OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-18-12 December 2017

LAWRENCE LIVERMORE NATIONAL SECURITY, LLC, COSTS CLAIMED UNDER DEPARTMENT OF ENERGY CONTRACT NO. DE-AC52-07NA27344 FOR FISCAL YEAR 2015

Department of Energy
Washington, DC 20585

December 22, 2017

MEMORANDUM FOR THE ACTING MANAGER, LIVERMORE FIELD OFFICE

FROM: April Stephenson
Principal Deputy Inspector General

SUBJECT: INFORMATION: Audit Report on "Lawrence Livermore National Security, LLC, Costs Claimed under Department of Energy Contract No. DE-AC52-07NA27344 for Fiscal Year 2015"

BACKGROUND

Lawrence Livermore National Laboratory is part of the Department of Energy's National Nuclear Security Administration, which has national security responsibilities that include ensuring the safety, security, and reliability of the Nation's nuclear weapons stockpile. National Nuclear Security Administration awarded a contract to Lawrence Livermore National Security, LLC (LLNS), to manage and operate Lawrence Livermore National Laboratory through September 2021.

As a management and operating contractor, LLNS' financial accounts are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. LLNS is required by contract to account for all net expenditures accrued annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and to claim only allowable costs. During fiscal year (FY) 2015, LLNS incurred costs totaling $1,489,911,852.45. LLNS is required to comply with the Department's Cooperative Audit Strategy, under which LLNS internal auditors perform audits of the contractor including the annual audit of costs claimed on the Statement of Costs Incurred and Claimed, also referred to as the annual incurred cost audit.

Each year, the Office of Inspector General (OIG) selects one management and operating contractor to test the effectiveness of the internal audit group's annual incurred cost audit. This is accomplished by performing the annual audit in place of the internal audit group. The annual audit is one procedure performed by the OIG to validate the effectiveness of the Cooperative Audit Strategy. For FY 2015, we selected LLNS. The objectives of our audit were to determine if the FY 2015 incurred costs were allowable, allocable, and reasonable in accordance with the terms of the contract, applicable cost principles, laws, and regulations, and to assess LLNS' internal audit work for the annual incurred cost audit.

RESULTS OF AUDIT

Based on our audit, we questioned costs totaling $1,262,454.77, identified weaknesses in internal controls for which we were unable to quantify the monetary impact, and identified weaknesses in

LLNS' Internal Audit Services (Internal Audit) audit procedures. In particular, we questioned $1,257,828.48 of interagency agreement costs for lack of supporting documentation and $3,900.61 in other areas such as purchased materials and UniCard costs. Except for the reported questioned costs and internal control weaknesses, nothing came to our attention to indicate that the other costs incurred by LLNS were not allowable.

Also, for areas where Internal Audit had provided audit coverage in FY 2015, e.g., subcontract costs, we reviewed its work to determine whether we could rely on the audit work in lieu of performing our own testing. Based on our review, we determined Internal Audit's work could be relied upon in the select areas reviewed and identified minor questioned costs of $725.68.

We did, however, identify internal control weaknesses in LLNS' accounting system that had not previously been reported by Internal Audit, though we were unable to determine the monetary impact. Those weaknesses included LLNS' management of its:

- Strategic partnership project cost overruns and underruns; and
- Unallowable costs.

Those internal control weaknesses occurred because LLNS did not properly follow contract terms and conditions, including the Federal Acquisition Regulations and Cost Accounting Standards, for the management of its strategic partnership project overruns/underruns and unallowable costs.

In addition, we identified two minor internal control weaknesses. LLNS did not maintain its own complete records of supplemental labor costs, and demonstrated an incomplete understanding of supplemental labor cost documents. Further, LLNS did not always adhere to internal policy and contract requirements to properly allocate travel and associated labor costs to the same project(s).

We identified areas that require improvement by Internal Audit in order for the OIG to continue to rely upon its work for future FYs under the Cooperative Audit Strategy. In our opinion, the audit procedures used by Internal Audit did not identify certain internal control weaknesses in LLNS' cost accounting and management practices. In particular, LLNS Internal Audit did not appear to place sufficient focus on entity controls. We consider these controls to be fundamental for proper accounting of costs on Government contracts. For example, we noted inappropriate charging of cost overruns/underruns of non-Departmental projects to the General and Administrative cost pool. As a result, we recommend the contracting officer request an improvement plan from Internal Audit to ensure that unallowable costs and internal control weaknesses identified in this report are properly audited in future incurred cost audits.

MANAGEMENT RESPONSE

Management concurred with the report's recommendations and has initiated corrective actions. Management's formal comments are included in Appendix 3.

Attachment

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

LAWRENCE LIVERMORE NATIONAL SECURITY, LLC, COSTS CLAIMED UNDER DEPARTMENT OF ENERGY CONTRACT NO. DE-AC52-07NA27344 FOR FISCAL YEAR 2015

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DETAILS OF FINDING

Based on our audit, we questioned costs totaling $1,262,454.77. Specifically, we questioned costs in the areas of interagency agreements, purchased materials, immigration, UniCards, and supplemental labor. Also, for areas where Lawrence Livermore National Security's (LLNS) Internal Audit Service (Internal Audit) had provided audit coverage in fiscal year (FY) 2015, we reviewed its work to determine whether we could rely on the work in lieu of performing our own testing. Based on our review, we determined Internal Audit's work could be relied upon in the select areas reviewed and identified minor questioned costs. A summary schedule of questioned costs identified during our audit is presented below.

Cost Category	Total Population	Total Sampled Costs	Questioned	
Interagency Agreements [1]	*	$ 1,257,828.48	$ 1,257,828.48	
Materials	$ 51,613,082.81	$ 2,410,594.43	$ 1,732.50	
Immigration	*	$ 6,969.07	$ 985.00	
UniCard Purchases	$ 77,664,729.68	$ 1,133,850.70	$ 599.86	
Supplemental Labor	$ 59,434,054.93	$ 629,196.54	$ 583.25	
Sub Total		*$ 5,438,439.22*	*$ 1,261,729.09*	
Internal Audit Results				
Relocation Audit			$ 598.00	
Subcontract Audits			$ 77.68	
Request for Offsite Services			$ 50.00	
Sub Total			*$ 725.68*	
		Total	**$ 1,262,454.77**	

In addition, we identified internal control weaknesses in LLNS cost accounting and management practices that had not previously been reported by Internal Audit. Specifically, we identified weaknesses with LLNS management of its strategic partnership project (SPP) cost overruns and underruns and unallowable costs. We also identified two minor internal control weaknesses where LLNS did not maintain its own complete records of supplemental labor costs, and demonstrated an incomplete understanding of supplemental labor documents. Also, LLNS did not always adhere to internal policy and contract requirements to properly allocate travel and associated labor costs to the same project(s). Except for the reported questioned costs and internal control weaknesses, nothing came to our attention to indicate that other costs incurred by LLNS were not allowable.

Finally, some areas require improvement by Internal Audit in order for the Office of Inspector General (OIG) to continue to rely upon its work for future FYs under the Cooperative Audit Strategy. In our opinion, the audit procedures used by Internal Audit did not identify certain control weaknesses in LLNS' cost accounting and management practices. We consider these controls to be fundamental for proper accounting of costs on Government contracts. For example, we noted inappropriate charging of cost overruns/underruns of non-Department projects to the General and Administrative (G&A) cost pool.

[1] Costs for interagency agreements and immigration are part of a larger cost category that is made up of various types of costs; therefore, we were not able to calculate the total population amount.

In most circumstances the following criteria are applicable to the identified questioned costs. Where appropriate, other relevant criteria are stated in the report. Federal Acquisition Regulation 31.201-2, *Determining Allowability*, states that a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles. This requirement is also found in LLNS' contract clause I-111, *Accounts, Records, and Inspection*, which requires the contractor to maintain a separate and distinct set of accounts, records, documents, and other evidence showing and supporting all allowable costs incurred. Federal Acquisition Regulation 31.201-3, *Determining Reasonableness*, states that there is no presumption of reasonableness attached to the incurrence of costs by a contractor. Reasonableness depends upon a variety of considerations and circumstances, including whether the type of cost is generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance, and including any significant deviations from the contractor's established practices.

Questioned Costs

Interagency Agreements Costs

We questioned $1,257,828.48 of costs for lack of supporting documentation. Specifically, LLNS was unable to provide adequate supporting documentation for costs it had incurred for all 13 interagency agreement transactions in our tested sample. An interagency agreement is an agreement created by the Department, on behalf of LLNS, and another Government agency. The work performed is billed to LLNS under its management and operating contract and charged to the Department. LLNS' contract requires it to maintain supporting documentation for the costs of the work performed.

When we requested supporting documentation, LLNS' finance department officials stated it was not available because the Department's payment and collection system (DOEPAC) and the intra-Governmental payment and collection system did not require supporting documentation. The intra-Governmental payment and collection system transfers funds between Federal Government agencies and the DOEPAC system transfers funds between the Department and its contractors. When the Federal agency performing the work requests payment through the intra-Governmental payment and collection system, Department funds are immediately transferred to the requestor agency. At that point, the Department sends a DOEPAC invoice to LLNS requesting funds for the transfer that had already taken place through the intra-Governmental payment and collection system.

When the LLNS' accounts payable group receives a DOEPAC invoice, it contacts the LLNS group that requested the interagency agreement work and confirms whether the invoice should be paid. After the group provides approval, accounts payable remits payment to the Department.

We spoke with personnel from several of the groups that requested such work. These individuals informed us that they did not receive or request supporting documentation for costs incurred. We noted that those groups had regularly monitored the technical aspects of their projects.

According to the Department's National Nuclear Security Administration, LLNS provided adequate supporting documentation for the interagency agreement costs it had incurred when it provided to the OIG the DOEPAC funds transfer invoice because interagency agreements are only subject to the Economy Act and not LLNS' prime contract requirements or the cost principles. We agree that interagency agreements are authorized by the Economy Act. However, the Economy Act does not relieve LLNS of the responsibility to support costs charged to the contract. LLNS claimed costs incurred through interagency agreements on its FY 2015 Statement of Costs Incurred and Claimed submittal. On its Statement of Costs Incurred and Claimed, LLNS certified that costs incurred under its prime contract were allowable. As stated above, LLNS was unable to provide supporting documentation that correlates the cost charged to the contract with work performed under the interagency agreement. Without proper verification of costs incurred, LLNS would not be able verify that the costs represented appropriate project efforts and, therefore, were properly charged to the contract.

We also asked Department personnel at National Nuclear Security Administration and the Oak Ridge Financial Service Center if documentation was maintained by them to support costs invoiced through the DOEPAC. We determined that support was not maintained at either location. In addition, the official from the Oak Ridge Financial Services Center, which managed part of the DOEPAC system during the FY under audit, added that there was no requirement that supporting documentation be included with the funding transfers because DOEPAC's intended purpose was only to move funds. Further, the expectation was that the supporting documentation should be kept by the contractor that incurs the costs.

We concluded that regardless of the method used to remit payment, LLNS was responsible for providing supporting documentation for costs incurred on the contract, in accordance with contract terms.

Materials Costs

We questioned costs of purchased materials totaling $1,732.50 for lack of supporting documentation. Specifically, in 1 of the 57 transactions tested, LLNS was unable to provide an adequate itemized invoice or proposal that provided a breakdown of the costs. Rather, a verbal vendor quote was used to estimate costs. LLNS' Procurement Standard Practices Manual requires that appropriate documentation be maintained to establish the propriety of the transaction and the reasonableness of the price paid. This would include any relevant records of verbal communications, such as telephone conversations, meeting minutes, etc.

Without proper documentation, LLNS would not be able to verify that vendor invoiced costs are allowable and that payments made are in accordance with subcontract and purchase order agreements.

Immigration Costs

We questioned $985 of immigration costs as unallowable because the cost was not required to be paid by LLNS and was not addressed in LLNS' retention policy. For one of the eight transactions tested, LLNS paid a fee for permanent residence on behalf of one employee as an employment retention incentive. The payment of immigration costs was not specifically addressed in LLNS' contract or cost principles. At the time of our review, LLNS did not have an established policy for payment of immigration costs or specific approval or direction from the contracting officer.

According to United States Citizenship and Immigration Services, payment of certain fees is the responsibility of the employer. However, permanent residence fees are not required to be paid by the employer. In addition, LLNS has a Retention Payment program that provides guidelines for retention incentives. The program is discretionary and is to be used by management to retain employees with special skills when there is a verifiable external recruiting threat. However, LLNS did not demonstrate that the employee whose fees were paid met the Retention Payment program criteria. During our audit, LLNS formalized guidelines to specifically address which immigration costs it considered a necessary part of operations.

UniCard Costs

We questioned $599.86 of UniCard costs for lack of adequate justification for the cost. Specifically, in 1 of the 58 transactions tested, LLNS was unable to adequately justify paying for an unreasonably oversized vehicle involving a blanket agreement. A UniCard is a procurement method utilizing a purchase card.

During our testing, we identified a purchase to transport 11 LLNS employees for which LLNS was billed $169 per hour, for a 35-passenger bus at a total cost of $1,225.25. However, the blanket agreement's Price Schedule sets a cost of $86.26 per hour, for a 14-passenger vehicle, for a total cost of $625.39. When asked why this occurred, a LLNS supply chain management official informed us that since transportation needs were in another state, the vendor used an affiliate who provided a larger vehicle and that there was no written justification for this purchase. Although the blanket agreement addendum states that "additional rates apply…" under certain circumstances, we concluded that the higher cost was due to the use of a larger vehicle at a higher rate. Additionally, the blanket agreement requires that "the services shall be furnished at the fixed unit prices identified in the incorporated Price Schedule."

Because LLNS could not provide adequate justification for renting a larger vehicle than required, we questioned the difference between the rate charged for a 14-passenger vehicle and a 35-passenger vehicle.

Supplemental Labor Costs

We questioned $583.25 of supplemental labor costs for the use of incorrect burdened labor rates. Specifically, in 2 of the 50 transactions tested from our original sample, we noted that LLNS was billed using the incorrect multiplier for 2 individual employees. After identifying the errors in our sample, we expanded it by an additional 2,769 transactions (transactions under 8 employees' names, job titles, and burdened labor rates from our original sample, including the employees from the 2 transactions questioned) and determined that the incorrect labor rate and multiplier were used for 257 of the expanded sample transactions (all of the transactions in our expanded sample relating to the employees from our two questioned transactions in the original sample).

As a result, we questioned the difference between the burdened labor costs charged for the two individual employees less our audit-determined burdened labor rate applied to each employee's labor hours within our sample. Supplemental labor services are supplied under a subcontract that provides qualified personnel to support LLNS' various programs, facilities, and projects under a blanket agreement.

Without proper documentation, LLNS would not be able to verify that the subcontractor was using the correct fully burdened labor rate for calculating invoiced costs.

Internal Audit Reliance

For areas where Internal Audit had provided audit coverage in FY 2015, we reviewed its work to determine whether we could rely on the work in lieu of performing our own testing. We reviewed select audits in the areas of relocation, cost-type subcontracts, and request for offsite services (ROS) agreements. Based on our review, we determined Internal Audit's work could be relied upon in the select areas reviewed and questioned $725.68 in costs, which we consider minor and non-systemic.

- Relocation Audit: We questioned $598 of meals and incidental expenses (M&IE) from our review of audit report 16-01. Specifically, we questioned $106.75 of M&IE that was paid for an *en route* travel day on which the employee did not travel. LLNS' Domestic Temporary Change of Station Policy states that an employee who travels via private automobile will be reimbursed an M&IE allowance *en route* based on the actual travel days or the allotted travel days, whichever is less. The employee's allotted travel days were five. The employee spent four days traveling between his temporary change of station assignment location and his home station in Livermore, California. For one of the five days he did not travel and did not claim an M&IE allowance. Thus, LLNS should have reimbursed the employee an M&IE allowance for four days, rather than the five that it reimbursed.

  In addition, we questioned $128 of M&IE for this same employee's *en route* change of station travel that exceeded General Services Administration Federal Travel Regulation's (FTR) maximum per diem rate. LLNS' Domestic Temporary Change of Station Policy states that *en route* M&IE shall be reimbursed in accordance with the FTR maximum per diem rates. The FTR states that per diem for *en route* relocation travel between old and new official stations will be at the standard contiguous United States (CONUS) rate. The employee claimed and was reimbursed at the maximum per diem rate for Livermore, California, rather than at the standard contiguous United States rate.

  Finally, we questioned $363.25 overpaid to this same employee for M&IE related to securing permanent housing, which is referred to as settling-in costs or temporary quarters subsistence expenses. LLNS' Domestic Temporary Change of Station Policy states M&IE shall be reimbursed in accordance with the FTR maximum per diem rate. The FTR maximum per diem rate for temporary quarters subsistence expenses is the standard contiguous United States rate. The employee was reimbursed for his settling-in M&IE at the maximum per diem rate for Livermore, California, rather than at the standard contiguous United States rate.

- Subcontract Audits: We questioned $77.68 of subcontract costs. Specifically, we questioned $45.75 of M&IE from our review of audit report 15-14. We noted that LLNS paid an invoice that included a subcontract employee's M&IE per diem of $45.75, even though the employee was in a travel status for only 10 hours. This reimbursement is contrary to the subcontract's terms and the FTR, which states employees will not be reimbursed for per diem expenses if official travel is 12 hours or less.

  Also, we questioned $31.93 of lodging per diem from our review of audit report 15-16. We noted that LLNS paid an invoice that included a subcontract employee's lodging per diem that exceeded the maximum lodging per diem rate, which is contrary to the subcontract's terms and LLNS' Travel Expense Rules for Sellers/Subcontractors.

- Request for Offsite Services Audit: We questioned $50 of transportation costs from our review of audit report 16-04. An employee was reimbursed for the cost of a limousine service from his hotel to the airport. Although LLNS' travel policy states that limo service to and from a common carrier airport is reimbursable with a receipt, we concluded that reasonable transportation costs would be those associated with the lesser of a taxi/limousine service or a rental vehicle. Our review of current rental rates revealed a car could be rented for the length of the employee's trip for approximately $50 less than the one-way cost of the limousine service. The issue appears to be unique to this ROS agreement, as the other invoice for similar work also shows charges for this limousine service; however, the other invoice was outside the scope of our audit.

Internal Control Weaknesses

During our audit we identified internal control weaknesses in LLNS' management of its SPPs and unallowable costs. We were unable to quantify the monetary impact of the control weaknesses for allowability of incurred costs.

Strategic Partnership Projects Costs

We identified an internal control weakness with the management of LLNS' SPPs. Specifically, we found that LLNS routinely charged SPP costs over (and under) the customer funding limit to the G&A cost pool. SPPs represent direct work performed by LLNS on behalf of non-Department entities, both Federal and non-Federal customers, who directly fund the full cost of the work. In FY 2015, LLNS performed $285,174,015.24 in work for SPPs.

Our testing identified 77 instances where LLNS charged SPP costs over (and under) the customer funding limit to the G&A cost pool. In addition, we noted two instances where SPP costs were inappropriately charged to the site support cost pool.

Through this practice, LLNS inappropriately moved direct SPP costs to indirect cost pools. As a result, the Department may have reimbursed LLNS for cost overruns on non-Department projects. Furthermore, the Department reimbursed LLNS for incurred costs that included allocations from the G&A and site support cost pools, including costs directly funded by other Federal and non-Federal agencies. Because this practice has been ongoing since at least 2010, we were unable to quantify the amount of SPP costs reimbursed by the Department through the allocation of G&A costs.

Cost Accounting Standards 402-40, *Fundamental Requirement*, states that all costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. No final cost objective shall have allocated to it as an indirect cost any cost, if other costs incurred for the same purpose, in like circumstances, have been included as a direct cost of that or any other final cost objective.

Contract clause I-088, *Work for Others Program (Non-Department Funded Work)*, requires LLNS to ensure that Department funds are not used to support SPP work. In addition, chapter 13 of the Department's Financial Management Accounting Handbook states that when conducting reimbursable work, such as SPP, obligations and expenditures for each reimbursable agreement shall not exceed the budgetary resources authorized on that reimbursable agreement. It also states that the Department shall not finance reimbursable work from its own appropriations or another customer's funds.

In addition, LLNS developed formal policies to assist it in conducting SPP work. For example, policies prescribe that Department funds are not to be used in support of SPP activities and, costs in excess of authorized funding are prohibited. However, in situations where costs did exceed available authorized funding, the LLNS Board of Governors established a funding mechanism to temporarily finance funding overruns. In such situations, cost overruns must be posted to an unallowable project. Finally, any cost underruns are to be returned to the customer.

These issues occurred because LLNS did not follow applicable requirements and concluded that SPP overruns and underruns are immaterial and administratively burdensome to track. Specifically, when asked, a LLNS accounting official told us that the amounts charged to the G&A cost pool were immaterial because when they were combined, the net effect to G&A costs was a credit charge of $558.07 in FY 2015.

Furthermore, LLNS developed other criteria that appeared to contradict those mentioned above. Specifically, a LLNS accounting official informed us that LLNS also developed and follows a set of internally approved guidelines for handling SPP cost overruns and underruns. Those guidelines state that SPP balances under $1,000 can be charged to the G&A cost pool if no further work or funding is anticipated. The reason for this practice is that the administrative burden and associated costs of researching immaterial amounts resulted in increased costs to the Government and provided insignificant benefit. However, we noted that the research to close out SPPs and identify cost overruns and underruns takes place regardless of whether the final cost objective is an indirect cost pool or an unallowable project. Consequently, the unallowable project already existed at the time the transfers were made.

Finally, regarding the two charges to the site support cost pool, LLNS accounting officials provided documentation stating that the charges represented costs to scope one project and manage the schedule for the other. However, we noted that the charges took place at SPP close-out, were for the same amount that had exceeded the customer's funding, and did not include a rationale for determining the amount. As a result, LLNS' internal controls were not properly accounting for SPP cost overruns and underruns in accordance with Department and Cost Accounting Standard requirements.

Management of Unallowable Costs

We identified an internal control weakness with the management of unallowable costs. Specifically, with the exception of unallowable salaries in the fringe rate, LLNS did not include direct unallowable costs in the indirect allocation bases. Instead, unallowable project costs were combined with corporate costs that were excluded from LLNS' indirect rate structure. Cost Accounting Standards 405.40(e), *Fundamental Requirement,* states that all unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases.

When we discussed our concern with management, a LLNS budget official commented that the costs collected against non-reimbursable projects are typically of a G&A cost nature, and therefore, would not be included in overhead or G&A allocation bases. However, we noted that no unallowable costs, aside from the unallowable salary costs, were included in the overhead or G&A bases. Therefore, LLNS did not report any unallowable costs than other G&A type costs. Additionally, LLNS did not specifically track these costs, and therefore, was unable to provide us with any analysis of the insignificance of its direct unallowable costs. We identified at least one direct unallowable SPP transaction cost that was not included in any allocation base. This was originally a direct cost charged to an SPP but was later deemed unallowable and charged to an unallowable project. However, the unallowable project was not included in any of the indirect allocation bases, even though the unallowable cost charged to it should still have been classified as a direct cost. Additionally, the SPP cost overruns identified in this report represent direct unallowable costs that were fully burdened resulting in the same direct costs being included in the G&A cost pool and the G&A allocation base.

This issue occurred because LLNS did not segregate unallowable costs into direct and indirect cost categories, and therefore, did not have the mechanism to track these costs separately. LLNS assigns unallowable costs to specific non-reimbursable projects; however, none of these projects were included in the indirect allocation bases, aside from the fringe base.

As a result, direct unallowable costs did not receive the appropriate indirect allocation of costs, and LLNS may have overcharged the Government and other customers for indirect costs.

Other Matters

Supplemental Labor

We identified a minor internal control weakness with LLNS' management of its supplemental labor costs. Specifically, we observed that LLNS did not maintain its own complete records of supplemental labor costs, and demonstrated an incomplete understanding of supplemental labor cost documents.

During our audit we requested documentation to support sampled supplemental labor transactions. LLNS provided the associated timesheets but obtained the remaining records from the subcontractor to support the request. We expected LLNS to maintain copies of the key documents used to validate costs incurred under the contract.

In addition, we noted that LLNS procurement did not have sufficient familiarity with calculating billing rates, various employee codes, and multipliers when responding to questions regarding the selected transactions. Instead, LLNS procurement deferred to the subcontractor to perform the needed calculations and provide specific information regarding billing codes used. Furthermore, we found that LLNS did not compare the actual labor billing rates charged to the approved labor billing rates prior to invoice payment. Instead, LLNS conducted weekly invoice reviews based only on overall prior actual costs. Such a review would not identify small changes in hourly billing rates. For example, small changes between weekly invoices due to an inappropriate increase in individual billing labor rates would not necessarily be noticed.

Finally, LLNS did not provide documentation to support sampled supplemental labor transactions in a timely manner. We initially requested support for our sampled transactions in June 2016, but were unable to resolve our concerns until April 2017, after repeated discussions, and multiple, detailed requests for sufficient documentation. LLNS stated that the delay resulted because the auditors did not obtain the requested documentation directly from the subcontractor as requested by LLNS. However, audit tests were designed to evaluate both the accuracy of the billing and charging documents for allowability, and to assess the controls surrounding LLNS' review and approval of the incurred costs on an ongoing basis. For that purpose, it was necessary to obtain information from LLNS as evidence of its review and approval processes.

As a result, LLNS has weaknesses in its ability to monitor the subcontract throughout the year and verify the allowability of costs charged for this relatively large subcontract (about $59.5 million was incurred in FY 2015).

Travel Cost Charging

We also identified a minor internal control weakness where LLNS did not always adhere to internal policy and contract requirements to properly allocate travel and associated labor costs to the same project(s). Specifically, in our testing of 47 travel transactions, we identified 5 transactions in which travel and associated labor costs were not appropriately allocated to the same project(s).

LLNS' policy requires that all travel and associated labor effort incurred for the same purpose be charged to the same project. In addition, Cost Accounting Standards 402-40, *Fundamental Requirement*, states that all costs incurred for the same purpose, in like circumstances, are either direct costs only or indirect costs only with respect to final cost objectives. Finally, FAR 31.201-4, *Determining Allocability*, states that a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.

Once travel is complete, an employee submits a final expense report that documents the allocation of travel costs to the appropriate project(s) for which travel was taken. In addition, travel labor is required to be allocated through the employee's time card to the appropriate project(s). However, for the five transactions we identified, the employees did not allocate travel charges, such as transportation and per diem costs, to the appropriate project(s) to correspond with labor charged on the time card. For example, in one transaction an employee charged all travel costs to a direct project, yet charged all labor to an indirect project. On another trip, the employee charged travel to a direct project, yet charged labor to various direct and indirect projects. An LLNS finance department official agreed that the issue we identified was a problem and should not have occurred. To its credit, LLNS was already aware of one of the transactions we identified. However, because it was identified at year end and the amount was deemed immaterial, a correction was not made.

This issue occurred because employees did not follow proper procedures for charging travel costs. As a result, in these instances LLNS could not properly track project costs.

Cooperative Audit Strategy Validation

Through our testing, we identified internal control weaknesses in LLNS' cost accounting and management practices that had not previously been identified and/or reported by Internal Audit. These are areas that require improvement by Internal Audit in order for the OIG to continue to rely upon its work for future FYs under the Cooperative Audit Strategy. The OIG, in consultation with the Department and the Contractor Internal Audit Council, developed and implemented the Cooperative Audit Strategy to maximize the overall audit coverage at management and operating contractors and fulfill its responsibility for auditing the costs incurred by the Department's major facilities contractors. The Department requires contractors to maintain an internal audit activity that is responsible for (1) performing operational and financial audits, including incurred cost audits; and (2) assessing the adequacy of management control systems to support the OIG as part of the Cooperative Audit Strategy.

In our opinion, while overall we can rely on Internal Audit's work, we consider the internal control weaknesses identified in this report to represent fundamental areas for proper accounting and management of costs on Government contracts and areas where Internal Audit could have increased its awareness and audit coverage. In particular, LLNS Internal Audit did not appear to place sufficient focus on entity controls. For example, we noted inappropriate charging of cost overruns/underruns of non-Departmental projects to the G&A cost pool, and not including direct unallowable costs in the indirect allocation bases.

RECOMMENDATIONS

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

1. Make a determination regarding the allowability of costs questioned in this report, and recover any amounts deemed unallowable;

2. Ensure LLNS maintains adequate documentation to support transactions processed through the Department's payment and collection system;

3. Review and approve LLNS' policies for the payment of immigration related costs;

4. Ensure LLNS modifies its internal policy and processes for handling SPPs and unallowable costs consistent with Cost Accounting Standards and other identified requirements, to include:

    a. Charging SPP overrun to the appropriate direct cost objective;

    b. Returning SPP underruns to the project sponsor;

    c. Segregating unallowable costs into direct and indirect cost categories; and

    d. Including direct unallowable costs in applicable indirect allocation bases.

5. Ensure LLNS addresses the supplemental labor subcontract cost management issues identified in the report to include;

    a. Ensuring LLNS has adequate information to verify that the labor subcontractor is using the correct, fully burdened labor rates for calculating invoiced costs; and

    b. Ensuring documentation is available in a timely manner to support internal and external audits.

6. Ensure that LLNS adequately addresses the improper charging of travel and labor costs when employees travel; and

7. Require Internal Audit to prepare an improvement plan to strengthen its planning and reporting processes to address the internal control weaknesses identified in this report.

MANAGEMENT RESPONSE

Management concurred with the report's recommendations and will use the results to inform other sites of potential areas for increased focus. Management's comments are included as Appendix 3.

AUDITOR COMMENTS

Management's comments and proposed actions are responsive to our findings and recommendations.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The dual objectives of our audit were to determine if the fiscal year 2015 incurred costs by Lawrence Livermore National Security, LLC's were allowable, allocable, and reasonable in accordance with the terms of the contract, applicable cost principles, laws, and regulations, and to assess Lawrence Livermore National Security, LLC's internal audit work for the annual incurred cost audit under the Cooperative Audit Strategy.

Scope

We performed our audit from March 2016 to December 2017 at Lawrence Livermore National Laboratory in Livermore, California. The audit scope was limited to costs incurred for fiscal year 2015, the allowability, allocability, and reasonableness of which will determine the basis for signing the Statement of Costs Incurred and Claimed. We did not evaluate the technical aspects of Lawrence Livermore National Security, LLC's performance. The audit was conducted under Office of Inspector General project number A16LL019.

Methodology

To accomplish our objectives, we:

- Reviewed applicable laws, regulations, policies, and procedures;

- Reviewed relevant reports issued by the Office of Inspector General, Government Accountability Office, Lawrence Livermore National Security, LLC Internal Audit Services (Internal Audit), Lawrence Livermore National Laboratory, and other entities;

- Conducted interviews with Federal and contractor personnel;

- Statistically sampled 46 of 604 transactions from Lawrence Livermore National Security, LLC' Business expenditure type category and judgmentally sampled 8 transactions from those not included in our statistical sample universe. This category included costs such as interagency agreements, immigration, and taxes. We did not project results to the transaction universe;

- Statistically sampled 47 of 51,444 UniCard transactions and judgmentally sampled 11 transactions from those not included in our statistical sample universe. We did not project results to the transaction universe;

- Statistically sampled 47 of 13,486 travel transactions. There were no findings to project to the transaction universe;

- Statistically sampled 49 of 6,974 materials and services purchase transactions and judgmentally sampled 8 transactions from those not included in our statistical sample universe. We did not project results to the transaction universe;

- Randomly sampled 50 of 249,553 supplemental labor transactions. We expanded our sample to include an additional 2,814 supplemental labor transactions. Because the selection was based on a judgmental or non-statistical sample, results and overall conclusions are limited to the items tested and cannot be projected to the entire population or universe of costs;

- Tested 100 percent of key personnel compensation costs;

- Judgmentally selected 19 of 720 Strategic Partnership Projects for review. Because the selection was based on a judgmental or non-statistical sample, results and overall conclusions are limited to the items tested and cannot be projected to the entire population or universe of costs;

- Tested transactions using the requirements contained in the Federal Acquisition Regulation and contract terms and conditions, by tracing transactions to books of original entry and to supporting records and documentation; and

- Reviewed policies and procedures for identifying subcontracts that require audit and arranging such audits.

In order to perform our reliance assessment on the allowable cost audit work conducted by Internal Audit, we reviewed allowable cost audit reports, work papers, and audit planning including risk assessments; auditor qualifications and independence; and overall Internal Audit strategy and compliance with applicable professional auditing standards. For our retest of fiscal year 2015 incurred cost transactions reviewed by Internal Audit, we judgmentally selected transactions associated with relocation and change of station files, two subcontracts, and request for offsite services agreements.

We conducted this performance audit in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Accordingly, we assessed significant internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objectives. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. Finally, we relied on computer-processed data to accomplish our audit objectives and performed appropriate tests to validate the results.

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 used for and should not be used by anyone other than these specified parties.

Management has waived the exit conference.

PRIOR REPORTS

- Audit Report on the *Lawrence Livermore National Laboratory's Laser Inertial Fusion Energy Endeavor* (OAI-M-16-13, July 2016) The audit found that while general and administrative expenditures for the Laser Inertial Fusion Energy endeavor ended in fiscal year (FY) 2013, Lawrence Livermore National Laboratory continued to work on approved Laser Inertial Fusion Energy Laboratory Directed Research and Development projects that had a 3-year scope ending in FY 2015. We did not find any evidence that Lawrence Livermore National Laboratory continued to fund Laser Inertial Fusion Energy activities after FY 2015. However, we questioned approximately $23.3 million of Lawrence Livermore National Laboratory's expenditures for Laser Inertial Fusion Energy activities from FY 2008 through 2013. Specifically, we determined that Lawrence Livermore National Laboratory incurred general and administrative costs for independent research and development activities outside its Laboratory Directed Research and Development program, which is expressly unallowable under the terms of its management and operating contract. Lawrence Livermore National Laboratory's management and operating contract only allows independent research and development expenditures through its Laboratory Directed Research and Development program, which has congressionally mandated cost limitations. In addition, Lawrence Livermore National Laboratory incurred general and administrative costs for Laser Inertial Fusion Energy activities that we determined did not meet the definition of general and administrative costs and are therefore questionable. Federal regulation requires general and administrative expenses to be incurred for managing and administering the entire business unit.

- Assessment Report on the *Audit Coverage of Cost Allowability for Lawrence Livermore National Security, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC52-07NA27344* (OAI-V-16-01, October 2015) Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Internal Audit for FY 2013 could not be relied upon. We did not identify any material internal control weaknesses with the cost allowability audits, which generally met the International Standards for the Professional Practice of Internal Auditing. Internal Audit identified $700,707 in questioned costs as part of its allowable cost audits, all of which have been resolved. In addition, $18,438 of questioned costs were identified in subcontract audits, and $39,557 of questioned costs were identified in other audits performed by Internal Audit, all of which have since been resolved or reimbursed to the Department. Further, we found that Lawrence Livermore National Security conducted reviews of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. Lawrence Livermore National Security' subcontract reviews resulted in $123,164 in questioned costs, all of which have been resolved. We did identify an issue that needs to be addressed to ensure that only allowable costs are claimed and reimbursed to the contractor. Specifically, our testing of a judgmental sample of 15 out of 111 employees' relocation and change-of-station transactions, which was performed independent of Internal Audit's cost allowability audit work, identified questioned costs of $205.75. These questioned relocation and change-of-station costs arose because Lawrence Livermore National Security' relocation and change-of-station policies allowed employees to claim 100 percent of the per diem meals and incidentals expense allowance on their first and last day of travel. The policies conflicted with language in Lawrence Livermore National Security' contract that only allows for 75 percent of the per diem to be claimed on employees' first and last day of travel.

MANAGEMENT COMMENTS

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

National Nuclear Security Administration

November 29, 2017

MEMORANDUM FOR APRIL STEPHENSON
ACTING INSPECTOR GENERAL

FROM: FRANK G. KLOTZ FGK 11/29/2017

SUBJECT: Comments on the Office of Inspector General Draft Report *Audit of Lawrence Livermore National Security (LLNS), LLC, Costs Claimed under Department of Energy Contract No. DE-AC52-07NA27344 for Fiscal Year 2015* (NNSA-2017-001936/A16LL019)

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the Office of Inspector General's (OIG) work, which validated the reliability of Lawrence Livermore National Security's (LLNS) internal audit work. While the findings in the report represent minor control considerations, we concur with the auditors' recommendations and will use the results to inform other sites of potential areas for increased focus.

The attachment to this memorandum outlines the detailed actions taken and planned to address the auditors' recommendations. Technical and general comments to enhance the clarity and factual accuracy of the report have also been provided for your consideration under separate cover. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audits and Internal Affairs, at (301) 903-1341.

Attachment

Attachment

NATIONAL NUCLEAR SECURITY ADMINISTRATION
Management Decision

Audit of Lawrence Livermore National Security, LLC, Costs Claimed under Department of Energy Contract No. DE-AC52-07NA27344 for Fiscal Year 2015

The Office of Inspector General recommended that the Manager, Livermore Field Office, direct the Contracting Officer to:

Recommendation 1: Ensure questioned costs are resolved and recover those amounts determined to be unallowable.

Management Response: Concur

The Contracting Officer will resolve all questioned costs and recover those amounts determined to be unallowable. The estimated completion date for this action is March 31, 2018.

Recommendation 2: Ensure that Lawrence Livermore National Security, LLC (LLNS), maintains adequate documentation to support transactions processed through the Department's payment and collection system.

Management Response: Concur

At the time of the audit, neither Departmental Payment and Collection System (DOEPAC) nor Intra-Agency Payment and Collection System (IPAC) guidance included a requirement for NNSA to obtain, or for the Management and Operating Contractors (M&O) to maintain, specific documentation in support of cost transfers made via these systems for Interagency Agreements. We do agree that Livermore and NNSA should maintain adequate documentation to support IPAC and DOEPAC transactions, consistent with valid requirements. NNSA's processes were consistent with requirements in place during the period under audit.

Since the time of the audit, the Department of Energy Chief Financial Officer (DOE CFO) issued Finance & Accounting Notice #02-2017, *Financial Policy on Invoice Documentation and Control of Cost Transfers for Reimbursable Agreements,* which addresses the auditors' observations regarding documentation. In light of the newly issued notice and the questions raised by the OIG, NNSA Acquisition and Project Management will coordinate with DOE CFO and the DOE Office of Acquisition Management to evaluate current policies and procedures for consistency with the Federal Acquisition Regulations, guidance from the Office of Federal Procurement Policy on interagency acquisitions, Treasury Department guidance on interagency payments, and requirements to protect the proprietary information of Federal contractors. The estimated completion date for this action is June 30, 2018.

Attachment

Recommendation 3: Review and approve LLNS' policies for the payment of immigration related costs.

Management Response: Concur

The Contracting Officer will review and approve LLNS' revised policies related to the payment of immigration-related costs. The estimated completion date for this action is March 31, 2018.

Recommendation 4: Ensure LLNS modifies its internal policy and processes for handling Strategic Partnership Projects (SPP) and unallowable costs consistent with Cost Accounting Standards and other identified requirements, to include:

a. Charging SPP overruns to the appropriate direct cost objective.

   Management Response: Concur

   The Contracting Officer will work with NNSA's Office of Management and Budget to review LLNS' policy and processes for SPPs and will approve a compliant practice. The estimated completion date for this action is March 31, 2018.

b. Returning SPP project underruns to the project sponsor.

   Management Response: Concur

   The Contracting Officer will work with NNSA's Office of Management and Budget to review LLNS' policy and processes for SPPs and will approve a compliant practice. The estimated completion date for this action is March 31, 2018.

c. Segregating unallowable costs into direct and indirect cost categories.

   Management Response: Concur

   The Contracting Officer will direct LLNS to modify its policy and processes for properly segregating direct and indirect costs. The estimated completion date for this action is March 31, 2018.

d. Including direct unallowable costs in applicable indirect allocation bases.

Attachment

Management Response: Concur

The Contracting Officer will direct LLNS to modify its policy and processes for properly allocating costs. The estimated completion date for this action is March 31, 2018.

Recommendation 5: Ensure LLNS addresses the supplemental labor cost management issues identified in the report:

Concur

The Contracting Officer will request LLNS to prepare a corrective action plan to: a) maintain complete records to evidence its review and approval of supplemental labor costs; and b) ensure personnel are properly trained and have sufficient understanding of the billing and support documents to facilitate adequate review and approval of costs. LFO will also review the timeline in which documents were provided to the auditors and identify any necessary corrective actions and lessons learned to be applied to future audits. The estimated completion date is March 31, 2018.

Recommendation 6: Ensure that LLNS adequately addresses the improper charging of travel and labor costs when employees travel.

Management Response: Concur

The Contracting Officer will direct LLNS to follow its policy for allocating travel and associated labor costs to the same project(s). The estimated completion date for this action is March 31, 2018.

Recommendation 7: Require Internal Audit to prepare a plan to strengthen its planning and reporting processes to address the control weaknesses identified in this report.

Management Response: Concur

To address this recommendation, the LLNS CO will direct LLNS IA to update its planning and reporting processes and procedures to: a) ensure future audit plans address basic program and entity controls, as well as activities to verify the allowability of incurred costs; and b) ensure control areas in this audit report are covered in future audit plans as appropriate. The estimated completion date for these actions is March 31, 2018.

FEEDBACK

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions and feedback to OIG.Reports@hq.doe.gov and include your name, contact information and the report number. Comments may also be mailed to:

Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 253-2162.