



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

REPORT
NO. 90-067

May 15, 1990

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION
ASSISTANT SECRETARY OF THE ARMY (FINANCIAL
MANAGEMENT)
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL
MANAGEMENT)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL
MANAGEMENT AND COMPTROLLER)
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Report on the Audit of Subcontracting for Services by
Federally Funded Research and Development Centers and
Other Nonprofit Research Institutions
(Project No. 9CA-5007)

Introduction

This is our final report on the Audit of Subcontracting for Services by Federally Funded Research and Development Centers (FFRDCs) and Other Nonprofit Research Institutions. We made the audit from January through December 1989. The audit objectives were to evaluate the subcontracting practices for research and consulting services of the FFRDCs and other nonprofit research institutions and to evaluate DoD's internal control procedures for monitoring the subcontracting activities of the FFRDCs and other nonprofit research institutions.

Discussion

The audit determined that the overall level of DoD oversight of subcontracting activities at FFRDCs and other nonprofit research institutions was generally adequate. We did find certain deficiencies in DoD's oversight of SRI International's subcontracting practices, which were addressed in a separate management letter to the Commander, Defense Contract Administration Services Region, Los Angeles, California (see Enclosure 2). Appropriate corrective actions have been initiated (see Enclosure 3). We also provided in a separate management letter to the Director, Defense Logistics Agency, an observation regarding its contractor purchasing system reviews of nonprofit research institutions.

The audit disclosed no material internal control weaknesses as defined by Public Law 97-255, Office of Management and Budget Circular A-123, and DoD Directive 5010.38. Our audit disclosed

some immaterial internal control weaknesses, which we discussed with appropriate officials.

Scope of Audit

The scope of the audit covered an evaluation of the subcontracting practices of the four largest DoD sponsored FFRDCs (Aerospace Corporation, Lincoln Laboratory, Mitre Corporation-C3I Division, and RAND Corporation) and four largest non-FFRDC research institutions (Charles Stark Draper Laboratory, Johns Hopkins University Applied Physics Laboratory, IIT Research Institute, and SRI International). It also included an evaluation of the applicable internal control procedures and practices of the research institutions, their cognizant DoD administering contracting office, and their principal sponsoring DoD activities. Special emphasis was placed on evaluating the procedures and practices relating to 43 statistically selected subcontracts awarded by these research institutions in FY 1987 and FY 1988. The criteria used to conduct the audit included Defense and Federal Acquisition Regulation Part 35, "Research and Development Contracting," and Part 44, "Subcontracting Policies and Procedures"; and Office of Federal Procurement Policy Letter 84-1, "Federally Funded Research and Development Centers." Records reviewed included Government contractor purchasing system review reports, DoD and contractor records relating to the subcontractor selection and approval process, and financial disclosure statements of DoD and contractor employees involved in the subcontractor selection and approval process.

This performance audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD, and accordingly, included such tests of internal controls as were considered necessary. The activities and contractors visited or contacted during the audit are listed in Enclosure 1.

Background

Federally Funded Research and Development Centers (FFRDCs) are privately operated nonprofit organizations primarily funded by the Federal Government on a relatively long-term basis. The Department of Defense sponsors 10 FFRDCs. In addition to the officially recognized FFRDCs, there are approximately 90 other nonprofit research institutions that receive research contracts from DoD. The four largest FFRDCs and four largest non-FFRDC nonprofit research institutions received approximately \$2.0 billion in DoD research contracts in FY 1987 and FY 1988 and reported subcontracting amounting to approximately \$600 million during each of those 2 years.

Prior Audit Coverage

The General Accounting Office (GAO) Audit Report No. GAO/NSIAD-88-22 (OSD Case No. 7551), "Competition: Issues on

Establishing and Using Federally Funded Research and Development Centers," March 7, 1988, addressed the issue of whether some of the work being performed by FFRDCs should be done by the private sector. The report concluded that research work carried out by the FFRDCs was generally within their charters. GAO, however, was unable to determine whether non-FFRDCs could do the research work better or at less cost. GAO found that the FFRDCs did not have to compete for the work they received from the Government because of their special relationship with their sponsor. The report concluded that the lack of competition limited the Government's ability to determine if a non-FFRDC could do the work better or at less cost. The report recommended that DoD implement a test program to determine if the use of broad agency announcements would improve DoD's ability to determine if non-FFRDCs could collaborate meaningfully with FFRDCs to pursue the DoD's research goals. DoD nonconcurred with the recommendation and stated that a thorough review process was conducted to select work not conducive to competition that could best be performed by FFRDCs. The report did not address the subcontracting practices of the FFRDCs.

The DoD Inspector General Report No. 86-062, "Federal Contract Research Centers and Not-for-Profit Corporations," February 4, 1986, evaluated whether policy on the levels and uses of reserves accumulated from fees and investments was adequate and if DoD's rights to assets were protected. The audit found no DoD written policy on control of levels and uses of reserves. Additionally, the DoD sponsors' rights to assets did not ensure that the Government would have any rights if the firms were dissolved. The report recommended that OSD require that fees be based on need, and that OSD issue policy to protect DoD's rights to the assets of existing and future FFRDCs and not-for-profit contractors. OSD concurred with the recommendations to develop appropriate coverage on contracting with FFRDCs in the Federal Acquisition Regulation. The requirements to have management fees based on need were incorporated into the DoD Federal Acquisition Regulation Supplement on August 1, 1987. The report did not address the subcontracting practices of the FFRDCs and other not-for-profit research institutions.

The DoD Inspector General Report No. 90-041, "Report on the Audit of the Contracting Practices of the Institute for Defense Analyses," March 1, 1990, evaluated how the Institute was selected to receive work from the Government, the adequacy of contract administration surveillance of the Institute during contract performance, and the adequacy of the Institute's procedures in selecting subcontracts. Only a limited review of subcontracting procedures was performed because the Defense Contract Administration Service was performing a special contractor purchasing system review during the audit. The report recommended that the contracting officer establish a time-phased plan for the Institute of Defense Analysis to implement the recommendations of the Defense Contract Administrative Service for correcting deficiencies in the Institute's purchasing system.

Report Staffing

We provided a draft of this report to the addressees on March 5, 1990. Because there were no recommendations, no comments were required of management, and none were received.

We appreciate the courtesies and cooperation extended to the audit staff. The names and titles of the audit team members are shown in Enclosure 4. The distribution of this report is shown in Enclosure 5. Please contact Mr. Richard Jolliffe, Program Director, on (202) 694-6260 (AUTOVON 224-6260) or Mr. Dennis Payne, Project Manager, on (202) 694-6259 (AUTOVON 224-6259) if you have any questions concerning this report.



Edward R. Jones
Deputy Assistant Inspector General
for Auditing

Enclosures

cc:
Secretary of the Army
Secretary of the Navy
Secretary of the Air Force

ACTIVITIES AND CONTRACTORS VISITED OR CONTACTED

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition, Washington, DC
Assistant Secretary of Defense (Production and Logistics),
Washington, DC

Department of the Army

Assistant Secretary of Army (Financial Management),
Washington, DC
Headquarters, United States Army Communications-Electronics
Command, Fort Monmouth, New Jersey

Department of the Navy

Assistant Secretary of the Navy (Financial Management),
Arlington, VA
Assistant Secretary of the Navy (Research, Development, and
Acquisition), formerly (Shipbuilding and Logistics)
Arlington, VA
David Taylor Naval Ship Research and Development
Annapolis, MD
Electromagnetic Compatibility Analysis Center
Annapolis, MD
Navy Plant Representative Office, Johns Hopkins University/
Applied Physics Laboratory, Laurel, MD
Office of Naval Research Resident-Representative,
Cambridge, MA
Space and Naval Warfare Systems Command,
Arlington, VA

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management
and Comptroller), Washington, DC
Systems Command:
Electronics Systems Division, Hanscom Air Force Base, MA
Rome Air Development Center, Griffing Air Force Base, NY
Space Division, Los Angeles, CA

Defense Contract Audit Agency

Headquarters, Alexandria, VA
Alexandria Branch Office, Alexandria, VA
Boston Branch Office, Boston, MA
Chicago Suboffices Branch Office, Chicago IL
Columbia Branch Office, Columbia, MD
Los Angeles Branch Office, Los Angeles, CA
Waltham Branch Office, Waltham, MA

Defense Logistics Agency

Headquarters, Alexandria, VA

Defense Contract Administration Services Management Areas:

Chicago, IL

El Segundo, CA

San Francisco, CA

Los Angeles, CA

Defense Contract Administration Services Region:

Boston, MA

Los Angeles, CA

Contractors

Aerospace Corporation, El Segundo, CA

Charles Stark Draper Laboratories, Cambridge, MA

Johns Hopkins University Applied Physics Laboratory, Laurel, MD

IIT Research Institute, Chicago, IL

Lincoln Laboratory, Bedford, MA

Mitre Corporation, C3I Division, Bedford, MA

RAND Corporation, Santa Monica, CA

SRI International, Menlo Park, CA



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

JAN 23 1990

**MEMORANDUM FOR COMMANDER, DEFENSE CONTRACT ADMINISTRATIVE SERVICE
REGION, LOS ANGELES**

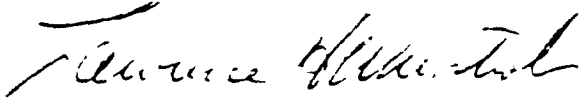
**SUBJECT: Deficiencies in Contract Administrative Oversight of
SRI International, Menlo Park, CA**

Our "Audit of Subcontracting for Services by Federally Funded Research and Development Centers and Other Nonprofit Research Institutions," (Project No. 9CA-5007), disclosed two deficiencies in the Defense Contract Administrative Services' oversight of subcontracting activities at SRI International, Menlo Park, California. We are bringing these matters to your attention for implementation of appropriate corrective actions. We plan to include a copy of this memorandum as an attachment to our audit report summarizing the overall results of this audit.

First, there is a need to perform a contractor purchasing system review of SRI International. No review has been performed during the past five years. Federal Acquisition Regulation 44.3, "Contractor Purchasing System Reviews (CPSR)," requires that purchasing system reviews be performed at least once every three years for contractors with SRI International's Government sales volume.

Second, there is a need to improve accountability over Confidential Statements of Affiliations and Financial Interests (DD Form 1555's). During the audit we identified DoD personnel at DCASMA-San Francisco who were in a position to approve or influence the selection of the subcontracts we selected for review at SRI International. DoD Directive 5500.7, "Standards of Conduct," requires that confidential statements be submitted annually by DoD personnel who are required to exercise judgement in making Government decisions or in taking Government action for contracting or procurement. The Directive requires the Designated Agency Ethics Official to ensure the proper collection and handling of the confidential statements and requires that the statements be retained for six years from the date of filing. We requested in September 1989 access to the confidential statements filed by the identified DCASMA-San Francisco personnel during the FY 1987 through FY 1989 period. We have been advised by your counsel, the Designated Agency Ethics Official, that ten of the requested confidential statements could not be located. No assurance could be provided that the identified personnel had even submitted the requested confidential statements.

We appreciate the courtesies and cooperation extended to the audit staff. Please contact Mr. Richard Jolliffe, Program Director, on (202) 694-6260 (AUTOVON 224-6260), or Mr. Dennis Payne, Project Manager, on (202) 694-6259 (AUTOVON 224-6259), if you have any questions or if we can provide any further assistance on this matter.



Lawrence H. Weintrob
Director
Contract Management Directorate



DEFENSE LOGISTICS AGENCY
DEFENSE CONTRACT ADMINISTRATION SERVICES REGION, LOS ANGELES
222 NORTH SEPULVEDA BOULEVARD
EL SEGUNDO, CALIFORNIA 90245-4320



IN REPLY
REFER TO DCASR LA-D

15 Feb 90

SUBJECT: Deficiencies in Contract Administrative Oversight of SRI
International, Menlo Park, CA

Mr. Lawrence H. Weintrob
Director
Contract Management Directorate
Inspector General Department of Defense
400 Army Navy Drive
Arlington, VA 22201-2884

Dear Mr. Weintrob:

Reference project no. 9CA-5007 and DoD IG letter dated January 23, 1990, same subject.

DCASR Los Angeles has researched the two findings cited in the referenced letter in order to take appropriate corrective actions, and gain the maximum benefit therefrom.

Between 1978 and 1989, administrative contracting officers and Contractor Purchasing System Review (CPSR) personnel agreed to give SRI low priority in the CPSR schedule, based on the nature of its subcontracting, and assessments of how best to use DCASR manpower, given inadequate resources. However identifying an increase in deficiencies in SRI's requests for subcontract consent in 1989, the contracting officer and CPSR personnel agreed to change SRI's priority and to schedule the institution for a CPSR in the third quarter of FY 90.

Inasmuch as we cannot locate DCASR's copies of the ten DD Forms 1555 cited in the referenced letter, we have contacted the employees concerned to obtain copies from them. Due to personnel turnover, we cannot account for the failure to maintain the forms in prior years, but the field office and our Legal Counsel will cooperate to preclude recurrence.

I, and my staff and field commanders, are dedicated to pursuing the DLA mission in cost effective ways, and in compliance with laws and regulations. We welcome the opportunity to respond to your audit findings, and to take corrective action as warranted. Please contact me if you require further information on these two matters.

Sincerely,

L. VINCENT
Captain, SC, USN
Commander

Enclosure 3

AUDIT TEAM MEMBERS

James J. McHale, Acting Director, Contract Management Directorate
Richard B. Jolliffe, Program Director
Dennis E. Payne, Project Manager
James A. Wingate, Team Leader
John M. Young, Team Leader
Arsenio M. Sebastian, Auditor
Cheri D. Givan, Auditor
Kathryn M. Holmes, Auditor

FINAL REPORT DISTRIBUTION

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Assistant Secretary of Defense (Public Affairs)
Comptroller of the Department of Defense

Department of the Army

Secretary of the Army
Assistant Secretary of the Army (Financial Management)
Auditor General, U.S. Army Audit Agency

Department of the Navy

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Director, Naval Audit Service

Department of the Air Force

Secretary of the Air Force
Assistant Secretary of the Air Force (Financial Management
and Comptroller)
Air Force Audit Agency

Other Defense Agencies

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency

NON-DOD

Office of Management and Budget
U.S. General Accounting Office,
NSIAD Technical Information Center

Congressional Committees:

Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Ranking Minority Member, Committee on Armed Services
House Committee on Appropriations
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Committee on Government Operations