



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  
UT-Battelle LLC During Fiscal Year 2014  
Under Department of Energy Contract  
No. DE-AC05-000R22725

OAI-V-16-11

July 2016

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**Department of Energy**  
Washington, DC 20585

July 29, 2016

MEMORANDUM FOR THE MANAGER, OAK RIDGE NATIONAL LABORATORY  
SITE OFFICE

FROM:

A handwritten signature in black ink, appearing to read "Debra K. Solmonson".

Debra K. Solmonson

Deputy Assistant Inspector General  
for Audits and Inspections  
Office of Inspector General

SUBJECT:

INFORMATION: Assessment Report on the "Audit Coverage of Cost Allowability for UT-Battelle LLC During Fiscal Year 2014 Under Department of Energy Contract No. DE-AC05-00OR22725"

BACKGROUND

Since 2000, UT-Battelle LLC (UT-Battelle) has managed and operated the Oak Ridge National Laboratory under a contract with the Department of Energy. Oak Ridge National Laboratory is part of the Office of Science and supports the Department's national missions of scientific discovery, clean energy, and security technologies through leadership in four major areas: neutron science, high-performance computing, materials research, and nuclear technology. During fiscal year (FY) 2014, UT-Battelle expended and claimed \$1,350,109,646.

As an integrated management and operating contractor, UT-Battelle'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. UT-Battelle 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 Cooperative Audit Strategy, UT-Battelle is required by its contract to maintain an Internal Audit activity with the responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, UT-Battelle 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 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;
- UT-Battelle 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 impacting allowable costs that were identified in prior audits and reviews have 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 UT-Battelle's 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 Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. During its FY 2014 audits, UT-Battelle's Internal Audit identified questioned costs totaling \$602, all of which have been resolved. Thus, we are not questioning any costs associated with these audits. Also, the contracting officer determined that UT-Battelle had generally addressed subcontract audit strategy concerns and had resolved costs previously determined to be questionable or pending audit for years prior to FY 2014. However, we identified a total of \$134,106,144 in subcontract costs incurred through FY 2014 that we consider unresolved pending audit.

### **Subcontract Costs**

In November 2013, Internal Audit updated its *Internal Audit Implementation Design* to revise its plan for both preaward and postaward audit of subcontracts. Specifically, the plan states that UT-Battelle's Business Policy and Assessment Group (BP&A) is responsible for ensuring preaward and postaward subcontract audits are conducted. Based on established risk factors, BP&A is required to either perform a review or request that a cognizant Federal audit agency or UT-Battelle's Internal Audit Directorate conduct an audit. In addition, Internal Audit is required to conduct an annual audit of UT-Battelle's subcontract review process. In September 2014, Internal Audit completed its annual audit, *Subcontract Audit Process* (Project IA2014-5). The purpose of the audit was to determine whether the subcontract audit process provided reasonable assurance that applicable requirements were being met. Internal Audit found that BP&A generally conformed to applicable standards and did not take exception to the results and overall conclusions resulting from the assessments and reviews of subcontracts performed by BP&A.

In FY 2014, UT-Battelle's BP&A performed 10 interim reviews of time and material subcontracts. There were no questioned costs identified during these interim reviews. In addition, BP&A performed closeout reviews of 45 cost reimbursement subcontracts with FY 2014 incurred costs totaling \$16,127,676, identifying \$2,179 in questioned costs, all of which have been resolved by UT-Battelle.

We also determined that \$75,387,578 in FY 2013 subcontract costs identified in our prior report were resolved. Our *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC05-00OR22725* (OAS-V-15-02, April 2015) identified \$75,387,578 in costs considered unresolved pending audit. Since that time, UT-Battelle used a risk-based strategy to complete audits of these costs. Based on the work performed by UT-Battelle, the Oak Ridge National Laboratory Site Office Contracting Officer determined the entire \$75,387,578 was allowable.

### **DCAA Questioned Costs**

Furthermore, our previous reports on prior fiscal year costs found that Defense Contracting Audit Agency (DCAA) had identified questioned costs of \$38,122 during FY 2010 and an additional \$236,393 during FY 2013 that remained unresolved. These costs were originally reported in *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC Under Department of Energy Contract No. DE-AC-00OR22725 During Fiscal Year 2010* (OAS-V-13-11, June 2013) and in *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC05-00OR22725* (OAS-V-15-02, April 2015). Subsequently, the Oak Ridge National Laboratory Site Office Contracting Officer reviewed the results of UT-Battelle's analysis of the subcontractor's costs and supporting documentation and made a final determination that the costs are allowable. Therefore, we consider these costs to be resolved.

### **Subcontract Costs Pending Audit**

Finally, we identified \$134,106,144 in subcontract costs through FY 2014 that are unresolved pending audit. Specifically, UT-Battelle had requested, but had not yet received, audits from DCAA on 13 subcontracts that, as of September 30, 2014, had incurred costs of approximately \$106 million. During our review, we became aware of events that may eliminate DCAA as an option for subcontract audits. On November 25, 2015, the President signed the National Defense Authorization Act (NDAA) for Fiscal Year 2016. The NDAA prohibits DCAA from performing audit support for non-Defense agencies until it reduces its backlog of incurred cost audits. According to Department officials, DCAA subsequently notified the Department that it would no longer be performing subcontract audits for UT-Battelle. In addition, UT-Battelle had requested, but had not received, audits from the Department of Energy on 13 subcontracts that, as of September 30, 2014, had incurred costs of \$27 million.

As they may no longer have access to DCAA for conducting subcontract audits, the Department's contractors will need to consider other options to meet their contractual obligations. In a recent assessment report,<sup>1</sup> we recommended that the Department's Office of Management issue guidance to its contractors detailing how they may satisfy the subcontractor audit requirement given the loss of DCAA audit support. Department officials informed us they are in the process of developing a path forward to address all of these outstanding audits. Thus, we consider \$134,106,144 unresolved, pending audit.

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<sup>1</sup> *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, February 2016)

## RECOMMENDATION

We recommend that the Manager of the Oak Ridge National Laboratory Site Office, direct the Contracting Officer to:

1. Ensure UT-Battelle develops a plan to obtain allowable cost audits on cost reimbursable subcontracts and recover those costs if any are determined to be unallowable.

## MANAGEMENT RESPONSE

Management agreed with the report and our recommendation. Specifically, management stated that it would require the contractor to develop a plan that complies with the terms of its contract regarding subcontract audits and include a requirement to recover those costs determined to be unallowable. Management also indicated that the conditions of contract performance have changed as a result of the FY 2016 NDAA restriction on DCAA.

## AUDITOR COMMENTS

Management's planned corrective actions are responsive to our recommendation. Even though management believes that the conditions of contract performance have changed, the requirement to audit subcontracts has not changed. The enactment of the FY 2016 NDAA merely limited the use of DCAA under certain circumstances. However, the Department has other options available to audit subcontracts in lieu of DCAA. Furthermore, according to UT-Battelle's *Internal Audit Implementation Design*, the Internal Audit Directorate is another option for performing audits of subcontracts. Management's comments are included in Attachment 1.

## SCOPE AND METHODOLOGY

This assessment was performed from August 2015 to July 2016, at the Oak Ridge National Laboratory, located in Oak Ridge, Tennessee. The assessment was limited to UT-Battelle's Internal Audit activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affect costs claimed by UT-Battelle on its Statement of Costs Incurred and Claimed for FY 2014. The assessment was conducted under Office of Inspector General project number A15GT050. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit, which 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 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 internal control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, UT-Battelle's 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 assessment objectives. Based on a recent review of Oak Ridge National Laboratory information technology controls performed by KPMG LLP, on behalf of the Office of Inspector General, we determined that data was sufficiently reliable for the purposes of this review. An exit conference was held with Oak Ridge National Laboratory Site Office officials on July 19, 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.

Attachment

## MANAGEMENT COMMENTS



### Department of Energy

ORNL Site Office  
P.O. Box 2008  
Oak Ridge, Tennessee 37831-6269

MEMORANDUM FOR DEBRA K. SOLMONSON  
DEPUTY ASSISTANT INSPECTOR GENERAL  
FOR AUDITS AND INSPECTIONS  
OFFICE OF INSPECTOR GENERAL

FROM: JOHNNY O. MOORE, MANAGER  
ORNL SITE OFFICE

SUBJECT: RESPONSE TO THE OFFICE OF INSPECTOR GENERAL'S DRAFT ASSESSMENT  
REPORT, "AUDIT COVERAGE OF COST ALLOWABILITY FOR UT-BATTELLE  
LLC DURING FISCAL YEAR 2014 UNDER DEPARTMENT OF ENERGY  
CONTRACT NO. DE-AC05-00OR22725" (A15GT050)

Thank you for the opportunity to review and comment on the subject draft report. We agree with the Office of Inspector General's (OIG's) findings, and our response to the recommendation follows below.

**Recommendation 1:** We recommend that the Manager of the Oak Ridge National Laboratory (ORNL) Site Office (OSO), direct the Contracting Officer (CO) to ensure UT-Battelle develops a plan to obtain allowable cost audits on cost reimbursable subcontracts and recover those costs determined to be unallowable.

**Management Response:** Concur.

**Action Plan:** The CO will require that the contractor develop a plan that complies with the terms of its contract with regard to subcontract audits. The plan will include a requirement to recover those costs to be unallowable. In consultation with leadership within OIG, it is this Office's intent to consider the recommendation and the unresolved cost closed once the plan is acceptable to the Department and approved by the CO.

The Department of Energy (DOE) OIG's Audit Manual, revised in 2014, states *"If the contractor has not audited or arranged for audits of subcontract costs requiring audit, the OA auditor will report the unaudited subcontract costs as "unresolved costs pending audit" and consider the issue as an internal control weakness. The materiality of the control weakness will depend on the significance of the unresolved costs."* The Department's Cooperative Audit Strategy

(Strategy) was updated in March 2016 but the new document was not received by ORNL or OSO, or loaded onto the DOE Acquisition Guide website until May 2016. The revised Strategy states *“To accomplish the [subcontract] audits, the contractor may (1) use its internal auditors or contract auditors, (2) request through the CO for DCAA assistance, or (3) request through the CO for audit assistance utilizing the audit support Blanket Purchase Agreement (BPA) administered by the Field Assistance and Oversight Division (MA- 621).”*

Since conditions of contract performance have changed, it is difficult to reasonably conclude that the ultimate control weakness exists in the contractor’s internal systems alone. DOE Acquisition Guide Chapter 70.4 assigns responsibility for Departmental audit policy to the OIG. It also states that the Cooperative Audit Strategy has been implemented by OIG at most major contractor locations, as is the case for ORNL. Effectively, one of the purposes of the Strategy is to provide guidance to contractors on how to comply with the Internal Audit Implementation Design requirement in the contract. As stated in the preceding paragraph, the Strategy was not updated until after OIG completed its field work for this review, so it is difficult for this Office to reconcile how the systemic control weakness can be limited to the contractor’s internal systems.

Finally, this Office understands that the long-term tracking of the Monetary Impacts identified in this report by the OIG as unresolved costs will not be necessary once the recommended plan is implemented.

**Estimated Completion Date:** September 30, 2016

If there are any questions or additional information is required, please contact Mark Million, OSO CO, at (865) 576-4523.

cc:

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