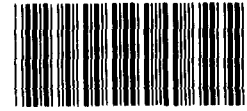




Testimony



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DOE MANAGEMENT

**DOE Needs to Improve Oversight of
Subcontracting Practices of Management
and Operating Contractors**

Statement of
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Before the
Committee on Governmental Affairs
United States Senate



Mr. Chairman and Members of the Committee:

We appreciate the opportunity to discuss our work that addresses your concerns about the adequacy of the Department of Energy's (DOE) management controls to prevent fraud, waste, and abuse in subcontracting. As you know, our work is still underway, and thus the results we are presenting today are preliminary. Our statement discusses (1) the extent to which subcontracting deficiencies exist at DOE--in particular at the Lawrence Livermore National Laboratory, one of DOE's largest nuclear weapons research and development facilities, and (2) whether DOE's Contractor Purchasing System Review Program, which periodically evaluates the subcontracting practices of DOE's management and operating (M&O) contractors, has been effective in identifying and correcting subcontracting deficiencies.

In summary, we believe that DOE's M&O subcontracts, totaling over \$5 billion in 1990, are vulnerable to fraud, waste, and abuse--a fact that is reflected in DOE's recent Contractor Purchasing System Reviews and our work at Lawrence Livermore National Laboratory. Poor procurement practices of the M&O contractors, coupled with inadequate oversight by DOE, have led to contractors' incurring excessive subcontract costs. Among other things, DOE's reviews have shown that M&O contractors often do not ensure that subcontract prices are fair and reasonable, and these contractors are also restricting competition by inappropriately using sole-source purchases. While the DOE reports do not estimate the extent of overpricing that is likely to be associated with the procurement weaknesses identified, we believe that millions of dollars may be wasted each year.

Our work at the Lawrence Livermore National Laboratory illustrates some of the problems identified in DOE's reviews of contractors. For example, the Laboratory leased 58 vehicles on a sole-source basis from the University of California--the M&O

contractor--and has paid at least \$590,000 more than it would have if the vehicles had been obtained through the General Services Administration (GSA). The Laboratory did not obtain required DOE approvals for the leases and was under direction by DOE at the time it leased the vehicles to reduce its vehicle fleet. We also found that the Laboratory has not complied with DOE directions to terminate commercial vehicle leases. Contract clauses that include the concept of reaching mutually agreeable solutions to procurement and property issues appear to have weakened DOE's ability to effectively oversee the Laboratory's vehicle fleet.

We also found that improvements in DOE oversight are needed to address M&O subcontracting weaknesses. DOE's Contractor Purchasing System Reviews have succeeded in identifying a number of internal control problems at M&O contractors, including the awarding of subcontracts after work has begun. As currently implemented, however, the review program has limitations that restrict its ability to identify all significant procurement weaknesses that exist and to ensure that identified problems are corrected. These limitations include insufficient headquarters oversight of the review program, inadequate follow-up by field offices, and a reluctance by DOE to limit contractor purchasing authority even when serious deficiencies are identified.

BACKGROUND

Most of DOE's subcontracts are awarded by contractors who manage and operate DOE's research and production facilities. During fiscal year 1990, DOE obligated about \$13.8 billion to the M&O contractors, and more than \$5 billion of these funds were spent on subcontracts. These subcontracts are awarded and administered through purchasing systems that are established by each of the M&O contractors and approved by DOE.

DOE oversees subcontracts awarded by the Department's M&O contractors primarily through Contractor Purchasing System Reviews, generally conducted for each of the contracts once every 3 years by DOE field offices (operations offices).¹ On the basis of the review results, the field offices approve or disapprove contractors' purchasing systems. Generally, the systems are approved with recommendations to correct identified problems. In the intervening years, DOE field offices are to provide oversight, termed surveillance, that includes monitoring contractor responses to the purchasing review recommendations and reviewing contracts in excess of established dollar thresholds.

DOE REVIEWS DISCLOSE SIGNIFICANT
M&O SUBCONTRACTING DEFICIENCIES

The contractor purchasing reviews that DOE conducted during the most recent 3-year cycle revealed many fundamental deficiencies in contractor purchasing systems. For example, reports from 37 of 40 recent reviews disclosed significant cost deficiencies; that is, contractors were not adequately performing and documenting basic analyses needed to ensure that subcontract prices were fair and reasonable. For example, DOE reported that one contractor demonstrated an overall lack of awareness of the importance of establishing fair and reasonable prices and another contractor generally accepted cost proposals at face value.

More than half of the reviews also identified a lack of adequate procurement planning and questionable sole-source purchases. These deficiencies can restrict competition and limit the government's ability to obtain the best contract terms. Also, 16 of the reviews expressed concerns regarding the uses of contract modifications. Among other things, the reviews reported that contractors (1) changed the scope of existing contracts when

¹In 1990 DOE had 52 M&O contracts with 35 contractors.

new contracts should have been used and (2) priced initial contracts under dollar thresholds that required DOE advance approval and subsequently used contract modifications to increase the prices above the DOE review thresholds.

Procurement deficiencies cited in DOE reviews that increase the risk for fraud, waste, and abuse include the award of subcontracts after work on the contract has begun; inadequate separation of duties, such as the same individual ordering and verifying receipt of goods and services; reliance on requisitioners (e.g., program officials)--rather than procurement officials (buyers)--to determine supply sources; and a contractor policy that permitted buyers to accept gifts, such as meals and tickets, in contravention of DOE's policies.

The DOE reviews do not estimate the extent of overpricing that is likely to be associated with the numerous procurement weaknesses identified. However, on the basis of our review of DOE's reports and our work at Lawrence Livermore, which I will now discuss, we believe that millions of dollars may be wasted each year.

SERIOUS DEFICIENCIES IN LAWRENCE LIVERMORE SUBCONTRACT PRACTICES AND DOE OVERSIGHT

Our work at Lawrence Livermore National Laboratory uncovered instances that demonstrate some of the effects of the serious, systemic weaknesses in M&O contractors' subcontracting practices that I have outlined. Among other things, we found cases in which the Laboratory (1) inappropriately used sole-source purchases, (2) did not comply with DOE review and approval requirements, and (3) did not give adequate attention to subcontract costs. These problems are illustrated by several subcontracts that the Laboratory used to acquire vehicles, including vehicles it acquired from the University of California, which operates the Laboratory.

Our work also demonstrates how some contract terms in the University of California contract with DOE limit DOE's ability to direct Laboratory actions.² We also found DOE oversight of Laboratory purchases was inadequate. As a result, important procurement and property management issues have been unresolved. For example, DOE and the Laboratory have not yet resolved a disagreement that has been on-going for at least 5 years regarding the appropriate vehicle fleet size for the Laboratory.

Required DOE Approvals Were Not Sought
for Costly, Sole-Source Vehicle Leases

Lawrence Livermore obtained the more than 1,100 vehicles used at the 1-square mile Laboratory site from several sources. While many of the vehicles are either owned by DOE or are leased from GSA, the Laboratory also obtained vehicles through leases with the University of California and commercial companies.

Since 1986 the Laboratory has leased up to 58 passenger vehicles on a sole-source basis from the University of California, which acquired the vehicles under a 4-year lease/purchase arrangement from Gelco Municipal Services. The Laboratory justified its sole-source procurement on the basis that (1) capital funds were not available for purchase of the vehicles and (2) GSA did not have available the types of vehicles required. However, funding issues such as the lack of capital funds are not relevant to sole-source justifications that should demonstrate, for example, why the source indicated is uniquely qualified to provide the goods or services. Further, we found that the Laboratory did not obtain the vehicles from GSA because at that time it was under direction by DOE to reduce its fleet size and had been instructed to stop submitting requests for additional GSA leases.

²The DOE Inspector General report, General Management Inspection of the San Francisco Operations Office, discusses similar problems associated with DOE's M&O contract clauses.

The initial purchase orders only reflected the first year's estimated costs of about \$250,000, although the total 4-year cost of the lease was close to \$1 million. Furthermore, the Laboratory split the initial procurement into three purchase orders under \$100,000 and thereby avoided the requirement to send all transactions over \$100,000 with the University to DOE for advance approval. The Laboratory also did not obtain advance approval from DOE for the long-term vehicle leases.

The University leases cost the Laboratory about \$987,000. The leases cost approximately 2 and 1/2 times the amount the Laboratory would have paid GSA--\$396,000--for similar vehicles. For example, a 1986 12-passenger van leased from the University cost \$439 per month; through GSA a similar vehicle would have cost \$151.

The University leasing charges include a monthly administrative fee for each vehicle. In 1989 this fee was increased from \$47 per vehicle to \$70. Total administrative fees paid to the University since 1986 have amounted to about \$150,000. The primary service we could identify that the University provided to the Laboratory to support the administrative fee was submitting monthly billings. We also found several instances in which the University billed the Laboratory for vehicles that had been returned to the University and, in one case, for a vehicle that had been reported to the University as destroyed when it was in an accident. The overbillings were paid by the Laboratory.

In addition, we found that the University billed the Laboratory for the vehicles--which remained in service at the Laboratory--after the full purchase price of the vehicles, including interest, had been paid and the University had taken title to the vehicles. The University intended to use funds received from the Laboratory over and above its vehicle costs to establish a vehicle replacement fund for the University, which it

said would result in lower leasing costs to the Laboratory and other University of California vehicle users in the future.

We found that the Laboratory paid the University the billed amount for the vehicles until last fall when it reached the funding limits specified in the purchase orders. After that, the Laboratory placed the monthly bills in the subcontract files without paying them and without reporting the accounts payable liability in the Laboratory's accounting records. When we raised questions about the expired leases, we were told that new subcontracts had not been entered into because of a Laboratory oversight--that is, the termination dates had been overlooked.

Following our meetings with the Laboratory on these vehicle leases, on June 27, 1991, the University reported that it will only charge the Laboratory the administrative fee of \$70 per vehicle, per month after the full purchase price has been paid. The University reported that it would make a retroactive adjustment for the overbillings.

Other Costly Laboratory Vehicle
Subcontracts Were Not Authorized by DOE

Other Laboratory leases with commercial vendors further illustrate the Laboratory's inattention to costs and noncompliance with DOE requirements. For example, the Laboratory had a lease with Hertz Rentals for 21 trucks at a cost substantially in excess of GSA rates for similar vehicles. This lease was not authorized by DOE. In 1990 DOE sent two notices to the Laboratory to terminate the lease because the vehicles were not sufficiently justified and therefore not authorized by DOE. Instead, the Laboratory actually extended the lease term for 8 months and then entered into a commercial lease for similar vehicles with another company, Action Rentals, on October 31, 1990. As of June 1991, 32 vehicles were being leased under this unauthorized subcontract.

The Action Rentals lease included a charge of \$35 per vehicle, per month, for tire insurance. The Laboratory carried out negotiations for the insurance without information on prior tire repair costs. During the first 4 months of the contract, the Laboratory paid approximately \$5,000 for tire insurance; during this time three flat tires were repaired at a cost of \$159.95 to the rental company, which subcontracted the work to a local garage. As a result of GAO's inquiries, the Laboratory has renegotiated the tire insurance rate to \$5 per vehicle.

The Laboratory also leased two full-size station wagons at rates substantially in excess of GSA costs, without obtaining DOE's required advance approval for long-term vehicle leases. The wagons are used by the Laboratory Director for transporting dignitaries around the San Francisco Bay area and are in addition to the one vehicle authorized by DOE for this purpose. DOE also directed the Laboratory to terminate these leases on two occasions. However, in this case, the DOE San Francisco field office manager later verbally authorized the Laboratory to continue the leases until overall agreement on the vehicle fleet size was reached.

Vehicle Issues Unresolved Because of Poor
DOE Oversight and the "Mutuality" Concept

DOE and the Laboratory have disagreed on the appropriate vehicle fleet size for at least 5 years. This situation appears to exist because of (1) inadequate DOE oversight of Laboratory purchases and property and (2) the concept of mutuality contained in certain clauses in DOE's prime contract with the University. For example, while DOE did attempt to get the Laboratory to terminate some of its unauthorized leases, DOE officials admitted that as of June 1991 they had never instructed the Laboratory to terminate the unauthorized University of California vehicle leases,

although they were aware of them. In addition, we believe DOE should have taken additional, follow-up actions to get the unauthorized commercial leases terminated.

Furthermore, the mutuality concept in the contract's procurement and property clauses appears to limit DOE's ability to unilaterally require the Laboratory to, for example, make procurement changes. Instead, the Laboratory has to agree with DOE, or, if the Laboratory disagrees, DOE and the Laboratory must agree to a mutually acceptable alternative. For example, regarding the Laboratory's noncompliance with DOE's termination notices for the commercially leased vehicles, a DOE property management official said it was not clear whether DOE had the legal authority to require the lease terminations. He also said that it has been difficult and time-consuming to reach a mutually acceptable solution to the vehicle disputes. The mutuality concept in the contract is a reflection of DOE's long-standing policy of "least possible interference" with its M&O contractors.

Progress Is Reported But Substantive
Vehicle Issues Remain Unresolved

After more than 5 years of disagreement over the vehicle fleet size, during which time the Laboratory has used more than 80 unauthorized vehicles, both DOE and the Laboratory say that they are now making progress on reaching a mutually acceptable solution. However, key decisions, such as the appropriate fleet size for the 1-square mile site and the appropriate vehicle-use standards, are not expected to be resolved for another 6 months to a year, according to DOE and Laboratory estimates. Before an agreement is reached on the vehicle issues, DOE managers expect to approve the Laboratory's recent requests to authorize additional vehicles--a reversal of their past position that new leases would not be authorized until the Laboratory was able to justify its fleet of more than 1,100 vehicles. DOE's approvals would eliminate all of

the existing unauthorized leases. However, we have concerns about DOE's approving additional vehicles before the agency has determined the appropriate fleet size for the Laboratory.

Earlier we outlined the serious procurement deficiencies that have been found at DOE's other M&O contractors. I would now like to discuss the problems we have with DOE's M&O oversight program.

WEAKNESSES IN DOE'S CONTRACTOR PURCHASING
REVIEW PROGRAM LIMIT ITS EFFECTIVENESS

DOE's Contractor Purchasing System Review Program can serve as an effective tool for identifying and correcting deficiencies in M&O contractors' subcontracting practices. As we discussed earlier, the program has identified weaknesses in M&O contractors' purchasing systems. Furthermore, DOE has taken steps in the last few years to strengthen the program, including increasing its headquarters oversight of the reviews performed by its field offices. Nevertheless, the program continues to have limitations that reduce its effectiveness. In particular, the program still does not ensure that all procurement activities are reviewed and that appropriate actions are taken to correct procurement deficiencies. In addition, our work indicates that field offices are relying on procurement data provided by contractors without verifying its accuracy.

DOE headquarters has developed a guide that sets forth the relevant purchasing criteria DOE field offices should address in the contracting purchasing system reviews. However, although it is aware that some reviews do not address all purchasing criteria, DOE does not require the field offices to follow its guide. Furthermore, DOE headquarters examination of field offices' reviews are not sufficient to determine whether the reviews were adequate in depth and scope. For example, rather than independently verifying that reviews covered all aspects of the

contractors' procurement systems, DOE headquarters relies solely on statements by the review team leader that areas not clearly addressed in the report were reviewed in sufficient depth. Finally, when DOE headquarters determines that a review has not included significant procurement areas, it does not require the responsible field office to review the omitted areas until the next review--3 years later.

To correct deficiencies identified in the reviews, DOE headquarters requires its field offices to submit surveillance plans describing oversight actions that will be performed between the reviews. However, for the reviews conducted from 1988 through 1990, DOE field offices have not submitted surveillance plans in almost 50 percent of the cases. In addition, many of the surveillance plans that have been submitted include broad descriptions of the oversight to be conducted--they do not specify tasks to be performed, methodologies to be used in the follow-up reviews, or whether the field offices will be reviewing the effectiveness of contractor responses to review recommendations. In June of 1991 we found that the DOE San Francisco office conducted its very first surveillance review at Lawrence Livermore National Laboratory just that month and that it had not yet issued a surveillance plan.

Some of these deficiencies are illustrated by the reviews that were performed for Reynolds Electrical & Engineering Company, the manager of DOE's Nevada Test Site. None of the three most recent reviews for Reynolds evaluated contract administration--an area in which reviews at other contractors have reported numerous deficiencies. DOE headquarters only became aware of this omission when a DOE headquarters procurement analyst participated in the latest review--something that rarely takes place. Further, after discovering that reviews of Reynolds had omitted contract administration, DOE headquarters did not require the field office to review the contract administration function until the next

review. Significant deficiencies that were identified in earlier Reynolds reviews also have not been corrected. For example, reviews in 1984, 1986, and 1989 all cited deficiencies in two critical purchasing activities--inattention to subcontract costs and inadequate justifications for noncompetitive purchases.

DOE has not taken appropriate corrective action when reviews have identified serious deficiencies in the contractors' procurement systems. For example, a recent DOE report stated that during 1990 purchasing system approval should have been either withheld or withdrawn (e.g., by reducing the level of contracting authority) in several cases until the contractors had corrected all major deficiencies. However, such action was not taken.

We are concerned that field office decisions may be driven more by resource constraints than by review findings because disapproval or reduced contracting authority requires DOE to increase its review of individual subcontracts. For example, in November of 1990, a special DOE procurement review of EG&G, Inc.--the M&O contractor at Rocky Flats--led by DOE's Procurement Director resulted in disapproval of the purchasing system by DOE headquarters. This occurred less than 4 months after the field office's review had resulted in approval of the contractor's system.

Furthermore, our work at Lawrence Livermore indicates that field offices rely too heavily on the M&O contractors for information needed to conduct appropriate oversight. For example, the San Francisco Field Office relied on procurement information provided by the contractor in developing its sample of actions to examine in its contractor purchasing system review. However, this information did not include all of the relevant subcontracts. In addition, DOE officials said that the San Francisco office has no system for verifying that the contractor sends in all subcontracts that require advance DOE approval. We found that the Laboratory

has not provided DOE with all subcontracts that should have been submitted.

DOE PLANS TO INCREASE HEADQUARTERS
OVERSIGHT OF M&O SUBCONTRACTING

We met with the Director of DOE's Office of Procurement on July 9, 1991, to discuss the results of our work on DOE's subcontracting activities. The Director told us that DOE plans to make changes in its Contractor Purchasing System Review Program as a result of the information we provided. For example, he said DOE headquarters officials will determine whether to approve or disapprove contractors' purchasing systems and will establish the appropriate thresholds for advance DOE approval of M&O subcontract actions. In addition, the Director said (1) future reviews will have to be conducted in accordance with DOE's Contractor Purchasing System Review Guide, (2) DOE headquarters staff will assume leadership roles for the reviews, (3) DOE will increase its headquarters staff for review program activities and will require that field offices dedicate staff full-time to the review program, and (4) DOE headquarters will establish new accountability standards for field offices to ensure that contractors take appropriate actions to correct identified procurement deficiencies.

CONCLUSION

In summary, we believe that the subcontracting practices of DOE's M&O contractors expose the government to a high level of risk for fraud, waste, and abuse. This risk could be significantly reduced with more stringent M&O procurement controls and improved DOE oversight. We believe DOE's Contractor Purchasing System Review Program provides a framework for DOE to identify and address procurement deficiencies; however,

improvements are needed in program implementation. DOE's proposed actions should help address these problems.

This concludes my prepared statement. I would be pleased to respond to any questions you or Members of the Committee may have.

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