



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-20-20

December 2019

**AUDIT COVERAGE OF COST
ALLOWABILITY FOR LOS ALAMOS
NATIONAL LABORATORY
FROM OCTOBER 1, 2013,
TO SEPTEMBER 30, 2016,
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-AC52-06NA25396**



Department of Energy
Washington, DC 20585

December 26, 2019

MEMORANDUM FOR THE ACTING MANAGER, LOS ALAMOS FIELD OFFICE

A handwritten signature in black ink, appearing to read "Bruce Miller".

FROM: Bruce Miller
Assistant Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on “Audit Coverage of Cost Allowability for Los Alamos National Laboratory from October 1, 2013, to September 30, 2016, Under Department of Energy Contract No. DE-AC52-06NA25396”

BACKGROUND

Beginning June 2006, Los Alamos National Security, LLC (LANS) operated the National Nuclear Security Administration’s Los Alamos National Laboratory (Los Alamos) for the Department of Energy. Los Alamos is a multi-program laboratory with critical national security responsibilities, including research and a limited production mission that helps to ensure the safety, security, and reliability of the Nation’s nuclear weapons stockpile. Los Alamos was managed under a \$27.6 billion cost-plus contract, including both award and incentive fees, which ran from June 1, 2006, through October 31, 2018. LANS incurred costs in excess of \$6.5 billion in fiscal years (FYs) 2014 through 2016.

Because LANS was an integrated management and operating contractor, its financial accounts were integrated with those of the Department, and the results of financial transactions were reported monthly according to a uniform set of accounts. LANS was required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and claim only allowable costs. Allowable costs are incurred costs that are reasonable, allocable, and allowable in accordance with the terms of the contract and applicable cost principles, laws, and regulations.

To help ensure that only allowable costs were claimed by the Department’s integrated contractors and make efficient use of available audit resources, the Office of Inspector General, the Department’s Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors implemented a Cooperative Audit Strategy. This strategy places reliance on the contractors’ internal audit function to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the

Cooperative Audit Strategy and as required by its contract, LANS maintained an internal audit (Ethics and Audit) activity with responsibility for conducting audits, including audits of the allowability of incurred costs. The Cooperative Audit Strategy also required that audits performed internally must, at a minimum, meet the standards prescribed by the Institute of Internal Auditors. In addition, LANS was required to conduct or arrange for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor.

The objectives of our assessment for FYs 2014 through 2016 were to determine based on our limited sampling whether:

- Ethics and Audit conducted cost allowability audits that complied with professional standards and could be relied upon;
- The contractor conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- Questioned costs and internal control weaknesses impacting allowable costs that were identified in prior audits and reviews had been resolved.

RESULTS OF ASSESSMENT

During our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Ethics and Audit for FYs 2014 through 2016 could not be relied upon. We conducted our assessment as a review attestation. A review is a substantially less in scope than an examination or audit. Our review was limited and would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. Based on our limited sampling, we found that Ethics and Audit's cost allowability audits generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing; however, we identified issues with the identification of questioned costs, as well as workpapers that did not meet Ethics and Audits Division Audit Manual policies. Specifically, we are questioning \$14,348 in costs that Ethics and Audit did not question, despite identifying these costs in findings associated with control weaknesses over cost allowability. This issue did not impact our ability to complete the objectives of this assessment. In addition, we are questioning \$8,437,970 in costs questioned by Ethics and Audit, as well as \$6,648 questioned in subcontract audits. Finally, we found that \$1,144,854 in prior period questioned costs had been resolved.

Questioned Costs

In FYs 2014 through 2016, Ethics and Audit identified \$10,431,017 in questioned costs. Of this amount, \$1,993,047 has been resolved. However, Ethics and Audit was unable to substantiate LANS management's resolution of \$597,827 identified in an audit of Marcon Excavating, Inc. In addition, \$7,840,143 identified in an audit of Housing Allowances remained unresolved. Ethics and Audit questioned this amount based on the lack of criteria at LANS for judging the

reasonableness of relocation benefits and recommended that the Department Contracting Officer and LANS reach an agreement on reasonableness. The Department and LANS officials told us that they were working to determine a LANS criteria for reasonableness and to resolve this amount. Accordingly, we question the \$8,437,970 in unresolved costs identified in these two audits (See Attachment 2, Table 1).

In addition, we identified cases where Ethics and Audit reported control weaknesses related to cost allowability but did not question associated costs. For example, in an audit of the Kofax invoice approval system, auditors identified invoices worth \$1,212,324 that had not been properly routed to ensure necessary approval prior to payment. Likewise, in an audit of Blanket Order Agreements, auditors found that approximately \$41,052 in invoices either did not include documented approval for foreign travel or did not have evidence of written authorization for purchases over \$500, contrary to subcontract requirements. In these cases, Ethics and Audit officials told us that the audits in question were intended to be audits of internal controls and were not audits of cost allowability. Accordingly, they stated that they had not questioned these costs as they had found no concrete evidence to indicate that unallowable costs had been charged to the contract, and they do not question costs without evidence that they are unallowable. However, the test work supporting both audits identified specific costs with associated control weaknesses. Despite identifying these costs, there was little to no evidence documented in the audit file that the auditors performed any additional test work on the allowability or unallowability of the specific associated costs. Further, we did not identify justification in the audit workpapers for not performing the additional reviews needed to explicitly determine allowability. At our request, Ethics and Audit officials were able to obtain evidence of the existence of other controls to demonstrate that LANS management approved the costs. However, included in the costs that Ethics and Audit identified but did not question are \$14,348 in costs that did not receive required Departmental approval. As these costs never received required approval, we are questioning the remaining \$14,348 (See Attachment 2, Table 2).

In addition, we found that Ethics and Audit conducted reviews of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. Ethics and Audit questioned subcontract audit costs of \$1,464,475 in audits conducted from FY 2015 through FY 2017 (including \$5,735 of costs incurred in FY 2017 which were outside of the scope of this review). Of the \$1,464,475 in total subcontract costs questioned by Ethics and Audit, \$1,457,827 in costs were resolved. Accordingly, we question the remaining \$6,648 in unresolved questioned subcontract costs (See Attachment 1, Table 3).

Finally, we identified workpapers in the Fiscal Year 2016 Allowable Cost Audit that did not meet the standards set in the Ethics and Audit Division Internal Audit Manual. The Internal Audit Manual required that workpapers be sufficiently complete and detailed to enable a reviewer to understand the audit work without supplementary explanation. However, in the Fiscal Year 2016 Allowable Cost Audit, we identified workpapers that were not sufficiently complete or detailed to enable us to understand the audit work completed without supplementary explanation. In addition, Ethics and Audit management could not adequately explain the workpapers in question without additional explanation from the office of the Los Alamos Chief Financial Officer. Ethics and Audit management told us that the auditor who performed the

work was counseled on the adequacy of the workpapers in the Fiscal Year 2016 Allowable Cost Audit and prior audits. However, there was no evidence in the project folder for us to validate that the employee had received adequate supervisory oversight, as required by the International Standards for the Professional Practice of Internal Auditing, Section 2340, which stated, “Appropriate evidence of supervision is documented and retained.”

Insurance Costs

In our prior assessment, we noted that LANS may not have been able to accurately determine insurance expense amounts paid. As a part of our assessment, we examined whether LANS was now able to make that determination. In particular, we noted that Ethics and Audit conducted a followup audit of insurance costs and confirmed, while developing the scope of that audit, that LANS had developed a method for determining the universe of insurance.

RECOMMENDATIONS

We recommend that the Acting Manager, Los Alamos Field Office, direct the Contracting Officer to:

1. Make a determination regarding the allowability of \$8,458,966 in questioned costs identified in this report and recover those costs determined to be unallowable;
2. Ensure that the contractor’s internal audit function ensures completed workpapers meet minimum standards and maintains adequate documentation of supervisory review in the audit file; and
3. Ensure that the contractor’s internal audit function either evaluates the allowability of costs identified in the audits of internal controls over cost allowability or documents the justification for not conducting this evaluation.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management concurred with the report’s recommendations and indicated that corrective actions are planned to address the issues identified in the report. Management’s comments and planned corrective actions are responsive to our recommendations.

Management’s comments are included in Attachment 3.

SCOPE AND METHODOLOGY

This assessment was performed from March 2018 to June 2019 at Los Alamos National Laboratory, located in Los Alamos, New Mexico. The assessment was limited to Ethics and Audit’s activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affect costs claimed by LANS on its Statement of Costs Incurred and Claimed for FYs 2014 through 2016. This assessment was conducted under the Office of Inspector General project number A18LA012.

To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Ethics and Audit that included a review of allowable cost audit reports, workpapers, auditor qualifications, independence, audit planning (including risk assessments and overall internal audit strategy), and compliance with applicable professional auditing standards.
- Conducted interviews with Department and Los Alamos personnel.
- Reviewed policies, procedures, and practices for identifying subcontracts that require audit and arranging for such audits.
- Judgmentally selected a sample of internal audits completed in FYs 2014 through 2016, as well as the Allowable Cost Audit for 2016, which was conducted during FY 2017. We assessed allowable cost audit work conducted by Ethics and Audit, which included a review of allowable cost audit reports, workpapers, a judgmental sample of transactions in the workpapers, auditor qualifications, independence, audit planning (including risk assessment and overall internal audit strategy), and compliance with applicable professional auditing standards.
- Judgmentally selected subcontract audits with costs incurred in FYs 2014 through 2016. We reviewed audits of subcontracts conducted by Ethics and Audit, which included a review of contract audit workpapers, a judgmental sample of transactions in the workpapers, reports, audit planning and risk assessment, and compliance with applicable professional auditing standards.
- Evaluated the resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Ethics and Audit, and other organizations.

We conducted our assessment in accordance with generally accepted government auditing standards for attestation engagements. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objectives. A review is substantially less in scope than an examination or audit where the objective is an expression of an opinion on the subject matter, and accordingly, for this review, no such opinion is expressed. Also, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on computer-processed data to accomplish our objectives. We determined that the computer-processed data was sufficiently reliable for the purposes of the review by comparing the data to source documents.

We held an exit conference on October 3, 2019.

This report is intended for the use of the Department contracting officers and field offices in the management of their contracts and is not intended to be and should not be used by anyone other than these specified parties.

Attachments

Summary of Questioned Costs for Los Alamos National Security, LLC

Table 1: Questioned Costs from Internal Audits in FY 2014 Through 2016

| Audit Title | Questioned Costs | Resolved | Unresolved |
|---|-------------------------|--------------------|--------------------|
| FY 2014 Allowable Cost Audit | \$8,600 | \$8,600 | \$- |
| Technology Transfer License and Royalty Income | \$18,000 | \$18,000 | \$- |
| Nuclear Materials Safeguards and Security Upgrades Project - Phase II | \$177,380 | \$177,380 | \$- |
| Non-Reimbursable Salaries and Fringe: CAS 402 & 405 | \$892,304 | \$892,304 | \$- |
| Marcon Excavating, Inc. | \$1,249,052 | \$651,225 | \$597,827 |
| Housing Allowances | \$7,981,804 | \$141,661 | \$7,840,143 |
| Accounting for Request for Offsite Services Agreements | \$36,235 | \$36,235 | \$- |
| Fixed-Price Subcontracts | \$67,642 | \$67,642 | \$- |
| Total Questioned Costs | \$10,431,017 | \$1,993,047 | \$8,437,970 |

Table 2: Questioned Costs Identified from Internal Audit Workpapers

| Audit Title | Questioned Costs | Resolved | Unresolved |
|-------------------------------|-------------------------|--------------------|-------------------|
| Invoice Approval System | \$1,212,324 | \$1,212,324 | \$- |
| Blanket Order Agreements | \$41,052 | \$26,704 | \$14,348 |
| Total Questioned Costs | \$1,253,376 | \$1,239,028 | \$14,348 |

Table 3: Subcontract Costs Questioned in FY 2015 Through 2017

| Costs Incurred In FY | Questioned Costs | Resolved | Unresolved |
|-------------------------------|-------------------------|--------------------|-------------------|
| Fiscal Year 2016 | \$57,390 | \$57,390 | \$- |
| Fiscal Year 2015 | \$152,496 | \$145,848 | \$6,648 |
| Fiscal Year 2014 | \$73,502 | \$73,502 | \$- |
| Fiscal Year 2013 | \$126,131 | \$126,131 | \$- |
| Fiscal Year 2012 | \$239,394 | \$239,394 | \$- |
| Fiscal Year 2011 | \$666,941 | \$666,941 | \$- |
| Fiscal Year 2010 | \$59,909 | \$59,909 | \$- |
| Prior Years | \$82,977 | \$82,977 | \$- |
| Total Questioned Costs | \$1,464,475 | \$1,457,827 | \$6,648 |

Table 4: Prior Period Questioned Costs

| Category | Questioned Costs | Resolved | Unresolved |
|--|-------------------------|--------------------|-------------------|
| Subcontract Costs Questioned in FY 2013 | \$894,721 | \$894,721 | \$- |
| Subcontract Costs Questioned in FY 2011 and 2012 | \$250,133 | \$250,133 | \$- |
| Total Questioned Costs | \$1,144,854 | \$1,144,854 | \$- |

PRIOR REPORTS

- Assessment Report on [*Audit Coverage of Cost Allowability for Los Alamos National Security, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC52-06NA25396*](#) (OAS-V-15-06, September 2015). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Los Alamos National Security, LLC's (LANS) internal audit (Ethics and Audit) for fiscal year 2013 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met International Standards for the Professional Practice of Internal Auditing (although we noted that LANS may not have been able to accurately determine insurance amounts paid, we do not consider this to be a material control weakness). Further, Ethics and Audit had conducted audits of subcontractors when costs incurred were a factor in determining the amount payable to the subcontractor. While we did not identify any material internal control weaknesses with either cost allowability or subcontract audit, we questioned \$526,562 of costs identified and questioned by Ethics and Audit that had not been resolved. In addition, we are reporting \$85,241 in previously reported questioned costs identified by Ethics and Audit in subcontract audits that were unresolved.
- Assessment Report on *Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Years 2011 and 2012 under Department of Energy Contract No. DE-AC52-06NA25936* (OAS-V-14-11, May 2014). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by LANS' Ethics and Audit for fiscal years (FYs) 2011 and 2012 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met International Standards for the Professional Practice of Internal Auditing. Further, Ethics and Audit had conducted audits of subcontractors when costs incurred were a factor in determining the amount payable to the subcontractor. While we did not identify any material internal control weaknesses with either cost allowability or subcontract audit, we are questioning \$601,927 of costs identified and questioned by Ethics and Audit, which consisted of \$351,794 identified in costs questioned in audits of cost allowability, and \$250,133 identified in audits of subcontracts.

In addition, we are reporting:

- \$10,699,001 in questioned costs from non-compliance with the Department Accounting Handbook associated with Los Alamos National Laboratory's (Los Alamos) Waste Management Risk Mitigation;
- \$50,317 in previously reported questioned costs identified by Ethics and Audit in the audit of Acquisition Services Management reviewed subcontracts; and
- \$35,487 in FY 2007 previously reported questioned costs that were unresolved.

- Assessment Report on *Assessment of Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Year 2010 under Department of Energy Contract No. DE-AC52-06NA25396* (OAS-V-13-01, November 2012). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by LANS' Ethics and Audit for fiscal year (FY) 2010 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met International Standards for the Professional Practice of Internal Auditing. During FY 2010, Los Alamos' Acquisition Services Management was responsible for the subcontract audit function until August 2010, when the responsibility was transferred to Ethics and Audit. While we did not identify any material internal control weaknesses with either cost allowability or subcontract audit performed by Ethics and Audit, we are questioning \$50,317 of costs identified and questioned by Ethics and Audit that have not been resolved.

In addition, we are reporting:

- \$6,256,593 in subcontract costs reviewed by Acquisition Services Management during FY 2010 as unresolved pending audit based upon previously identified material weaknesses in Los Alamos' subcontract audit function and strategy;
 - \$17,491,046 in subcontract costs incurred during FY 2010 subject to audit by Ethics and Audit and remain unresolved pending completion of those audits;
 - \$1,397,871 in unresolved questioned costs identified by Ethics and Audit during its recent audits of subcontract costs incurred between FY 2003 and FY 2010;
 - \$10,699,001 in questioned costs from a potential Anti-Deficiency Act violation associated with Los Alamos' Waste Management Risk Mitigation;
 - \$432,194,109 in FY 2007 to FY 2009 previously reported costs unresolved subcontract costs pending audit by Ethics and Audit; and
 - \$1,953,020 in FY 2007 to FY 2009 previously reported questioned costs that were unresolved.
- Assessment Report on *Assessment of Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Years 2008 and 2009 under Department of Energy Contract No. DE-AC52-06NA25396* (OAS-V-12-05, April 2012). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by LANS' Ethics and Audit for fiscal years (FYs) 2008 and 2009 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met International Standards for the Professional Practice of Internal Auditing. However, we are questioning \$1,954,308 of costs identified by Ethics and Audit that had not been resolved. Additionally, we found material weaknesses in the FYs 2008 and 2009 subcontract audit work performed by Acquisition Services Management, which did not meet the relevant auditing standards as

required by Department regulations and the LANS contract. Therefore, we consider \$165,092,842 in subcontract costs incurred in FYs 2008 and 2009 that Acquisition Services Management reviewed to be unresolved pending Ethics and Audit's review. In addition, we consider \$271,982,318 in previously reported subcontract costs as unresolved pending audit. We also identified concerns with the coverage required by the subcontract audit strategy, mischarging of costs and control issues identified by the National Nuclear Security Administration's Chief Financial Officer, and resolution of previously reported unaudited subcontract costs which need to be addressed to ensure that only allowable costs are claimed by and reimbursed to the contractor. Finally, we are reporting \$55,487 in prior period unresolved costs identified and questioned by Ethics and Audit that have not been resolved.

MANAGEMENT COMMENTS



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



September 18, 2019

MEMORANDUM FOR TERI L. DONALDSON
INSPECTOR GENERAL

FROM: LISA E. GORDON-HAGERTY

SUBJECT: Response to the Office of Inspector General Draft Report
*Audit Coverage of Cost Allowability for Los Alamos National
Laboratory from October 1, 2013, to September 30, 2016,
Under Department of Energy Contract No. DE-AC52-
06NA25396 (A18LA012)*

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the auditors' validation of Los Alamos National Laboratory's internal audit work. The Department of Energy's National Nuclear Security Administration (NNSA) concurs with the Office of Inspector General's recommendation to make final determinations regarding the allowability of unresolved questioned costs and the recommendations to improve internal audit documentation.

The attachment to this memorandum details the actions planned and taken by NNSA. NNSA subject matter experts have also provided technical comments to your audit team under separate cover to enhance the accuracy of the report. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audits and Internal Affairs, at (301) 903-1341.

Attachment



NATIONAL NUCLEAR SECURITY ADMINISTRATION
Management Decision

Audit Coverage of Cost Allowability for Los Alamos National Laboratory from October 1, 2013, to September 30, 2016, Under Department of Energy Contract No. DE-AC52-06NA25396 (A18LA012)

The Office of Inspector General (OIG) recommended that the Manager, Los Alamos Field Office, direct the Contracting Officer to:

Recommendation 1: Make a determination regarding the allowability of \$8,458,966 in questioned costs identified in this report and recover those costs determined to be unallowable;

Management Response: Concur. The Contracting Officer will make a determination regarding the allowability of \$8,458,966 in questioned costs identified in this report and recover those costs determined to be unallowable. The Field Office Manager will direct the Contracting Officer to review the questioned costs, and if appropriate, use 48 CFR 52.242-1 Notice of Intent to Disallow process to recover any unallowable costs. Estimated Completion Date: September 30, 2020

Recommendation 2: Ensure that the contractor's internal audit function ensures completed workpapers meet minimum standards and maintains adequate documentation of supervisory review in the audit file;

Management Response: Concur. LANL internal audit management agrees that the workpapers should meet minimum standards that include adequate documentation of supervisory review. According to the implementation guidance for the referenced standard, evidence of conformance with Standard 2340 may include workpapers electronically approved by the engagement supervisor within a workpaper software system. The current process meets these standards as there is evidence of supervisory approval on every electronic workpaper and procedure performed in our electronic workpaper system (Teammate). To ensure consistency, LANL internal audit management will update the internal audit manual to more clearly define responsibilities for electronically approving a workpaper within Teammate. The updates will be discussed with all engagement supervisors to ensure quality is maintained in all audit files. Estimated Completion Date: September 30, 2020

Recommendation 3: Ensure that the contractor's internal audit function either evaluates the allowability of costs identified in the audits of internal controls over cost allowability or documents the justification for not conducting this evaluation.

Management Response: Concur. LANL internal audit management agrees with this recommendation. LANL has already implemented a change in practice to document in Teammate the reasoning behind either performing or not performing additional testing to determine questioned costs when an issue is identified. This new practice will be formalized in the Internal Audit Manual during its next update. Estimated Completion Date: September 30, 2020

FEEDBACK

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