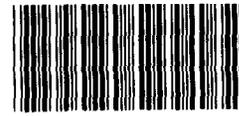


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DOE MANAGEMENT

Improvements Needed In Oversight of
Procurement and Property Management
Practices at the Lawrence Livermore
National Laboratory

Statement of
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Before the
Assembly Committee on Higher Education
California Legislature



Mr. Chairman and Members of the Committee:

We appreciate the opportunity to discuss management issues relating to the University of California's (UC) operation of the Lawrence Livermore National Laboratory. As you are aware, the Department of Energy (DOE) has decided to extend the contract it has with the University for operating the Laboratory (which will expire on September 30, 1992). As you requested, my testimony today summarizes the weaknesses in Laboratory management that we reported in three reports issued during the past 16 months, and material from on going work presented to the Senate Governmental Affairs Committee on August 1, 1991. Our work in the procurement area is still underway, and thus the results we are presenting today are preliminary.

The Lawrence Livermore National Laboratory has received considerable praise for its research activities. However, our reports, and on going work, have identified several problems related to the management of this Laboratory. Specifically, we found problems with

- University of California controls over Laboratory operations such as managing property, protecting classified documents, and procuring common goods and services;

- DOE oversight to ensure that the University complies with DOE rules and regulations; and

- clauses in the University contract that hamper DOE's ability to effectively manage the Laboratory.

DOE's Office of Inspector General (IG) reports, San Francisco Operations Office Contractor Purchasing System Reviews and Property Management Reviews, have reported similar weaknesses.

During the past year or two, DOE has come to recognize that management weaknesses exist and that actions are needed to address them. DOE's current negotiations with the University on the contract's content provide an opportunity to obtain an increased commitment to effective management by the University of California and to implement changes to the contracts to better enable DOE to ensure that the Laboratory is effectively managed.

I would now like to describe the laboratories covered by the University of California and Department of Energy contracts, and discuss some of the specific problems we have identified at the Laboratory.

BACKGROUND

The DOE/UC relationship originated with the Manhattan Project in the early 1940's. The purpose of the contract was to bring the best scientific minds to bear on pressing defense needs of the day in order to defend the United States and to end the War. The University entered into the arrangement out of a sense of national pride and dedication to public service. While government contracting rules, regulations and objectives have changed since that time, such changes have only been formally recognized by the University where statutorily required. The basic relationship has not changed much over the last 50 years. Throughout their 50 year history, several basic concepts have been integral to the UC contracts and to the relationship they represent. The basic concepts of mutuality (which restricts DOE from unilaterally requiring policy and procedural changes in contractor operations, unless the changes are required by law or executive order), and of no risk of loss to the University are not typical of the usual Government contract between a buyer and seller. Additionally, although the University is compensated for its indirect costs in managing the laboratories, the contracts do not provide the University with a profit.

The University of California serves as the management and operating (M&O) contractor for three DOE multi-program laboratories--Lawrence Livermore, Los Alamos, and Lawrence Berkeley. In fiscal year 1990,

DOE obligated approximately \$2.3 billion to these contracts--\$1.1 billion to Lawrence Livermore, \$1 billion to Los Alamos, and \$200 million to Lawrence Berkeley. The University also operates the DOE Laboratory of Radiology and Environmental Health, a much smaller facility. The contracts between DOE and the University call for the federal government to pay all expenses of the laboratories, and to pay the University a management allowance. The current allowance is \$12.5 million per year. The multi-program laboratories serve as DOE's primary mechanism for conducting energy and defense research and development. Laboratories involved primarily in energy research, such as Lawrence Berkeley, are under the cognizance of DOE's Director of Energy Research. On the other hand, laboratories concentrating on defense research, such as Los Alamos and Lawrence Livermore, are under the cognizance of DOE's Assistant Secretary for Defense Programs.

INADEQUACIES FOUND IN UNIVERSITY

MANAGEMENT OF LABORATORY OPERATIONS

Three reports that we have issued in the past 16 months, as well as our on going audit of the Lawrence Livermore's subcontracting activities, have pointed out weakness in the University of California's operation of the Laboratory. These weaknesses include inadequate controls for managing property, protecting classified documents, and procuring common goods and services.

Property Management

In April 1990, we reported that a substantial amount of government-owned property was missing from the Laboratory. Specifically, 16 percent, or 27,528, of the items recorded in the Laboratory's property management data base could not be located. The acquisition cost of this equipment was \$45 million. We also found the Laboratory did not have adequate controls to ensure that property in its custody is safeguarded against theft, unauthorized use, or loss. For example, the Laboratory had not tagged, marked, or otherwise identified as government property some of the items it had acquired for conducting weapons and energy R&D.

Following our April 1990 report on property controls, the Laboratory reported to the press that it had found virtually all of the equipment--approximately 99 percent. The Laboratory, however, excluded over 20,000 non-capital equipment items costing between \$500 and \$5,000--such as cameras, television equipment, printers, and modems--that are still missing. The Laboratory calculated the percentage of located items based on cost, whereas the percentage of items that we reported as missing was based on the number of missing items. In actuality, the Laboratory had located only about 3 percent of the equipment. About 13 percent of the inventoried equipment, acquired at a cost of \$18.6 million, is still missing.

Rather than being strengthened, the Laboratory's property accountability controls, overall, have actually been weakened since April 1990. In response to our report recommendations, DOE required the Laboratory to develop a property management system. As a first step, the Laboratory developed a property policy manual. While the policies outlined in this manual may improve equipment management in some areas, accountability controls will be eliminated over non-capital equipment. These items, costing between \$500 and \$5,000, account for 81 percent of the government-owned property items previously accounted for in the Laboratory's property management data base. They also constitute over 92 percent of the items that we reported as missing in April.

Furthermore, Laboratory management has not offered a sound basis for its actions to eliminate accountability controls over non-capital equipment. For example, according to Laboratory management, one reason for eliminating accountability controls is that they are not cost-effective. Yet the University of California requires the accountability of its own property at the \$500 level--not the \$5,000 level now used on government-owned property at the Laboratory. This inconsistency provides greater protection to University property than is afforded to the government-owned property at the Laboratory.

Classified Documents

In February 1991, we reported on the inadequacy of accountability for secret classified documents in the Laboratory's custody. We reported that the Laboratory could not locate a substantial number of secret documents--approximately 10,000 out of 600,000 such documents were missing. Adequately safeguarding and controlling secret documents is vital to the national security interests of the United States. If, for example, information on nuclear weapons design were disclosed to unauthorized sources, the potential would exist for serious consequences to national security. We also reported that the Laboratory had not assessed the potential for compromise to the national security for the documents as required. As a result, neither the Laboratory nor DOE could provide assurance that national security had not been damaged.

Likewise, we reported that accountability for secret documents in the Laboratory's custody was inadequate. Because control over secret documents at the Laboratory was decentralized and diverse, practices varied. As a result, Laboratory management could not readily ensure that secret information was being effectively managed or controlled Laboratory-wide.

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

The Laboratory currently has more than 1,100 vehicles for use on its 1-square mile Laboratory site. These vehicles were obtained 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 the time it was under direction by DOE to reduce its fleet size and had been instructed to stop submitting requests for additional GSA leases.

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 had been paid. The University

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. The Laboratory is paying \$585 a month each for the two station wagons (servicing and maintenance included), while a station wagon leased from GSA would cost \$147 plus 19 cents a mile (including gas, servicing and maintenance). 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.

difficult and time-consuming to reach a mutually acceptable solution to the vehicle disputes.

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.

In lieu of the standard property management provision, the contract between DOE and the University provides for establishing a "mutually approved system" for property management. The terms of this system, however, had not been developed nor agreed upon. As a result, the system at the laboratory did not ensure that property was adequately safeguarded, and DOE could not provide assurance that government-owned property at the laboratory was being adequately safeguarded.

A number of other standard Department of Energy Acquisition Regulations (DEAR) clauses are not included in the contracts, including the following:

- The DEAR requires that the system of accounts employed by the contractor be satisfactory to DOE and in accordance with generally accepted accounting principles consistently applied. The contracts with the University, however, specify that the University's system of accounts shall be changed only as mutually agreed. According to a DOE memorandum, the University of California and laboratory management had refused to accept DOE directives pertaining to generally accepted accounting principles and DEAR cost principles because the contracts are silent as to whether the University needs to apply these principles.

system, contract management was cited as a material weakness. Initiatives to correct this weakness include changing the procurement system reviews and developing a work authorization process for DOE's M&O contractors. In addition DOE has developed new regulations on contractors' accountability and award fees (finalized in June 1991), but these regulations do not apply to nonprofit contractors such as the University of California.

DOE is also considering actions to strengthen the contracts with the University as part of the agency's process for negotiating the extension of the contracts. Specifically, DOE has identified 10 key management areas needing improvement. These include controls over property management, internal audit procedures, financial systems, and increased University attention to management of the laboratories. DOE officials told us that they discussed these issues with the University prior to deciding to extend the contracts.

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

-- obtaining a commitment for improved management by the University and

-- obtaining agreement that the new contracts will contain clauses giving DOE clear authority to administer the contracts in a manner that will protect the government's interest.

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Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions you or Members of the Committee may have.

Procurement of Common Goods and Services

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. 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.

Our work also demonstrates how some contract terms in the University of California contract with DOE limit DOE's ability to direct Laboratory actions.¹ 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.

¹The 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, each 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 as required for all 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 over-billings were paid by the Laboratory.

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. Sixteen of these vehicles are 12 foot flatbed trucks for which the Laboratory pays \$635 a month for each (servicing and maintenance included), versus a comparable flatbed truck leased from GSA at \$250 plus 27.5 cents a mile (gas, servicing and maintenance included). As of June 1991, 32 vehicles were being leased under this unauthorized subcontract. DOE officials have indicated that given the mutuality aspect of the current contract, they feel somewhat constrained in telling the laboratory what to do. Laboratory officials, on the other hand, frequently do not feel they must abide by DOE direction.

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 its unauthorized commercial 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

DOE'S ABILITY TO EFFECTIVELY MANAGE THE
LABORATORIES HAMPERED BY CONTRACT CLAUSES

DOE's ability to effectively manage the contracts for the University-operated laboratories is also impaired because the contracts contain clauses that provide DOE with less authority than the standard clauses in the federal and DOE acquisition and property regulations. Many of these nonstandard clauses contain the concept of mutuality, which restricts DOE from unilaterally requiring policy and procedural changes in contractor operations, unless the changes are required by law or executive order.

For example, in our April 1990 property management report, we noted that DOE did not require its standard property management provision in the contract with the University. The standard property management provision, normally included in all DOE M&O contracts, requires that a contractor maintain and manage a property management system in accordance with sound business practice and DOE property management regulations. According to the DOE Contracting Officer at the field office, DOE tried to insert its standard provision into the contract, but the University opposed its inclusion. The University argued that such a requirement would impose a superior-subordinate relationship between the government and contractor rather than the historical relationship of mutuality and consent. DOE subsequently dropped this as a negotiating point.

-- The contracts with the University also do not include the standard DEAR clause requiring that the contractor conduct internal audits and examinations satisfactory to DOE of the records, operations, expenses, and transactions with respect to the costs claimed to be allowable under the contract. In a March 1991 memorandum on internal controls at the Laboratory, DOE's IG stated that the lack of the internal audit clause and its requirements were a material internal control deficiency.

-- The DEAR requires a contractor to maintain a purchasing system acceptable to DOE. The contracts with the University specify that the system must be acceptable to the University and DOE. This may hamper DOE's ability to mandate needed changes to the purchasing system.

DOE HAS ACTED TO IMPROVE CONTRACT MANAGEMENT

Our reports have made a number of recommendations to DOE to correct the problems we identified in the areas of property management and classified documents. DOE has acted on many of those recommendations. In addition, DOE has recognized the need for overall improvements in contract management, particularly in its administration of M&O contracts. In the Secretary of Energy's fiscal year 1989 and 1990 Federal Managers' Financial Integrity Act reports, the Department's evaluation of its management control

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.

CONCLUSIONS

Our work points out the need for substantial improvements in the University of California management of the laboratories and DOE oversight of that management effort. DOE has taken action to address many of the specific problems that we have identified and to improve overall contract management.

Negotiations with the University of California to extend the Laboratory contracts will be another opportunity for DOE to take a firm stance regarding the need for management improvements, including