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Office of Inspector General

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September 30, 1991

Report on

**Financial Administration of
Work For Nonfederal
Sponsors DOE Field Office,
Albuquerque
Albuquerque, New Mexico**

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U.S. DEPARTMENT OF ENERGY
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FINANCIAL ADMINISTRATION OF WORK
FOR NONFEDERAL SPONSORS
DOE FIELD OFFICE, ALBUQUERQUE
ALBUQUERQUE, NEW MEXICO

Report Number: WR-BC-91-2
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Western Regional Audit Office
Albuquerque, NM 87115

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FINANCIAL ADMINISTRATION OF WORK
FOR NONFEDERAL SPONSORS
DOE FIELD OFFICE, ALBUQUERQUE
ALBUQUERQUE, NEW MEXICO

TABLE OF CONTENTS

	<u>Page</u>
SUMMARY	1
PART I - APPROACH AND OVERVIEW	2
Purpose and Objectives	2
Scope and Methodology	2
Background	3
Observations and Conclusions	3
PART II - FINDINGS AND RECOMMENDATIONS	5
1. Financing Nonfederal Work	5
2. Collecting Claims	11
PART III - MANAGEMENT AND AUDITOR COMMENTS	15
PART IV - EXHIBIT A: Schedule of Costs in Excess of Nonfederal Sponsor Advances, Los Alamos National Laboratory, 1989	
EXHIBIT B: Schedule of Costs in Excess of AFP Obligational Authority for Non- federally Sponsored Work, Los Alamos National Laboratory, 1989	
EXHIBIT C: Schedule of Costs in Excess of AFP for Nonfederally Sponsored Work Attributable to DOE Field Office, Albuquerque, Delays, 1989	

U.S. DEPARTMENT OF ENERGY
OFFICE OF INSPECTOR GENERAL
OFFICE OF AUDITS

FINANCIAL ADMINISTRATION OF WORK
FOR NONFEDERAL SPONSORS
DOE FIELD OFFICE, ALBUQUERQUE
ALBUQUERQUE, NEW MEXICO

Audit Report Number: WR-BC-91-2

September 30, 1991

SUMMARY

The Department of Energy (DOE) Field Office, Albuquerque (AL) is responsible for managing and controlling nonfederally sponsored work done by Los Alamos National Laboratory (LANL). The audit objective was to determine whether the funding of, and accounting for, work done under a 1984 funds-in agreement and work for others in Fiscal Year (FY) 1989 complied with laws, regulations, and policies.

The audit showed that, contrary to Department policy, 1985 and 1986 (all references are to fiscal years) project costs for the funds-in agreement were \$1.8 million more than the sponsor's advance and LANL's Approved Funding Program (AFP) budget authority. Again throughout 1989, LANL's costs on other nonfederal projects exceeded sponsor advances, by as much as \$460,000, and exceeded LANL's AFP budget authority by up to \$719,000. These conditions placed the Department at risk for financing the sponsors' work and for exceeding an allotment. In the case of the 1984 funds-in agreement, the Department did not collect \$1.5 million of cost.

Management agreed with most of our conclusions and recommendations.

Office of Inspector General

PART I

APPROACH AND OVERVIEW

PURPOSE AND OBJECTIVES

The purpose of our review was to determine if the funding of, and accounting for, reimbursable work for others done under Funds-In Agreement DE-FI04-84AL25165 and FY 1989 reimbursable work for others done by LANL complied with laws, regulations, and policies. Specifically, our objectives were to determine if (i) work for nonfederal sponsors at LANL was funded in advance of doing the work, and (ii) the Department properly collected claims arising from the work.

SCOPE AND METHODOLOGY

Except for assessing the reliability of AL and LANL computer-processed accounting data, the audit was done according to generally accepted Government auditing standards for performance audits, which included tests of internal control and compliance with laws and regulations to the extent necessary to satisfy the audit objective. The computer data reliability assessment was not performed because of inadequate audit resources.

We limited the review to AL agreements with nonfederal sponsors, and to the work done by LANL under the agreements, specifically (i) 1984 Funds-In Agreement DE-FI04-84AL25165, for which LANL recorded costs in 1985 and 1986, and (ii) several 1989 LANL projects having costs incurred in excess of funds advanced by the sponsor.

To meet the first audit objective, we identified the Department's policy and guidance applicable to the funding of, and accounting for, nonfederal work. We tested for compliance with cash advance requirements and limitations on expenditures.

For the second audit objective, we identified claims collection criteria, including Title 4 of the Code of Federal Regulations, and tested for compliance. We reviewed AL's and LANL's settlement records for what we believe is a claim against a nonfederal sponsor.

We interviewed AL and LANL officials, as well as officials of one nonfederal sponsor. Reports prepared by AL's Internal Review & Evaluation Division and other AL staff on LANL reimbursable work, the report on the Controller Compliance Review conducted at AL from August 18

through August 28, 1986, and AL's 1990 Federal Managers' Financial Integrity Act (FMFIA) reporting for reimbursable work were all reviewed.

We assessed the significant internal controls with respect to advance funding of work for nonfederal sponsors. Our assessment consisted of (i) identifying AL's key internal control procedures to prevent costs incurred at LANL from exceeding advance funds, (ii) testing the operation of those control procedures, and (iii) identifying any needed adjustments to the procedures. Since our review was limited to the one agreement and ten projects shown above, it would not necessarily have disclosed all internal control deficiencies which existed. Part II of the report discusses our findings about financing nonfederal work, and collecting claims.

Field work occurred from May 1989 through December 1990 at Albuquerque and Los Alamos, New Mexico. The audit period consisted of 1985-87 for Funds-In Agreement DE-FI04-84AL25165 (the agreement period) and 1989 for the other projects reviewed.

The firm of KPMG Peat Marwick participated with the Office of Inspector General in conducting this audit.

An exit conference was held with the Director of the AL Financial Management Division on September 4, 1991.

BACKGROUND

The Economy Act of 1932 and the Atomic Energy Act of 1954 authorize the Department to conduct research and development activities for other entities (work for others), including such nonfederal entities as local governments, individuals, and commercial firms. According to Department policy, work for others must be performed according to the Department's procurement and financial regulations. The Department's management and operating (M&O) contractors do the work, using Government-owned facilities. The University of California is the M&O contractor for LANL. LANL's work for nonfederal sponsors increased in recent years--from \$8 million in 1987 to \$13.8 million in 1989, when LANL had 36 active nonfederal projects.

OBSERVATIONS AND CONCLUSIONS

Throughout the audited years, AL and LANL were not in compliance with the funding and accounting requirements. LANL expenditures exceeded the cash advance requirements and the spending authority contained in LANL's AFP. The

excess expenditures were as high as \$1.8 million. AL did not have the financial data needed to monitor and record all of the costs that LANL was incurring. Further, AL was slow in obtaining cash advances and in adding those advances to LANL's AFP.

We believe that AL did not properly collect the claim that arose when expenditures for the 1984 funds-in-agreement exceeded the sponsor's advance. AL agreed to settle the \$1.8 million overexpenditure for \$300,000. The agreement led to a misuse of appropriated funds.

These findings are discussed in Part II of this report. The findings on financing nonfederal work and collecting claims point out internal control weaknesses which AL should consider when preparing the year-end assurance memorandum on internal control. (AL's 1990 FMFIA internal control reporting showed implementation of Department Order 2100.10A, "Financial Policy and Procedures for Reimbursable Work," to be an area of moderate weakness.)

Our finding on financing nonfederal work provides an update on a condition that the Department found several years ago. Two internal review reports showed LANL doing reimbursable work without the required advances. A 1987 report on the August 1986 Controller Compliance Review stated that LANL regularly performed reimbursable work on an anticipated funding basis and used Department funds to support work for others. The report also stated that such practices were clearly contrary to Department policies. A separate September 1987 AL Internal Review & Evaluation Division report stated that LANL was still operating reimbursable projects on the basis of anticipated funding and had failed to implement financial controls at the funding document level (individual work order).

PART II

FINDINGS AND RECOMMENDATIONS

1. Financing Nonfederal Work -

FINDING

Expenditures for nonfederal projects were to be limited to the amount of the sponsor's advance and to LANL's AFP budget authority. However, in 1985 and 1986, project costs at LANL for one sponsor's work were \$1.8 million more than the advance and LANL's budget authority. Again throughout 1989, LANL's costs on other nonfederal projects exceeded sponsor advances, by as much as \$460,000, and exceeded the AFP authority by up to \$719,000. These problems were caused by: (i) AL having inadequate financial data to monitor and record costs; and (ii) AL being slow in obtaining advances from sponsors and adding advances received to LANL's AFP. At a minimum, these deficiencies placed the Department at risk for financing the sponsor's work and exceeding an allotment. Of the \$1.8 million of 1985-86 project costs, the Department did not collect \$1.5 million.

RECOMMENDATIONS

To provide reasonable assurance that M&O contractor costs do not exceed advanced funds, we recommend that the AL Manager:

1. Require LANL to implement internal controls that will provide reasonable assurance that LANL will not exceed its AFP spending limits;
2. Obtain sufficient timely and accurate data to monitor M&O contractor obligations and expenditures for nonfederal work for others;
3. Ensure that AL's records include all costs incurred by M&O contractors for nonfederal work, in the appropriate accounting period;
4. Promptly obtain advance funds from the nonfederal sponsor, and add advances received to the M&O contractor's AFP; and
5. Report, as an administrative funds control violation, the expenditures in excess of sponsor advances.

Because the condition of costs exceeding sponsor advances has been a continuing one at AL, we recommend that the Department Controller monitor AL's implementation of the above recommendations.

MANAGEMENT REACTION

AL concurred with Recommendation 2 and concurred with qualification to Recommendations 1, 3, and 4. AL did not concur with Recommendation 5.

The Department Controller's Office concurred with the recommendation made to it.

Complete management comments and auditor comments are in Part III of this report.

DETAILS OF FINDING

Expenditures Limited to Cash Advance and AFP Authority

Department Orders 2100.10 (October 17, 1983) and 2100.10A (August 15, 1988) required the Department to obtain cash advances from nonfederal sponsors. The advances were to be sufficient to preclude Department financing of the sponsor's work with federal appropriations. Accordingly, the advances were to be received before the work began.

Department spending on each nonfederal project was to be limited to the amount of the cash advance. According to these same two Department Orders, expenditures for reimbursable agreements were limited to the lesser of (a) the reimbursable authority granted in allotments, or (b) the budgetary resource available for obligation. These Orders effectively limited the budgetary resource for each reimbursable agreement to the amount advanced by the sponsor. Department Order 2200.5 (May 4, 1988) stated that an administrative violation (i.e., a violation of Department policy for controlling appropriations and funds) occurred when expenditures for a reimbursable work order exceeded the budgetary resource for that order.

By the terms of the Department's contract with the Regents of the University of California (University), the University agreed to comply with limitations on costs established in the AFP for LANL. According to an AL official, AL provided LANL a monthly "Intra-AL Transfers Report," which constituted LANL's budget authority for nonfederal work. Our review of the report showed that the amount of spending authority appeared at the individual

project level. The same official told us that LANL's spending authority for each project was increased only after AL had received the sponsor's check and the check had cleared.

Expenditures Exceeded Advances and AFP Budget Authority

LANL costs for Funds-In Agreement DE-FI04-84AL25165 were \$1.8 million greater than the sponsor's cash advance and the budget authority shown in LANL's AFP. Although the original advance was expended by June 1985, LANL continued to incur costs and AL did not bill the nonfederal sponsor for additional funds until February 1986. Upon receiving the invoice, the sponsor immediately terminated the agreement. In June 1987, the sponsor made an additional payment of \$300,000 to AL. A month later, LANL wrote off the remaining costs of \$1.5 million.

Throughout 1989, LANL again incurred costs that exceeded other sponsors' advances and LANL's AFP budget authority. Costs in excess of advances reached a 1989 high of \$461,409 in June, as shown in Exhibit A. Costs in excess of LANL's budget authority were even higher, peaking at \$719,166 in August, as shown in Exhibit B. (The second amount is greater than the first because of a timing difference. An advance could be received by AL in one month, but not be included in LANL's AFP until the following month.)

Internal Control Weaknesses

Although AL and LANL revised their funding controls in 1987-88, the changes did not overcome other weaknesses, some of which existed in 1985-86 and persisted through 1989: (i) AL had inadequate financial data to monitor and record costs; and (ii) AL was slow in obtaining advances from sponsors and adding advances received to LANL's AFP.

1987-88 Revisions to Funding Controls

In 1987 and 1988, AL and LANL took actions to strengthen and emphasize internal control policies and procedures. AL issued Order 4300.2A, which required AL's M&O contractors to monitor and control work for nonfederal entities on an individual work order basis to assure that obligations and costs did not exceed available funds. The order also established a minimum advance, at all times, of three months' estimated costs for nonfederal work expected to cost more than \$50,000. AL also sent LANL two memos which called attention to the Departmental and AL orders applicable to non-Department funded work. LANL issued written procedures that required it to notify AL when a

project was 80 percent obligated, to stop procurements of material when a project was 95 percent obligated, and to place the project in an inactive status when costs exceeded funding. Notwithstanding these changes, costs at LANL continued to exceed sponsor advances in 1989.

Lack of Financial Data for Monitoring

Department and AL Orders required current and accurate financial data on reimbursable work. According to Department Order 2100.10A and AL Order 4300.2A, AL divisions were to (i) develop and maintain accurate and current financial information on the status of funds, obligations, and expenditures on each reimbursable agreement, and (ii) monitor and control program execution to assure that no obligation is authorized or incurred in excess of available funds. These requirements were implicit in the earlier Order, DOE 2100.10.

We believe AL would have had the necessary financial data if AL had followed Department accounting guidance on transferring and recording costs. The "Accounting Practices and Procedures Handbook" (October 1979) implemented Department Order 2200.1. The handbook stated, regarding accounting transfers, that costs incurred should be transferred immediately to the authorizing office. (We believe AL was the "authorizing office," because AL provided LANL's budget authority for nonfederal work.) In 1988, the Department issued Order 2200.4 and cancelled Order 2200.1. Although Order 2200.4 did not specifically address cost transfers, it did set forth the principle that cost reporting was needed to keep spending within limits. Concerning recording costs, Department Order 2100.10A required the field elements to promptly and accurately record expenditures against reimbursable agreements.

AL did not obtain the cost information needed to effectively monitor each project. Contrary to the Department's accounting guidance, AL limited LANL's cost transfers to the AFP amount for the reimbursable agreement and did not record costs above that amount. AL restricted the costs transferred to discourage its contractors from incurring costs in excess of the budgetary resource. By restricting cost transfers, AL avoided recording, in the period in which they were incurred, LANL's costs in excess of budgetary resources.

AL Delay in Obtaining Advances

After collecting the initial advance, AL was slow at billing nonfederal sponsors for more funds. In 1989, AL usually billed and collected advanced funding to cover the estimated costs for the first three months of work before notifying LANL to proceed. We were told that AL then waited an additional 30 days before billing the sponsor again. This reduced the advanced funds to two months of costs, rather than the required three months of costs, thereby reducing the amount of advance funds available to cover unanticipated events, such as short-term cost increases.

Also, AL did not have follow-up procedures if the sponsors did not pay the advance billings. An AL official told us that the sponsors were not contacted about payment unless LANL called about a shortage of funds. The sponsors of several projects with costs in excess of advances in 1989, for example, made payment an average of 66 days after AL billed them. One sponsor that was billed over \$100,000 per month delayed payment an average of 74 days. We believe that an average of 66 days to receive payment is excessive and that AL should have taken aggressive action to expedite receipt of the payments.

Delay in Adding Advances to LANL AFP

AL delayed in adding advances received to LANL's AFP. AL's budget division usually added receipts from sponsors to LANL's AFP once a month. However, in 1989 it took AL more than 30 days to add many of the receipts to LANL's AFP, so that the average delay was 29 days.

As shown in Exhibit C, the excess spending would have been reduced from a 1989 maximum of \$719,166 to \$56,766 if AL practices then had included: (i) billing according to Department policy, using amounts shown in the project spending plans; (ii) collecting the funds 30 days later; and (iii) increasing LANL's AFP upon receipt of funds. However, it should be emphasized that AL's delay in adjusting LANL's AFP did not justify LANL exceeding its AFP spending limits.

Weaknesses Placed Department at Risk

When the M&O contractor's cost for nonfederal work exceeded the sponsor's advance, the Department (ultimately the taxpayer) was at risk for having to fund the deficit. The amount at risk in 1989 on eight projects reached a high of \$461,409 in June (Exhibit A). For Funds-In Agreement

DE-FI04-84AL25165, the Department had \$1.8 million at risk and collected only \$300,000 of that amount.

The Department also incurred the risk of exceeding an allotment. When a lower level of spending limit was exceeded, there was the risk that a higher level limit was also breached. Therefore, spending more than the budgetary resource could have resulted in exceeding an allotment.

Although we did not find an allotment violation, we concluded that the specific problems at AL and LANL were indicators of the limited ability or willingness of the Department to exercise effective managerial and financial control over the work at LANL. In consideration of the size of the work for nonfederal sponsors program, it is imperative that the Department and LANL improve financial controls over nonfederal work.

2. Collecting Claims

FINDING

Federal laws and regulations required the Department to aggressively pursue collecting amounts owed the Government and to refer large (more than \$20,000) claims it could not collect to the Department of Justice for litigation. AL did neither in attempting to collect \$1.8 million owed by one private sponsor. Instead, AL agreed to settle the claim for \$300,000. AL's agreement to settle the claim may have caused a loss to the Government of \$1.5 million and led to a misuse of appropriated funds.

RECOMMENDATIONS

We recommend that the AL Manager:

1. Aggressively pursue collection of all future amounts owed the Department;
2. Refer to the Department of Justice the future large claims AL cannot collect; and
3. Obtain an Office of General Counsel opinion on whether the Federal Claims Collection Standards apply to the funds-in agreement. If they do apply, immediately refer the claim to the Department of Justice. (In the Tentative Findings and Recommendations version of this report, we recommended the \$1.5 million claim be referred to the Department of Justice for review. Because of issues raised by AL in its comments, the recommendation was modified to call for an Office of General Counsel opinion.)

MANAGEMENT REACTION

AL concurred with the first recommendation with comment. AL concurred with the second recommendation. AL did not concur with the third recommendation.

Complete management comments and auditor comments are in Part III of the report.

DETAILS OF FINDING

Federal Regulations Prescribe Collection Procedures

The Federal Claims Collection Standards (4 CFR Chapter II, Parts 101 through 105) prescribe standards for the administrative collection, compromise, and termination of agency collection activities on civil claims. These standards are incorporated in 10 CFR Chapter 10, Part 1015, where a "claim" is defined to include amounts due the United States from the sales of products and services. These standards are also covered in Department Order 2200.6, Chapter III, "Receivables." (Prior to Order 2200.6, receivables were covered in Chapter VII of the Department's Accounting Practices and Procedures Handbook.)

Part 102 of 4 CFR Chapter II requires each agency to take aggressive action, on a timely basis, with effective followup, to collect all claims of the United States for money or property arising out of activities of, or referred to, that agency.

Parts 103 and 104 limited the authority of agency heads to compromise, suspend or terminate collection activities to claims of \$20,000 or less. The authority to compromise, suspend, or terminate collection activities on claims in excess of \$20,000 rested solely with the Department of Justice. Recently, the threshold was raised to \$100,000.

Part 105 provides that agency heads shall promptly refer to the Department of Justice, for litigation, any claims that can not be compromised or on which collection actions cannot be suspended or terminated in accordance with Parts 103 and 104.

AL Agreement to Settle a Claim

The \$1.8 million in project costs that AL settled for \$300,000 in June 1987 (see Finding 1) constituted a claim for purposes of the Federal Claims Collection Standards. A claim existed because AL was selling services to the sponsor and AL issued a Bill of Collection to the sponsor for \$1.8 million.

Project files did not indicate that AL aggressively pursued collecting the \$1.8 million. For example, although the director of AL's Contracts and Industrial Relations Division stated that the settlement was accepted because AL did not want to force the sponsor into bankruptcy, we did

not find any evidence that AL had reviewed the sponsor's financial statements or credit reports. In fact, the chairman of the sponsor's board told us that the board thought the sponsor was legally responsible and that the sponsor had the funds necessary to pay the \$1.8 million. Although we did not independently confirm the sponsor's ability to pay, the chairman's statements, if accurate, appear to contradict the contention that pursuing the \$1.8 million claim would have bankrupted the sponsor.

Effect of Settlement

Possible Loss of \$1.5 Million

AL's decision to compromise rather than to pursue the full claim through a referral to the Department of Justice, as prescribed in collection procedures, may have caused the loss of \$1.5 million. If the Department had promptly referred the claim to the Department of Justice, it is possible the \$1.5 million could have been collected in prior years.

Misuse of Appropriated Funds

Department Orders and 31 U.S.C. 1301 prohibited using funds received from one nonfederal sponsor to finance another sponsor's work, and restricted the purposes for which appropriated funds could be used. Department Orders 2100.10 and 2100.10A stated that funds provided under reimbursable agreements were to be used solely for the intended purpose, and to do otherwise would constitute the unauthorized use of funds. 31 U.S.C. 1301 required the Department to apply appropriated funds only to the objects for which the appropriations were made except as otherwise provided by law. Department Order 2200.5 (May 4, 1988) stated that misuse of funds was a violation of 31 U.S.C. Section 1301, and defined "misuse of funds" as obligating or expending funds for a purpose other than that for which the funds were appropriated.

The claims settlement led LANL to charge \$1.5 million to LANL's Institutional Supporting Research and Development (ISRDR) program as a write-off of a bad debt. We believe that charging the \$1.5 million to ISRDR was a misuse of appropriated funds, that is, the Department used funds for a purpose other than that for which they were appropriated. We reached this conclusion because some ISRDR funds came from projects funded by other agencies, whose appropriations could not be expected to cover the Department's work for nonfederal sponsors. An additional reason for believing misuse occurred is that some ISRDR funds came from programs whose legislation restricted the

use of program funds. For example, Office of Civilian Radioactive Waste Management (OCRWM) funds were used for ISRD, although OCRWM legislation specifically prohibited the use of OCRWM funds for non-OCRWM work.

In our audit report number DOE/IG-0267, issued May 17, 1989, we recommended that the Department request a legal opinion from General Counsel as to the propriety of taxing programs and using the resulting funds for discretionary projects. The Department requested such an opinion on June 5, 1990, but has not yet received a response.

In the same audit report, we also raised the issue of using discretionary research funds, such as ISRD funds, to pay the costs of nongovernment work. We stated that of the \$131.4 million LANL charged in 1986 and 1987 for discretionary projects, \$3.2 million was used for the costs of nongovernment work, a purpose prohibited by Department Order 5000.1A.

PART III

MANAGEMENT AND AUDITOR COMMENTS

In responding to the tentative findings and official draft versions of this report, the Director of AL's Financial Management Division provided comments on the findings, and concurred and nonconcurred with various recommendations. We also met with AL officials to clarify parts of the written responses.

1. Financing Nonfederal Work

Recommendation 1: The AL Manager require LANL to implement internal controls that will provide reasonable assurance that LANL will not exceed its AFP spending limits.

Management Comments--AL

AL provided a qualified concurrence to the first recommendation. In its comments, AL stated that the issue was one of compliance with existing requirements rather than implementation of additional internal controls. AL stated that it and LANL had worked together over the past three to four years to implement changes in the systems of internal control to comply with the requirements of Department Order 4300.2A and AL Order 4300.2A. A reduction in LANL cost overruns from \$9.4 million in July 1986 to \$651,000 in February 1991 was cited as an example of significant improvement.

In a May 14, 1991 memo, the AL Manager directed LANL to identify and correct all instances of noncompliance with sound financial practices. The memo reiterated the intent of existing Department and AL policies and procedures regarding the financial administration and controls over work for others, and specifically directed the LANL Director to ensure that work for others was not performed in excess of authorized funding on an individual work order basis.

AL also cited the fact that Department Order 2200.6, Chapter IX, paragraph 2.i.(1).(b) now provides an exception to AFP limitations. Specifically, the Order allows an integrated contractor to begin reimbursable work upon receiving from the Department's contracting officer a written authorization indicating that the Department has obtained a valid budgetary resource that will be reflected in the next contract modification. As a normal operating

practice, AL issues AFPs about the 20th of each month. The AFPs include the nonfederal sponsor advances received through the AFP issue date. Advances received after the cutoff date are handled on a case-by-case basis through written notifications to the integrated contractor. However, the purpose of the notifications has been ambiguous. AL will alter its internal process to incorporate the provisions of Order 2200.6, Chapter IX, not only to maximize the availability of funds, but also to eliminate any perception that the formal AFP process may be contributing to the delay of work.

Auditor Comments

We believe the May 14, 1991 memo is responsive to the recommendation. We are not convinced that additional controls are unnecessary at LANL. The fact that there were apparent LANL cost overruns of \$661,000 as recently as February 1991 indicates that the existing controls are inadequate. However, the May 14, 1991 memo appears to make it possible for AL to disallow contractor costs in excess of authorized funding on an individual work order basis, and thus, in our opinion, provides LANL an incentive to voluntarily implement additional internal controls.

We believe that providing the integrated contractor with written notification of budgetary resources received after the AFP has been issued would reduce the amount of costs in excess of AFP obligational authority. Exhibit C shows the reduction in costs in excess of AFP obligational authority that would have occurred in 1989 if AL's practices then had included increasing LANL's AFP upon receipt of funds.

Recommendation 2: The AL Manager obtain sufficient timely and accurate data to monitor M&O contractor obligations and expenditures for nonfederal work for others.

Management Comments--AL

AL concurred with the second recommendation. AL will institute a formal and uniform non-Department funded work report showing, at a minimum, the monthly status of costs and obligations at the individual work order basis. The report will supplement existing reporting requirements, such as the required notification when eighty percent of the funding is used and the balance remaining is insufficient to complete the agreed upon scope of work. AL will review this report monthly to monitor the execution of all reimbursable agreements with nonfederal sponsors.

Auditor Comments

We believe AL's planned action is responsive to the recommendation.

Recommendation 3: The AL Manager ensure that AL's records include all costs incurred by M&O contractors for nonfederal work, in the appropriate accounting period.

Management Comments--AL

AL concurred to the recommendation, with comment. AL stated that it has traditionally limited cost transfers from its integrated contractors to amounts available on an individual work order basis. This policy was instituted to discourage the incurrence of cost overruns and, if incurred, to assure such overruns were subjected to a thorough administrative review prior to transfer to AL. Premised also on the terms and conditions of the M&O contract, whereby the integrated contractor is expected to comply with the limitations established by the AFP, costs in excess of these limitations may represent a funding violation and, as such, may be subject to allowability determinations prior to reimbursement. It was the AL position that permitting integrated contractors to transfer cost overruns prior to full and complete administrative review may be perceived by the integrated contractors as relieving them of further liability or responsibility for those costs. In this regard, it should be recognized that no officer or employee of the U.S. Government knowingly or willfully authorized or permitted LANL to incur costs in excess of an individual non-Federal sponsor work order nor was the spirit or intent of the AL cost transfer policy to promote or permit LANL to exceed available funding on an individual work order basis.

AL stated that it had revised its cost transfer policy, by requiring the contractors to review all costs incurred, including unbilled costs, before transferring the costs to AL. The contractors were to be held accountable for any cost overruns incurred. Month-end cost transfers will be reviewed by the Financial Management Division and, as necessary, program and legal staff, for adherence to this policy.

Auditor Comments

We believe AL's policy change, communicated to the contractors in a June 26, 1991 memo, is responsive to the recommendation. However, the spirit of the recommendation calls for the contractor to record costs allocable to a particular nonfederal project in the period in which the costs are incurred, and for those costs to be transferred to AL, whether or not the costs exceed the sponsor's advance. The contractor should not use the "review" process as a pretext to delay recording and transferring project costs until additional advances are received.

Recommendation 4: The AL Manager promptly obtain advance funds from the nonfederal sponsor, and add advances received to the M&O contractor's AFP.

Management Comments--AL

AL provided a qualified concurrence to the fourth recommendation. The qualification related to the part of the recommendation that called for advances to be promptly added to the contractor's AFP. In this regard, AL again cited the written notification procedure now provided by Order 2200.6, Chapter IX. AL also reported that in February 1990 it revised its procedures to call for advance funding to cover 120 days and monthly billings thereafter. AL will also issue stop work notices when advance funding cannot be maintained and will increase its vigilance on the follow-up of receivables.

Auditor Comments

We believe AL's planned action is responsive to the recommendation, with qualification. We believe the follow-up on receivables will improve only if AL staff implements appropriate control procedures. Accordingly, we encourage AL to determine that necessary written policies and procedures exist, and to regularly review the implementation of those policies and procedures.

Recommendation 5: The AL Manager report the administrative funds control violation to the Office of the Controller.

Management Comments--AL

AL did not concur with this recommendation.

AL stated it did not agree that an administrative control of funds violation occurred. It gave as one reason the fact that LANL did not violate the spending authority at the Budget and Reporting Classification number level. AL asserted that the control point for determining administrative control of funds-violations was at that level.

Another reason given by AL for disagreeing was AL's belief that its administrative control of funds system complied with the "Standards for Internal Controls in the Federal Government," issued by the U.S. General Accounting Office (GAO). AL quoted the following material from GAO's explanation of the standard of "reasonable assurance" (emphasis provide by AL):

Internal control systems are to provide reasonable assurance that the objectives of the systems will be accomplished. The standard of reasonable assurance recognizes that the cost of internal control should not exceed the benefit derived. Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits, and risks. The required determinations call for judgment to be exercised.

Examples of benefits include increasing the probability of detecting fraud, waste, abuse, or error; preventing an improper activity; or enhancing regulatory compliance.

AL stated that the standard does not require absolute assurance; conversely, the standard appears to be asking for a best-faith effort, which AL believes it has provided.

AL stated that specific instances of violations of the administrative funding control system would have to be individually evaluated to determine whether the violation was beyond AL's control or whether there was willful misconduct. With over 40,000 contractor employees, there were numerous opportunities to circumvent, ignore, and disregard the controls AL had in place. If users of the system abided by the funding levels communicated by the system, the system could be characterized as being effective.

Auditor Comments

We continue to believe that the recommendation is appropriate because of the guidance given in Department Order 2200.5. The order states that an administrative

violation occurs when expenditures for a reimbursable work order exceed the budgetary resources authorized for that work order. We believe this report demonstrates that expenditures at LANL exceeded the budgetary resource, which was the amount of the sponsor's advance. The Order also calls for allottee reports to the Controller on violations or apparent violations of legal or administrative control limitations.

We do not think that compliance or noncompliance with the standard of reasonable assurance determines whether or not a violation is reportable. However, adherence to GAO's internal control standards might be given weight in a Departmental decision on action to be taken in response to a violation.

Management Comments-Department Controller

The Controller concurred with the recommendation to monitor the implementation of the recommendations to AL. During the FY 1991 Compliance Review, the Controller found that AL had not implemented all recommendations from the prior review in 1986. The AL Manager has agreed to provide the Controller with monthly status reports of progress made and actions taken in implementing recommendations. The Controller will utilize these monthly status reports to monitor and ensure the timely implementation of the recommendations made by the compliance review team and the Office of Inspector General.

The Controller also noted that the cost review process at the contractor could be used as a pretext to delay recording and transferring project costs until additional advances were received. The Controller believed that the only way to ensure that AL can provide effective oversight of its contractors' financial management of reimbursable work is to direct the contractors to transfer all reimbursable work costs to AL at month end without any period of delay for a review by the contractor. Further, AL should be aggressively monitoring any overruns of individual work orders that result from the transfer of reimbursable work costs.

Auditor Comments

We believe the Controller's planned action is responsive to the recommendation.

2. Collecting Claims

Recommendation 1: The AL Manager aggressively pursue collection of all future amounts owed the Department.

Management Comments--AL

AL concurred with the first recommendation, with comment. AL stated that while it agrees with the spirit and intent of the recommendation, the basis for the finding and attendant recommendation was the presumption that the \$1.8 million action was a bad debt and therefore subject to the debt collection procedures including referral to the Department of Justice for litigation. The AL determined the \$1.8 million action was a contract dispute, not a bad debt, and therefore not subject to the debt collection procedures. For all qualifying actions, AL will use the guidance and procedures outlined in Department Order 2200.6, Chapter III, "Receivables," for referral of claims to the Department of Justice.

Auditor Comments

We believe the planned action is responsive to the recommendation. We are not persuaded that the claims collection standards did not apply; see Auditor Comments under Recommendation 3, below.

Recommendation 2: The AL Manager refer to the Department of Justice the future large claims AL cannot collect.

Management Comments--AL

AL concurred with the second recommendation, with comment. AL stated that it agrees with the spirit and intent of the recommendation and, for all qualifying actions, will use the guidance and procedures outlined in Department Order 2200.6, Chapter III, "Receivables," for referral of claims to the Department of Justice.

Auditor Comments

We believe the planned action is responsive to the recommendation.

Recommendation 3: The AL Manager should obtain an Office of General Counsel opinion on whether the Federal Claims Collection Standards apply to the funds-in agreement. If they do apply, immediately

refer the claim to the Department of Justice. (In the Tentative Findings and Recommendations version of this report, we recommended the \$1.5 million claim be referred to the Department of Justice for review. Because of issues raised by AL in its comments, the recommendation was modified to call for an Office of General Counsel opinion.)

Management Comments--AL

AL nonconcurring with the recommendation. AL stated that the funds-in agreement action for \$1.5 million was settled as a contract dispute and not as a bad debt. The Department did not compromise this action but handled it as a normal negotiated claim settlement consistent with the provisions contained in the Federal Acquisition Regulation (FAR). The negotiation was within the authority vested in the contracting officer under Title 41, U.S.C., Section 605, which states, "...all claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer...." Also, an OIG investigation concluded that the settlement agreement was based on a contract negotiation. No further action is considered by AL.

Auditor Comments

We believe an Office of General Counsel opinion is needed because of the complexity of the issues. The issues involve (i) the applicability of certain regulations and United States Code sections, (ii) whether a contract dispute justified a settlement agreement, and (iii) the benefits cited in the settlement agreement.

We believe that neither the FAR nor Title 41, U.S.C., Section 605, provided the contracting officer with the authority to settle the claim, for neither one applied to a funds-in agreement. The FAR applied to acquisitions of supplies and services with appropriated funds. 41 U.S.C. 605 applied to procurements of property, services, and construction. The funds-in agreement was not a procurement contract; rather, it was more of a sales contract, under which the Department agreed to have LANL develop certain items for the nonfederal sponsor. Further, even if 41 U.S.C. 605 did apply, the contracting officer's authority to settle claims appeared to be limited during the audit period by the \$20,000 threshold set in 4 CFR 103 and 104.

AL's March 1987 Determinations and Findings paper does not support AL's position that the settlement was based on a contract dispute. The document does not cite a contract

dispute as the basis for a cost reduction. Rather, this document cites the basis as: a reduction in costs due to scaling down the statement of work; a reduction in the period of performance; and the accrual of benefit to the Department and LANL.

The accrued benefits cited as a basis for reducing the sponsor's costs were tangibles and intangibles that the Department already either owned or had provided consideration for. According to the Determinations and Findings, the Government obtained a building and equipment costing \$770,000. However, the original funds-in agreement provided for Government ownership of all tangible property purchased, constructed, or produced as a result of expenditures made during the performance of the agreement. The Determinations and Findings also cited as intangible benefits the information, techniques, and training derived in doing the work. However, we believe the Department provided consideration for these intangibles when it waived depreciation and added factor for the funds-in agreement. The basis for the waiver was that the work would directly benefit Department programs.

There was no intent to draw a conclusion on this issue in the OIG investigation report. The report's discussion was intended to reflect what the investigators were told by various officials.

We acknowledge that this issue is cloudy, and believe that such a condition warrants an Office of General Counsel opinion.

LOS ALAMOS NATIONAL LABORATORY
COSTS IN EXCESS OF NONFEDERAL SPONSOR ADVANCES
FISCAL YEAR 1989

<u>Month</u>	<u>Costs in Excess of Sponsor Advances</u>	<u>No. of Projects With Excess Cost</u>
Oct	-0-	0
Nov	\$ 11,209	2
Dec	\$ 26,358	3
Jan	\$ 56,407	3
Feb	\$ 59,096	2
Mar	\$145,508	3
Apr	\$159,411	4
May	\$229,782	6
Jun	\$461,409	4
Jul	\$389,650	4
Aug	\$334,166	4
Sep	-0-	0

LOS ALAMOS NATIONAL LABORATORY
COSTS IN EXCESS OF AFP OBLIGATIONAL AUTHORITY
FOR NONFEDERALLY SPONSORED WORK
FISCAL YEAR 1989

<u>Month</u>	<u>Costs in Excess of AFP Obligational Authority</u>	<u>No. of Projects With Excess Cost</u>
Oct	-0-	0
Nov	\$ 98,999	3
Dec	\$ 26,991	4
Jan	\$131,495	5
Feb	\$257,012	4
Mar	\$286,508	3
Apr	\$174,411	4
May	\$385,769	6
Jun	\$484,735	6
Jul	\$389,650	4
Aug	\$719,166	4
Sep	-0-	0

NOTES

1. Amounts in Exhibit A are less than amounts in Exhibit B because of a timing difference. The cost in excess of sponsor advances in Exhibit A is based on the month in which the Department received the sponsor's advance, while the cost in excess of AFP obligational authority in Exhibit B is based on the month in which the advance appeared in the transfers report.
2. LANL's project accounting records did not show costs in excess of AFP obligational authority at the September 30, 1989 year end. For some projects (projects T-487, T-494, T-530, and T-534), LANL transferred the operating account balances, about \$34,000, to the balance sheet account, Unbilled Receivables, and then reversed the entries at the beginning of FY 1990. (These entries would have been unneeded if AL and LANL had observed the requirement that costs should not exceed the sponsor's advances.) For four other projects (projects T-271, T-530, T-534, and T-567), LANL redistributed about \$25,000 of project costs to different projects.

LOS ALAMOS NATIONAL LABORATORY
COSTS IN EXCESS OF AFP FOR NONFEDERALLY SPONSORED WORK
ATTRIBUTABLE TO ALBUQUERQUE OPERATIONS OFFICE (AL) DELAYS
FISCAL YEAR 1989

<u>Month</u>	(a) <u>Costs in Excess of AFP</u> <u>Obligational Authority</u>	(b) <u>Attributable</u> <u>To AL Delays</u>	(a-b) <u>Balance</u>
Oct	-0-	-0-	-0-
Nov	\$ 82,451	\$ 82,251	\$ 200
Dec	\$ 10,072	-0-	\$10,072
Jan	\$ 97,913	\$ 75,089	\$22,824
Feb	\$223,429	\$217,915	\$ 5,514
Mar	\$252,935	\$252,925	-0-
Apr	\$174,028	\$152,784	\$21,244
May	\$385,387	\$328,621	\$56,766
Jun	\$484,359	\$449,222	\$35,137
Jul	\$389,650	\$387,812	\$ 1,838
Aug	\$719,166	\$715,620	\$ 3,546
Sep	-0-	-0-	-0-

NOTE

Costs in column (a) of this exhibit are less than those shown in Exhibit B because fewer projects were used to prepare this exhibit. The only projects used in this exhibit were those where LANL updated the spending plans to reflect changing circumstances.

END

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