



OFFICE OF INSPECTOR GENERAL

Catalyst for Improving the Environment

Audit Report

EPA Should Further Limit Use of Cost-Plus-Award-Fee Contracts

Report No. 08-P-0093

February 26, 2008



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Abbreviations

CPAF	Cost-Plus-Award-Fee
EPA	U.S. Environmental Protection Agency
EPAAR	Environmental Protection Agency Acquisition Regulation
OIG	Office of Inspector General
PEB	Performance Evaluation Board

Cover photo: A site in Benton Harbor, Michigan, that had been cleaned up using a Region 5 Cost-Plus-Award-Fee contract (photo courtesy EPA).



At a Glance

Catalyst for Improving the Environment

Why We Did This Review

We sought to determine whether the U.S. Environmental Protection Agency (EPA):

- Used award fee plans for Cost-Plus-Award-Fee (CPAF) contracts that clearly identified the specific award fee criteria and properly established performance indicators;
- Achieved a higher level of performance by using this contract type; and
- Sufficiently reviewed, approved, and awarded fees.

Background

CPAF contracts are used to motivate contractors to provide a high level of performance. CPAF contracts provide base fees and award amounts based on a judgmental evaluation by EPA. In recent years, EPA has begun to move away from using CPAF contracts. As of October 2006, EPA had 14 active CPAF contracts valued at \$4.2 billion.

For further information, contact our Office of Congressional and Public Liaison at (202) 566-2391.

To view the full report, click on the following link:
www.epa.gov/oig/reports/2008/20080226-08-P-0093.pdf

EPA Should Further Limit Use of Cost-Plus-Award-Fee Contracts

What We Found

While EPA has paid contractors nearly \$16 million in award fees over the past 10 years on the nine contracts reviewed, it has no assurance that the use of CPAF contracts facilitates a higher level of performance than other types of contracts. EPA CPAF contracts generally contain performance indicators tied to the Agency's mission. EPA consistently provided contractors with high ratings and award fees. However, we could not determine if EPA properly awarded fees because it did not sufficiently document the basis for the ratings. Because EPA consistently provided high ratings, we believe award fees are more of an expectation for contractors rather than a factor that motivates excellence.

In some instances, EPA paid a higher base fee than allowed by the EPA Acquisition Regulation. We found five contracts that contained a base fee percentage higher than the 3 percent allowed. Two of those contracts have significant time remaining. For those two, we estimated that EPA overpaid about \$100,000 of base fee through July 2007, and will overpay another \$760,000 over the remaining life of the contracts. The high base fees were provided because of a lack of knowledge by EPA employees regarding the regulation and an oversight by Headquarters.

Developing and administering CPAF contracts is a labor intensive process, and many EPA employees involved with contract management believe that competition is a more effective way to motivate contractors. Also, the CPAF process could be made less burdensome. The calculation used to compute base fees on these contracts is overly complex, and eliminating the requirement for contractors to submit self evaluations could save up to \$50,000 over the course of a contract.

What We Recommend

We recommend that EPA further limit the use of CPAF contracts by revising the Contracts Management Manual to require that a cost-benefit analysis be conducted prior to awarding a CPAF contract. In instances when CPAF contracts are used, we recommend that EPA better document the basis for decisions to substantiate the performance ratings given. EPA should also modify its contracts to bring them into compliance with the EPA Acquisition Regulation to avoid the future overpayment of base fees. Further, EPA should simplify its CPAF process. EPA agreed with a majority of our recommendations or provided a valid alternative. EPA did not agree with some of our recommendations related to simplifying the CPAF process, and those recommendations have been revised for the final report.



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
INSPECTOR GENERAL

February 26, 2008

MEMORANDUM

SUBJECT: EPA Should Further Limit Use of Cost-Plus-Award-Fee Contracts
Report No. 08-P-0093

FROM: Melissa M. Heist *Melissa M. Heist*
Assistant Inspector General for Audit

TO: Luis A. Luna
Assistant Administrator for Administration and Resources Management

Donald S. Welsh
Regional Administrator, Region 3

Mary A. Gade
Regional Administrator, Region 5

This is our report on the subject audit conducted by the Office of Inspector General (OIG) of the U.S. Environmental Protection Agency (EPA). This report contains findings that describe the problems the OIG has identified and corrective actions the OIG recommends. This report represents the opinion of the OIG and does not necessarily represent the final EPA positions. Final determinations on matters in this report will be made by EPA managers in accordance with established audit resolution procedures.

The estimated cost of this report – calculated by multiplying the project's staff days by the applicable daily full cost billing rates in effect at the time – is \$336,936.

Action Required

In accordance with EPA Manual 2750, you are required to provide a written response to this report within 90 calendar days. You should include a corrective action plan for agreed upon actions, including milestone dates. We have no objections to the further release of this report to the public. This report will be available at <http://www.epa.gov/oig>.

If you or your staff have any questions, please contact Michael Petscavage, Acting Director, Contract Audits, at 202-566-0897 or Pescavage.Michael@epa.gov.

Table of Contents

Chapters

1	Introduction	1
	Purpose	1
	Background	1
	Noteworthy Achievements	2
	Scope and Methodology	3
	Internal Control Structure	3
2	EPA Not Assured CPAF Contracts Provide High Performance	4
	EPA Consistently Provided Contractors High Performance Ratings	4
	EPA Needs to Improve Documentation for Performance Ratings	6
	CPAF Contracts May Not Be Worth the Associated Costs	7
	Conclusion	8
	Recommendations	9
	Agency Response and OIG Comments	9
3	EPA Paid Higher Base Fees than EPAAR Allows	10
	Potential Overpayments Noted	10
	Recommendations	11
	Agency Response and OIG Comments	11
4	Other Matters	12
	Computation of Base Fees Is Overly Complex	12
	Contractor Self Evaluations of Minimal Value	12
	Minor Errors Noted	13
	Recommendations	13
	Agency Response and OIG Comments	13
	Status of Recommendations and Potential Monetary Benefits	15

Appendices

A	Agency Response	16
B	Distribution	20

Chapter 1

Introduction

Purpose

The U.S. Environmental Protection Agency (EPA) is currently using several large dollar value Cost-Plus-Award-Fee (CPAF) contracts. The Office of Inspector General (OIG) initiated this audit of CPAF contracts to determine whether EPA:

- Used award fee plans that (1) clearly identified the specific award fee evaluation criteria, and (2) properly established performance indicators that are tied to the Agency's mission and goals;
- Achieved a higher level of performance in support of the Agency's mission through the use of award fees; and
- Sufficiently reviewed, approved, and awarded fees according to the established award fee plan.

Background

EPA can choose among several contract types to acquire products and services, one of which is a CPAF contract. A CPAF contract is a cost-reimbursement contract that provides for a fee consisting of a base amount (which may be zero) and an award amount based on a judgmental evaluation by EPA. Federal Acquisition Regulation 16.305 states that the award fee amount should be sufficient to provide motivation for excellence in contract performance. Excellent performance is generally sought in areas of quality, timeliness, technical ingenuity, and cost-effective management.

EPA has historically used CPAF contracts as a way to motivate contractors to provide higher-than-satisfactory performance. All of the Agency's regional Remedial Action Contracts were CPAF contracts at one time. However, EPA has begun to move away from using CPAF contracts and is using other contracting methods to motivate contractors. Although some of the Remedial Action Contracts are no longer CPAF, those that still exist represent large dollar amounts. As of October 2006, EPA had 14 active CPAF contracts, valued at \$4.1 billion.

EPA's Office of Administration and Resources Management sets policy for using contracts, including CPAF contracts, and oversees the general use of such contracts. Headquarters offices and the regions award and administer the actual contracts. This includes evaluating the contractor's performance and providing award fees. For the most part, EPA specifies award fee evaluation criteria and performance indicators that are tied to the Agency's mission and goals.

Table 1-1 provides a general overview of the process for evaluating and determining CPAF award fees, which occurs every 6 months.

Table 1-1: General Overview of Award Fee Process

1. The project officer distributes a call letter to work assignment managers.
2. The work assignment managers evaluate active and completed work assignments and provide written evaluations to the project officers.
3. The project and contracting officers evaluate the contractor's program support (i.e., administrative and technical support, mobilization, and reporting) and the project officer evaluates the contractor's overall performance.
4. The contracting officer calculates the available award fee for completed work assignments.
5. The project officer compiles evaluation material, including material for the Performance Evaluation Board (PEB) to review. The project officer uses several interim ratings to compute a weighted average score for completed work assignments.
6. The PEB members review evaluation material prior to the PEB meeting.
7. The PEB meets to discuss contractor performance. Attendees include all PEB members, project officers, contracting officers, and sometimes work assignment managers.
8. The project officer (sometimes assisted by the contracting officer) prepares a report that summarizes the PEB's decision and presents it to the PEB for signature.
9. The project officer coordinates and chairs a debriefing with the contractor.
10. The contracting officer verifies fee calculations and prepares a letter for signature by the EPA fee determination official.
11. Once a fee determination letter is signed, the contracting officer issues a contract modification allowing the contractor to bill for the award fee.

Source: OIG analysis of EPA data

Noteworthy Achievements

In lieu of CPAF contracts, EPA in some instances has begun using performance-based contracts and competition to motivate contractor performance. Many PEB members believe competition and the anticipation of future work are better motivators than award fees. EPA is also considering other types of contracts to motivate contractor performance, such as award-term contracts, where contractors can earn extra contract years based on their performance.

EPA Headquarters took prompt action to correct inadequate documentation requirements for one Headquarters contract. The award fee plan for this contract actually required performance evaluation documentation to only be retained for 1 year. When we informed the contracting officer of this condition, the

contracting officer immediately modified the contract to require documentation to be maintained well beyond the completion of the contract.

Scope and Methodology

We performed this audit from March to September 2007 in accordance with generally accepted government auditing standards, issued by the Comptroller General of the United States. We visited EPA Headquarters in Washington, DC, as well as EPA regional offices in Philadelphia, Pennsylvania (Region 3), and Chicago, Illinois (Region 5).

To accomplish our objectives, we reviewed the Federal Acquisition Regulation, the EPA Acquisition Regulation (EPAAR), and EPA's Contracts Management Manual. We performed in-depth reviews of the award fee process for 9 of 14 CPAF contracts, with a total contract value of over \$2 billion. The nine contracts selected were awarded by Headquarters and Regions 3 and 5. Headquarters awarded the largest dollar value CPAF contracts. Region 3 was discontinuing the use of CPAF contracts, while Region 5 had recently awarded two large CPAF contracts. We reviewed contract files, award fee plans, Work Assignment Completion Reports, and PEB documentation at both Headquarters and regional locations. Additionally, we reviewed the base fee percentages for all 14 CPAF contracts. We interviewed Headquarters personnel, as well as project officers, contracting officers, and PEB members in Regions 3 and 5. Although we reviewed prior OIG reports related to CPAF contracts, we did not follow up on any of the recommendations in those reports because they did not relate to our objectives.

Internal Control Structure

In planning and performing our audit, we reviewed management controls related to our objectives. As part of this review, we examined the Agency's Contracts Management Manual and other guidelines that outline EPA's controls and monitoring procedures used under CPAF contracts. We confirmed our understanding of these controls and procedures through interviews and documentation reviews. We also reviewed documents EPA completed in compliance with the Federal Managers' Financial Integrity Act. This included a review of EPA's Fiscal Year 2005 and 2006 Performance and Accountability Reports, in addition to integrity assurance letters prepared by the Office of Administration and Resources Management and Office of Solid Waste and Emergency Response. EPA did not report any material or Agency weaknesses related to its use and management of CPAF contracts.

Chapter 2

EPA Not Assured CPAF Contracts Provide High Performance

While EPA has paid contractors nearly \$16 million in award fees over the past 10 years on the nine contracts reviewed, it has no assurance that the use of CPAF contracts facilitated a higher level of performance than other types of contracts. EPA CPAF contracts generally contain performance indicators tied to the Agency’s mission. EPAAR specifies that award fees are only to be awarded for performance that exceeds satisfactory. EPA consistently provided contractors with high ratings and award fees without sufficiently documenting the basis for those ratings. Moreover, the CPAF process is subjective in nature, and numerous personal judgments occurred without being documented. Because EPA consistently provided high ratings, we believe award fees are more of an expectation for contractors than a factor that motivates excellence.

EPA Consistently Provided Contractors High Performance Ratings

Contractor performance ratings were generally high throughout the life of a work assignment, resulting in contractors receiving a large portion of available award fees. EPA paid nearly \$16 million in award fees over the past 10 years from the almost \$20 million available for award fees under the nine contracts we reviewed. Table 2-1 shows the percentage of award fees paid for the seven CPAF contracts in our review that had received award fees (two did not yet receive any award fees because no work assignments had been completed at the time of site visits).

Table 2-1: Award Fees Issued Through CPAF Contracts

Contract Purpose	Available Award Fee	Award Fee Paid	Percent
1. Remedial Action Contract	\$334,242	\$237,714	71.1%
2. Remedial Action Contract	587,447	465,498	79.2%
3. Remedial Action Contract	1,552,521	1,284,117	82.7%
4. Response Engineering and Analytical Contract to support Environmental Response Team Centers	1,561,337	1,314,057	84.2%
5. Input, manage, provide, and maintain information technology services	6,647,067	5,296,701	79.7%
6. Provide information technology support for integration and development of large systems	6,580,244	5,764,390	87.6%
7. Remedial Action Contract	2,663,017	1,577,118	59.2%
Total	\$19,925,875	\$15,939,595	

Source: OIG analysis of EPA data

Note: Remedial Action Contracts provide professional architect/engineer, technical, and management services to support remedial response, enforcement oversight, and non-time critical removal activities.

CPAF contracting is intended to facilitate a high level of contractor performance. Contractors are to be compensated for satisfactory work through the base fee, while award fees should be for greater-than-satisfactory work. EPAAR 1516.404-273(a) states, “No award fee may be earned if the Fee Determination Official determines that contractor performance has been satisfactory or less than satisfactory.” The award fee plans for CPAF contracts support this criterion. Regions 3 and 5 Award Fee Plans for Remedial Action Contracts state, “The performance fee should motivate the contractor to provide excellence in performance.”

High performance ratings were typical for the contracts we reviewed. Most work was consistently given a rating of exceeds expectations or outstanding. We reviewed 956 final ratings and found that 809, or 85 percent, had a score higher than satisfactory and resulted in the contractor receiving award fees. These high final performance ratings translated into significant award fees for contractors. For example, for a Region 3 contract that had 32 completed work assignments at the time of our review, the average interim rating prepared by the work assignment managers for 19 (almost 60 percent) was higher than satisfactory. Further, the final ratings determined by the PEB substantially increased the number of assignments rated higher than satisfactory to 29 of the 32 work assignments (91 percent). Table 2-2 summarizes the interim and final ratings for work assignments for this contract.

Table 2-2: Summary of Ratings for Region 3 Contract

Rating Category	Interim Ratings	Final PEB Rating
Outstanding	2	7
Exceeds Fully Successful	17	22
Satisfactory	13	3
Unsatisfactory	0	0

Source: OIG analysis of EPA data

PEB members provided several reasons for increased final performance ratings. The most common reason given was that several PEB members give substantial consideration to end results and environmental outcomes achieved by the work. The PEB members said such factors as timeliness, budget, results achieved, and obstacles overcome cannot be realized until a project is complete. They also acknowledge there is a tendency to award the contractors some type of award fee. A satisfactory rating seems to have a negative connotation, and contractors tend to get ratings greater than satisfactory. As a result, award fees can be more of an expectation for contractors than a factor that motivates excellence in performance.

EPA Needs to Improve Documentation for Performance Ratings

The documentation associated with performance evaluations often did not support the ratings given. The Government Accountability Office's Internal Control Management and Evaluation Tool establishes that documentation for transactions and other significant events should be complete and accurate. Documenting the rationale for ratings is not required by the Contracts Management Manual. The manual gives broad authority to the PEB to determine final ratings and recommend award fees, and does not require that all aspects of the decision be documented.

We reviewed interim performance evaluations prepared by Regions 3 and 5, as well as Headquarters. Generally, Region 5's interim evaluations were adequately supported, while the ratings prepared by Region 3 and Headquarters did not always contain sufficient documentation to justify the rating given. For example, a work assignment under a Headquarters contract was given an interim rating of exceeds expectations for Program Management. The support for that rating was as follows: "The project management was excellent with no problems encountered and costs were within scope of work." There was no further description of how the work exceeded expectations or project management was excellent. We believe that indicating that the project did not encounter problems or go over budget is only descriptive of satisfactory work.

Documentation for final ratings and corresponding award percentages also often did not support the ratings or awards given. The project or contracting officers provided the PEB with documentation associated with interim ratings. The PEB used this information as the primary source for determining its final overall rating. Since documentation to support the interim ratings sometimes did not justify the rating, PEB members said they often relied on the testimony of project officers and work assignment managers. Discussions that took place during PEB meetings and the specific reasons for final decisions were not documented for any of the contracts we reviewed. Also, when final ratings were higher than the interim ratings, no documentation was available to support the change. For example, the following excerpt from a Region 5 PEB report applies to a work assignment with an interim rating of satisfactory that the PEB increased to exceeds expectations:

The contractor's overall historical performance was rated as "satisfactory." The contractor's self-evaluation has requested a Performance Award of 80%. The PEB recommends a Performance fee of 65% consistent with an overall rating of exceeds expectations....

Region 5's narrative, which is the same basic language used in all Region 5 PEB ratings, lacks the reasoning for increasing the contractor's rating. This same language was consistently used within Region 5 PEB reports to document final

decisions. It gives the appearance that the PEB increased the final rating based on the contractor's self evaluation. Region 5 PEB members said the contractor self evaluations were only included as general information and had no influence on final ratings; several Region 5 PEB members indicated they barely considered self evaluations. However, they agreed that the language in their reports was misleading and should be improved.

PEB members in Regions 3 and 5 told us that PEB reports were the only source of documentation for final PEB decisions. Several EPA employees from Headquarters, Region 3, and Region 5 agreed that documentation needs to be improved to support both interim and final ratings. When the PEBs do not receive sufficient documentation from project officers and work assignment managers, the PEBs are limited in the information they have to make final decisions. In particular, work assignment managers generally have the most contact with contractors performing work, and thus can provide the most meaningful input on contractor evaluations. Also, without documentation on why the PEB modified final ratings, work assignment managers cannot effectively apply the PEB's logic to future evaluations. To adequately justify and substantiate performance ratings, EPA needs to better document interim ratings, and the PEB needs to document the basis for its final decisions.

Without sufficiently documenting contractor evaluations, the process allows for and relies on unsupported personal opinions and individual judgments. Work assignment managers provide the first evaluation of the contractor's performance. However, as one Region 3 contracting officer noted, it can be difficult for work assignment managers to maintain an arms length relationship with contractors. They work closely together on a regular basis so personal opinions are developed that can lead to bias, both positive and negative. PEB members also use personal judgment when determining final ratings. The PEB members we spoke with said they take into account that some work assignment managers are tough raters and others are not.

PEB members also place different emphasis on the criteria set forth in the award fee plan, based on whether their interest is technical or programmatic. PEB members with a programmatic interest tend to emphasize end results and environmental outcomes achieved. Those with a contract administration background tend to be more concerned with contract provisions.

CPAF Contracts May Not Be Worth the Associated Costs

EPA cannot demonstrate whether the CPAF process resulted in EPA receiving higher performance from contractors and, if so, the benefits received justified the increased administrative costs of these contracts. CPAF contracts require substantial resources to administer. Numerous EPA employees spend substantial time evaluating performance throughout the life of the contract. Also, contractors incur extra administrative costs, which they pass on to EPA. For these reasons,

we believe a cost-benefit analysis should be performed and approved by Office of Acquisition Management personnel prior to using CPAF contracts in the future, even though this type of analysis is not presently required by the CMM.

In spite of the resource-intensive process, EPA could not substantiate that CPAF contracts resulted in a higher level of performance than other types of contracts, even though a high percentage of the available award fees was being paid. Some PEB members from Regions 3 and 5 believe that overall fees paid to a contractor and the performance received are the same whether using CPAF or Cost-Plus-Fixed-Fee contracts. This demonstrates that some employees familiar with CPAF contracts see little difference in performance despite the extra resources required to administer CPAF contracts.

Several EPA contracting officers, project officers, and program employees told us that CPAF contracts do have advantages because the process forces EPA personnel and the contractor to examine performance on a regular basis. Conversely, other EPA employees said the process did not provide any relevant motivation to contractors since contractors generally expect to receive high ratings and fees. Instead, many PEB members and other EPA employees told us that the potential for future work and competition were the primary motivations for contractors to perform well – contractors would try to perform well regardless of the contract type because they want to get the next contract. Further, several employees said the award fee amounts may not be substantial enough to motivate higher performance.

Conclusion

Developing and administering CPAF contracts is a labor intensive process that causes EPA to spend significant amounts of time evaluating and documenting contractor performance. For this reason, many EPA employees involved with contract management as well as with the program offices believe that competition is a more effective way to motivate contractors to perform. Portions of EPA have already begun to move away from CPAF contracts and are using, or planning to use, other types of contracts to motivate contractor performance, such as performance-based contracts or award-term contracts. We agree that EPA should continue to explore other types of contracts. This will allow EPA to avoid the subjective CPAF process and the costly administrative effort associated with them. While EPA's Contracts Management Manual does not require a cost-benefit analysis, we believe that if a CPAF contract is needed, a cost-benefit analysis should be performed to ensure that the expected benefits are worth the additional administrative costs. Additionally, future CPAF contracts should be approved at a management level sufficient to provide adequate oversight (e.g., the contracting officer's Service Center Manager).

Recommendations

We recommend that the Assistant Administrator for Administration and Resources Management:

- 2-1 Revise the Contracts Management Manual to require that:
 - a cost-benefit analysis be conducted prior to awarding a CPAF contract, and
 - all CPAF contracts be approved by the contracting officer's Service Center Manager.

- 2-2 Revise the Contracts Management Manual to require work assignment managers, project officers, contracting officers, and PEB members to explicitly document the basis for award-fee decisions made.

Agency Response and OIG Comments

EPA concurred with our recommendation to perform a cost-benefit analysis prior to awarding future CPAF contracts. It also agreed with our recommendation to revise the Contracts Management Manual to have work assignment managers, project officers, contracting officers, and PEB members explicitly document the basis for award-fee decisions made. The OIG concurs with EPA's proposed resolutions to address the recommendations by revising the Contracts Management Manual and Acquisition Handbook.

EPA did not agree with our original recommendation to have CPAF contracts approved by the Office of Administration and Resources Management. EPA stated that, consistent with the Federal Acquisition Regulation, the appropriate approval level for these contracts is at the contracting officer level, and that it does not see a compelling reason to elevate approval to the Office of Administration and Resources Management level. EPA did propose an alternative plan that includes revising the Contracts Management Manual to require the Service Center Manager to approve the contracting officer's decision to award a CPAF contract. Since OIG believes that EPA's proposed alternative will adequately address the problem by providing additional oversight above the previous required level, the OIG agrees with the proposed alternative plan. We revised our recommendation accordingly.

EPA's complete response is in Appendix A.

Chapter 3

EPA Paid Higher Base Fees than EPAAR Allows

EPA overpaid contractors on 5 of its 14 CPAF contracts by awarding base fees that exceeded the EPAAR limitation. This condition occurred because EPA employees were unaware of the limitation and Headquarters did not note the issue. Although three of the contracts were nearly completed, for the two awarded in 2006, we estimated that EPA already overpaid the contractors about \$100,000 and will overpay an additional \$762,000 during the remaining life of the contracts if they are not modified.

Potential Overpayments Noted

EPAAR 1526.404-273(b) provides that base fees paid to contractors shall not exceed 3 percent of the estimated cost of the contract, exclusive of the fee. However, of 14 contracts reviewed, we found that payments for 5 exceeded the 3-percent amount, as shown in Table 3-1. The September 1998 contract was awarded by Region 9 while the other four were awarded by Headquarters or Region 5 for work administered by Region 5.

Table 3-1: CPAF Contracts with Base Fee

Contract	Base Fee %	Date Awarded
1	4.0%	September 1996
2	4.0%	May 1997
3	4.0%	September 1998
4	5.0%	March 2006
5	4.2%	June 2006

Source: OIG analysis of EPA data

Two of the Region 5 contracts and the Region 9 contract are nearly complete. Therefore, we only calculated the potential overpayments for the remaining two contracts, which were issued in 2006 and potentially may not be complete for 9 more years. We recomputed the base fees for both contracts using the same methods employed by EPA except that we used a base fee of 3 percent, and then applied our computations to the professional hours billed on the contracts through July 2007. This indicated that EPA overpaid \$100,020 so far on these two contracts. We used the same calculations prorated over the remaining life of the contracts and estimated that EPA will overpay an additional \$762,468 unless the contracts are modified to bring them into compliance with EPAAR. The \$762,468 represents a potential monetary benefit to EPA.

Region 5 contracting officers, project officers, and program employees told us they were unaware of the EPAAR limitation on base fees under CPAF contracts.

Office of Administration and Resources Management personnel also acknowledged that the fee percentages for the contracts were higher than that allowed by EPAAR, and allowing the use of those percentages was an oversight by Headquarters.

Recommendations

We recommend that the Regional Administrator, Region 5:

- 3-1 Negotiate with contractors to modify contracts currently providing base fees in excess of the 3-percent limit cited by EPAAR 1526.404-273(b) so that the fees no longer exceed the 3-percent limit.

We recommend that the Assistant Administrator for Administration and Resources Management:

- 3-2 Communicate the 3-percent base fee limit included in EPAAR to all contracting and project officers using CPAF contracts and verify compliance during Headquarters reviews.

Agency Response and OIG Comments

EPA concurred with both OIG recommendations. Specifically, EPA Region 5 said it will develop a strategy for bringing its contracts into compliance with the EPAAR by March 30, 2008. Further, EPA said it will communicate the 3-percent base fee via a Flash Notice. The OIG concurs with EPA's proposed actions to address the recommendations.

EPA Region 5 said it did not agree that it overpaid \$100,020 in base fees on the two contracts awarded in 2006. Region 5 based its position on the fact that it has not yet reached 3 percent of the funds obligated, exclusive of fees. While this may be true, the base fee percentage in the contract was greater than the maximum 3 percent allowed by EPAAR. The billable base fee amounts are calculated by using a formula that includes this higher base fee percentage. The OIG recalculated the billable base fee by using the same formula, and inserting the maximum allowable 3 percent into the formula to derive its estimate of overpaid base fees. Therefore, the OIG continues to believe that EPA overpaid base fees by using a rate higher than allowed by EPAAR.

EPA's complete response is in Appendix A.

Chapter 4 Other Matters

We noted some administrative procedures required by EPA's CPAF contract award fee process that appear to be overly burdensome and provide minimal benefits. Some of these procedures could be simplified or eliminated, reducing the administrative workload for both EPA and the contractor.

Computation of Base Fees Is Overly Complex

The computation of base fees in EPA's CPAF contracts is overly complex. The base fee is not a multiplication of direct labor costs by the base fee percentage included in the contract. Instead, the base fee is computed by using a dollar amount that is applied to each direct labor hour charged to EPA. This dollar amount is calculated using the estimated base fee and estimated direct labor hours for each contract period. This is shown below for a contract that provided a base fee of 4.2 percent.

$$\frac{\text{Estimated Base Fee}}{\text{Estimated Direct Labor Hours}} = \frac{\$42,825}{10,000 \text{ hrs.}} = \$4.28$$

The contractor multiplied each professional hour billed to EPA by \$4.28 to compute the base fee that EPA will pay. The amount of base fee paid becomes complex because each contract will eventually have a different dollar factor for the base period and each subsequent option year. Moreover, a different base fee percentage is applied to subcontractor costs. EPA uses this methodology to ensure that contractors do not charge base fees too quickly during the life of a contract. However, the benefits received from using this factor appear to be minimal, while it unnecessarily complicates the base fee calculation and makes EPA's ability to verify amounts billed by contractors difficult.

Contractor Self Evaluations of Minimal Value

EPA CPAF contracts generally required each contractor to submit a self evaluation every 6 months. These self evaluations generally are three or four pages, depending on the work done and the number of contractor work assignments; self evaluations can be as much as 50 pages if not more. Several PEB members told us they did not use contractor self evaluations when rating performance because the evaluations were biased. Some PEB members did not read the contractor self evaluations, while others read them to ensure EPA had not missed anything but did not place much weight on them.

EPA does not require the contractors to separately track the time spent or costs billed to EPA for producing self evaluations. In the absence of such cost data, we estimated that each self evaluation would take approximately 4 labor hours to produce. We also noted that some of the contracts reviewed had over 150 work assignments. Based on these figures, we estimated that for each of EPA's 14 CPAF contracts, EPA could pay almost \$50,000 for self evaluations over the course of a contract that provide minimal if any input and value to the CPAF process.

Minor Errors Noted

Given the overall complexity of the CPAF process and the large volume of information processed, it was inevitable that some minor errors occurred. In two instances, records indicated that EPA Region 5 incorrectly paid for fees contrary to provisions in the award fee plan. On two work assignments for which the contractor was rated "Exceeds," the award fee plan indicated the maximum percentage that could be awarded for that rating was 80 percent. The contractor was awarded 90 percent of the available award fee, resulting in an overpayment to the contractor of over \$3,000. EPA reviewed these instances and responded that for one work assignment, this was a documentation mistake and that the rating actually was "Outstanding" rather than "Exceeds Expectations", and thus the award was correct. However, during its review of the documentation, EPA found an overpaid amounts totaling \$4,801 for the other work assignment.

Recommendations

We recommend that the Assistant Administrator for Administration and Resources Management:

- 4-1 Analyze alternatives and determine a way to simplify the base fee calculation for CPAF contracts.
- 4-2 Require the contracting officers for all current CPAF contracts to review the self-evaluation requirement and either eliminate the requirement or provide written justification for not eliminating the requirement.

We recommend that the Regional Administrator, Region 5:

- 4-3 Recover the \$4,801 in overpaid award fees paid to a contractor, or offset this amount against future payments.

Agency Response and OIG Comments

EPA disagreed with our original Recommendation 4-1 to simplify the base fee calculation and stated that the OIG recommendation creates a cost-plus-percentage-of-cost contract. We do not believe that this is the case; our

recommendation was for EPA to find a simpler way to distribute a fixed amount of base fee to a contract because the current method is overly complex and creates difficulties in verifying the amounts billed. Because of the importance of effectively verifying amounts billed by contractors, we continue to recommend that EPA simplify its method of calculating base fee charges. We did not recommend a specific method for distributing base fee in the future, simply that EPA should develop a method that is less complex than the current method. We have modified our original recommendation to clarify our intent.

EPA partially agreed with our original Recommendation 4-2 to eliminate the contract requirement for contractor self evaluations. While the Agency believes the requirement could be eliminated in some cases, EPA did not agree that the requirement for self evaluations should be eliminated across the board because some EPA officials find the self evaluations to be useful. We continue to question the utility of contractor self evaluations and believe EPA should not pay contractors to develop justifications for providing themselves with performance ratings and proposed award amounts. If there is a case where the self evaluations are useful, the contracting officer should justify the need for this requirement in writing. Therefore, we have revised our original recommendation to provide for the contracting officers to review all active CPAF contracts and either eliminate the requirement for self evaluations or justify the need for the self evaluations in writing.

With regard to our Recommendation 4-3, EPA did not agree with the amount of improper fees the OIG calculated regarding two work assignments under a Region 5 contract. However, in reviewing these work assignments, EPA calculated \$4,801 in overpaid fees for one of the work assignments. For the other work assignment, EPA determined the fee awarded was correct, but the rating was incorrectly documented as “Exceeds Expectations” and should have been “Outstanding.” We agree with EPA's proposed resolutions to (1) recoup the overpayment by obtaining a refund from the contractor, or offsetting the overpayment against a future invoice; and (2) document appropriate contract files to reflect the correct rating. We have modified our recommendation accordingly.

EPA's complete response is in Appendix A.

Status of Recommendations and Potential Monetary Benefits

RECOMMENDATIONS						POTENTIAL MONETARY BENEFITS (in \$000s)	
Rec. No.	Page No.	Subject	Status ¹	Action Official	Planned Completion Date	Claimed Amount	Agreed To Amount
2-1	9	Revise the Contracts Management Manual to require that: <ul style="list-style-type: none"> • a cost-benefit analysis be conducted prior to awarding a CPAF contract, and • all CPAF contracts be approved by the contracting officer's Service Center Manager. 	O	Assistant Administrator for Administration and Resources Management			
2-2	9	Revise the Contracts Management Manual to require work assignment managers, project officers, contracting officers, and PEB members to explicitly document the basis for decisions made.	O	Assistant Administrator for Administration and Resources Management			
3-1	11	Negotiate with contractors to modify contracts currently providing base fees in excess of the 3-percent limit cited by EPAAR 1526.404-273(b) so that the fees no longer exceed the 3-percent limit.	O	Regional Administrator, Region 5			
3-2	11	Communicate the 3-percent base fee limit included in EPAAR to all contracting and project officers using CPAF contracts and verify compliance during Headquarters reviews.	O	Assistant Administrator for Administration and Resources Management		\$762.4	
4-1	13	Investigate alternatives and determine a way to simplify the base fee calculation for CPAF contracts.	O	Assistant Administrator for Administration and Resources Management			
4-2	13	Have the contracting officers for all current CPAF contracts review the self-evaluation requirement and either eliminate the requirement or provide written justification for not eliminating the requirement.	O	Assistant Administrator for Administration and Resources Management			
4-3	13	Recover the \$4,801 in overpaid award fees paid to a contractor, or offset this amount against future payments.	O	Regional Administrator, Region 5		\$4.8	\$4.8

¹ O = recommendation is open with agreed-to corrective actions pending;
C = recommendation is closed with all agreed-to actions completed;
U = recommendation is undecided with resolution efforts in progress

Agency Response

OFFICE OF
ADMINISTRATION
AND RESOURCES
MANAGEMENT

MEMORANDUM

SUBJECT: Response to Draft Audit Report: EPA Should Further Limit Use
Of Cost-Plus-Award-Fee Contracts

FROM: Luis A. Luna
Assistant Administrator

TO: Michael Petscavage
Acting Director, Contract Audits

Thank you for the opportunity to comment on the draft report entitled “EPA Should Further Limit Use of Cost-Plus-Award-Fee Contracts,” dated December 14, 2007. We generally agree with your findings regarding the need for the Agency to better document its need for using cost-plus-award-fee (CPAF) contracts and the basis for ratings given to contractors. We offer the following comments on your recommendations:

Recommendation 2-1 – That the Assistant Administrator for Administration and Resources Management revise the Contracts Management Manual to require that:

- a cost-benefit analysis be conducted prior to awarding a CPAF contract, and
- all CPAF contracts be approved by the Office of Administration and Resources Management (OARM).

Response: We concur with the first part of this recommendation. We intend to revise the Contracts Management Manual (CMM) and Acquisition Handbook (AH) to adequately address contract types and the need to use considerations such as risk and cost-benefit analyses when selecting the type of contract. The Office of Federal Procurement Policy (OFPP) has recently issued guidance on the appropriate use of incentive contracts, which we will incorporate into the CMM and AH revisions. We expect to complete all revisions by September 30, 2008.

We do not agree with the second part of the recommendation. The current approval level for such contracts, per the Federal Acquisition Regulation (FAR), resides with the contracting officer. We see no compelling reason to elevate this level up to the OARM Assistant Administrator. However, since the contracting officer's Service Center Manager (SCM) serves as the Fee Determination Official (FDO) on such contracts, we will require that the SCM review and concur with the CO's decision to award a CPAF contract. This will be accomplished through a revision to the required levels of approval in the CMM, which will be completed by September 30, 2008.

Recommendation 2-2 – That the OARM AA revise the CMM to require work assignment managers, project officers, contracting officers, and PEB members to explicitly document the basis for award-fee decisions.

Response : We concur with this recommendation, and we intend to revise the CMM chapters related to the use of CPAF contracts to strengthen the coordination in decision-making and documenting the basis for decisions made. We expect to complete all revisions by September 30, 2008.

Recommendation 3-1 – That the Regional Administrator, Region 5, negotiate with contractors to modify contracts currently providing base fees in excess of the 3-percent limit cited by EPAAR 1526.404-273(b) so that fees no longer exceed the 3-percent limit.

Response : Region 5 concurs that the contracts were awarded with base fees in excess of the 3-percent limit, and they intend to bring these contracts into compliance with the EPAAR. First, they need to analyze each contract to determine if they should: (1) renegotiate the base fee; (2) request a waiver; or (3) pursue other options. Region 5 will submit its overall strategy for bringing the contracts into compliance, to OAM by March 31, 2008. Once OAM reviews and approves the strategy/plan, Region 5 will begin implementation within 30 days of the approval. Final resolution of this issue will depend on the option chosen, and whether negotiations with contractors are required. This is not a unilateral type of action, and any contract modification will require the contractor's concurrence

Recommendation 3-2 – That the OARM AA communicate the 3-percent base fee limit included in the EPAAR to all contracting and project officers using CPAF contracts and verify compliance during Headquarters reviews.

Response : We concur with this recommendation. OAM will communicate this information to EPA's acquisition community via a Flash Notice by March 31, 2008. This Flash Notice will also request that all Agency contracting offices verify through their Quality Assessment Plan (QAP) process, that they are complying with the 3-percent base fee limit for their CPAF contracts. OAM also intends to follow up by sending out reminder verification/compliance request notices

on an annual basis (by March 31 of each year), starting 2009, to OAM Division Directors and Regional Contracting Officer Supervisors.

Recommendation 4-1 – That the OARM AA simplify the base fee calculation for CPAF contracts by not calculating a separate factor for billing purposes.

Response : We do not agree with this recommendation. The EPAAR 1516.301-70, Payment of Fee, states: “The policy of EPA for cost-reimbursement, term form contracts is to make provisional payment of fee (i.e., the fixed fee on cost-plus-fixed-fee type contracts or the base fee on cost-plus-award-fee type contracts) on a percentage of work completed basis, when such a method will not prove detrimental to proper contract performance. Percentage of work completed is the ratio of the direct labor hours performed in relation to the direct labor hours set forth in the contract...”

This fee calculation was designed to avoid a situation where the Agency is paying fee based on costs the contractor expended – a cost-plus-percentage-of-costs contract, which is forbidden by the FAR. The method the OIG recommends of calculating the base fee by multiplying the base fee percentage times the direct labor costs may be easier, but creates a cost-plus-percentage-of-cost contract.

Recommendation 4-2 – That the OARM AA eliminate the contract requirement for the submission of contractor self evaluations.

Response : We partially concur with this recommendation. We agree with the OIG that our contracting officers should not require contractors to prepare and submit self evaluations if they are of limited or no use to EPA. We intend to communicate this to EPA’s acquisition community by March 31, 2008, encouraging contracting officers and program officials to either make better use of contractors’ self evaluations, or work with their contractors to remove the requirement from the award fee plans of their contracts. We do not agree that the contract requirement should be eliminated across the board, as some EPA officials do find the self evaluations to be useful.

Recommendation 4-3 – That the Regional Administrator, Region 5, recover the \$3,503 in improper award fees paid to a contractor, or offset this amount against future payments.

Response : Region 5 does not agree that they overpaid \$3,503 in improper award fees for the two Work Assignments (WA) cited in the draft report. They concur that there was an error in the computation of the award fee for WA No. 105. Their analysis indicates that the Performance Evaluation Board (PEB) had agreed on a consensus score of 75% for this site. Region 5 recomputed the award fee for this WA and determined that it should have been \$24,006.15,

instead of the \$28,807.38 that was awarded. The Region will recoup this overpayment of \$4,801.23 by obtaining a refund from the contractor, or offsetting the overpayment against a future invoice, by March 31, 2008.

Region 5 disagrees with the OIG's recommendation that they obtain a refund or offset for overpayment of award fee under WA No. 212. After discussing the rating with the project officer and PEB members, it was determined that there was an error made in the adjectival rating (should have been Outstanding), and not the numeric consensus rating (which was 90%, correct for an Outstanding rating). Therefore, the award fee was correctly computed for this site. Region 5 will document the WA and contract modification files to reflect the correct adjectival rating by March 31, 2008.

Region 5 does not agree that they overpaid \$100,020 in base fees on the two contracts. The OIG calculated the 3-percent base fee by applying it to the total level-of-effort (LOE) hours incurred to date. In accordance with the EPAAR Subpart 1516.404-273(b), the base fee paid to contractors shall not exceed 3 percent of the estimated cost of the contract. Region 5's calculations indicate that the total amount of base fee paid to the contractor to date is less than 3 percent of the total funds currently obligated under the contract, exclusive of fees.

We look forward to receiving your final report. Should you have any questions, please contact Kerrie O'Hagan, Director, Policy, Training & Oversight Division in the Office of Acquisition Management, at (202) 564-4315.

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