U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL

NEVADA OPERATIONS OFFICE'S IMPLEMENTATION OF FULL COST RECOVERY POLICIES

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SUMMARY

Department of Energy (Department) policy is to recover the full cost of providing services to other Federal agencies and non-Federal entities. In keeping with this policy, the Nevada Operations Office (Nevada) bills and collects from other Federal agencies and non-Federal entities the Nevada Test Site support service allocation (test site allocation), depreciation, and administrative factors to achieve full cost recovery. Also, Nevada requires its management and operating contractors to recover these factors from orders received from other integrated contractors if the original source of funds requires such action.

Nevada's three integrated management and operating contractors did not consistently apply the proper rates for the test site allocation, depreciation, or administrative factors. One contractor, for example, did not apply the proper rates while the other two did not apply any rates. The inconsistency in rate application occurred because of internal control weaknesses and because the contractors did not request sufficient information about their customers. Also, Nevada did not adequately monitor the contractors' implementation of full cost recovery policies.

Based on our audit, Nevada did not recover at least $575,600 in test site allocation, depreciation, and administrative factor costs. Nevada agreed to implement our recommendations, including providing additional guidance to its management and operating contractors.

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PART I

APPROACH AND OVERVIEW

INTRODUCTION

The audit assessed whether the Nevada Operations Office's integrated management and operating contractors consistently recovered the full costs of performing cash work for integrated contractors.

SCOPE AND METHODOLOGY

The audit was conducted at the Nevada Operations Office from March through October 1994. Detailed audit information was obtained at Nevada's three integrated management and operating contractors: Reynolds Electrical and Engineering Company, Inc. (REECo), EG&G Energy Measurements (EG&G), and Raytheon Services Nevada (Raytheon).

The audit encompassed cash work orders (orders) for integrated contractors that were open on February 27, 1994. For the projects reviewed, costs incurred from October 1, 1991, through March 31, 1994, were verified. In performing the audit, we also:

- reviewed applicable laws, Department regulations and policies, and the contractors' operating procedures;
- reviewed previous audits and inspections conducted by the Office of Inspector General, Nevada, contractor internal auditors, or outside audit organizations;
- reviewed selected work orders;
- evaluated the billing process to ensure that only allowable and accurate costs were being charged; and,
- traced sample transactions in the computer systems to assure the reliability of the computerized records.

We selected a random sample of open cash work orders for REECo and EG&G and reviewed all of Raytheon's open cash work orders. REECo, EG&G, and Raytheon had 357, 178, and 39 open orders, respectively, on February 27, 1994.

The audit was conducted according to generally accepted Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. We relied extensively on computer-processed data and, therefore, examined that data to obtain assurance of its reliability.

We assessed the significant internal controls with respect to accounting and billing systems. Our assessment consisted of testing accounting transactions for their accuracy and reviewing the billings. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. Internal control weaknesses disclosed by the audit are discussed in Part II.

An exit conference was held with the Nevada Operations Office's Chief Financial Officer on December 6, 1994.

BACKGROUND

Although a nuclear test ban is now in effect, Nevada's mission includes ensuring that the Department is prepared to test nuclear weapons. As a means to efficiently and effectively utilize test site facilities, Nevada's three integrated management and operating contractors are permitted to accept work directly from other integrated Departmental contractors. This "cash work" should complement Nevada's mission and should not affect the contractors' normal work load.

Cash work is performed on a cost-reimbursable basis. Nevada's contractors are required to bill their integrated contractor customers monthly and the billing must be for the full cost of performing the service. Full cost includes the addition of the test site allocation as well as added factors for administration and depreciation, when they apply. For the period covered by the audit (October 1991 through March 1994), the three contractors had incurred costs of $80.9 million on cash work for integrated contractors.

An Office of Inspector General report issued November 28, 1988, "Funding and Costing Practices Used in Performing Work for Others at the Nevada Operations Office," discussed many problems associated with Nevada's handling of the work for others program. Nevada implemented all but one of the recommendations from that report. This audit reviewed the open issue on full cost recovery.

OBSERVATIONS AND CONCLUSIONS

Our audit showed that Nevada's integrated management and operating contractors were not consistently applying the appropriate allocations to cash work orders and, therefore, were not recovering the full costs of this work. One contractor, REECo, was not consistent in the application of the test site allocation and made errors in calculating the added factors. The other two contractors, EG&G and Raytheon, did not charge the test site allocation or the added factors when they were required.

These inconsistencies occurred because the contractors had internal control weaknesses or did not request sufficient funding information from their customers. REECo's procedures for the computerized billing system, for example, did not have internal controls to assure that the necessary data was in the data fields. EG&G and Raytheon did not request sufficient funding information from their integrated contractor customers. Responsible officials at both EG&G and Raytheon believed that all their work was for the Department's weapons testing or funded by the weapons testing program and, consequently, did not collect the test site allocation. Finally, Nevada did not adequately monitor the projects to assure compliance with Department orders and guidance.

In January 1993, Nevada's Chief Financial Officer issued guidance requiring the integrated management and operating contractors to determine the original funding source for all integrated contractor work. Since this guidance was issued, there has not been a change in compliance. Of the 42 orders with full cost recovery errors at the three contractors, 29 ($78,800) were after the start of Fiscal Year 1993.

Department Headquarters issued a new policy on integrated contractor orders, effective October 1, 1994. This policy requires all integrated contractor orders of $100,000 or more to be sent through the operations offices, thus giving the operations offices more control. However, only 7 of the 42 errors found were orders of $100,000 or more.

As a result, we recommended that certain allocable costs from active orders as of October 1, 1994, be recovered; that necessary corrections be made to contractor billing systems procedures; and, that appropriate funding information be obtained from customers. We also recommended that Nevada's Chief Financial Officer monitor the application and collection of allocable costs.

When preparing its yearend assurance memorandum on internal controls, Nevada should consider problems in the recovery of full costs on cash work orders a material internal control weakness.

PART II

FINDING AND RECOMMENDATIONS

Full Cost Recovery

FINDING

Federal Government, Department of Energy, and Nevada Operations Office policies require full recovery of all costs associated with work for others projects. At Nevada, such costs encompass a number of allocable categories, including administration, depreciation, and the costs of operating the test site. We found that Nevada's integrated management and operating contractors did not consistently recover these allocable costs when performing cash work for integrated contractors. Costs were not recovered either because of billing system internal control weaknesses or because the contractors did not gather sufficient information from their customers. At the same time, Nevada did not adequately monitor the recovery of allocable costs. Based on our audit results, Nevada did not recover about $575,600 in allocable costs.

RECOMMENDATIONS

We recommend that the Manager, DOE Nevada Operations Office:

1. Require Management and Operating contractors to:

   a. recover all allocable costs from the active projects as of October 1, 1994;

   b. make necessary corrections to their billing systems to ensure appropriate cost recovery; and,

   c. gather, before commencement of work, sufficient information about their customers and their customers' sources of funds to recover all appropriate costs.

2. Require the Chief Financial Officer to:

   a. monitor the application of allocable rates and,

   b. expand the coverage of the financial compliance reviews to include the review of the application of rates to the integrated contractor requests.

MANAGEMENT REACTION

Management concurred with the finding and agreed to implement the recommendations. Detailed management and auditor comments are provided in Part III of this report.

DETAILS OF FINDING

Office of Management and Budget Circular A-25, "User Charges," emphasizes the need to recover the full cost of providing governmental services. The Department implements this circular via DOE Order 2110.1A, "Pricing of Departmental Materials and Services.". This order defines full cost recovery as all direct costs, plus such allocable costs as depreciation and added factors, including administrative factors for headquarters and local operations offices.

Nevada's policy further defines full cost recovery to include a test site allocation. The test site allocation recovers the cost of maintaining the Nevada Test Site's infrastructure, including its cafeteria, water, road maintenance, and other categories of costs. The test site allocation varies based on the original funding source and the area of the test site where contractors perform the work.

Proper recovery of allocable costs requires Nevada's contractors to determine the original funding source among their integrated contractor customers. For example, the headquarters and local administrative added factors do not apply to work performed for other Departmental programs. However, they do apply to work performed for other Federal agencies and, consequently, should be recovered from that category of customer. Fiscal Year 1993 guidance from Nevada specifically stated that the original funding source must be determined for each customer. The following schedule shows which allocable cost categories apply to the various potential customers.

ALLOCABLE COSTS

PROGRAM FUNDING SOURCE	RATES THAT APPLY: NEVADA TEST SITE SUPPORT SERVICES ALLOCATION	DEPRECIATION	DOE ADMINISTRATIVE: HEADQUARTERS	LOCAL
DOE:				
WEAPONS TESTING	NO	NO	NO	NO
OTHER PROGRAMS	YES	NO	NO	NO
OTHER FEDERAL AGENCIES:				
DNA*	NO	NO	YES	YES
OTHER AGENCIES	YES	NO	YES	YES
NON-FEDERAL	YES	YES	YES	YES

* DNA is the Defense Nuclear Agency which has a waiver from the test site allocation.

The various combinations of applicable rates shown in the chart illustrate the importance of identifying the original funding sources to ensure proper allocation of costs. Identification of original funding sources is also a requirement of Nevada Operations Office's Order NV-4300.2A-9, "Non-Department of Energy Funded Work."

NEVADA OPERATIONS OFFICE CONTRACTORS' COST RECOVERY

We found that Nevada Operations Office's three integrated management and operating contractors did not consistently recover the appropriate allocable costs from their customers. For the three contractors combined, we reviewed 196 work orders and noted 42 errors in application of allocable costs.

REECo

REECo did not consistently recover the test site allocation and added factors. Our statistical sample revealed 30 errors in 87 orders selected from a universe of 357 total active orders. For example, during Fiscal Year 1992, REECo did not recover approximately $502,000 for test site allocation from Westinghouse of Ohio for low-level waste disposal.

REECo also did not recover about $18,200 for work performed for Lawrence Livermore National Laboratory in Fiscal Year 1993 on a project funded by the Department of Defense. REECo's budget branch noted that in this case, both the test site allocation and the local factor applied. However, REECo's finance office overlooked these rates when preparing the monthly billings. When we informed REECo's chief accountant about this example, REECo took immediate corrective action and received full payment from Lawrence Livermore National Laboratory.

Additionally, REECo did not recover the correct test site allocation, depreciation, or administrative factors for services provided to a private firm (Fiscal Years 1992 - 1994). REECo over-recovered a combined total of about $1,800 from this firm. For example, REECo billed the firm about $10,840 for February 1994. Applying the proper rates for the test site allocation, depreciation, and administrative factors, REECo should have billed $10,770, equating to an over-billing of $70. Similar billing errors occurred almost monthly since October 1991.

EG&G

A statistical sample for EG&G cash work disclosed 2 errors in a sample of 70 work orders reviewed out of a universe of 178 active work orders. Both errors occurred because EG&G did not apply the test site allocation. In one case, EG&G did not collect the $9,900 test site allocation on work performed for Lawrence Livermore National Laboratory for delivery of jet fuel at the test site. This was not weapons testing work and the test site allocation, therefore, applied.

Raytheon

We reviewed all 39 of Raytheon's cash work orders and found 10 errors. All the errors occurred because Raytheon did not apply the test site allocation. For example, we noted that Raytheon did not recover $4,200 for test site allocation on a project for Sandia National Laboratory. The project was funded by the Department's Office of Environmental Management and required work at the test site.

INTERNAL CONTROLS AND MONITORING

These errors occurred because the management and operating contractors had weak internal controls for the recovery of allocable costs or they did not gather sufficient information about their customers. REECo's computerized billing system, for example, did not have the necessary data in the fields to ensure that the appropriate rates were recovered. Also, REECo officials told us that personnel changes, due to retirements and reassignments, were responsible for some of the errors.

EG&G and Raytheon did not know the source of their customers' funds. Both believed all their work was for the Department's weapons testing or funded by the weapons testing program. They concluded, therefore, that the allocable costs did not apply to any of their cash work orders. Consequently, EG&G

and Raytheon did not request sufficient information on their customers and had not determined the allocable costs on their work orders.

We also found that Nevada did not monitor the contractors' recovery of allocable costs. Although Nevada issued specific guidance for handling the allocable cost in Fiscal Year 1993, significant errors still occurred because the Chief Financial Office officials did not ensure compliance with that guidance.

TEST SITE ALLOCATION AND ADDED FACTORS RECOVERY

In reviewing the 196 cash work orders, we found that Nevada's management and operating contractors made 42 errors, amounting to about $575,600 in allocable costs not recovered. Because one item accounted for 87 percent of the total dollar error in the sample, there was a very wide range in the potential unrecovered allocable costs if the sample was projected to the universe of 574 work for others orders. The sample does provide, however, a reliable estimate of the number of billing errors that would be expected. Based on the errors found, we are 95 percent confident that the universe of 574 cash work orders contained between 101 and 174 billing errors (see Appendix).

In our opinion, the errors are not limited to the $575,600 identified in our sample. Significant recoveries can likely be obtained by evaluating the cash work orders that were still open as of October 1, 1994, to identify incorrect application of test site allocation, depreciation, or administrative factors. Significant recovery will also be obtained by instituting corrective actions to ensure that appropriate rates are applied in future years.

PART III

MANAGEMENT AND AUDITOR COMMENTS

In responding to the Initial Draft Report, Management concurred with the finding and agreed to implement the recommendations. Management and auditor comments on specific recommendations follow.

Recommendation 1.

Management Comments. Management stated that it would reemphasize existing guidance on full cost recovery and provide additional guidance needed. In addition, the contractors will be directed to provide formal action plans for implementation of the recommendations.

Auditor Comments. Management comments and action are responsive to the recommendation.

Recommendation 2.

Management Comments. Management stated that it would include coverage of the application of allocable rated in its Fiscal Year 1995 financial oversight activities.

Auditor Comments. Management comments and action are responsive to the recommendation.

PART IV

APPENDIX

STATISTICAL SAMPLE PROJECTIONS BY MANAGEMENT AND OPERATING CONTRACTOR AT A 95 PERCENT CONFIDENCE LEVEL

Contractor	Number of Errors	Total Sample	Total Universe	Error Range Low	Error Range High
REECo	30	87	357	92	154
EG&G	2	70	178	2	10
Raytheon	10	39	39	10	10
Totals	42	196	574	104	174

Contractor	Actual Dollars
REECo	$537,600
EG&G	12,000
Raytheon	26,000
Totals	$575,600

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