



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

ASSESSMENT REPORT

Audit Coverage of Cost Allowability for Iowa State University During Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE-AC02-07CH11358

OAI-V-16-08

June 2016



Department of Energy
Washington, DC 20585

June 6, 2016

MEMORANDUM FOR THE MANAGER, AMES SITE OFFICE

A handwritten signature in black ink, appearing to read "Jack Rouch".

FROM: Jack Rouch
Deputy Assistant Inspector General for Audits
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on “Audit Coverage of Cost Allowability for Iowa State University During Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE-AC02-07CH11358”

BACKGROUND

Since 1947, Iowa State University (ISU) has managed and operated the Ames Laboratory (Ames) under contract with the Department of Energy. Ames is one of ten Office of Science laboratories and seeks solutions to energy-related problems through the exploration of physics, chemistry, engineering, applied mathematics, and materials sciences. During fiscal years (FYs) 2013 and 2014, ISU expended and claimed \$83,601,772.

As an integrated management and operating contractor, ISU’s financial accounts for Ames are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. ISU 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, integrated management and operating 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, ISU is required by its contract to maintain an Internal Audit activity at Ames with the responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, ISU 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 FYs 2013 and 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;
- ISU 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 prior 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 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. Internal Audit identified \$775 in questioned costs during its audits of FY 2013 and 2014 costs, all of which had been resolved. At the time of our review, ISU had not conducted any subcontract audits but did schedule an audit of one subcontract. Finally, nothing came to our attention to indicate that questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews had not been adequately resolved. We identified no other audits or reviews that reported questioned costs or internal control weaknesses affecting the allowability of costs claimed for FYs 2013 and 2014.

In response to our previous report *Assessment of Audit Coverage of Cost Allowability for Ames Laboratory during Fiscal Years 2009 through 2012 under Department of Energy Contract No. DE-AC02-07CH11358* (OAS-V-14-07, January 2014) ISU established a policy for auditing cost-type subcontracts using a risk methodology in July 2014 that generally addressed our previous subcontract audit concerns. However, we noted areas that could be strengthened as the practices evolve under this new policy. Specifically, we found that the subcontract audit policy did not establish a risk methodology for determining whether to perform interim audits of cost-type subcontracts, but rather relied on sampling subcontractor invoices during the annual cost allowability audit performed by Internal Audit. We noted the budget for Ames has grown from \$24.9 million in FY 2012 to \$49.8 million in FY 2016, increasing the likelihood that subcontracts of longer duration and larger total value will be awarded and necessitate interim audits. Additionally, the subcontract audit policy did not require documented risk assessments to determine whether closeout audits should be performed. We were told that risk assessments were performed; however, we could neither verify that all cost-type subcontracts were assessed nor review the rationale behind decisions not to audit subcontracts prior to the closing of the subcontracts. For instance, we noted documentation did not exist to support that risk assessments were performed for the 21 subcontracts active after the implementation of the new policy in July 2014. These 21 subcontracts totaled \$16.8 million, including 4 subcontracts that totaled over \$1 million each.

Further, we found the new subcontract audit policy had not been fully integrated with the purchasing processes. Specifically, the new policy stated that the Internal Audit Manager would conduct risk assessments in consultation with the Purchasing and Property Services (Purchasing)

Manager to determine the audit coverage of costs incurred for cost-type subcontracts approaching the end of their performance periods. However, this coordination did not occur. According to the Internal Audit Manager, through the risk assessment process, a labor hour subcontract was selected for audit in 2016; however, we found that the Purchasing Manager had already closed this subcontract without an audit. When we brought this to her attention, the Internal Audit Manager decided to audit a different subcontract. We also found that Purchasing had not updated the checklist it uses through the closeout process to include the subcontract audit policy requirements. Although the Purchasing Manager stated that informal risk assessments were performed and a list of subcontracts was subsequently sent to Internal Audit in June of 2015, coordination and formal documentation that these steps were completed would have benefited both offices.

SUGGESTED ACTIONS

We suggest that the Manager of the Ames Site Office direct Iowa State University to:

1. Revise the subcontract audit policy to include the risk factors that would lead to interim audits of cost-type subcontracts being performed.
2. Document the risk assessments of its cost-type subcontracts to demonstrate the rationale behind the decisions to conduct or not conduct audits.
3. Revise Purchasing's checklist to address subcontract audit policy requirements to coordinate on subcontract audits.

Ames Site Office management agreed to ensure that actions are taken consistent with our suggestions. We appreciate the cooperation of your staff during our assessment. A formal response to this report is not required.

SCOPE AND METHODOLOGY

This assessment was performed from December 2015 to June 2016, at Ames, located in Ames, Iowa. 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 ISU on its Statements of Costs Incurred and Claimed for FYs 2013 and 2014. The assessment was conducted under Office of Inspector General project number A16CH012. To accomplish our objectives, we did the following:

- Assessed allowable cost audit work conducted by Internal Audit for FYs 2013 and 2014. Our assessment included a review of allowable cost audit reports; work papers; auditor qualifications; independence; audit planning, including risk assessments and overall internal audit strategy; and compliance with applicable professional auditing standards.
- Conducted interviews of Ames Site Office and ISU personnel at Ames.

- Judgmentally selected a sample of 33 of the 217 transactions that Internal Audit tested in its FY 2014 Cost Allowability Audit 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 policies, procedures, and practices to identify subcontracts requiring audit coverage and arranging for the audits.
- Assessed subcontract audit status.
- 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 our conclusions based on our objectives. A review is substantially less in scope than an examination or audit where the objective is an expression of 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 and determined that data was sufficiently reliable for the purposes of our review by comparing the data to source documents. Ames Site Office management waived an exit conference on May 20, 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 REPORT

Assessment Report on *Audit Coverage of Cost Allowability for Ames Laboratory during Fiscal Years 2009 through 2012 under Department of Energy Contract No. DE-AC02-07CH11358* (OAS-V-14-07, January 2014). This assessment found that Ames Laboratory had not established a policy requiring audits of subcontracts in which costs incurred were a factor in determining the amount payable to the subcontractor. The impact of this issue was determined to be minimal because during the scope of the review, no significant cost-type subcontracts fell into this category. However, because of the possibility of large subcontracts in the future, we suggested establishing a policy on subcontract audits.