetitive acquisitions from an affiliate. Before fiscal year 1992, Bechtel acquired about \$35 million in services directly from its parent company, Bechtel National, Inc., without purchase orders and did not document that the services were received or that they were acceptable. A Westinghouse internal review in 1992 reported that adequate control procedures and management oversight had not been established to properly plan for, procure, monitor, and pay for Bechtel's acquisitions from Bechtel National.

A subsequent review by Westinghouse's Subcontract Accounting Branch of selected fiscal year 1992 Bechtel National invoices totaling \$3,469,000 identified \$291,592 in unallowable costs, \$51,900 in charges from prior years that may have already been paid, and about \$500,000 in charges for subcontracting and consulting services that were prohibited by the Bechtel contract. Additionally, Westinghouse's Subcontract Accounting Branch withheld payment on a \$67,024 cost overrun and questioned \$945,930 of charges in excess of the amounts authorized for reactor restart geotechnical services. Furthermore, our limited review of selected acquisitions from the affiliate included one that had subcontracting costs of about \$426,000 that Westinghouse viewed as being prohibited by the Bechtel contract.

As a result of the problems with Bechtel's acquisitions, Westinghouse and DOE have initiated various corrective actions. For example, in August 1993 DOE established that all of Bechtel's acquisitions from affiliates, regardless of dollar value, are to be submitted to DOE at Savannah River for approval.

Inappropriate Contract Approval  
and Contract Payments

This example involves two of Westinghouse's acquisitions from an affiliate--the first for \$336,000 and a second follow-on acquisition for \$625,000--to carry out legislative monitoring and liaison activities at DOE headquarters over a period of several years. On the basis of our review of Westinghouse's and DOE's records and discussions with various officials, we found the following:

- Extensions of the first acquisition, which overlapped the second acquisition for 17 months, were authorized by the Westinghouse Electric Corporation and were not approved by either Westinghouse or DOE.
- DOE's and Westinghouse's procurement officials did not have knowledge of payments made under the overlapping extensions approved by Westinghouse Electric Corporation and charged to the Westinghouse contract.
- Westinghouse did not have detailed cost estimates to support the \$625,000 requested for the second acquisition; yet DOE retroactively approved it, on a conditional basis, in August 1992 back to February 1990, without obtaining information on the costs incurred before August 1992. DOE did not know that only about \$104,000 had been incurred as of August 1992, or that about \$80,000 of this amount had been billed and paid under the overlapping extensions of

the first acquisition that had not been approved by DOE or Westinghouse.

As a result of the various problems we identified in this example, Westinghouse and DOE have initiated a number of corrective actions, which are discussed in the appendix to our report.

Several Factors Contributed  
to Monitoring Problems

Weaknesses in Westinghouse's management systems and internal reviews and limitations in DOE's internal controls were factors that contributed to the monitoring deficiencies and procurement problems facing DOE at Savannah River. For example, Westinghouse's system for monitoring procurements does not provide some data needed by DOE, such as a list of procurements, broken out by dollar threshold, that required DOE's review and approval. Also, some data within the Westinghouse procurement system are missing or inaccurate. According to DOE, improvements to the procurement data base are being made, but the system may have to be replaced.

In addition, DOE has not implemented other needed internal controls to ensure that management and operating contractors identify acquisitions from their affiliates and submit them to DOE for approval. For example, DOE does not verify that Westinghouse submits such acquisitions for approval, as required. Instead, DOE relies on Westinghouse to comply with the requirement. As a result, in fiscal year 1992 DOE did not review 26 of Westinghouse's acquisitions from affiliates that required DOE approval; these acquisitions cost \$514,240.

DOE'S IMPLEMENTATION OF REGULATIONS WEAKENS OVERSIGHT

The DOE Acquisition Regulation allows management and operating contractors to make noncompetitive acquisitions from their

affiliates in limited circumstances. Competition must be obtained, except for purchases of technical services from affiliates that have special expertise that is documented. Under DOE's contract with Westinghouse and Westinghouse's contract with Bechtel, each contractor may obtain services for "necessary or desirable support" from affiliates. DOE officials at Savannah River have interpreted this provision as allowing contractors to obtain noncompetitively a broad range of services, such as training and legislative monitoring, without having to document that the affiliate has special expertise. This interpretation, which has effectively eliminated the DOE Acquisition Regulation's requirements for acquisitions from affiliates at Savannah River, seems contrary to the regulation's stated purpose of strictly controlling such acquisitions. For example, the June 27, 1988, preamble to DOE's final rulemaking on purchasing regulations for management and operating contractors states that purchases from affiliates must be controlled. The preamble states that

"These types of purchases, because of the opportunity for favoritism, must be no less regulated than a normal competitive transaction. In fact, we believe that such purchases must be more strictly regulated."

Westinghouse and Bechtel have also been able to obtain support from affiliates without the same level of DOE documentation that would apply if the purchases were made from nonaffiliated third parties. These transactions have not been subject to the same DOE requirements, such as organizational conflict-of-interest disclosure statements and detailed cost estimates, that generally apply to purchases from third parties. When it lacks this kind of information, DOE is relying on both contractors to determine that their acquisitions from affiliates are in the best interests of the government. As illustrated by the problems we identified, this has not always been the case.

DOE HAS IDENTIFIED AFFILIATE ACQUISITION  
PROBLEMS AT SAVANNAH RIVER AND OTHER  
DOE LOCATIONS

The problems with acquisitions from affiliates that we identified at Savannah River do not appear to be unique. We found that many of the same affiliate acquisition problem areas we identified were also highlighted in DOE's April 1993 review of Westinghouse's and Bechtel's affiliate transactions. According to the review, (1) Westinghouse did not obtain DOE's approval for all changes in the statement of work for contracts and orders placed with the Westinghouse Electric Corporation and its affiliates, (2) DOE's procedures for review and approval of Westinghouse's procurement actions with Westinghouse Electric Corporation required strengthening, and (3) noncompetitive acquisitions with Bechtel National, Inc.--the parent company of Bechtel--were not submitted to DOE for approval. Although several recommendations were made to correct the problems identified, DOE did not ensure timely implementation of the recommendations. Actions on the recommendations have not been tracked, and no plans exist for following up on the recommendations until the next regularly scheduled affiliate transaction review, which is currently planned for August 1994.

During a December 1993 meeting at DOE headquarters, DOE officials, including the Director of the Office of Contractor Management and Administration, informed us that they were not surprised by the affiliate acquisition problems we found at Savannah River. These officials stated that DOE, through its reviews of contractors' purchasing systems over the last 18 months, has recognized the need to ensure that adequate procedures are

developed for determining whether awards to affiliated entities are in the best interests of the government; that effective cost analyses, technical evaluations, and negotiations are conducted and documented; and that payment procedures are structured to ensure that affiliated entities do not receive unreasonable interim payments. To illustrate the types of problems DOE has found during its reviews, these officials provided us with an excerpt from DOE's October 1993 Contractor Purchasing System Review and Contractor Personal Property System Review Annual Observations Report and Statistical Summary--October 1992-September 1993 that echoed many of the problems we identified at Savannah River. According to the report:

- If contractor-controlled sources had the capabilities to perform the work, they were selected, without satisfying the requirement to maximize the government's best interests.
- Requisitions for affiliate acquisition authorizations generally contained broad scopes of work that did not permit analyses of the factors of quality, cost, and time.
- Proposals provided no justification for the hours proposed and did not relate the proposed hours to the specifics of the scope of work.
- Proposed costs were not effectively evaluated. Technical evaluations of cost proposals took no exceptions to any of the proposed efforts.

ACTIONS STILL NEEDED TO ADDRESS  
AFFILIATE ACQUISITION PROBLEMS

DOE needs better and more complete information on acquisitions from affiliates at Savannah River in order to be in a position to effectively monitor the proper use of such acquisitions. In the past, DOE has placed too much reliance on Westinghouse and Bechtel to carry out these activities. As a result, DOE officials at Savannah River do not know the full extent of acquisitions from affiliates being made and are not taking advantage of any possible opportunities to maximize cost savings and competition.

The examples highlighted in our testimony and in our report demonstrate the types of financial impact and other problems that can occur when DOE does not exercise appropriate monitoring of acquisitions from affiliates. In addition, DOE studies and reports have demonstrated a heightened need for improved monitoring of acquisitions from affiliates throughout DOE. Without such improvements, DOE will not know whether (1) any of the affiliates obtained an unfair competitive advantage under the existing contracting process and (2) fair and reasonable prices were paid for acquisitions from affiliates.

At Savannah River, DOE has not required acquisitions from affiliates to comply with the DOE Acquisition Regulation's requirement that competition must be obtained, except for purchases of technical services from affiliates that have special expertise and that expertise is documented. This practice appears to be contrary to the existing DOE Acquisition Regulation requirement's stated purpose of strictly controlling acquisitions from affiliates.

In our report, which you released today, we cited several recommendations to the Secretary of Energy and the DOE Manager at Savannah River to ensure that acquisitions made from affiliated entities of Westinghouse and Bechtel at Savannah River are in the best interests of the federal government. For example, we recommended that the Secretary of Energy (1) provide for increased monitoring of the contractors' acquisitions from affiliated entities and (2) except for the purchases of technical services where the affiliate has special expertise and that expertise is documented, require that affiliate acquisitions comply with the DOE Acquisition Regulation's requirement that competition must be obtained and subject such acquisitions to the same standards that apply to nonaffiliated third-party transactions.

CONTRACT REFORM INITIATIVES AND  
FINANCIAL MANAGEMENT ISSUES

Mr. Chairman, you also asked that we discuss DOE's recent contract reform initiatives. The kinds of problems identified in our testimony today once again underscore the need for substantial improvements in DOE contracting practices. We are happy to report that DOE is currently taking an important first step toward contracting reform. Its Contract Reform Team, chaired by Deputy Secretary White, is proposing a wide variety of initiatives aimed at making contracting "work better" and "cost less." We support the concepts advanced in the contract reform team's report. In particular, we support the team's goal to lessen DOE's near total reliance on cost reimbursable contracts, increase the use of specific performance measures in contracts, and upgrade financial management systems and auditing capabilities.

The success of these and other reform measures will be based largely on the ability of the DOE work force to implement these changes effectively. As you know, we have called attention to weaknesses in DOE's work force in the past. DOE will also need to develop and improve its information systems, and those of the contractors, before these new contracting reforms work properly. These are major challenges for DOE, and it will take substantial time before the benefits of contract reform are realized.

Mr. Chairman, financial management at DOE is the final area you asked us to address at today's hearing. DOE's financial management operations have been heavily influenced by the historical and evolving relationship between DOE and its major contractors which operate government-owned facilities. Since the late 1940's, DOE's financial operations were designed to accommodate DOE's policy of "least interference" with these major contractors and consequently DOE treated them as subsidiaries for financial management purposes.

In September 1993<sup>1</sup>, we reported that this DOE policy contributed to financial management weaknesses including,

- contract provisions that did not fully protect the government's interests or permit DOE to exercise adequate oversight and financial control,

---

<sup>1</sup>Financial Management: Energy's Material Financial Management Weaknesses Require Corrective Action (GAO/AIMD-93-29, Sept. 30, 1993).

- a financial system that could not provide all of the information that program managers believed was needed to effectively oversee integrated contractors,
- insufficient staffing levels in DOE's field finance offices to perform needed reviews of contractors' financial management practices and procedures, and
- difficulty in promptly completing required audits of contractors' allowable costs.

We reported that these weaknesses were serious enough to be disclosed as a material weakness in DOE's Federal Managers' Financial Integrity Act report. However, DOE did not make financial management a material weakness in its 1993 report. We continue to believe that DOE's financial management problems, particularly its lack of financial oversight of its integrated contractors, is a reportable material weakness under the Federal Managers' Financial Integrity Act.

While financial management problems continue to be a material weakness at DOE, the agency recently has made important strides towards establishing a revamped culture that emphasizes financial control and accountability. For example, DOE issued guidance requiring inclusion of all standard financial management clauses in every management and operating contract, unless deviations are approved by DOE's Chief Financial Officer. In addition, the Contract Reform Team is recommending actions to improve DOE's financial information systems, contractor reviews (including audits) and training. Such improvements include ensuring that DOE's audit goals place a high priority on reviews and evaluations

of contractors' financial management systems. These initiatives are a significant start towards achieving improved financial management.

Another way that DOE can achieve more effective financial oversight is to require its integrated contractors to have audited financial statements. This is particularly important since the DOE Inspector General has experienced difficulty auditing, in a timely manner, whether costs claimed by integrated contractors are allowable and in accordance with DOE accounting policy. To address its audit problems, DOE's Inspector General adopted a strategy calling for increased reliance on the contractors' internal auditors to perform allowable cost audits. As we reported in September, we believe that the Inspector General did not adequately consider alternatives to this strategy. For example, one option would be to require audited financial statements for DOE's government-owned, contractor-operated facilities. These audits should incorporate steps to ensure that costs are allowable and accurately reported. Currently these contractors, which accounted for over \$16 billion (or 63 percent) of DOE's fiscal year 1992 obligations, are not required to have audited financial statements.

Further, in testimony before this Committee on February 23, 1994<sup>2</sup>, to help fill this gap, we urged the Congress to enact the provisions of H.R. 3400 (the Government Reform and Savings Act of 1993) that expand audited financial statement requirements. In addition, we suggested that the Congress refine H.R. 3400 to make it clear that the Congress expects that the major components of

---

<sup>2</sup>Improving Government: GAO's Views on H.R. 3400 Management Initiatives (GAO/T-AIMD/GGD-94-97, Feb. 23, 1994).

agencies also have audited financial statements under the Chief Financial Officer Act. Separate financial statements for component level entities are essential to providing relevant financial facts related specifically to their distinctive operations. Major government-owned, contractor-operated facilities such as those managed and operated for DOE could be covered by such component reports.

While the Acting Chief Financial Officer has made progress in many areas to enhance DOE's financial management operations and comply with the Chief Financial Officer Act's requirements, DOE has not had a presidentially appointed Chief Financial Officer since the Act was passed in 1990. Naming a Chief Financial Officer would provide added impetus to ensure strengthened oversight of integrated contractors' financial management through a clear and consistent message from a top level Administration leader.

- - - - -

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or Members of the Committee may have.

(308668)