



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

Audit Report

Management Controls Over
Subcontract Administration by
the Argonne National Laboratory



Department of Energy

Washington, DC 20585

March 12, 2004

MEMORANDUM FOR THE MANAGER, CHICAGO OPERATIONS OFFICE

From:

A handwritten signature in black ink, appearing to read "Rickey R. Hass".

Rickey R. Hass, Director
Science, Energy, Technology, and Financial Audits
Office of Audit Services
Office of Inspector General

Subject:

INFORMATION: Audit Report on "Management Controls
over Subcontract Administration by the Argonne National
Laboratory"

BACKGROUND

Argonne National Laboratory is a multi-program science laboratory operated by the University of Chicago under a contract with the Department of Energy. In Fiscal Year 2002, Argonne's budget was \$460 million, including \$93 million in work-for-others funding. As part of its management and operation responsibilities, Argonne issued 24,800 contracts and purchase orders worth \$135 million during FY 2002.

The Department permits its contractors to design and implement purchase systems that satisfy local needs. While certain flexibilities are permitted, Argonne's contract and the Department of Energy Acquisition Regulation require that it use competitive contracting methods to the extent practical. Argonne's contract also requires that it develop and implement controls to protect Government property in the hands of subcontractors. Based on the extent and value of subcontracting, the Office of Inspector General initiated this audit to determine whether Argonne was procuring goods and services in accordance with Government policies and best business practices.

RESULTS OF AUDIT

Argonne relied heavily on sole source procurements without, in many cases, adequately supporting their use. Specifically, we noted that Argonne:

- Used sole source awards for 62 percent of its FY 2002 active contracts over \$100,000 and, for 50 percent of those reviewed (14 of 28), did not demonstrate a compelling reason for limiting competition;
- Restricted competition by obtaining bids based on the knowledge of contract or technical specialists rather than advertising procurement actions; and,



- Awarded a sole source contract to an individual who lacked unique credentials; causing the Government to expend about \$500,000 on a contract that was terminated before completion.

In addition, Argonne did not always adequately safeguard property acquired by subcontractors. In particular, the Laboratory did not independently identify or inventory, and in some cases, was unaware of property acquired by subcontractors.

Despite longstanding indications that the Laboratory unnecessarily limited competition, the Department had not ensured that Argonne's procurement system was adequate nor had it incorporated competition-focused performance measures in its contract. In addition, the Department had not established performance goals and Argonne did not clearly communicate roles and responsibilities regarding the control of subcontractor-held property. As a consequence, for the nearly \$54 million in sole source contracts active in FY 2002 whose value exceeded \$100,000, the Department lacked assurance that it received the lowest price or highest quality goods and services and that qualified vendors had access to Federally-funded contracts. Also, taxpayer-provided property purchased by subcontractors may have been at risk of loss or diversion.

During our audit we also learned that the Office of Science conducted an assessment in May 2003 of Argonne's management of personal property, and identified similar issues related to management of property in the hands of subcontractors. Additionally, in April 2003 a peer review chartered by the Headquarters Office of Procurement and Assistance Management conducted an assessment, and identified problems concerning Argonne's use of sole source contracts and the adequacy of justifications. At the completion of our audit, Argonne had not fully responded to or initiated corrective actions for either of these reviews. Accordingly, we recommended a number of actions designed to improve Argonne's administration of subcontracts.

This audit is one in a series on subcontract administration by management contractors. We recently issued a report on *Procurement Administration at the Oak Ridge National Laboratory* (OAS-L-03-20, September 2003). Related work is ongoing at the National Renewable Energy Laboratory, Sandia National Laboratories, Los Alamos National Laboratory and Lawrence Livermore National Laboratory.

MANAGEMENT REACTION

The Manager, Chicago Operations Office generally concurred with the report's recommendations. Management pointed out, however, that Argonne purchases are not subject to the Federal Acquisition Regulations. Rather, the Laboratory is required to satisfy the terms and conditions of its contract to, among other things, apply the best in commercial purchasing practices and to ensure the use of effective competitive techniques. Additionally, management concluded that, while Argonne is in full compliance with the competition requirements of its contract with the Department, the Laboratory can improve its procurement activities. Specifically, management agreed to

review and monitor Argonne's procurement activity to ensure that Laboratory use of sole source contracts is minimized. Consistent with management's comments, we believe that increased competition will help provide greater assurance that resulting contracts are fair and reasonably priced. Management's comments are included as Appendix 3.

Attachment

cc: Director, Office of Science, SC-1
Director, Office of Procurement and Assistance Management, ME-60
Team Leader, Audit Liaison, ME-1.1

MANAGEMENT CONTROLS OVER SUBCONTRACT ADMINISTRATION BY THE ARGONNE NATIONAL LABORATORY

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COMPETITIVE AND PROPERTY PROTECTION PRACTICES

Competition and Property Protection

Argonne National Laboratory (Argonne) did not always ensure adequate competition when procuring goods and services, awarded contracts to sources that lacked necessary credentials or experience that would justify sole source selections, and did not adequately protect Government property in the hands of subcontractors.

Solicitation and Award

Argonne used sole source contracts in 123 of the 198 (62 percent) subcontracts over \$100,000 active during Fiscal Year (FY) 2002. We judgmentally selected 28 sole source contracts for review and found that 14 were not adequately supported. In particular, the justifications to support use of sole-source contracting did not contain sufficient facts or rationale to demonstrate that the qualifications of the subcontractor were unique. While contract files generally supported that the firm or individual selected was capable of performing the work, documentation was not sufficient to establish that it was the only source of the goods or services. On the contrary, we observed that certain procurements were for commonly available services such as marketing and information technology support.

Since the early 1990s, the Office of Inspector General (OIG) has identified similar problems with competition at Argonne in several audits. For example, our report on *Subcontract Administration at Argonne National Laboratory* (ER-B-93-06, August 1993), noted that Argonne awarded sole source contracts that were not adequately documented. In that report, we recommended that the Department of Energy (Department) ensure that Argonne award sole source contracts only when competition was not practical and use advertising to ensure fair and effective competition. We also questioned aspects of Argonne's sole source subcontracting in our subsequent audit of *Support Services Subcontracts at Argonne National Laboratory* (DOE/IG-0416, December 1997).

The Department partially concurred with our previous audit recommendations, but stated that the Laboratory had established and implemented numerous procedures for assuring fair and effective competition throughout its procurement system. However, during the current audit, we noted that barriers to competition persist. Specifically, we determined that the Laboratory had not advertised any of the 198 contracts we reviewed. Argonne management officials told

us that they did not believe that such action was appropriate because the costs of advertising, in terms of time and money, outweighed expected benefits.

During our review, we identified an example where the contractor's qualifications and/or experience did not justify the use of sole source contracts. Specifically, in one sole source selection, a contract was awarded to perform marketing work and assist in licensing an environmental test process developed at Argonne. The contract was awarded even though the source lacked specialized marketing or other unique skills. After 3 years and expenditures of \$500,000, Argonne asked the subcontractor to prepare a summary of work performed and accomplishments. This summary revealed that the contractor had not completed many of the tasks necessary to accomplish the stated objective. Specifically, only one license for the process had been obtained and that was from an existing Argonne contractor that was already using the technology. Prior to actually receiving the summary, however, Argonne terminated the contract with 7 months and \$141,000 remaining.

Property Accountability

Argonne also did not adequately protect Government property in the hands of subcontractors. Specifically, it did not independently identify property purchased by subcontractors with Government funds, track or periodically inventory such property, or ensure that it was clearly identified as Government-owned property. Rather, Argonne relied on annual disclosures in which subcontractors identified Government property held. Based on these disclosures, Argonne recorded the property in a tracking system and issued property tags. Argonne did not, however, reconcile these annual disclosures with purchase records of property acquired by the subcontractors, nor did it periodically inventory such property. Had it done so, it may have discovered problems such as the \$300,000 in undisclosed property that we identified and confirmed during our testing of selected subcontracts.

Monitoring and Performance

Although its prime contract and the Department of Energy Acquisition Regulation (DEAR) required competitive selection of subcontractors to the maximum extent practical, Argonne's Procurement Manual did not stress the requirement to adequately justify sole-source actions or require the publication of procurement actions. Departmental officials contributed to competition problems at the Laboratory by approving

Argonne's Procurement System even though it did not contain safeguards needed to correct excessive and improper use of sole-source actions. In spite of the unusually persistent nature of these problems spanning a 10 year period, the Department also had not taken action to incorporate specific and competition-focused performance requirements in Argonne's contract.

In addition, Argonne did not devote sufficient attention to establishing and documenting controls over Government property purchased and maintained by subcontractors. Although the Laboratory was required by its contract to protect Government property in the hands of its subcontractors, its Property Management Manual did not assign the responsibility of notifying property management officials of the acquisition or disposition of property purchased or held by subcontractors. Based on interviews with Argonne employees, we observed a lack of communication regarding responsibilities for identifying such property and ensuring that it had been properly recorded. For example, although one technical representative had knowledge of \$300,000 of unrecorded Government property in the hands of three subcontractors, he did not notify Property Management because it was not required by his operating manual and he assumed someone else was responsible. We also noted that the Department had not established expectations in the form of performance measures regarding the management of Government owned property at Argonne.

Competition Benefits

In FY 2002, Argonne had nearly \$54 million in active sole source contracts. Without a rigorous procurement system to ensure that opportunities for competitive awards are maximized and sole source purchases are adequately justified, the Department cannot determine that Argonne is procuring goods and services in the most efficient manner. Open competition is a key tool for the Government to obtain the lowest possible price and the highest quality goods or services. In addition, more effective advertising of procurement actions helps to ensure that the greatest possible number of qualified vendors have access to Federally-funded contracts. The lack of a current and complete property tracking system increases the risk that this property will not be properly safeguarded and recovered at completion of the contract.

RECOMMENDATIONS

To ensure that Argonne is procuring goods and services in accordance with the terms of its contract and Department policies, we recommend that the Manager, Chicago Operations Office ensure that:

1. Sole source procurement actions are adequately justified and documented;
2. Whenever practical, full and open competition is used for Federally-funded procurements;
3. An adequate method for identifying, tagging, and tracking Government property purchased by subcontractors is established; and,
4. Argonne's performance measures are modified to include elements specific to procurement competition and subcontractor property management.

MANAGEMENT REACTION

Management generally concurred with the report's recommendations. However, management's comments pointed out that Argonne purchases are not Federal procurements, and are not directly subject to the Federal Acquisition Regulations. Rather, the Laboratory is required to satisfy the terms and conditions of its contract that requires the contractor to, among other things, apply the best in commercial purchasing practices and to ensure the use of effective competitive techniques. Specifically, management pointed out that the contract does not require the Laboratory to use advertising to ensure fair and open competition. Additionally, management concluded that Argonne is in full compliance with the competition requirements applicable to subcontracts of its contract with the Department. Regarding the adequacy of contractors' qualifications and experience as sole source justifications, management stated that the marketing contractor cited in our report did have the prerequisite experience and that the contract was not terminated because of inferior work on the part of the contractor. While management believed that Argonne was in compliance with the terms of its contract, Area Office officials told us that they recognized that the improvements were needed and committed to review and monitor Argonne's procurement activity and to minimize its use of sole source contracting.

AUDITOR COMMENTS

We agree that Argonne purchases are not directly subject to the Federal Acquisition Regulations. However, advertising can be an effective tool for ensuring fair and open competition and we are concerned that Argonne did not advertise any of the 198 subcontracts active during FY 2002. In this regard, we noted that in 2003 a peer review chartered by the Department's Office of Procurement and Assistance Management found that competition for awards was an area of concern. Specifically, the peer review questioned how Argonne could determine prices were fair and reasonable without outside competition for awards. Furthermore, the peer review found that Argonne's practice of utilizing potential contractors supplied by the requestor did not meet the definition of competition.

Finally, regarding management's position that the source awarded the marketing contract referred to in our report had the prerequisite experience to justify a sole source award, our review of the contractor's resume indicates that the source did not have specialized experience or knowledge and was not uniquely qualified. Problems in this area are not unique, and as noted in the previously discussed peer review, Argonne was previously cited for problems related to inadequate justification and validity of sole source awards. Specifically, the peer review recommended that Argonne review the adequacy of sole source justifications rather than the mere presence of it. In the case of the marketing contractor, the only support for the contention that the contractor had knowledge of the technology to be marketed was a hand written note to the file. Such assertion, however, was not supported by information in the contractor's resume.

We also made a number of technical changes to our report based on management's comments. Based on these changes and because of the lengthy nature of the comments, management's technical comments have been omitted from the report. We discussed this issue with officials from the Argonne Area Office on February 4, 2004.

Appendix 1

OBJECTIVE

The objective of this audit was to determine whether Argonne was procuring goods and services in accordance with Government policies and best business practices.

SCOPE

The audit was performed between May 2003 and February 2004 at Argonne and Chicago. The scope of the audit included subcontracts with values greater than \$100,000 that were active or were in the closeout phase during FY 2002.

METHODOLOGY

To accomplish our objective, we:

- Reviewed applicable laws and regulations pertaining to procurement management and property management. We also reviewed audit reports by the Office of Inspector General and the General Accounting Office;
- Reviewed Argonne policies and procedures related to procurement management and property management;
- Reviewed the Government Performance and Results Act of 1993 and determined if performance measures had been established;
- Performed detailed tests on 40 active subcontracts and 20 inactive subcontracts with values over \$100,000;
- Reviewed property records and related documentation, as well as, invoices received and paid for by Argonne accounting;
- Held discussions with officials and personnel from Argonne and Chicago; and,
- Reviewed past and current Departmental assessments of Argonne's Procurement and Property Management systems.

The audit was conducted in accordance with generally accepted Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to

Appendix 1 (continued)

the extent necessary to satisfy audit objectives. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of the audit. We relied on computer processed data to accomplish our audit and through limited testing, established the reliability of data we considered critical to satisfying our objective.

An exit conference was held with Chicago personnel on February 4, 2004.

PRIOR REPORTS

- *Management of Sensitive Equipment at Selected Locations*, (DOE/IG-606, June 2003). The audit found that excessive effort on the part of management was necessary to locate virtually all of the items of sensitive equipment sampled. Recommendations were made to improve the identification and accounting of sensitive property in the hands of contractors. Management generally agreed with the findings and recommendations and began initiating corrective actions.
- *Support Services Subcontracts at Argonne National Laboratory*, (DOE/IG-0416, December 1997). The audit found that four major Headquarters program offices were acquiring support services through subcontracts awarded by Argonne during Fiscal Year 1996. Recommendations were made to discontinue this practice, and establish controls to assure program managers acquire support services through normal Departmental procurement processes. The program offices agreed with the audit findings and recommendations.
- *Subcontract Administration at Argonne National Laboratory*, (DOE/IG ER-B-93-06, August 1993). The audit found that Argonne did not fully comply with applicable Department of Energy Acquisition Regulation and contract terms for the awarding and administering of subcontracts. Specifically, Argonne did not use fair and open competition, allowed unauthorized personnel to purchase goods and services, did not use adequate proposal analysis to negotiate prices, and contract closures were not timely. Management generally concurred with the findings and recommendations with the exception of the proposal analysis improvement recommendation.



Department of Energy
Chicago Operations Office
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JAN 21 2004

Rickey R. Hass, Director
Science, Energy, Technology, and Financial Audits
IG-34 GTN

**SUBJECT: DOE-CH MANAGEMENT RESPONSE TO DRAFT AUDIT REPORT ON
SUBCONTRACT ADMINISTRATION AT ARGONNE NATIONAL LABORATORY (ANL)**

Reference: Memorandum, IG-34 (A03CH046) to Manager, Chicago Operations Office, Subject: Draft Report on Subcontract Administration at Argonne National Laboratory, dated November 14, 2003

The DOE Chicago Operations Office appreciates the opportunity to review the draft audit report as presented by the referenced memorandum.

The stated objective of the DOE Inspector General audit on subcontract administration at Argonne National Laboratory was to determine whether Argonne is procuring goods and services in accordance with Government policies and best business practices. The draft audit report concludes that Argonne National Laboratory relied heavily on sole source procurements/did not always ensure adequate competition when procuring goods and services; awarded contracts to sources that lacked necessary credentials or experience; and did not adequately protect Government property in the hands of subcontractors.

In the interest of ensuring that Argonne procures goods and services in accordance with the terms and conditions of its contract and Department of Energy policies, the draft audit report recommends that the Manager, Chicago Operations Office ensure that:

1. Sole source procurement actions are adequately justified and documented;
2. Whenever practical, full and open competition is used for Federally funded procurements;
3. An adequate method for identifying, tagging, and tracking Government property purchased by Laboratory subcontractors is established, and;
4. Argonne's performance measures are modified to include elements specific to procurement competition and subcontractor property management.

With respect to the recommendations of the draft audit report, we comment as follows:

Recommendation No. 1.

Ensure that sole source procurement actions are adequately justified and documented.

Management Response:

We concur with the IG's recommendation. In September 2003, the Laboratory issued a procurement directive advising all ANL personnel that there will be an increased emphasis on selection of suppliers on a competitive basis. Furthermore, all JNCPs will be carefully scrutinized by ANL procurement management to ensure the validity and appropriateness of the rationale to award on a non-competitive basis.

Appendix 3 (continued)

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JAN 21 2004

Recommendation No. 2.

Ensure that whenever practical, full and open competition is used for Federally-funded procurements.

Management Response:

We concur with the principle outlined in the IG's recommendation. However, note should be made that the language used in the draft IG report is an oversimplification of the requirements of the ANL prime contract. A detailed explanation of this is attached and we request that the attachment be incorporated into the IG's Final Report.

Recommendation No. 3.

Ensure that an adequate method for identifying, tagging, and tracking Government property purchased by Laboratory subcontractors is established.

Management Response:

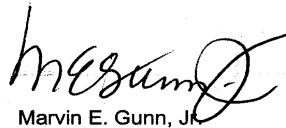
We concur with the IG's recommendation. The subcontractor-held property issue was initially identified as an area requiring ANL management attention during the onsite DOE Office of Science Personal Property Management Assessment in May 2003. Procurement, Property Management, Accounting, and Internal Audit functions at the Laboratory have identified, and are in the process of implementing additional management and administrative control measures as well as revisions to the Procurement Operations Manual (POM), Property Management Manual, and Accounting Handbook to address these concerns. A corrective action plan has been developed by the Laboratory which indicates that remediation has been initiated and/or completed regarding process changes, identification of roles and responsibilities, and related training. Interactions between the ANL Procurement and Accounts Payable functions have also been initiated to enhance communication and existing property management policies and procedures. The DOE-CH Argonne Area Office will validate the ongoing implementation of proposed corrective actions to ensure an adequate ANL subcontractor-held property management program exists and is maintained.

Recommendation No.4.

Ensure that Argonne's performance measures are modified to include elements specific to procurement competition and subcontractor property management.

Management Response:

We concur with the IG's recommendation. The Laboratory's Procurement Balanced Scorecard (PBSC) Self-Assessment Plan for FY 2004 has been revised to include an "Effective Use of Competition" performance measure and target. The ANL FY 2004 Property Management System Assessment Measure requires that the Laboratory complete the corrective actions associated with the observations identified in the DOE Office of Science Personal Property Management Assessment. In addition, DOE ME-62 has developed a new Balanced Scorecard Measure regarding subcontractor-held property which will be implemented in FY 2004.



Marvin E. Gunn, Jr.
Manager

Enclosure:
As Stated

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