



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

AUDIT REPORT

Subcontract Administration at Selected
Department of Energy Management and
Operating Contractors

OAS-M-15-07

July 2015



Department of Energy
Washington, DC 20585

July 31, 2015

MEMORANDUM FOR THE UNDER SECRETARY FOR NUCLEAR SECURITY,
NATIONAL NUCLEAR SECURITY ADMINISTRATION
DEPUTY DIRECTOR FOR FIELD OPERATIONS,
OFFICE OF SCIENCE

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

FROM: Rickey R. Hass
Deputy Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Audit Report: "Subcontract Administration at
Selected Department of Energy Management and Operating
Contractors"

BACKGROUND

The Department of Energy's (Department) management and operating (M&O) contractors have the responsibility to develop, implement, and maintain formal policies, practices, and procedures to be used in the award of subcontracts consistent with established Department and Federal acquisition regulations. Subcontracting can represent a large percentage of the total costs incurred by the M&O contractors.

In prior audits of contractor procurement activities, the Office of Inspector General identified various subcontracting issues, such as closeout backlogs, unaccounted property purchased by subcontractors, and inadequate competition. Due to the large percentage of subcontract costs incurred by M&O contractors, and based on prior audit findings, we initiated this audit to determine whether selected M&O contractors administered their subcontracts in accordance with Departmental regulations. We selected for review the National Nuclear Security Administration's Kansas City Plant (Kansas City). In fiscal year (FY) 2013, Kansas City had a total of 18,026 subcontracts worth almost \$241 million. We also visited the Office of Science's Thomas Jefferson National Accelerator Facility (Jefferson Lab), a facility that had a total of 1,743 subcontracts in FY 2013 with a value of almost \$152 million. This audit is the first in a planned series of audits focusing on M&O contractor subcontract administration.

RESULTS OF AUDIT

Nothing came to our attention to indicate that Kansas City and Jefferson Lab had not administered the subcontracts substantially in accordance with established policies and procedures and contract terms. While we did not discover material issues with administration of

subcontracts we tested at Kansas City, we did observe that a certain class of subcontracts had been noncompetitively awarded. Specifically, we found that Kansas City awarded 8 of the 47 subcontracts we reviewed, or \$10.2 million of \$33.7 million in subcontracts, on a sole-source basis without specific justification.

The majority of the \$10.2 million related to five subcontracts totaling \$9.6 million for Work for Others customers where Kansas City used the subcontractors specified by the customers without competition. While Kansas City's policies and procedures permit noncompetitive procurements when a Work for Others customer requires the use of a specific subcontractor, this practice appears to run contrary to Federal Acquisition Regulation (FAR) 52.244-5, *Competition in Subcontracting*; Department of Energy Acquisition Regulation (DEAR) 970.5244-1, *Contractor Purchasing System*; and DEAR 970.5217-1, *Work for Others Program (Non-DOE Funded Work)*. Because of the nature of the request, a Kansas City contracting official told us that he could not discern the exact nature of the project and thus accepted the customer's requirement that a specific subcontractor be used. As such, the Kansas City contracting official was unable to provide specific justification for why these five subcontracts were selected noncompetitively.

For three other subcontracts valued at about \$590,000, Kansas City procurement officials were unable to provide documentation necessary to support the sole-source procurement. Specifically, Kansas City:

- Awarded a subcontract to a vendor that its parent company previously selected through competition without adequate justification that the lack of additional competition resulted in fair and reasonable prices. The Kansas City buyer stated she did not expect additional competition to result in more favorable pricing or terms than those provided by the vendor to the parent. However, no documentation in the file supported this expectation.
- Awarded a subcontract without the required sole-source justification documentation. A Kansas City official asserted there was only one source for the product purchased but acknowledged that this should have been documented in the file. The official stated that the lack of documentation was an oversight.
- Contracted with a single vendor without adequate documentation that no other vendors were available. Apparently, Kansas City was seeking to develop a second source for a particular product. However, Kansas City claimed the buyer ultimately determined there was adequate justification to sole source the supplier, a determination that was not documented in the file.

Policy and Procedures

As noted, the majority of the subcontract administration issues at Kansas City occurred due to a policy providing an exception from competition in instances when a Work for Others customer required the use of a specific subcontractor. Kansas City officials stated the use of a customer-directed subcontractor without competition was permissible because Kansas City's Procurement Work Instructions (Work Instructions) allowed such action. Specifically, the Work Instructions stated that an exception to subcontract competition is allowed when a customer directed, in

writing, the use of a specific subcontractor. However, the Work Instructions appear to be inconsistent with (1) DEAR requirements in the contract, DEAR 970.5217-1, *Work for Others Program (Non-DOE Funded Work)*, which require M&O contractors to select the subcontractor and the work to be subcontracted for Work for Others customers, and (2) FAR 52.244-5, *Competition in Subcontracting*, and DEAR 970.5244-1, *Contractor Purchasing System*, which require the use of competition.

While the customers may have legitimate reasons to request a specific subcontractor work on the project, the Work Instructions did not require these reasons be documented and retained in the subcontract file to justify the noncompetitive award. Further contributing to the issue with Work for Others subcontract awards, Kansas City did not develop an overall Work for Others policy for Departmental approval as required by contract terms. Such policy should have addressed contractual requirements, such as not directly competing with the domestic private sector, recovering all costs associated with the work, and controlling the work to be subcontracted. The development and approval of such a policy may have highlighted the noncompliance or need to justify the use of customer-specified subcontractors.

In the other three previously noted examples, Kansas City did not always follow its procedures for using competition or providing adequate justification when a sole-source subcontract was awarded. Kansas City's Senior Contract Manager stated that the first two examples occurred because the buyer simply did not follow through on the requirement for adequate documentation. For the remaining example, the Senior Contract Manager stated that the cost and time required to qualify suppliers to achieve competition exceeded any possible savings that might be realized from competition among two or more suppliers. We recognize that some procurements require buyers to make a determination on whether potential subcontractors are qualified, which, as stated by a Kansas City official, may be costly and time consuming. However, without adequate documentation to support sole-source selections, Kansas City could not demonstrate that the subcontract prices were fair and reasonable.

Impact and Path Forward

In response to our findings, the Kansas City Field Office's Contracting Officer agreed the policies and procedures were noncompliant with the FAR and DEAR requirements regarding subcontracts under Work for Others agreements and would direct Kansas City to (1) update its procedures to reflect current regulations, and (2) ensure the procurement files contained adequate justification when subcontracting without competition.

RECOMMENDATIONS

To ensure that subcontract administration activities are conducted appropriately, we recommend that the Manager, Kansas City Field Office, along with the Contracting Officer, direct the National Nuclear Security Administration's Kansas City Plant to:

1. Develop a Work for Others policy that includes subcontract award procedures for documenting justifications to use customer-specified subcontractors without competition and request Department approval in accordance with contract terms and Departmental regulations;

2. Revise its Work Instructions to reflect contract terms and Departmental regulations; and
3. Provide training and guidance to appropriate procurement personnel regarding the new Work for Others policy and to reinforce revisions made to the Work Instructions regarding competition and sole-source justifications.

Further, we recommend the Manager, Kansas City Field Office, direct the Contracting Officer to:

4. Determine whether the Work Instructions and Work for Others policy comply with contract terms and Departmental regulations; and
5. Validate that Kansas City is following the approved Work Instructions and Work for Others policy.

MANAGEMENT RESPONSE

National Nuclear Security Administration Management concurred with the report's recommendations and detailed specific actions planned to address each recommendation, as well as timelines for completion. Specifically, Management stated that Kansas City will develop Work Instructions for managing its Work for Others program, including requirements for documenting justifications for subcontracts acquired without competition. The requirements will be consistent with the contract terms and regulations. It will also remove references to the Work for Others exception, thereby requiring all Work for Others procurements to use the same sole-source justification that apply to other subcontract awards. These changes will be communicated and training will be provided to the contractor's staff. Furthermore, the Contracting Officer agreed to review the revised Work Instructions and validate the implementation of the revised practices. Management's comments are included in Attachment 3.

AUDITOR COMMENTS

Management's comments and planned corrective actions were responsive to our recommendations.

Attachments

cc: Deputy Secretary
Under Secretary for Science and Energy
Chief of Staff
Associate Administrator for Acquisition and Project Management, National Nuclear Security Administration
Director, Audit Coordination and Internal Affairs, National Nuclear Security Administration

OBJECTIVE, SCOPE, AND METHODOLOGY

OBJECTIVE

The objective of this audit was to determine whether selected management and operating contractors administered their subcontracts in accordance with Department of Energy (Department) regulations.

SCOPE

We conducted the audit from May 2014 to July 2015, at the Office of Management and the Office of Science in Washington, DC. We also visited the Thomas Jefferson National Accelerator Facility (Jefferson Lab) in Newport News, Virginia, and the National Nuclear Security Administration's (NNSA) Kansas City Plant (Kansas City) in Kansas City, Missouri. The scope of the audit covered active subcontracts for fiscal year (FY) 2013. This audit was conducted under Office of Inspector General project number A14CH043. This audit is the first in a planned series of audits focusing on management and operating contractor subcontract administration.

METHODOLOGY

To accomplish the audit objective, we:

- Researched Federal and Departmental regulations and guidance related to subcontracting.
- Reviewed prior reports issued by the Office of Inspector General and the Government Accountability Office.
- Interviewed personnel from the Office of Science, the Office of Management, and the NNSA.
- Visited the Jefferson Lab and Kansas City sites, and discussed subcontract processes with Department and contract officials.
- Judgmentally selected an NNSA and an Office of Science site for subcontract evaluation from a universe of 24 management and operating contractors. Because a judgmental sample of Department sites was used, the results were limited to the sites selected.
- Obtained and reviewed listings of subcontracts active in FY 2013 at each site. We initially randomly selected 30 subcontracts at each site for detailed review. We then judgmentally selected another 17 subcontracts at Kansas City and 6 subcontracts at Jefferson Lab based on an analysis of risk factors such as monetary value of the subcontracts. Because our samples included judgmental or nonstatistical selections, the results and overall conclusions were limited to the items tested and could not be projected to the entire population or universe of subcontracts.

- Evaluated sample subcontract files at each of the selected sites comparing the documentation to the requirements and policies.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objective. Accordingly, the audit included tests of controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. In particular, we assessed the implementation of the *GPRA Modernization Act of 2010* and found that performance measures had not been established for subcontract administration activities reviewed. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We utilized computer-processed data to identify the population and samples of subcontracts to achieve our audit objective. Based on our comparisons of computer-processed data to supporting documentation, we determined that the data was sufficiently reliable for the purposes of our report. Management waived an exit conference.

RELATED REPORTS

Office of Inspector General

- Audit Report on [*Management Controls Over Subcontract Administration by the Argonne National Laboratory*](#) (OAS-M-04-01, March 2004). The audit found that Argonne National Laboratory (Argonne) relied heavily on sole-source procurements without, in many cases, adequately supporting their use. Argonne used sole-source procurements for 62 percent of its fiscal year (FY) 2002 subcontracts over \$100,000. We noted that 50 percent of the subcontracts reviewed did not demonstrate a compelling reason for limiting competition. Argonne also 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.
- Audit Report on [*Management Controls Over Subcontract Administration by the National Renewable Energy Laboratory*](#) (OAS-M-04-02, March 2004). The audit found that National Renewable Energy Laboratory (NREL) subcontractors acquired property that could not be located and fabricated experimental property that had not been included in inventory and was not properly safeguarded. Problems with management of the NREL's procurement cycle occurred because it had not always adhered to property management requirements or best business practices.
- Audit Report on [*Procurement Administration at Brookhaven National Laboratory*](#) (CR-B-02-02, August 2002). The audit found that Brookhaven National Laboratory (Brookhaven) did not always provide the Department of Energy (Department) with required advance notice for certain procurement actions, including those that exceeded specified dollar thresholds; prepare adequate justifications for noncompetitive procurements or exemptions from requirements of the *Buy American Act*; or accurately maintain procurement data on small business contracting and small purchases. Problems with procurement administration occurred because Brookhaven had not provided adequate training for acquisition staff, implemented appropriate control measures, or effectively implemented an assessment and performance measurement program.
- Audit Report on [*Management Controls Over Subcontract Administration at the National Security Laboratories*](#) (OAS-M-04-06, August 2004). For FYs 2001 and 2002, the audit found that the Lawrence Livermore, Los Alamos, and Sandia National Laboratories did not always effectively manage certain aspects of their subcontracting process. Specifically, the laboratories did not always ensure that audits were conducted, questioned costs were resolved, or completed subcontracts were closed in a timely manner. These problems occurred because the laboratories lacked appropriate controls.

Government Accountability Office

- Report on [*Department of Energy Needs to Strengthen Controls Over Contractor Payments and Project Assets*](#) (GAO-07-888, July 2007). This report found that the Department's internal controls over payments to the Waste Treatment Plant contractor did not provide reasonable assurance against the risk of improper payments. The Department relied primarily on the prime contractor to review and validate subcontractor charges without having a process in place to assess whether the prime contractor was properly carrying out its subcontractor oversight responsibility.

MANAGEMENT COMMENTS



Department of Energy
Under Secretary for Nuclear Security
Administrator, National Nuclear Security Administration
Washington, DC 20585



MEMORANDUM FOR GREGORY H. FRIEDMAN
INSPECTOR GENERAL

FROM: FRANK G. KLOTZ [Signature] 7/7/16

SUBJECT: Comments on the Office of Inspector General Draft
Report Titled Subcontract Administration at Selected
Department of Energy Management and Operating
Contractors (A14CH043)

Thank you for the opportunity to review and comment on the subject draft report.
The National Nuclear Security Administration (NNSA) concurs with the Office of
Inspector General's recommendations. The attachment to this memorandum
details the specific actions planned to address each recommendation, as well as
timelines for completion.

We appreciate the auditors' efforts in highlighting opportunities to enhance our
processes. If you have any questions regarding this response, please contact
Mr. Dean Childs, Director, Audit Coordination and Internal Affairs, at
(301) 903-1341.

Attachment



Attachment

NATIONAL NUCLEAR SECURITY ADMINISTRATION
Response to Report Recommendations

Subcontract Administration at
Selected Department of Energy Management and Operating Contractors (A14CH043)

The IG recommended the Kansas City Plant:

Recommendation 1: Develop a Work for Others policy that includes subcontract award procedures for documenting justifications to use customer-specified subcontractors without competition, and request Department approval in accordance with contract terms and departmental regulations.

Management Response: Concur

The contractor will develop a Work Instruction (WI) describing requirements for managing the Work for Others Program, including the development of a procurement package for acquiring subcontract work. The WI will identify requirements for documenting justifications when acquiring subcontract work without competition. The requirements will be consistent with the Prime Contract (including the DEAR and FAR clauses) and the Procurement Work Instructions. This action will be complete by August 31, 2015.

Recommendation 2: Revise Work Instructions to reflect contract terms and Departmental regulations.

Management Response: Concur

The contractor's existing procurement WI includes an exception to the single source justification requirements for Work for Others procurements. The contractor will be instructed to remove all references to the Work for Others exception, thereby requiring all Work for Others procurements to abide by the same Single Source Justification requirements that apply to all other subcontract awards. In addition, the contractor will be instructed to revise the buyer justification documents included in procurement files to remove the Work for Others single source justification exception. This action will be complete by August 31, 2015.

Recommendation 3: Provide training and guidance to appropriate procurement personnel regarding the new Work for Other policy and to reinforce revisions made to the Work Instructions regarding competition and sole-source justifications.

Management Response: Concur

The contractor will be instructed to notify Procurement and Work for Others staff of the changes to the WI and the buyer justification document. The contractor will also train staff on single

Attachment

source documentation on non-competitive Work for Others procurements in accordance with the revised WI. This action will be complete by September 30, 2015.

The IG recommended the Contracting Officer:

Recommendation 4: Determine whether Kansas City Work Instruction and Work for Others policy comply with contract terms and Departmental regulations.

Management Response: Concur

The Contracting Officer will review the Work Instruction and Work for Others documents and make a determination as to their compliance with contract terms and Departmental regulations. This action will be complete by September 30, 2015.

Recommendation 5: Validate that Kansas City is following the approved Work Instructions and Work for Others policy.

Management Response: Concur

The Contracting Officer will review and validate implementation of revised practices related to sole source acquisitions, including a review of purchase order files. This action will be complete by March 31, 2016.

FEEDBACK

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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

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