OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

INFORMATION REPORT

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April 2021

AUDIT COVERAGE OF SUBCONTRACT COSTS FOR LAWRENCE LIVERMORE NATIONAL SECURITY, LLC FROM OCTOBER 1, 2013, THROUGH SEPTEMBER 30, 2014, AND FROM OCTOBER 1, 2015, THROUGH SEPTEMBER 30, 2017

Department of Energy
Washington, DC 20585

April 7, 2021

MEMORANDUM FOR THE MANAGER, LIVERMORE FIELD OFFICE

FROM: John E. McCoy II
Deputy Assistant Inspector General
for Audits
Office of Inspector General

SUBJECT: Information Report on "Audit Coverage of Subcontract Costs for Lawrence Livermore National Security, LLC from October 1, 2013, through September 30, 2014, and from October 1, 2015, through September 30, 2017"

BACKGROUND

Since October 2007, Lawrence Livermore National Security, LLC (LLNS) managed and operated Lawrence Livermore National Laboratory (LLNL) under contract with the Department of Energy's National Nuclear Security Administration (NNSA). LLNL has national security responsibilities that include ensuring the safety, security, and reliability of the Nation's nuclear weapons stockpile. During the period from October 1, 2013, through September 30, 2014, and from October 1, 2015, through September 30, 2017, LLNS incurred and claimed costs totaling $4,702,519,282.99. Of these costs, LLNL incurred $1.3 billion in subcontract costs through various contract award types, such as cost reimbursable, fixed price, time and material, labor hour, and memo purchase orders.

Under the Department of Energy Acquisition Regulation (DEAR), 970.5232-3(c), *Accounts, Records, and Inspections*, LLNS was required to audit subcontractors' records, including fixed price or unit price subcontracts or purchase orders, where, under the terms of the subcontract, costs incurred were a factor in determining the amount payable to the subcontractor. These audits, if performed internally, must at a minimum meet the standards prescribed by the Institute of Internal Auditors. During our draft assessment review of "*Audit Coverage of Cost Allowablilty for Lawrence Livermore National Security, LLC from October 1, 2013, to September 30, 2014, and from October 1, 2015, to September 30, 2017, Under Department of Energy Contract No. DE-AC52-07NA27344*," we identified concerns with the way LLNS conducted subcontract audits or reviews on incurred subcontract costs. Specifically, LLNS' contract was modified in 2013, allowing the conduct of audits or reviews of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. LLNS received approval through a DEAR deviation to conduct audits or compliance reviews on subcontractor costs at their discretion, and in consultation with the Livermore Field Office. This deviation did not receive written concurrence (i.e. agreement) by NNSA's Field Chief Financial Officer (CFO) as required by DEAR clause 970.3270, *Standard Financial Management Clauses*, due to concerns from the NNSA Field CFO that the Cost/Price Analysts conducting reviews lacked independence and were not subject to professional standards.

The Office of Inspector General (OIG) is providing this informational report in lieu of a final assessment report because the concerns we identified during that review were fully addressed by NNSA prior to issuance.

SUBCONTRACT AUDIT COVERAGE CONCERNS

During fiscal years 2014, 2016, and 2017, LLNS incurred $1.3 billion in both cost reimbursable and fixed price subcontract costs. According to Internal Audit, approximately $252 million of the $1.3 billion in subcontract incurred costs required an audit or review; this did not include approximately $941 million of fixed price subcontracts. Internal Audit conducted eight audits covering approximately $32 million of the $252 million subcontract costs requiring an audit or review, plus one audit on a fixed price subcontract with costs incurred of approximately $7 million. With the deviation allowing reviews of subcontract costs, LLNS' Cost/Price Analysts completed reviews on 29 percent of subcontractor costs incurred of the $1.3 billion subcontract costs, totaling approximately $376 million, which included reviews on cost reimbursable, time and material, labor hour, and fixed price subcontracts.

In our prior audits and assessments, we did not look at the appropriateness of the DEAR deviation in making a determination on whether or not to rely on Internal Audit's work; we simply relied on the DEAR deviation when assessing the risk-based approach. However, due to the small percentage of subcontract costs actually audited during the scope of this assessment, we took a closer look at the appropriateness of the deviation.

DEAR DEVIATION FOR SUBCONTRACT AUDITS

LLNS obtained a deviation from two DEAR clauses pertaining to subcontract audits from the Department's Senior Procurement Executive; however, LLNS did not receive concurrence (i.e. agreement) by NNSA's Field CFO. DEAR clause, 970.5232-3(c), *Accounts, Records, and Inspections*, requires an audit of subcontractors' records, including fixed price or unit price subcontracts or purchase orders, where, under the terms of the subcontract, costs incurred were a factor in determining the amount payable to the subcontractor. The contractor is required to either conduct an audit of the subcontractor's costs or arrange for such an audit to be performed by the cognizant government audit agency through the Contracting Officer. DEAR clause 970.5244-1, *Contractor Purchasing System*, requires a periodic post-award audit of cost-reimbursement subcontracts.

In 2010, LLNS obtained a deviation from both DEAR clauses noted above. The memorandum granting the deviation stated that the Department's Senior Procurement Executive expected subcontract audits to be performed when appropriate, and in general, for large cost-reimbursement subcontracts. It also allowed the Livermore Field Office Contracting Officer the discretion to determine when an audit should be performed on subcontract costs. Despite the authority of the Senior Procurement Executive to make deviations from the DEAR, NNSA's Field CFO did not concur with the deviation as required by DEAR clause 970.3270*, Standard Financial Management Clauses.* DEAR clause 970.3270 requires that deviations from standard financial management clauses be approved by the Head of the Contracting Activity with written concurrence of the Department's Field CFO.

NNSA's Field CFO non-concurred with Livermore's request to deviate from DEAR clause 970-5232-3(c) and DEAR clause 970.5244.1 because the Field CFO considered that subcontract audits should be independent and performed following auditing standards. As part of DEAR clause 970-5232-3(c), contractors can either conduct an audit of the subcontractor's costs or arrange for such an audit to be performed by the cognizant government audit agency through the Contracting Officer. NNSA's Field CFO further stated that the Cost/Price Analysts performing reviews at LLNL were not organizationally independent and were placed in situations that could impair their objectivity. As a result of not following professional auditing standards, there is increased risk that unallowable costs could go undetected.

In 2013, NNSA's Office of Field Financial Management conducted an analysis of subcontract oversight at NNSA's management and operating contractors, and according to LLNS' Internal Audit officials, the NNSA Field CFO approved of the deviation as part of this analysis. However, the report did not state there was an actual approval of the DEAR deviation. The analysis only stated that the risk-based methodology proposed by LLNL for fiscal year 2014 was reasonable and resulted in an effective use of internal audit resources. Furthermore, the circumstances resulting in the Field CFO's non-concurrence continue to exist, as the Cost/Price Analysts are still not independent and do not follow auditing standards.

Because of our concern with the appropriateness of granting the DEAR deviation, we requested a legal opinion from an OIG Attorney Advisor, who analyzed the DEAR deviation and concluded that despite the authority of the Senior Procurement Executive to make deviations from the DEAR, the deviation with respect to DEAR clause 970.5232-3 was improperly authorized in this instance. The Senior Procurement Executive has the power to deviate from DEAR clause 970.5232-3 with the Head Contracting Authority's approval and written concurrence of the Department's CFO as stated by DEAR clause 970.3270(c). However, we found no written concurrence from the Department's CFO approving the deviation in 2010.

On February 19, 2021, based on the recommendations made in our draft assessment review on "*Audit Coverage of Cost Allowablilty for Lawrence Livermore National Security, LLC from October 1, 2013, to September 30, 2014, and from October 1, 2015, to September 30, 2017, Under Department of Energy Contract No. DE-AC52-07NA27344*," officials from NNSA's Management and Operating Contracting Branch and the Office of Acquisition Management issued a memorandum "Revocation of Deviations for Department of Energy Acquisition Regulation (DEAR) 970.5232-3 Accounts, Records, And Inspections and DEAR 970.5244-1 Contractor Purchasing System for Contract DE-AC52-07NA27344." NNSA's Senior Procurement Executive approved the memorandum to ensure that the requirement for LLNS to conduct audits on its subcontractors be restored in the contract. Per the memorandum, this action is consistent with requirements in all of NNSA's other management and operating contracts, and addresses the issues identified in the OIG's draft assessment review.

PATH FORWARD

As a result of the memorandum issued on February 19, 2021, a Livermore Field Office and LLNS official stated that LLNS' Internal Audit is developing a cost benefit analysis and implementation plan to conduct audits in accordance with the DEAR clauses 970-5232-3(c) and 970-5244.1. LLNS' Internal Audit plans to conduct interim and closeout audits on subcontracts over $1 million and LLNS' Cost/Price Analysts will focus on pre-award and rate reviews.

Based upon the actions taken by NNSA and LLNS, we are issuing an informational report that does not include recommendations made in the OIG's draft assessment review. We appreciated the cooperation from NNSA, the Livermore Field Office, and LLNS during this review and in addressing our concerns.

SCOPE

The original review was performed from August 2019 through September 2020 at LLNL located in Livermore, California. The review was limited to LLNS' Internal Audit activities and subcontract audits by LLNS from fiscal years 2014, 2016, and 2017. We conducted the original review under OIG project number A19LV040.

FEEDBACK

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