



**U.S. Department of Energy**  
**Office of Inspector General**  
**Office of Audits and Inspections**

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# ASSESSMENT REPORT

Audit Coverage of Cost Allowability for  
Babcock & Wilcox Technical Services Pantex  
LLC During Fiscal Year 2013 Through June 30,  
2014, Under Department of Energy Contract  
No. DE-AC54-00AL66620

OAI-V-16-04

February 2016

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**Department of Energy**  
Washington, DC 20585

February 12, 2016

MEMORANDUM FOR THE MANAGER, NNSA PRODUCTION OFFICE

A handwritten signature in black ink, appearing to read "David Sedillo".

FROM: David Sedillo, Director  
Western Audits Division  
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on “Audit Coverage of Cost Allowability for Babcock & Wilcox Technical Services Pantex LLC During Fiscal Year 2013 Through June 30, 2014, Under Department of Energy Contract No. DE-AC54-00AL66620”

BACKGROUND

Babcock & Wilcox Technical Services Pantex LLC (B&W Pantex) managed and operated the Pantex Plant (Pantex) under contract with the Department of Energy (Department) from February 1, 2001, through June 30, 2014. Pantex is part of the Department’s National Nuclear Security Administration (NNSA), and is a nuclear weapons assembly and disassembly facility with a mission to safely and securely maintain the nation’s nuclear weapons stockpile and dismantle weapons retired by the military. During fiscal year (FY) 2013 through June 30, 2014, B&W Pantex incurred and claimed costs totaling approximately \$966 million.

As an integrated management and operating contractor, B&W Pantex’s financial accounts are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. B&W Pantex is required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and to claim only allowable costs. Allowable costs are incurred costs that are reasonable, allocable, and in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

The Department’s Office of Inspector General, Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy (Strategy) to make efficient use of available audit resources while ensuring that the Department’s contractors claim only allowable costs. This Strategy places reliance on the contractors’ internal audit function (Internal Audit) to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the Strategy, B&W Pantex is required by its contract to maintain an Internal Audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, B&W Pantex is required to conduct or arrange for audits of its subcontractors when

costs incurred are a factor in determining the amount payable to a subcontractor. To help ensure that audit coverage of cost allowability was adequate for FY 2013 through June 30, 2014, the objectives of our assessment were to determine whether:

- Internal Audit conducted cost allowability audits that complied with professional standards and could be relied upon;
- B&W Pantex conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- Questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews had been adequately resolved.

### RESULTS OF ASSESSMENT

Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by B&W Pantex's Internal Audit for FY 2013 through June 30, 2014, could not be relied upon. We did not identify any material internal control weaknesses with the cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing (IIA Standards). During its FY 2013 through June 30, 2014, audits of cost allowability, Internal Audit identified questioned costs totaling \$1,348,050, of which \$1,180,723 had been resolved. Thus, we are questioning the remaining \$167,327.

The unresolved questioned costs included the following:

- Compensation Increase Plan administration errors and subcontract payments made outside subcontract terms and conditions totaling \$7,753;
- Certification payments made without adequate documentation, erroneous payment of certification pay, unauthorized contract commitments, and subcontract payments made outside subcontract terms and conditions totaling \$115,870;
- Labor and travel payments made outside subcontract terms and conditions totaling \$20,915; and
- Coordination of medical benefits totaling \$22,789.

Because of the unresolved questioned costs, the FY 2013 Statement of Costs Incurred and Claimed had not been signed by the Contracting Officer as required by the Department's Accounting Handbook. As a result, the Office of Inspector General is unable to sign the FY 2013 Statement of Costs Incurred and Claimed until the questioned costs are resolved.

We also noted that an external assessment of Internal Audit was not conducted as required by IIA Standards, which require an assessment of internal audit activities at least once every five years by an entity external to the organization. The most recent external assessment was

conducted in July 2009. However, Internal Audit, in conjunction with the external assessment team and the Director of Ethics & Internal Audit, determined that the assessment would be of limited value because the contract transitioned to another management and operating contractor on July 1, 2014. In addition, Internal Audit reasoned that an external assessment specific to Pantex would be unnecessary because the new contract consolidated Pantex and Y-12 National Security Complex (Y-12) operations, and the Y-12 Internal Audit function had an external assessment performed in December 2013 and would continue as such under the new contract. Alternatively, Internal Audit performed an internal self-assessment to document conformance with IIA Standards. The NNSA Production Office agreed to postpone the external assessment until a later date. We suggest that an external assessment of Internal Audit be performed by December 2018. As such, the external assessment would be conducted within the 5-year timeframe required by IIA Standards since the prior external assessment conducted at Y-12 was in December 2013.

### RECOMMENDATION

We recommend that the Manager of the NNSA Production Office direct the Contracting Officer to make a determination regarding the allowability of questioned costs identified by B&W Pantex Internal Audit totaling \$167,327 and recover those amounts determined to be unallowable.

### MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management agreed with the report and recommendation, and their planned action is responsive to our recommendation. Management stated that the estimated date for resolving all questioned costs is March 31, 2016. Attachment 1 contains Management Comments.

### SCOPE AND METHODOLOGY

This assessment was performed from June 2015 to December 2015, at the Pantex Plant located in Amarillo, Texas. The assessment was limited to Internal Audit's activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affected costs claimed by B&W Pantex on its Statement of Costs Incurred and Claimed for FY 2013 through June 30, 2014. The assessment was conducted under Office of Inspector General project number A15LV039. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit that included a review of allowable cost audit reports, workpapers, auditor qualifications, independence, audit planning including risk assessments and overall internal audit strategy, and compliance with applicable professional auditing standards;
- Conducted interviews of auditors;
- Reviewed policies, procedures, and practices to identify subcontracts requiring audit and arrange for audits;

- Assessed subcontract audit status; and
- Evaluated resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Internal Audit, and other organizations.

We conducted our assessment in accordance with generally accepted Government auditing standards for attestation engagements. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for conclusions based on our objectives. A review is substantially less in scope than an examination or audit where the objective is an expression of an opinion on the subject matter and accordingly, for this review, no such opinion is expressed. Also, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on computer-processed data to accomplish our objectives. We determined that the computer-processed data was sufficiently reliable for the purposes of the review by comparing the data to source documents. Management waived an exit conference.

This report is intended for the use of Department and NNSA contracting officers and field offices in the management of their contracts and is not intended to be and should not be used by anyone other than these specified parties.

Attachments

MANAGEMENT COMMENTS



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



January 19, 2016

MEMORANDUM FOR RICKEY R. HASS  
ACTING INSPECTOR GENERAL

FROM: FRANK G. KLOTZ JK 1/19/2016

SUBJECT: Comments on the Office of Inspector General Draft Report Titled *Audit Coverage of Cost Allowability for Babcock and Wilcox Technical Services Pantex LLC during Fiscal Year 2013 Through June 30, 2014, Under Department of Energy Contract No. DE-AC54-00AL66620" (A15LV039)*

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the auditors' validation of the B&W Pantex internal audit work and recognition of their proactive efforts to self-identify questioned costs. NNSA concurs with the report's recommendation to complete the Contracting Officer's determination on the allowability of the remaining questioned costs, and recover any costs deemed unallowable as appropriate. The estimated date for resolving all questioned costs is March 31, 2016.

If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audit Coordination and Internal Affairs, at (301) 903-1341.

