



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

ASSESSMENT REPORT

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



Department of Energy
Washington, DC 20585

September 30, 2015

MEMORANDUM FOR THE MANAGER, LOS ALAMOS FIELD OFFICE

A handwritten signature in black ink, appearing to read "David Sedillo".

FROM: David Sedillo, Director
Western Audits Division
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report: "Audit Coverage of Cost Allowability for Los Alamos National Security, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC52-06NA25396"

BACKGROUND

Since June 2006, Los Alamos National Security, LLC, (LANS) has operated the National Nuclear Security Administration's (NNSA's) Los Alamos National Laboratory (LANL) for the Department of Energy (Department). LANL is a multiprogram 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. LANL is managed under a \$17.3 billion cost-plus contract, including both award and incentive fees, which runs from June 1, 2006, through September 30, 2017. During fiscal year (FY) 2013, LANS incurred and claimed costs totaling \$2.06 billion.

Because LANS is an integrated management and operating contractor, its financial accounts are integrated with those of the Department, and the results of financial transactions are reported monthly according to a uniform set of accounts. LANS is required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed (SCIC), 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 are claimed by the Department's integrated contractors and make efficient use of available audit resources, the Office of Inspector General (OIG), the Department's Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy (Strategy). The Strategy places reliance on the contractors' internal audit function (Internal Audit) to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the Strategy and as required by its contract, LANS maintains an Internal Audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. The Strategy also requires that audits performed internally must,

at a minimum, meet the standards prescribed by the Institute of Internal Auditors. In addition, LANS is required to conduct or arrange for audits of its subcontractors when costs incurred are a factor in determining the amount payable to a subcontractor.

To help ensure that audit coverage of cost allowability was adequate during FY 2013, the objectives of our assessment were to determine whether:

- Internal Audit conducted cost allowability audits that complied with professional standards and could be relied upon;
- LANS 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 affecting allowable costs that were identified in audits and reviews had been adequately resolved.

RESULTS OF ASSESSMENT

Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by LANS Internal Audit for FY 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 prescribed by the Institute of Internal Auditors. As part of its allowable cost audits, Internal Audit identified \$205,894 in questioned costs, which have since been resolved. In addition, we found LANS conducted reviews of subcontractors when costs incurred were a factor in determining the amount payable to the subcontractor. However, we are questioning \$526,562 of questioned costs identified by Internal Audit during audits of subcontracts (Table 1¹) that had not been resolved. In addition, we are reporting \$85,241 in previously reported questioned costs identified by Internal Audit in subcontract audits (Table 2) that were unresolved.

Subcontract Audits Performed by Internal Audit

We are reporting \$526,562 in subcontract costs as questioned and unresolved. During FY 2014, Internal Audit performed audits of 78 subcontracts for 30 different subcontractors and identified \$894,721 in questioned costs that were incurred between FY 2009 and FY 2013 (Table 1). For example, Internal Audit identified \$423,826 in questioned costs incurred over multiple years in which the subcontractor did not submit supporting documentation for all costs incurred.² According to LANS officials, they received a closure package that appeared to close most of the findings, but LANS has not yet finished the review of the documentation. As of February 2015, the entire amount was still unresolved.

¹ See Attachment 1 for all tables.

² The \$423,826 is included in the \$526,562 of unresolved questioned costs shown in Table 1. The \$423,826 in questioned costs were incurred over multiple years and consist of \$258,661 (FY 2009), \$61,005 (FY 2010), and \$104,160 (FY 2012).

Prior Period Questioned and Unresolved Costs

In our May 2014 report *Assessment of Audit Coverage of Cost Allowability for Los Alamos National Laboratory During Fiscal Years 2011 and 2012 Under Department of Energy Contract No. DE-AC52-06NA25396* (OAS-V-14-11, May 2014), we identified a total of \$11,386,732 in questioned and unresolved costs. These costs included \$11,136,599 of questioned costs identified during Internal Audit allowable costs audits and the Department's review of the Waste Management Risk Mitigation costs; all costs that have been resolved (Table 3). We also reported a total of \$250,133 in questioned subcontract costs incurred between FY 2006 and FY 2012. As of March 2015, \$164,892 of the total subcontract costs have been resolved and the remaining \$85,241 costs are unresolved (Table 2). LANS is negotiating with the subcontractor to resolve the questioned costs.

Insurance Costs

As part of our assessment, we reviewed LANL insurance cost data for FY 2013 to determine whether LANS claimed insurance costs that were not permissible under the contract. For example, we tested whether LANS incurred costs on fiduciary liability insurance, a nonreimbursable cost by the Department, and found that these costs were not claimed by and reimbursed to LANS.

While our review did not disclose any unallowable costs related to insurance purchases, we noted that LANS may not be able to accurately determine insurance expense amounts paid. LANS explained that it does not have an expense type for insurance payments. To extract insurance payments from its accounts payable records, LANS used a query (i.e., a keyword search) but could not provide assurance that all insurance costs were captured. In fact, LANS explained that the query would most likely miss some insurance payments. For example, with the OIG's assistance, LANS determined that the query did not identify some insurance payments because vendor names or descriptions were not associated with an insurance provider. In a subsequent query, LANS added a vendor that was previously missed but still could not provide assurance that all insurance costs were captured. We are concerned with LANS' inability to determine the accurate or complete universe of insurance expenses and that LANS had not reviewed insurance costs for allowability. LANS told us that the Ethics and Audits Division plans to audit insurance costs as part of its FY 2014 allowable cost audit or as its own separate audit. We intend to review their audit work on insurance costs in a future SCIC review.

RECOMMENDATIONS

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

1. Make a determination regarding the allowability of questioned costs identified in this report and recover those costs determined to be unallowable; and
2. Ensure that LANS can determine the accurate and complete universe of insurance expenses.

MANAGEMENT AND AUDITOR COMMENTS

NNSA management concurred with the OIG's recommendations and is taking action to resolve the questioned costs noted in the report.

Management's proposed actions are responsive to our recommendations. Management comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from September 2014 to September 2015 at LANL, located in Los Alamos, New Mexico. The assessment was limited to Internal Audit's activities, subcontract audits, resolution of questioned costs, and internal control weaknesses that affect costs claimed by LANS on its SCIC for FY 2013, and insurance costs for FY 2013. The assessment was conducted under OIG project number A14LA063. To accomplish our objectives, we:

- Judgmentally selected and reviewed three internal audits with costs incurred in FYs 2012 and 2013. Two cost incurred audits were issued during FY 2013, and the FY 2013 Allowable Cost Audit was issued in FY 2014. We assessed allowable cost audit work conducted by Internal 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 three subcontract audits with costs incurred in FYs 2009–2013. We reviewed audits of subcontracts conducted by Internal 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. The subcontract audits covering FY 2013 were issued during FY 2014.
- Interviewed LANS and NNSA officials.
- Evaluated the resolution of questioned costs and internal control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the OIG, LANS Internal Audit, and other organizations.
- Evaluated insurance costs for FY 2013 to determine whether LANS purchased insurance in compliance with applicable Department requirements and contract provisions.

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 did not rely on computer-processed data to accomplish our objectives. An exit conference was waived August 21, 2015.

This report is intended for the use of the Department and NNSA 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: Subcontract Costs Questioned in FY 2013

Cost Incurred in Fiscal Year	Questioned Costs	Resolved	Unresolved
Fiscal Year 2013	\$96,433	\$53,992	\$42,441
Fiscal Year 2012	\$184,654	\$80,494	\$104,160
Fiscal Year 2011	\$133,926	\$129,214	\$4,712
Fiscal Year 2010	\$152,034	\$61,694	\$90,340
Fiscal Year 2009	\$327,674	\$42,765	\$284,909
Total Questioned Costs	\$894,721	\$368,159	\$526,562

Table 2: Subcontract Costs Questioned in FY 2011 and FY 2012

Cost Incurred in Fiscal Year	Questioned Costs	Resolved	Unresolved
Fiscal Year 2012	\$721	\$721	\$0
Fiscal Year 2011	\$175,707	\$144,679	\$31,028
Fiscal Year 2010	\$46,662	\$4,574	\$42,088
Fiscal Year 2009	\$21,643	\$9,518	\$12,125
Fiscal Year 2008	\$2,839	\$2,839	\$0
Fiscal Year 2007	\$1,580	\$1,580	\$0
Fiscal Year 2006	\$981	\$981	\$0
Total Questioned Costs	\$250,133	\$164,892	\$85,241

Table 3: Prior Period Questioned Costs

Category	Questioned Cost	Resolved	Unresolved
Waste Management Risk Mitigation Accounting Handbook	\$10,699,001	\$10,699,001	\$0
Acquisition Services Management's Subcontract Reviews	\$50,317	\$50,317	\$0
FY 2007 Questioned Costs	\$35,487	\$35,487	\$0
FY 2012 ROS	\$347,000	\$347,000	\$0
FY 2012 Inadequate Support for Other Costs	\$4,794	\$4,794	\$0
Total Questioned Costs	\$11,136,599	\$11,136,599	\$0

MANAGEMENT COMMENTS



Department of Energy
Under Secretary for Nuclear Security
Administrator, National Nuclear Security Administration
Washington, DC 20585
September 25, 2015



MEMORANDUM FOR GREGORY H. FRIEDMAN
INSPECTOR GENERAL

FROM: FRANK G. KLOTZ *FK 9/25/15*

SUBJECT: Comments on the Office of Inspector General Draft Report Titled "Assessment of Audit Coverage of Cost Allowability for Los Alamos National Security, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC52-06NA25396" (A14LA063)

Thank you for the opportunity to review and comment on the subject draft report. The National Nuclear Security Administration concurs with the Office of Inspector General's recommendations to make final determinations regarding the allowability of unresolved questioned costs. Actions are also planned to improve the accuracy and completeness of insurance expense reporting.

The attachment to this memorandum details the specific actions planned to address the recommendations, as well as timelines for completion. If you have any questions regarding this response, please contact Dean Childs, Director, Audit Coordination and Internal Affairs, at (301) 903-1341.

Attachment



Attachment

Response to Report Recommendations

Assessment of Audit Coverage of Cost Allowability for
Los Alamos National Security, LLC, (LANS) During Fiscal Year 2013
under Department of Energy Contract No. DE-AC52-06NA25396

The Office of Inspector General recommended the responsible contracting officer:

Recommendation 1: Make a determination regarding the allowability of questioned costs identified in this report and recover those costs determined to be unallowable.

Management Response: *Concur*

The contracting officer will review the unresolved questioned costs from Fiscal Years (FY) 2011 to 2013, make allowability determinations, and take action to recover any costs deemed unallowable as appropriate. The initial estimated completion date for resolving all questioned costs is July 30, 2016, based on the current schedule of the LANS Ethics and Audits Group to complete the supporting reviews.

Recommendation 2: Ensure that LANS can determine the accurate and complete universe of insurance expenses.

Management Response: *Concur*

The Los Alamos National Laboratory (LANL) internal audit department is in the process of conducting an audit of insurance costs. The contracting officer will obtain monthly updates on the status of the audit and take appropriate action to recover any costs deemed unallowable as appropriate. In addition, the Contracting Officer will direct Los Alamos National Security (LANS) to develop and execute an action plan to provide complete and accurate insurance cost data on an on-going basis. The initial estimated completion date for resolving any questioned costs found by LANL internal audit and implementing reliable data reporting is July 2016.