

## Audit Problems at Los Alamos

Written by Nick Sanders  
Monday, 07 May 2012 00:00

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The National Nuclear Security Administration (NNSA), a special agency within the U.S. Department of Energy (DOE), operates the Los Alamos National Laboratory (LANL), using funding provided in part from the U.S. Department of Defense (DOD).

Los Alamos National Security, LLC (LANS) operates LANL on behalf of NNSA and DOE.

LANS is a limited liability corporation formed by the University of California, Bechtel, Babcock & Wilcox Technical Services, and URS Energy and Construction. LANS has operated LANL since 2006, when it took over from the University of California, who had operated the Laboratory on behalf of the DOE (and its predecessor agencies) since the days of the Manhattan Project in World War II.

Still with us? Good. You will need to know that alphabet soup in order to navigate this article.

On April 19, 2012, the DOE Inspector General (DOE IG) issued audit report number [OAS-L-1 2-04](#), with the catchy title: “Questioned, Unresolved, and Potentially Unallowable Costs Incurred by Los Alamos Laboratory During Fiscal Years 2008 and 2009.” According to the DOE IG audit report, during those two years LANL “incurred and claimed” \$3.7 Billion, of which approximately \$2 Million was identified as being “unresolved questioned costs” and another \$437 Million was identified as being “FYs 2008 and 2009 and prior year subcontract costs that were unresolved pending audit or review by Los Alamos’ Internal Audit.”

\$2 Million out of \$3.7 Billion is a pretty paltry amount: it’s about three-tenths of one percent, according to our math. But we were interested in the story behind the audit report, and we think it’s worth bringing to your attention as well.

### Unallowable Labor Costs

According to the DOE IG audit report, the \$2 Million in “questioned and unresolved” costs

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related to costs questioned by LANL's own Internal Audit function, which found certain costs to be either unallocable to the contract or else in violation of the contract's "allowable cost provisions." \$1.9 Million of the \$2 Million in questioned costs was related to employee labor charges. The audit report stated—

For example, the [internal] 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.

That tells us that the internal audit found employees spending time working on tasks unrelated to the contract's Statement of Work. (We have to assume that job searches were unrelated to the contract Statement of Work. The audit report doesn't tell us that, but the finding would be nonsense otherwise.) Now, we are not sure what the LANL timekeeping policies were or what LANL's internet usage policy was, or whether the employees in question were in violation of those policies. There's a lot we don't know, because the DOE IG audit report doesn't provide any of those details. But if "unreasonable labor cost" is the best that the LANL Internal Audit function could come up with, then we suspect the problem really wasn't so bad after all.

And LANL management seemed to have reached a similar conclusion. The DOE IG audit report stated that, "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." That tells us that LANL management reviewed the Internal Audit report and disagreed with its findings.

The LANL management position makes some sense if you understand that the allowability of the labor cost of salaried, exempt, employees is a complex topic. (For example, you need to understand that a salaried, exempt, employee gets paid his/her salary for a full week even if the person only works five minutes, according to Federal labor laws. And you need to understand that unallowable labor charges for salaried, exempt, employees needs to be identified and segregated from allowable labor costs only if material in amount. But we digress....)

NNSA disagreed with LANL management's disagreement, and referred the matter to the cognizant Contracting Officer for resolution. According to the audit report, as of January 2012 no resolution had been reached. So that's the "unresolved part" of the issue: nearly five years

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after the labor hours were recorded, the parties still haven't reached a resolution on this miniscule issue. Hey DOE Contracting Officer, if you just delay making a decision for another 18 months, you can forget about it because the Contract Disputes Act's Statute of Limitations will have precluded any claim you could make.

And taxpayers wonder why government contracts cost so much...

### Unresolved Subcontractor Costs

The DOE IG audit report reported that \$165,092,842 in costs incurred by LANL subcontractors during Fiscal Years 2008 and 2009 were also "unresolved." The costs were unresolved because, even though LANL reviewed those costs, the reviews (allegedly) did not comply with Generally Accepted Government Audit Standards (GAGAS). Since the reviews did not comply with GAGAS—

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.

We found that comment to be quite interesting. The DOE IG audit report provided some details that shed light on the situation.

LANL's Acquisition Services Management (ASM) function reviewed the \$165 Million in subcontractor costs. However, ASM's strategy and methodology were found to be lacking—not only by the DOE IG, but also by LANL's own Internal Audit function. The DOE IG audit report stated—

... we noted that [LANL's] 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 2010. ... 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

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generally accepted Government auditing standards.

In addition to the \$165 Million issue discussed above, the DOE IG audit report also stated that, in 2009, the DOE IG had informed NNSA that “28 subcontracts with \$285,177,886 in FY 07 incurred costs ... required audit.” However, LANS “believed most of the 28 subcontracts did not require audit under the thresholds approved in May 2009, which were made retroactive to the beginning of the contract.”

So which is it? Did the subcontracts need to be audited, or not? The DOD IG audit report doesn't say.

The DOD IG 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.” The DOE IG reported—

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 ... that ASM’s validation of subcontract invoices ... was not adequate to ensure that billed costs were accurately compiled, properly supported, and allowable. ... 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 ... Los Alamos’ strategy had not 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.

Did you notice what we noticed?

Did you notice that the people most critical of LANL’s ASM subcontract audit strategy were the very same people who (a) used to perform subcontractor audits, and (b) would perform subcontractor audits again when the function was taken away from ASM.

Does that sound like the Internal Audit folks had an incentive to find problems with ASM’s work? Do you think that incentive might create a bias that could interfere with objectivity and independence?

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We do.

That's not to say that ASM's strategy was faultless. Nope. In fact, the DOE IG report stated that, under ASM's strategy, "only two of the 975 cost-type subcontracts and none of the 429 time and materials/labor hour subcontracts" were audited by ASM. Clearly, ASM had room for improvement.

But making LANS re-perform audits of somewhere in the neighborhood of \$400 million in subcontractor costs, by the very same function that criticized the prior audits, seems a bit questionable to us. Surely there has to be another approach that would satisfy the need to protect taxpayer funds while minimizing the cost of doing so.