



U.S. ENVIRONMENTAL PROTECTION AGENCY

OFFICE OF INSPECTOR GENERAL



Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract

Report No. 13-P-0209

April 4, 2013



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Abbreviations

A&E	Architect and Engineering
CMM	Contracts Management Manual
CO	Contracting Officer
COR	Contracting Officer Representative
EPA	U.S. Environmental Protection Agency
EPAAR	EPA Acquisition Regulations
FAR	Federal Acquisition Regulations
IGCE	Independent Government Cost Estimate
OAM	Office of Acquisition Management
OIG	Office of Inspector General
OMB	Office of Management and Budget
SOW	Statement of Work

Cover photo: The facility to treat sediment dredged from the Spring Creek Arm of the Keswick Reservoir at the Iron Mountain Mine Superfund Site, Shasta County, California. It was constructed under task order 45 and operated under task order 50 of contract EPS90804. (Photo courtesy of CH2M Hill, Inc.)

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At a Glance

Why We Did This Review

The purpose of this review was to determine whether, for time and materials contracts, the U.S. Environmental Protection Agency (EPA) has a process to verify that contractor personnel met the qualifications specified in the contract and received the level of services for which it paid. We focused our review on remedial action contract EPS90804 awarded by EPA Region 9. The government should only use a time and materials contract when it cannot accurately estimate either the extent or duration of the work, or anticipate costs with any reasonable degree of confidence. Contract EPS90804 supports EPA responses to releases of hazardous substances and counter-terrorism. Under this contract, the region pays the contractor a fixed hourly rate for labor plus other direct costs. A Region 9 contracting officer and contracting officer representatives monitor the contractor's activity.

This report addresses the following EPA Goal or Cross-Cutting Strategy:

- *Strengthening EPA's Workforce and Capabilities*

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

The full report is at:
www.epa.gov/oig/reports/2013/20130404-13-P-0209.pdf

Opportunities for EPA-Wide Improvements Identified During Review of a Regional Time and Materials Contract

What We Found

EPA Region 9 did not require its contracting personnel to verify that personnel for the contractor had the qualifications necessary to execute contract EPS90804. This may be an EPA-wide problem in managing time and materials contracts. In addition, Region 9 contracting personnel did not consistently:

- Update the statement of work that identifies the work it expects the contractor to perform so EPA can use the statement of work to monitor performance.
- Document the review of the qualifications of contractor personnel performing the contract tasks.
- Document the reviews of monthly progress, contractor performance, and quality of deliverables.
- Become familiar with the contract.
- Issue memorandums appointing contracting officer representatives (CORs).

These practices put EPA at risk of not receiving the level or quality of service for which it paid. As the services ordered under the contract were to restore the environment after the releases of hazardous substances, services that do not meet the standards EPA intended under the contract could increase risk that human health and the environment were not adequately protected.

Additionally, EPA Region 9 personnel negotiated a prohibited profit clause in the contract, resulting in EPA improperly paying the contractor over \$1.5 million in additional profit.

Recommendations and Planned Agency Corrective Actions

We recommend that the Regional Administrator for Region 9 direct the contracting officer for EPS90804 to require CORs to document oversight according to regulations and policies, which he agreed to do. We also recommend that the Regional Administrator recover funds for the prohibited clause, as well as determine if the clause is in other contracts and recover funds for those contracts. Finally, we recommend that the Assistant Administrator for Administration and Resources Management enforce the requirement for CORs to ensure contract staff meet the qualifications, and review EPA's practices for paying contractors who perform similar activities. For the latter recommendations, the EPA officials provided alternative corrective action without completion dates or they disagreed. EPA must provide a corrective action plan in its final response.



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

THE INSPECTOR GENERAL

April 4, 2013

MEMORANDUM

SUBJECT: Opportunities for EPA-Wide Improvements Identified During Review of a
Regional Time and Materials Contract
Report No. 13-P-0209

FROM: Arthur A. Elkins Jr.

A handwritten signature in black ink, appearing to read "Arthur A. Elkins Jr.", is written over the printed name.

TO: Jared Blumenfeld, Regional Administrator
Region 9

Craig E. Hooks, Assistant Administrator
Office of Administration and Resources Management

This is a report on the subject evaluation 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 position. This report contains the intended corrective actions and planned completion date for one recommendation. This recommendation is considered resolved. The report also contains four recommendations that the Agency and OIG are in disagreement and are considered unresolved.

Action Required

In accordance with EPA Manual 2750, resolution should begin immediately upon issuance of the report. We are requesting a meeting between the Region 9 Administrator, the Assistant Administrator for Administration Resources Management, and the Assistant Inspector General for Program Evaluation, to start the resolution process and attempt to obtain resolution. If resolution is still not reached with 30 days, the Region 9 Administrator and the Assistant Administrator for Administration and Resources Management are required to complete and submit the dispute resolution request to the Chief Financial Officer to continue the resolution process. We have no objections to the further release of this report to the public. We will post this report to our website at <http://www.epa.gov/oig>.

If you or your staff have any questions regarding this report, please contact Carolyn Copper, Assistant Inspector General for Program Evaluation, at (202) 566-0829 or copper.carolyn@epa.gov; or Eric Lewis, Product Line Director, Special Reviews, at (202) 566-2664 or lewis.eric@epa.gov.

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Chapter 1

Introduction

Purpose

The purpose of this review was to determine whether, for time and materials contracts, the U.S. Environmental Protection Agency (EPA): (1) had a process to verify that contractor personnel met the qualifications specified in the contract, and (2) received the services for which it paid. We focused our review on remedial action contract EPS90804.

Background

EPA Region 9 awarded remedial action contract EPS90804 to CH2M Hill, Inc., on September 24, 2008. Under the contract, the contractor provides professional architect/engineer, technical, and management services to the EPA to support activities under the Comprehensive Environmental Response, Compensation and Liability Act of 1980. This contract is intended to address and/or mitigate endangerment to public health, welfare, or the environment; and to support states and communities in preparing for responses to releases of hazardous substances. The base performance period was 3 years, with options for up to 7 more years. EPA awarded the first option period, extending the contract to September 23, 2013. The contract ceiling was not to exceed \$116,250,000.

Contract EPS90804 is a fixed rate indefinite delivery/indefinite quantity award term contract. The contract provides for the government to order work through task orders, including fixed rate time and materials type task orders. A time and materials task order is a vehicle for acquiring services based on direct labor hours, at specified fixed hourly rates, and actual cost for materials. Fixed hourly rate includes wages, overhead, general and administrative expenses, and profit. This type of pricing may be used only when it is not possible at the time of placing the contract to accurately estimate the extent or duration of the work, or anticipate costs with any reasonable degree of confidence. Such a pricing method provides no incentive to the contractor for cost control or labor efficiency. Thus, EPA must overcome the disadvantages of contracts with fixed rate/time and materials type pricing arrangements by having enough properly trained staff to adequately perform and document reviews of invoices, monthly progress, contractor performance, and daily oversight to provide reasonable assurance that the contractor uses efficient methods and effective cost controls. In 2012, in response to the Administration's *Campaigns to Cut Waste*, and OMB's memo *Reduced Contract Spending for Management Support Services*, EPA released guidance which encouraged the agency to move from "high-risk" contracts, which include time and materials contracts, to more fixed price contracts.

Region 9 provided for multiple levels of monitoring the work. To help contracting officers (COs) manage the contract, COs used a memorandum to appoint contracting officer representatives (CORs) in accordance with Federal Acquisition Regulation (FAR) at 48 CFR Section 1.604. This included a contract-level COR as well as task order CORs.

The contracting officer issues task orders for government-required work to be performed. For each task order, the task order COR drafts the statement of work (SOW) to identify the work EPA wants the contractor to perform, as well as the independent government cost estimate (IGCE) on how much the work might cost. Once the task order is issued, it is the responsibility of the task order COR to monitor the contractor's performance to ensure that EPA obtains a quality product, on time, and within cost. Monitoring includes giving technical direction, reviewing deliverables, conducting meetings, reviewing monthly progress reports and invoices, and evaluating contractor performance.

Scope and Methodology

We conducted our work from January to December 2012 in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our review objectives.

We selected contract EPS90804 because it had the largest dollar value of regional contracts that included time and materials task orders, based on the Office of Acquisition Management's (OAM's) active contracts list as of June 2011. When we started work, the CO had issued 64 task orders funded for \$97.8 million. All of these task orders were time and materials. We selected a sample of 12 out of the 64 task orders (18 percent), which represented 63 percent of the contract dollars (table 1).

Table 1: Task orders reviewed

Number	Site name	Date issued	Amount funded
7	Frontier Fertilizer	12-29-2008	\$9,612,753.00
8	Frontier Fertilizer	12-30-2008	1,960,000.00
17	Sulphur Bank	12-30-2008	1,897,613.00
23	B.F. Goodrich	12-31-2008	4,130,475.00
40	Iron Mountain Mine	02-20-2009	512,312.67
45	Iron Mountain Mine	04-13-2009	20,692,769.33
49	El Monte	06-23-2009	900,000.00
50	Iron Mountain Mine	06-23-2009	18,560,340.00
51	Lava Cap	07-23-2009	381,387.00
53	Frontier Fertilizer	08-31-2009	2,499,997.43
55	Ordot Landfill	05-21-2010	149,973.00
60	Glendale Chromium	09-26-2011	300,000.00
Total for Task Orders Reviewed			\$61,597,620.43

Source: OIG analysis

We interviewed the Region 9 staff managing the contract, including the current CO; Contract Acquisition Manager, who was the CO who negotiated and signed contract EPS90804; the current contract-level COR; the eight Region 9 staff serving at the time as task order CORs for the 12 task orders reviewed; and their supervisors. We reviewed the supporting documentation for each task order in the sample as well as applicable laws, regulations, and guidance documents.

Prior Evaluation/Audit Coverage

The following Office of Inspector General (OIG) reports addressed issues related to the scope of our review

- Report No. 09-P-0242, *Contractor Invoice Internal Controls Need Improvement*, September 23, 2009.
- Report No. 10-R-0113, *EPA Should Improve Its Contractor Performance Evaluation Process for Contractors Receiving Recovery Act Funds*, April 26, 2010.
- Report No. 12-P-0320, *Policies Needed for Proper Use and Management of Cost-Reimbursement Contracts Based on Duncan Hunter Act*, March 6, 2012.

Chapter 2

Region 9 Should Improve Documenting Contract Oversight Activities and Requirements

EPA Region 9 did not require its contracting personnel to verify that personnel for the contractor have the qualifications necessary to execute contract EPS90804. This may be an EPA-wide problem in managing time and materials contracts. This occurred because EPA did not use an appropriate government surveillance plan to review the work of the contractor. Specifically, the lack of contract oversight put EPA at risk of not receiving the level or quality of service for which it paid. Region 9 contracting personnel did not consistently:

- Modify the SOW that identifies the work it expects the contractor to perform so that the region can use the SOW to monitor performance.
- Document the review of the qualifications/résumés of contractor personnel performing the contract tasks.
- Document the reviews of monthly progress, contractor performance, and quality of deliverables.
- Become familiar with the contract.
- Issue memorandums appointing CORs .

A time and materials-type pricing arrangement provides no profit incentive to the contractor for cost control or labor efficiency. Therefore, appropriate government surveillance of contractor performance is required to give reasonable assurance that efficient methods and effective cost controls are being used. The FAR and EPA Acquisition Regulations (EPAAR), as well as other EPA and Office of Management and Budget (OMB) guidance, address the need for documentation in these situations. Region 9's inconsistent documentation to support decisions and management of this contract poses a risk that it will not receive the level and quality of services for which it paid. As the services ordered were to restore the environment after the releases of hazardous substances, this risk could endanger public health and welfare.

SOW Is the Basis for Work Performed

According to the February 2009 EPA Contracts Management Manual (CMM), Section 11.1, the SOW is one of the main documents in the procurement process, from initiation through completion. The SOW:

- Delineates the tasks that the contractor must perform.
- Describes essential technical needs or requirements that the contractor must fulfill.
- Provides the standards that the government will use to determine that the contractor met the contract requirements.

The SOW serves as the basis for performance under the contract. The June 2010 EPA *Guide for Preparing Independent Government Costs Estimates [IGCE]* states that the SOW provides the foundation to determine the price, performance schedule, and deliverables (EPA Guidance 2010, p 8). Contract EPS90804, Attachment 1, requires that the contractor perform all activities identified in the SOW of the individual task orders.

Region 9 Did Not Always Modify the SOW

The contract clause H.42(n)1 requires the contractor to develop a work plan to achieve the objectives listed in the SOW. However, some task order CORs relied on the contractor-prepared work plan to establish government objectives and to monitor contractor progress. There were differences between the deliverables in the SOW and the work plan prepared by the contractor. This occurred because the task order CORs did not always keep notes or track changes to deliverables agreed upon in meetings with the contractor and failed to communicate those changes to the CO. Region 9 contracting personnel should modify the SOW accordingly to show the changes and the rationale for the agreed-upon terms.

Development of the Work Plan

The COR prepares a SOW for each task order and related IGCE, and gives the documents to the contract-level COR, who gives them to the CO. After any needed changes are made, the CO gives the SOW (but not the IGCE) to the contractor. The COR then participates, as needed, in negotiations with the contractor and CO to ensure a mutual understanding of the work that EPA wants the contractor to perform. Based on these negotiations, the COR may revise the SOW to reflect changes agreed upon during the meeting. The contractor then prepares the work plan. The work plan details the contractor's approach to performing the tasks identified in the SOW, lists the related deliverables, estimates the cost to perform the work, and identifies the name and function of staff considered key personnel to deliver the work.

To ensure that the work plan reflects the needs of EPA, the task order COR compares the work plan to the SOW and IGCE. Recently, the CO introduced a Cost Proposal Evaluation Checklist to assist task order CORs in evaluating work plans (see appendix B). As the checklist was introduced after some of the task orders were issued, only 6 of the 12 task orders that we reviewed had a completed checklist to document the task order COR's review of the work plan. If the work plan is acceptable to the task order COR, the contract-level COR, and the CO, the CO issues the task order, attaching both the SOW and work plan. Appendix A outlines the best practices for issuing the task order.

Deliverables in SOW and Work Plan Were Not Always Consistent

When comparing the work plan to the SOW, the task order COR should pay particular attention to the deliverables to ensure that Region 9 receives the services needed. For six task orders with completed checklists, there were differences between the SOW and work plan, including differences in deliverables. The task order COR did not document these differences in the checklist. Thus, the task order CORs did not ensure that deliverables in the work plans were consistent with the deliverables in the SOWs. For the 12 task orders reviewed, the SOWs had 120 deliverables and the work plans had 109. The deliverables in the SOW and work plan were the same for two task orders. For 10 task orders, there were differences of 54 deliverables between the SOWs and the work plans, as shown in table 2. For example, some of the SOWs included deliverables not in the work plan, and some work plans included deliverables not in the SOWs. Thus, EPA risks the possibility of (1) needing work that the contractor did not perform and/or (2) paying for work that was not essential.

Table 2: Deliverables in SOWs and work plans differed

Task order	Number of differences in deliverables
7	5
8	10
17	18
23	0
40	3
45	1
49	10
50	1
51	2
53	2
55	0
60	2
Totals	54

Source: OIG analysis

In contrast to EPA's policy and best practices, the CORs considered the documenting of scoping meetings to be optional. However, in some of these meetings, the deliverables in the SOW were changed. As a result, the SOW's list of deliverables differed from the lists in the work plan because task order CORs' documentation of scoping meetings is discretionary. According to EPA's CMM, CORs must set-up a file system containing all relevant documentation, including the basic contract, internal correspondence, technical direction, contract deliverables received and reviewed, payment file, and other items that will provide an audit trail of the actions on the acquisition.

EPA's Records Management policy requires that there should be documentation to show a clear picture of how the Agency conducts its business and makes decisions. This can include meetings and conference calls where decisions are made. EPA's October 2008 COR training material tells CORs, as a best practice,

that all meetings must be documented. Further, the COR training material states someone who attended the meeting should prepare minutes and provide a copy to all those who attended. The minutes generally document who attended, the reason for the meeting, discussions, and who will handle action items. Four of the six task order CORs stated that they did not always take scoping meeting notes. Two of these six stated they took notes but could not provide them; one of those two said she destroyed her notes because her office was moving and she believed she no longer needed them.¹

Some task order CORs and the contract-level COR said that when task order CORs recommended approving the work plan they were accepting that the deliverables reflected EPA's expectations without actually comparing them to the SOW. However, this is in opposition to the FAR requirement that the SOW must include the description of work performed. In addition, EPA's suggested best practice has the SOW as the most critical element of the task order. It helps ensure a common understanding of project requirements by the contractor and the government, and assists the COR in monitoring the project and evaluating deliverables.

Not all task order CORs used the SOW as the primary document to monitor contract work. One task order COR stated that she used the work plan as the primary document to monitor the expected deliverables because it was the most accurate document after the scoping meeting. Another task order COR stated that he used the SOW in conjunction with the work plan and other documents to monitor expected deliverables. The task order CORs' practice of using the contractor's work plan to track progress leaves it at risk of the contractor changing the nature of the agreed-upon contract services. This entails great risk to the government.

The EPA Records Management Manual, Chapter 1, states that there should be documentation to show a clear picture of how EPA conducts its business and makes decisions. If task order CORs do not document results of scoping meetings, they are not keeping records that reflect a clear understanding of how EPA agreed to tasks committed to by the contractor. There is no internal control in place for EPA to assure that contractors are committing to agreed-upon tasks delineated in the scoping meetings. EPA, using the SOW, should identify and define the requirements for the goods and services.

Region 9 CORs Did Not Always Review or Document Review of Qualifications of Contractor Personnel Who Billed EPA

Once Region 9 and the contractor agree on the task order work, the contractor must provide qualified staff to perform it. However, the task order CORs did not consistently review the qualifications of contractor staff listed in the work plans.

¹ Two of the CORs included in our sample of eight did not attend scoping meetings because they were appointed after the task order was issued, to replace the original COR.

Contract EPS90804 identified the qualifications for each labor category and made the contractor responsible for ensuring contract staff met required qualifications.

For time and materials or labor hour contracts, the FAR states in 52.232-7(a) that the hourly rates shall be paid for all labor performed on the contract that meets the labor qualifications specified in the contract. It does not identify who must ensure the labor meets the specified qualifications, but EPA suggests the COR do so as a best practice. According to the COR basic training material, the COR can request the contractor to submit resumes outlining the qualifications of staff to perform the work.

Region 9 should improve its review and document as part of the review contractor personnel identified on task orders. Four of eight task order CORs, managing four task orders, stated they did not review the qualifications of contract staff. The remaining four task order CORs, managing eight task orders, stated that they reviewed the qualifications of key staff proposed in the work plan. However, the CORs we asked did not provide any documentation supporting this claim. The CORs lacked documentation of sufficient controls to assure that the contractor used qualified personnel to provide the service for which EPA paid.

Because the Region 9 CORs do not consistently review or document their review of qualifications, EPA is relying solely on the contractor to ensure that the personnel billed under the contract are qualified to perform agreed-upon tasks. Contract EPS90804 requires that individuals billed must meet the qualifications for the labor categories specified in the contract. Clause B.3 identifies the qualifications for each labor category and requires that the contractor employee meet the qualifications set forth in the contract for the labor category. According to contract attachment 5, Invoice Preparation Instructions, the face of each voucher should contain the following certification: "I certify that all payments requested are for appropriate purposes and in accordance with the agreements set forth in the contract." Thus, because the CORs do not consistently review or document the review of the qualifications of contractor staff, EPA is inappropriately allowing the contractor to determine that its staff met the qualifications of the labor categories required to accomplish the work specified in the contract. This increases the risk of the contractor substituting lesser-qualified staff while EPA pays the rate for fully qualified individuals. In 2009, the OIG found that a contractor billed EPA for staff that did not meet the minimum qualifications specified in the contract. As a result, OIG recommended that EPA disallow the costs of the labor hours charged.

Review of Contractor Qualifications is Required

EPA OAM's Interim Policy Notice issued in September 2010 requires task order CORs to verify that billed hours were worked by qualified personnel at the labor categories charged. Further, the memorandum appointing the task order CORs states that CORs must assure the contractor uses the levels of personnel

contracted for and needed to perform the contractual requirements, and that the level of personnel contracted for is not diluted by the excessive use of lower-caliber personnel. Additional support for the review of qualifications is listed below.

- FAR Subsection 16.601(a) states the hourly rate means the rate(s) prescribed in the contract for payment for labor that meets the labor category qualifications of a labor category specified in the contract.
- FAR Subsection 52.232-7(a) states that hourly rates shall be paid for all labor performed on the contract that meets the labor qualifications specified in the contract. Labor hours incurred to perform tasks for which labor qualifications were specified in the contract will not be paid if the work is performed by employees who do not meet the qualifications specified in the contract.
- The September 2008 EPA COR training materials, Chapters 4 and 6, state that CORs can review résumés of proposed staff for task orders.

EPA Does Not Believe Verification of Qualifications Is Necessary

EPA does not enforce the FAR requirement to ensure contract staff meet labor qualifications. The OAM Director stated that he is not concerned with the education level or amount of experience possessed by any staff member as long as they can perform the work required, and if EPA has a policy requiring EPA to review credentials of all those working on tasks the requirement needs to be changed. The CO believes there are no requirements for EPA to review the qualifications of any staff. He also stated that EPA takes the contractor's word for the qualifications of its staff; EPA is not the contractor's human resource office. According to the CO, verifying qualifications of contractor personnel was crossing the line into personal services and deemed unnecessary because EPA evaluated key personnel during the contract selection process.

The FAR defines a personal services contract in Subsection 37.104(a); it states a personal services contract results in an employer-employee relationship between government personnel and the contractor's employees. A process to ensure contract staff meet the qualifications specified in the contract has no connection to personnel services. Specifically, checking a sample of the qualifications/résumés of the contractor staff satisfies the requirements in FAR Subsection 16.601 that the government only pay contractor staff that meet the qualifications specified in the contract. This better assures that the government obtained the level of service for which it paid. It does not allow EPA contracting personnel to direct the work of the contractor's employees. In fact, reviewing qualifications does not require any direct contact between the contractor's employees and Region 9 task order CORs.

Contract Staff Billed Did Not Match Key Contract Staff Proposed

The contractor did not identify in the work plans most of the individuals who were ultimately billed. As shown in table 3, for the 12 task orders reviewed, the work plans identified 229 individuals as key staff. However, 46 of these 229 individuals (20 percent) were never billed. Conversely, the contractor billed for 1,029 individuals but 846 (82 percent) were not in the work plans. According to the CORs, they did not attempt to review the qualifications of the 846 personnel not listed in the work plans.

Table 3: Individuals on work plans did not match those billed

Task order	Number of key staff on work plan		Number of individuals billed	
	Total	Billed	Total	Not in work plan
7	17	13	110	97
8	11	10	88	78
17	15	15	148	133
23	4	4	102	98
40	21	17	64	47
45	53	49	164	115
49	10	5	27	22
50	68	53	194	141
51	6	5	59	54
53	10	5	26	21
55	8	2	17	15
60	6	5	30	25
Totals	229	183	1,029	846

Source: OIG analysis

Task order CORs explained that these differences in staffing did not pose a concern as such differences are common with large contractors. However, if the contractor bills individuals not mentioned in the work plans and the task order CORs are unaware of the background of these individuals, Region 9 cannot ensure their qualifications comply with the terms of the contract. This increases the risk that the contractor is billing the government for work performed by less-qualified individuals.

Region 9 Task Order CORs Did Not Always Document Reviews of Monthly Progress, Contractor Performance, and Quality of Deliverables

Region 9 did not consistently document the review of monthly progress or the quality of deliverables. Although there was a form available to evaluate contractor performance on a monthly basis, task order CORs did not use it. Documentation on the quality of deliverables varied between task orders. The FAR requires in Subsection 16.601 that the government review the contractor's performance to provide reasonable assurance that the contractor is using efficient methods and cost controls, and FAR Subsection 46.104 requires that the government must document decisions regarding the acceptability of products. EPA guidance and

contract EPS90804 also require that Region 9 have documentation showing that it conducted appropriate performance reviews of the contractor. Region 9 could better support the reasonableness of the payments to the contractor and the formal contractor evaluations with more consistent documentation on the contractor's monthly progress and the quality of deliverables. Further, if a dispute arises concerning deliverables, Region 9 would have the documentation needed to support its decisions.

Monthly Progress Reviews Not Documented

FAR Subsection 46.401(a) requires that quality assurance surveillance plans should be prepared in conjunction with the preparation of the statement of work. The plans should specify all work requiring surveillance and the method of surveillance. Contrary to the requirements in the FAR, no surveillance plan was prepared for contract EPS90804. Instead of a surveillance plan, contract EPS90804 attachment 8, Award Term Incentive Plan, addressed monitoring categories. Attachment 8 briefly described a method of surveillance. The method described that formal evaluations will generally be performed annually, but EPA will informally evaluate the contractor's performance on a monthly basis as part of the invoice/ status report approval process. However, task order CORs did not complete the portion of the invoice approval form that would have documented the monthly progress review. Thus, EPA failed to use the tool described in the method of surveillance. If an appropriate government surveillance plan had been prepared and executed, it would have improved controls for task orders on contract EPS90804.

Contract EPS90804, clause G.2, requires the contractor to submit monthly progress reports and invoices. The EPA CMM states that the government must document to show appropriate review of contract invoices for cost reasonableness. The task order CORs used the Task Order Costs/Hours Verification Form to certify that they reviewed the monthly invoice and verify that the contractor made sufficient progress to support paying for the work performed. The verification form had two sections (see appendix C). The first section was the mandatory verification statement mentioned above; the second was an optional section to assess contractor's performance. For the task orders reviewed, all the task order CORs filled out the required section for the invoices.

Most task order CORs did not have documentation on the extent of their review of the invoice. The current verification form only requires that the task order CORs certify that they reviewed the invoice but does not account for the depth of the review. Two of the eight task order CORs who managed six task orders could provide documentation, in addition to the verification forms, that they reviewed monthly invoices. For example, both of these task order CORs had records challenging or suspending amounts invoiced. Other task order CORs stated that they reviewed invoices but could not provide documentation. When we

questioned one of these task order CORs about progress and costs invoiced, the COR was unable to give explanations showing she understood the invoice. Contract EPS90804 attachment 8, Award Term Incentive Plan, stipulated that Region 9 will continually monitor the contractor's performance and will informally evaluate the performance monthly. As mentioned before, the verification form had an optional portion for the task order CORs to assess contractor's performance. This section covered the quality of services delivered, effectiveness of management, and timeliness of performance. For the task orders reviewed, none of the task order CORs completed the contractor performance section of the verification forms. The CO and a supervisor stated that there have been times when EPA made changes to the contractor deliverable reports.

Every 6 months, the task order CORs are supposed to complete a formal evaluation of the contractor's performance. If task order CORs completed the monthly assessment for contractor performance, there would be better support for the semi-annual assessment. By not completing the evaluation section of the verification form, EPA has missed an opportunity to provide better oversight of taxpayer funds.

Task Order CORs Did Not Consistently Document Their Review of the Quality of Deliverables

Numerous directives require EPA to document that it accepts deliverables. FAR Subsection 46.104(c)(2) requires that agencies document decisions regarding the acceptability of products. The September 2010 EPA OAM's *An Acquisition Guide for Executives* requires that program managers identify the deliverables that are required for their programs, such as overseeing technical programs and inspecting and accepting contract deliverables. "EPA's focus has traditionally been on ensuring funds are obligated...oversight is needed to ensure that funds are used for their intended purpose and in accordance with applicable terms and regulations (EPA Guidance 2010, p 25)." The appointment memorandum requires that task order CORs inspect completed work and/or services, certify acceptance or non-acceptance of work, and review and evaluate the contractor's accomplishment of technical objectives. The appointment memorandum requires that task order CORs:

- Inspect completed work and/or services.
- Certify acceptance or non-acceptance of work.
- Review and evaluate the contractor's accomplishment of technical objectives.
- File (among other things) copies of deliverables, comments on deliverables, and approvals of deliverables.

The CO stated he relied on task order CORs to review the quality of deliverables, but the documentation on the reviews was inconsistent. Six of the 8 task order CORs, managing 10 task orders, indicated that they evaluated the quality of the deliverables

for their task orders. However, the documentation supporting these evaluations varied. Examples of how the task order CORs documented approval included e-mails, the related verification form, a signed approval page in the deliverable, or posting the deliverable to the Web page for the site. Two task order CORs, managing six task orders, said they sometimes gave oral approval of deliverables.

Two of the eight task order CORs who managed two different task orders could not provide documentation to support that they reviewed the quality of their deliverables. When we asked one of these task order CORs how that COR reviewed the quality of her task order deliverables, the COR could not provide an answer.

Region 9 Did Not Always Comply With Directives or Best Practices, or Consistently Issue COR Appointment Memorandums

The CMM and the appointment memorandums identify the task order CORs' responsibilities. The COR training materials identify task order COR best practices. The CMM requires that CORs be familiar with the contract terms and conditions, and keep a copy of the contract in their files. The memorandums require that the CORs:

- Ensure that the contractor complies with the task order statement of work or specifications.
- Assure that the contractor uses the levels of personnel contracted for and necessary for performance of contractual requirements.
- Review contractor invoices and recommend approval/disapproval for payment as appropriate.
- Monitor the task order performance.
- Review and evaluate the contractor's accomplishment of technical objectives

The COR training manual tells CORs that as a best practice:

- When needed, modify the SOW.
- Review qualifications of contractor staff.
- Review contractor performance.
- Review the quality of deliverables.

Task order CORs not being familiar with contract clauses is counter to the directives of the CMM and the appointment memorandum. We found that some task order CORs did not read contract EPS90804. They seemed unaware of contract clauses such as the requirement in Attachment 8 that EPA will informally evaluate contractor performance on a monthly basis.

In addition, only two task order CORs received appointment memorandums; the current CO issued these memorandums. The task orders issued before this CO

started managing the contract did not have appointment memorandums for the task order CORs. This illustrates the need for the CO to issue appointment memorandums and effectively communicate what is expected of task order CORs on a regular basis.²

Conclusion

Region 9 does not enforce the FAR requirement that contract staff meet labor qualifications specified in the contract. Because CORs do not consistently review or document the review of contractor staff qualifications, EPA may be allowing the contractor to determine that its staff met the qualifications of the labor categories required to accomplish the work specified in the contract. This increases the risk of the contractor substituting lesser-qualified staff while EPA pays the rate for fully qualified individuals. Further, not all task order CORs used the SOW as the primary document to monitor contract work. The task order CORs' practice of using the contractor's work plan to track progress increases the risk of the contractor changing the nature of the agreed-upon contract services without the CORs knowledge. Also, Region 9 did not consistently document the review of monthly progress or the quality of deliverables. Consequently, if a dispute arises concerning deliverables, Region 9 may not have the documentation needed to support its decisions. Finally, we found that some task order CORs did not read contract EPS90804, and CORs not being familiar with contract clauses is counter to the directives of the CMM and the appointment memorandum.

Recommendations

We recommend that the Regional Administrator, Region 9:

1. Direct the CO for contract EPS90804 to:
 - a. Require that minutes of scoping meetings are prepared, provided to those who attended, and committed to the official contract file.
 - b. Instruct task order CORs to modify the SOW, if needed, to show changes to which EPA and the contractor agreed in the scoping meeting.
 - c. Instruct task order CORs to continue to complete the Cost Proposal Evaluation Checklist for each task order and commit it to the official contract file.
 - d. Instruct task order CORs to complete the Task Order Costs/Hours Verification Form in its entirety, including the contractor performance evaluation section.
 - e. Instruct task order CORs to commit to the official contract file a record of deliverables received and whether they were acceptable.

² FAR Subsection 1.602-2(d)(6) did not require the CO to use appointment memorandums to appoint CORs until March 16, 2011. However, the EPA CMM required appointment memorandums in 2009.

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

2. Direct OAM to require task order CORs to evaluate the qualifications of contractor key staff proposed by the contractor in the work plan. The task order CORs should also review qualifications for samples of the non-key staff billed on invoices.

Agency Comments and OIG Evaluation

The Regional Administrator agreed to recommendation 1 and provided a timeframe for implementing it. In his comments, the Regional Administrator said that the Agency believes that many of the recommendations included in chapter 2 of the report have merit and point out opportunities for Region 9 to improve the contract oversight being provided by CORs. The region's response on recommendation 1 is complete and the recommendation will be designated as open with agreed-to actions pending.

Regarding recommendation 2, the Assistant Administrator for Administration and Resources Management agreed that if the contract contains personnel requirements such as required education or years of experience for contractor staff, the CO and task order CORs must review and evaluate those qualifications. He indicated that Region 9 was no longer using this contracting approach in new procurements. OAM would use its balanced scorecard performance management and measurement program to determine the need for additional guidance on performance based contracting approaches. The balanced scorecard addresses and implements solutions to various acquisition planning, evaluation, award, and administration issues Agency-wide. We do not have sufficient information to determine whether the proposed method meets the intent of our recommendation, nor did OAM provide a timeframe for completing it. Therefore, we consider recommendation 2 to be unresolved.

Chapter 3

Contract Included a Prohibited Payment Clause

Region 9 negotiated a prohibited clause in contract EPS90804 that allowed for paying profit on subcontracts. Paying profit on subcontracts under an indefinite delivery/indefinite quantity contract with time and materials pricing arrangements is duplicative and prohibited by the FAR. As a result, the contractor billed, and EPA paid, over \$1.5 million for profit on subcontracts. EPA must take appropriate actions to prevent future payments of duplicative profit on subcontracts.

Paying Profit on Subcontracts Is Prohibited

Beginning in February 2007, the FAR prohibited paying profit on subcontracts under time and materials pricing arrangements. FAR Subsection 16.601(b) states that a time and materials contract provides for acquiring supplies or services based on direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, profit, and the actual cost of materials (with certain exceptions). “Materials” includes subcontracts. Further, the related clause for payments under time and materials pricing arrangements—FAR Subsection 52.232-7(b)(7)—specifically states that the government will not pay profit or fees to the prime contractor on materials.³ Therefore paying profit to the contractor on subcontracts is inappropriate under time and materials pricing arrangements.

As noted in chapter 1, contract EPS90804 is a fixed rate, indefinite delivery/indefinite quantity contract. The indefinite delivery/indefinite quantity requirement gives the government flexibility in both quantities and delivery scheduling of orders. Indefinite delivery contracts may provide for any appropriate cost or pricing arrangement.

Besides the above prohibition, profit is also prohibited as a percentage of cost. Paying the cost of the subcontracts plus a percentage of that cost for profit resembles a cost-plus-a-percentage-of-cost contract, which FAR prohibits. FAR Subsection 16.102(c) states: “The cost-plus-a-percentage-of-cost system of contracting shall not be used (citations omitted).”

Contract Inappropriately Allows Paying Profit on Subcontracts

Contract EPS90804, clause B.3, contains the pricing schedule for the contract. It requires that Region 9 pay the contractor:

³ There are two exceptions to not paying profit on subcontracts. They pertain to materials, supplies, and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a common control. These exceptions do not apply to contract EPS90804.

- A fixed rate per hour for identified labor categories.
- Travel costs.
- Subcontract costs.
- Other direct costs.
- Profit of 4.00 percent applicable to subcontracts only.

Through April 27, 2012, the contractor billed Region 9 the cumulative amount of \$38,104,278.36 for subcontracts, plus cumulative profit on the subcontracts of \$1,524,196.44. Under the terms of the contract, EPA is still liable to the contractor for excess profits on work to be completed.

One plausible reason why the FAR prohibits the profit clause is because it is duplicative. The fixed hourly rates paid for the identified labor categories include profit. The CO stated that he did not understand the rationale for the clause because the Region 9 Acquisition Manager negotiated it when he served as the CO. We received conflicting responses from the Region 9 Acquisition Manager on this issue.

- Initially the Region 9 Acquisition Manager stated that the 4.00 percent was for costs associated with managing the subcontracts and the contract erroneously identified it as subcontract profit. However, this explanation is not consistent with a September 2008 negotiation document he signed. In the document, there was consistent use of the term “profit” regarding the fee to be applied to the cost of subcontracts. In addition, in negotiating this item, the Acquisition Manager used EPAAR Subsection 1515.404-471, EPA structured approach, for developing profit or fee objectives.
- After the OIG team’s visit during this review, the Region 9 Acquisition Manager received confirmation from the contractor that the 4.00 percent was profit. The contractor stated it referred to it as a fee. The Region 9 Acquisition Manager stated that the contractor’s use of that term confused him and he interpreted the fee as overhead. The agency should have understood that the FAR prohibits both “fees” and “profits.”
- The Region 9 Acquisition Manager also stated that remedial action contracts issued by other regional offices might have this clause. However, we found only two other remedial action contracts that were similar in type and date to those issued by Region 4, and they did not include the clause.

The issue extends beyond contract EPS90804. The Region 9 Acquisition Manager signed at least one other contract that included time and materials task orders with similar payments for profit. Region 9 awarded remedial action contract EPS90803 on June 24, 2008, which also provided that the region would pay profit of 4.00 percent applicable to subcontracts only.

EPA Disagrees That the Clause Was Inappropriate or Duplicative

In August 2012, the Region 9 acquisition staff, the OAM Director, and members of his staff disagreed that the 4.00 percent profit on subcontracts allowed by contract EPS90804 is duplicative and inappropriate. The Agency stated:

- *Type of Contract:* Contract EPS90804 is not a time and materials contract because they issued task orders with other pricing arrangements under this contract.
- *Risk in managing subcontracts:* The contract requires the contractor to subcontract the construction work. Management of construction is riskier than some other types of architect and engineering services, so the contractor should be entitled to additional profit above that in the fixed hourly rates for managing construction subcontracts. The contractor proposed that EPA compensate them for the increased risk by adding additional profit only on the subcontracts. This might cost EPA less than if the contractor had increased the profit ratio in their fixed rates.
- *Types of subcontracts:* The subcontracts negotiated were often fixed price or firm-fixed rate, and thus the additional 4.00 percent is fixed in a similar manner rather than billed as a percentage of cost.

Type of Contract

For the 12 task orders we evaluated, EPA paid the contractor on a time and materials basis as allowed by the contract clauses cited below. Since EPA chose to acquire these services using a time and materials arrangement, the related limitations apply and the contractor is not entitled to additional profit that the FAR prohibits.

- Clause B.2 (b) permits the government to order work by using a fixed-price, firm-fixed rate with a cost reimbursement line item for other direct costs, or fixed rate time and materials type task orders.
- Clause B.3 meets the definition of time and materials in FAR Section 16.601 because it provides for paying the contractor based on direct labor hours at specified fixed hourly rates plus the cost of materials.

The Director and his staff could not provide FAR references to justify paying the additional profit. The Agency stated that the clause in FAR Subsection 52.232-7 prohibiting the payment of profit on subcontracts was not included in the contract and therefore does not apply. That clause was not in the contract, even though the FAR requires it in contracts when applicable. FAR Subsection 52.301 provides a matrix on the applicability of the clauses and provisions. We disagree that excluding the clause from the contract exempts EPA from that requirement. This matrix indicates the clause in FAR Subsection 52.232-7 is required when applicable for time and materials contracts, and for labor hour contracts. The contract contained a clause addressing payments under fixed rate contracts. Clause G.3, from EPAAR Subsection 1552.232-73, limits the reimbursement of materials to cost. Thus, EPA should prohibit profit on subcontracts under contract

EPS90804 task orders with time and materials pricing arrangements. Further, FAR Subsection 16.601 applies even without the payment clause in 52.232-7.

Risk in Managing Subcontracts

Regarding whether managing construction subcontracts is riskier than other types of architect and engineering services, under a time and materials arrangement, the government factors in the risk since the contractor will be paid for the work performed at a fixed hourly rate that includes profit. Of the 12 task orders we evaluated, task orders 45 and 50 billed the most dollars for subcontracts (\$16.6 million and \$11.5 million, respectively). As required by the statement of work, the work plan for task order 45 included the following architect and engineering services related to the subcontracts:

- Task 3 – Procurement of Subcontract: This subtask includes completing all subcontracting efforts for the Phase II work including pre-bid, award, and post-award activities.
- Task 4 – Management Support: The purpose of this task is to manage and monitor the subcontracts implemented under this task order, and to develop, implement, and document procedures for confirmation that the work activities are performed in accordance with the contract documents.
- Task 5 – Detailed Resident Inspection: The purpose of this subtask is to provide field supervision of remedial activities that are scheduled to take place under this task order. The remedial activities include construction of the disposal cell and pipelines.

The above tasks show that EPA paid the contractor directly for managing the subcontracts. Under task order 45, the contractor billed EPA over \$2.5 million for labor on the above three tasks. Task order 50 included these same tasks. For task order 50, the contractor billed EPA a total of \$4.7 million for labor on these three tasks. The fixed rates for each of the related labor hours included profit. Consequently, the additional 4.00 percent is duplicative.

Types of Subcontracts

Region 9 acquisition staff does not believe the 4.00 percent profit resembles the prohibited cost-plus-a-percentage-of-cost type of contract. According to them, some of the subcontracts negotiated were fixed price. Since these subcontractors were not paid on a cost basis, the related 4.00 percent is not cost-plus-a-percentage-of-cost. However, the method for determining the price of the subcontracts is not pertinent. The pricing arrangement between the contractor and its subcontractor could be fixed price, fixed rate, or something else. Whatever it was, contract EPS90804 provided for reimbursing the contractor for the actual cost. The 4.00 percent profit rate was applied to that amount. Thus, it resembles the prohibited cost plus a percentage of cost type of contract.

In response to this review, the OAM Director agreed to have his staff (1) work with the Region 9 acquisition staff to assess and possibly restructure how EPA will pay the contractor for such work, and (2) determine how EPA paid other remedial action contractors for managing construction subcontracts.

Conclusion

Paying profit to the contractor on subcontracts is inappropriate under time and materials pricing arrangements. However, Region 9 negotiated such a clause in contract EPS90804. As a result, through April 27, 2012, the contractor billed, and EPA paid, over \$1.5 million for profit on subcontracts. EPA is liable to the contractor for additional profit on work to be completed under this contract. Region 9 has at least one other contract (EPS90803) that included time and materials task orders with similar payments for profit on subcontracts. EPA acquisition staff disagreed that paying profit on subcontracts was inappropriate. However, they could not provide FAR references to justify such payments.

Recommendations

We recommend that the Regional Administrator, Region 9:

3. Direct the CO for contract EPS90804 to:
 - a. Remove the profit clause or terminate the contract so that Region 9 no longer has to pay profit on subcontracts.
 - b. Recover the 4.00 percent profit paid.
4. Coordinate with the EPA OAM to:
 - a. Perform an independent review of all current Region 9 contracts with time and materials pricing provisions to determine whether they contain profit payment clauses.
 - b. If the review finds these clauses, take appropriate actions to recover the profits paid and remove the clause to prevent such payments in the future.

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

5. Ensure that OAM conducts and documents the results of the review prompted by this evaluation of all remedial action contracts to:
 - a. Determine the best method for paying the remedial action contractors for all subcontract management costs.
 - b. Consistently apply this method for all remedial action contracts Agency-wide.

Agency Comments and OIG Evaluation

As summarized below and detailed in appendixes D and E, the Regional Administrator for Region 9 and Assistant Administrator for Administration and Resources Management disagreed that paying additional profit on the subcontracts was inappropriate. They proposed alternative corrective actions for recommendations 3, 4 and 5. The Regional Administrator also provided technical comments, which we include in appendix F, and provided a response.

Regarding recommendation 3, the Regional Administrator said that both Region 9 and the OAM disagree that the profit clause in the contract represents a prohibited payment. Thus, termination of the contract or removal of the clause is unnecessary and there is no need to recover the amounts paid. However, he proposed an alternate action. Future contracts would include a negotiated comprehensive set of rates that segregates those specialties associated with architectural and engineering services and those associated with construction oversight services. Each set of rates can include costs and profits representative of the work being conducted. We commend Region 9 for proposing that the terms of future contracts address cost and profit differently. However, that does not resolve the issues with the current contract. We disagree with the Regional Administrator's position, and consider recommendation 3 unresolved.

Regarding recommendation 4, the Regional Administrator said that OAM had already independently reviewed this contract, similar Region 9 contracts, and their clauses before award. OAM also recently performed oversight reviews of Region 9 with no findings on these provisions. In reviewing these contracts, Region 9 and OAM both considered these provisions to be appropriate. As an alternative corrective action, the Regional Administrator proposed that future contracts issued by Region 9 would use different pricing arrangements. However, according to the Assistant Administrator, both Region 9 and the OAM agree that the methodology of applying the 4.00 percent premium negotiated in the subject contract for construction management required corrective action. We consider this recommendation unresolved.

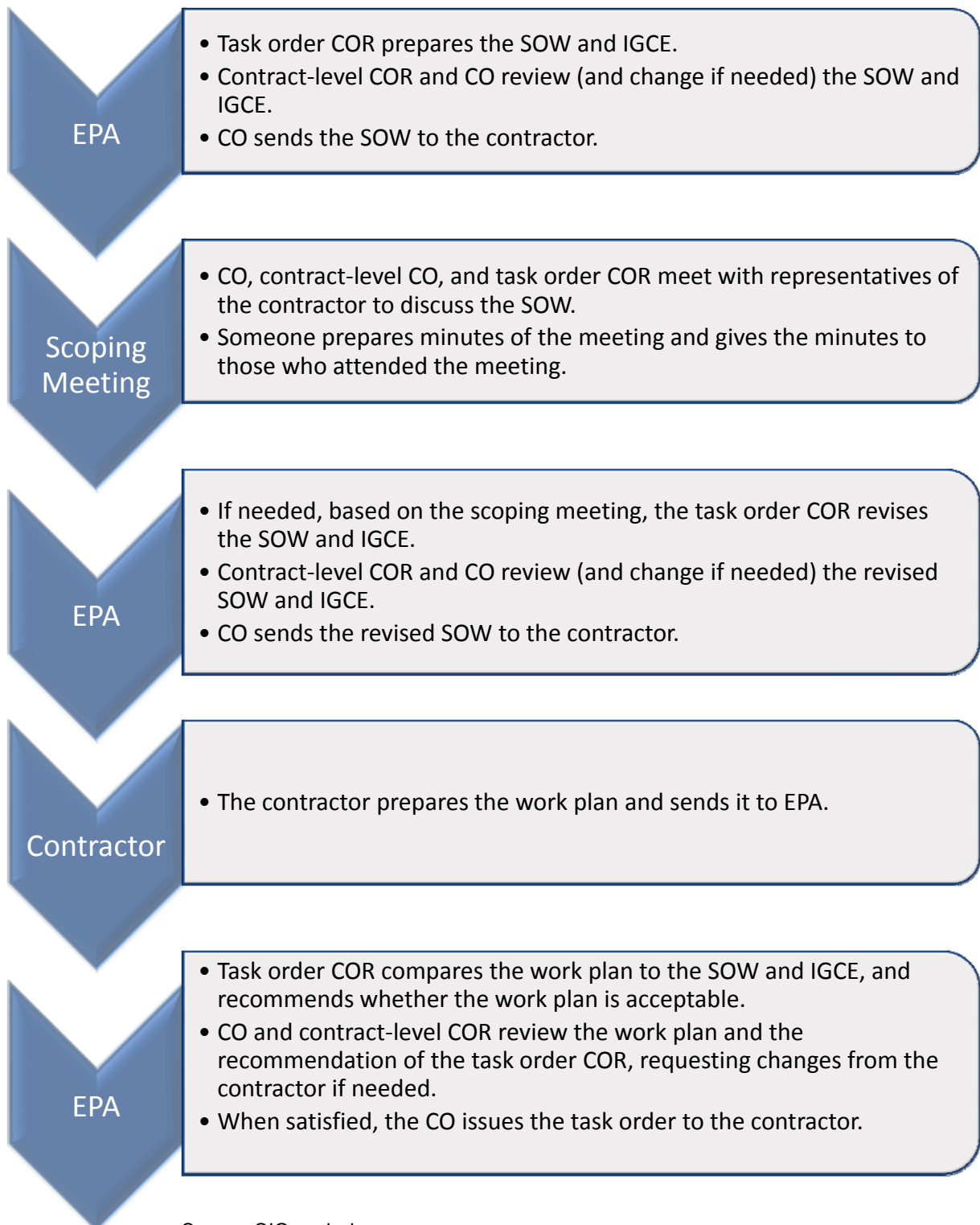
Regarding recommendation 5, the Assistant Administrator said that OAM has surveyed other similar headquarters and regional contracts and determined that no other office is using the pricing methodology associated with this finding. He also stated that OAM will use the balanced scorecard process to assess the need for additional guidance on adequate file documentation and proper payment procedures. The fact that OAM determined that no other office was using this pricing methodology casts doubt on the validity of Region 9 applying this method. We disagree with the proposed corrective action using the balanced scorecard. Our recommendation was to identify the methods currently used to pay remedial action contractors for managing subcontracts, determine the best practices, and use them throughout EPA. We believe the proposed alternative corrective action will not do this, so we consider this recommendation unresolved.

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
1	14	Direct the CO for contract EPS90804 to: <ul style="list-style-type: none"> a. Required that minutes of scoping meetings are prepared, provided to those who attended, and committed to the official contract file. b. Instruct task order CORs to modify the SOW, if needed, to show changes to which EPA and the contractor agreed in the scoping meeting. c. Instruct task order CORs to continue to complete the Cost Proposal Evaluation Checklist for each task order and commit it to the official contract file. d. Instruct task order CORs to complete the Task Order Costs/Hours Verification Form in its entirety, including the contractor performance evaluation section. e. Instruct task order CORs to commit to the official contract file a record of deliverables received and whether they were acceptable. 	O	Regional Administrator, Region 9	9/30/13		
2	15	Direct OAM to require task order CORs to evaluate the qualifications of contractor key staff proposed by the contractor in the work plan. The task order CORs should also review qualifications for samples of the non-key staff billed on invoices.	U	Assistant Administrator for Administration and Resources Management			
3	20	Direct the CO for contract EPS90804 to: <ul style="list-style-type: none"> a. Remove the profit clause or terminate the contract so that Region 9 no longer has to pay profit on subcontracts. b. Recover the 4.00 percent profit paid. 	U	Regional Administrator, Region 9		\$1,524	
4	20	Coordinate with the EPA OAM to: <ul style="list-style-type: none"> a. Perform an independent review of all current Region 9 contracts with time and materials pricing provisions to determine whether they contain profit payment clauses. b. If the review finds these clauses, take appropriate actions to recover the profits paid and remove the clause to prevent such payments in the future. 	U	Regional Administrator, Region 9			
5	20	Ensure that OAM conducts and documents the results of the review prompted by this evaluation of all remedial action contracts to: <ul style="list-style-type: none"> a. Determine the best method for paying the remedial action contractors for all subcontract management costs. b. Consistently apply this method for all remedial action contracts Agency-wide. 	U	Assistant Administrator for Administration and Resources Management			

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

Process for Issuing a Task Order Under Contract EPS90804



Source: OIG analysis

Cost Proposal Evaluation Checklist

Task Order Project Officer:
 Site Name:
 Task Order Number:
 Cost Proposal Dated:

1. Addressing the Statement of Work (SOW)

a. Does the Contractor address all tasks outlined in the SOW? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	g. Are proposed staff levels for each task reasonable to accomplish the tasks? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
b. Does the Contractor include any work not required in the SOW? <input type="checkbox"/> Yes (see below) <input type="checkbox"/> No <input type="checkbox"/> N/A	h. Is a reasonable level of clerical/home office support staff proposed? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
c. Is the proposed schedule acceptable? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	i. Are appropriate hours proposed for each staff level? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
d. Is the management structure sound? Is appropriate QA oversight staff included? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	j. Is a reasonable budget developed for each activity? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
e. Does the technical approach and methodology for accomplishing each task appear effective? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	k. Is there enough detail in the WP and budget structure to support future cost recovery? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
f. Does the Contractor demonstrate a thorough understanding of the task order? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	l. If fieldwork is to be done, is preparation of a HASP, QAPP and FSP included? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A

TOPO comments regarding (1) above:

2. Travel

a. Are the number and length of trips, number of travelers, fares, and duration reasonable and acceptable? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	
---	--

TOPO comments regarding (2) above:

3. Subcontracting

a. Are the proposed subcontracting efforts and costs reasonable and acceptable? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A	b. Are laboratory services, other than CLP, appropriate? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A
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TOPO comments regarding (3) above:

4. Other Direct Costs

<p>a. Do reproduction (production copier) costs appear reasonable and appropriate? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>	<p>c. Are Postage and Shipping costs reasonable and appropriate? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>
<p>b. Are proposed material and equipment costs reasonable and appropriate? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>	<p>d. Government-furnished property is justified, where appropriate. <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>

TOPO comments regarding (4) above:

5. Cost Proposal

<p>a. Is the Contractor's total proposed budget within a reasonable range of the IGCE? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>	<p>c. Have the Indirect Rates and Service Center Rates already been negotiated and included in the contract? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>
<p>b. Is the proposed budget within reasonable range of the IGCE for each task? <input type="checkbox"/> Yes <input type="checkbox"/> No (see below) <input type="checkbox"/> N/A</p>	

TOPO comments regarding (5) above: See Attachment A.

6. TOPO Recommendation

I have reviewed the Contractor's Cost Proposal, and make the following recommendation:

Cost Proposal is recommended for approval as submitted. The Contractor's cost proposal adequately addresses the Statement of Work. Any proposed travel, subcontracting, and other direct costs have been reviewed and are necessary and reasonable. The proposed budgets are reasonable (see #5 above for discussion regarding cost reasonableness).

Cost Proposal is not recommended for approval. Cost Proposal approval is not recommended for the following reason(s):

Partial Cost Proposal approval is recommended. The following tasks/subtasks are recommended for approval as submitted. For these tasks/subtasks recommended for approval, The Contractor's cost proposal adequately addresses the Statement of Work. Any proposed travel, subcontracting, and other direct costs have been reviewed and are necessary and reasonable. The Cost Proposal budgets for these tasks/subtask are reasonable (see #5 above for discussion regarding cost reasonableness). List tasks/subtasks recommended for approval:

The remaining tasks/subtasks are not recommended for approval for the following reason(s):

<p><i>TOPO Signature and Date:</i></p>
--

(Submit Completed form to the Project Officer)

TASK ORDER COSTS/HOURS VERIFICATION FORM		
Please Return the Forms to (SFD-2) by <<Date>>		
Date of Distributing the Monthly Progress Report and Invoice to TOPO: <<Date>>		
Contractor: CH2M HILL	Contract No.: EP-S9-08-04	Period of Performance for This Invoice: «Period of Performance»
Invoice No: «Invoice No»		Amount: «Amount Billed»
TOPO: «RPM Name» «Mail Code»		Contract PO:
TO No.: «TO No»	Title: «TO Title»	Site Name: «Site Name»
<p>Please check one of the statements below and provide verification signature. Keep the invoice and monthly report for your record. Any unreasonable and/or confusing information should be brought to the attention of the contractor and the Contract Project Officer in a prompt fashion.</p> <p>_____ I agree with this invoice. Sufficient progress has been made by the contractor to support payment of the work performed.</p> <p>_____ Contractor must provide additional justification for verification of costs and/or hours on this task order.</p> <p>_____ Cost listed below should be withheld since they can not be verified.</p> <p>Comments/Explanation:</p>		
<p>Optional Monthly Contractor Performance Evaluation: The minimum acceptable rating is “Good.” The rating below “Good” or any problem areas indicated below should be addressed immediately by Project Officer and contractor Program Manager. Please rate each criterion:</p> <p style="text-align: center;">5 – Outstanding 4 – Excellent 3 – Good 2 – Fair 1 – Poor 0 - Unsatisfactory</p>		
Quality of Services Delivered Rating: _____	Effectiveness of Management Rating: _____	
Initiative in Meeting Contract Requirement Rating: _____	Timeliness of Performance Rating: _____	
Cost Control Rating: _____	Business Practices Rating: _____	
Customer Satisfaction Rating _____		
List Any Positive Feedback or Problem Areas That Need To Be Addressed:		
Signature & Date: I have reviewed the monthly progress and financial reports and verify to the best of my ability the costs incurred.		

Office of Acquisition Management Comments to Recommendations



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

JAN 24 2013

OFFICE OF
ADMINISTRATION
AND RESOURCES
MANAGEMENT

MEMORANDUM

SUBJECT: OAM Response to OIG Draft Report, Improved Management Needed for EPA Contract EPS90804 to Address Risk of Misusing Funds

FROM: Craig E. Hooks, Assistant Administrator

TO: Carolyn Copper
Assistant Inspector General for Program Evaluation

The Office of Administration and Resources Management appreciates the opportunity to review and comment on the December 14, 2012 Office of Inspector General draft report titled "Improved Management Needed for EPA Contract EPS90804 to Address Risk of Misusing Funds." In order to provide a timely response to the findings and recommendations, Region 9 is submitting its response separately. However, we have coordinated our responses.

The report contains a review of contract EPS90804 awarded by Region 9 in FY 2008. Since that time, the Office of Acquisition Management has implemented an oversight and compliance review program under the EPA Balanced Scorecard Performance Management and Measurement Program. This program addresses and implements solutions to various acquisition planning, evaluation, award, and administration issues agency-wide.

Recommendations and Responses related to OAM:

Recommendation 2. Direct OAM to require Task Order Contracting Officer Representatives (CORs) to evaluate the qualifications of contractor key staff proposed by the contractor in the work plan. The Task Order CORs should also review qualifications for samples of the non-key staff billed on invoices.

OAM Response: OAM agrees if the contract contains personnel requirements such as required education or years of experience for vendor staff, then Task Order CO's and CORs must review

and evaluate those qualifications. However, OAM does not believe this is the best approach for managing contract performance. Rather, OAM supports performance based procurement approaches which require the vendor to identify the labor categories and mix required to ensure successful contract performance. This approach shifts the risk of contract performance to the vendor, which is the intent of performance based contracting and the reason why this approach is the preferred procurement method. Under this approach, per FAR 7.1 only

key personnel are subject to government approval. OAM does not support using terms and conditions that include qualifications for contractor staff and does not intend to continue this procurement approach. Furthermore, Region 9 is no longer using this contracting approach in new remediation procurements. However, notwithstanding that this finding results from review of a single contract, OAM will use the BSC PMMP process to determine the need for additional guidance on performance based contracting approaches.

Recommendation 5. Ensure that the OAM conducts and documents the results of the review prompted by this evaluation of all remedial action contracts to:

- a. Determine the best method for paying the remedial action contractors for all subcontract management costs.
- b. Consistently apply this method for all remedial action contracts agency-wide.

OAM Response: While both Region 9 and OAM agree that the methodology of applying the 4% premium negotiated in the subject contract for construction management required corrective action, those costs do not qualify as prohibited payments. Region 9 has already indicated how they will appropriately address similar situations for future contracts, as applicable. Additionally, OAM has surveyed other similar headquarters and regional contracts and determined that no other office is using the pricing methodology associated with this finding. OAM will use the BSC PMMP process to assess need for additional guidance on adequate file documentation and proper payment procedures.

Should you have any questions regarding this response, please contact John Bashista, Director of the Office of Acquisition Management, at (202) 546-4310.

cc: Nanci Gelb, Principal Deputy Assistant Administrator, OARM
John Bashista, Director, Office of Acquisition Management, OARM
Raoul Scott, Acting Deputy Director, Office of Acquisition Management, OARM
Sandy Womack, Audit Follow-up Coordinator, OARM
Alexander Kramer, Contracting Chief, Region 9
Arthur Elkins, Jr., Inspector General
Alan Larsen, Counsel to the Inspector General
Melissa Heist, Assistant Inspector General for Audit, OIG
Eileen McMahon, Assistant Inspector General for Congressional, Public Affairs, and Management, OIG

Region 9 Comments to Report Recommendations



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY

REGION IX

75 Hawthorne Street

San Francisco, CA 94105

MEMORANDUM

SUBJECT: Response to Office of Inspector General Draft Report No. OPE-FY12-0008
Improved Management Needed for EPA Contract EPS90804 to Address Risk of
Misusing Funds

FROM: Jared Blumenfeld
Regional Administrator, Region 9

TO: Carolyn Copper
Assistant Inspector General for Program Evaluation

Thank you for the opportunity to respond to the issues and recommendations in the subject audit report. Following is a summary of the Agency's overall position, along with its position on each of the report recommendations. For those report recommendations with which the Agency agrees, we have provided either high-level intended corrective actions and estimated completion dates to the extent we can or reasons why we are unable to provide high-level intended corrective actions and estimated completion dates at this time. For those report recommendations with which the Agency does not agree, we have explained our position and proposed alternatives to recommendations. For your consideration, we have included a Technical Comments Attachment to supplement this response. We officially request that the Technical Comments Attachment be included with the draft report.

AGENCY'S OVERALL POSITION

The Agency has reviewed the findings included in the draft report. The Agency believes that many of the recommendations included in Chapter 2 of the report have merit and point out opportunities for Region 9 to improve the contract oversight being provided by Contracting Officer's Representatives (COR). With respect to the findings and recommendations included in Chapter 3, the Agency does not concur with the report's assertion that the subcontract profit clause represents a prohibited payment. The Agency's reasoning is included in the responses below as well as the Technical Comments Attachment.

AGENCY'S RESPONSE TO REPORT RECOMMENDATIONS

Agreements

No.	Recommendation	High-Level Intended Corrective Action(s)	Estimated Completion by Quarter and FY
1.	<p>We recommend that the Regional Administrator, Region 9, direct the CO for contract EPS90804 to require that:</p> <ul style="list-style-type: none"> a. Minutes of seeping meetings are prepared, provided to those who attended, and committed to the official contract file. b. Task Order CORs modify the SOW, if needed, to show changes to which EPA and the contractor agreed in the seeping meeting. c. Task Order CORs continue to complete the Cost Proposal Evaluation Checklist for each task order and commit it to the official contract file. d. Task Order CORs complete the Task Order Costs/Hours Verification Form in its entirety, including the contractor performance evaluation section. e. Task Order CORs commit to the official contract file a record of deliverables received and whether they were acceptable. 	<ul style="list-style-type: none"> a. Minutes will be prepared for each seeping meeting and provided to participants as well as included in the official task order file for each order. b. Task Order CORs will modify the SOW prior to issuance with a task order to reflect any changes agreed upon during the seeping meeting c. Task Order CORs will continue to complete the Cost Proposal Evaluation Checklist for each task order and commit it to the official contract file. d. Task Order CORs will be required to complete the Task Order Cost/Hours Verification Form in its entirety. Should any performance issues arise they will be noted in the contract performance section and reported to the contract level COR. e. Task Order CORs will commit to the official task order file a record of deliverables received and whether or not they were acceptable. 	<p>3rd Quarter FY 2013</p> <p>4rd Quarter FY 2013</p> <p>Already Implemented</p> <p>4th Quarter FY 2013</p> <p>4th Quarter FY 2013</p>

Disagreements

No.	Recommendation	Agency Explanation/Response	Proposed Alternative
3.	<p>Direct the CO for contract EPS90804 to:</p> <p>a. Remove the profit clause or terminate the contract so that Region 9 no longer has to pay profit on subcontracts.</p> <p>b. Recover the 4 percent profit paid.</p>	<p>a. As noted in the subject draft report and the Technical Comments Attachment item numbers 6 and 7, R9 and OAM disagree with assertion in the report that the profit clause included in the contract represents a prohibited payment. The agency used an appropriate EPAAR clause 1552.232-73 in lieu of the referenced FAR clause 52.232-7 which acknowledges a difference between materials subcontracts and separately addresses other subcontracted efforts. EPAAR 1552.232-73(b)(2) does not prohibit profit from being paid on a subcontract. Additionally, these subcontracts are not "incidental" services and thus do not meet the definition of materials in FAR 16.601. The profit clause does not qualify as cost-plus-percentage-of-cost either for the reasons noted in the report and Technical Comments Attachment item number 8. Since the Agency does not consider the profit clause a prohibited payment, termination of the contract or removal of the clause is unnecessary.</p> <p>b. Since the Agency does not consider the profit clause a prohibited payment, there is no reason to recover the amounts paid since they represent legitimate costs.</p>	<p>a. In order to avoid future confusion on this issue, R9 suggests that when an audited subcontract administration rate or G&A rate is not available for a particular contractor; that all future contracts include a negotiated comprehensive set of rates that segregates those specialties associated with A&E services and those associated with construction oversight services. Then each set of rates can include costs and profits representative of the work being conducted. If that structure is implemented, the current separate profit clause will no longer be necessary.</p> <p>b. Same alternative as a. above</p>

4.	<p>Coordinate with the EPA Office of Acquisition Management to:</p> <p>a. Perform an independent review of all current Region 9 contracts with time and materials pricing provisions to determine whether they contain profit payment clauses.</p> <p>b. If the review finds these clauses, take appropriate actions to recover the profits paid and remove the clause to prevent such payments in the future.</p>	<p>a. OAM has already independently reviewed this contract, similar R9 contracts, and their clauses prior to award. OAM has also performed oversight reviews of Region 9 recently with no findings on these provisions of the contract. In reviewing these contracts, Region 9 and OAM have both considered these provisions to be appropriate.</p> <p>b. Since the independent reviews have already been performed and did not find these clauses to be prohibited payments, no further action is necessary.</p>	<p>a. R9 proposes to issue any future contracts in accordance with our alternative 3.a.</p> <p>b. Same alternative as a. above</p>
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CONTACT INFORMATION

If you have any questions regarding this response, please contact Alexander Kramer, Regional Acquisition Manager in Region 9 at 415-972-3126.

Attachments:
 Technical Comments

- cc: Nanci Gelb, Principal Deputy Assistant Administrator, OARM
 John Bashista, Director, Office of Acquisition Management, OARM
 Raoul Scott, Acting Deputy Director, Office of Acquisition Management, OARM
 Sandy Womack, Audit Follow-up Coordinator, OARM
 Alexander Kramer, Contracting Chief, Region 9
 Kevin Castro, Project Officer, Region 9
 Nancy Riveland, Superfund Program Management Section Chief, Region 9
 Nancy Lindsay, Superfund Deputy Director, Region 9
 Janie Thomas, Comptroller, Region 9

Magdalen Mak, Audit Follow-up Coordinator, Region 9

Arthur Elkins, Jr., Inspector General

Alan Larsen, Counsel to the Inspector General

Melissa Heist, Assistant Inspector General for Audit, OIG

Eileen McMahon, Assistant Inspector General for Congressional, Public Affairs, and
Management, OIG

Region 9 Technical Comments and OIG Evaluation

Technical Comment #1

Page 5 of the above referenced report states:

"...some task order CORs relied on the contractor-prepared work plan to establish government objectives and to monitor contractor progress."

Region 9 believes this statement is factually incorrect and confuses the purposes of the SOW and contractor workplan. Government objectives are not re-established by the contractor. The work plan provides a greater level detail, but the basic objectives of the project remain the same. It is more appropriate to think of the documents in different contexts. As a part of a performance based contract, the SOW outlines the primary objectives and general methodologies for accomplishing task order requirements. The contractor's work plan provides specific numbers of hours and the technical approach that will be used to meet the objectives outlined in the SOW. The additional level of detail in the workplan further supports SOW requirements rather than redefining its objectives.

OIG Evaluation: The statement in the report is factually correct, i.e., some CORs relied on the work plan. Specifically, CORs for six task orders relied on the work plans to monitor. Here are examples of what some of them stated:

- The COR relied on the work plan that the contractor produces to capture what was discussed in the scoping meeting for the task order.
- The SOW is not an accurate documentation of the contracted deliverables so the work plan may be different.
- The work plan would be one of the ways he would direct the work to be performed. If it was signed by the task order COR, that meant it reflected the work expected by the Agency.

Technical Comment #2

Page 6 of the report immediately above the included table states:

"EPA risks the possibility of (1) needing work that the contractor did not perform and (2) paying for work that was not essential."

Region 9 believes this statement is misleading since the mistakes identified reflect errors in the administrative process which would have corrected the listed deliverables in the task orders. There was little real risk to the government in not receiving needed services or paying for additional work since COR oversight ensured the level of services provided was appropriate.

OIG Evaluation: EPA's documentation does not support this assertion that there was no real risk. The table in the report shows that there were deliverables in the SOWs that were not in work plans, which indicates there was work that EPA needed that the contractor did not perform. In addition, there were work plans that had deliverables that were not in the SOWs, which indicates there was work that the contractor performed that EPA had not identified as essential. In the latter case, it appears the contractor is dictating to the government what the government needs.

Technical Comment #3

The top of the last paragraph on page 7 of the report states:

"The task order CORs' practice of using the contractor's work plan to track progress leaves it at risk of the contractor changing the nature of the agreed-upon contract services. This entails great risk to the government.

Region 9 believes this statement is misleading and its assertion of the risk to the government is inaccurate. Using both the SOW and workplan concurrently does not violate reasonable contract oversight procedures. When task orders are issued, the workplan is officially incorporated as an attachment to the order. Region 9's task orders explicitly state that "the work plan, along with any stated assumptions or caveats, shall not supersede the requirements of this Statement of Work." However, using both documents helps to mitigate risk by ensuring the COR has adequate information to perform task order oversight. It is generally expected that CORs would track some project details based on the contractor workplan because it includes more detailed information on the contractor's technical approach than the SOW.

OIG Evaluation: We understand that the work plan has more detail than the SOW, and agree that the SOW and work plan can be used together to oversee contracts. However, the two should be in agreement. As stated in the report, we found instances where the work plans and SOWs had different deliverables. See analysis in technical comment 2. Further, some CORs stated they relied on the work plan and not the SOW to oversee task orders. See analysis in technical comment 1. When the SOW and work plan disagree, using only the work plan creates the risk that the government is not getting the services for which the task order was intended.

Technical Comment #4

At the bottom of Page 8, the report states:

"Thus, because the CORs do not verify the qualifications of contractor staff, EPA is inappropriately allowing the contractor to determine that its staff met the qualifications of the labor categories required to accomplish the work specified in the contract.

Region 9 believes this statement is inaccurate and misleading. The contract specifically states the qualifications expected of the individual labor categories utilized. This statement from the contractor on the invoice is a legal certification on the contractor's behalf that they are providing costs and personnel in accordance with the contract. EPA has the final approval over all costs claimed. EPA is not allowing the contractor to substitute its assessment of qualifications since they have already

been defined in the contract document. This is a matter of compliance. If the contractor is falsely certifying the experience of their personnel that is a matter for the EPA OIG to investigate. False claims investigations fall outside the purview of individual COR's responsibility and would be more appropriately handled by auditors and the responsible contractor.

OIG Evaluation: The statement in the report is accurate. Although the CORs could review the qualifications of those billed under the contract, they have not been directed to do so. The contract provides that the COR receives an invoice from the contractor and that they have the right to review, among other things, qualifications of persons billed. Clause B.1 incorporates by reference FAR clause 52.212-4 Alternate I, which states:

(4) *Access to records.* At any time before final payment under this contract, the Contracting Officer (or authorized representative) will have access to the following (access shall be limited to the listing below unless otherwise agreed to by the Contractor and the Contracting Officer):

(i) Records that verify that the employees whose time has been included in any invoice meet the qualifications for the labor categories specified in the contract...

Also, while Region 9 states that the certification on the invoice is sufficient support that contractor's qualifications are in accordance with the contract, OAM contradicts this. According to the Assistant Administrator's response to the draft report, OAM contends that if the contract contains personnel requirements, task order COs and CORs must evaluate those qualifications.

Further, the U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* requires that management must put internal controls in place to ensure compliance with applicable laws and regulations and to prevent and detect fraud. The OIG's role is to conduct audits relating to program operations, not to assume management's role in safeguarding government resources. The OIG does not replace the responsibility of EPA's program to establish internal controls in their daily operations.

Technical Comment #5

Towards the bottom of page 9, the report states:

"The CO believes there are no requirements for EPA to review the qualifications of any staff. He also stated that EPA takes the contractor's word for the qualifications of its staff; EPA is not the contractor's human resource office. According to the CO, verifying qualifications of contractor personnel was crossing the line into personal services and deemed unnecessary because EPA evaluated key personnel during the contract selection process. The OIG finds no support for that position."

Region 9 asserts that this statement is factually inaccurate and misrepresents statements made by the CO. The CO did not say there are no requirements for EPA to review the qualifications of any staff. As noted, the CO referenced the required reviews of personnel resumes in the preaward selection process. Similar to the response in Technical Comment #5, the CO stated that additional checks are a matter of compliance. If the contractor is falsely certifying the experience of their personnel and knowingly providing personnel that do not have the experience required and identified in the contract, that is a matter for EPA audit and investigation personnel. Systematic false claims investigations fall outside the purview of standard contract management. Furthermore, if a COR were to review all resumes beyond a simple matching of qualifications to the labor category

definitions- and then tell the contractor which individuals were qualified in their opinion to staff the task order; COR would essentially be directing the contractor on staffing and employment decisions which are personal services by definition.

OIG Evaluation: The statement in the report was accurate. We received contradictory statements from the CO concerning the requirement for CORs to review contractor qualifications.

- (1) In February 2012, the CO stated there were no requirements to review the qualifications of any staff.
- (2) In May 2012, the CO stated that the task order CORs were expected to assure that contractor personnel met the qualifications needed to complete the tasks in the task order, and would expect that task order CORs request resumes as needed.

As stated in the report, the OIG maintains that having CORs review qualifications does not cross the line into personal services. The contract clause gives EPA the right to review the contractor's documentation on qualifications. Similarly, the COR training materials state that CORs can request qualifications. The report did not suggest that the CORs do more than match the qualifications of those billed under the contract to the labor category definitions. That would allow EPA to determine it got the level of services for which it paid. Otherwise, the contractor determines how much EPA must pay.

Technical Comment #6

Page 15 of the report states:

"FAR Subsection 16.601(b) states that a time and materials contract provides for acquiring supplies or services based on direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, profit, and the actual cost of materials. Materials includes subcontracts. Further, the related clause for payments under Time and Materials pricing arrangements-FAR Subsection 52.232-7(b)(7)-specifically states that the government will not pay profit or fees to the prime contractor on materials."

Under this contract, the labor rates and profit included in pre-negotiated rates are meant to cover the primary services of the contract which are Architect and Engineering (A&E). EPA has required for this class of contract that A&E firms subcontract out construction services that are related to the A&E work performed. The definition in FAR 16.601 "Materials" (2) covers "Subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." The referenced report makes the blanket statement that all subcontracts are materials, but the qualifier of "incidental" is not reflected. As the report notes, \$38,104,278.36 was incurred in subcontracts which, while not a majority, does not necessarily qualify as "incidental" services. Similarly, some of the labor categories included in the contract would cover the services performed by subcontractors; however, the Agency has required that the prime contractors use sub contractors for all construction work. Thus if the services are not "incidental," the classification as materials is incorrect and the restriction on profit from FAR 52.232-7 is no longer applicable. In that case, the 4% profit on those subcontracts is not a prohibited payment.

At the time of award in an IDIQ contract, there is no reasonable way to estimate the types or number of construction related requirements; however the A&E contractor is responsible for management of those construction subcontracts and subcontracts for other services as well. Since EPA has required that some services be subcontracted, and the requirements cannot be estimated at award, including a separate profit rate on subcontracts is a legitimate approach. Profit rates may be reasonably different for services that entail more contractor risk, uncertainty, or different market requirements. For instance, a construction management contractor is expected to be named on the bond for the construction being performed. That is a potentially large liability and risk that does not occur with A&E services. The report incorrectly implies that just allowing for profit on subcontract administration is enough to mitigate the inherent risks like the example of bond liability that occur in different services. The 4% negotiated in this case is actually substantially lower than the industry standard of approximately 10% for construction management services.

OIG Evaluation: We disagree. The Regional Administrator asserts that paying 4.00 percent profit on subcontract costs is acceptable because the subcontracts are not “incidental” services. This is because (1) the contractor was required to subcontract out construction services, and (2) the value of the subcontracts exceeds \$38 million. Since the subcontracts are not “incidental,” they do not meet the definition of “material” in FAR 16.601. Thus, the profit on the subcontracts is not a prohibited payment.

Except for one task order that was fixed price, the task orders issued under contract EPS90804 had time and material pricing arrangements. Whether “incidental” or not, the only way the contractor under a time and materials pricing arrangement can be reimbursed is if the subcontracts are billed as material. The other option, payment at the fixed hourly rate, would not apply. When contract EPS90804 was awarded, according to clause B.4, the line item for subcontracts was estimated to be \$30 million of the \$110 million contract ceiling. Finally, clause B.5(d) includes construction services as part of the subcontract line item because it states, in part:

Specific activities which generally necessitate utilization of the [subcontract] CLIN include, but are not limited to: well-drilling, analytical services (when not provided by the Government), special consultants to support technical projects or to serve as expert witnesses, aerial mapping, surveying, fencing, or construction activities associated with a Remedial Action.

The Regional Administrator indicated that EPA required some services to be subcontracted, so including a separate profit rate on subcontracts is a legitimate approach. He stated that profit rates may be reasonably different for services that entail more contractor risk, and offered as an example being named on the bond for construction work performed. Further, according to the Regional Administrator, the 4.00 percent negotiated in this contract is substantially lower than the industry standard of approximately 10.00 percent for construction management services.

This position ignores the FAR prohibition on profit under time and material pricing arrangements, except for the profit in the fixed hourly rates. Thus, an industry standard of 10.00 percent is not relevant. Also, even if the contractor was concerned about additional risks due to reliance on subcontractors, a partial remedy may be found in contract clauses H.30 and H.40. These clauses appear to allow the contractor to shift some of the bond risk to the subcontractors.

Technical Comment #7

At the bottom of page 17, the report states:

"The contract contained a clause addressing payments under fixed rate contracts. Clause G.3, from EPAAR Subsection 1552.232-73, limits the reimbursement of materials to cost."

R9 used the cited EPAAR clause 1552.232-73 in lieu of the referenced FAR clause 52.232-7. EPAAR 1552.232-73 further acknowledges a difference between materials subcontracts and separately addresses other subcontracted efforts. EPAAR 1552.232-73(b)(2) does not prohibit profit from being paid on a subcontract.

OIG Evaluation: We disagree with the statement that EPAAR 1552.232-73(b)(2) does not prohibit profit from being paid on a subcontract. As stated in the report, this clause limits the reimbursement of materials to cost only. Thus, it does prohibit profit on subcontracts. Further, according to FAR 52.201(a), an agency modification of a FAR clause cannot alter the substance of the clause. Since 52.232-7 prohibits paying a contractor profit on material, EPAAR 1552.232-73 cannot allow it.

Technical Comment #8

At the bottom of page 18, the report states:

"However, the method for determining the price of the subcontracts is not pertinent. The pricing arrangement between the contractor and its subcontractor could be fixed price, fixed rate, or something else. Whatever it was, contract EPS90804 provided for reimbursing the contractor for the actual cost. The 4.00 percent profit rate was applied to that amount. Thus, it resembles the prohibited cost plus a percentage of cost type of contract."

The statement included above is factually inaccurate and conflates different contract types erroneously. If a contract is fixed-price or fixed rate, then companies are not being reimbursed on an actual cost basis. For example, if EPA is charged on a fixed price basis for the installation of monitoring wells, the contractor is paid the same per well installed whether it takes 10 hours or 40 hours. If the per well cost is \$5,000 the cost with the 4% profit is \$5,200. The number of wells is determined by EPA's needs not the prime contractor and the fact remains that the cost to EPA is still only \$5,200 per well regardless of whether it takes 40 hours instead of the expected 10. The contractor remains incentivized to minimize costs in order to keep below the fixed amount provided. This is a very different scenario than the prohibited cost-plus percentage-of-cost where contractor would be incentivized to utilize as many hours and materials as possible since profit increases as those costs increase. Thus the method for determining the price of the subcontracts is pertinent and the arrangement in the Contract does not create the incentive that is the reason for the prohibition on cost-plus-percentage-of-cost type contracts. The two arrangement do not resemble one another.

OIG Evaluation: It is irrelevant what the agreement is between the subcontractor and contractor in terms of reimbursements. Under this contract, money that the contractor pays to the subcontractor can be claimed by the contractor as a cost to be reimbursed by EPA. The additional 4.00 percent gives the contractor incentive to claim services as subcontracts that would otherwise not be.

Distribution

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