



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

B-207000

SEPTEMBER 6, 1983

The Honorable William V. Roth, Jr.
Chairman, Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate

Dear Mr. Chairman:

Subject: Department of Energy Contracts With the
Decision Planning Corporation (GAO/AFMD-
83-92)

This is in response to your letter of November 11, 1982, re-
questing that we review certain aspects of the Department of En-
ergy's (DOE's) Chicago operations office contracts with the Deci-
sion Planning Corporation (DPC). Specifically, you asked us
whether the method used by DPC to compute overhead resulted in the
Government bearing a disproportionate share of indirect costs.

You also requested a review of (1) the history of these con-
tracts including an analysis of award methods, (2) the effective-
ness of DOE's contract monitoring particularly with respect to the
payment of contractor vouchers, and (3) the propriety of contract-
ing for this work rather than having it done by full-time DOE per-
sonnel. As we had agreed to, we briefed your staff on the results
of our work on March 23, 1983.

OBJECTIVES, SCOPE, AND METHODOLOGY

Beginning in 1977, DOE's Chicago operations office awarded to
DPC three cost-plus-fixed-fee contracts totaling more than \$6 mil-
lion. We reviewed the history of these contracts in order to an-
swer the questions you posed. In December 1982, DPC was selected
to receive a fourth contract to provide management support services
to the Chicago operations office. This contract, totaling approxi-
mately \$4.6 million, has been postponed because of a competitor's
bid protest and therefore was not included in our review.

We conducted field work at DPC's headquarters in Costa Mesa,
California, and at DOE's Chicago operations office. To determine
whether indirect costs were equitably distributed, we reviewed

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DPC's books and records and analyzed the contractor's method of identifying and allocating these costs. We also reviewed relevant contract records at the Chicago operations office including the documentation on contract award, negotiations, and monitoring. Finally, we reviewed Defense Contract Audit Agency (DCAA) reports and workpapers regarding DPC operations, and interviewed DOE and DPC officials as well as DCAA auditors to obtain their views and explanations of the issues in question. We conducted our review in accordance with generally accepted government audit standards.

HISTORY AND AWARD METHOD

Since mid-1977, DOE's Chicago operations office has awarded three cost-plus-fixed-fee contracts to the Decision Planning Corporation. The contracts were negotiated after DPC was selected from respondents to DOE requests for proposals. In evaluating the proposals for each contract, DOE gave primary consideration to staff qualifications and corporate experience and secondary consideration to proposed cost.

The first contract initially called for the development of a control system for a single project. The second and third contracts were much broader in scope in that they called for DPC to provide support to a number of different projects. The latter two contracts had 14 and 16 task orders, respectively, to define the scope of the work and set the cost limits. The following chart gives pertinent information on the three contracts.

| <u>Effective date</u> | <u>Contract number</u> | <u>Cost</u> | <u>Fixed fee</u> | <u>Total</u> |
|-----------------------|------------------------|-------------|------------------|--------------|
| a/5/1/77 | DE-AC02-77CH00137 | \$ 580,629 | \$ 58,612 | \$ 639,241 |
| 6/5/78 | DE-AM02-78CH99000 | 2,479,001 | 230,799 | 2,709,800 |
| 2/2/81 | DE-AC02-81CH10065 | 3,088,042 | 299,540 | 3,387,582 |

a/As mentioned on page 7 of this report, while the contract effective date was May 1, 1977, the agreement was not executed until July 14, 1977.

For the first contract, DOE issued 45 copies of the request for proposal and received nine responses. DPC was selected because its technical staff was judged the most highly qualified and its proposed costs were considered realistic. The costs of the nine respondents ranged from \$86,348 to \$363,304; DPC's contract was valued at just over \$205,000. It called for DPC to develop a project control system manual for the safety research experimental facilities and to plan, organize, and administer a 3-day seminar on the use of earned value/cost schedule performance measurement techniques. Two supplemental agreements were added later, however, increasing the contract cost to almost \$640,000. The supplements reinstated tasks previously deleted from the original proposal because of a lack of funds and added management support tasks required because of extensive changes in the project.

DPC was selected for the second contract after DOE issued 163 copies of the request for proposals and considered the 13 responses. While the basic contract included terms and conditions, it did not include a definitive scope of work or estimated costs and obligations. From August 1978 through May 1980, the operations office negotiated 14 task orders under this contract for management support services for various projects. The projects included the Industrial and Small Scale Low BTU Coal Gasification and the Solar Research Institute facilities.

The third agreement was executed on February 2, 1981, as a 90-day letter contract (maximum liability \$350,000). The purpose of the letter contract was to maintain continuity of management support services until a definitive contract could be executed. By supplemental agreement in April 1981, the operations office extended the letter contract and increased its maximum liability to \$427,000.

On June 2, 1981, the operations office executed a definitive contract to run through February 1, 1983, with an estimated cost ceiling of \$3,088,042, and a fixed fee of \$299,540. Before awarding this third contract, DOE issued 197 copies of the request for proposals and evaluated the nine responses. Two firms were considered superior to the other respondents: DPC and Booz, Allen & Hamilton. Although DPC was considered to have the best technical proposal, its proposed costs were significantly higher. After discussions with both firms, DOE asked for their best and final offers.

DPC then submitted a modified cost proposal reducing its costs. Even though the proposed cost of DPC's revised proposal still exceeded Booz, Allen & Hamilton's proposal by \$117,000, the operations office selected DPC because it considered that firm's technical qualifications to be superior.

The Chicago operations office initially selected DPC to receive a fourth contract for management support services. The \$4.6 million contract was scheduled to begin in February 1983. However, a bid protest was filed alleging that DPC should have been considered a nonresponsive bidder and that it had an unfair competitive advantage. In its comments on this report, DOE advised us that the selection of DPC had been withdrawn. Both proposals in the competitive range were reevaluated, discussed with the bidding firms, and revised. The DOE source evaluation board is now considering this new information.

ALLOCATION OF INDIRECT COSTS TO DOE CONTRACTS

You specifically asked us to consider the following two possibilities:

"--If DPC used a company-wide overhead pool, including all of their consulting contracts, was DOE absorbing a disproportionate amount of indirect costs since DPC employed subcontractors ('associate consultants')"

"having little or no fringe benefits and low indirect costs on their DOE contracts?"

"--Even if DPC calculated overhead rates per individual contract, was DOE being charged more than DPC's actual indirect costs on the DOE contract(s)?"

We found that DPC did not calculate overhead rates per individual contract. When each of the first two contracts was awarded, DPC used a companywide, combined overhead and general-and-administrative rate to distribute its indirect cost to a base. The base included both employee and nonemployee (associate consultant) direct labor costs. When the third contract was awarded, DPC segregated its indirect costs into a field overhead rate applying only to Chicago operations office work, a separate overhead rate applying to non-DOE work; and a general-and-administrative rate applying to all work.

To see whether or not DOE absorbed a disproportionate share of indirect costs, DCAA examined DPC's indirect expense claims for the first two contracts. It found that even though DPC's cost accounting procedures were not the most desirable, the procedures were acceptable under the Federal Procurement Regulations and Cost Accounting Standards. Furthermore, as discussed below, DCAA found in auditing the fiscal years covered by the first contract that DOE was not overcharged for indirect costs.

The Cost Accounting Standards and the Federal Procurement Regulations provide guidance on the equitable distribution of contractor indirect costs. To summarize: Indirect costs should be allocated to cost objectives, such as contracts, to the extent that they benefit or are caused by those cost objectives.¹

In developing its cost proposal for the first contract, DPC calculated the ratio of total indirect costs to total direct labor costs for the preceding period. The direct labor cost total for that period included both associate consultants and employees. The ratio was found to be 100.4 percent. To protect itself, since this was a cost reimbursement contract, DOE insisted that this ratio be established as a maximum allowable ceiling subject only to downward adjustment if actual costs were less.

We compared this method of allocating indirect costs with the criteria set forth by the Cost Accounting Standards and the Federal

¹The Cost Accounting Standards state that indirect costs shall be accumulated in homogeneous pools and should be allocated to the cost objectives from which they originate or which they benefit. Moreover, the Federal Procurement Regulations state that indirect costs should be allocated to cost objectives using a common distribution base. The base selected should permit allocation of indirect cost on the basis of benefits accruing to several cost objectives.

Procurement Regulations. We concluded that a single, companywide, indirect cost rate applied to direct labor costs would equitably distribute indirect costs if (1) the indirect costs attributable to both associate consultants and employees were part of the indirect cost pool, and (2) associate consultants were used throughout the business to approximately the same extent on each contract.

While we found that the cost of support activities for associate consultants and employees was in the indirect cost pool, and associate consultants were used throughout DPC's business both before and during the DOE contracts, we noted they were used to a much greater extent on the first DOE contract than in DPC's other work in progress at that time. We were advised by DPC that more associates were used on this contract because full-time, onsite support was needed for a relatively short time.

In the case of the first DOE contract, almost 90 percent of the contract was performed by associate consultants rather than employees, as shown below:

| <u>Direct labor</u> | <u>First DOE contract</u> | <u>Other DPC work at that time</u> |
|-----------------------|-------------------------------|--|
| | ----- (percent) ----- | |
| Associate consultants | 87 | 46 |
| DPC employees | 13 | 54 |

Based on the above ratios, a single composite overhead rate would distribute a disproportionate amount of employee fringe benefit costs to the first DOE contract because of the more extensive use of associate consultants. However, a DCAA audit showed that DOE was, in fact, not overcharged because a cost ceiling was specified in the contract. As mentioned previously, the contract allowed DPC to charge DOE only up to 100.4 percent of direct labor costs. The contractor's actual indirect costs exceeded the ceiling by a considerable amount. Thus, DCAA concluded that the costs charged were proper. Based upon our review of DCAA's audit reports and supporting working papers and our own limited tests of DPC's direct and indirect expenses, we agree with DCAA's position.

The potential for such overallocation did not exist on the second and third contracts. On the second contract, while we noted that single, composite, indirect cost rate ceilings were negotiated when each of the 14 tasks were identified, the mix of associate consultants and employees making up the direct labor costs was essentially the same as on DPC's other work.

When the third contract was being negotiated, DPC initially proposed a single, companywide, overhead rate and a general-and-administrative rate. DOE advised us that after it received and analyzed initial proposals, it held separate discussions with the two firms determined to be in the competitive range, asking each

firm a standard list of questions. At the conclusion of the discussions, the two firms were asked to submit their best and final offers. DPC subsequently revised its initial proposal to reflect a 41-percent field overhead rate, which applied only to its DOE Chicago work, and a 27.4-percent general-and-administrative rate. According to DPC, the establishment of the field overhead rate reduced its estimated cost and fee for the third contract by more than \$700,000.

Our discussions with responsible DCAA audit officials indicated that the DPC accounting system and method of allocating indirect costs on the first two contracts were not the most desired, but were acceptable. The DCAA auditors said they were pleased with the improvements the company has made to its accounting system and with its method of cost accumulation and indirect cost allocation.

DOE MONITORING OF CONTRACTS

As you requested, we reviewed the effectiveness of the Energy Department's monitoring of DPC contracts, particularly the payment of contractor vouchers. Our review indicated that monitoring procedures were adequate and were being followed. Standard procedures have been established for collecting information on performance and cost. DPC is providing the reports required by the contract, such as weekly synopses and monthly status reports. The DOE technical representative reviews the reports and discusses the projects and DPC's support services with DPC staff consultants, technical project contractor officials, and operations office project managers.

To determine whether DPC charges are reasonable, the DOE technical representative compares direct labor charges with the monthly status and weekly highlight reports and relates cost charges to manpower expended. He then relates this data to DPC's cost and manpower projections and analyzes variances.

In reviewing DPC's vouchers for payment, the technical representative compares the number of hours charged, travel expenses, equipment, overhead, and fee charges with the cost reports. In addition, before payment is approved, a contract specialist relates cost charges to the estimated cost negotiated in the contract to ensure that the amounts charged are reasonable, overhead rates are not higher than the negotiated rate, and the labor rate and fee charges are correct.

Because of the Subcommittee's concern, we also looked into an incident of possible overbilling by DPC. A DOE analyst at one of the project sites had questioned the hours charged for a task in the second contract and raised the issue with the DOE official responsible for monitoring that contract. We found that further information provided by DPC had satisfied both the DOE contract monitor and the analyst that the charges were proper.

PROPRIETY OF CONTRACTING FOR THESE SERVICES

As you requested, we looked into the propriety of contracting for this work rather than having it done by full-time DOE personnel. According to OMB Circular A-76, basic management functions such as direct management of Federal employees, selection of program priorities, technical analysis and evaluation of research and development activities, and control of Federal monetary transactions must be performed by Federal employees. Further, Department of Energy Order 4200.3 provides that administrative agency employees must perform those functions essential to retaining control of the conduct of Federal programs. These include the exercise of discretionary authority and final value judgments that have day-to-day and long term effect on Federal programs. Services supporting the foregoing functions may be provided by staff organizations or private sources.

The contracts with DPC did not appear to violate the regulations of the Office of Management and Budget or of DOE concerning functions that must be conducted by Government employees. Essentially, DPC provides support services to DOE managers to enable them to manage research projects. DPC's support services include analyzing, summarizing, and reporting data, and highlighting problem areas. DPC staff prepare monthly reports to the operations office technical representative relating to project costs incurred, staff hours used, work progress achieved, and problem areas. For example, in an April 1981 letter regarding one of the projects, the DPC staff consultant notified the operations office technical representative that DOE needed to promptly approve two subcontracts for the project to prevent slippage on one and voiding of the other.

According to operations office officials, DPC staff have no authority to direct managers or employees of Department of Energy research projects. Moreover, work performed by DPC is subject to the surveillance and written technical direction of a DOE technical manager. This can include redirection of contract effort, shifting of emphasis among work areas or tasks, and other technical guidance.

OTHER MATTERS

We found that, contrary to sound procurement practice, on two occasions the Department of Energy allowed DPC to begin work before a contract was formally executed. The first DPC contract was not executed until July 14, 1977; however, DPC claimed almost \$80,000 for work performed from May 3 through July 13, 1977. Work began even before negotiations were completed. Similarly, while the last supplemental agreement under this contract was not executed until June 23, 1978, DOE paid for work performed from April 1 through June 22, 1978.

DOE officials stated that this was done quite often at the time, but that in response to GAO recommendations they have taken

steps to eliminate the practice. GAO report EMD-81-12, "Unauthorized Commitments: An Abuse of Contracting Authority In the Department of Energy," December 4, 1980, disclosed that DOE procuring activities were authorizing a substantial number of contractors to proceed with work prior to negotiation and execution of contracts. That report recommended that the practice be stopped.

We obtained official oral comments from DOE, and informal comments from DCAA and DPC, on a draft of this report. They all essentially agreed with the report, but suggested minor changes which we made where appropriate.

If you have any questions, or if we can be of further assistance, please let us know.

Sincerely yours,


W. D. Campbell
Acting Director