

**STATEMENT OF GREGORY H. FRIEDMAN
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BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

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Mr. Chairman and Members of the Subcommittee, I am pleased to be here at your request to testify on the Office of Inspector General's (OIG) reviews of management practices at the Los Alamos National Laboratory (Laboratory).

In February of this year, I testified before this Subcommittee regarding our Special Inquiry report on *Operations at Los Alamos National Laboratory* (DOE/IG-0584, January 2003). That report noted a series of actions taken by Laboratory officials, which obscured serious property and procurement management problems and weakened relevant internal controls. In March, I testified before the House Committee on Government Reform on the Department of Energy's (Department) contract administration activities, including the need for the Department to more effectively manage certain aspects of contract operations at Los Alamos.

In light of criticism regarding internal control weaknesses at the Laboratory, the National Nuclear Security Administration (NNSA) requested that the OIG perform an audit of the costs incurred by the Laboratory for Fiscal Years 2000 through 2002. Today, I will discuss the results of this review, as well as our recent report on computer controls at the Laboratory. Based on the record developed from these and previous reviews, we concluded that the business operations at the Laboratory have not been given adequate attention. This conclusion is consistent with the findings of a series of reviews commissioned by the University of California (University), the Laboratory's operating contractor.

COSTS CLAIMED AND RELATED INTERNAL CONTROLS

Consistent with NNSA's request, my office sought to determine the allowability of the \$5.2 billion charged to the contract for the last three fiscal years and to evaluate relevant controls. Our report, *University of California's Costs Claimed and Related Internal Controls for Operation of Los Alamos National Laboratory* (DOE/IG-0596, April 2003), questioned the allowability of \$14.6 million in costs claimed and identified a number of internal control weaknesses.

QUESTIONED COSTS

We identified potentially unallowable costs incurred by the Laboratory between Fiscal Years 2000 and 2002. This included about \$3.7 million for working meals that were inconsistent with acquisition regulations, \$7.4 million for travel in excess of contract limits, and \$3.5 million for an internal audit function that did not meet Department requirements.

The majority of the \$3.7 million in questioned meals was provided by the same contractor that provides services to the Laboratory's cafeteria. The remainder was for meals at restaurants in Los Alamos, Santa Fe, and Albuquerque, New Mexico. In our judgment, the number, frequency, and apparent routine nature of most meals provided indicated that the Laboratory was not exercising care to distinguish situations when working meals truly were in the Government's best interest. In addition, the Laboratory had a more restrictive policy for using University funds, than for using Government funds, on meal expenses. When University funds were being

used, the approval of the Director's office was required, but when Government funds were being used for meals at the Laboratory, Group Leader approval was sufficient.

The University also charged \$7.4 million to the contract for travel costs that were not in compliance with Federal Travel Regulations. Travelers were reimbursed for lodging that exceeded established General Services Administration rates, conference fees that had no accompanying receipts, and various other costs that were not in accordance with the Federal Travel Regulations. After the completion of our review, we were informed that the Laboratory was able to locate additional supporting documentation that was not available during our audit. NNSA may be able to use this documentation to assist in making final allowability determinations. However, the absence of documentation at the time of our review calls into question the travel claim review process used by the Laboratory.

Finally, we questioned as unreasonable about \$3.5 million charged to the contract by the University for the cost to operate a Laboratory audit function that did not meet the requirements of the contract. Specifically, the function was not organizationally independent, did not adequately plan and execute its internal audit work, and did not conduct timely follow-up reviews.

CONTROL WEAKNESSES

During our review, we noted a series of internal control weaknesses that contributed to an environment where questionable costs could be incurred and claimed. These weaknesses related to:

- The Laboratory audit function;
- Financial system reconciliations;
- Payroll and travel approval processes;
- Financial management personnel turnover; and,
- Financial system review and approval.

Laboratory Audit Function

A quality internal audit function is crucial to effective program management. The University contract required the Laboratory to establish an audit function that was acceptable to the Department. We concluded that, for the period Fiscal Year 2000 through Fiscal Year 2002, the Los Alamos National Laboratory's internal audit function did not meet Department requirements.

For example, the audit function did not prepare a plan to audit subcontracts for the three years reviewed, although subcontracting represented about one-half of the expenses of the Laboratory. Of particular concern to us was the fact that the Laboratory provided documentation indicating unaudited subcontract costs of over \$1 billion at the time of our review. Further, for one of the subcontracts that had been audited, the results of the examination (including \$12.8 million in questioned costs) had not been reported to the Department's contracting officer. Given the dollar value of the subcontracts to be examined and weaknesses in reporting, we concluded that the subcontract audit function at the Laboratory needed substantial strengthening.

Financial System Reconciliations

The review also identified weaknesses in reconciling cost data from the Laboratory's financial systems. The Laboratory has over 60 feeder systems that provide cost information to its Financial Management Information System (FMIS). The University had not established a process to periodically reconcile costs generated by these systems. University officials told us that reconciliations could be completed, but only with great difficulty. We were able to reconcile the payroll system to within \$1.4 million of payroll costs in FMIS and the travel disbursements system to within \$2.3 million of costs in FMIS. However, the absence of a process to periodically reconcile costs, and our inability to completely reconcile payroll and travel data, led us to conclude that the costs claimed by the University could be misstated and the universe of costs subjected to audit could be incomplete.

Payroll and Travel Approval Processes

The Laboratory also permitted payments to be made based on electronic signatures of administrative personnel or, in some cases, subcontractor support staff. Supervisors made only 15 of the 120 electronic approvals checked in our sample. The written policy for approvals stated that travel claims and payroll time sheets required supervisory approval - Deputy Group Leader and above - using either online electronic signature or hardcopy signature prior to paying travels claims and salaries. Although we were able to verify in some instances that hardcopy signatures did exist, our primary concern was that the Laboratory's Business Operations Division made payments based exclusively on the electronic signatures without any process, test-basis or otherwise, to verify supervisory approval of transactions.

Financial Management Personnel Turnover

During our review we also noted that there had been substantial turnover in Laboratory personnel responsible for financial management activities. While we recognized the challenge of retaining qualified personnel, the fact remained that excessive turnover left a void in the Accounting Department's ability to fully understand and execute the interfaces and capabilities of the Laboratory's financial management systems. In particular, Accounting had been severely affected, with five of seven managers (71 percent) having less than one year of experience in their current positions.

Financial System Review and Approval

Finally, the University had not obtained Department approval for its financial systems. Although the University's contract required such approval, we found no evidence that the Department approved the Laboratory's existing financial systems. Further, the University had initiated a 5-year, \$70 million overhaul of its existing system without required Department approval.

MANAGEMENT RESPONSE AND CORRECTIVE ACTIONS

In response to this report, NNSA indicated that corrective actions had been taken or were planned. Planned actions included improving controls and conducting a review of the allowability of the \$14.6 million in questioned costs. Although the University took strong exception to our characterization of questioned costs and internal control weaknesses, University officials informed us of several recent changes intended to address weaknesses in the audit

function at the Laboratory. For example, the University reported that it had established an independent reporting structure for the audit function. If successfully implemented, the NNSA and Laboratory initiatives should address the identified internal control concerns.

CONTROLS OVER LAPTOP COMPUTERS

The Office of Inspector General also recently issued an interim report focusing on accountability of laptop computers at the Laboratory, *Inspection of Internal Controls Over Personal Computers at Los Alamos National Laboratory* (DOE/IG-0597, April 2003). The Laboratory maintains approximately 30,000 desktop and 5,000 laptop computers for processing a broad range of classified and unclassified information. We determined that internal controls over classified and unclassified laptop computers at the Laboratory were inadequate. Laptop computers were not appropriately controlled or adequately safeguarded from loss, nor were they managed in accordance with security requirements.

The Laboratory's process did not assure that required inventory controls were followed when new computers were acquired using purchase cards. During Fiscal Years 2001 and 2002, the Laboratory used purchase cards to acquire over 1,000 new personal computers. Laboratory policy identifies computers as "sensitive items" due in part to their susceptibility to theft. Sensitive items should have property numbers assigned to them when they are acquired, and if the item was acquired using a purchase card, this number should be entered into the purchase card database. We found that the purchase card database was incomplete, in this regard, for 70

percent of the computers acquired during this period. In addition, laptop and desktop computers were acquired using purchase cards even after the Laboratory limited such purchases. A number of other control weaknesses were identified. For example:

- Laptop computers reported as "unlocated" were written-off of the Laboratory property inventory without a formal inquiry;
- Thefts of laptops were not always reported to the appropriate Laboratory security office; and,
- Laboratory employees were not held accountable in accordance with Laboratory requirements for the loss of their assigned Government computers.

The review also disclosed weaknesses in controls over classified computers. For example, during our review, the Laboratory provided us a listing of laptop computers that had been “accredited” for use in processing classified information; however, several discrepancies were found. Specifically, we identified instances where laptops used for classified processing were not on the list. In two of these cases, the computers were being used to process classified information even though they were not accredited to do so.

Based on these and other discrepancies, we concluded that the Laboratory could not provide adequate assurance that classified, sensitive, or proprietary information was appropriately protected. We referred these findings to the Department's Offices of Counterintelligence and Independent Oversight and Performance Assurance and the NNSA's Office of Defense Nuclear Counterintelligence for further review and appropriate action.

In summary, our reviews have disclosed significant internal control weaknesses in the Laboratory's management systems. In response to our recent reports and those of other external reviewers, the University has indicated that it has implemented a number of reforms.

CONCLUSION

The environment described in my testimony today can – as was the case with many issues raised in previous reviews – be attributed in large measure to management decisions and policies that did not assure the interests of the Federal taxpayers were adequately protected. In this context, our recent work at Los Alamos and at other Department locations has led us to develop a list of lessons learned that can be used by the Department to strengthen its management practices.

Specifically, the Department needs to:

- Ensure that its contractors establish robust, effective, and reliable business systems;
- Promote contractor governance models that adequately protect the Department's interests;
- Foster a culture where contractors fully understand and honor the special responsibility associated with managing taxpayer-funded Federal facilities;
- Promote an environment where both Federal and contractor employee concerns can be raised and addressed without fear of retaliation;
- Develop quantifiable, outcome-oriented metrics and maintain a system to track critical aspects of contractor performance; and,
- Rate and reward contractors commensurate with their accomplishments.

To assist the Department in addressing the weaknesses discussed today and measure progress against these lessons learned, my office will continue to review the situation at Los Alamos National Laboratory and other contractor-operated facilities.

Mr. Chairman and Members of the Subcommittee, this concludes my statement. I will be pleased to answer any questions.