



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

ASSESSMENT REPORT

Audit Coverage of Cost Allowability for
UChicago Argonne LLC During Fiscal Years
2010 Through 2013 Under Department of
Energy Contract No. DE-AC02-06CH11357

OAI-V-16-05

March 2016



Department of Energy
Washington, DC 20585

March 9, 2016

MEMORANDUM FOR THE DIRECTOR, OFFICE OF ACQUISITION MANAGEMENT
MANAGER, ARGONNE SITE OFFICE

Sarah B. Nelson

FROM: Sarah B. Nelson
Assistant Inspector General
for Audits and Administration
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on “Audit Coverage of Cost Allowability for UChicago Argonne LLC During Fiscal Years 2010 Through 2013 Under Department of Energy Contract No. DE-AC02-06CH11357”

BACKGROUND

UChicago Argonne LLC (UC Argonne) operates the Argonne National Laboratory (Argonne) under a contract with the Department of Energy (Department). Argonne is part of the Department’s Office of Science, performing research in areas of basic science, environment, energy resources, and national security. For fiscal years (FYs) 2010 through 2013, UC Argonne expended and claimed \$3,012,190,788.

As an integrated management and operating (M&O) contractor, UC Argonne’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. UC Argonne 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 allowable in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

The Department’s Office of Inspector General, Office of Acquisition Management, the integrated M&O contractors, and other select contractors have implemented a Cooperative Audit 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, UC Argonne is required by its contract to maintain an Internal Audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. The strategy also requires that audits performed internally

must, at a minimum, meet the standards prescribed by the Institute of Internal Auditors. In addition, UC Argonne is required to conduct or arrange for audits of its cost-type subcontracts to ensure that associated costs incurred were allowable.

To help ensure that audit coverage of cost allowability was adequate for FYs 2010 through 2013, 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;
- UC Argonne 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 Internal Audit 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 prescribed by the Institute of Internal Auditors. Additionally, we found that UC Argonne had conducted or arranged for 21 cost-type subcontract audits totaling \$57.7 million for the period under review. Internal Audit had identified \$63,877 in questioned costs, which were resolved. In addition, subcontract audits performed by the Defense Contract Audit Agency (DCAA) and Health and Human Services identified \$93,354 in questioned costs that were recovered during the period of our review.

While we did not identify any material control weaknesses that would affect overall reliance on cost-allowability work performed by Internal Audit, we noted concerns that need to be addressed to ensure that only allowable costs are claimed by and reimbursed to UC Argonne. Specifically:

- UC Argonne received payments for Board of Governors' expenses during FYs 2010 through 2013 in the absence of approved budgets, contrary to contract terms. For example, in FY 2013, UC Argonne received \$1.5 million in reimbursements for Board of Governors' expenses despite the absence of an approved budget.
- UC Argonne used \$2,363 of royalty income to pay for social events that served alcohol, an expense we questioned as inappropriate under the terms of the contract.
- Internal Audit used judgmental sampling, rather than statistical sampling, despite Cooperative Audit Strategy guidance that established an expectation that internal auditors employ a recognized statistical sampling methodology sufficient to reach a conclusion on the allowability of costs and permit the projection of unallowable costs.

- UC Argonne excluded 42 ongoing and completed cost-type subcontracts, with a combined value of \$106.7 million, from consideration for audit. Consequently, of the \$106.7 million worth of subcontracts excluded from audit consideration, we consider the completed subcontracts totaling \$35.2 million unresolved pending audit.

Board of Governors' Expenditures

UC Argonne received payments for Board of Governors' expenses during FYs 2010 through 2013 in the absence of approved budgets, contrary to contract terms. For example, in FY 2013, UC Argonne received \$1.5 million in reimbursements for Board of Governors' expenses despite the absence of an approved budget. Prime contract clause H.14, *Board of Governors' Expenses*, allows for the reimbursement of Board of Governors' activities, such as staff costs and meeting expenses. However, the clause requires UC Argonne to submit a detailed budget 60 days before the beginning of the fiscal year to the Contracting Officer for review, and then the parties would agree to a provisional amount for the year that could be used for advanced payments prorated monthly at 85 percent. The clause states that any costs incurred in excess of the mutually agreed upon provisional budget shall be unallowable unless an increase is approved by the Contracting Officer in writing.

We discovered that neither UC Argonne nor the Argonne Site Office had been adhering to the budget submittal and approval requirements. For example, the budgets for FYs 2011 and 2012 were submitted in December and not approved until February, more than 4 months into the respective fiscal years. The budgets for FYs 2010 and 2013 were also submitted in December but signed approval letters could not be found.

Although Internal Audit had conducted an audit of the Board of Governors' expenses, it did not question the allowability of the claimed costs, despite the lack of documentation approving the provisional budget. Instead of applying the contractual requirements in its evaluation of expenses, Internal Audit relied on the Argonne Site Office's "tacit" or implied approval of the Board of Governors' annual budget. Internal Audit noted in its workpapers that using the prior fiscal year's approved provisional budget was the established practice for payment of Board of Governors' expenses. However, Internal Audit could not provide us with a written policy that included this practice.

In its audit of Board of Governors' expenses, Internal Audit identified \$35,687 in questioned costs, related mostly to travel and meetings. However, we also found instances where Internal Audit accepted salary expenditures for the Board of Governors that were not properly supported by source documents. According to a UC Argonne official, the salary costs were allocated to the Board of Governors based on an estimated percentage of time spent for Board of Governors' activities. The official further stated that while the estimates were stable over the past several years, a formal annual review was planned for implementation in FY 2015.

During our assessment, the Argonne Site Office completed its final review of FY 2013 Board of Governors' expenditures, based on actuals spent, and issued its final cost determination letter in January 2015. The Argonne Site Office did not question any additional costs beyond the

amounts questioned previously by Internal Audit. Because the Contracting Officer has made a final determination on these costs, we are not questioning the \$1.5 million in costs that were reimbursed in the absence of an approved budget; however, steps should be taken to ensure compliance with the contract terms in the future. Reimbursement of Board of Governors' expenses, in the absence of an approved budget, raises the risk that unreasonable costs will be claimed and reimbursed.

Royalty Income Spending

We noted that in its audit, *Divisional Spending of Royalty Revenue*, Internal Audit found, but did not question, UC Argonne's use of \$2,363 of royalty income to pay for social events that served alcohol during an educational workshop. Internal Audit relied on internal guidance when reviewing spending of royalty income, rather than the contractual requirements. UC Argonne's prime contract included the Department of Energy Acquisition Regulation (DEAR) 970.5227-3, *Technology Transfer Mission*, which identified appropriate uses of royalty income as scientific research, development, technology transfer, and education at the laboratory. Despite these limitations, Internal Audit applied UC Argonne's less restrictive royalty distribution policy that allowed for more liberal spending of royalty income on amenities, such as certain travel, entertainment, and social activities. Internal Audit justified the application of the policy because it did not consider the royalty funds to be Department funds and subject to the Department's rules. Although not coming directly from the Department, the royalties were the result of Department-funded research, and as such, the Department established the appropriate uses of the royalties in its contract with UC Argonne.

As a result of our inquiries, we questioned the \$2,363 of royalty income used to pay for social event costs as unrelated to scientific research, development, technology transfer, and education. We brought this use of royalty income to the attention of Argonne Site Office officials. They stated their internal review found that UC Argonne added the amenities language after they approved the policy. They also informed us that UC Argonne has revised its policy to agree with the contract terms.

Judgmental Sampling

Internal Audit used judgmental sampling, rather than statistical sampling, despite Cooperative Audit Strategy guidance that established an expectation that internal auditors employ a recognized statistical sampling methodology sufficient to reach a conclusion on the allowability of costs and permit the projection of unallowable costs. When a judgmental sampling methodology is used, the rationale should be clearly documented in the workpapers. While Internal Audit properly identified its samples were judgmental and described the selection process, it did not explain why judgmental samples were more appropriate than statistical samples. To illustrate, Internal Audit judgmentally sampled costs from travel each year and typically questioned costs in this category. The use of statistical sampling may have facilitated projecting the sample results to quantify the full extent of unallowable travel costs in the universe.

Subcontract Audits

UC Argonne did not sufficiently conduct or arrange for audits of all of its cost-type subcontracts as contractually required. Although UC Argonne had subcontract audit policies requiring interim and final audits of cost-type subcontracts, UC Argonne did not consider for audit 42 ongoing and completed cost-type subcontracts, with a combined value of \$106.7 million. The unaudited cost-type subcontracts included 16 time-and-material (T&M) subcontracts valued at \$38.4 million, and 26 other cost-type agreements with multiple task orders valued at \$68.3 million that, when the task orders were aggregated, exceeded UC Argonne's audit thresholds for interim or final audits.

DEAR 970.5232-3, *Accounts, Records, and Inspection*, as incorporated in the UC Argonne prime contract, requires that the contractor conduct or arrange for audits of subcontracts when costs incurred are a factor in determining the amount payable to the subcontractor. UC Argonne's policy is to obtain interim audits of cost-type subcontracts when the subcontracts are 3 years old, have at least \$1 million in cost for each of the 3 years, and are expected to continue for at least 2 more years. Additionally, the policy requires final closeout audits for cost-type subcontracts with invoiced costs over \$700,000.

According to a UC Argonne official, the 16 T&M subcontracts were not considered for audit because they were not considered cost-type subcontracts. However, while T&M subcontracts contain fixed labor rates, they also contain variable components, such as labor hours incurred, materials and other direct costs, which are a factor in determining the amount payable to a subcontractor. A UC Argonne official provided various other reasons why these subcontracts were not considered for audit, such as the other direct costs charged were minimal and competition was used to select the subcontractor. However, our sample of T&M subcontract invoices showed that other direct costs were not minimal; as they were more than 40 percent of the invoiced costs. When asked about why competition would preclude the need for closeout audits, a UC Argonne official could not provide an explanation.

Regarding the remaining 26 cost-type unaudited agreements, UC Argonne officials stated that audits were not conducted on these because they were basic ordering agreements where they issued task orders that individually did not meet UC Argonne's audit threshold. They explained that case law has established that basic ordering agreements do not constitute contracts, but rather each individual task order issued represents a separate contract. Under the policy, only individual contracts that meet the established thresholds are subject to audit. However, we found two individual task orders, for the same contractor, did exceed UC Argonne's audit threshold of \$700,000, and therefore should have been audited under the policy. The total value of this agreement was about \$4.2 million and, while there had been no cost activity since 2008, no audit had been performed. For the other 25 subcontractors, we noted that individual task orders did not meet the audit threshold as management stated. However, we found that when the values of the underlying task orders were aggregated for each agreement, the overall value of the agreements ranged from about \$795,000 to \$5.2 million. As such, we are concerned that the policy does not adequately address the risk associated with multiple task orders to a single contractor that may, in the aggregate, represent a substantial financial exposure.

Another official stated that some of the task order subcontracts were with universities, and these may have already been audited under the requirements of Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. However, although we requested all audits it had obtained, UC Argonne did not provide us with Circular A-133 audit reports for all its university-type subcontractors. Regardless, UC Argonne's subcontract audit policy did not describe any of these reasons for excluding these cost-type subcontract awards from audit consideration.

We also found weaknesses in UC Argonne's audit request and documentation process. Specifically, the Accounts Payable Department, the organization responsible for requesting subcontract audits and closing the subcontracts once the audits are completed, did not ensure that (1) it had the full universe of subcontracts potentially subject to audit, and (2) all audits requested were actually completed. The Accounts Payable Department did not use the Procurement Department's online system that would have provided it with the universe of subcontracts potentially subject to audit. Further, Accounts Payable was tracking its subcontract audit requests manually, and had not reconciled the audits it requested to the audit reports it received, a problem highlighted when we attempted to determine the status of the subcontract audit requests. We also learned that the Argonne Site Office had not always forwarded the requests received from UC Argonne to the appropriate organizations to ensure an audit occurred. The Argonne Site Office official responsible for sending the audit request documentation to the agency cognizant for audits of the subcontractor did not realize that this was his responsibility.

Overall we concluded that the lack of audit coverage occurred because UC Argonne did not have a fully documented risk-based strategy in its policies or its Internal Audit Implementation Design to implement its contractually required subcontract audit responsibilities specified by the DEAR and the Cooperative Audit Strategy. A fully documented policy, for example, might document the risks associated with T&M subcontracts and agreements with multiple task orders along with the appropriate situations where an audit would not be necessary. It might also describe the various roles, responsibilities, and procedures, such as obtaining the lists of subcontracts potentially subject to audit or tracking audit requests and receipt of audit reports. As we stated in our previous report entitled, *Special Report: Management and Operating Contractors' Subcontract Audit Coverage* (DOE/IG-0885, April 2013), the failure to ensure that effective subcontract audit policies are developed and implemented substantially increases the risk that unallowable costs will be incurred and not detected in a timely manner.

In response to this Special Report, in October 2013, the Department issued Acquisition Letter 2014-01, to achieve greater Department-wide emphasis on auditing cost-type subcontracts by providing guidance for monitoring M&O contractors' fulfillment of their contractual obligation to provide audit coverage of cost-type subcontracts. Among other things, the Acquisition Letter provided guidance for establishing and implementing procedures requiring subcontract audits that are based on a reasonable risk-based approach, including appropriate thresholds and selection criteria, and capturing T&M subcontracts in the universe. Argonne Site Office officials stated that they considered the guidance in the Acquisition Letter but did not feel any action was warranted based on their interactions with UC Argonne's procurement personnel and understanding of the procurement practices. Finally, although Argonne Site Office officials

indicated that they monitor subcontracts through monthly meetings with interested parties, we also noted that they had not documented their procedures and were not tracking the audits they requested on behalf of UC Argonne or the audit reports they received. Consequently, of the \$106.7 million worth of subcontracts excluded from audit consideration, we consider the completed subcontracts totaling \$35.2 million unresolved pending audit.

Other Matters

During this review, we became aware of events that may eliminate DCAA as an option for subcontract audits. First, an official from the Office of Science's Chicago Office brought to our attention a situation where DCAA declined to audit \$1.9 million in costs associated with a UC Argonne subcontractor based on the application of its *Policy and Procedures for Sampling Low-Risk Incurred Cost Proposals* that affected subcontracts less than \$250 million. Once DCAA declined the audit, UC Argonne did not pursue other options for getting the required audit, such as engaging contract auditors or its own Internal Audit. Accordingly, we consider the \$1.9 million as unresolved pending audit, bringing the total unresolved costs to \$37.1 million.

We notified Department procurement officials of our concern that implementation of DCAA's policy may result in the failure to obtain audits on the majority of subcontracts. In response, the Office of Management informed us that on October 22, 2015, it issued guidance to Heads of Contracting Activities advising them of our concern and stating that clarifying guidance regarding participation in DCAA's risk initiative would be forthcoming.

Subsequently, on November 25, 2015, the President signed the *National Defense Authorization Act for Fiscal Year 2016* prohibiting DCAA from providing audit support for non-Department of Defense agencies until it reduces its backlog of incurred costs audits. As DCAA support may not be available for conducting all subcontract audits, Argonne and other Department contractors will need to consider other options to meet their contractual obligations.

RECOMMENDATIONS

We recommend that the Manager of the Argonne Site Office:

1. Document procedures for requesting and obtaining subcontract audits on behalf of UC Argonne.

We also recommend that the Manager of the Argonne Site Office direct the Contracting Officer to:

2. Make an official determination regarding the appropriateness of the questioned costs and ensure those costs determined inappropriate are returned and used for the activities stipulated in the contract.
3. Ensure that Internal Audit performs statistical samples in its cost allowability audits or fully describe the rationale for using judgmental samples.

4. Establish an approved budget for Board of Governors' spending before the start of the fiscal year, as required by the contract, and ensure payments do not occur until the provisional budget is approved.
5. Ensure UC Argonne obtains audits of cost-type subcontracts as required by its contract and revises its policy for auditing cost-type subcontracts, as appropriate. As highlighted in Acquisition Letter 2014-01, the policy should have a reasonable risk-based approach and delineated roles, responsibilities, and procedures. The policy should address the risks associated with T&M contracts and multiple task orders to individual contractors under basic ordering agreements.
6. Verify that UC Argonne has an adequate means to track subcontract audit requests and receipts of subcontract audits.

In addition, we recommend that the Director of the Office of Acquisition Management:

7. Issue guidance to the Department's contractors detailing how they may satisfy the subcontractor audit requirement, given the loss of DCAA audit support.

MANAGEMENT RESPONSE

Argonne Site Office management officials concurred with the six recommendations addressed to them and stated that they had implemented corrective actions to address them. Management officials stated that they had developed a procedure to track and process subcontract audit requests. Additionally, management officials determined the royalty funds we questioned were connected with an educational endeavor, which was consistent with the Prime Contract. Management officials reported that they also instructed UC Argonne to comply with the guidelines in the Prime Contract and use prudent and reasonable judgment in the administration of royalty funds. Further, management officials stated that Internal Audit standardized its documentation of its sampling rationale. Management officials also informed us that they had communicated to UC Argonne their expectations regarding timely submissions of the annual Board of Governors' budgets and stated that in the future, the Contracting Officer will ensure no reimbursements are made prior to approval of the budget. Finally, management officials reported that UC Argonne updated its subcontract audit policies for requesting audits as well as for tracking and receiving the audits.

The Office of Acquisition Management officials concurred with our recommendation to revise its guidance on obtaining independent contract audit support. Management also commented that DCAA may provide audit support in some instances based on guidance DCAA issued on January 7, 2016.

Management's formal comments are included as Attachment 2.

AUDITOR COMMENTS

Overall, actions proposed by the Argonne Site Office and the Office of Acquisition Management were generally responsive to our recommendations. While the Argonne Site Office determined not to recover the royalty funds for the social events associated with the educational event, we remain concerned about that portion of the social event costs that were spent on alcohol, which is specifically prohibited by Federal Acquisition Regulation. Although UC Argonne's expenditures of royalty income are not subject to these rules, we believe the Federal Acquisition Regulation establishes a reasonable benchmark for determining whether costs are reasonable and prudent in these circumstances.

Finally, in response to the Office of Acquisition Management's comments, we revised our report to clarify information regarding the availability of DCAA audit support.

SCOPE AND METHODOLOGY

This assessment was performed from September 2014 to March 2016, at Argonne National Laboratory in Argonne, Illinois. The assessment was limited to Internal Audit's activities, subcontract audits and reviews, and resolution of questioned costs and internal control weaknesses that affected costs claimed by UC Argonne on its Statement of Costs Incurred and Claimed for FYs 2010 through 2013. The assessment was conducted under Office of Inspector General project number A14CH067. To accomplish our objectives, we did the following:

- Assessed allowable cost audit work conducted by Internal Audit for FYs 2010 through 2013. Specifically, we reviewed Internal Audit's charter, policies, and procedures; allowable cost audit reports and related workpapers; auditor qualifications; independence; audit planning; risk assessments; overall audit strategy; and compliance with applicable professional auditing standards.
- Conducted interviews of UC Argonne management officials and audit staff, as well as members of the Department's Chicago Office and Argonne Site Office.
- Judgmentally selected a sample of 16 of the 143 transactions that Internal Audit tested in its FY 2013 Cost Allowability Audit, plus another 5 transactions from its audit on Board of Governors' Cost Allowability for retesting to determine whether the fieldwork was conducted in accordance with applicable auditing standards. Because selection was not statistical, the results and overall conclusions are limited to the transactions retested and cannot be projected to the entire population of transactions tested.
- Reviewed UC Argonne's policies, procedures, and practices for identifying subcontracts that required interim or postaward audit coverage and arranging for the audits.
- Evaluated the questioned costs and internal control weaknesses resolution process. Specifically, we met with contracting officers to determine the thoroughness of the questioned costs determination process.

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 our conclusions based on our objectives. A review is substantially less in scope than an examination or audit in which 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 our review by comparing the data to source documents. The Office of Acquisition Management waived an exit conference on February 17, 2016. Argonne Site Office management waived an exit conference on February 18, 2016.

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

Attachments

PRIOR REPORTS

- Special Report on [Management and Operating Contractors' Subcontract Audit Coverage](#) (DOE/IG-0885, April 2013). This special report highlighted subcontract audit issues that we identified in previous reports. Between 2010 and 2012, the Office of Inspector General reported subcontract audit weaknesses with nine of the Department of Energy's (Department) Management and Operating (M&O) contractors. Subcontracts valued in excess of \$906 million had not been audited or were reviewed in a manner that did not meet audit standards. The subcontract costs were not audited because the Department did not ensure that its M&O contractors developed and implemented robust procedures to meet their contractual requirements. While some sites had taken action in response to our reports, we stressed the need for a top-down emphasis to ensure that the M&O contractors audited their cost-type subcontracts to reduce the risk that unallowable costs would be incurred and not detected in a timely manner.
- Assessment Report on *Audit Coverage of Cost Allowability for UChicago Argonne LLC Under Department of Energy Contract No. DE-AC02-06-CH11357 for Fiscal Year 2009* (OAS-V-11-07, March 2011). This assessment found that UChicago Argonne LLC did not always conduct or arrange for interim audits of its subcontractors when costs incurred were a factor in determining the amount payable to subcontractors. UChicago Argonne LLC's procurement policy did not require audits of cost-type subcontracts until after the subcontracts were completed and being closed out. Recognizing that it may not be practical to audit every cost-type subcontract on an interim basis, we identified two multiyear subcontracts valued at about \$38 million that we believed should have been audited on an interim basis. We considered the \$5,084,379 in costs incurred during fiscal year 2009 for these two subcontracts as unresolved costs pending audit.

MANAGEMENT COMMENTS



Department of Energy

Argonne Site Office
9800 South Cass Avenue
Argonne, Illinois 60439

DEC 11 2015

MEMORANDUM FOR: RICKEY R. HASS
ACTING INSPECTOR GENERAL FOR AUDITS AND
ADMINISTRATION
OFFICE OF INSPECTOR GENERAL

FROM: JOANNA M. LIVENGOOD *Joanna M. Livengood for JML*

SUBJECT: RESPONSE TO INSPECTOR GENERAL'S DRAFT ASSESSMENT
REPORT, "AUDIT COVERAGE OF COST ALLOWABILITY FOR
UCHICAGO ARGONNE, LLC DURING FISCAL YEARS 2010
THROUGH 2013 UNDER DEPARTMENT OF ENERGY CONTRACT
NO. DE-AC02-06CH11357"

Thank you for the opportunity to review and comment on the attached subject draft report. Our response to the specific recommendations follow.

Recommendation 1:

Document procedures for requesting and obtaining subcontract audits on behalf of UC Argonne

Management Response: Concur.

Action Plan: During the timeframe that this audit was conducted, the OIG determined the tracking and forwarding of UChicago Argonne, LLC (Argonne) audit requests of subcontracts were not adequately documented. Since the audit, the Argonne Site Office (ASO) has implemented the following procedure for tracking and processing subcontracts forwarded by Argonne for audit:

- *Subcontract requests are forwarded by Argonne to ASO for audit;*
- *ASO documents receipt of the request in its SMART action tracking system and forwards the request to Integrated Support Center-Team leader/Internal Review and Advisory Services group DOE's Office of Science (SC-CH) for review/audit;*
- *The Team leader signs off on the receipt of the Audit Request and returns a copy (Cover page) to ASO, which records this in the SMART action tracking system;*
- *ASO then forwards to the Lab, documenting that the request is being processed.*
- *At the completion of the audit (internal or external) the recommendations are forwarded to ASO, which closes out the SMART item and the report is then transmitted to Argonne for action.*

Estimated Completion Date: Completed, November 25, 2015

A component of the Office of Science

DEC 11 2015

Rickey R. Hass

-2-

Recommendation 2:

Make an official determination regarding the appropriateness of the questioned costs and ensure those costs determined inappropriate or unallowable are returned and used for the activities stipulated in the contract.

Management Response: Concur

Action Plan: The Prime Contract defines the parameters by which Argonne may use royalties or other earned income. The funds in question were used in connection with an educational endeavor which is consistent with the objectives of the Prime Contract.

The ASO has instructed Argonne regarding the administration of royalty funds to ensure compliance with the guidelines outlined in the Prime Contract and to use prudent and reasonable judgment in the application of these guidelines.

Estimated Completion Date: Completed, December 1, 2015

Recommendation 3:

Ensure that Internal Audit performs statistical samples in its cost allowability audits or fully describe the rationale for using judgmental samples.

Management Response: Concur.

Action Plan: Argonne's Internal Audit has implemented a standard method to document the sampling rationale.

Estimated Completion Date: Complete, December 1, 2015

Recommendation 4:

Establish an approved budget for Board of Governors' spending before the start of the fiscal year, as required by the contract, and ensure payments do not occur until the provisional budget is approved.

Management Response: Concur

Action Plan: ASO Management met with UChicago representatives to communicate expectations and timelines regarding annual submission and recoupment of Board of Governor annual budget and expenditures. In the future, the DOE Contracting Officer will ensure approval of the Board of Governors' annual budget prior to start of the fiscal year or will ensure no reimbursement is made prior to DOE approval.

Estimated Completion Date: Complete, November 30, 2015

DEC 11 2015

Richey R. Hass

-3-

Recommendation 5:

Ensure UC Argonne obtains audits of cost-type subcontracts as required by its contract and revises its policy for auditing cost-type subcontracts, as appropriate. As highlighted in

Acquisition Letter 2014-01, the policy should have a reasonable risk-based approach and delineated roles, responsibilities, and procedures. The policy should address the risks associated with T&M contracts and multiple task orders to individual contractors under basic ordering agreements.

Management Response: Concur.

Action Plan: Argonne's Procurement Manual, POM Chapter 9 Argonne Specific Requirements – Section 9.4 Sourcing, Awarding, and Administration of Contracts, Purchase Orders, and Agreements; Sub Section 9.4.2 Supplier Audits and Surveys (Capable and Reliable), was updated to include the following language pertaining to contract audits.

- *Audits may be conducted as part of the administration of a cost-type contract to verify cost information on which payments are to be based, or to verify total costs incurred as part of a close-out audit, as necessary. Audits will be conducted on cost-type contracts that exceed \$750,000 in value or for labor hour/time-and-material contracts when material costs exceed \$750,000 in value.*
- *Interim audits will be conducted on any cost-type contract that is three years old, has at least \$1M in cost for each of the three years, and is expected to continue for an additional two years. Subsequent audits will be conducted every three years, as necessary.*
- *Pre-award, interim, or close-out audits may be requested for contracts of any value if the Laboratory suspects improper billing has occurred. Additionally, when improper billing is suspected, the Laboratory may aggregate task orders or multiple purchase orders or contracts issued to such contractor for the audit requested.*

Estimated Completion Date: Completed November 25, 2015.

Recommendation 6:

Verify that UC Argonne has an adequate means to track subcontract audit requests and receipts of subcontract audits.

Management Response: Concur.

Action Plan: Argonne's Procurement Manual, POM Chapter 9 Argonne Specific Requirements – Section 9.4 Sourcing, Awarding, and Administration of Contracts, Purchase Orders, and Agreements; Sub Section 9.4.2 Supplier Audits and Surveys (Capable and Reliable), was updated to include the following language pertaining to contract audits.

DEC 11 2015

Rickey R. Hass

-4-

- *Argonne's procurement specialist will prepare the request for their Procurement Systems Manager. The Procurement Systems Manager will ensure the request is transmitted to ASO, or an alternate independent audit entity if appropriate. Requests will be tracked with periodic follow-ups if needed. Copies will be provided to Argonne's Accounts Payable so that retention amounts will not be prematurely disbursed or records destroyed prior to the appropriate time limitation from final contract payment at close-out.*
- *Close-out audits will be requested by the Procurement Specialist using Form PD-2, and audit requests shall provide that audit reports shall be delivered to the Procurement Systems Manager for internal distribution.*

Estimated Completion Date: Completed November 25, 2015.

The proceeding actions represent the steps/measures that have been implemented and/or are ongoing since the audit was conducted to remediate the recommendations made by the OIG.

If you should have any questions, please contact John Kasproicz of my staff. You may reach him by email at john.kasproicz@science.doe.gov, or by phone at (630) 252-2621.

Attachment:
As Stated

cc: G. Smeets, SC-CH
D. Price, ANL
G. Gozum, CF-12
J. Venneri, SC-41.1
S. Martinez, ASO



Department of Energy
Washington, DC 20585

February 2, 2016

MEMORANDUM FOR RICKEY R. HASS
ACTING INSPECTOR GENERAL

FROM: *Berta Schreiber*
BERTA SCHREIBER
ACTING DIRECTOR
OFFICE OF ACQUISITION MANAGEMENT

SUBJECT: Response to the Office of Inspector General Draft Assessment Report Titled "Audit Coverage of Cost Allowability for UChicago Argonne LLC During Fiscal Years 2010 Through 2013 Under Department of Energy Contract No. DE-AC02-06CH11357"

The Department of Energy (the Department) Office of Management (MA) appreciates the opportunity to review the subject draft report. The draft report makes seven recommendations; however, only recommendation #7 is directed at MA. Recommendation #7 has been revised since the previous version submitted to our office for review and below you will find MA's response to the revised recommendation #7.

Recommendation #7: Issue guidance to the Department's contractors detailing how they may satisfy the subcontractor audit requirement, given the loss of DCAA audit support.

Management Response:

Concur. The Office of Management partially concurs with the recommendation. Guidance is provided in the Department of Energy Acquisition Guide, a Department of Energy Acquisition Letter, and the Department of Energy Acquisition Regulation (DEAR). By April 30, 2016, the Acquisition Guide chapter will be revised to include clarifying language emphasizing that independent contract audit support must be conducted by qualified auditors and must meet the Institute of Internal Auditors Standards.

Technical Comments

In addition, the Office of Management would like to take this opportunity to provide suggested technical corrections to the draft report. It is the view of MA that the proposed changes provide clarity with respect to the effects of the National Defense Authorization Act on DCAA audit support available to DOE.



Printed with soy ink on recycled paper