DOE/IG-0430

AUDIT REPORT

PROJECT HANFORD MANAGEMENT CONTRACT COSTS AND PERFORMANCE

NOVEMBER 1998

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDIT SERVICES

November 5, 1998

MEMORANDUM FOR THE SECRETARY

FROM: Gregory H. Friedman
Inspector General

SUBJECT: INFORMATION: Audit Report on "The U.S. Department of Energy's Project Hanford Management Contract Costs and Performance"

BACKGROUND

To offset the negative impact of downsizing its facilities, the Department of Energy (DOE) established a commitment to economic stability. In its Fiscal Year (FY) 1997 *Strategic Plan*, DOE set a goal to help industry sustain long-term economic growth. That goal was to create 10,000 to 15,000 new jobs comparable to or better in skill than the jobs being lost at DOE facilities.

RESULTS OF AUDIT

Consistent with the *Strategic Plan*, the Project Hanford Management Contract (Management Contract) established a goal that Fluor Daniel Hanford, Inc. (Fluor Daniel) and its major subcontractors would help create 3,000 new, non-Hanford, private sector jobs over a 5-year period that would help stabilize and diversify the Tri-Cities' economy. Specifically, the Management Contract required that 200 jobs be created by the end of the first year.
However, we found that most of the new jobs Fluor Daniel claimed it established during FY 1997 were not comparable to Hanford Site jobs and did not help the Richland Operations Office (Richland) meet its commitment for long-term, economic stability. We recommended that Richland establish Management Contract performance expectations that define the quality of jobs promised by Fluor Daniel and desired by DOE.

MANAGEMENT REACTION

Management did not concur with our overall finding and recommendation.

Attachment

cc: Under Secretary

PROJECT HANFORD MANAGEMENT CONTRACT COSTS AND PERFORMANCE

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OVERVIEW

INTRODUCTION AND OBJECTIVE

On August 6, 1996, the Richland Operations Office (Richland) awarded the Project Hanford Management Contract (Management Contract) to Fluor Daniel Hanford, Inc. (Fluor Daniel). This performance-based, 5-year contract to support cleanup of the Department of Energy's (DOE) Hanford Site (Hanford) contained performance goals or expectations related to the stabilization, transition, and diversification of the Tri-Cities' economy near Hanford in southeastern Washington. One of these economic goals was that Fluor Daniel and its major subcontractors would help generate 3,000 new, non-Hanford, private sector jobs that would help stabilize and diversify the Tri-Cities' economy. The contract specifically called for Fluor Daniel to help generate 200 jobs, establish an investment fund, and bring 6 new growth-oriented "enterprise companies" to the Tri-Cities by the end of Fiscal Year (FY) 1997. Although these companies began as corporate affiliates of the prime and major subcontractors at Hanford, they were expected to become independent, competitive companies that would have enduring potential.

DOE's commitment to economic stability was echoed in various documents. The premise of Fluor Daniel's *FY 1997 Economic Transition and Outsourcing Plan for Project Hanford*, for example, was to stabilize and diversify the local economy while a goal in DOE's FY 1997 S*trategic Plan* was to help industry sustain long-term economic growth that creates high-wage jobs. In its FY 1998 *Strategic Plan*, DOE set a target of 10,000 to 15,000 new jobs nationally by the end of 1999. According to an official in the Department's Office of Worker and Community Transition, DOE's intent is to establish jobs that are comparable or better in skill to the DOE jobs being lost.

The objective of the audit was to determine whether Richland was making adequate progress in stabilizing and diversifying the economy of the Tri-Cities by creating 3,000 new, non-Hanford jobs within 5 years. Accordingly, we examined the progress made in FY 1997, which was the first year of the Management Contract.

CONCLUSIONS AND OBSERVATIONS

Richland and Fluor Daniel are at risk of not meeting the Management Contract's goals of stabilizing and diversifying the economy of the Tri-Cities because most of the new jobs created during FY 1997 were not comparable to Hanford jobs and, thus, may not sustain long-term economic goals. The new jobs, for example, did not have one or more of the following characteristics: high skill, high pay, long-term employment, and non-Hanford related. Therefore, Fluor Daniel has not met its expectations in the first year and is not making adequate progress toward meeting the Management Contract's overall economic goals.

(Signed)

Office of Inspector General

JOB CREATION

Desired Economic Stability For The Tri-Cities

Because of the diminishing Hanford workload, one goal common to the 1996 Management Contract, Fluor Daniel's *FY 1997 Economic Transition and Outsourcing Plan for Project Hanford*, and DOE's FY 1997 *Strategic Plan* was to stabilize and diversify the economies of impacted communities. This was to be done by creating new jobs that were highly skilled, high paying, long-term, and unrelated to DOE's mission. Consistent with this goal, Fluor Daniel committed to help create 3,000 jobs in the Tri-Cities within 5 years. Specifically, the contract had a performance measurement that stipulated that Fluor Daniel would establish 200 new jobs in FY 1997.

Fluor Daniel claimed to have surpassed the FY 1997 performance measurement by creating 271 new jobs. Richland concurred that Fluor Daniel met the measurement but accepted only 201 jobs. The audit showed, however, that only 61 of these 201 jobs were comparable to ones that will be lost at Hanford. These 61 jobs included employment in aluminum extrusion, engineering, waste management, and computer services.

Approved Jobs That Do Not Meet The Management Contract Goal

We questioned the remaining 140 non-Hanford jobs because they did not meet the economic stabilization goal established in the Management Contract and discussed in the FY 1997 *Strategic Plan*. Specifically, the jobs were not comparable to those that currently exist at Hanford nor did they result in new, highly skilled, high paying, or long-term employment. Further, some were not described in sufficient detail to determine if they qualified as new jobs. For instance:

- 102 jobs involved telemarketing activities. Although the telemarketing jobs were new, the jobs required semi-skilled labor and paid about $21,000 per year. Conversely, the jobs lost at Hanford typically were highly skilled and paid about $55,000 per year. Thus, the new jobs were not comparable substitutes.

- 28 of the jobs were not adequately documented or described in sufficient detail for us to determine if the jobs were new, highly skilled, high paying, long-term, and non-Hanford related. Richland’s only documentation for these positions consisted of one page, written by the contractor, asserting it had established 28 jobs, and brief notes from a telephone conversation. Earlier, Richland had cited insufficient documentation as its reason for rejecting 73 other new jobs claimed by Fluor Daniel.

- 6 of the jobs directly relied on existing Hanford contractors. The six jobs involved administering and managing an investment fund required under the Management Contract. These jobs were completely supported by fee awarded to the contractors and, consequently, were dependent on the Hanford mission. We noted that Richland had rejected jobs claimed by Fluor Daniel for a similar reason; that is, the jobs directly related to the privatization of Hanford work and were, therefore, related to the Hanford mission.

- 4 other jobs were not new jobs. These jobs competed directly with jobs that already existed in the Tri-Cities. Thus, the jobs did not stabilize and diversify the economy.

Richland's management disagreed with some of our conclusions. For example, Richland stated that the 28 jobs we questioned as inadequately documented had met the performance expectation. However, Richland could not provide any additional supporting documentation. When we asked the contractor for further support, a corporate official told us that there was no requirement in the contract to provide any additional details. The documentation available to us simply did not provide meaningful data about the jobs in question. Also, management noted that the 6 jobs questioned in the report as relying on Hanford contractors, had lasted 18 months and pointed out that "even if these jobs are eliminated at or before the end of the contract, they will have met our criteria for creating jobs that have 'enduring potential'." We do not agree with management's view that these jobs, which depend on the Hanford mission and which may be eliminated at the end of the contract, represent jobs with enduring potential. Finally, management felt that the qualitative criteria used to discount four jobs were arbitrary. Qualitative criteria, however, are essential aspects of performance measures.

Job-Related Performance Measures Not Specific

Recent publications including the 1994 report, *Making Contracting Work Better and Cost Less* and DOE's June 1996, *Guidelines for Performance Measurement* have pointed out the importance of preparing effective performance measures. DOE guidance, for example, states that performance measures should clearly state what is expected from the contractor and contain performance characteristics that are measurable against the expectation. Acquisition Letter 98-08 provides further guidance and states that performance incentives should contain both qualitative and quantitative performance requirements.

Although the FY 1997 performance measure contained a quantitative stipulation of 200 jobs by the end of FY 1997, it lacked necessary qualitative characteristics. That is, the performance measure described the jobs as "new" and "non-Hanford," but did not include important qualitative characteristics, such as skill or pay level. Qualitative characteristics were not established because Richland wanted to allow Fluor Daniel maximum flexibility and creativity in developing its economic transition program. Since these qualitative characteristics were omitted, Richland accepted jobs that did not meet the Management Contract's goal of stabilizing and diversifying the economy. In addition, the jobs did not meet Richland's goal that the jobs be comparable in skill and pay to those jobs previously held by displaced workers.

Local Community Losses

If outcomes continue to fall short of expectations, Richland may not succeed in making its desired contribution to the stabilization and diversification of the Tri-Cities economy. For example, a Pacific Northwest National Laboratory's economics expert estimated that the $55,000 average salary earned by a Hanford employee is ultimately worth about $116,000 annually to the local economy. When this data is applied to the 3,000 new, non-Hanford jobs that Fluor Daniel is expected to create, they are potentially worth about $347 million per year. However, if new jobs are created at a significantly lower average salary, the local economy may not receive the same benefit.

Not only may the local economy suffer, but Richland may not achieve the results it desired through the payment of additional fees. During contract negotiations, Richland questioned Fluor Daniel's proposed fee because it was considerably more than the fee under the previous contract. Fluor Daniel partially justified its requested performance fee by stating that a substantial portion would be invested to support the Tri-Cities' economic transition. After the Management Contract was awarded, Fluor Daniel argued that it needed additional fee for its enterprise companies to support the effort to "preserve and grow local jobs." Richland concurred and began negotiating supplemental fee rates for each enterprise company. Richland estimated these fees will cost up to an additional $15.4 million for FY 1997 to achieve the performance goal related to economic transition. In our opinion, however, Fluor Daniel has not made adequate progress in achieving the Management Contract's economic expectations envisioned by DOE.

these guidelines. Further, if it were not the intent of the Management Contract to achieve this result, we questioned why it was necessary to significantly increase the fee that could be earned by Fluor Daniel and its subcontractors.

performance goal related to economic transition. In our opinion, however, Fluor Daniel has not made adequate progress in achieving the Management Contract's economic expectations envisioned by DOE.

RECOMMENDATION

We recommend the Manager, Richland Operations Office, establish Management Contract performance expectations that clearly and completely define the quality of jobs desired by DOE.

MANAGEMENT REACTION

Richland did not concur in the finding, conclusions, or recommendation made in the report. Management said that Fluor Daniel was making adequate progress toward meeting its commitment to help create 3,000 jobs over the next 5 years. Further, management stated that the report appeared to be based on the erroneous assumption that jobs created must be "comparable to ones that currently exist at Hanford." In support of its position, management pointed to the Request for Proposal for the Management Contract and said that it did not contain criteria applicable to the quality or wage level for new jobs. Indeed, Fluor Daniel did not commit to help create jobs at any minimum wage or skill level. Richland "did not feel that it would be appropriate or advantageous to require the contractor to help create jobs that would be equivalent to Hanford jobs" because it would not be "advantageous to this community to perpetuate artificially high salaries where it is not appropriate." Richland also pointed out that the DOE strategic goal to help industry sustain long-term economic growth that creates high wage jobs is more appropriately associated with the transfer of technology under DOE's science and technology activities.

AUDITOR COMMENTS

The report is based on a careful analysis of the Management Contract and other documents that provide content and criteria necessary to understand the Department's economic goals for the area. The other documents included Fluor Daniel's proposal, the Hanford *Strategic Plan*, the Department's *Strategic Plan,* and Fluor Daniel's *FY 1997 Economic Transition and Outsourcing Plan for Project Hanford*. Reasonable readers of these documents will conclude that the Department's intent was to replace Hanford jobs with jobs of comparable skill and wage levels. For example, a goal cited in the Department's *Strategic Plan*, and echoed in the Hanford *Strategic Plan*, is to aid employees and communities faced with workforce reductions by creating new, local community jobs that are comparable in skill and wage levels to jobs that are lost. The Management Contract incorporates the goals of both strategic plans by reference. Richland's position that the focus of creating new jobs should be on quantity, not quality, is inconsistent with the Departmental philosophy articulated in these guidelines. Further, if it were not the intent of the Management

Appendix 1

SCOPE

The audit was performed from June 10, 1997 through June 9, 1998, at Richland, Fluor Daniel, and its subcontractors. We examined DOE's performance expectations and accomplishments in FY 1997, the first year of the contract. Specifically, we focused on compliance with expectations that (1) contained specific incentives and (2) Richland had approved as "successfully completed" by the end of our fieldwork.

METHODOLOGY

We accomplished the audit objective by reviewing DOE guidance, the Management Contract, Strategic Plans for FY 1997 and 1998, economic transition performance measures and expectations, and documentation pertaining to non-Hanford job creation claimed by Fluor Daniel. We also interviewed personnel from Headquarters, Richland, contractor management, and local private businesses that competed for DOE work.

The audit was conducted in accordance with generally accepted Government Auditing Standards for performance audits, which included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. Internal controls were assessed with respect to established performance measures. Because the review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We did not rely on computer generated data during the audit.

An exit conference was held with Richland management officials on August 12, 1998.

SUMMARY OF RELATED OFFICE OF INSPECTOR GENERAL REPORTS

Although the following reports do not relate to generating jobs, they do relate to the establishment of goals and expectations under a performance based contract.

- *Inspection of the Performance Based Incentive Program at the Richland Operations Office*, Office of Inspector General Report Number DOE/IG-0401, dated March 1997. The report showed that Richland did not always make the best use of the incentive fees paid to the management and operating contractor.

- *Audit of Environmental Restoration at the Los Alamos National Laboratory*, Office of Inspector General Report Number DOE/IG-0410, dated July 1997. The report showed that the performance criteria used to evaluate cost effectiveness of remediating contaminated sites were not always reasonable, measurable, and complete.

- *Audit of the Contractor Incentive Programs at the Rocky Flats Environmental Technology Site*, Office of Inspector General Report Number DOE/IG-0411, dated August 1997. The report showed that performance measures did not always include clearly defined criteria, were not structured to encourage and reward superior performance, and were often not results-oriented.

- *Audit of the Contractor Incentive Program at the Nevada Operations Office*, Office of Inspector General Report Number DOE/IG-0412, dated October 1997. The report showed that many performance measures were vague and non-specific and, as a result, Nevada rewarded performance that could not be objectively validated.

- *The Cost Reduction Incentive Program at the Savannah River Site*, Office of Inspector General Report Number ER-B-98-08, dated May 1998. The report showed that cost proposals were not innovative and that the Savannah River Operations Office continued to provide incentive awards for non-innovative proposals.

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