



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 Year
2010



Department of Energy
Washington, DC 20585

November 20, 2012

MEMORANDUM FOR THE ADMINISTRATOR, NATIONAL NUCLEAR SECURITY
ADMINISTRATION

A handwritten signature in blue ink, appearing to read "Rickey R. Hass".

FROM: Rickey R. Hass
Deputy Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Special Report on "Questioned, Unresolved and
Potentially Unallowable Costs Incurred by Los Alamos National
Laboratory During Fiscal Year 2010"

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. During Fiscal Year (FY) 2010, Los Alamos incurred and claimed costs of \$2.2 billion.

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 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 November 19, 2012, we issued a separate contract report on the *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). The objectives of the assessment 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 assessment identified specific costs and internal control issues that had yet to be resolved under the contract.

CONCLUSIONS AND OBSERVATIONS

We identified approximately \$50,000 in questioned and unresolved costs claimed by Los Alamos during FY 2010. We also identified nearly \$24 million in subcontract costs requiring audit; nearly \$1.4 million in unresolved questioned subcontract costs; and, approximately \$10.7 million in unresolved costs pertaining to a potential Anti-Deficiency Act violation. Finally, we identified more than \$434 million in previously reported unresolved costs from prior years.

The resolution of questioned and unallowable costs ensures that costs charged to the Government are allowable, makes certain that taxpayer's money is spent wisely, and has the potential to free significant funds that would be better spent on Los Alamos' mission critical program activities.

Unresolved Questioned Costs

NNSA had not resolved approximately \$50,000 in costs questioned by Los Alamos' internal audit function during FY 2010 (see Attachment 1). The unresolved questioned costs were identified during the audit of Los Alamos' Acquisition Services Management (ASM) reviewed subcontracts. As of July 2012, the contracting officer and NNSA's Office of Field Financial Management (OFFM) were working with Los Alamos to resolve the questioned costs.

Unresolved Subcontract Costs Pending Review by Internal Audit

We identified more than \$6 million in subcontract costs incurred during FY 2010 that we considered unresolved pending review by Internal Audit based upon weaknesses noted in the ASM subcontract audit function and strategy. Los Alamos management reassigned the responsibility for the subcontract audit function from ASM to Internal Audit as of August 2010 following an assessment of ASM's subcontract audit function in which Internal Audit concluded that ASM's subcontract audit function was ineffective. The Office of Inspector General also identified material weaknesses in ASM's subcontract audit strategy during its review of FY 2008 and FY 2009 costs incurred and claimed in *Report on Audit Coverage of Cost Allowability for Los Alamos National Laboratory during FYs 2008 and 2009 under Department of Energy Contract No. DE-AC52-06NA25396* (OAS-V-12-05, April 2012). In our April 2012 report, we recommended that NNSA reevaluate Los Alamos' audit strategy. Management concurred with our recommendation and is reviewing a revised subcontract audit strategy recently proposed by Los Alamos.

In addition, we found over \$17 million in subcontract costs incurred during FY 2010 requiring audit that had not been audited. Los Alamos deferred audit of these costs until after the contract under which the costs were incurred closed on December 31, 2010. These costs are currently under audit by Internal Audit, thus, we reported these costs as unresolved pending audit completion (see Attachment 1).

Unresolved Questioned Subcontract Costs from FY 2003 to FY 2010

We reported nearly \$1.4 million in prior years subcontract costs as unresolved questioned costs. During 2011, Internal Audit identified approximately \$1.5 million in additional questioned subcontract costs that were incurred between FY 2003 and FY 2010. For example, based on an

evaluation of actual indirect rates for FYs 2007, 2008 and 2009, Internal Audit questioned more than \$386,000 of indirect costs billed and paid to one subcontractor. As of May 2012, nearly \$1.4 million of the approximate \$1.5 million in subcontract costs remain unresolved (see Attachment 1). About \$80,000 in subcontract costs were resolved primarily through reimbursements to Los Alamos.

Potential Anti-Deficiency Act Violation

During the course of our assessment, we noted that the Department was reviewing a potential Anti-Deficiency Act (ADA) violation of approximately \$10.7 million. The potential violation arose from Los Alamos expending nearly \$10.3 million more than appropriated on the Waste Management Risk Mitigation (WMRM) line item construction project. The total project costs exceeded original estimates due to Los Alamos having to correct defective work performed by the general contractor hired to design and construct the WMRM project. Therefore, Los Alamos filed a claim against the general contractor in court to recoup costs for correcting defective work. Los Alamos continued to incur costs on the WMRM project and legal fees of about \$425,000. The lawsuit filing the claim was unsuccessful and Los Alamos did not receive any funds from the legal proceedings. As of September 2012, these costs were unresolved, and therefore, we reported the nearly \$10.3 million of costs incurred in excess of approved funding and the \$425,000 in legal fees associated with the WMRM project as unresolved costs (see Attachment 2).

Unresolved Costs from Prior Years

In our April 2012 contract report, we identified more than \$439 million in prior year unresolved and questioned costs (see Attachment 2). These costs included approximately \$437 million in FY 2007 to FY 2009 unresolved subcontract costs pending audit or review by Internal Audit, and nearly \$2 million questioned costs.

While some progress had been made, a significant percentage of the costs remained unresolved as of the completion of our review. In February 2012, Internal Audit completed an audit of nearly \$5 million in subcontract costs from FY 2007. During its review, Internal Audit did not identify any questioned costs; therefore, we considered the approximately \$5 million in previously reported subcontract costs requiring audit as resolved. In May 2012, Internal Audit submitted an action plan to the Los Alamos Site Office (Site Office) proposing an audit strategy to address unresolved subcontract costs reviewed by ASM and the subcontracts requiring an audit from FY 2007. As of August 2012, the Site Office had not made a determination on the adequacy of the action plan proposed by Internal Audit. We also noted that approximately \$57,000 in unresolved questioned FY 2008 and 2009 costs identified by Internal Audit had been resolved. The contracting officer and OFFM continue to work with Los Alamos to resolve the remaining costs; therefore, we considered approximately \$434 million remaining costs as unresolved costs.

NNSA Field Chief Financial Officer Signature of Los Alamos SCIC

The NNSA Field Chief Financial Officer (CFO) signed the FY 2010 Los Alamos SCIC in September 2012. The CFO noted that Los Alamos had made significant improvements to its internal controls to address deficiencies cited in his December 2011 memorandum, in which he qualified his approval of the FY 2007 through FY 2009 SCICs. The memo further stated that the

institutional controls were generally adequate to minimize the risk of incurring unallowable or unreasonable costs, and identified corrective actions to address current and previous years' concerns.

In our contract report on costs incurred by Los Alamos during FY 2010, we recommended that the Manager, Los Alamos Site Office, direct the contracting officer to make a determination regarding the allowability of questioned and unresolved costs identified in this report and recover those costs determined to be unallowable. Additionally, we recommended that the NNSA Field CFO ensure that Los Alamos completes corrective actions to address CFO concerns.

These recommendations, if fully implemented, should help NNSA recover funds that would be better spent on program activities and improve institutional controls to eliminate the recurrence of similar questioned and unallowable costs in the future.

MANAGEMENT AND AUDITOR COMMENTS

NNSA management concurred with the findings and recommendations, and identified corrective actions. In addition to making a determination as to the allowability of the questioned subcontract costs, management committed to the contracting officer continuing efforts to review and resolve other previously identified questioned costs. Further, management said the contracting officer will monitor the status of contractor efforts to complete subcontract audits. Management also plans to continue to monitor the contractor's progress in addressing concerns raised by the NNSA Field CFO. Finally, the Director, Office of Financial Risk, Policy, and Controls stated that they continue to work with the General Counsel's office and NNSA in assessing the potential Anti-Deficiency Act violation.

Management's comments and planned actions are responsive to our recommendations. Management's verbatim comments are attached (See Attachments 3 and 4).

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 Audit
Fiscal Year 2010
Los Alamos National Security, LLC
Contract No. DE-AC52-06NA25396

Questioned Costs Identified by Internal Audit			
Questioned Costs Category	Questioned Costs	Resolved	Unresolved
Time and Labor Discrepancies	\$5,189	\$5,189	\$0
Employee Relocation	\$20,683	\$20,683	\$0
Misapplied LDRD Charges	\$822,705	\$822,705	\$0
Employee Travel	\$237	\$237	\$0
Subcontractor Billing Errors ¹	\$311,209	\$311,209	\$0
Subcontractor Invoice ²	\$174,335	\$174,335	\$0
ASM's Subcontract Reviews	\$50,317	\$0	\$50,317
Total Questioned Costs	\$1,384,675	\$1,334,358	\$50,317

Unresolved Subcontract Costs Pending Review by Internal Audit			
Cost Category	Subcontract Reviews by ASM during FY 2010	Subcontracts Reviewed by Internal Audit	Unresolved Pending Review
ASM's Subcontract Reviews	\$10,845,485	\$4,588,892	\$6,256,593
FY 2010 Subcontract Audit In Process			\$17,491,046
Total Costs	\$10,845,485	\$4,588,892	\$23,747,639

Questioned Subcontract Costs Identified by Internal Audit			
Fiscal Year	Questioned Costs	Resolved	Unresolved
Fiscal Year 2010	\$35,322	\$29,614	\$5,708
Fiscal Year 2009	\$84,767	\$6,144	\$78,623
Fiscal Year 2008	\$116,158	\$18,255	\$97,903
Fiscal Year 2007	\$210,287	\$0	\$210,287
Fiscal Year 2006	\$135,345	\$0	\$135,345
Fiscal Year 2005	\$199,911	\$0	\$199,911
Fiscal Year 2004	\$516,494	\$25,025	\$491,469
Fiscal Year 2003	\$178,625	\$0	\$178,625
Total Questioned Costs	\$1,476,909	\$79,038	\$1,397,871

¹ Subcontractor billing errors identified by Internal Audit during its FY 2010 quarterly audits of The American Recovery and Reinvestment Act of 2009 funded activities at Los Alamos.

² Subcontractor billing errors identified by Internal Audit during its audit of Internal Controls Over Subcontractor Payments, issued September 2011.

**Summary of Questioned Costs, Unresolved Costs, and Unresolved Costs Pending Audit
Fiscal Year 2010
Los Alamos National Security, LLC
Contract No. DE-AC52-06NA25396**

WMRM Potential Anti-Deficiency Act Violation Costs			
Fiscal Year	Potential ADA Violation Costs	Resolved	Unresolved
Fiscal Year 2010	\$1,769,138	\$0	\$1,769,138
Fiscal Year 2009	\$6,947,510	\$0	\$6,947,510
Fiscal Year 2008	\$1,982,353	\$0	\$1,982,353
Total ADA Costs	\$10,699,001	\$0	\$10,699,001

Prior Year Questioned and/or Unresolved Costs				
Cost Category	Questioned Costs	Pending Review or Audit	Resolved	Unresolved
ASM's Subcontract Reviews		\$165,092,842	\$0	\$165,092,842
FY 2007 Subcontracts Requiring Audit ³		\$271,982,318	\$4,881,051	\$267,101,267
Subtotal Previously Reported Subcontract Costs		\$437,075,160	\$4,881,051	\$432,194,109
FY 2007 Questioned Subcontract Costs ⁴	\$55,487		\$0	\$55,487
FY 2008 and 2009 Questioned Costs	\$1,954,308		\$56,775	\$1,897,533
Subtotal Previously Reported Questioned Costs	\$2,009,795		\$56,775	\$1,953,020
Total Prior Year Costs	\$2,009,795	\$437,075,160	\$4,937,826	\$434,147,129

³ These costs are unresolved pending review by Internal Audit.

⁴ These costs are unresolved pending audit by Internal Audit.



Department of Energy
National Nuclear Security Administration
Washington, DC 20585



October 23, 2012

MEMORANDUM FOR David Sedillo,
Director, Western Audits Division
Office of Inspector General

FROM: Dean Childs
Director, Internal Control

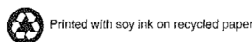
SUBJECT: Comments on the Inspector General Draft Report Regarding
"Audit Coverage of Cost Allowability for Los Alamos National
Laboratory during Fiscal Year 2010 under Department of Energy
Contract No. NA25396" (A11AL015/2011-02194)

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 Year 2010 under Department of Energy Contract No. NA25396*. The report identified two 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 agrees with the recommendations in the report and I have attached our initial response which includes planned corrective actions to resolve the IG's findings. 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



Attachment

Initial Response to Report Recommendations

To address the issues noted in the report, the Inspector General provided the following recommendations for executive action:

Recommendation 1: We recommend that the Manager, Los Alamos Site Office, direct the contracting officer to make a determination regarding the allowability of questioned and unresolved costs identified in this report and recover those costs determined to be unallowable.

Management Response: Agree

Upon receipt of the IG's final report and completion of a formal NNSA legal review, the Contracting Officer (CO) will make a determination as to the allowability of the \$50,317 in questioned subcontract costs. The estimated completion date is September 30, 2013. In addition, the CO will continue efforts to review and resolve other previously identified questioned costs, as well as monitor the status of contractor efforts to complete sub-contract audits and the status of legal reviews of the costs related to the Waste Tank Management Risk Mitigation project.

Recommendation 2: We recommend that the NNSA Field CFO ensure that Los Alamos completes corrective actions to address CFO concerns.

Management Response: Agree

The NNSA Office of Field Financial Management will continue to monitor the contractor's progress in addressing current and previous years' concerns raised by the NNSA Field CFO. The initial estimated completion date is September 30, 2013.



Department of Energy

Washington, DC 20585

October 16, 2012

MEMORANDUM FOR RICKEY R. HASS
DEPUTY INSPECTOR GENERAL FOR AUDIT SERVICE

FROM: APRIL G. STEPHENSON *April Stephenson*
DIRECTOR, OFFICE OF FINANCIAL RISK, POLICY,
AND CONTROLS

SUBJECT: Comments on Draft Report on Audit Coverage of Cost Allowability for
Los Alamos National Laboratory During Fiscal Year 2010 Under
Department of Energy Contract No. NA25396 (IG-36 (A11AL015))

Thank you for the opportunity to provide comments to the subject draft report. Our comments are focused solely on the potential Anti-Deficiency Act (ADA) issue mentioned in the draft report.

We continue to work with the General Counsel's office and NNSA in assessing the potential ADA as referred by the NNSA Field CFO. We anticipate resolution of the issue no later than the first quarter of FY 2013.



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