

GAO

Report to the Ranking Minority
Member, Subcommittee on Emerging
Threats and Capabilities, Committee
on Armed Services, U.S. Senate

September 2002

DOE CONTRACTOR MANAGEMENT

Opportunities to Promote Initiatives That Could Reduce Support-Related Costs



G A O

Accountability * Integrity * Reliability

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United States General Accounting Office
Washington, DC 20548

September 20, 2002

The Honorable Pat Roberts
Ranking Minority Member
Subcommittee on Emerging Threats
and Capabilities
Committee on Armed Services
United States Senate

Dear Senator Roberts:

The Department of Energy (DOE) has 30 major research, development, production, and environmental cleanup sites around the country that account for about three-fourths of DOE's over-\$20-billion annual budget. DOE manages these sites largely through contractors, which can be either industrial firms or educational institutions. To oversee these contractors, the department uses headquarters program offices—principally the Offices of Defense Programs,¹ Environmental Management, and Science—and departmental field operations offices around the country. Contractors receive DOE program office funding to carry out departmental missions, such as nuclear weapons stockpile maintenance, environmental cleanup, scientific research, and other activities. The program offices also fund activities that support the missions, such as administration, maintenance, utilities, and physical security. Costs for such activities are commonly referred to as support-related costs.

In DOE contractors' accounting systems, some types of support-related costs are specifically categorized as overhead costs.² Historically, the Congress has been concerned about these costs, and in this regard, you asked us how DOE tracks and manages them. However, DOE does not track contractor overhead costs on a departmentwide basis, because overhead costs are not defined consistently from contractor to contractor. Under federal regulations,³ in conformance with cost accounting standards, each DOE contractor has the flexibility, based on its mission

¹ Defense Programs is a part of the National Nuclear Security Administration, created in fiscal year 2000 as a semi-autonomous agency within DOE.

² According to DOE, overhead costs are costs that support one or more mission activities.

³ *Federal Acquisition Regulation, part 31, Contract Cost Principles and Procedures.*

and corporate structure, to determine which costs are classified as overhead and to specify how these costs will be allocated to mission activities. Because overhead is not comparable from contractor to contractor, DOE developed its own definitions for a broad array of support-related costs that collectively it termed “functional support costs.” These definitions allow DOE to gather consistent information on support-related costs across all DOE contractors.

As agreed with your office, we specifically examined three questions: (1) How much have DOE’s major contractors spent in recent years on support-related activities? (2) On a departmentwide basis, to what extent does DOE manage support-related costs? (3) At the DOE field office and contractor level, what has been done in recent years to manage support-related costs? In addressing these questions, we documented the means by which DOE’s Chief Financial Officer and other headquarters offices,⁴ field operations offices, and major contractors manage support-related costs, but we did not conduct a review of DOE’s or its contractors’ accounting systems. (See app. I for further information about the scope and methodology of our review.)

Results in Brief

Since fiscal year 1999, DOE’s major contractors have spent about \$6 billion each year on support-related activities. This amount represents about 40 percent of the contractors’ total annual costs. DOE began tracking support-related costs after recognizing that a significant portion of the departmental budget was being spent on activities that support DOE’s mission and that there was no mechanism to obtain consistent information on these costs across the department. Support-related costs, as identified in DOE’s Chief Financial Officer’s Functional Support Cost Reporting System, have remained relatively unchanged departmentwide during the last few years.

DOE’s management of support-related costs on a departmentwide basis is limited, consisting mainly of the Chief Financial Officer’s annual analysis, and departmentwide dissemination, of summary data on these costs. The Chief Financial Officer’s analysis includes comparing the most recent data with data for previous years, highlighting trends and potential anomalies. The Chief Financial Officer disseminates a summary of the analysis departmentwide, through the department’s computerized Executive

⁴ The Chief Financial Officer directs DOE’s Office of Management, Budget, and Evaluation.

Information System as well as in hard-copy reports. In providing the analysis to the program offices, the Chief Financial Officer discusses with program office representatives the apparent trends and potential anomalies related to their programs and the sites they fund. The program offices generally use the Chief Financial Officer's annual analysis for information purposes. They do not directly manage or closely monitor contractors' support-related costs, but instead rely mainly on field offices and contractors to manage these costs.

At the DOE field and contractor level, virtually all contractors examined during our review have in recent years implemented initiatives to manage certain support-related costs. Some of these initiatives have resulted in millions of dollars in savings reported by the contractor. To achieve these savings, contractors have sometimes set targets for reducing specific types of support-related costs, such as overhead costs. For example, the contractor that operates the Sandia National Laboratories in New Mexico and California set a cost-reduction target of \$250 million in overhead costs—or about 4 percent of the site's total operating costs—for fiscal years 1996-2000. The contractor reported meeting this target through improved efficiency in various support-related areas such as administration and the infrastructure for information exchange. In other cases, the savings have been achieved through streamlining support-related activities without setting specific cost-reduction targets. For example, the contractor that operates the Savannah River Site in South Carolina revised its sitewide maintenance procedures, resulting in reported savings of \$8.5 million—or about 6 percent of the site's total maintenance costs—for fiscal year 2000. According to DOE's Chief Financial Officer staff, some of these field and contractor initiatives—or aspects of them—may represent approaches to managing support-related costs that can be shared elsewhere in the department. However, DOE does not analyze the merits of these initiatives and promote those that have applicability at other sites to achieve cost savings. As a result, the department may be missing significant cost-saving opportunities.

To help ensure that the department realizes these opportunities, we are recommending that the Secretary of Energy direct the Chief Financial Officer to analyze the merits of site-specific initiatives implemented to manage support-related costs, identify those that have broader applicability within DOE, and work with program officials to promote those most likely to reduce support-related costs. We provided a draft of this report to DOE for review and comment. The department concurred with our recommendation.

Background

DOE and its contractors define support-related costs in varying ways, to serve varying purposes. As defined by DOE and its contractors, four terms for support-related costs are particularly relevant. The first, “overhead,” normally includes facilitywide costs such as executive direction, legal services, and financial management. The second, “indirect costs,” normally includes overhead costs as well as costs for department or division management, maintenance, support, and other general activities.⁵ DOE contractors contacted in the course of this review generally used the term “indirect costs” rather than “overhead.” Some of them used “indirect costs” interchangeably with “overhead,” while others considered indirect costs to be more inclusive than overhead. The third term, “functional support costs,” was specifically developed by DOE to measure support-related costs consistently from contractor to contractor. The term captures most or all overhead and indirect costs as well as some costs more closely aligned to DOE’s mission. For example, functional support costs include utility costs that are considered indirect costs, as well as costs for electricity used by pieces of equipment that could be directly charged to a specific mission activity. The final term is “fixed costs.” As used in some DOE offices, fixed costs normally include the costs of support-related activities aimed at “keeping the doors open,” such as site security. In contrast with costs that fluctuate with the amount of program activity, such as costs for weapon maintenance, fixed costs remain relatively unchanged despite fluctuations in program activity.

DOE’s Major Contractors Have Spent about \$6 Billion Each Year on Support-Related Activities

Since fiscal year 1999, DOE’s major contractors have spent about \$6 billion each year, or about 40 percent of their total annual costs, on a broad array of support-related activities. DOE refers to the costs for support-related activities as “functional support costs.” DOE’s major contractors annually report all of their costs, including both support-related and mission costs, to DOE’s Chief Financial Officer, who is responsible for financial management oversight within the department.

In order to track contractors’ support-related costs, DOE’s Chief Financial Officer implemented the Functional Support Cost Reporting System in fiscal year 1997.⁶ The system was developed in part because the

⁵ As used in DOE, “indirect costs” are identified with more than one activity, in contrast to “direct costs,” which are identified with only one activity.

⁶ A prototype of the system was developed in fiscal year 1996 by the Chief Financial Officer, the Office of Environmental Management, and DOE contractors.

department recognized support-related costs to be a significant portion of its budget. In the past, there had been little consistent departmentwide information showing the nature of, amount of, and trends in these costs. For example, the Office of Environmental Management helped to develop the system because it recognized it lacked consistent cost data from various contractors to help track how much of its increasing funding for environmental cleanup at DOE sites was being expended on actual “hands on” cleanup versus support-related activities.

In implementing the Functional Support Cost Reporting System to track support-related costs, the Chief Financial Officer has developed consistent definitions for 22 specific cost categories—such as “facility management,” “safeguards and security,” or “site maintenance”—that contractors use in reporting their support-related costs. These 22 specific categories fall into three general categories: “general support,” “mission support,” and “site specific support.” General support costs include management and administrative activities such as executive direction, human resources, legal costs, and outreach activities. Mission support costs include activities more closely associated with site operations such as environmental compliance, safety and health, maintenance, and utilities. Site-specific support costs include contractors’ fees, local taxes, and the cost of laboratory-directed research and development. In addition to tracking support-related costs, the system tracks “mission direct” costs. These costs include all mission operations costs not classified as support-related, as well as capital construction costs. In order to report costs to the Chief Financial Officer in these categories, DOE contractors take their total annual costs from various categories in their own financial accounts and reapportion them into the categories defined under the Functional Support Cost Reporting system.⁷ To ensure that contractors conform to the standardized definitions and categories in reporting their support-related costs, DOE’s Chief Financial Officer staff has worked closely with the contractors from the inception of the Functional Support Cost Reporting System. DOE and the contractors have interacted through a departmental financial management idea-sharing forum, the Financial Management Systems Improvement Council, on which DOE Chief Financial Officer staff and contractors are represented.

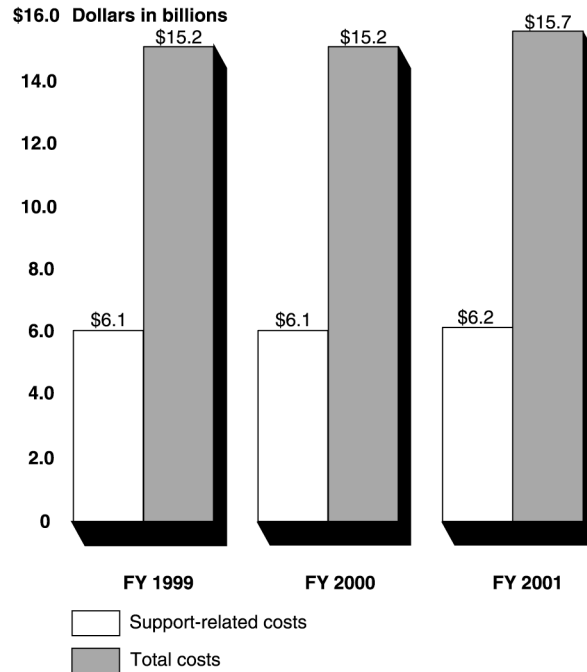
⁷ For example, under the system, each contractor is required to categorize and report all of its utility costs consistently—as functional support costs—even though some of these costs, such as those related to keeping management offices in operation, could be considered overhead and others, such as those related to manufacturing operations for a specific project, could be considered direct costs.

Chief Financial Officer staff stated that the quality of the reported data has improved since the reporting system was first implemented in fiscal year 1997.⁸ A factor in the improvement has been peer review of the reported data, a process implemented since 1998. The peer reviews consist of on-site data quality examinations conducted by financial staff from other sites. According to Chief Financial Officer staff, since the peer reviews have been implemented, the reported data have been very consistently defined from contractor to contractor. The Chief Financial Officer staff, DOE headquarters and field officials, and contractor officials interviewed generally agreed that the data, though not of budget quality, are of reasonable quality for use as a management tool. Chief Financial Officer staff said their office currently continues to work with the contractors through peer reviews and other oversight activities to monitor the data's quality and consistency.

Each year, after DOE's major contractors report their total costs and support-related costs through the operations offices to the Office of the Chief Financial Officer, that Office issues a report on these costs. Among other things, the report compares contractors' aggregate support-related costs and total costs for the most recent year with those for previous years, as illustrated in figure 1.

⁸ The reporting system has expanded, from 21 contractors reporting in fiscal year 1997 to the current 30.

Figure 1: DOE Contractors' Support-Related Costs Compared with Total Costs from Fiscal Year 1999 to Fiscal Year 2001



Note: All costs are presented in fiscal year 2001 dollars.

Source: *Fiscal Year 2001 Functional Support Cost Report*, DOE, May 2002.

As shown in the figure, the amount spent (in fiscal year 2001 dollars) for support-related costs has remained relatively unchanged since fiscal year 1999. The percentage of total support-related costs compared with total contractor costs has also remained relatively unchanged. In fiscal year 1999, support-related costs were 40.5 percent of total costs, compared with 40.3 percent in fiscal year 2000, and 39.4 percent in fiscal year 2001.

The report contains detailed site-specific information on support-related costs reported to the Chief Financial Officer. The information includes contractors' support-related costs in 22 standardized categories, as well as their total mission direct costs. The contractor-supplied information shows how these different categories of costs can vary from site to site, as well as from 1 year to the next at a given site. For example, for fiscal year 2001, major DOE contractor sites reported widely ranging percentages of support-related costs compared to total costs, from 21.1 percent to 70.5 percent of total costs. In part, these large disparities in reported costs reflect the varied nature of the support-related activities conducted at the

sites by DOE's contractors. For example, some contractors at DOE laboratories that conduct considerable basic scientific research have recently reported support-related costs of below 30 percent of total costs, while some other sites where DOE is cleaning up environmental contamination have reported support-related costs of nearly 50 percent. (More detailed information on site-specific support-related costs for fiscal years 1999-2001 is presented in app. II.)

On a Department-wide Level, DOE Management of Support-Related Costs Is Limited

DOE's management of contractor support-related costs on a department-wide basis is limited. It mainly consists of the Chief Financial Officer's annual efforts to analyze and disseminate throughout the department summary data on support-related costs from DOE's Functional Support Cost Reporting System, and to use the data as an indicator of financial management performance in implementing the Government Performance and Results Act of 1993.⁹ The Chief Financial Officer has undertaken these efforts with the intent of encouraging the department's headquarters program offices to use these support-related cost data as a management tool. These offices, which have line responsibility for funding and overseeing the contractors' activities, generally use the data for information purposes. They do not directly manage or closely monitor contractors' support-related costs but instead rely mainly on field offices to oversee these costs.

Chief Financial Officer Uses Support-Related Cost Data to Identify Cost Trends and Raise Oversight Questions

Each fiscal year, after receiving data on support-related costs from DOE's major contractors and compiling the data into detailed functional categories,¹⁰ Chief Financial Officer staff analyze the data, comparing the most recent year's data with data for several previous years in order to observe trends. According to Chief Financial Officer staff, trends in the data help to indicate how effectively the department and individual contractors may be managing support-related costs. For example, in their view, the department's recent annual percentages of support-related costs compared with total costs—about 40 percent over the last 3 fiscal years—indicate that the department is controlling its contractors' support-related costs. However, they said there still may be room for reductions in

⁹ Under the act, DOE sets performance goals in an annual performance plan and reports on its progress in meeting the goals in an annual accountability report.

¹⁰ In reporting the functional support cost data, contractors provide written summary explanations of the data.

support-related costs, and they plan to focus in the future on areas where reductions could be achieved.

Trends in support-related costs can vary significantly for a given site over time, and among sites. For example, in the most recent data from the Functional Support Cost Reporting System, for fiscal years 1999-2001, some contractor sites had overall increases of more than 5 percent in support-related costs, while others had decreases of more than 5 percent. In some cases, sites funded under the same program office showed significantly divergent trends—one site having upwardly trending costs and another having downward trending costs. DOE and contractor officials cautioned that, although comparing support-related costs among sites can be useful, such comparisons can also be problematic because each site has its own location, size, mission, infrastructure, and other characteristics that could explain differences in the magnitude of costs among sites. Nevertheless, observing trends for a given site over time and comparing support-related cost trends among sites can be a valuable “benchmarking” exercise and can provide upper-level DOE managers in the program offices with an overall perspective and an early warning of potential problems.

Analysis of the support-related cost data in the Functional Support Cost Reporting System can also raise oversight questions. Chief Financial Officer staff said such oversight questions often arise in their analysis of a given site’s submitted data. Questions raised include queries to the responsible program office and the contractor about apparent mathematical errors, miscategorized costs, or significant cost variations that call for further explanation. Chief Financial Officer staff said addressing such questions can sometimes identify potential anomalies in support-related costs at one or more sites, in one or more cost categories. For example, in analyzing the fiscal year 2001 data for the Chief Financial Officer’s most recent functional support cost report, the staff, in coordination with program office staff, asked several questions of contractors. In one instance, they asked contractor staff at a national laboratory to further explain (1) its reported increases, during fiscal years 1999-2001, in support-related costs in the category of “facility management” and (2) for the fiscal year 2000-01 period, its reported decreases in costs for the “safeguards and security” category. In other instances, they asked contractor staff of two national laboratories to further explain reported significant increases in their costs in the “site maintenance” category for the fiscal year 1999-2001 period. According to Chief Financial Officer staff, in each of these instances, the contractor readily provided additional information sufficient to resolve the oversight

question. The staff said that the process allows for more extensive follow-up by Chief Financial Officer staff if questions are not adequately addressed.

After identifying trends and raising oversight questions with the program offices and contractors, the Chief Financial Officer disseminates the support-related cost data from the Functional Support Cost Reporting System departmentwide—through DOE’s computerized Executive Information System, as well as through the Chief Financial Officer’s annual hard-copy report. In addition, under a congressional requirement, the report is annually submitted to the House Appropriations Subcommittee on Energy and Water Development. After providing the analysis to the program offices, the Chief Financial Officer staff meet with program office representatives—principally, representatives of the Offices of Defense Programs, Environmental Management, and Science, which fund the large majority of the work of DOE’s contractor sites. Chief Financial Officer staff discuss trends and potential anomalies in the data with program office staff and follow up on issues where appropriate. According to the staff, the data analysis and dissemination process can be a valuable “starting point” toward better departmental understanding of support-related costs at individual sites as well as across programs and the entire DOE complex.

Finally, in addition to using the cost analysis to inform the program offices and enhance oversight, the Office of the Chief Financial Officer has used the analysis as its own financial management tool, in implementing the Government Performance and Results Act of 1993. Under the act, DOE offices, including that of the Chief Financial Officer, are accountable for pursuing performance goals. The broad performance goals for which the Office is accountable are financial management oriented. For fiscal year 2000, these goals were (1) using efficient and effective management systems and approaches to guide decision making, streamline and improve operations, align resources, and reduce costs; and (2) improving the delivery of products and services through contract reform and the use of business-like management practices. The office has used data on support-related cost trends from the Functional Support Cost Reporting System as one of several quantitative measures of departmental performance against

these goals.¹¹ In this regard, according to office staff, the slight reductions departmentwide in support-related costs as a percentage of total costs over the past few fiscal years are an indication of progress in managing these costs.

Program Offices Make Little Use of the Chief Financial Officer's Support-Related Cost Analysis

Officials of DOE's headquarters program offices, which have line responsibility to oversee the contractors' use of departmental funds, told us they generally use the Chief Financial Officer's annual analysis of support-related costs for information purposes. While individual program offices have in the past attempted to closely monitor and manage various aspects of support-related costs from headquarters, the three program offices that fund the large majority of DOE's major contractors' activities—the Offices of Environmental Management, Defense Programs, and Science—currently all rely mainly on field offices to oversee contractors' management of support-related costs.¹²

The Office of Environmental Management, which is responsible for the cleanup of more than a hundred environmentally contaminated DOE sites around the country, at one time attempted to directly manage contractors' support-related costs from headquarters. In the mid-1990s, the office was concerned about the magnitude of support-related costs being accrued by contractors for environmental cleanup activities.¹³ The office compiled data on its contractors' support-related costs and set quantitative cost targets for individual contractors. An Environmental Management official told us that by using this "top down" approach, the office had some success in reducing contractors' support-related costs, and the official provided data indicating that at seven Environmental Management

¹¹ Recent GAO reports on DOE implementation of the Government Performance and Results Act have not specifically addressed these goals or the Functional Support Cost Reporting System, but have found problems in defining coherent strategic goals and linking them to performance measures. See *Government Performance and Results Act: Information on Science Issues in the Department of Energy's Accountability Report for Fiscal Year 1999 and Performance Plans for Fiscal Years 2000 and 2001*, [GAO/RCED-00-268R](#) (Washington, D.C.: 2000).

¹² These program offices are involved in implementing a variety of departmental responsibilities that are cost management related, such as strategic planning and budgeting, project management, contract management, and management of facilities and infrastructure.

¹³ This concern led the office to join with the Chief Financial Officer and DOE contractors in developing a prototype of the functional cost reporting system in fiscal year 1996.

funded sites, these costs declined 3 percent from fiscal year 1996 to fiscal year 1997. However, Environmental Management officials told us that some contractors objected to this approach, considering it to be micromanagement from DOE headquarters. In part because of the contractors' concerns, the office discontinued using such targets in 1998, preferring other means of cost management from program headquarters, such as providing contractors with performance incentives in contracts to meet cleanup project schedules within projected costs. The office accepts and repackages the support-related cost data from the Chief Financial Officer from an environmental management perspective, and an office manager said he examines the data for indicators that could be useful to headquarters program managers. However, the office leaves the direct management of support-related costs largely to DOE field offices and contractors.

The Office of Defense Programs, a part of the National Nuclear Security Administration, does not actively manage the support-related costs of its contractors from headquarters. The office oversees several sites across the DOE complex—both national laboratories and weapons production sites—that do research and production work to help maintain the U.S. nuclear weapons stockpile. In 1999-2000, the office attempted to determine the magnitude of support-related costs associated with contractor facilities and activities involved in performing the office's mission. Defense Programs officials referred to these costs as "fixed" costs—contractor facility costs that remained relatively unchanged despite fluctuations in program activity. As a result of an internal review, and because headquarters program managers viewed their contractors' fixed costs in support of Defense Programs' mission as potentially too high, the office attempted to better identify and control these costs through the planning and budgeting process. More specifically, they wanted to highlight these costs in a budget category called "Readiness in Technical Base and Facilities." However, this attempt to better determine these costs was unsuccessful, owing to problems with defining fixed costs consistently across the nuclear weapons complex and reconciling these definitions and cost allocation interpretations with DOE's Office of the Chief Financial Officer. Currently, the Office of Defense Programs relies mainly on field offices and contractors to closely monitor and manage fixed costs and other support-related costs.

The Office of Science, which oversees basic science research conducted at 11 DOE laboratories, does not closely monitor or manage contractors' support-related costs. Like the Offices of Environmental Management and Defense Programs, it generally leaves the direct management of these

costs to the field offices and contractors. According to Science officials, the office has historically preferred a “hands off” approach to controlling support-related costs, not wanting to micromanage its contractors from headquarters. Science officials said they occasionally monitor major contractors’ support-related costs in annual site reviews, but they said various contractors prefer to use their own productivity indicators—or “metrics”—to track such costs instead of relying on functional support cost data. These metrics may include, for example, the laboratory’s ratio of research labor costs to support-related labor costs. In this regard, contractors routinely generate several such metrics for their own cost-monitoring purposes and for the information of oversight entities, such as the Secretary of Energy’s Laboratory Operations Board. The board monitors DOE national laboratories’ management, and its members include representatives of the department, industry, academia, and the public.

At the DOE Field and Contractor Level, Initiatives to Manage Certain Support-Related Costs Have Resulted in Reported Savings

Over the last several years, at the DOE field and contractor level, many site-specific initiatives have been implemented to manage certain support-related costs.¹⁴ In this regard, virtually all contractors we examined during our review have in recent years conducted one or more such initiatives. Some contractors have set specific, quantitative targets for reducing support-related costs—in the form of overhead and indirect costs—and have reported cost savings in the millions of dollars. For example:

- In 1995, the contractor that operates the Sandia National Laboratories in New Mexico and California made a management commitment to the then-Under Secretary of Energy to save \$250 million in laboratory indirect costs—or about 4 percent of the site’s total operating costs—over 5 years. For fiscal years 1996-2000, Sandia reported meeting this target through improved efficiency in several areas. These areas included realigning administrative processes and the infrastructure for information exchange, as well as eliminating burdensome DOE orders and directives.
- For fiscal year 2001, under the contract for the Oak Ridge National Laboratory in Tennessee, the contractor was required to pursue an overhead reduction target of \$20 million. In attempting to meet the target, the contractor reported, among other steps, eliminating 300 support-related staff positions. According to a contractor official, unexpected

¹⁴ These initiatives are in addition to contractors’ day-to-day accounting practices, conducted under the oversight of DOE field offices.

support-related costs for utilities and infrastructure kept the laboratory from fully meeting the target, but the contractor nevertheless reported savings of \$13 million from this initiative.

Other initiatives have included holding support-related costs at a certain level. For example, for fiscal year 2001, the contractor that operates the Los Alamos National Laboratory in New Mexico set a target of reducing indirect costs as a percentage of total costs or holding the percentage to the fiscal year 2000 level. According to contractor officials, the target was a useful cost-control mechanism, and the laboratory was able to maintain the percentage for fiscal year 2001. Similarly, the contractor that operates the Sandia National Laboratories set a target of maintaining their overall fiscal year 2002 indirect costs at fiscal year 2001 levels. In addressing the target, the contractor's New Mexico location has been examining the efficiency of support-related activities in a dozen areas, such as environmental, safety, and health activities; safeguards and security; human resources; and information services. According to a Sandia financial official, the New Mexico site is currently well on track to meet the target and will know officially at the end of fiscal year 2002.

In other cases, contractors have conducted initiatives to streamline various specific support-related processes without setting quantitative cost targets. Such initiatives have addressed various aspects of support-related costs, such as procurement, information services, maintenance, facilities and infrastructure, and safety and health activities. Specific initiatives have included the following:

- During fiscal years 1997-99, the contractor that operates the Oak Ridge National Laboratory realigned its environmental, safety, and health support-related activities, as well as its financial management activities. It did so by staff reductions resulting from developing new computer applications, making other data management improvements, and organizational restructuring. For the period, the laboratory reported savings of \$13.1 million from this initiative.
- In fiscal year 2000, the Savannah River Site contractor reevaluated the efficiency of its maintenance activities across all of the site's operating divisions. In realigning these activities, the contractor reported savings of \$8.5 million—or about 6 percent of the site's total maintenance costs—for fiscal year 2000. The contractor expects to report additional savings of \$27.6 million in final tabulations for fiscal year 2001.
- During fiscal years 1995-97, the contractor that operates the Pacific Northwest National Laboratory in Washington state conducted an effort to eliminate waste and inefficiency from major support processes. The effort

included vacating underutilized and high-cost facilities, leading to reported savings of \$10.2 million for fiscal years 1996-99.

- During fiscal years 1995-2001, the contractor at the Rocky Flats Environmental Technology site in Colorado undertook various support-related cost reduction and realignment steps in pursuing future closure of the site. Key steps reported included implementing new, more efficient financial systems; realigning environmental, safety, and health support-related activities; and reducing support-related staff. As a result of these efforts, for the period, the site reported functional support cost reductions of \$182 million.
- In fiscal year 2001, the Nevada Operations Office began a streamlining initiative, aimed at reducing its contractor's indirect costs. The initiative identified 25 focus areas for potential streamlining, including maintenance, property management and procurement, and information services. As a result of improved efficiencies in these areas, the contractor has reported cost reductions of more than \$1.6 million for fiscal year 2001, with further cost reductions from this initiative expected for fiscal year 2002.

In addition to setting quantitative cost targets and streamlining processes, many contractors have attempted to manage support-related costs through other steps, such as monitoring on-site cost trends. Such monitoring often includes compiling quantitative, support-related productivity metrics to give managers an indication of the site's operating efficiency in comparison to other DOE sites or private industry firms. Such metrics may include, for example, the ratio of indirect costs to direct costs, overhead costs as a percentage of total costs, or the ratio of research labor costs to support labor costs. Sometimes such metrics are used in connection with the performance-based contracting process. For example, at the Argonne National Laboratory in Illinois, in recent years the contractor has been required to monitor overhead costs as a percentage of total costs.

According to the contractor, such monitoring has contributed to a reduction of about 3 percent in laboratorywide overhead costs for fiscal years 1994-2000. This reduction in part reflects improvements in the laboratory's overall ratio of research personnel to support personnel. Similarly, at the Pacific Northwest National Laboratory, the contractor has been required, under the contract, to attempt to optimize the ratio of overhead costs to costs for direct salary and fringe benefits (in labor charges to the laboratory's customers). In this regard, for fiscal years 1994-2002, the contractor reported that monitoring this metric in the prime contract was a factor in reducing the overhead charged in labor rates to customers from 60 percent to 53 percent. Other contracts have addressed monitoring of support-related costs in a less prescriptive manner. For example, the contract for the Lawrence Livermore National Laboratory in

California mentions, but does not require, monitoring the ratio of direct to indirect costs as a potential factor in determining the contractor's overall performance rating for the year.

Some of these various targeting, streamlining, and contractor performance monitoring initiatives—or aspects of them—may represent approaches to managing support-related costs that can be applied elsewhere across the department, according to Chief Financial Officer staff. Initiatives that have resulted in millions of dollars in reported cost savings could potentially result in substantial savings at other sites. However, while the Office of the Chief Financial Officer annually collects summary information on these initiatives and disseminates it departmentwide, DOE does not analyze the merits of these initiatives and promote those that have applicability at other sites to achieve cost savings.

Conclusions

DOE funds billions of dollars in contractors' support-related costs annually. On a departmentwide level, its management of these costs is limited, conducted mainly through the Chief Financial Officer, who tracks, analyzes, and disseminates data on contractors' support-related costs through the Functional Support Cost Reporting System. At the field and contractor level, management of support-related costs has been more aggressive. Various initiatives to reduce support-related costs have been implemented—including setting targets for overhead costs and streamlining support-related processes. Such contractor initiatives have sometimes resulted in significant reported dollar savings, and some of the initiatives may have broader applicability in DOE. However, the department does not have a process to analyze and promote those initiatives that could be used by contractors across the department to better manage or reduce support-related costs. Without proactively promoting those initiatives that they determine to be “best practices” and suggesting areas where they might be useful based on, among other things, analysis of data from the Functional Support Cost Reporting System, the department may be missing opportunities for further cost savings.

Recommendation for Executive Action

We recommend that the Secretary of Energy direct the Chief Financial Officer to develop a system to analyze the merits of cost-saving initiatives implemented at contractor sites, identify those that have broader applicability in DOE, and work with program officials to promote those most likely to reduce support-related costs.

Agency Comments

We provided DOE with a draft of this report for the department's review and comment. DOE concurred with the recommendation. DOE's comments are provided in appendix III.

We conducted our review from September 2001 through August 2002 in accordance with generally accepted government auditing standards. Appendix I provides details about the scope and methodology of our review.

As agreed 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 of this report to the Secretary of Energy; Director, Office of Management and Budget; appropriate congressional committees; and other interested parties. We will make copies available to others upon request. In addition, the report will be available at no charge at the GAO Web site at <http://www.gao.gov>.

If you have any questions concerning this report, please contact William Fenzel, Assistant Director, on (202) 512-3156. Major contributors to this report include Cynthia Norris, Carol Kolarik, and Dave Brack.



Sincerely yours,

(Ms.) Gary L. Jones
Director, Natural Resources
and Environment

Appendix I: Scope and Methodology

We conducted our review of Department of Energy (DOE) contractors' support-related costs through document retrieval, data analysis, and interviews at DOE headquarters, departmental field offices, and major departmental contractors. We did not conduct a review of DOE's or its contractors' accounting systems. In this regard, we did not examine whether the magnitude of DOE's support-related costs is reasonable or whether the department is appropriately categorizing these costs in its financial reporting.

To determine how much DOE's major contractors have spent on support-related costs in recent years, we examined the functional support cost data included in DOE's annual functional support cost reports and performed selected independent checks on data reliability. We also discussed the data with members of the Chief Financial Officer's staff, DOE headquarters program and field officials, and contractor officials. From these checks and discussions, we concluded that the data, though not of budget quality, were of reasonable quality for DOE's use as a cost management tool.

To determine the extent to which DOE manages support-related costs on a departmentwide basis, we documented through interviews, document examinations, and data analysis, the cost management activities and processes conducted by the following DOE headquarters and field entities:

- at headquarters, the Office of the Chief Financial Officer, as well as the three headquarters program offices—Defense Programs, Environmental Management, and the Office of Science—that fund the large majority of the research, weapons production, environmental cleanup, and other work conducted by the department's major contractors;
- in the field, six operations offices—Albuquerque, New Mexico; Chicago, Illinois; Idaho; Nevada; Oak Ridge, Tennessee; and Oakland, California. The operations offices that we contacted oversee 19 of the 30 major contractor sites included in this review.

To determine what DOE has done in recent years at the field and contractor level to manage functional support costs, we analyzed how field entities interacted with DOE headquarters and how field offices and contractors conducted routine cost management. In addition, we identified site-specific initiatives conducted in the field that addressed support-related costs—whether these costs were defined as overhead, indirect costs, functional support costs, or otherwise. In obtaining information on such initiatives, we looked in particular for initiatives that were effective in controlling support-related costs.

In regard to all three of our objectives, we also obtained information from 13 contractors. To obtain the information, we visited the Los Alamos and Sandia National Laboratories in New Mexico. Further, we made telephonic or E-mail contacts with representatives of contractors operating the following national laboratories: Argonne in Illinois, Brookhaven in New York, Lawrence Berkeley and Lawrence Livermore in California, Oak Ridge in Tennessee, Pacific Northwest in Washington State, and the Idaho National Engineering and Environmental Laboratory. In addition, we contacted contractor officials at the Stanford Linear Accelerator Center in California, the Y-12 site in Tennessee, the Rocky Flats Environmental Technology site in Colorado, and the Savannah River site in South Carolina. We also interviewed representatives of the Secretary of Energy's Laboratory Operations Board.

Appendix II: DOE Facility Support-Related Costs (Fiscal Years 1999-2001)

This appendix provides information on DOE's major contractor facilities' support-related costs for fiscal years 1999 through 2001. Tables 1 and 2 are in fiscal year 1999 and fiscal year 2000 dollars, respectively, and table 3 is in fiscal year 2001 dollars.

**Appendix II: DOE Facility Support-Related
Costs (Fiscal Years 1999-2001)**

Table 1: Contractor Facilities' Support-Related Costs for Fiscal Year 1999 (Dollars in millions)

Facility	Program	Support costs	Total costs	Support costs as a percentage of total costs
Ames Laboratory	Science	\$10.6	\$27.1	39.3
Argonne National Laboratory	Science	148.1	499.9	29.6
Bettis Atomic Power Laboratory	Naval Reactors	66.8	305.2	21.9
Brookhaven National Laboratory	Science	159.4	404.6	39.4
Fermi National Accelerator Laboratory	Science	84.3	293.0	28.8
Fernald Environmental Management Project	Environmental Management	100.6	277.5	36.3
Golden (National Renewable Energy Laboratory)	Renewable Energy	51.6	200.4	25.8
Hanford	Environmental Management	466.9	940.2	49.7
Idaho National Engineering and Environmental Laboratory	Environmental Management	315.8	623.5	50.6
Kansas City Plant	Defense	160.5	344.8	46.5
Knolls Atomic Power Laboratory	Naval Reactors	73.4	281.5	26.1
Lawrence Berkeley National Laboratory	Science	109.9	370.7	29.6
Lawrence Livermore National Laboratory	Defense	409.3	1,359.0	30.1
Los Alamos National Laboratory	Defense	550.7	1,433.4	38.4
Mound Plant	Environmental Management	48.0	90.1	53.3
Nevada	Defense	165.6	406.3	40.8
Oak Ridge Environmental Management and Enrichment Facility	Environmental Management	156.3	418.7	37.3
Oak Ridge National Laboratory	Environmental Management and Science	187.9	537.2	35.0
Pacific Northwest National Laboratory	Science	170.9	487.4	35.1
Pantex	Defense	179.0	287.6	62.2
Princeton Plasma Physics Laboratory	Science	24.5	57.3	42.8
Rocky Flats	Environmental Management	380.9	642.9	59.2
Sandia National Laboratories	Defense	493.0	1,434.6	34.4
Savannah River Site	Environmental Management	742.6	1,378.7	53.9
Stanford Linear Accelerator Center	Science	47.3	175.2	27.0
Strategic Petroleum Reserve	Fossil Energy	90.0	172.0	52.3
West Valley	Environmental Management	54.0	107.4	50.3
Waste Isolation Pilot Plant	Environmental Management	58.8	93.2	63.1
Y-12	Defense and Environmental Management	304.4	654.4	46.5
Yucca Mountain	Environmental Management	61.7	192.1	32.1
Total DOE (fiscal year 1999 dollars)		\$5,873.0	\$14,496.0	40.5
Total DOE (fiscal year 2001 dollars)		\$6,149.1	\$15,177.5	40.5

Source: Fiscal Year 2001 Functional Support Cost Report, DOE, May 2002.

**Appendix II: DOE Facility Support-Related
Costs (Fiscal Years 1999-2001)**

Table 2: Contractor Facilities' Support-Related Costs for Fiscal Year 2000 (Dollars in millions)

Facility	Program	Support costs	Total costs	Support costs as a percentage of total costs
Ames Laboratory	Science	\$9.8	\$24.9	39.3
Argonne National Laboratory	Science	146.7	488.3	30.0
Bettis Atomic Power Laboratory	Naval Reactors	68.0	327.1	20.8
Brookhaven National Laboratory	Science	176.2	420.5	41.9
Fermi National Accelerator Laboratory	Science	82.8	304.0	27.3
Fernald Environmental Management Project	Environmental Management	103.1	279.6	36.9
Golden (National Renewable Energy Laboratory)	Renewable Energy	49.7	186.2	26.7
Hanford	Environmental Management	492.9	1,018.6	48.4
Idaho National Engineering and Environmental Laboratory	Environmental Management	357.3	670.2	53.3
Kansas City Plant	Defense	159.7	346.8	46.1
Knolls Atomic Power Laboratory	Naval Reactors	76.3	277.2	27.5
Lawrence Berkeley National Laboratory	Science	109.9	405.5	27.1
Lawrence Livermore National Laboratory	Defense	407.2	1,332.5	30.6
Los Alamos National Laboratory	Defense	599.4	1,496.0	40.1
Mound Plant	Environmental Management	50.7	101.4	50.0
Nevada	Defense	166.9	417.6	40.0
Oak Ridge Environmental Management and Enrichment Facility	Environmental Management	146.8	426.9	34.4
Oak Ridge National Laboratory	Environmental Management and Science	194.4	586.5	33.1
Pacific Northwest National Laboratory	Science	178.0	501.1	35.5
Pantex	Defense	179.9	280.4	64.1
Princeton Plasma Physics Laboratory	Science	29.9	68.3	43.7
Rocky Flats	Environmental Management	336.5	656.8	51.2
Sandia National Laboratories	Defense	488.5	1,445.6	33.8
Savannah River Site	Environmental Management	747.9	1,406.3	53.2
Stanford Linear Accelerator Center	Science	48.1	182.7	26.4
Strategic Petroleum Reserve	Fossil Energy	80.2	118.0	68.0
West Valley	Environmental Management	47.3	111.9	42.3
Waste Isolation Pilot Plant	Environmental Management	59.7	102.6	58.2
Y-12	Defense and Environmental Management	317.4	663.8	47.8
Yucca Mountain	Environmental Management	70.4	203.3	34.6
Total DOE (fiscal year 2000 dollars)		\$5,981.8	\$14,850.6	40.3
Total DOE (fiscal year 2001 dollars)		\$6,127.0	\$15,211.1	40.3

Source: Fiscal Year 2001 Functional Support Cost Report, DOE, May 2002.

**Appendix II: DOE Facility Support-Related
Costs (Fiscal Years 1999-2001)**

Table 3: Contractor Facilities' Support-Related Costs for Fiscal Year 2001 (Dollars in millions)

Facility	Program	Support costs	Total costs	Support costs as a percentage of total costs
Ames Laboratory	Science	\$9.7	\$23.8	40.5
Argonne National Laboratory	Science	158.1	516.9	30.6
Bettis Atomic Power Laboratory	Naval Reactors	69.9	331.1	21.1
Brookhaven National Laboratory	Science	177.8	449.0	39.6
Fermi National Accelerator Laboratory	Science	85.2	312.7	27.2
Fernald Environmental Management Project	Environmental Management	94.1	271.5	34.7
Golden (National Renewable Energy Laboratory)	Renewable Energy	50.3	207.5	24.3
Hanford	Environmental Management	524.4	1,074.2	48.8
Idaho National Engineering and Environmental Laboratory	Environmental Management	380.7	719.5	52.9
Kansas City Plant	Defense	173.4	406.1	42.7
Knolls Atomic Power Laboratory	Naval Reactors	74.1	275.7	26.9
Lawrence Berkeley National Laboratory	Science	120.2	432.0	27.8
Lawrence Livermore National Laboratory	Defense	444.6	1,373.0	32.4
Los Alamos National Laboratory	Defense	670.9	1,721.0	39.0
Mound Plant	Environmental Management	44.2	97.5	45.3
Nevada	Defense	176.8	482.1	36.7
Oak Ridge Environmental Management and Enrichment Facility	Environmental Management	172.9	500.2	34.6
Oak Ridge National Laboratory	Environmental Management and Science	181.8	617.1	29.5
Pacific Northwest National Laboratory	Science	190.8	517.1	36.9
Pantex	Defense	199.0	317.9	62.6
Princeton Plasma Physics Laboratory	Science	34.4	76.1	45.2
Rocky Flats	Environmental Management	289.4	633.3	45.7
Sandia National Laboratories	Defense	507.2	1,492.5	34.0
Savannah River Site	Environmental Management	690.8	1,477.0	46.8
Stanford Linear Accelerator Center	Science	51.9	209.7	24.8
Strategic Petroleum Reserve	Fossil Energy	88.3	125.4	70.5
West Valley	Environmental Management	53.2	112.0	47.5
Waste Isolation Pilot Plant	Environmental Management	55.3	112.9	49.0
Y-12	Defense and Environmental Management	324.7	626.1	51.9
Yucca Mountain	Environmental Management	94.2	210.0	44.9
Total DOE (fiscal year 2001 dollars)		\$6,188.4	\$15,721.0	39.4

Source: Fiscal Year 2001 Functional Support Cost Report, DOE, May 2002.

Appendix III: Comments from the Department of Energy



Department of Energy

Washington, DC 20585

SEP 16 2002

Ms. Gary L. Jones
Director, Natural Resources and Environment
U.S. General Accounting Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Jones:

Thank you for the opportunity to comment on the General Accounting Office Report entitled *DOE Contractor Management: Opportunities to Promote Initiatives That Could Reduce Support-Related Costs*.

The Department concurs with the recommendation in the report. As such, the Chief Financial Officer will develop a system to analyze the merits of cost-saving initiatives implemented at contractor sites, identify those that have broader applicability in the Department, and work with program officials to promote those most likely to reduce support-related costs.

If you have any questions concerning our response, please call Rick Sweeney, Director, Office of Program Liaison and Financial Analysis, on 301-903-2561.

Sincerely,

A handwritten signature in cursive script that reads "Bruce M. Carnes".

Bruce M. Carnes
Director, Office of Management, Budget
and Evaluation/CFO

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