

GAO

Report to the Chairman, Subcommittee  
on Energy and Power, Committee on  
Commerce, House of Representatives

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December 1996

# DEPARTMENT OF ENERGY

## Contract Reform Is Progressing, but Full Implementation Will Take Years



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United States  
General Accounting Office  
Washington, D.C. 20548

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

B-274918

December 10, 1996

The Honorable Dan Schaefer  
Chairman, Subcommittee on Energy and Power  
Committee on Commerce  
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we assess certain aspects of the Department of Energy's contract reform initiative. The report describes the overall status of individual reform initiatives and contains recommendations designed to better link the Department's goals to contract goals and to improve the pricing of contracts and the setting of incentives in management and operating contracts.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will send copies to the Secretary of Energy; the Director, Office of Management and Budget; the House Committee on Government Reform and Oversight; the Senate Committee on Governmental Affairs; the House and Senate Committees on Appropriations; and other interested parties. We will make copies available to others upon request.

If you or your staff have any questions about this report, please call me at (202) 512-3841. Major contributors to this report are listed in appendix III.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'Victor S. Rezendes', written in a cursive style.

Victor S. Rezendes  
Director, Energy, Resources, and  
Science Issues

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# Executive Summary

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## Purpose

As the largest civilian contracting agency in the federal government, the Department of Energy (DOE) obligated \$17.5 billion, or about 91 percent of its fiscal year 1995 obligations to contracts. For several years, GAO has reported on weaknesses in DOE's contracting practices. In May 1993, the Secretary of Energy told the Congress that DOE was not adequately in control of its contractors and, as a result, was not "in a position to ensure effective and efficient expenditures of taxpayer dollars . . ."<sup>1</sup> As a result, the Secretary initiated a complete review of DOE's contracting practices. This review, completed in February 1994 by the Secretary's Contract Reform Team, resulted in recommendations to make DOE's contracting work better and cost less.

Concerned about the results of DOE's undertaking, the Chairman, Subcommittee on Energy and Power, House Committee on Commerce requested, in January 1996, that GAO review DOE's contract reform efforts and focus on the key contracting areas of competition and performance goals. Specifically, GAO (1) determined the status of the Contract Reform Team's recommendations; (2) evaluated the effect of the initiatives on competition for management and operating contracts, which are used to manage and operate DOE's facilities; (3) evaluated DOE's initial efforts at inserting performance goals in its management and operating contracts; and (4) evaluated DOE's early use of incentive contracts to control the costs of its management and operating contracts.

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## Background

DOE's contracting practices were framed during World War II and date from that era. Although this nation has changed considerably during the decades since the War, DOE's contracting practices for its management and operating contracts have remained much the same as they were in the 1940s. DOE's practices led to an undocumented policy of blind faith in its contractors' performance, which is called its "least interference" policy. This policy, in many cases, left DOE unaware of its contractors' activities. Additionally, DOE accepted and paid nearly every cost that these contractors incurred.

DOE's contract reform has been an elusive and longstanding goal. The last two Secretaries of Energy have sought to correct the problems, and the current Secretary initiated a new and extensive effort at contract reform. The current reform effort is based on a February 1994 report by DOE's Contract Reform Team. In its report, the Reform Team recommended

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<sup>1</sup>Testimony before the House of Representatives, Committee on Energy and Commerce, Subcommittee on Oversight and Investigations (May 26, 1993).

actions to make DOE's contracting work better and cost less. Each of these actions required a specific end product to be prepared and a deadline for the completion of each action. In response to the Reform Team's recommendations, DOE has written policy and guidance to change its past practices and is in the process of implementing the Contract Reform Team's recommendations.

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## Results in Brief

DOE has completed action on 47 of the 48 contract reform recommendations, but 9 of the completed actions did not meet the requirements of the Contract Reform Team. DOE explained that while actions may not have strictly adhered to the requirements of the Reform Team, nevertheless, the actions achieved their intended goals. DOE also missed its deadlines for completing the required new policies, guidance, and plans that serve as the framework for contract reform by an average of 11 months. The missed deadlines have added to the time needed to implement contract reform.

While DOE has changed its policy and adopted competitive contract awards as the new standard for management and operating contracts, in practice, DOE continues to make noncompetitive awards for these contracts. Of 24 decisions to award new management and operating contracts between July 1994 and August 1996, DOE decided to noncompetitively award 16 of them. Furthermore, DOE decided not to competitively award three major contracts before it negotiated the terms of the contract renewal—a practice that is contrary to contract reform. Such actions can weaken DOE's position to negotiate acceptable terms.

DOE's contracting offices are including performance goals in their management and operating contracts, but the contract goals are not always clearly linked to those of the Department. Although DOE acknowledges that contract goals must be clearly linked to its departmental goals, the connection between contract and departmental goals is unclear. In addition, some contract language allows contractors to dispute the available amount and allocation of incentives. These situations impinge on DOE's authority to place priorities on contract work, motivate contractors to perform the work, and create the potential for compromising DOE's ability to fulfill its missions.

DOE's contracting offices have moved quickly to implement another important reform by using incentive contracts, which can be used effectively to control costs, but the negotiation of these incentives did not

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always prove effective. For cost incentives to work under these contracts, the incentives must be based on good contract price negotiations. Although the governmentwide procurement regulation identifies procedures to follow in negotiating contract prices and incentives, DOE's procurement regulation for its management and operating contracts does not. Since DOE is authorized to use its own procurement regulation for management and operating contracts, the contracting offices have been left to use their own judgment and have achieved different results with the use of these incentives.

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## Principal Findings

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### DOE Has Made Progress on Reforms, but Their Implementation Is in Its Early Stages

DOE stated that it has completed action on 47 of its 48 contract reform recommendations. To its credit, DOE has developed a number of new policies, guidance, and plans that form the framework of reform. Although DOE has made significant progress in developing this framework, GAO found that nine actions did not fully respond to the requirements of the Contract Reform Team. For example, to operate DOE's facilities in a more efficient and cost-effective manner, the Reform Team recommended that DOE establish a preference for its management and operating contractors to subcontract various functions, such as laundry and cafeteria services, and provide contractors with an incentive to encourage them to subcontract these services. However, DOE's proposed regulation, published in the Federal Register in June 1996, did not include provisions for the incentives that were recommended by the Reform Team. DOE officials who were responsible for completing the actions explained that although DOE did not always meet the exact requirements of the Contract Reform Team, the intent of the Reform Team was met.

DOE missed the deadlines on 45 of the 47 completed actions by an average of 11 months because, among other things, of the unexpectedly lengthy internal coordination and review required. Moreover, nearly one-half of the reform actions were completed recently in fiscal year 1996. This has added to the time required to fully and properly implement contract reform, which is now in its early stages. As discussed below, GAO also has identified some early implementation problems that need to be addressed and corrected for contract reform to produce the results that are intended.

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## DOE Continues to Renew Most Contracts Without Competition

Despite changing its policy to adopt the Contract Reform Team's recommendation to competitively award management and operating contracts except in unusual circumstances, between July 1994 and August 1996, DOE decided to award 16 of 24 management and operating contracts noncompetitively. The average age of these 16 contracts is 35 years. Furthermore, in three recent decisions covering major contracts, DOE did not negotiate the renewal terms of the contracts before making its decision to extend the contract—contrary to another Contract Reform Team recommendation. Thus, DOE continues to miss the infusion of the new offerors it had hoped for under competition and continues to weaken its negotiating position on noncompetitive contracts.

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## Problems Emerge in Early Use of Contract Performance Goals

The early implementation of a key contract reform—the placement of performance goals in contracts—shows that contract goals are not consistently linked to DOE's departmental goals. While DOE was working on contract reform, it also was developing its strategic planning process. DOE's strategic plan, developed in April 1994, identifies DOE's departmental goals for its five business lines and four key success factors. DOE's business lines and key success factors include areas such as national security and environment, safety, and health. Since most of DOE's missions are performed by its management and operating contractors, DOE's contract reform and strategic planning personnel acknowledged that contract goals must be linked to the strategic plan goals. However, in a review of several contracts awarded after DOE's strategic plan was published, GAO had significant difficulty linking contract goals to strategic goals. For example, one contract contained goals listed under seven different categories. However, the seven categories were not comparable to the nine business lines or key success factors. As a result, GAO could not link the contract goals to the goals of DOE.

In addition, some contract provisions provided that if disagreements arose between the contractor and DOE in regard to incentives, the contractor had the legal right to contest either DOE's decision on the amount of the incentive fee available or the allocation of the incentive fee to the specific contract goals. By providing contractors with the authority to question its decisions, these contracts could hinder DOE's ability to determine the priority of its work, motivate the contractors, and fulfill its mission requirements.

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## Early Problems Are Surfacing With the Use of Incentive Contracts

Another key contract reform—the use of incentive contracts to control costs—also has experienced some problems with its initial implementation. Two DOE contracting offices used incentive contracts that are designed to provide incentives for the management of contract costs. Although these contracts can be effective tools to control costs by transferring cost risk to the contractor, the setting of incentives under these contracts must be based on a contract target cost that is realistic. If this is not done, the contractor can earn additional profits without any real improvement in performance.

The governmentwide procurement regulation provides clear guidance for assessing whether costs are realistic. DOE's management and operating contract regulation does not. Since DOE is not required to use the governmentwide procurement regulation to negotiate its management and operating contracts, DOE's contracting offices have been left to use their own judgment in setting the incentives and negotiating target costs. Under these conditions, two contracting offices improvised and obtained different results. Under one contract, the contractor earned the incentive profit without any improved performance. Under the second contract, both the contracting office and the contractor believe that the contractor's performance was improved by the incentive.

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## Recommendations

GAO makes several specific recommendations to the Secretary of Energy directed at linking contract goals to departmental goals and improving the pricing of contracts and the setting of incentives in management and operating contracts.

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## Agency Comments

GAO transmitted a draft of this report to DOE for review and comment and has incorporated changes as needed. DOE's written comments and GAO's response appear in appendix II. Overall, DOE had two main concerns. First, DOE believes that the draft report did not fully recognize DOE's efforts to improve contracting problems identified in GAO's past reports nor its current accomplishments under contract reform. GAO agrees that DOE has taken steps to reform its contracting problems. DOE has (1) changed its policy and adopted competitive awards as its new contracting standard, (2) included performance goals in its contracts, and (3) moved quickly to implement the use of incentive contracts to control costs. However, DOE's new contracts were not based on final policy, and they had been in effect for only about 1 year. Thus, it will take years to determine the extent to which DOE has met its goal of making contracting work better and cost

less. Second, DOE believes that GAO's draft report did not adequately acknowledge the implementation of its new competition policy. Specifically, DOE was concerned that GAO did not adequately recognize its culture change for increased competition and disagreed with GAO's assessment over the contract extension decision for three DOE laboratories. DOE believes that the Department's culture has changed from one in which extending contracts was the normal practice to one in which competition is the first consideration. DOE also states that in all cases where noncompetitive extensions have been sought, the Department subjected each decision to a rigorous examination of the facts and circumstances. Finally, DOE states that rather than using the existing contract as a basis for negotiation, the Department developed administrative mechanisms to ensure that contract reform terms and conditions were the bases for negotiation.

GAO believes that it did adequately represent DOE's new reform that requires contracts to be competitively awarded—except in unusual circumstances. Yet, regardless of this goal, two-thirds of DOE's decisions were to noncompetitively extend management and operating contracts. Such a large proportion of noncompetitively extended contracts suggests that DOE still has a long way to go before it realizes the benefits of competitive contracting. Although DOE states that it is improving its existing contracts through noncompetitive negotiations, it is doing just that—negotiating in a noncompetitive environment. This does not identify new contractors as contract reform intended. Only competition will do that.

DOE states that extending the three laboratory contracts was contingent on incorporating contract reform provisions and achieving other negotiation objectives. However, on the basis of DOE's past performance, it will be difficult for DOE to implement such a policy on these contracts. The Secretary's decision to extend these contracts stated that considering other contractors was unrealistic and incompatible with program requirements. Once DOE stated that only one contractor could do this work, the Department weakened its negotiating position. While DOE is not legally bound to extend these contracts, its actions to date give the appearance that the decision to extend the contracts was made prior to the completion of successful negotiations and is inconsistent with the intent of contract reform.

DOE generally agrees with GAO's recommendations that contract reform goals be linked to agency goals and that policies be adopted to improve

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**Executive Summary**

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incentive contract cost controls. DOE also indicated that these recommendations will be implemented.

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# Contents

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<b>Executive Summary</b>		2
<b>Chapter 1</b>		12
<b>Introduction</b>	DOE's Contracting Practices Are Rooted in World War II	12
	GAO Designated DOE's Contract Management as an Area of High Risk	13
	DOE Has Made Efforts to Reform M&O Contracts	13
	Objectives, Scope, and Methodology	15
<b>Chapter 2</b>		17
<b>DOE Is Making Progress in Developing a Framework for Contract Reform</b>	DOE Sets Up Processes for Developing Contract Reform Actions	17
	DOE Has Acted on 47 Recommendations but Some Actions Did Not Comply With Contract Reform Team's Requirements	18
	Completed Reform Actions Are Behind Schedule	19
	Too Early to Assess Effect of Reform Actions but Implementation May Be Problematic	20
	Conclusions	21
	Agency Comments and Our Evaluation	21
<b>Chapter 3</b>		23
<b>Competition Becomes the Rule but Not the Practice</b>	New DOE Policy on M&O Contracts Reflects Contract Reform Team's Recommendations	23
	In Practice, Noncompetitive Extensions Remain the Norm	25
	DOE Weakened Its Bargaining Position Before Contract Terms Were Negotiated	28
	DOE's Implementation of the New Competition Policy Could Be Beneficial	29
	Conclusions	30
	Agency Comments and Our Evaluation	30
<b>Chapter 4</b>		32
<b>DOE's Contract Reform and Strategic Planning Reveal Inconsistencies in Contract Goals</b>	DOE's Ongoing Contract Reform and Strategic Planning Are Interconnected	32
	Contract Goals Are Not Always Clearly Linked to Strategic Plan's Goals	34
	Some Contract Provisions Could Affect DOE's Authority to Set Contract Incentives	35
	Learning Process Cited as Cause of DOE's Weaknesses	37
	Conclusions	37
	Recommendations	38

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Agency Comments and Our Evaluation	38
<b>Chapter 5</b>	39
<b>M&amp;O Procurement</b>	39
<b>Regulations Do Not</b>	41
<b>Provide Guidance for</b>	45
<b>Incentive Contracts</b>	45
Effectiveness of Cost Incentives Depends on the Pricing of the Contract	39
Case Studies Show the Effect of No M&O Guidance	41
DOE Acknowledges Weaknesses With Its Contract Pricing Regulations	45
Conclusions	45
Recommendations	45
Agency Comments and Our Evaluation	45
<b>Appendixes</b>	
Appendix I: Status of 48 Contract Reform Recommendations	48
Appendix II: Comments From the Department of Energy	53
Appendix III: Major Contributors to This Report	77
<b>Related GAO Products</b>	79
<b>Tables</b>	
Table 3.1: List of M&O Contracts That Were Extended or to Be Extended as of August 31, 1996	25
Table 3.2: List of M&O Contracts That Were Competitively Awarded or Planned for Competition, as of August 31, 1996	27
Table 4.1: Key Contract Features for the Development of Goals, Indicators, and Incentives	36
Table 5.1: Negotiated and Expected Contract Cost for the Powerhouse Demolition Task Order	42
Table 5.2: Pricing and Actual Costs on Incentive Parts of Waste Isolation Pilot Plant Contract for Fiscal Year 1995	44

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**Abbreviations**

CERCLA	Comprehensive Environmental Response, Compensation and Liability Act
DOE	Department of Energy
FAR	Federal Acquisition Regulation
GAO	General Accounting Office
GPRA	Government Performance and Results Act of 1993
M&O	management and operating

# Introduction

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For about 50 years, the Department of Energy (DOE) and its predecessors have used contracting policies that were developed during the crisis of World War II. Since that time, billions in taxpayer dollars have been spent on contracts where competition was the exception, almost any contractor's cost was reimbursed, and lax oversight of contractors was the practice. In 1990, DOE began taking initial steps toward improving its contracting. The current Secretary of Energy, after acknowledging that DOE was not in control of its contractors, is continuing to reform DOE's contracting.

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## DOE's Contracting Practices Are Rooted in World War II

DOE is the largest civilian contracting agency in the federal government. In fiscal year 1995, DOE had contract obligations of \$17.5 billion, or about 91 percent of the Department's total fiscal year 1995 obligations. Its contracting practices are rooted in the development of the atomic bomb under the Manhattan Project during World War II. This Project was a unique undertaking to produce atomic capability under emergency conditions and under circumstances of utmost urgency, extreme risk, and unprecedented security. Special contracting arrangements were developed by DOE's predecessor agencies with participating industry and academic organizations, including the government's agreement, with few exceptions, to fully reimburse all of the contractors' costs and completely indemnify contractors against any liability incurred from their involvement on the project.

From these roots, DOE's contracting took two separate paths—(1) the path for management and operating (M&O) contracts, the direct descendants of the Manhattan Project, under which several current contracts were originally awarded during World War II and (2) the path for non-M&O contracts. The M&O contracts, which accounted for 82 percent (\$14.3 billion) of DOE's fiscal year 1995 contract obligations, have been governed in key procurement areas by DOE's own unique procurement regulations. M&O contracts are for the operation, maintenance, or support of government-owned research, development, production, or testing facilities, both nuclear and nonnuclear. The non-M&O contracts, which account for the remaining 18 percent (\$3.2 billion) are governed by the governmentwide Federal Acquisition Regulation (FAR).<sup>2</sup> As a result of the two different paths, these contracts have distinct differences. For

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<sup>2</sup>The contracting practices of federal executive agencies are governed by the Federal Acquisition Regulations System, including the (1) FAR, which is the governmentwide procurement regulation, and (2) individual agency acquisition regulations that implement or supplement the FAR for activities that are unique to the individual agency. DOE's unique agency regulation is called the Department of Energy Acquisition Regulation.

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example, noncompetitive procurement has been the normal practice for M&O contracts, while competitive contracting has been the norm for non-M&O contracts.

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## GAO Designated DOE's Contract Management as an Area of High Risk

In early 1990, we designated DOE's contract management as one of 16 high-risk areas in the federal government warranting close attention over a period of several years. We did so because we believed that DOE was highly vulnerable to waste, fraud, abuse, and mismanagement as a result of DOE's extensive reliance on contracting and its history of inadequate oversight of contractors. From this effort, we have issued a series of reports and testimonies on DOE's contracting practices that have contributed to Congress's deliberation on DOE's budget and have provided an important impetus for DOE's efforts to reform its M&O contracts. (See the end of this report for a list of related GAO products and testimonies.) DOE's contract reform initiatives encompass a myriad of efforts. This report focuses on important changes being made in the areas of competition, performance goals, and incentives but does not cover all aspects of DOE's contract reform effort.

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## DOE Has Made Efforts to Reform M&O Contracts

Reforming M&O contracts has been an elusive and longstanding DOE goal. For the fiscal 1989, 1990, and 1991 Federal Managers' Financial Integrity Act reports, the Secretary of Energy identified contract management as a material weakness and recommended actions to correct some of the weaknesses.<sup>3</sup> In April 1992, we reported that the Secretary's recognition of contract management weaknesses, commitment to strengthening contract controls, and actions to address some contracting weaknesses were important first steps for reform.<sup>4</sup> However, we concluded that the weaknesses would not be corrected in the near future because the corrective actions would take several years to implement.

In May 1993, the Secretary of Energy told the Congress that DOE was not in control of its M&O contractors and was not in a position to ensure the effective and efficient expenditure of taxpayer dollars.<sup>5</sup> To find solutions

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<sup>3</sup>Weaknesses are material when the deficiency significantly impairs the fulfillment of a mission or significantly weakens safeguards against waste, loss, and the unauthorized use or misappropriation of funds, property, or other assets, among other things.

<sup>4</sup>Energy Management: Vulnerability of DOE's Contracting to Waste, Fraud, Abuse, and Mismanagement (GAO/RCED-92-101, Apr. 10, 1992).

<sup>5</sup>DOE Contract Management Issues, statement by the Secretary of Energy before the House of Representatives, Committee on Energy and Commerce, Subcommittee on Oversight and Investigations (May 26, 1993).

to its contracting problems, the Secretary announced the creation of a Contract Reform Team, chaired by the Deputy Secretary of Energy, to do a “top-to-bottom” review of DOE’s contracting mechanisms and practices. In February 1994, the Contract Reform Team published its report, Making Contracting Work Better and Cost Less. In the report, the Reform Team focused its efforts on M&O contracting and identified a number of problems that needed correction, including the following:

- Loose accountability for contractors’ performance and few controls to ensure that funds are spent on the highest priorities.
- Few controls over contractors’ costs.
- Fees that did not properly reflect the quality of the contractor’s performance.
- Insufficient fee incentives to encourage excellent performance.
- The reimbursement of costs that the government should not reimburse.
- Insufficient competition and a strong bias for existing contractors.
- Insufficient financial accountability.

To correct these problems, the Reform Team recommended 47 specific actions to make DOE’s contracting work better and cost less. The Secretary subsequently added another recommendation to the Reform Team’s list regarding diversity among participating contractors and subcontractors. These 48 recommendations included requirements to develop items, such as policy, guidance, and plans to correct identified problems. The policy and guidance provide a framework for reform, but their actual implementation will require a period of years, as the current contracts are either competitively awarded or renewed and the reform provisions incorporated into the contracts.

Chief among the Contract Reform Team’s goals, represented by several recommendations, was a new contract form that the Reform Team proposed—the Performance-Based Management Contract. Key elements of this contract included the following:

- Clearly stated, results-oriented, performance goals and indicators of performance.
- Incentives for contractors to meet and exceed the performance goals effectively and efficiently.
- Criteria and incentives for contractors to seek opportunities to subcontract work that could be performed better by firms other than the M&O contractor.
- Incentives for cost-saving.

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- Improved financial accountability.

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## Objectives, Scope, and Methodology

Concerned about the results of DOE's undertaking, the Chairman, Subcommittee on Energy and Power, House Committee on Commerce requested, in January 1996, that we review DOE's contract reform efforts and focus on the key contracting areas of competition and performance goals. Specifically, we (1) determined the status of the Contract Reform Team's recommendations; (2) evaluated the effect of the initiatives on competition for M&O contracts, which are used to manage and operate DOE's facilities; (3) evaluated DOE's initial efforts at inserting performance goals in its M&O contracts; and (4) evaluated DOE's early use of incentive contracts to control the costs of its M&O contracts.

To determine the status of DOE's actions in response to the Contract Reform Team's recommendation, we analyzed the Contract Reform Team's report and identified the actions that the recommendations required. We then reviewed DOE's documentation supporting the actions to determine if they met each requirement of the individual recommendations. To determine the timeliness of each action, we compared the original and amended deadlines with the actual dates that the actions were completed. We discussed each action with the staff of the Contract Reform Project Office and staff of the DOE organizations that acted on the Reform Team's recommendations.

To evaluate the effect of contract reform on competition for M&O contracts, we reviewed the Contract Reform Team's report and recommendations and reviewed DOE's interim and final policy for the award of M&O contracts. We identified each decision to award contracts including those listed in the Secretary of Energy's July 5, 1994, decision memorandum to those decisions made by the end of August 1996 and obtained information from DOE showing whether these contracts had been competitively awarded previously. We then analyzed the information provided by DOE to determine if the new decisions reflected an increase in competition from past procurements. Since DOE did not provide specific justification for each of its noncompetitive decisions in the July 5, 1994, decision memorandum, we could not evaluate whether these decisions were appropriate.

To evaluate DOE's use of performance goals for M&O contracts, we reviewed the requirements of the Government Performance and Results Act of 1993, DOE's strategic plan, and the Secretary's performance

agreements with the President for fiscal years 1995 and 1996. Additionally, we reviewed the performance goals and indicators contained in the contracts for the Rocky Flats Environmental Technology Site, the Nevada Operations Office's Support, the Argonne National Laboratory, and the Thomas Jefferson National Accelerator Facility (formerly called the Continuous Electron Beam Accelerator Facility). We compared the performance goals from these contracts with the goals identified in DOE's strategic plan and annual performance agreements. We also discussed the goals and plans with DOE's strategic planning staff, contract reform staff, and contracting staff involved with the contracts we reviewed.

To evaluate the use of cost incentives on incentive contracts, we reviewed DOE's M&O procurement regulations and the FAR for the negotiation of contract prices. To evaluate two alternative ways in which DOE applied cost incentives to its M&O contracts, we reviewed the two contracts that used contract types that typically are used to control costs. These included contracts for the Oak Ridge facility and the Waste Isolation Pilot Plant. These two contracts used incentive contracts that are typically used to provide a cost incentive in their pricing arrangement. We discussed the contracts with DOE contracting staff involved in the setting of incentives for these contracts and with cognizant contracting officials at DOE's headquarters.

We provided DOE with a draft of this report for its review and comment. The Department provided us with written comments on the draft report, which are presented and evaluated in chapters 2 through 5 and are reprinted in appendix II.

We performed our review from March 1996 through November 1996 in accordance with generally accepted government auditing standards.

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# DOE Is Making Progress in Developing a Framework for Contract Reform

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DOE is making headway in developing policies, procedures, and guidelines in response to the Contract Reform Team's report. Together, these reform actions, among others, should serve as the framework for contract reform. At the end of August 1996, DOE reported completing 47 of the 48 actions needed to respond to the Reform Team's recommendations.

Our analysis indicates, however, that DOE has not completed nine actions in accordance with the Reform Team's recommendations. Moreover, DOE is well behind its original schedule for completing reform actions, which will add to the time that is needed to fully and properly implement contract reform for its contracts. Furthermore, DOE staff that developed reform actions have reported potential problems with implementation. In subsequent chapters in this report, we identify examples of problems that DOE has encountered as it begins to implement contract reform.

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## DOE Sets Up Processes for Developing Contract Reform Actions

As a result of its review of DOE's contracting practices, DOE's Contract Reform Team made 47 recommendations in its February 1994 report to make DOE's contracting work better and cost less. Shortly after the Reform Team's report was published, the Secretary of Energy added a 48th recommendation concerning diversity. For the most part, the Reform Team's recommendations dealt with the development of policies, procedures, guidance, or plans involving such key contracting issues as competitive procurement, performance goals, and performance and cost-reduction incentives. For each recommendation, the Reform Team prescribed a specific reform action to be taken, established a specific deadline for the action, and assigned a specific DOE organization with the responsibility for developing the reform action. (See app. I for a list of the specific reform actions and their status.)

In March 1994, the Secretary established an executive committee to oversee the implementation of contract reform, and in June 1994, the committee established the Contract Reform Project Office within the Office of the Deputy Secretary. The purpose of the Project Office is to provide DOE organizations having responsibility for completing actions with guidance as well as to shepherd completed reform actions through the approval process. Among its other duties, the Project Office ensures that (1) recommendations have been assigned to the proper departmental organizations for action, (2) desired reform goals have been clarified, and (3) systems have been established to track reform efforts. The Project

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Office considers a reform action complete when the action has been officially approved by the executive committee.<sup>6</sup>

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## DOE Has Acted on 47 Recommendations but Some Actions Did Not Comply With Contract Reform Team's Requirements

DOE states that it has completed action on 47 recommendations. However, nine of DOE's actions were not performed in accordance with the Reform Team's requirements. DOE's Contract Reform Project Office staff explained that all of their completed actions complied with the intent of the Reform Team.

We reviewed the documentation for each of DOE's completed actions performed in response to the Reform Team's recommendations and found that nine actions did not meet the specific requirements of the Reform Team's recommendations. For example, to operate DOE's facilities in a more efficient and cost-effective manner, the Reform Team recommended that DOE establish a preference for its M&O contractors to subcontract various functions, such as laundry and cafeteria services, unless the M&O contractor could perform these functions at a lower cost. The Reform Team further recommended that contractors be provided with incentives to encourage the contractors to subcontract these services. However, DOE's proposed regulation, published in the *Federal Register* in June 1996, did not include provisions for the incentives that were recommended by the Reform Team. According to Project Office officials, the incentives were unnecessary because the proposed regulation would require contractors to subcontract for these services where appropriate. However, the Project Office officials stated that several DOE field offices are currently providing their contractors with incentives to subcontract these services.

Furthermore, in an effort to implement performance-based contracting methods for support service contracts, the Reform Team recommended that DOE develop a plan for converting cost-reimbursement support service contracts to performance-based contracts, when applicable. Although DOE provided illustrations of potential application of performance-based methods to support services and identified specific program and field offices that are now planning to convert some of their support service requirements to performance-based support, DOE did not develop an actual plan with targets and milestones for converting these possible support services as required by the Reform Team.

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<sup>6</sup>A proposed action may be approved for implementation directly by the executive committee or after having received the proposed action, the executive committee does not comment within 2 weeks.

Project Office officials and program office officials who were assigned to develop actions in response to recommendations stated that while actions may not have strictly adhered to the requirements of the Reform Team's report, these actions, nevertheless, achieved their intended goals. For example, the Reform Team recommended that DOE reduce its current audit backlog in order to improve the ability of DOE managers to administer financial operations. In doing so, the Reform Team advised DOE to identify ways to provide the Defense Contract Audit Agency with sufficient funding to permit additional resources to be assigned to DOE's non-M&O contracts. Before providing the Defense Contract Audit Agency with funds, however, the Reform Team recommended that the costs and benefits of obtaining such additional resources as well as any plausible alternatives be assessed. In response, DOE provided the Defense Contract Audit Agency with funding in fiscal year 1995 to reduce DOE's current audit backlog with plans to continue funding until the current backlog is eliminated. However, DOE neither performed a cost-benefit analysis nor suggested any viable alternatives as recommended in the contract reform report.

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## Completed Reform Actions Are Behind Schedule

Although DOE has made progress in its efforts to write new policy, guidelines, and plans, it has substantially exceeded its deadlines for 45 of 47 completed reform actions. DOE exceeded its deadlines by an average of 11 months, and 13 actions were from 18 months to 26 months late.<sup>7</sup> Moreover, many of the original deadlines had been subsequently extended by the executive committee at the request of cognizant departmental organizations. However, even the extended deadlines have been exceeded as well.

According to Project Office officials, unanticipated circumstances often caused delays in the processing of actions. For example, some of these delays were caused by the review process. Moreover, Project Office officials said that a considerable amount of time was consumed in an attempt to achieve greater participation from departmental organizations in reviewing and commenting on actions. Delays were also encountered in the assigning of actions to specific departmental organizations. For example, Project Office officials mentioned that the Office of Procurement and Assistance Management opposed being assigned responsibility for six action items because these actions were inherently field related, which the officials believed, could best be handled by the Office of the Associate Deputy Secretary for Field Management. Project Office officials further

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<sup>7</sup>Average includes two reform actions that were on time.

pointed out that the reform actions were done by staff on a part-time basis because the reform action work was in addition to their normal duties. Moreover, because many of the actions were new approaches that crossed lines of responsibility, they often required considerable internal coordination among the offices that shared such responsibility. According to the officials, other factors such as newly established initiatives, downsizing, and retirements also caused delays in completing actions.

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## Too Early to Assess Effect of Reform Actions but Implementation May Be Problematic

Although it is too soon to assess the overall effectiveness of the reform actions on achieving DOE's contract reform goals, early indications suggest that delays, limited available resources, and overly broad guidance may inhibit implementation.

The deadlines for the vast majority of the reform actions were missed. Of those reform actions that are now reported as complete, many have been completed recently. For example, 49 percent were completed during fiscal year 1996. Because of these delays in setting the framework of contract reform, successful implementation of the new policies will be pushed further into the future.

Several task teams have expressed concerns about whether available resources can adequately support the reform actions they developed. For example, the task team with responsibility for developing specific performance goals and indicators for real and personal property reported that numerous stakeholders expressed concerns that implementation may be problematic "because of the lack of resources and baselines to be measured against." We raised similar concerns in a 1995 report on property management at DOE's Rocky Flats site.<sup>8</sup> In the report, we concluded that without accurate data on property, neither DOE nor its contractor can determine how much property is present at the site and how much has been lost or stolen.

Furthermore, the task team charged with developing generic and specific performance goals and indicators for business management as well as environment, safety, and health expressed similar concerns. The task team recommended that "prior to commencing implementation, detailed planning, including an assessment of the impact on staffing and infrastructure and the ability to adjust to such impact, must be done." The team further reported that the performance goals and indicators were

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<sup>8</sup>Department of Energy: Property Management Has Improved at DOE's Rocky Flats Site (GAO/RCED-96-39, Dec. 28, 1995).

developed “at a high level and may not directly apply to an individual contract being incentivized.”<sup>9</sup> The team finally added that many of the examples contained in its report were based on site-specific goals that would need to be replaced with goals that are relevant to each contractor.

Project Office officials reiterated that it may take years to determine whether many of these actions will make DOE contracting work better and cost less. However, the Project Office expects to issue its own report on the impact of the contract reform actions in late 1996. Project Office officials stated that they will not assess each action individually but will assess the cumulative impact of the actions on such things as competition, performance goals, and incentives.

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## Conclusions

Although, DOE has made significant progress in setting a framework for contract reform through the issuance of new policies, guidance, and plans, the real test of contract reform will be in the implementation of these reforms in contracts. These changes will take time to come to fruition because (1) it will take time for DOE’s existing contracts to be replaced by new ones incorporating reform measures, (2) some reform actions are still works-in-progress and will continue to evolve, and (3) DOE was late in completing almost all of its reform actions.

Because of the magnitude of DOE’s reforms, some of which are directly opposed to its previous contracting policy, we believe that implementation problems are to be expected. These problems must be identified and corrected during implementation for contract reform to succeed. For this reason, we believe it is vital for the continued monitoring of contract reform implementation by the Secretary of Energy and other top DOE officials. Since contract reform has been a high priority of the Secretary, we are not making any recommendations along this line. While we recognize that having new policies in place is an important step toward ensuring that reform occurs, the actual implementation of contract reform and these policies should not lose momentum nor priority.

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## Agency Comments and Our Evaluation

DOE believes that our draft report did not provide a comprehensive overview of their reform efforts and failed to address the extent to which contract reform has made contracting work better and cost less. We believe that DOE has taken some very important steps in reforming its contracting problems. DOE has (1) changed its policy and adopted

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<sup>9</sup>The word incentivized means being provided with an incentive.

competitive awards as its new contracting standard, (2) included performance goals in its contracts, and (3) moved quickly to implement the use of incentive contracts to control costs. In our opinion, the broad strategy presented by DOE is inextricably linked with contract reform and, more particularly, the 48 action items. Furthermore, the completion of the policies, procedures, and guidance developed under the action items is the backbone of sustained contract reform. Therefore, the status of these action items provides a reasonable assessment of DOE's progress and the framework for future assessments as DOE's overall effort evolves.

Furthermore, DOE's new contracts are not based on final policy, and they had been in effect for only about 1 year. Thus, it will take years to determine the extent to which DOE has met its goal of making contracting work better and cost less.

DOE believes that our report does not address what the Department has done to make each of the 48 action items a reality, and it attached specific comments relating to these items. Our detailed responses addressing the specific items that DOE questioned is discussed in appendix II.

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# Competition Becomes the Rule but Not the Practice

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In response to one of the most significant recommendations of the Contract Reform Team, DOE has changed its policy from one of making noncompetitive M&O contract awards to one that adopts full and open competition as the norm for M&O contract awards. For various reasons, however, the majority of M&O contracts continue to be extended on a noncompetitive basis. Of the 24 decisions made between July 1994 and August 1996, DOE decided to extend 16 on a noncompetitive basis while competitively awarding 8.<sup>10</sup> Furthermore, for three University of California contracts, DOE made the decision to extend the contracts prior to completing negotiations despite the Contract Reform Team's recommendation to the contrary. As a result, DOE has placed itself in the same weak negotiating position that it has maintained for years and that contract reform was designed to prevent.

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## New DOE Policy on M&O Contracts Reflects Contract Reform Team's Recommendations

The Contract Reform Team recommended, and DOE put in place, a policy to overturn years of noncompetitive contracting with M&O contractors. Prior to contract reform, DOE's procurement regulation authorized competition for M&O contracts when it appeared likely that the government's position might be meaningfully improved in terms of cost or performance unless it was determined that to change contractors would be contrary to the best interests of the government. As a result of this policy and practice, the Contract Reform Team concluded that noncompetitive contracting had become the norm in M&O contracting.

The Contract Reform Team was critical of this noncompetitive policy stating that because, in part, of the close working relationships with particular contractors, contracts were routinely extended every 5 years, thus resulting "in many contractors continuing to perform for decades." The Reform Team further said that this practice created a bias that favored the incumbent contractor and that a new policy favoring competition would improve DOE's contracting by encouraging new contractors to participate in M&O awards because they would understand that DOE and the incumbent contractor would no longer have perpetual relationships. Finally, the Reform Team noted that DOE's decisions to extend individual M&O contracts were made before negotiations were held with the contractors. As a result, DOE's negotiating position with its contractors was weakened.

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<sup>10</sup>According to DOE's Procurement and Assistance Data System, DOE had 42 active M&O contracts as of July 1, 1996.

DOE established an interim policy on September 28, 1994, that changed its M&O contract award policy to one favoring full and open competition. As recommended by the Contract Reform Team, the policy provided that competitively awarded M&O contracts would include a basic contract term of 5 years or less and may include an option to extend the term of the contract for 5 additional years or less and a maximum term limit of 10 years. As recommended, the policy also provided for noncompetitive extensions of M&O contracts, in exceptional circumstances, where competition was “incompatible with the effective and efficient discharge of Departmental programs or is otherwise incompatible with the paramount interest of the United States.” In these instances, the Secretary of Energy was to authorize the use of noncompetitive procedures to extend an existing contract, and the extension of the contract was to be conditioned upon the successful negotiation of DOE’s objectives.

DOE’s final policy, which became effective on August 23, 1996, adopted a standard of full and open competition in the award of M&O contracts, including performance-based management contracts. The policy further states that an M&O contract may be awarded or extended without providing for full and open competition only when justified under one of the exceptions provided under the Competition in Contracting Act of 1984. The seven exceptions provided by the act include identified and specific circumstances such as where only one source can perform the work or when an agency’s need for an item is of unusual and compelling urgency.<sup>11</sup> The policy states that noncompetitive extensions shall be considered conditional upon the successful negotiation of the contract. Additionally, the Secretary must authorize all awards that do not use full and open competition.

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<sup>11</sup>The seven exceptions to full and open competition are listed at FAR 6.302.

**In Practice,  
Noncompetitive  
Extensions Remain  
the Norm**

From July 5, 1994 to August 31, 1996, DOE made 24 decisions to competitively award or noncompetitively extend M&O contracts. Of these 24 decisions, 16 were to noncompetitively extend contracts and 8 were to competitively award contracts.<sup>12</sup> Additionally, decisions were made on four other former M&O contracts that either brought them to an end or converted them to cooperative agreements.<sup>13</sup>

The 16 contracts that DOE noncompetitively extended or plans to noncompetitively extend include 12 contracts that, according to DOE, have never been competitively awarded. The average age of these 16 contracts is about 35 years. Table 3.1 lists contracts that DOE either noncompetitively extended or plans to noncompetitively extend.

**Table 3.1: List of M&O Contracts That Were Extended or to Be Extended as of August 31, 1996**

<b>Facility</b>	<b>Current contract date</b>	<b>Competitively awarded in</b>	<b>Current contractor</b>
Waste Isolation Pilot Plant	1985	1978	Westinghouse Electric
West Valley Demonstration Project	1981	1981	West Valley Nuclear Services
Kansas City Plant	1948	Never competitively awarded	Allied Signal
Argonne National Laboratory	1946	Never competitively awarded	University of Chicago
Brookhaven National Laboratory	1947	Never competitively awarded	Associated Universities
Thomas Jefferson National Accelerator Facility <sup>a</sup>	1984	1984	Southeastern University Research Associates
Ames Laboratory	1943	Never competitively awarded	Iowa State University
Stanford Linear Accelerator Center	1976	Never competitively awarded	Leland Stanford, Jr. University
Knolls Atomic Power Laboratory	1946	Never competitively awarded	KAPL

(continued)

<sup>12</sup>On July 5, 1994, the Secretary signed the initial decision memorandum for a number of DOE facility contracts. Included in this memorandum were competitive procurements for the Idaho National Engineering Laboratory and the Rocky Flats Environmental Technology Site which were in progress. Also included in the memorandum were the noncompetitive negotiation of the West Valley Demonstration Project contract, which was in process, and the noncompetitive negotiation for the Knolls Atomic Power Laboratory, which was recently completed.

<sup>13</sup>These include the decisions whereby the agreements for the Savannah River Ecology Laboratory and the Inhalation Toxicology Research Institute would be converted to cooperative agreements and decisions whereby the agreements for the Laboratory of Radiological & Environmental Health and the Energy Technology Engineering Center would be discontinued.

**Chapter 3  
Competition Becomes the Rule but Not the  
Practice**

<b>Facility</b>	<b>Current contract date</b>	<b>Competitively awarded in</b>	<b>Current contractor</b>
Pacific Northwest National Laboratory	1964	Never competitively awarded	Battelle Memorial Institute
Lawrence Livermore National Laboratory	1940	Never competitively awarded	University of California
Los Alamos National Laboratory	1943	Never competitively awarded	University of California
Lawrence Berkeley National Laboratory	1947	Never competitively awarded	University of California
Princeton Plasma Physics Laboratory	1975	Never competitively awarded	Princeton University
Fermi National Accelerator Laboratory	1967	Never competitively awarded	Universities Research Association
Pantex Plant	1991	1991	Mason & Hangar-Silas Mason

<sup>a</sup>Until 1996, this facility was known as the Continuous Electron Beam Accelerator Facility.

Source: DOE's Contract Reform Project Office.

The eight contracts that DOE has competitively awarded or is planning to competitively award include four prior contracts that were competitively awarded in the late 1980s, according to DOE. These include the contracts for the Savannah River, Hanford Reservation, Hanford Environmental Health Center, and Mound facilities. However, the Oak Ridge contracts, which DOE plans to competitively award, will replace contracts that were noncompetitively awarded. On the other hand, the new competitively awarded contracts for the Idaho, Nevada, and Rocky Flats facilities each replaced several contracts that were both competitively and noncompetitively awarded. Table 3.2 presents a list of the competitively awarded procurements or procurements that are planned for competition.

**Chapter 3  
Competition Becomes the Rule but Not the  
Practice**

**Table 3.2: List of M&O Contracts That Were Competitively Awarded or Planned for Competition, as of August 31, 1996**

<b>Facility</b>	<b>New contract awarded</b>	<b>Current contractor</b>
Idaho National Engineering Laboratory and the Specific Manufacturing Plant <sup>a</sup>	1994	Lockheed Idaho Technology
Rocky Flats Environmental Test Site	1995	Kaiser Hill
Nevada Operations Office Support	1995	Bechtel Nevada
Savannah River Site	1996	Westinghouse Savannah River
Hanford	1996	Fluor Daniel Hanford
Hanford Environmental Health Center	Not yet awarded	Hanford Environmental Health Foundation
Mound Facility	Not yet awarded	EG&G Mound Applied Technologies
Oak Ridge Facility and Laboratory <sup>b</sup>	Not yet awarded	Lockheed Martin Energy Systems Lockheed Martin Energy Research

<sup>a</sup>Two new Idaho contracts replaced and consolidated the work regarding five individual M&O contracts that were competed at different times in the past, and the new Nevada contract replaced three previous contracts.

<sup>b</sup>This contract was noncompetitively extended in August 1995. In early 1996, DOE split the national laboratory work from the contract and awarded a second contract noncompetitively to the incumbent contractor. DOE's current plans are to award three separate contracts competitively in the future for the facility's defense work, environmental restoration work, and national laboratory work.

Source: DOE's Contract Reform Project Office.

In reaching its decisions on whether to competitively award or noncompetitively extend a contract, DOE considered such things as

- the transition of its facilities to environmental restoration facilities;
- the long-standing relationships with its incumbent contractors at research and development laboratories and the need to make special arrangements with contractors on whose property the facilities were situated (some of DOE's laboratories are located on the campuses of universities); and
- the need to maintain core competencies in nuclear weapons design, production, and dismantlement during the transition to a post-Cold War society.

We discussed the results for the 24 contract decisions with the Deputy Assistant Secretary for Procurement and Assistance Management, the Director of the Contract Reform Project Office, the Deputy Associate

Deputy Secretary for Field Management, and other DOE staff. They explained that the new noncompetitive contracts are really new contracts that include new clauses and new requirements. In addition, they stated that there is increased competition for former M&O work, which is being competitively awarded through DOE's privatization efforts. For example, at the Hanford facility, the procurement for the Tank Waste Remediation System, which in the past would have been done noncompetitively by the current M&O contractor, is now being competitively awarded as a separate procurement. Finally, the procurements for sites that had a change in their missions or were in transition from one mission to another were competitively awarded and the contracts were noncompetitively extended for those where there was a significant amount of continuity with the contractor.

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## DOE Weakened Its Bargaining Position Before Contract Terms Were Negotiated

Although contrary to a recommendation by the Contract Reform Team, DOE may have weakened its bargaining position with the University of California when it conditionally decided to extend the contracts prior to their negotiation.

The Contract Reform Team recommended that the terms of contracts be negotiated before making the decision to extend contracts, but a recent decision for three University of California contracts, which had fiscal year 1995 obligations of \$2.3 billion, appears to contradict this recommendation. For example, in the Secretary of Energy's May 14, 1996, "conditional extension decision" for the management and operation of the Los Alamos National Laboratory and the Lawrence Livermore National Laboratory, the Secretary summarized the university's more than 50 years of work under the two existing contracts and concluded that

"Under these circumstances, it would be unrealistic to consider the introduction of an unknown and untested management team to these critical scientific and technical endeavors."

Likewise, in discussing the university's nearly 50 years' performance on the existing contract for the Lawrence Berkeley National Laboratory, where the laboratory's facilities are located on university property, the Secretary concluded that

"The loss of such resources by transferring to a different contractor is equally incompatible with our program requirements."

At the end of the decision, the Secretary explained that any award to the University is contingent on improvements in the terms of the current contracts.

We discussed this decision with the Deputy Assistant Secretary for Procurement and Assistance Management, the Director of the Contract Reform Project Office, and the Deputy Associate Deputy Secretary for Field Management and were told that regardless of the statements, DOE has the resolve to competitively award these contracts if it does not obtain the contract reforms that it is seeking from the university. Additionally, the officials explained that they were very careful in the wording of the decision and that the comments about the university only reflected its scientific capabilities and not its business management, which must be improved.

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## DOE's Implementation of the New Competition Policy Could Be Beneficial

DOE's new policy on competition became effective on August 23, 1996. As a result, the timing of our work did not give us the opportunity to review DOE's justifications for noncompetitive procurement under the new policy. However, we note that the new policy adopts a standard of full and open competition. DOE's policy also adopts the provision of the Competition in Contracting Act, as implemented by the FAR, that provides specific exceptions to the act's requirements for full and open competition. Under these exceptions, DOE can continue to justify its noncompetitive procurements and not fulfill the intent of its own competition policy.

The Competition in Contracting Act was enacted in 1984 to increase the use of competitive procurement in the federal government. Although the act requires full and open competition, it provides seven exceptions to full and open competition that can permit noncompetitive procurement. One exception that DOE could use to justify noncompetitive procurements for many of its M&O contracts is the exception that authorizes noncompetitive procurements to maintain an essential engineering, research, or development capability to be provided by a federally funded research and development center. Although this exception is available to DOE, in the past, DOE has successfully awarded M&O contracts competitively to operate its research centers at the Sandia National Laboratory and the Idaho National Engineering Laboratory. Additionally, within the last few months, DOE has decided to competitively award the future contract for the Oak Ridge National Laboratory—another research center. We believe that DOE should continue its efforts to competitively award its research centers whenever feasible.

In the event that DOE does need to use this exception to justify a noncompetitive procurement, we believe that, whenever feasible, DOE should use noncompetitive procedures only after segregating the research work from other activities of its M&O contractors. For example, in 1995, we reported that about 50 percent of the funds spent by M&O contractors in fiscal year 1994 under 19 contracts for research centers was for research and development activities.<sup>14</sup> The remaining funds were spent on such things as the environmental restoration of facilities contaminated with hazardous and nuclear waste. Thus, about 50 percent of the M&O contractors' funds were not directly associated with research activities. DOE could maximize its competitive awards by separating the nonresearch work from that of the research center and competitively awarding the nonresearch work.

We discussed the new competition policy and its potential use in regard to the research centers with the Deputy Assistant Secretary for Procurement and Assistance Management, the Director of the Contract Reform Project Office, and the Deputy Associate Deputy Secretary for Field Management. They told us that DOE shares our concern about the granting of exceptions from competition for all of the work done at research facilities. Furthermore, they told us that DOE is also concerned with the number of its federally funded research and development centers and is considering a reduction in the number of research centers it now operates.

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## Conclusions

Bringing competition into DOE's contracting could be the single most significant aspect of the contract reform initiative. However, DOE's new policy is only as good as its implementation. After nearly 2 years of experience under contract reform and after 24 decisions, DOE's actions show that it has a long way to go before it realizes the benefits of competition. Although DOE officials told us that DOE is improving its existing contracts through noncompetitive negotiations, it is doing just that—negotiating in a noncompetitive environment. This does not identify new potential contractors as contract reform intended. Only competition will do that.

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## Agency Comments and Our Evaluation

DOE believes that our draft report did not adequately acknowledge the impact of the Department's new competition policy. Specifically, DOE believes that real changes have occurred in its contract competition

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<sup>14</sup>Federal Research: Information on Fees for Selected Federally Funded Research and Development Centers (GAO/RCED-96-31FS, Dec. 8, 1995).

culture and practices and that the proposed extension of the three laboratory contracts conforms to its policy.

First, DOE states that in all cases where noncompetitive extensions have been sought, the Department subjected each decision to a rigorous examination of the facts and circumstances. Also, DOE states that rather than using the existing contract as a basis for negotiation, the Department developed administrative mechanisms to ensure that contract reform terms and conditions were the basis for negotiation. While we agree that DOE has changed its competition policy, the Department decided in two-thirds of its decisions to noncompetitively extend M&O contracts. Furthermore, the Contract Reform Team's report concluded that contracts should be competitively awarded except for unusual circumstances. We believe that such a large proportion of noncompetitively extended contracts suggests that DOE still has a long way to go before realizing the benefits of competitive contracting. Although DOE believes that it is improving its existing contracts by negotiating in a noncompetitive environment, it is not obtaining the benefits of competition.

Second, DOE states that extending the three laboratory contracts was contingent on incorporating contract reform provisions and achieving other negotiation objectives. As noted in our draft report, the Secretary's decision to extend these contracts stated that considering other contractors was unrealistic and incompatible with program requirements. Once DOE stated that only one contractor could do this work, DOE effectively weakened its negotiation position. Even though the Secretary also noted that any resulting contract was contingent on the incorporation of reform measures, we believe that DOE's actions to date, give the appearance that the decision to extend these contracts was made prior to the completion of successful negotiations and therefore is inconsistent with the intent of contract reform.

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# DOE's Contract Reform and Strategic Planning Reveal Inconsistencies in Contract Goals

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One of the key elements of DOE's new Performance-Based Management Contracts is their inclusion of clearly stated, results-oriented performance goals and indicators to determine if the performance was achieved.<sup>15</sup> However, as DOE seeks to implement its new contracting approach together with its strategic planning initiative, contract weaknesses are becoming apparent. DOE's new contracts do not always contain a clear linkage between the contract goals and those of the Department. In addition, some contract provisions allow contractors to dispute either the total amount of the contract incentive or the amount of the incentive provided for a specific goal. Because DOE relies heavily on its contractors to carry out its missions, it is essential that the goals in DOE's contracts be aligned with DOE's strategic goals. Additionally, DOE's contracts should not harm the Department's authority to allocate incentives to the performance of contract goals. DOE officials agree that their efforts to put reforms and initiatives in place quickly resulted in inconsistencies. They see these early stages of implementing contract reform and strategic planning as a learning process.

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## DOE's Ongoing Contract Reform and Strategic Planning Are Interconnected

Two DOE initiatives—contract reform and strategic planning—are closely aligned. The conversion of M&O contracts into Performance-Based Contracts is a major goal of the Contract Reform Team's report and DOE has been converting its management and operating contracts to Performance-Based Contracts. The Reform Team concluded that earlier M&O contracts included loose accountability for performance with few quantitative controls to ensure that funds were spent on the highest priorities. While DOE was incorporating performance goals in its new contracts, it also was working on its strategic planning initiative. During its strategic planning efforts, DOE developed a strategic plan that includes performance goals to be achieved and performance indicators to determine if the goals were achieved. Considering that DOE's M&O contractors were provided with about 74 percent of DOE's total fiscal year 1995 obligations, it is clear that DOE cannot fulfill its strategic goals without directing the work of its M&O contractors. Therefore, DOE's contract reform and strategic planning initiatives are closely linked.

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<sup>15</sup>We use the terms goal and indicators as identified in the Government Performance and Results Act of 1993. DOE's strategic plan, performance agreements, and contracts included a variety of terminology such as goals, indicators, criteria, measures, commitment, strategies, and objectives.

In February 1995, DOE developed contract reform guidance for the use of performance goals, indicators, and incentives in M&O contracts.<sup>16</sup> Among other things, the guidance stated that (1) a top-down approach should be used to link DOE's strategic plan to subordinate strategic plans and ultimately into specific goals and indicators in contracts and (2) performance goals and indicators should be traceable to the successive levels of strategic plans. Additionally, the guidance indicated that goals and indicators must be derived from the site where the contract work is to be performed.

Under the Government Performance and Results Act of 1993 (GPRA), most federal agencies, including DOE, will be required to set strategic goals, measure performance, and report on the degree to which their goals are met. Specifically, by September 30, 1997, they will be required to prepare a strategic plan covering at least a 5-year period that describes, among other things, (1) general goals and objectives for the major functions and operations of the agency, (2) how the agency intends to achieve these goals and objectives, and (3) how the goals of the strategic plan are related to those to be used in annual performance plans. In later years, agencies will be required to prepare annual performance plans with goals that are related to those of the strategic plans and program evaluation reports that show the success at accomplishing their goals. Finally, the GPRA identifies the drafting of strategic plans, annual performance plans, and program performance reports as inherently governmental functions that must be performed by federal employees.

DOE is ahead of the deadlines imposed by GPRA's requirements and published its first departmental strategic plan in April 1994. The plan identifies five programmatic business lines and four critical success factors.<sup>17</sup> The plan includes performance goals and indicators to determine if the goals for the business lines and success factors have been achieved. Additionally, the Secretary of Energy developed performance agreements between herself and the President for fiscal years 1995 and 1996. DOE considers these performance agreements to be similar to the annual performance plans that will be required by GPRA in future years.

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<sup>16</sup>Report on Contract Reform Actions 3, 4, 5, 6, 8, and 14 Performance Criteria, Measures and Incentives (Feb. 16, 1995).

<sup>17</sup>DOE's April 1994 Strategic Plan listed industrial competitiveness, energy resources, science and technology, national security, and environmental quality as its business lines and communication and trust; human resources; environment, safety, and health; and management practices as its critical success factors.

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## Contract Goals Are Not Always Clearly Linked to Strategic Plan's Goals

Although DOE cannot fulfill its strategic goals without the work of its M&O contractors, it is difficult to find a connection between DOE's overall strategic plan goals, its performance agreement goals, and its M&O contracts. Without a clear connection, DOE is not assured that its contractors are focused on the Department's identified goals. Additionally, it will be difficult for DOE to quantify, in the performance reports required by GPRA, its success in meeting goals.

DOE's strategic plan and annual performance agreements identify its five departmental lines of business and its four critical success factors.<sup>18</sup> The performance goals and indicators are then listed together with the lines of business and the success factors. We reviewed four contracts that were awarded after the development of DOE's strategic plan in 1994 to determine if the contracts' performance goals could be traced to the strategic plan's goals. We also compared contract goals with the performance agreement goals using the fiscal year performance agreement that was in effect when the contract was awarded.

In some cases, a contract goal could be clearly linked to the strategic plan goal. For example, a goal of the departmental strategic plan under the business line "science and technology" is to "Provide new insights into the nature of matter and energy, address challenging problems, and create a climate in which breakthroughs occur." The contract for the Argonne National Laboratory under its "science and technology" area included a corresponding contract goal to "Provide new insights [into] the nature of matter and energy." Although, through experience, DOE may find a need for more specific goals in the individual contracts, such clear linkage to the strategic plan's business lines and goals can help DOE's contract efforts and contract results focus on the identified goals of the Department.

In other cases, contract goals were difficult to link to the strategic plan or the current fiscal year's performance agreement. For example, the M&O contract that supports the Nevada Operations Office included goals grouped under seven categories. However, the seven contract categories were not the same as the nine departmental business lines and key success factors. As a result, we could not link the contract goals to those of the strategic plan. A DOE Nevada operations office official explained that specific goals were in the contract even though the Nevada office's mission was uncertain. Additionally, the office noted a lack of direction

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<sup>18</sup>The performance agreements for fiscal years 1995 and 1996 use the goal "economic productivity" in place of the industrial competitiveness goal which is identified in the strategic plan.

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from DOE headquarters during the negotiation of performance goals for the contract.

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## Some Contract Provisions Could Affect DOE's Authority to Set Contract Incentives

Some contract provisions give the contractors the right to legally dispute DOE's determination of the total amount of contract incentives available or the amount of incentives that can be applied to specific contract goals. Such provisions can compromise DOE's ability to place priorities on its contract work because these incentives are used to motivate contract performance.

The setting of the goals by DOE is clearly important because DOE needs to maintain its authority to direct the work. However, the setting of incentives is also important. Incentives are used to motivate contractors' efforts that might not otherwise be emphasized. Without the authority to identify the amount of incentives necessary to motivate the contractor, DOE loses an important contracting tool that helps it direct the contract work. DOE's procurement regulation for its award-fee contracts, a type of contract providing an incentive for contractor performance, likewise emphasizes that the government has the unilateral right to identify the criteria to evaluate the contractor's performance and the percentage of award fee to be allocated to the individual criterion.

However, for the four new M&O contracts identified in table 4.1, we found that the contract language in each contract was different for determining how goals would be determined and how incentives would be allocated to the goals. For example, under the Rocky Flats contract, the contractor can propose goals to add to the contract, but if there is a disagreement between the contractor and DOE, the contractor may legally dispute the amount of an incentive to be applied to a goal.<sup>19</sup> On the other hand, the Hanford contract specifically states that the final determination of goals and the distribution of incentives will be made solely by DOE and the contractor cannot dispute DOE's decision.

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<sup>19</sup>Under the provisions of the contracts, the contractors may contest (dispute) the decision of a contracting officer, which could ultimately result in a legal decision against the government.

**Chapter 4**  
**DOE's Contract Reform and Strategic**  
**Planning Reveal Inconsistencies in Contract**  
**Goals**

**Table 4.1: Key Contract Features for the Development of Goals, Indicators, and Incentives**

<b>Contract</b>	<b>Key features</b>
Rocky Flats Environmental Technology Site Contract	<p>DOE and contractor may initiate negotiations to set goals and/or incentives.</p> <p>Contractor may propose projects, tasks, or other goals that may qualify for incentive fees.</p> <p>Contractor may dispute DOE's determination of the amount of available incentive fee provided for the goals.</p>
Nevada Management and Support Contract	<p>Contractor proposes revisions to the goals and indicators.</p> <p>Contractor meets with DOE and other stakeholders to select recommended high-priority incentive objectives.</p> <p>Contractor develops incentive goals that are specific to each incentive objective with input from DOE and other stakeholders.</p> <p>Contracting officer reviews the plan including goals and indicators as necessary.</p> <p>Contractor may dispute DOE's decision on the amount of incentive fee available including the performance-based incentive fee components.</p>
Idaho National Engineering Laboratory Contract	<p>DOE and the contractor may propose specific projects, discrete tasks, and associated incentives for the projects and/or tasks.</p> <p>Contractor is encouraged to propose projects or tasks that it feels are appropriate for incentive fees.</p> <p>Contractor may not dispute an incentive amount for any project and/or task.</p>
Hanford Management Contract	<p>DOE develops performance goals with the related fee distribution.</p> <p>Contractor also prepares additional performance goals to be negotiated prior to placement in the contract.</p> <p>Final determination of goals, indicators, and incentives are made solely by DOE.</p> <p>Contractor may not dispute DOE's goals and indicators.</p>

DOE's field offices gave us different reasons for using these provisions. For example,

- contracting staff at Rocky Flats and Nevada told us they included the provisions because they considered these provisions as typical standard provisions in DOE contracts;

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- contracting staff at Idaho said they incorporated language prohibiting disputes on goal setting to protect the government's interests and to minimize disputes; and
  - the chief counsel at DOE's Richland office, which manages the Hanford contract, stated that Richland incorporated language prohibiting disputes on goal setting and the amount of incentives applied to each goal because Richland considered the setting of goals and incentives to be basic to DOE's ability to direct the work of the contractor in fulfilling the government's requirements.

Language permitting contractors to dispute how DOE will apply incentives to goals can compromise DOE's ability to place priorities on the work that it deems necessary at its facilities.

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## Learning Process Cited as Cause of DOE's Weaknesses

DOE personnel are in the early stages of implementing contract reform and strategic planning and are still learning about the processes. Although DOE officials agree that the linkage should exist, they cite their attempts to put things in place quickly as reasons for the differences in actual practice. With changes occurring simultaneously and different offices initiating different actions, inconsistencies are occurring in implementation.

DOE's strategic planning staff and contract reform staff agreed with us that there should be a clear linkage of departmental strategic plan goals to those of the M&O contracts. They explained that at present, this clear linkage does not exist, in part, because of DOE's changing mission and the learning process involved in these new initiatives. They also explained that DOE focused on moving forward with changes and that at times, policy and guidance did not precede the actual implementation of the contract reform and strategic-planning implementation. Because of the concurrent development of guidance and its actual implementation, several different strategies have been followed in DOE's contracts.

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## Conclusions

A clear linkage of goals in M&O contracts, annual performance agreements, and strategic plans is needed to manage DOE's complex and varied missions. Such linkage should help DOE in directing the performance of its missions and reporting on its success in accomplishing mission goals. Additionally, contracts that contain provisions that impinge on DOE's authority to set incentives have the potential to detrimentally affect DOE's ability to perform its missions.

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## Recommendations

We recommend that the Secretary of Energy require that

- the goals written into the M&O contracts be clearly linked to DOE's strategic plan and annual performance goals and
- a mandatory standard contract clause be included in all M&O contracts that gives DOE the exclusive authority to set contract goals and incentives that support the strategic plans and missions of the Department.

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## Agency Comments and Our Evaluation

Although DOE generally agrees with our two recommendations, it was concerned over two issue related to the linkage of contract performance goals and departmental goals. Specifically, DOE believes that (1) our analysis did not consider subordinate goals, such as program goals, that would better link departmental goals with contract goals and (2) we should have taken a larger sample of contracts in our analysis of performance goals.

In analyzing DOE's goals, we considered the provisions of GPRA and did not find the linkage between agency and contract goals. We reviewed DOE's strategic plan, annual performance agreements, strategic plans for DOE's five business lines and key success factors, and site-strategic plans. We discussed our results with staff of DOE's Office of Strategic Planning, Budget and Program Evaluation and the Contract Reform Project Office and explained to them that we could not track the goals from the Departmental Strategic Plan, through the subordinate program plans, and into the M&O contracts.

In selecting the contracts for detailed review, we chose from 11 contracts that were awarded at the time of our selection. From these, we selected four because they had the most thorough provisions for performance goals. On the basis of this selection process, we believe our detailed analysis was sufficient to suggest that as DOE moves forward with contract reform and strategic planning, it needs to ensure that contract goals are clearly identified with departmental goals.

# M&O Procurement Regulations Do Not Provide Guidance for Incentive Contracts

Another key element of the Contract Reform Team's new Performance-Based Management Contract is the inclusion of incentives to control contract costs. As DOE begins to use incentive contracts to control costs, its M&O procurement regulations are not providing the necessary direction for the placement of these incentives in contracts by DOE's contracting officers. For a cost incentive to be effective, the contracting officer must establish a reasonable target price to motivate the contractor to effectively manage costs. Although the FAR provides considerable direction on the pricing of contracts, DOE's M&O regulations do not. Since DOE's contracting officers are not required to follow the FAR for pricing M&O contracts, they are largely left on their own to determine how best to accomplish this task. Our analysis of two DOE contracts—where one contracting officer used important aspects of the FAR requirements and the other did not—show that when the FAR requirements were used, DOE was able to affect the contractor's performance.

## Effectiveness of Cost Incentives Depends on the Pricing of the Contract

Incentive contracts can be used to effectively reduce costs. However, to be effective, incentives need to be properly set within the pricing structure of the contract. Although the FAR provides direction and procedures for the pricing of contracts, DOE's M&O procurement regulation only provides guidance for the setting of fees.

Two basic incentive contracts used by government contracting officers to control costs are the fixed-price-incentive and cost-plus-incentive contracts. Under each of these contracts, the contracting officer's goal is to negotiate a target cost and a profit or fee that motivates the contractor to effectively manage costs. The incentive should provide the contractor with an incentive to reduce costs and a disincentive to overrun costs. Typically, incentives are expressed as a sharing ratio between the government and the contractor. For example, a sharing ratio of 50/50 indicates that for each dollar of cost reduction below the target cost, the government saves 50 cents and the contractor increases its profit by 50 cents, while for each dollar over the target cost, the government's costs increase by 50 cents and the contractor's profit or fee is reduced by 50 cents.

These contracts provide the contractor with a clear understanding of how its cost performance will affect its profits or fee and can be effective tools to control costs. However, in order for them to be effective, the contracting officer needs to properly negotiate the target cost of the contract.

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## The FAR Provides Directions for Negotiating Contract Prices

Under the FAR, a key responsibility of the government contracting officer is to obtain supplies and services at fair and reasonable prices. In the negotiation of contract prices, the contracting officer must determine a fair and reasonable price through an analysis of proposed costs and/or prices. This analysis may include the review and evaluation of individual cost elements, such as materials, labor, and subcontract prices that support the contractor's overall proposed price. For contracts expected to cost \$500,000 or more, the contractor may be required to submit cost or pricing data that include all the facts that prudent buyers and sellers would reasonably expect will affect price negotiations significantly. These data are then certified by the contractor as being accurate, current, and complete as of the date of agreement on the contract price or another date agreed to by the contracting officer and the contractor.

For a cost analysis, contracting officers generally are to request a technical analysis of the contractor's proposed costs. This technical analysis is done by specialists who advise the contracting officer on costs for such things as material and labor. In addition, the contracting officer may have the proposal reviewed by an auditor.

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## DOE's M&O Procurement Regulation Lacks Guidance on Price Negotiations

DOE's M&O procurement regulations do not require contracting officers to negotiate costs and prices, determine fair and reasonable prices, obtain cost or pricing data, nor analyze proposed costs. Instead, contract costs are determined by the M&O contractors, who then submit this information to DOE as the basis for the Department's annual budget process. This process reflects DOE's historical long-term relationship with its M&O contractors and not the typical arm's-length relationship between buyers and sellers.

As part of the budget process, M&O contractors prepare their own budget requests for the upcoming fiscal year in accordance with DOE's policy. The budget requests are reviewed by DOE personnel in accordance with DOE's budget formulation process. M&O contract funding is then determined by the amount of funds appropriated by the Congress and the amount of funds that DOE obligates to the M&O contracts.

DOE is including various different cost reduction and cost incentive clauses in its contracts as a contract reform. However, as discussed in the two case studies below, DOE's process did not provide its contracting officers with the needed direction to price their incentive contracts.

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## Case Studies Show the Effect of No M&O Guidance

As DOE begins to implement contract reform and adopt cost incentive contracts the need for cost guidance becomes important. Therefore we reviewed DOE's two incentive contracts used under contract reform to determine the possible impact of the absence of guidance for price negotiations. One of these contracts included both a fixed-price-incentive provision and cost-plus-incentive provision and the other contract included only a cost-plus-incentive provision. The experiences of DOE's contracting officers at the Oak Ridge Facility and the Waste Isolation Pilot Plant, who used these contracts, demonstrates how contracting officers developed cost incentives in the absence of procedures.

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### Oak Ridge Facility Contract

The Oak Ridge Facility Contract involves work for DOE's national security and the environmental management and uranium enrichment facilities programs at Oak Ridge, Tennessee; Paducah, Kentucky; and Piketon, Ohio. The contract is structured as a cost-plus-award-fee contract and it includes a base fee. The award fee includes three parts: (1) performance fee, (2) cost reduction fee, and (3) remaining award fee. In addition, the contract established a cost-plus-incentive-fee arrangement for performing work assigned for specific task orders.

We reviewed Oak Ridge's efforts at negotiating a cost-plus-incentive-fee arrangement on one of the task orders that included this incentive arrangement. We selected the first task order negotiated under the contract—for a demolition project—because it had a large dollar value and the work performed on the task order was nearing completion. As of March 31, 1996, DOE had issued 17 task orders estimated to cost \$144 million under the contract with a total available fee of \$13 million for these task orders.

Table 5.1 shows the amounts negotiated between the contracting officer and the M&O contractor for the one task order and the amount that DOE expects the completed work will actually cost.

**Table 5.1: Negotiated and Expected Contract Cost for the Powerhouse Demolition Task Order**

Negotiated and actual costs and fees	Cost-plus-incentive fee
Negotiated costs and fees:	
Target cost	\$18,700,000 to \$19,700,000
Target fee	935,000
Incentive fee	654,500
<b>Negotiated cost and fee</b>	<b>\$20,289,500 to \$21,289,500</b>
Expected actual costs and fees:	
Actual cost	\$14,809,000
Expected target fee earned	935,000
Expected incentive fee earned	654,500
<b>Expected total cost and fee</b>	<b>\$16,398,500</b>

Source: GAO's analysis of DOE's contract data.

On the surface, the task order pricing arrangement appears to have been successful. However, as explained below, the contractor received the incentive because DOE accepted the contractor's unsubstantiated target costs (which were significantly higher than actual costs) as part of the contract.

A major cost element of the task order was the M&O contractor's proposed subcontract cost, which the contractor estimated at \$10.9 million without obtaining actual bids from any subcontractors. Although DOE's contracting officer requested a technical analysis of the estimated subcontract costs from an independent engineering firm, the contracting officer did not require the contractor to support its subcontract cost estimate with actual bids from prospective subcontractors. The engineering firm advised the contracting officer that the subcontract should cost about \$4.9 million. However, the contracting officer did not use the engineering firm's advice because the project manager believed that the engineering firm's estimates were too low. The task order's target cost was then negotiated with a final subcontract amount of \$10 million.

After the cost and fees were agreed to on the task order, the M&O contractor obtained competitive bids for the subcontract work that were much less than the negotiated amount. According to the contracting officer and the project manager, the winning bid was about \$3.5 million—or about \$6.5 million below the task order cost of \$10 million. Under the incentive agreement, the M&O contractor will receive a target fee of \$935,000 if the project cost comes within the target

range of \$18.7 million to \$19.7 million and could earn an additional incentive fee of up to \$654,500 for underrunning the target cost to as low as \$17 million. Additionally, the incentive fee was based on a sharing ratio in which the contractor receives 40 percent of the cost underrun. For example, if the target cost was underrun by \$1 million, the contractor would receive 40 percent of the underrun, or \$400,000. Since the total potential incentive was limited to \$654,500, the contractor is limited to that amount even though its costs were expected to be much lower than the \$18.7 million to \$19.7 million target. On this task order, the M&O contractor earned the entire incentive fee simply by obtaining competitive subcontract bids and not through any effort associated with the work.

DOE's Oak Ridge officials acknowledged the problem that this situation created and to counter it, adopted a "capping" policy on fee amounts that could be paid to the M&O contractor for cost reductions resulting from subcontract costs that are lower than the negotiated cost. The capping policy limits the fee amount that the contractor can receive to a prenegotiated amount. Although this policy limits the incentive fee that the M&O contractor can earn by shopping for bids after task order prices are negotiated, it is only a partial solution. We believe that additional guidance is needed.

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## Waste Isolation Pilot Plant

The Waste Isolation Pilot Plant contract is for a repository for the disposal of transuranic wastes resulting from defense activities and programs. The contract is a multiple incentive contract including both a fixed-price-incentive and a cost-plus-award fee that acts much like a cost-plus-incentive to control contract costs.<sup>20</sup> In addition to the cost incentives, this contract also included performance incentives.

In pricing the contract, the contracting officer started with the M&O contractor's budget request for fiscal year 1995. The budget request had been reviewed and approved by DOE during the budget process. In addition, the contracting officer requested that DOE specialists evaluate the budget amounts. After the budget request was approved by DOE, the M&O contractor identified two work items that could be performed at less cost by a subcontractor. These new amounts were then negotiated into the contract and represented a decrease from the amount that had been submitted in the budget request and earlier approved by DOE. Although not

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<sup>20</sup>The cost-plus-award-fee part of the contract included incentives and disincentives for cost control with a sharing formula for cost underruns and overruns. Although, DOE called this a cost-plus-award-fee contract, because of the cost incentive features, it effectively worked like a cost-plus-incentive-fee contract.

required by DOE's M&O procurement regulations, the contracting officer obtained a certificate of current cost or pricing data from the contractor in accordance with the FAR because she did not believe that the DOE M&O procurement regulations were adequate for contract pricing of incentive contracts. Table 5.2 shows the negotiated costs for the incentive parts of the contract, the actual costs incurred, and the fees earned.

**Table 5.2: Pricing and Actual Costs on Incentive Parts of Waste Isolation Pilot Plant Contract for Fiscal Year 1995**

<b>Negotiated and actual costs</b>	<b>Fixed-price-incentive fee</b>	<b>Cost-plus-award fee</b>
Negotiated costs:		
Target cost	\$41,024,000	\$28,569,000
Negotiated target profit or base fee	0	1,277,000
Negotiated performance incentive or award fee	4,000,000	1,915,500
Cost incentives	40 percent of cost underruns and 60 percent of cost overruns up to 110 percent of the target and 100 percent thereafter	40 percent of cost underruns limited to the amount of unearned award fee and 40 percent of overruns limited to the amount of the earned award fee
<b>Negotiated costs, fees, and profit</b>	<b>\$45,024,000</b>	<b>\$31,751,500</b>
Actual costs:		
Costs	\$39,191,735	\$21,478,432
Target profit or base fee earned	0	1,277,000
Performance incentives or award fee earned	4,000,000	620,622
Cost reduction incentives earned	732,906	1,294,878
<b>Costs, fees, and profits earned</b>	<b>\$43,924,641</b>	<b>\$24,670,932</b>

Source: GAO's analysis of DOE's contract data.

The contracting officer believed that the cost incentive provision served as the catalyst for the substantial cost reduction under the cost-plus-award-fee part of the contract. Although we did not evaluate the incurred costs to determine the reasons for the reduction in cost, both the contractor and the contracting officer said that the contractor's efficiencies and improved performance contributed to the reduction in the estimated cost of the work.

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For the fiscal year 1996 price negotiations, the contracting officer went a step further toward the FAR requirements, again on her own initiative, by (1) requesting that the contractor submit cost or pricing data and (2) analyzing the contractor's documentation that supported about 48 percent of the proposed costs for the contract.

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## DOE Acknowledges Weaknesses With Its Contract Pricing Regulations

We discussed our findings regarding DOE's incentives under these two contracts with the Deputy Assistant Secretary for Procurement and Assistance Management, the Director of the Contract Reform Project Office, and the Deputy Associate Deputy Secretary for Field Management. They acknowledged that DOE's regulations are inadequate for the pricing of contracts and the use of incentives tied to the contract pricing. Specifically, they noted that the basic problem is that DOE's M&O costs are budget based and not cost based. They explained that incentives should not be based on the budgeted amounts but should be based on negotiated contract costs.

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## Conclusions

Under contract reform, DOE planned to increase the use of incentive contracts. However, in the absence of M&O procurement regulations governing the negotiation of contract prices, DOE's ability to control costs under this type of contract is limited. When the FAR was used, DOE was able to reduce its contract costs.

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## Recommendations

To continue DOE's reforms that are aimed at placing more cost risk on its contractors through the use of cost incentives and in a further effort to bring M&O contracting into the mainstream of federal contracting, we recommend that the Secretary of Energy adopt federal contract pricing policies such as those contained in the FAR.

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## Agency Comments and Our Evaluation

DOE agrees with our recommendation regarding the inclusion of cost incentives based on those included in the FAR. Furthermore, DOE has a draft fee policy that contains a requirement that contracts (cost plus incentive fee, fixed price incentive fee, and firm fixed price) in the future will be developed pursuant to FAR Part 16. However, FAR Subpart 15.8 provides specific guidance on the analysis of prices and costs and the documentation of price negotiations. DOE's draft policy should include provisions from this part of the FAR that are appropriate for the pricing of M&O contracts.

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DOE also believes that our discussion of cost incentives is limited by the number of contracts that we reviewed. However, our primary purpose was to determine the impact of the lack of DOE regulations on how to set these incentives. We looked at two contracts because one case demonstrated the benefits of applying the FAR to this process and the other case showed the impact of not having a regulation.

In addition, DOE's comments questioned our reference to Oak Ridge's capping policy on fee amounts. DOE officials acknowledged problems with cost incentives at Oak Ridge and adopted a capping policy to limit the fees that could be earned and to provide a check on potential errors in estimating unique projects. Although this policy may have some benefits, it does not fully resolve the identified contract pricing problems.

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# Status of 48 Contract Reform Recommendations

Recommendation number and action	End product	Completion date		Addressed report requirements <sup>a</sup>
		Deadline	Actual	
<b>Selecting alternatives to traditional cost-reimbursement contracts</b>				
1, 2, and 17. Review work requirements of current M&O contracts and identify discrete tasks that may be acquired through fixed-price contracts and subcontracts.	<p>Site-by-site assessment of work requirements that identifies the supplies or services that may be obtained by other than a cost reimbursement contract.<sup>b</sup></p> <p>A plan for each site to increase its use of fixed-price contracts and subcontracts for tasks that can be acquired on a fixed price. The plan must include a schedule and the identification of pilot sites and must address workforce displacements.<sup>b</sup></p> <p>A plan to test the effectiveness of using fixed-price contracts and subcontracts and acquiring selected goods and services on a "least cost" basis.<sup>b</sup></p>	3/31/95 <sup>c</sup>	3/8/96	Yes
3, 4, 5, 6, 8, and 14. Develop performance criteria and measures and corresponding incentive mechanisms for defense programs, environmental restoration and waste management programs, applied technology programs, environmental safety and health requirements, and business management requirements.	<p>Matrices of performance criteria and measures and incentives for both for profit and nonprofit entities, and an integrated plan to implement these mechanisms in existing M&amp;O contracts and future Performance-Based-Management contracts.<sup>b</sup></p>	9/30/94 <sup>c</sup>	3/31/95	Yes
7. Train DOE program personnel in performance-based contracting.	Plan for training personnel in performance-based contracting	6/1/94 <sup>c</sup>	4/25/96	Yes
9. Establish an appropriate management fee policy for nonprofits.	Establish revised fee policy, identify pilot solicitation(s), and contract to validate. <sup>b</sup>	12/1/94 <sup>c</sup>	6/24/96	No (fee policy not revised)
10. Establish compensation incentives for senior nonprofit laboratory personnel.	Performance-based incentive compensation policy for senior laboratory personnel.	1/31/95 <sup>c</sup>	12/1/95	Yes
11. Develop a DOE-wide incentive program for the contractor cost-reduction/cost-avoidance programs.	Policy guidelines and implementation plan that include identification of pilot contract(s). <sup>b</sup>	9/1/94	2/22/95	Yes

(continued)

**Appendix I  
Status of 48 Contract Reform  
Recommendations**

Recommendation number and action	End product	Completion date		Addressed report requirements <sup>a</sup>
		Deadline	Actual	
12. Use cost-sharing arrangements in performance-based management contracts.	Policy that requires solicitation of cost-sharing arrangements in the selection process for new contractors; identification of pilot solicitation(s). <sup>b</sup>	9/1/94	11/22/95	Yes
13. Use multiple-fee arrangements in performance-based management contracts.	Policy guidelines on the use of multiple-fee arrangements.	9/1/94	5/27/95	No (multiple fee policy guidelines not officially established)
<b>Making cost-effective “make-or-buy” decisions</b>				
15. Obtain quality performance at the least cost, consistent with departmentally approved program-specific factors.	Policy and program-specific criteria regarding DOE’s “make or buy” decisions; identification of pilot sites. <sup>b</sup>	9/30/94 <sup>c</sup>	1/27/95	Yes
16. Require management contractors to prepare “make-or-buy” plans.	Contractual requirements and associated incentives for an annual “make-or-buy” plan.	11/15/94 <sup>c</sup>	6/24/96	No (associated incentives not in proposed rulemaking)
<b>Increasing competition to improve performance</b>				
18. Except in unusual circumstances, automatically award management contracts competitively after no more than one extension.	DOE policy emphasizing competition.	8/1/94	6/24/96	Yes
19. Negotiate the terms of the extended contract before making the extend decision, and make the decision-making process open to public scrutiny.	Revised extend/competitive award policy.	8/1/94	6/24/96	Yes
20. Develop evaluation and selection criteria that increase competition.	Guidelines that will increase competition.	9/30/94 <sup>c</sup>	5/16/96	Yes
<b>Streamlining the procurement process</b>				
21. Create a Procurement System Improvement Task Force to streamline DOE’s procurement process.	Report and recommendations to increase the speed, quality, and competitiveness of DOE’s procurements.	12/31/94	11/22/95	Yes
<b>Reducing the use of contracts for support services</b>				
22. Identify DOE support services that can be cost-effectively performed by federal employees.	Plan to reduce program costs and improve program management by converting contractor positions to federal positions over the next 3 years.	8/1/94	1/27/95	Yes

(continued)

**Appendix I  
Status of 48 Contract Reform  
Recommendations**

Recommendation number and action	End product	Completion date		Addressed report requirements <sup>a</sup>
		Deadline	Actual	
23. Reduce support service contracting by at least 10 percent in fiscal years 1995-97.	Plans for reducing support service contracting in fiscal years 1995-97.	8/1/94	6/1/95	Yes
24. Implement performance-based contracting methods for support service contracts.	Plan for conversion to performance-based support service contracts.	7/15/94 <sup>c</sup>	1/27/95	No (conversion plan not completed)
<b>Strengthening financial and accounting systems</b>				
25. Improve DOE's financial management information system.	Develop plan for revised financial information systems. <sup>b</sup>	12/31/94 <sup>c</sup>	Open	Incomplete (action still in review process)
26. Ensure that the Office of Inspector General's audit goals place high priority on reviews and evaluations of contractors' financial management systems.	Revised audit plans that reflect the new priorities of the Department.	12/31/94	1/27/95	Yes
27. Develop departmentwide guidelines for coordination of contractor oversight programs.	Guidelines for coordination of contractor oversight.	12/1/94	9/29/95	Yes
28. Explore the use of alternatives to the voucher accounting for net expenditures accrued.	Report and recommendations on alternatives.	12/31/94	12/1/95	No (report does not address specific goal for action alternatives not provided)
29. Evaluate increasing departmental capability for review and audit of contracts and contractors.	Report on evaluation and recommendations for alternatives.	2/1/95	1/27/95	No (alternatives not provided)
30. Provide the Defense Contract Audit Agency with the funding needed to eliminate audit backlog.	Report on costs and benefits of obtaining additional resources and recommendations on alternatives.	9/30/94	1/27/95	No (cost-benefit analysis not performed viable alternatives not provided)
31. Train DOE managers to use integrated financial and managerial reporting systems effectively.	Training program and implementation plan.	12/1/94	7/17/96	Yes

(continued)

**Appendix I  
Status of 48 Contract Reform  
Recommendations**

Recommendation number and action	End product	Completion date		Addressed report requirements <sup>a</sup>
		Deadline	Actual	
<b>Improving the management of particular categories of costs and cost controls</b>				
32. Initiate departmentwide benchmarking of various indirect-cost categories against the "best in class" of public and private businesses and initiate planning for specific goals for reducing indirect costs.	Report on specific goals and benchmarks and implementation plan.	5/1/95 <sup>c</sup>	12/1/95	No (specific goals, benchmarks, and implementation plan not completed)
33. Establish effective contract performance measures for real and personal property management and accountability.	A matrix of generic and specific performance criteria and measures.	8/1/94 <sup>c</sup>	2/22/95	Yes
34. Manage contractors' maintenance costs more effectively.	System to track maintenance costs.	7/1/95	7/17/96	Yes
35. Develop a departmentwide policy on pension fund management and oversight.	Policy for managing and overseeing pension funds.	7/1/94	4/12/96	Yes
36. Develop departmental policy on claims adjustment and evaluation of contractor risk management.	Policy for insurance risk management.	12/1/94	4/12/96	Yes
37. Implement improved overtime policy.	Policy on use of contractor overtime.	9/1/94 <sup>c</sup>	2/22/95	Yes
38. Conduct two reviews of uncosted balances each year.	Report on uncosted balances twice a year.	11/1/94	1/27/95	Yes
39. Reexamine the need for advanced funding through special bank accounts.	Report recommending improvements and/or changes and alternatives. <sup>b</sup>	10/1/94	7/19/96	Yes
<b>Modifying and improving cost-reimbursement policies</b>				
40. Revise the Department of Energy Acquisition Regulation provisions on fines and penalties, third-party liabilities, and related matters.	Notice of proposed rulemaking.	9/1/94	6/24/96	Yes
41. Apply comparable reimbursement rules to nonprofit contractors.	Notice of proposed rulemaking.	9/1/94	6/24/96	Yes
42. Develop guidance on determining the "reasonableness" of contractors' costs.	Guidelines on "reasonableness."	1/31/95	1/27/95	Yes

(continued)

**Appendix I  
Status of 48 Contract Reform  
Recommendations**

Recommendation number and action	End product	Completion date		Addressed report requirements <sup>a</sup>
		Deadline	Actual	
43. Develop and implement a contractor indemnification scheme for response action contractors consistent with the principles of section 119 of CERCLA.	Notice of proposed rulemaking.	12/1/94	6/24/96	Yes
<b>Reducing cost of contractor litigation</b>				
44. Issue uniform guidance on the review and oversight of contractor litigation.	Guidelines on procedures for litigation management.	3/31/94	1/27/95	Yes
45. Institute training in litigation management techniques.	Identification of training programs and establishment of round table discussion format for Chief Counsel meetings.	3/31/94	1/27/95	Yes
46. Select one or two large pilot cases for immediate implementation of cost-reduction techniques.	Report on pilot projects, including recommendations for cost reductions.	7/1/94	1/27/95	Yes
47. Develop an explicit policy concerning the allowability of defense costs in "whistleblower" cases.	Option paper on allowability of defense costs in "whistleblower" cases. <sup>b</sup>	5/15/94 <sup>c</sup>	6/24/96	Yes
<b>Diversity</b>				
48. Develop contract evaluation and selection criteria and related strategies that promote and facilitate economic diversity through the participation of small, small disadvantaged, and women-owned business participation in DOE contracts.	Evaluation and selection strategies and criteria with guidelines for their use; and identification of necessary training requirements and pilot applications.	10/31/94	2/13/95	No (training requirement and pilot application not completed)

Legend

CERCLA = Comprehensive Environmental Response, Compensation and Liability Act

DOE = Department of Energy

M&O = management and operating

<sup>a</sup>Making Contracting Work Better and Cost Less, Report of the Contract Reform Team (DOE/S-0107, Feb. 1994).

<sup>b</sup>The original end product was modified by the Executive Committee.

<sup>c</sup>The original deadline was modified by the Executive Committee.

Source: DOE's Contract Reform Project Office and GAO Analysis.

# Comments From the Department of Energy

Note: GAO comments supplementing those in the report text appear at the end of this appendix.



## Department of Energy

Washington, DC 20585

November 12, 1996

Mr. Victor Rezendes, Director  
Energy, Resources, and Science Issues  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Rezendes:

Thank you for the opportunity to comment on GAO's report entitled Department of Energy: Contract Reform is Progressing But Full Implementation Will Take Years (GAO/RCED-97-18).

As we discussed with you in our meeting on November 6, 1996, contract reform is one of the most significant Departmental initiatives, and the advice and evaluation by the GAO is of extreme interest to us. Therefore, we welcome the opportunity to provide additional information concerning the Department's accomplishments in contract reform as well as clarifying other aspects of our initiative to provide a more complete view of the Department's efforts.

It is important to note that the Department moved out aggressively and did not wait until the somewhat protracted guidance and rulemaking process was completed to implement the basic elements of contract reform. As you will observe from our comments, the Department in almost every instance proceeded to implement the necessary changes in its new contracts before action items were closed. We felt that this was necessary because, in some cases, failure to incorporate the changes in these new contracts could have delayed implementation of contract reform changes for up to an additional five years.

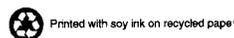
The attached response includes summary comments as well as a more detailed response to specific statements in the draft report. Again, we thank you for the opportunity to meet with you and your staff, and to provide these comments.

Sincerely,

A handwritten signature in cursive script, reading "Jerry L. Bellows".

Jerry L. Bellows  
Director, Contract Reform Project Office

Attachment



**SUMMARY COMMENTS ON THE  
OCTOBER 30, 1996 DRAFT GAO REPORT ON CONTRACT REFORM**

**General**

Many past General Accounting Office (GAO) reviews of the Department of Energy's (DOE) contracting practices have provided valuable critical analysis, and in fact, these reports were a major impetus for DOE's 1994 contract reform initiative. (See Appendix C of the February 1994 Report of DOE's Contract Reform Team) However, with respect to the October 30 draft report, we are concerned about factual inaccuracies and other limitations, which, if not corrected, will limit the report's value to Congress and this Department.

See comment 1.

First, the draft report does not place the contract reform initiative in historical perspective. It does not capture how the DOE has addressed GAO's past criticisms (either successfully or unsuccessfully) and where the Department needs to improve its contract reform implementation. In addition, the draft report does not take into account the evolutionary nature of reform and DOE's efforts to improve its reform efforts over a period of years as it built on lessons learned.

See comment 2.

Second, the draft report purports to provide a comprehensive overview of the DOE's contract reform initiatives since 1994 by focusing on the implementation of the recommendations of the Contract Reform Team's report. However, the draft report has a persistent focus on administrative outputs, such as guidance, and fails to focus on the concrete results of reform in making contracting work better and cost less. The full flavor of the DOE's reform efforts -- both achievements and remaining challenges -- is lost in the draft report's focus on limited, quantitative measures of accomplishment, as delineated by the Contract Reform Team's Report.

Of the eleven elements of contract reform, the report only looks at one element -- competition -- in any in-depth way. Seven of the elements of contract reform -- increased use of fixed price contracting; improved financial management; greater financial accountability; increased use of FAR-based cost principles; results-oriented statements of work; protection of workers, the public, and the environment; and increased diversity -- are not discussed at all, except for a quantitative summary of the number of action items implemented. Many of these contract reform elements addressed concerns expressed in previous GAO reports. Thus, we believe that the report fails to recognize significant and substantive accomplishments in these important areas during the past three years. For example:

See comment 3.

- By the end of 1996, 21 of the Department's M&O contracts will be performance-based management contracts, each with the full range of contract reform provisions.
- There is evidence that contractor performance has measurably improved, and that performance objectives, measures, and incentives were important in achieving the

improved results. For example, the contract at Pinellas will be closed out ahead of schedule. At the INEL Advanced Test Reactor, there have been no unplanned outages for a year; efficiency is the highest in the history of the reactor; operating costs are the lowest since 1991; and personnel radiation exposure is the lowest ever.

- Large privatization initiatives have been launched at Hanford and Idaho.
- Contractors are assuming greater financial accountability for their performance. For example, as new contracts have been negotiated, they now have imposed increased risk on contractors for fines and penalties, damage to or loss of government property, third party liabilities (including “whistle blower” actions) and qui tam actions under the False Claims Act.
- Extensive rulemaking is underway to codify contract reform.
- New policies have been issued, e.g., elimination of the “federal norm.”
- Uniform procedures to manage and reduce the cost of litigation are in widespread use.
- Preliminary results suggest that implementation of the revised “make-or-buy” policy has significantly increased the volume of subcontracts, the preponderance of which are competitive and fixed-price. For example, fixed price subcontracting at the Waste Isolation Pilot Plant has increased 65 percent.
- There is evidence that reduction of DOE Orders has decreased costs. For example, a pilot program on seven orders in the area of Life Cycle Asset Management indicates decreased costs of \$114 million.
- Significant actions have been taken to improve environment, safety, and health performance through contract reform mechanisms. For example, a number of the standard and special contract clauses have been modified as a direct result of the contract reform initiative. The contract for operations at Savannah River includes several new clauses, including one requiring integration of ES&H into all aspects of work, and (like Hanford) a “killer clause” that puts the entire fee at risk in the event of a fatality or serious injury. The same is true for the Nevada and Oak Ridge contracts. Changes also have been made in the non-profit contracts to improve accountability for E,S&H, even where fee is not at risk. These changes reflect a fundamental shift in the relationship between DOE and its contractors and provide important mechanisms to enhance protection of worker health and safety and the environment.

Appendix II  
Comments From the Department of Energy

See comment 4.

Three additional elements of contract reform -- performance measures, performance-based incentives, and cost reduction -- are discussed in the draft GAO report but this discussion is limited. In the area of performance goals, the report looked at only four of the thirteen contracts negotiated under the Department's contract reform initiative -- the contracts for the Rocky Flats Environmental Technology Site, the Nevada Operations Office's Support, the Argonne National Laboratory, and the Thomas Jefferson National Accelerator Facility. We believe that a wider sample is necessary to fairly assess the Department's efforts in these areas.

In addition, the draft report only evaluates one aspect of the implementation of performance goals in DOE contracts -- whether the performance goals in the contracts incorporate goals identified in DOE's strategic plan and annual performance measures. This limited measure does not provide any analysis of cost or technical performance resulting from DOE's new way of doing business.

Most significant is the fact that even in this limited area analyzing the relationship between contract performance goals and strategic goals, the draft report does not discuss DOE's recent Project Hanford Management Contract. This new contract, which was awarded on August 6, built on lessons learned during the past three years of contract reform, and it has been recognized by Office of Management and Budget officials as a major step forward in performance-based contracting at the DOE. We offer the Hanford contract as an important example of DOE's efforts to link programmatic and site strategic goals to contract performance goals.

See comment 5.

The draft report's discussion of performance-based incentives is also limited. It only assesses two of the thirteen contracts negotiated by the Department under the contract reform initiative -- the Oak Ridge two-year extension and the Waste Isolation Pilot Project. Moreover, the draft report only evaluates one aspect of performance-based incentives -- the implementation of cost incentives in incentive contracts. The report does not recognize the numerous examples of new and innovative performance-based incentives incorporated into DOE contracts during the past three years.

See comment 6.

Third, the draft report references numerous examples to support negative findings but presents few examples to support the many positive findings of the draft. For example, the report concludes that 39 of the 48 actions items have been fully implemented but it does not indicate the positive examples or results associated with those 39 action items. Rather, the report only provides examples of the 9 action items that were not fully implemented, in the judgment of the GAO.

See comment 7.

Finally, the draft report contains some conclusions without sufficient justification, based on your sampling data. For example, the report concludes that "although it is too soon to assess the overall effectiveness of the reform actions in achieving DOE's contract reform goals, early indications suggest that delays, limited available resources, and overly broad guidance may inhibit

implementation.” The preliminary results of the Department’s own self-assessment provide evidence that substantial implementation of contract reform is occurring throughout the DOE complex (although improvements certainly need to be made based on “lessons learned.”)

**Chapter 2**

This chapter assumes that the 1994 Contract Reform Team’s report constitutes the full scope of the Department’s Contract Reform Initiative. It does not recognize that the Team’s report and its 48 action items were just the beginning of a process that has developed and is continuing to evolve. While the 48 action items were significant in the initiation and development of contract reform in the Department, they do not provide the total “framework” for reform. As the GAO stated in its March 1994 Report (Challenges to Implementing Contract Reform), “The challenge facing DOE’s leadership will be developing a strategy for implementing these reforms so that real change takes place.”

Consistent with the GAO’s recommendation, the Department has established a broad strategy and framework for contract reform during the past three years. This strategy has included:

- Establishing a culture in which the Department’s business is characterized by receptivity and responsiveness to new contracting approaches and structures, encouragement of new partners and new ideas, willingness to replace outmoded and burdensome practices, and a climate of experimentation and innovation;
- Defining and communicating to the Department and its contractors what is meant by “the full range of contract reform” by delineating the eleven elements of contract reform and developing model contract provisions as a guide to assist contracting officers.
- Developing and issuing new policies, procedures, and regulations;
- Experimenting with new contracting strategies, such as the management and integration approach and teaming arrangements;
- Utilizing privatization as a tool to achieve the Department’s goals;
- Enhancing contract reform training and education;
- Establishing institutional mechanisms to ensure implementation of contract reform (i.e., the Contract Reform Executive Committee, Contract Reform Project Office, Special Contract Reform Review Board);

See comment 8.

- Providing ongoing “lessons learned” within the Department to ensure continuous improvement; and
- Instituting major changes in contractor oversight and contract administration.

We believe that the draft report neither recognizes the above strategy nor addresses the Department’s progress in implementing the strategy.

In addition, we have a number of specific concerns and comments with respect to the conclusions reached in Chapter 2 concerning the 48 action items. First, while we agree that there was not always an exact match between the deliverables specified in the Contract Reform Team Report and the deliverables accepted by the Department, we believe that it was necessary to recognize changing circumstances and, in some cases, a better understanding of the problem at hand. Second, the draft report equates the administrative closure of the action items with actual progress or lack of progress on contract reform. Third, the draft report does not address what the Department has done to make each recommendation of the Contract Reform Team a reality. Attached are: (1) specific comments relating to the completion and tracking of the 48 action items, and (2) detailed comments relating to particular findings and conclusions in Chapter 2. (See Attachment A)

### **Chapter 3**

The GAO’s conclusions on competition reflect a misunderstanding of the Contract Reform Team’s recommendations, the implementing policy, and actual practice. Accordingly, the draft report chapter on competition contains significant inaccuracies which should be corrected before the report is released.

First, the draft report is incorrect in concluding that the Department failed to follow the recommendations of the Contract Reform Team Report (p. 38) in the handling of the conditional extensions for the contracts for Lawrence Livermore (Livermore), Lawrence Berkeley (Berkeley), and Los Alamos National Laboratories (Los Alamos). Under the DOE’s competition policy, a decision by the head of the Department to seek a noncompetitive extension must occur prior to the commencement of any negotiations. Absent that decision, the Department would lack a legal and regulatory basis for entering into negotiations on a noncompetitive basis with any offeror. Under the new policy, if, after a reasonable period of time, the parties are unable to reach agreement on the conditions of the contract extension, the Department would be expected to revisit its decision regarding noncompetitive extension.

Thus, in the case of the Livermore, Berkeley, and Los Alamos contracts, the draft report has confused the Department’s authorization to its negotiators to seek an extension, which is conditioned on the successful achievement of the negotiation objectives, with a final extend

See comment 9.

See comment 10.

Now on p. 28.

decision. In fact, the essence of the Secretary's decision memorandum regarding the UC contracts was its clear message that the extension was conditioned on the incorporation of contract reform provisions and the achievement of other negotiation objectives in areas such as environment, safety and health, environmental management, and community development.

Second, the GAO's reliance on an analysis of "the numbers" to assess the impact of DOE's new competition approach neglects real changes in both the culture and practices of the Department. The thrust of the contract reform recommendations was a recognition that the Department's past policies created a bias toward noncompetitive extensions of management and operating contracts and a burden to prove that competition would result in meaningful improvements in contract performance. The Contract Reform Team report recognized the need to replace that policy with a policy that established competition as the norm.

However, the recommendations of the Contract Reform Team did not envision that every contract would be competed. In cases where a noncompetitive extension is sought, the new policy creates an onus to prove that the noncompetitive extension is in the best interests of the Government under Government-wide authorities provided under the Competition in Contracting Act. Accordingly, in all cases where noncompetitive extensions have been sought, the Department subjected each decision to a rigorous examination of the facts and circumstances.

In any case, the report does not make clear that DOE's commitment to consider competition first (as opposed to the past practice of considering competition in exceptional circumstances), has had a variety of positive effects. For instance, prior to the contract reform initiative, the Department had conducted only 21 competitions for the management and operation of major Departmental sites and facilities since the inception of the Atomic Energy Commission (in the 1952 to 1953 time frame). Since 1994, there have been 7 decisions to compete management and operating (M&O) contracts (with an approximate value of \$21 billion) compared to only 3 decisions over the previous 10 years (with an approximate value of \$9.8 billion).

Even in those instances where extension was justified and supported based upon the statutory exceptions contained in the Competition in Contracting Act, the specter of competition increased the contractor's commitment to innovation and cost reduction. All DOE decisions to seek extensions were conditional extensions, and in all cases, the conditions imposed included the incorporation of the full range of contract reform into the extended contract before the extension was finally granted. In every case, this changed the basis of negotiation. Rather than using the existing contract as the basis for negotiation, the Department developed administrative mechanisms to ensure that contract reform terms and conditions were the basis for negotiation. The net effect of this strategy was an extension of the existing relationship, not an extension of the existing contract.

In addition, during the past three years, the Department has achieved a substantial increase in competitively awarded work that traditionally had fallen within the purview of management and

operating contractors. DOE also has accomplished several large-scale privatizations, thereby achieving greater competition in its contracting. (See the August 2, 1996 GAO report on the Hanford Tank Waste Privatization effort) The result is that DOE's shift in its competition policy has had the effect of subjecting noncompetitive decisions to a more disciplined analytical process, rather than the routine, pro-forma, decisions of the past.

Third, the GAO inaccurately concludes that the Department did not implement its competition policy until August 26, 1996. Although the GAO acknowledges that the Department took measures to effect change prior to the August 26, 1996 effective date of DOE's new regulation, the report indicates in several places that implementation of the policy did not occur until that date. (i.e., pp. 35, 59)

The Secretary of Energy's decisions, as reflected in her July 5, 1994 decision memorandum, to compete or noncompetitively extend certain management and operating contracts represented an aggressive effort to promptly implement the competition recommendations of the Contract Reform Team Report. At the time, the Department was faced with a significant number of decisions regarding the competition or extension of its management and operating contracts. The Department realized the urgency to take advantage of the narrow window of opportunity to apply the new policy to these immediate situations. In arriving at decisions to either compete or extend these contracts, there also was an underlying recognition that the Department had limited resources which it could deploy to conduct meaningful competitions, and, equally as important, that there were limitations in the marketplace regarding the extent to which potential competitors would be willing and able to participate in a large number of concurrently run competitions.

Moreover, on September 28, 1994, the Department issued Acquisition Letter 94-14 to implement the Contract Reform Team's competition recommendation. This Acquisition Letter established the policy of using full and open competition in the award of management and operating contracts, except in unusual circumstances and only when approved by the Secretary. Through the issuance of the Acquisition Letter, the Department effectively and formally superseded its previous regulatory policies that favored long-term, noncompetitive extensions of its management and operating contracts and implemented a policy that established competition as the norm. Accordingly, the competition policy effected by formal rulemaking on August 26, 1996 merely represents the culmination of these interim actions and is not the "first step" by the Department to effect the competition recommendations of the Contract Reform Team Report.

In conclusion, we believe that the GAO report does not adequately acknowledge the impact of the new competition policy. The DOE's commitment to consider competition first, as opposed to the past practice of routinely extending contracts with incumbent contractors, has had positive effects that are not appropriately recognized in the report.

**Chapter 4**

The Department generally agrees with the GAO regarding its conclusions that (1) performance goals set out in management and operating contract be aligned with the Department's strategic goals and (2) that contract terms and conditions should permit DOE the necessary authority to establish appropriate performance measures and incentives. Nonetheless, we are concerned because your review appears to have centered on establishing direct linkages from the strategic goals to the contract without considering subordinate documents developed by the Department's program offices that implement strategic plan objectives.

In this regard, your review of four M&O contracts did not evaluate the long-range programmatic performance goals, which are integral parts of the flowdown from the Department's goals to the specific site and contract goals. We believe that a good example of this flowdown can be found in the recently awarded Project Hanford Management Contract. This contract links the contract's performance goals with the Environmental Management (EM) strategic goals and the Hanford Site's strategic goals. For your information, I have included the relevant Project Hanford contract sections and a matrix linking strategic goals to performance goals. (See Attachment B)

The important area of E,S&H highlights this flowdown of strategic goals. Both the Department's Strategic Plan and the performance agreement between the Secretary and the President contain specific language making safety performance a core value. The Environmental Management Strategic Plan further underscores that safety is a core value, and the Hanford contract itself formally includes these values in the contract.

On page 46 of your report, you recommend that "the goals written into the M&O contracts be clearly linked to DOE's strategic plan and annual performance goals." We agree with the concept that contract goals should be linked to strategic goals. However, your recommendation should be refined to include programmatic goals (i.e., Environmental Management, Defense Programs) and site strategic goals, and not simply focus on broad Department wide goals.

You also recommend that " a mandatory standard clause be included in all M&O contracts that gives DOE the exclusive authority to set contract goals and incentives that support the strategic plans and missions of the Department." We agree with this recommendation, and in fact, the Department's draft fee policy, which is expected to be released shortly, contains a standard clause which is consistent with your recommendation. The clause specifies that the contracting officer may unilaterally establish the amount of available fee and performance expectations if the DOE is not able to reach agreement with a contractor regarding the available fee and performance incentives for a specific performance period.

See comment 11.

Now on p. 38.

**Chapter 5**

The draft report recommends that the Secretary of Energy adopt policies on cost incentives based on those contained in the Federal Acquisition Regulation (FAR). We agree and believe that the Department's draft fee policy, which is in final preparation for rulemaking, addresses this recommendation. The draft fee policy contains a requirement that if cost plus incentive fee, fixed price incentive, or firm fixed price arrangements are entered into, they must be done pursuant to FAR Part 16 (as well as DEAR 915.6).

With respect to the Department's experience with cost incentive contracts at both Oak Ridge and the Waste Isolation Pilot Project, we learned various lessons in implementing these contracts that should lead to more effective implementation in future contracts. However, we believe that our efforts produced improved results in terms of cost-effectiveness and performance.

In addition, we question certain conclusions made in this chapter. For example, we are concerned about the comment in the draft report about the Oak Ridge contracts that contends that adopting a "capping" policy on fee amounts "is not a good solution because it continues to provide the contractor with incentive profits without improving cost control." (p. 53) The Department believe that "capping" is effective because it limits fees earned and provides a check on potential errors in estimating unique projects.

See comment 12.

Now on p. 43.

**ATTACHMENT A**

**DETAILED COMMENTS ON CHAPTER 2**

**Comments Relating to Completion and Tracking of the 48 Action Items**

In your section, **Completed Reform Actions Are Behind Schedule**, you note that 45 of 47 action items had substantially exceeded their deadlines. The completion date noted in your report was the date that the Executive Committee formally accepted the deliverables. As shown on the attached list (Attachment A-1), the action items were, for the most part, delivered to the Contract Reform Project Office (CRPO) on or very near the due date assigned to them. Therefore, the draft report's finding of significant delays in the completion of the action items is misleading. Furthermore, this misleading finding underpins the conclusion of the report that such "delays...may inhibit implementation."

Soon after issuance of the Contract Reform Team Report in February 1994, the entire Department began to mobilize to implement the action items, issue the deliverables and meet due dates shown in the report. Points of contact from each office listed in the report were named and personnel throughout the Department were recruited to staff the newly formed teams for each action item. However, the Department realized a number of things early on.

First, it was clear that it would not be effective to address each of the 48 action items independently in the time frames and by the organizations stated in the Contract Reform Team Report. It was readily apparent that:

- Some action items could be logically and appropriately grouped together in order to reach a more systematic and comprehensive Departmental position;
- More time would be required in order to meet some of the deliverables; and
- Offices other than those listed in the report could be more effective in organizing resources.

For instance, Action Items 3,4,5,6,8, and 14 (which dealt with performance measures to be incorporated into the new performance-based contracts) were grouped together and an extension was requested. Also, Action Items 1,2 and 17, which dealt with fixed price contracts and make/buy plans, were grouped together, and the deadline for Action Item 17 became the consolidated deadline. As part of this sorting process, it was mutually determined that the Office of Field Management was the more appropriate organization to organize both field and headquarters elements to meet the new requirements of these combined action items.

See comment 13.

Second, it was clear that the Department needed a closure process which would assure that the action item deliverable was complete, responsive to the specific requirements contained in the Contract Reform Team Report, and consistent with the overall goals of the Contract Reform Initiative. However, it was also evident that implementation of contract reform could not await full completion and closure of the action items. The closure process can be summarized as follows:

1. Once the action item teams submitted their deliverables to the CRPO, it was determined that they had met their obligation under the Contract Reform Team Report, and would be required to resolve the comments from the closure review process only. Upon receipt of the deliverable from the individual task teams, CRPO forwarded the deliverable to and requested comments from the:
  - Office of the Associate Deputy Secretary for Field Management (FM)
  - Office of General Counsel (GC)
  - Assistant Secretary for Human Resources and Administration (HR)
  - Other pertinent organizations
2. When CRPO received comments, it provided the forum for any needed resolution of issues with the responsible Action Item organization. After resolution of all issues, CRPO furnished copies of the deliverables to the Executive Committee for review and comment. If there was no objection by the Executive Committee members within two weeks of receipt of the deliverable, the deliverable was accepted and the Action Item was closed.

During the time that each deliverable was going through this closure process, interim guidance and mechanisms were established so that the recommendations of the action items could be implemented in newly competed and extended contracts. As stated above, the Department recognized that implementation needed to be initiated immediately. On July 5, 1994, the Secretary issued a decision memorandum in which she decided on extensions and competitions for 19 major contracts, stated that contract reform would be done throughout the Department, and said that henceforth, all major contracts would be performance-based.

The July 5 memorandum speeded up the pace of contract reform, and in many cases, it overtook the more formal and lengthy team process of originating and issuing an action item deliverable. During this period, interim policy, guidance, and model contract clauses were developed for non-profit and for-profit contracts and were utilized in the new contracts that were being competed and extended. In addition, training was conducted early in the process. For

example, while certain action items involving training were not formally closed until 1996, actual training was occurring in 1995. Thus, implementation occurred concurrently with the Departmental team process of preparing and issuing the action item deliverables.

In summary, the draft report's conclusion that delays in the closure of action items pushed successful implementation of the new policies far into the future is mistaken. As discussed above and elsewhere in our response, implementation of the contract reform initiative began immediately. It was given a high priority and profile within the Department. Several hundred DOE employees were involved in preparing action item deliverables, interim policies, guidance, training modules, and contract provisions which were reflected in the performance based management contracts that were negotiated and executed beginning with the summer of 1994.

Other Comments Relating to Specific Findings and Conclusions

1. On page 21, the GAO's draft report discusses the Reform Team recommendation that DOE establish a preference for its M&O contractors to subcontract various functions, such as laundry and cafeteria services, and that incentives be provided to contractors to encourage the subcontracting of such services. The main point made in this section is that DOE's proposed regulation did not include incentive provisions as recommended by the Reform Team. This is factually correct. However, as indicated to the GAO earlier, the Department fully evaluated and considered the recommendation, but does not believe its regulations should provide such incentives. We do not believe that the Department should be expected to follow through on a recommendation which, after fuller evaluation, it does not believe to be a sound business strategy. The Department's objective is to achieve effective business decisions which take into account programmatic and other considerations. A regulation which provides for incentives for subcontracting of services could, in many instances, defeat the Department's objective. Results should be incentivized, not the process.

Also, as with other portions of the draft report, no recognition is given to what the Department has achieved. No mention is made that: (1) the Department's proposed regulations include a revised make/buy policy; (2) the Department's model contract provisions include stronger make/buy requirements; or (3) the Department has outsourcing and privatization initiatives across the complex that are making the Contract Reform Team's recommendation a reality.

2. With respect to the Department's efforts to implement performance-based contracting methods for support services, the GAO draft report states that, "DOE did not develop an actual plan with targets and milestones for converting these possible support services as required by the Team." We agree that there is no single document "with targets and milestones."

Now on p. 18.

See comment 14.

See comment 15.

However, the Department has developed a structured approach for implementing performance-based contracting methods for support services, which meets the intent of the Contract Reform Team's recommendation. This approach is outlined in correspondence with the OMB over the last two years, and includes: (1) Departmental policy to use, to the maximum extent practicable, the full range of performance-based contracting concepts and methods in its contract requirements for services; (2) Departmental participation in OMB's pilot program for Performance-Based Support Service Contracting; (3) the Department's identification of 65 service contract requirements suitable for performance-based contracting approaches, and the steps the Department is taking to fulfill its commitment to OMB; and (4) development of training programs.

In addition, the Department instituted the Strategic Alignment Initiative, one aspect of which is to substantially reduce support services subcontracting. As part of this Initiative, the Secretary directed that the Department reduce its support service contracting by \$90 million per year for 5 years. For Fiscal Year 1996, a Departmental ceiling of \$600 million was established. The Department exceeded its goal by obligating less than \$500 million for engineering, technical, and management support services.

3. We also have concerns about the discussion in the GAO's draft report (p. 22) concerning the implementation of the Contract Reform Team's recommendation for DOE to reduce its current audit backlog. Although the GAO's draft report concedes that the Department met its objective to provide funding to reduce the audit backlog by funding audits by the Defense Contract Audit Agency (DCAA). However, the draft report faults DOE for not performing a cost-benefit analysis or evaluating alternatives to the use of DCAA audit services, as was recommended in the Contract Reform Team Report.

The GAO report's implication is that the Department has not implemented the core recommendation. We strongly disagree. While DOE did not perform a formal written cost-benefit analysis of alternative audit approaches, there were oral discussions within the Department on the subject. In addition, following the issuance of the Contract Reform Team's report, the difficult budget environment of the Department precluded the hiring of in-house auditors to reduce the audit backlog. The only option available to meet the objective of reducing the audit backlog was to provide DCAA with additional funds, which the Department did. The GAO draft report does not recognize this important budgetary reality.

4. On page 23, we take exception to the inference that the Office of Procurement and Assistance Management was in any way less than enthusiastic in meeting the Secretary's goals of contract reform. The Office of Procurement and Assistance Management has provided leadership and guidance in all phases of the contract

Now on p. 19.

See comment 16.

Now on p. 19.

See comment 17.

reform initiative. Furthermore, as noted above, the regrouping and reassignment of action items was considered to be necessary to the Department as a whole.

Now on p. 20.

See comment 18.

5. At the bottom of page 23, the draft report states that because of delays in setting the framework of contract reform (i.e. completing the 48 action items), "successful implementation of the new policies will be pushed further into the future." This comment ignores the fact that implementation of contract reform started in 1994. Every management and operating contract competed or extended since July 1994 has embodied the full range of contract reform.

Now on p. 20.

See comment 19.

6. On page 24, the draft report references discussions with several task teams regarding their concern with the adequacy of resources and the lack of baselines. The Department agrees that resources and the need for baselines are issues that must be dealt with. However, it is not clear what point the GAO is attempting to make here.

Now on p. 21.

See comment 20.

7. Also on page 24, the draft report quotes a task team in stating that performance goals and indicators were developed "at a high level and may not directly apply to an individual contract being incentivized." It also notes that examples contained in the Contract Reform Team Report would need to be replaced with goals that are relevant to each contractor. Again, it is not clear what point the GAO is making. Nevertheless, this is a true statement, and it was done by design. The Department's missions and sites are so diverse that specific goals and indicators can only be adequately developed at the programmatic and site levels. This, in fact, is happening. Every management and operating contract negotiated since 1994 has contained site specific measures and incentives.

Now on p. 21.

See comment 21.

8. Finally, at the bottom of page 24, the draft report quotes Project Office officials as stating that it "may take years to determine whether many of these actions will make DOE contracting work better and cost less." This statement is taken out of context and implies that nothing is happening. While the Project Office did indicate that the full benefits of the action items are not yet known or proved, there is emerging evidence that contracting is working better and costing less. (See pp. 1-2)

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The following are GAO's comments on the Department of Energy's letter dated November 12, 1996.

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## GAO's Comments

Our comments on DOE's two main themes—that the draft report did not (1) fully recognize DOE's efforts to improve contracting problems identified in GAO's past reports nor DOE's current accomplishments under contract reform and (2) adequately acknowledge the implementation of its new competition policy—are summarized in the executive summary. In addition, applicable chapters contain summarized comments. In this appendix, we address each of the comments made in DOE's letter and attachment.

1. DOE does not believe that the draft report placed the contract reform initiative in its historical perspective. Although we agree that our prior reports had an important impact on DOE's overall contracting initiatives, our focus was on evaluating the results of the Contract Reform Team's effort. Furthermore, we believe that DOE is putting in place policies and practices to correct its historical contracting deficiencies, including those identified in our reports and testimonies. However, we also believe that DOE's Contract Reform Team's report is an important event dealing with contracting in DOE's history. While we acknowledge the evolutionary nature of DOE's contract reform efforts, it will be some time before we can fully assess whether DOE accomplished its goal of making contracting work better and cost less.

2. DOE believes that our draft report did not provide a comprehensive overview of its reform efforts, focuses on administrative outputs, and fails to address the extent to which contract reform has made contracting work better and cost less. DOE states that we only looked at 1 of the 11 elements of contract reform—competition—in an in-depth way and that 7 of the elements were not discussed at all. Since the contract reform report's issuance, DOE has taken its 48 action items and linked them under the 11 elements. We addressed these elements as they related to the 48 specific action items.

We also believe that DOE has taken some very important steps in reforming its contracting problems. DOE has (1) changed its policy and adopted competitive awards as its new contracting standard, (2) included performance goals in its contracts, and (3) moved quickly to implement the use of incentive contracts to control costs. However, DOE's new contracts were not based on final policy and they had been in effect for only about 1

year at the time of our analysis. Thus, it will take years to determine the extent to which DOE has met its goal of making contracting work better and cost less. DOE agrees with GAO's recommendations and indicated that they were being implemented.

While we could have listed all of the efforts DOE has made, as indicated in chapter 2, many of them are just beginning and are in the form of new policies and procedures. In addition, DOE characterizes our discussion in chapter 2 as administrative outputs. However, we believe that our presentation addresses the requester's need for information on the status of the reform efforts. Because of the delays experienced in completing many of the reforms, it is premature to assess the extent to which they will make contracting work better and cost less.

3. DOE also lists a series of its accomplishments over the past 3 years. For example, DOE notes that by the end of 1996, 21 of its management and operating (M&O) contracts will be performance based. As stated earlier, we also believe that these are important steps in reforming DOE's contracting. However, in the Summer of 1996, when we reviewed these contracts, they were generally about 1 year old. Thus, these contracts were not in place long enough for us to assess whether DOE's contracting works better and costs less.

4. DOE believes that we should have taken a larger sample of contracts in our analysis of performance measures. In selecting the contracts for detailed review, we chose from 11 contracts that were awarded at the time of our selection. From these, we selected four because they had the most thorough provisions for performance goals. On the basis of this selection process, we believe our detailed analysis was sufficient to suggest that, as DOE moves forward with contract reform and strategic planning, it needs to ensure that contract goals are in line with departmental goals. DOE also noted that our report did not discuss its Hanford management contract, which DOE believe is an important example of its efforts to link programmatic and site-strategic goals to contract performance goals. We did not include this contract because it was not awarded until August 6, 1996, too late to be included for detailed review.

5. DOE also believes that our discussion of cost incentives is limited by the number of contracts that we reviewed. However, our primary purpose was to determine the impact of the lack of DOE regulations on how to set these incentives. We looked at two contracts because one case demonstrated

the benefits of applying the Federal Acquisition Regulation (FAR) to this process and the other case showed the impact of not having a regulation.

6. DOE is concerned that we did not provide examples of the actions that it had completed. As discussed in our conclusions to chapter 2, DOE has made significant progress in setting a framework for contract reform through the issuance of new policies, guidance, and plans. However, we did not provide specific examples of this progress, but rather we focused on those actions that were not completed in accordance with the requirements.

7. DOE believes that we do not have sufficient justification to conclude in our report that “although it is too soon to assess the overall effectiveness of the reform actions in achieving DOE’s contract reform goals, early indications suggest that delays, limited available resources, and overly broad guidance may inhibit implementation.” Our conclusion is based on our review and generally summarizes the sentiments of DOE staff who completed some of the contract reform actions and staff within the Contract Reform Project Office.

DOE also notes that preliminary results of its own self-assessment provide evidence that substantial implementation of contract reform is occurring throughout DOE. We do not question that contract reform is occurring. However, our analysis indicated that nearly half of the contract reform actions were completed recently—within the past fiscal year. In our view, the true success of contract reform will be realized by the consistent application of reform policies and procedures in contracts, resulting in contracts that work better and cost less.

8. DOE believes that we did not recognize that the Contract Reform Team report and its 48 action items were just the beginning of a process that is evolving and is much broader than the report’s action items. DOE outlined efforts under its evolving strategy and believes that we did not recognize the progress in implementing this strategy. As previously discussed (responses 1 and 2), we believe that DOE has taken some very important steps in reforming its contracting problems, and we recognize that its efforts are broader than the Contract Reform Team report. In our opinion, the broad strategy presented by DOE is inextricably linked with contract reform and, more particularly, the 48 action items. Furthermore, the completion of the policies, procedures, and guidance developed under the action items is the backbone of sustained contract reform. Therefore, the status of these action items provides a reasonable assessment of DOE’s

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progress and the framework for future assessments as DOE's overall effort evolves.

9. DOE believes that our draft report did not address what it has done to make each of the 48 action items a reality, and it attached detailed comments relating to these items. As discussed earlier, we believe that it will take years to fully assess whether DOE's actions are effective in making contracting work better and cost less. Our detailed responses addressing the specific items DOE questioned in its Attachment A starts at number 13 below.

10. DOE believes that our conclusions in chapter 3 reflect a misunderstanding of the Contract Reform Team's report and that we do not adequately acknowledge the impact of its new competition policy. Specifically, DOE believes that (1) the proposed extension of the three laboratory contracts conforms to its new policy, (2) real changes have occurred in its contract culture and practice, and (3) we did not acknowledge that its competition policy was adopted in 1994.

First, DOE states that extending the three laboratory contracts was contingent on incorporating contract reform provisions and achieving other negotiation objectives. On the basis of DOE's decision and past performance, it will be difficult for DOE to implement such a policy on these contracts. As noted in our draft report, the Secretary's decision to extend these contracts stated that considering other contractors was unrealistic and incompatible with program requirements. Once DOE stated that only one contractor could do this work, it effectively weakened its negotiating position. Even though the Secretary also noted that any resulting contract was conditional upon the incorporation of reform measures, it appears that the decision to extend these contracts was made prior to the completion of successful negotiations and is inconsistent with the intent of contract reform.

From a historical perspective, we note that DOE's earlier extension of these contracts was also predicated upon incorporating reforms. Our work and that of DOE's Inspector General pointed out problems preceding the award of the prior contracts, such as contract clauses that weakened DOE's position. However, the resulting contracts perpetuated DOE's weak position.

Second, DOE believes that the Department's culture has changed from one in which extending contracts was the normal practice to a culture in

which competition is the first consideration. While DOE believes that a cultural change has occurred, two-thirds of its decisions were to noncompetitively extend management and operating contracts. Furthermore, the Contract Reform Team report concluded that contracts should be competitively awarded—except for unusual circumstances. We believe that such a large proportion of noncompetitively extended contracts seems inconsistent with the Contract Reform Team’s criterion of “unusual” circumstances.

In achieving greater competition in its contracting, DOE cites the new contract for the Hanford Tank Waste Privatization effort. (This effort is different from the broader contract awarded on August 6, 1996, for the management of DOE’s Hanford facility.) DOE expects this approach to affect cost savings because competing contractors will strive for the most cost-effective operation. However, as we reported in August 1996, because of the less-than- expected actual competition on the effort and the large margin of error in the cost estimates, the savings estimates must be viewed with caution.<sup>21</sup>

Third, DOE believes that our draft report incorrectly stated that the competition policy did not go into effect until August 1996. DOE believes that the policy was in effect 2 years earlier. Our draft report clearly explained that DOE issued an interim policy on September 28, 1994, and that its current and final policy was effective on August 23, 1996. However, regardless of the date the policy was put in place, as stated above, the policy had little effect on competition. DOE also believes that it did not have time or resources to competitively award more contracts at the time it issued the July 5, 1994, decision memorandum. We believe that DOE could have extended these contracts to allow for staggered completion dates to provide for orderly competitions.

11. Although DOE generally agrees with our conclusion that contract performance goals should be linked to departmental goals as discussed in chapter 4, DOE was concerned that our analysis did not consider subordinate goals, such as program goals, that would better link departmental goals with contract goals. However, we reviewed DOE’s strategic plan, annual performance agreements, strategic plans for DOE’s five business lines and key success factors, and site strategic plans. We discussed our results with staff of DOE’s Office of Strategic Planning, Budget and Program Evaluation and the Contract Reform Project Office and explained to them that we could not track the goals from the

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<sup>21</sup>See Hanford Waste Privatization (GAO/RCED-96-213R, Aug. 2, 1996).

Departmental Strategic Plan, through the subordinate program plans, and into the management and operating contracts.

Furthermore, DOE believes that our recommendation should be refined to include program goals and site goals and should not just focus on broad departmentwide goals. As discussed in chapter 4, we believe that these linkages are important and that our recommendation already addresses this linkage.

DOE agreed with our conclusion and recommendation to retain the authority to establish contract goals and incentives.

12. DOE agrees with our recommendation in chapter 5 regarding the inclusion of cost incentives based on those included in the FAR. Furthermore, DOE has a draft fee policy that contains a requirement that certain contracts must be done pursuant to federal regulations. DOE states that it is going to use FAR part 16, which addresses the contract types. However, FAR part 15.8 provides specific guidance on the analysis of prices and costs and the documentation of price negotiations. DOE's draft policy should include provisions from this part of the FAR that are appropriate for the pricing of M&O contracts.

In addition, DOE's comments questioned our reference to Oak Ridge's capping policy on fee amounts. As discussed in chapter 5, DOE officials acknowledged problems with cost incentives at Oak Ridge and adopted a capping policy for fee amounts. Although this policy limits the incentive fee that the contractor can earn, it does not fully resolve the identified contract pricing problems.

13. DOE disagrees with our finding that significant delays occurred in the completion of many of its action items and provides a detailed description of its approval process. DOE also states that implementation of the reforms began immediately, and it did not wait for the action items to be finalized. Rather than use the final approval date to assess the completion of the action items, DOE believes that it is more appropriate to assess completion on the basis of the date an item was delivered to the Contract Reform Project Office. Finally, DOE does not believe that the delays in the closure of action items pushed successful implementation of the policies far into the future.

DOE believes that submission of an action item to the Project Office constitutes completion. However, we believe that at this point, the

proposed action is only a draft that will undergo further review to ensure conformance with departmental policy. For example, action item number 25 is reported by DOE as having been completed on June 1, 1995. However, as of August 13, 1996, the action was still undergoing comment resolution within the Department and was thus subject to change. Therefore, we could not assess the completion of the action items until they were finalized by the Executive Committee. Finally, our subsequent analysis of the action items using DOE's completion criteria still showed that nearly 70 percent of them did not meet their respective deadlines. While DOE's approach of implementing the action items before they are finalized gets reform efforts under way, it also raises some serious concerns. These items are being implemented without final approval and concurrence by important offices within the Department. For example, they are being implemented before the Office of General Counsel gives final legal approval. At best, we believe they become test items and may not accurately reflect new policies. Therefore, the success of DOE's new policies cannot be measured until they are implemented in their final form. In fact, this would include any changes that could occur in the adoption of final regulations after undergoing public comment. Because approximately 49 percent of these actions were not formally accepted by the Executive Committee until fiscal year 1996, it is too soon to assess their success.

Although we recognize DOE's zeal in implementing many reform actions before they were formally approved, we nonetheless believe that successful implementation will take some time. We maintain that the delays in developing final departmental policy will delay successful implementation of the new policies.

14. DOE agrees that we correctly assessed the completeness of the action item that required DOE to provide incentives for its contractors to subcontract various routine functions. However, DOE believes that it should not be required to implement a recommendation that does not result in sound business practices, as it believes in this case. We agree with DOE's assessment that a recommendation should not be employed if it is deemed an unsound business strategy. However, we believe that this recommendation does represent sound business strategy. In fact, according to officials in the Contract Reform Project Office, several DOE contracts contain incentives to encourage the subcontracting of routine functions. If DOE believes that this is an unsound business practice, it should not be allowed to occur. Furthermore, such inconsistencies can occur in an environment in which DOE allows the implementation of its action items before the policies are finalized.

15. Again, DOE acknowledges that for another action item concerning the implementation of performance-based contracting methods for support service contracts, it did not develop an action plan with targets and milestones. Rather, DOE maintains that it reduced support service contracting primarily by its Strategic Alignment Initiative. We agree and acknowledged this in our draft report under the action item requiring a reduction of support service contracts by 10 percent in fiscal years 1995-97.

16. DOE believes that it has implemented the main thrust of the action item to reduce its current audit backlog. This action item required a cost-benefit analysis for obtaining additional resources and recommendations on alternative approaches. DOE believes that it had no other alternative and thus did not do a cost-benefit analysis because of budgetary constraints. We agree that DOE has implemented the main thrust of this action item. However, without studying additional approaches, DOE's action may not be the most cost-beneficial. One option that DOE could have considered is the FAR's quick closeout procedure that allows the contracting officer to reach some agreements without a contract closeout audit.

17. DOE contends that our draft report inferred that the Office of Procurement and Assistance Management was less than enthusiastic in meeting the Secretary's goals of contract reform. We disagree. Our reference to the Office of Procurement and Assistance Management was to illuminate the difficulties encountered by DOE in effectuating contract reform. As stated in our draft report, that office opposed being assigned responsibility for six action items because it believed those actions were inherently field related and not due to a lack of enthusiasm.

18. Again, DOE believes that we ignored the fact that the implementation of contract reform started in 1994 and disagrees that successful implementation of the new policies will be pushed into the future. As discussed elsewhere in these comments, we recognize the efforts that DOE has made; but, nonetheless, we believe that successful implementation will take some time.

19. DOE was unclear about our reference to the adequacy of resources and lack of baselines to adequately support the reform actions. This concern was expressed by several of the task teams in their action item reports. Our intent was to show possible barriers to implementing contract reform.

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20. DOE is uncertain of the meaning of our reference to goals and indicators being developed at a high level. As noted above, our goal was to reflect the task team's concern over possible difficulties in implementing contract reform.

21. DOE asserts that the statement made by a Project Office officials that "it may take years to determine whether many of these actions will make DOE contracting work better and cost less" is taken out of context by implying that nothing is happening. To the contrary, as discussed throughout our draft report, we indicated that DOE is making progress in enacting contract reform. We also noted that it is too early to assess the effect of reform action items on contracting goals because, among other things, it will take time for existing contracts to be replaced by new ones that incorporate reform measures.

# Major Contributors to This Report

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Resources,  
Community, and  
Economic  
Development Division

Jeffrey E. Heil, Assistant Director  
Robert M. Antonio  
Gene M. Barnes  
James S. Crigler  
John C. Johnson  
Casandra D. Joseph  
Robert E. Sanchez

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Office of the General  
Counsel

Doreen S. Feldman

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**Appendix III**  
**Major Contributors to This Report**

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# Related GAO Products

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Managing DOE: The Department's Efforts to Control Litigation Costs  
(GAO/T-RCED-96-170, May 14, 1996).

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