



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

# Special Report

Questioned, Unresolved and Potentially  
Unallowable Costs Incurred by Los  
Alamos National Laboratory during  
Fiscal Years 2008 and 2009



**Department of Energy**  
Washington, DC 20585

April 19, 2012

**MEMORANDUM FOR THE ADMINISTRATOR, NATIONAL NUCLEAR SECURITY  
ADMINISTRATION**

A handwritten signature in cursive script that reads "George W. Collard".

**FROM:** George W. Collard  
Assistant Inspector General  
for Audits  
Office of Inspector General

**SUBJECT:** INFORMATION: Special Report on "Questioned, Unresolved and Potentially Unallowable Costs Incurred by Los Alamos National Laboratory during Fiscal Years 2008 and 2009"

**BACKGROUND**

Since June 2006, Los Alamos National Security, LLC, has 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 help to ensure the safety, security and reliability of the Nation's nuclear weapons stockpile. Los Alamos incurred and claimed costs of \$1.8 billion in Fiscal Year (FY) 2008 and \$1.9 billion in FY 2009.

As an integrated management and operating contractor, Los Alamos' 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. Los Alamos is required by its contract to account for all funds advanced by the Department, safeguard assets in its care, and to claim only allowable costs. Further, Los Alamos is required to account for costs incurred annually on its Statement of Costs Incurred and Claimed (SCIC).

On April 3, 2012, we issued a separate contract audit report on *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). The objectives of the audit were to determine whether questioned costs and internal control weaknesses impacting allowable costs identified in prior audits and reviews had been adequately resolved, and whether Los Alamos conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. Among other observations, the audit report identified specific costs and internal control issues that had yet to be resolved under the contract.

**CONCLUSIONS AND OBSERVATIONS**

We identified approximately \$2 million in questioned and unresolved costs claimed by Los Alamos during FYs 2008 and 2009. We also identified more than \$437 million in FYs 2008 and

2009 and prior year subcontract costs that were unresolved pending audit or review by Los Alamos' Internal Audit. Finally, we noted other concerns that need to be addressed to ensure that only allowable costs are claimed by and reimbursed to Los Alamos.

#### Unresolved Questioned Costs

NNSA had not resolved about \$2 million in costs questioned by Los Alamos' internal audit function during FYs 2008 and 2009 (See Attachment 1). The majority of these costs concerned labor charges of \$1.9 million that Internal Audit found either did not benefit NNSA or did not comply with the contract's allowable cost provisions. For example, the audit identified two employees who charged a combined total of 1,656 hours to the contract between November 2007 and June 2008 while conducting job searches. Internal Audit recommended that Los Alamos senior management determine if the costs should be refunded to NNSA as unreasonable costs. According to a September 2010 Los Alamos memo on actions in response to the report, Los Alamos management determined that the \$1.9 million was not significant or unreasonable. The NNSA Office of Field Financial Management (OFFM) did not concur and referred the matter to the Contracting Officer for resolution. As of January 2012, the Contracting Officer was working with Los Alamos to resolve the questioned costs.

#### Unresolved FY 2008 and FY 2009 Subcontract Costs

We identified \$165,092,842 in subcontract costs incurred during FYs 2008 and 2009 that we consider unresolved because the subcontract audit function, performed by Los Alamos' Acquisition Services Management (ASM) during this period, conducted reviews that did not meet generally accepted Government auditing standards (See Attachment 1). Therefore, the reviews did not comply with the terms of the prime contract, which requires periodic audits of subcontracts where costs incurred are a factor in determining the amount payable. We reviewed the workpapers used to support two of ASM's reports and concluded the workpapers did not provide sufficient evidence to determine what work was done or to support the conclusions reported by ASM. Finally, we noted that Internal Audit found that ASM's audit function was inadequately staffed, there were no FY 2008-2009 risk assessments of subcontracts requiring audits, and no audit work plan had been prepared for either FY 2008 or FY 2009, as required by the contract. After Internal Audit's assessment of ASM's subcontract audit function, Los Alamos management returned responsibility for the subcontract function to Internal Audit effective August 2010.

#### Unresolved Costs from Prior Years

In our contract audit *Report on the Assessment of Changes to the Internal Control Structure and Their Impact on the Allowability of Costs Claimed by and Reimbursed to Los Alamos National Laboratory under Department of Energy Contract No. DE-AC52-06NA25396 from June 1, 2006 to September 30, 2007* (OAS-V-09-10, August, 2009), we identified 28 subcontracts with \$285,177,886 in FY 2007 incurred costs that required audit (See Attachment 2). NNSA's response to our prior report committed to having these costs audited. However, the contractor believed most of the 28 subcontracts did not require audit under thresholds approved in May 2009, which were made retroactive to the beginning of the contract. Recently, Internal Audit

audited \$13,195,568 in FY 2007 subcontract incurred costs. Based on our review of ASM's subcontract audit function and Internal Audit's determination that the function was ineffective, we concluded that ASM reviews did not meet generally accepted Government auditing standards. Therefore, we considered the remaining \$271,982,318 in FY 2007 subcontract costs unresolved pending audit. A Los Alamos Site Office official indicated that the Site Office will work with Internal Audit to address the unaudited subcontracts previously reported by the Office of Inspector General.

In addition, we previously reported a total of \$2,193,910 of questioned costs for the period June 2006 through September 2007. As of January 2012, Los Alamos had resolved all questioned costs except \$55,487. The Contracting Officer and OFFM continue to work with the contractor to resolve these costs. Finally, our previous report identified costs of \$7,592,056 incurred on 49 subcontracts requiring closeout. The subcontracts have either been closed or extended beyond FY 2009. Therefore, none of these subcontracts required further action as of the end of FY 2009.

### Subcontract Audit Strategy

We also questioned whether Los Alamos' subcontract audit strategy, which was based on a subset of the Defense Contract Audit Agency's (DCAA) requirements, provided sufficient coverage to ensure that only allowable costs were paid with NNSA funds. Specifically, in addition to not auditing most subcontracts, we noted that ASM's invoice review was not effective in ensuring that unallowable costs were not paid. Further, Internal Audit reported in September 2011 that ASM's validation of subcontract invoices during FY 2010 was not adequate to ensure that billed costs were accurately compiled, properly supported, and allowable. Under the approved subcontract audit strategy, only two of the 975 cost-type subcontracts and none of the 429 time and materials/labor hour subcontracts active during the period required an audit. We benchmarked Los Alamos' subcontract audit strategy against the DCAA Audit Manual and found that Los Alamos' strategy did not meet key DCAA requirements. For example, unlike DCAA Audit Manual requirements, Los Alamos' strategy had no procedures for: (a) independently determining or reviewing risk, leaving risk determination solely to ASM management's judgment; (b) selecting or auditing a random sample of low-risk subcontracts; and, (c) triggering referral of contracts below \$15 million annual incurred costs for audit.

Subsequent to our raising concerns to the Los Alamos Site Office, the Site Office issued direction in November 2011 to the contractor stating that heightened attention to verification and validation of subcontractor costs invoiced and paid was warranted, and that it expected a more exhaustive subcontract audit program to remediate identified weaknesses. Site Office officials told us that they were concerned about the gaps we identified between DCAA requirements and the Los Alamos' subcontract audit strategy. They stated that Los Alamos had not provided sufficient resources for subcontract oversight, including audit resources; and this had been a problem for several years, which was consistent with our analysis of activities in FYs 2008 and 2009 and Internal Audit's recent audit findings. In response to our concerns, Internal Audit told us that it plans to select a number of lower-risk subcontracts for audit with resources that remain after it performs the subcontract audits required under the current thresholds and any audits

requested by ASM. In November 2011, Internal Audit also proposed performing closeout audits on subcontracts with total costs over the life of the contract exceeding \$15 million, which were previously not subject to audit.

#### NNSA Field Chief Financial Officer Signature on FY 2008 and 2009 SCICs

The NNSA Field Chief Financial Officer (CFO) signed the FY 2008 and 2009 SCICs in December 2011. However, the CFO's approval was qualified because of concerns that mischarging may result in unallowable costs being charged to the Government. The CFO also noted that control environment issues at Los Alamos may impede the identification of unallowable costs. Internal Audit re-opened some corrective actions in the employee relocation costs and labor charging areas during the course of our audit that will require Los Alamos management to take additional steps to address these issues. As of January 2012, OFFM continued to work with the Contracting Officer and the Department to resolve these issues. Although the SCICs were signed by the NNSA Field CFO, the OIG will not sign the SCICs for FYs 2008 and 2009 until corrective actions are completed to address both the CFO's concerns and the issues raised in this report.

In our contract audit report on costs incurred by Los Alamos during FYs 2008 and 2009, we recommended that the Administrator, National Nuclear Security Administration, require the Manager, Los Alamos Site Office, to direct the Contracting Officer to:

1. Make a determination regarding the allowability of questioned and unresolved costs identified in this report and recover those costs determined to be unallowable;
2. Ensure that the contractor provides assurance that the reviews performed by ASM were sufficient to ensure that all unallowable costs were identified and, where possible, recovered;
3. Re-evaluate Los Alamos' subcontract audit strategy and the resources allocated to the audit function to ensure adequate audit coverage of subcontracts; and,
4. Ensure that Los Alamos completes audits on the FY 2007 subcontract costs previously reported as requiring audit.

#### MANAGEMENT AND AUDITOR COMMENTS

NNSA concurred with the findings and recommendations, and identified corrective actions. Management noted that NNSA has taken significant actions to enhance Los Alamos' audit program, including documenting shortcomings and withholding substantial incentive fees when appropriate. Since the audit, Los Alamos has submitted a revised audit strategy proposal that includes positive steps toward resolving the issues noted in the report. Management stated that the Contracting Officer will make a final determination on the allowability and recovery of the questioned and unresolved costs identified in the report. In addition, the Contracting Officer will direct the contractor to perform supplemental audit procedures on the amounts reviewed by ASM in 2008 and 2009 to help ensure no significant unallowable costs were missed and to support

resolution of those costs. As noted, Los Alamos has proposed a new subcontract audit strategy. It will only be approved by the Contracting Officer if it improves audit coverage and meets generally accepted Government auditing standards and the Department of Energy Acquisition Regulations. Finally, management stated that the Contracting Officer will direct Los Alamos to complete audits on the FY 2007 subcontract costs previously identified as requiring audit.

Management comments and proposed actions were responsive to our recommendations. Management's verbatim comments are in Attachment 3.

#### Attachments

cc: Deputy Secretary  
Associate Deputy Secretary  
Principal Deputy Administrator, National Nuclear Security Administration  
Chief of Staff

Summary of Questioned Costs, Unresolved Costs and Unresolved  
Costs Pending Internal Audit Review  
Fiscal Years 2008 and 2009  
Los Alamos National Security, LLC  
Contract No. DE-AC52-06NA25396

Questioned Cost Category	Questioned Costs		Total	
	FY 2008	FY 2009	Questioned	Unresolved
Conference Travel	\$27,332		\$27,332	\$0
Employee Relocation Costs <sup>1</sup>	\$17,875		\$17,875	\$0
Employee Relocation Costs <sup>2</sup>		\$24,458	\$24,458	\$11,211
Accounts Payable		\$40,564	\$40,564	\$40,564
Special Payroll Disbursements		\$4,000	\$4,000	\$0
Employee Relocation Costs <sup>3</sup>		\$155,027	\$155,027	\$0
Laboratory Sponsored Conferences		\$29,532	\$29,532	\$5,000
Displaced Personnel and Transition Labor		\$1,897,533	\$1,897,533	\$1,897,533
Travel to Parent Organization Events		\$95,034	\$95,034	\$0
Subsistence Costs and Change of Station		\$149,305	\$149,305	\$0
<b>Total Questioned Costs<sup>4</sup></b>	<b>\$45,207</b>	<b>\$2,395,453</b>	<b>\$2,440,660</b>	<b>\$1,954,308</b>

Unresolved Subcontract Costs Pending Review by Internal Audit			
	FY 2008	FY 2009	Unresolved
ASM's Subcontract Reviews <sup>5</sup>	\$141,399,488	\$23,693,354	\$165,092,842

<sup>1</sup> Questioned Employee Relocation Costs (ERC) from the Fiscal Year (FY) 2008 Allowable Cost Audit (IA-09-01).

<sup>2</sup> Questioned ERC from the FY 2009 Allowable Cost Audit (IA-10-04).

<sup>3</sup> Questioned ERC from the FY 2009 ERC Audit (IA-08-08).

<sup>4</sup> Total Questioned Costs figures may not add due to rounding.

<sup>5</sup> In addition, Los Alamos National Laboratory Acquisition Services Management (ASM) also reviewed several University of California subcontracts, which are outside the scope of this audit. These reviews questioned \$64,555 in costs, all of which have been resolved.

Current Status of Previously Reported Questioned and Unresolved Costs  
 Los Alamos National Security, LLC  
 Contract No. DE-AC52-06NA25396

<b>Prior Year Questioned Costs</b>			
	<b>Questioned</b>	<b>Unresolved</b>	
Delinquent Accounts Receivable	\$28,590	\$0	
Previously Questioned Subcontract Costs	\$2,165,320	\$55,487	
<b>Total Prior Year Questioned Costs</b>	<b>\$2,193,910</b>	<b>\$55,487</b>	
<b>Prior Year Unresolved Subcontract Costs</b>			
	<b>Pending Audit</b>	<b>Audited</b>	<b>Pending Audit</b>
Subcontracts Requiring Audit <sup>1</sup>	\$285,177,886	\$13,195,568	\$271,982,318
	<b>Pending Closeout</b>	<b>Closed or Extended</b>	<b>Unresolved</b>
Subcontracts Requiring Closeout <sup>2</sup>	\$7,592,056	\$7,592,056	\$0
<b>Total Prior Year Subcontract Costs</b>	<b>\$292,769,942</b>	<b>\$20,787,624</b>	<b>\$271,982,318</b>

<sup>1</sup> As of May 2011, the final subcontract was being audited by Los Alamos National Laboratory Internal Audit.

<sup>2</sup> The period of performance was extended on six subcontracts totaling \$798,246, which did not require action during Fiscal Years 2008 or 2009.

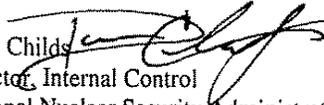
MANAGEMENT COMMENTS

Department of Energy  
National Nuclear Security Administration  
Washington, DC 20585



March 20, 2012

MEMORANDUM FOR George W. Collard  
Assistant Inspector General  
for Performance Audits

FROM: Dean Childs   
Director, Internal Control  
National Nuclear Security Administration

SUBJECT: Comments to IG Draft Report on "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" ( A10AL013/2010-01978)

The National Nuclear Security Administration (NNSA) appreciates the opportunity to review the Inspector General's (IG) draft report *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*. The report identified four recommendations for management action to help improve internal and sub-contract audit processes and provide reliable support for the allowability of the costs charged to the Federal Government.

NNSA generally agrees with the recommendations in the report and has identified corrective actions to address the IG's concerns. In addition, it should be noted that NNSA has taken significant actions to enhance the LANL audit program, including documenting shortcomings in monthly performance system feedback and withholding substantial incentive fees when appropriate. Since the audit, LANL has submitted a revised audit strategy proposal which, as noted in the attachment to this memorandum, includes positive steps toward resolving the issues noted in the report. NNSA remains committed to ensuring our contractors execute effective internal and sub-contract audit processes to meet the objectives of the cooperative audit strategy, while appropriately balancing risk and resources.

The attachment to this memorandum summarizes our initial response to the report recommendations and provides additional general and technical comments to enhance the factual accuracy and context of the report. Should you have any questions about this response, please feel free to contact me at 301-903-1341.

Attachment

cc: Kevin Smith, Manager, Los Alamos Site Office  
Philippa Griego, Los Alamos Liaison  
Joseph Waddell, Senior Procurement Executive  
Chad Glines, Manager Financial Review & Performance Assessment  
Richard Kovash, Manager, Operations Division

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