



U.S. Department of Energy
Office of Inspector General
Office of Audit Services

Audit Report

Management Controls over BWXT's Teaming Partner Arrangement at Pantex



Department of Energy

Washington, DC 20585

February 8, 2006

MEMORANDUM FOR THE ASSOCIATE ADMINISTRATOR FOR MANAGEMENT AND ADMINISTRATION, NATIONAL NUCLEAR SECURITY ADMINISTRATION

FROM: *George W. Collard*
MANAGER, PANTEX SITE OFFICE
George W. Collard
Assistant Inspector General
for Performance Audits
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Management Controls over
BWXT's Teaming Partner Arrangement at Pantex"

BACKGROUND

The Pantex Plant (Pantex) is a Department of Energy (Department) facility that is a critical part of the National Nuclear Security Administration (NNSA). The facility assembles and disassembles nuclear weapons, provides surveillance of nuclear weapons in the weapons stockpile, and stores nuclear weapon components.

In July 2000, the Department awarded BWXT Pantex, L.L.C. (BWXT) a five-year management and operating contract for Pantex. The award was based in part on BWXT's teaming arrangement, which included an integrated subcontract with Bechtel North Texas, Inc. (Bechtel). Under this teaming arrangement, Bechtel provides BWXT with key personnel to execute the construction/project management functions at Pantex. This teaming arrangement differs from traditional contractor-subcontractor relationships since Bechtel receives a percentage of BWXT's fee paid by the Department under the management and operating contract, and Bechtel personnel are integrated into key positions of authority in the BWXT organization. In 2003, BWXT approved a subcontract modification that allowed Bechtel to non-competitively obtain services from its parent corporation, Bechtel National, Incorporated (Bechtel National).

Since BWXT and Bechtel are related parties at Pantex, we conducted the audit to determine whether BWXT minimized costs to the Department when administering the Bechtel subcontract.

RESULTS OF AUDIT

We found that BWXT did not always act to minimize costs to the Department when administering the Bechtel subcontract. Specifically, BWXT included Bechtel employees in the Department-funded post-retirement health benefits plan without Departmental



approval and BWXT reimbursed the parent company of Bechtel, Bechtel National, for indirect costs in excess of contract limits. This occurred because the Pantex Site Office did not: 1) ensure that BWXT complied with contractual provisions that limited post-retirement health benefits to BWXT employees, and 2) implement adequate controls to mitigate potential conflict of interest situations involving purchases from Bechtel National and affiliates. As a result, the Department was at risk of paying \$3 million in post-retirement health benefits for individuals who were ineligible for the benefits. Additionally, the Department has reimbursed BWXT approximately \$90,000 for questionable costs associated with indirect charges made by Bechtel National.

During our review we identified a similar teaming arrangement at the Department's Nevada Test Site (Nevada). According to Nevada personnel, integrated subcontractor/teaming partner employees could receive Government-funded post-retirement health benefits.

The Office of Inspector General has previously identified problems related to contractor post-retirement health benefits. In our report, *Contractor Post-Retirement Health Benefits at the Oak Ridge Reservation* (DOE/IG-0690, May 2005), we found that the Department's NNSA incurred unreasonable costs for contractor employee post-retirement health benefits at the Y-12 National Nuclear Security Complex (Y-12). NNSA was paying 100 percent of the employer's portion of post-retirement health benefits for Y-12 employees who transferred from the corporate offices of BWXT and Bechtel National regardless of how long they worked in the Department's service. This will result in a future liability of more than \$7 million for BWXT/Bechtel employees at Y-12. Based on our report, NNSA agreed to modify all contracts at the earliest opportunity to ensure that non-Department corporate service credit for transfers does not count toward eligibility for post-retirement health benefits.

MANAGEMENT REACTION

Management concurred with our recommendations and indicated that they had initiated corrective actions to address the recommendations. Additionally, management stated that subsequent to the completion of our fieldwork, Bechtel became a member of BWXT Pantex, L.L.C. and all of the Bechtel employees at Pantex were transferred to BWXT. While these actions should eliminate the risk of inappropriate future payments for post-retirement health benefits and ensure that future related party transactions with Bechtel National are subjected to Department oversight, the Department needs to ensure that related party transactions are identified and appropriately controlled in the future. Management comments are summarized in our report and are included in their entirety in Appendix 3.

Attachment

cc: Administrator, National Nuclear Security Administration
Chief of Staff
Manager, Pantex Site Office
Director, Policy and Internal Controls Management, NA-66

REPORT ON MANAGEMENT CONTROLS OVER BWXT'S TEAMING PARTNER ARRANGEMENT AT PANTEX

TABLE OF CONTENTS

Teaming Partner Arrangement

Details of Finding 1

Recommendations 2

Comments 3

Appendices

1. Objective, Scope, and Methodology 5

2. Prior Audit Reports 7

3. Management Comments 8

Teaming Partner Arrangement

Related Party Transactions

BWXT Pantex, L.L.C. (BWXT) did not always act to minimize costs to the Department of Energy (Department) when administering the Bechtel North Texas, Inc. (Bechtel) subcontract. Specifically, BWXT included Bechtel employees in its Government-funded post-retirement health benefits plan without Department approval. In addition, BWXT paid indirect charges from Bechtel's parent company, Bechtel National Incorporated (Bechtel National) in excess of contractual amounts.

BWXT included Bechtel employees in its Government-funded post-retirement health benefits plan without Department approval. At the time of the subcontract award, BWXT had indicated that it would seek Departmental approval to include Bechtel employees in the post-retirement health benefits plan. Although it did not seek or obtain Departmental approval, BWXT included one Bechtel retiree in the post-retirement health plan who is currently receiving benefits. Additionally, 29 current Bechtel employees may, upon retirement, receive post-retirement health benefits. Specifically, BWXT included these 29 employees in the annual calculation of liability for Government-funded post-retirement benefits.

BWXT also paid Bechtel approximately \$90,000 in questionable costs, or approximately 10 percent of work order values, for indirect charges that were in excess of contractual rates. For example, in May 2003, BWXT approved the temporary transfer of a Bechtel National employee to Pantex to provide support services for environmental remediation. BWXT agreed to pay \$83 per hour for the employee's services. However, BWXT incurred charges of \$110 per hour for this individual once the final rate was received from Bechtel National.

Oversight and Control Structure

The Pantex Site Office did not ensure that BWXT:

- Complied with contractual provisions that limited post-retirement health benefits to BWXT employees; and,
- Established adequate controls to mitigate potential conflict of interest situations involving purchases from Bechtel and Bechtel National

The BWXT prime contract states that only BWXT employees are eligible for the post-retirement health benefits package; however, the Pantex Site Office did not require BWXT to adhere to contractual limitations. BWXT included Bechtel employees in

Government-funded post-retirement health benefits despite the fact that they did not transfer to BWXT. In response to our review, the Pantex Site Office issued a memorandum to BWXT which stated that Bechtel employees were not eligible to participate in the BWXT post-retirement health benefits program. The Pantex Site Office based its determination on the fact that Bechtel employees do not transfer to BWXT, but remain employees of Bechtel while working at Pantex.

In addition, the Pantex Site Office did not require BWXT to provide a conflict of interest mitigation plan for purchases from Bechtel National even though Bechtel and its employees have influence at BWXT, and the Department has required other contractors to provide conflict of interest mitigation plans for purchases from affiliates. Bechtel is in a position to influence BWXT purchase decisions since Bechtel has non-voting representation on the BWXT Board of Managers, and Bechtel personnel directly impact the amount of fee BWXT earns as a result of the teaming relationship. Since BWXT was not required to adopt a conflict of interest mitigation plan, it did not apply contract provisions that would have required it to obtain contracting officer pre-approval of all purchases from corporate affiliates and document external review of indirect rates.

Overstated Liabilities and Costs Incurred

As a result, the Department was at risk of paying \$3 million in post-retirement health benefits for retirees who were not eligible to receive the benefits. In addition, the Department was at risk of reimbursing BWXT for questionable costs in indirect rates associated with \$1,000,000 in costs for work performed by Bechtel.

During our review we identified a similar teaming arrangement at the Department's Nevada Test Site (Nevada). According to Nevada personnel, integrated subcontractor/teaming partner employees could receive Government-funded post-retirement health benefits.

RECOMMENDATIONS

We recommend that the:

1. Manager, Pantex Site Office:
 - a. Determine the allowability of costs incurred for purchases made from Bechtel affiliates and funds already spent to provide post-retirement health benefits to Bechtel employees;

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- b. Determine the appropriateness of including Bechtel employees in the BWXT post-retirement health benefits plan, and if necessary, remove employees from the health benefits plan and reduce the associated liability; and,
 - c. Direct BWXT to cease awards to Bechtel affiliates until controls over related-party transactions, which include a Department-approved Organizational Conflict of Interest Mitigation Plan with thresholds for Department notification and consent, are implemented.
2. Associate Administrator for Management and Administration, National Nuclear Security Administration (NNSA):
- a. Develop and issue guidance related to employee benefits for integrated subcontractors included in teaming partner arrangements; and,
 - b. Determine whether controls over integrated subcontractors at Nevada and any other site with teaming partner arrangements are adequate to protect the Government's interest.

MANAGEMENT REACTION

Management concurred with our recommendations and indicated that they had initiated corrective actions to address our recommendations. Specifically management: 1) began the allowability determination process for purchases from Bechtel affiliates, 2) requested that BWXT provide the amount of funds spent to date for the Bechtel employee receiving post-retirement health benefits, and 3) requested that BWXT provide an Organizational Conflict of Interest Mitigation Plan for related party transactions. In addition, Department management stated that Bechtel became a member of BWXT Pantex, L.L.C., and all Bechtel employees were transferred to BWXT. These actions should eliminate the risk of inappropriate future payments for post-retirement health benefits and subject future related party transactions to Department control.

Management did not agree that the Department was at risk of paying \$3 million in post-retirement health benefits to Bechtel retirees who were not eligible for the benefit. Management also emphasized that they have consistently ensured that BWXT complied with contractual provisions. After management learned that a Bechtel employee was going to retire with BWXT post-retirement health benefits, they issued a memorandum to BWXT stating that Bechtel employees were not eligible to participate in the BWXT post-retirement health benefits program.

**AUDITOR
COMMENTS**

Management's comments and actions are responsive to our recommendations. In addition, we commend NNSA and BWXT Pantex on their actions taken upon learning of the issues identified during the audit. The Pantex Site Office was supportive throughout the audit and was responsive by issuing clarification related to the allowability of post-retirement health benefits for Bechtel employees.

However, Management's assertion that Department funds were not at risk was not supported by past practice, since Bechtel employees were consistently included in the post-retirement health benefit liability disclosed in the Department's annual financial statements. Additionally, BWXT used Department funds to pay post-retirement health benefits for one employee. This occurred despite guidance to the contrary. These costs have yet to be recovered by the Department.

Appendix 1

OBJECTIVE The objective of this audit was to determine whether BWXT minimized costs to the Department when administering the Bechtel subcontract.

SCOPE The audit was performed from April 2005 through January 2006, at Department of Energy Headquarters in Washington, D.C. and the Pantex Plant in Amarillo, Texas. The scope of the audit included Department-funded post-retirement health benefits for Bechtel employees at Pantex after February 2001, and the contractual relationship between BWXT and Bechtel May 2003 to September 2005.

METHODOLOGY To accomplish the audit objective, we:

- Interviewed NNSA Headquarters procurement and benefits personnel;
- Discussed benefits with NNSA Service Center and Pantex Site Office employees;
- Calculated the estimated liability for post-retirement health benefits at Pantex;
- Reviewed the BWXT prime contract and Bechtel subcontract;
- Reviewed existing work order authorizations under the subcontract's supplemental agreement;
- Evaluated BWXT controls over related-party transactions; and,
- Reviewed applicable regulations, Departmental Orders, procedures, and practices related to post-retirement health benefits.

We conducted the audit in accordance with 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. Because our review was limited, it would not necessarily have

Appendix 1 (continued)

disclosed all internal control deficiencies that may have existed at the time of our audit. We conducted a limited assessment of computer-processed data related to personnel information for the Bechtel employees. We found the data to be reliable.

Finally, we assessed the Department's compliance with the Government Performance and Results Act of 1993. The Department did not establish specific performance measures related to contractor post-retirement health benefits or teaming arrangements at Pantex.

Management waived the exit conference.

PRIOR AUDIT REPORTS

Office of Inspector General

- *Contractor Post-Retirement Health Benefits at the Oak Ridge Reservation* (DOE/IG-0690, May 2005). The audit found that the National Nuclear Security Administration (NNSA) incurred costs that were considered to be unreasonable for contractor employee post-retirement health benefits at the Y-12 National Nuclear Security Complex (Y-12). Specifically, the NNSA was paying 100 percent of the employer's portion of post-retirement health benefits for Y-12 employees who transferred from the corporate offices of BWXT and Bechtel National regardless of how long they work in the Department's service. We estimated that NNSA will incur costs of about \$460,000 for currently retired contractor employees and accrue a future liability of more than \$7 million for BWXT/Bechtel employees currently working at Y-12. This occurred because the Department did not have a corporate policy regarding its contractor post-retirement health benefit program.

Government Accountability Office

- *Department of Energy: Certain Postretirement Benefits for Contractor Employees Are Unfunded and Program Oversight Could Be Improved* (GAO-04-539, April 2004). The GAO found that as of September 30, 2003, the Department reported an estimated \$13.4 billion in unfunded contractor post-retirement health and pension benefits. The approval and monitoring of Department contractor employee pension and post-retirement health benefits was primarily the responsibility of Department contracting officers, who administered contracts at individual contractor locations. Management did not systematically review information developed at individual contractor locations to identify best practices or areas where benefit comparisons do not adhere to agency requirements or guidance. Developing and disseminating this information agency-wide would enhance the Department's oversight of contractor employee benefit costs.




Department of Energy
National Nuclear Security Administration
Washington, DC 20585



JAN 06 2006

MEMORANDUM FOR George W. Collard
Assistant Inspector General
for Performance Audits

FROM: Michael C. Kane 
Associate Administrator
for Management and Administration

SUBJECT: Comments to Draft Report on BWXT's Teaming
Partner Arrangement at Pantex; A05OR041/2005-
12821

The National Nuclear Security Administration (NNSA) appreciates the opportunity to review the Inspector General's (IG) draft report, "BWXT's Teaming Partner Arrangement at Pantex." The Pantex Site Office has expressed their appreciation for the courtesy and professionalism extended by the IG auditors to Site Office and contractor staff during the audit. The auditors kept both elements well informed of the results of the audit and gave every opportunity to provide feedback concerning the audit.

NNSA is providing the following general comments to the report as well as specific comments to the recommendations.

- **Results of Audit;** "This occurred because the Site Office did not: 1) ensure that BWXT complied with contractual provisions that limited post-retirement benefits to BWXT employees; ..."
- **Oversight and Controls;** "The BWXT prime contract states that only BWXT employees are eligible for the post-retirement benefits package; however, the Pantex Site Office did not require BWXT to adhere to contractual limitations."
- **Overstated Liabilities;** "The Department is at risk of paying at least \$3 million in post-retirement health benefits to retirees who are not eligible for such benefits."

The response addresses all three of the bullet points collectively. One could get the impression that the Site Office intentionally allowed BWXT to disregard contract provisions. In fact, the Site Office has consistently ensured that BWXT comply with contractual provisions. Prior to the audit, there were no Bechtel North Texas (BNT) employees who had retired at the Pantex Plant. However once the Site Office learned that a BNT employee was going to retire and that BWXT intended to provide that individual with post retirement health benefits, the Site Office issued a memorandum to BWXT stating that BNT employees were not eligible to participate in the BWXT post-retirement health benefits program. The Site Office based its determination on the fact that BNT employees do not transfer to BWXT, but remain employees of BNT while working at Pantex.

Additionally, the Site Office became aware that BWXT is providing post-retirement health benefits to one BNT employee despite the Site Office's memorandum. The Site Office requested BWXT to provide the actual dollar figure that has been spent to date for post-retirement benefits for that individual. The Site Office will then make an allowability cost determination once the requested information is received.

Rather than what is claimed in the audit report, the Department is not at risk of paying at least \$3 million in post-retirement health benefits to retirees who are not eligible for such benefits, since BNT employees were not eligible to participate in the BWXT post-retirement health benefit program. As an aside, Bechtel became a part of BWXT Pantex LLC as of October 1, 2005. Subsequently, all BNT employees became employees of BWXT on December 19, 2005, and are now eligible to participate in BWXT's post-retirement health benefits program.

Recommendations for the Site Office Manager:

1. "Determine the allowability of costs incurred for purchases made from Bechtel affiliates and funds already spent to provide benefits to Bechtel employees."

Concur

The Site Office began the allowability determination process for the purchases from Bechtel affiliates by requesting BWXT to obtain completion vouchers for each of the Work Order Authorizations. These vouchers reflect the actual cost of work performed. After receipt, the Site Office and BWXT will validate the costs, and then the Site Office will seek reimbursement from Bechtel for any over payment.

As far as funds already spent to provide post-retirement health benefits to BNT employees, the Site Office requested BWXT to provide the actual dollar figure that has been spent to date for post-retirement benefits for the one BNT employee who is currently receiving the benefit. At that point an allowability cost determination will be made.

We believe that we have met the intent of the recommendation.

2. "Determine the appropriateness of including Bechtel employees in the BWXT post-retirement health benefits plan, and if necessary, remove employees from the health benefits plan and reduce the associated liability."

Concur

While we agree with the recommendation, as we stated earlier, BNT employees became employees of BWXT effective December 19, 2005 because Bechtel became a member of BWXT Pantex LLC on October 1, 2005.

Therefore, the intent of the recommendation has been met.

3. "Direct BWXT to cease awards to Bechtel affiliates until controls over related-party transactions, which include a Department-approved Organizational Conflict of Interest Mitigation Plan with thresholds for Department notification and consent, are implemented.

Concur

The Site Office requested BWXT, on December 19, 2005, to submit an Organizational Conflict of Interest Mitigation Plan for related party transactions to the Site Office by January 16, 2006. In the interim, the Site Office has directed that all related party transactions, including those to affiliates of Bechtel, will be reviewed and approved by the Site Office Contracting Officer.

We believe that the intent of this recommendation has been met.

Recommendations for the Associate Administrator for Management and Administration:

1. "Develop and issue guidance related to employee benefits for integrated subcontractors included in teaming partner arrangements."

Concur

NNSA will assess the appropriate guidance vehicle working in consort with the Department of Energy during the development of their over-arching pension/post retirement benefits policy. After development, NNSA will use the policy to assess adequacy of existing arrangements and to guide the design of new ones.

2. “Determine whether controls over integrated subcontractors at Nevada and any other site with teaming partner arrangements are adequate to protect the Government’s interest.”

Concur

As stated above, NNSA will assess the appropriate guidance vehicle working in consort with the Department of Energy during the development of their over-arching pension/post retirement benefits policy. After development, NNSA will use the policy to assess adequacy of existing arrangements and to guide the design of new ones.

Should you have any questions related to this response, please contact Richard Speidel, Director, Policy and Internal Controls Management.

cc: Robert Braden, Senior Procurement Executive
Daniel Glenn, Manager, Pantex Site Office
Karen Boardman, Director, Service Center

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