



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

ASSESSMENT REPORT

Assessment of Audit Coverage of Cost
Allowability for UT-Battelle, LLC, During
Fiscal Year 2013 Under Department of Energy
Contract No. DE-AC05-000R22725

OAS-V-15-02

April 2015



Department of Energy
Washington, DC 20585

April 29, 2015

MEMORANDUM FOR THE MANAGER, OAK RIDGE NATIONAL LABORATORY
SITE 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: Report on "Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, During Fiscal Year 2013 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 contract with the Department of Energy (Department). Oak Ridge National Laboratory is the largest science and energy national laboratory in the Department. Its scientific programs focus on materials, neutron science, energy, high performance computing, systems biology, and national security. During fiscal year (FY) 2013, UT-Battelle expended and claimed \$1,414,239,679.

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.

To help ensure that only allowable costs are claimed by the Department's integrated contractors and to make efficient use of available audit resources, the Office of Inspector General, the Department's Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy. 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. During FY 2013, UT-Battelle's Business Policy and Assessment Division was

responsible for the preaward and postaward subcontract audit function. To help ensure that audit coverage of cost allowability was adequate for FY 2013, the objectives of our assessment were to determine whether:

- Internal Audit conducted a cost allowability audit 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 affecting 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 cost allowability audits, which generally met Institute of Internal Auditors Standards for the Professional Practice of Internal Auditing. UT-Battelle's Internal Audit identified \$8,080 of questioned costs during FY 2013, all of which had been resolved. Additionally, we noted that \$236,393 questioned by the Defense Contract Audit Agency (DCAA) had not been resolved, so we are questioning this amount.

Consistent with our previous reports (see Attachment 1), we identified weaknesses with subcontract auditing that need to be addressed to ensure that only allowable costs are claimed by and reimbursed to the contractor. Specifically, we found that UT-Battelle did not always conduct or arrange for periodic postaward or interim audits of subcontracts as noted in our assessments and audits. Consequently, incurred costs totaling \$75,387,578 in FY 2013 are considered unresolved pending audit. UT-Battelle updated its Internal Audit Implementation Design, effective November 2013, to incorporate a risk-based approach to address periodic postaward or interim audits of subcontracts. Further, UT-Battelle reported it resolved the unaudited subcontract costs identified in our prior reports covering FYs 2010 and 2011.

Subcontract Audits

As mentioned above, our previous reports on prior fiscal year costs found that UT-Battelle had not always conducted periodic postaward or interim audits of subcontracts in which costs were a factor in determining the amount payable to a subcontractor, as required by contract clause I.152 Department of Energy Acquisition Regulation 970.5232-3, *Accounts, Records and Inspection*, and clause I.162 970.5244-1, *Contractor Purchasing System*, as well as UT-Battelle's Internal Audit Implementation Design. UT-Battelle's Internal Audit Implementation Design, which is intended to include the overall strategy for internal audit activity, required interim audits for cost reimbursement contracts valued over \$1 million and close out audits for all cost reimbursement subcontracts. Cost-reimbursement subcontracts include both time and materials and other cost-type subcontracts. However, we noted that time and materials subcontracts valued over \$1 million did not receive interim audits. Additionally, time and materials subcontracts and other cost-type

subcontracts were not always audited at closeout as required. We recommended that UT-Battelle audit subcontracts as required and use risk-based approaches in determining when interim and closeout audits should be conducted. Management agreed with our previously issued recommendations and, as noted above, implemented a risk-based subcontract audit approach.

UT-Battelle utilized its risk-based approach to resolve the FY 2010 and 2011 unaudited subcontract costs and was in the process of resolving such FY 2012 costs. However, due to time constraints, UT-Battelle had not yet audited FY 2013 subcontracts. Specifically, we found that UT-Battelle did not audit 66 time and material subcontracts, each valued over \$1 million, with costs incurred in FY 2013 totaling \$43,387,646. Additionally, UT-Battelle did not obtain or perform closeout audits of 303 time and materials subcontracts with FY 2013 incurred costs of \$31,999,932 that were closed during FY 2013. Consequently, incurred costs totaling \$75,387,578 in FY 2013 are considered unresolved pending audit.

Unresolved Costs

DCAA identified questioned costs of \$38,122 during FY 2010 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-AC05-00OR22725 During Fiscal Year 2010* (OAS-V-13-11, June 2013). On August 29, 2013, DCAA issued an additional report for the same subcontractor, covering multiple years, which questioned a total of \$274,515 in costs related to this subcontractor's operations with UT-Battelle. According to UT-Battelle, the \$38,122 in previously questioned costs is included in this amount. All costs will remain unresolved until the Contracting Officer makes a final determination of allowability. As such, we are questioning the additional \$236,393.

RECOMMENDATIONS

We recommend that the Manager, Oak Ridge National Laboratory Site Office:

1. Direct UT-Battelle to use a risk-based approach to ensure adequate audit coverage of \$75,387,578 in FY 2013 subcontract costs considered unresolved pending audit; and
2. Ensure that questioned costs identified by DCAA are resolved and recover those amounts determined to be unallowable.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management generally agreed with the report and recommendations. Management stated that FY 2013 subcontract costs would be reviewed in compliance with UT-Battelle's risk assessment approach and resolved accordingly by January 31, 2016. Management further stated that UT-Battelle would also resolve the questioned costs identified by DCAA during the subcontract closeout process by December 31, 2015. Management's planned actions are responsive to our recommendations. Management's comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from June 2014 to April 2015, at the Oak Ridge National Laboratory, located in Oak Ridge, Tennessee. The assessment was limited to Internal Audit's activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affect costs claimed by UT-Battelle on its Statements of Costs Incurred and Claimed for fiscal year 2013. 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; we also 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 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 audit objectives. Based on a recent review of UT-Battelle's 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 the review. An exit conference was waived on April 16, 2015.

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

- Report on the *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, Under Department of Energy Contract No. DE-AC05-00OR22725 During Fiscal Year 2010* (OAS-V-13-11, June 2013). This assessment found that UT-Battelle, LLC, (UT-Battelle) did not always conduct or arrange for audits of its subcontractors when costs incurred were a factor in determining the amount payable to subcontractors. Thus, incurred costs totaling \$66,267,764 were considered unresolved pending audit. This amount included costs of \$33,740,603 that were incurred on 54 time and materials subcontracts that met the \$1 million threshold and \$32,527,162 of incurred costs associated with 158 subcontracts that were closed during fiscal year (FY) 2010.
- Report on *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, Under Department of Energy Contract No. DE-AC05-00OR22725 During Fiscal Year 2011* (OAS-V-13-14, September 2013). Consistent with our June 2013 report on *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC, Under Department of Energy Contract No. DE-AC05-00OR22725 During Fiscal Year 2010* (OAS-V-13-11, June 2013). This review found that UT-Battelle had not conducted or arranged for audits of its time and materials subcontracts when costs incurred were a factor in determining the amount payable to subcontractors. Specifically, we found that UT-Battelle had not obtained required interim audits of 75 time and materials subcontracts with incurred costs of \$62,500,182 that were open through the end of FY 2011. Additionally, UT-Battelle had not obtained closeout audits of 398 time and materials subcontracts valued at \$72,978,570 that closed out during FY 2011. Consequently, incurred costs totaling \$135,478,752 in FY 2011 were considered unresolved pending audit.
- Report on [*Audit of Incurred Costs for UT-Battelle Under Department of Energy Contract No. DE-AC05-00OR22725 During Fiscal Year 2012*](#) (OAS-M-14-05, April 2014) was conducted by KPMG, LLP, on behalf of the Office of Inspector General. KPMG, LLP, concluded that UT-Battelle generally prepared its FY 2012 Statement of Costs Incurred and Claimed in accordance with applicable guidance regarding accuracy, allowability, allocability, and reasonableness of incurred costs. However, KPMG, LLP, identified subcontractor costs totaling \$45,248,484 for which audits of the subcontractors' final indirect cost rates had not yet occurred. As such, this amount was considered unresolved.

MANAGEMENT COMMENTS



Department of Energy

ORNL Site Office
P.O. Box 2008
Oak Ridge, Tennessee 37831-6269
April 16, 2015

MEMORANDUM FOR DAVID SEDILLO
DIRECTOR, WESTERN AUDITS DIVISION
IG-323

FROM: JOHNNY O. MOORE, MANAGER
ORNL SITE OFFICE

SUBJECT: ASSESSMENT OF AUDIT COVERAGE OF COST ALLOWABILITY FOR
UT-BATTELLE, LLC (UT-BATTELLE) UNDER DEPARTMENT OF ENERGY (DOE)
CONTRACT NUMBER DE-AC05-00OR22725 DURING FISCAL YEAR (FY)
2013

Thank you for the opportunity to review and comment on the subject draft report. With respect to the specific recommendations in the draft report, the Oak Ridge National Laboratory Site Office (OSO) comments follow below. In addition, OSO found no areas in the report that would warrant technical or general comments as to clarity and factual accuracy.

Recommendation 1: We recommend that the OSO Manager direct UT-Battelle to use a risk-based approach to ensure adequate audit coverage of \$75,387,578 in FY 2013 subcontract costs considered unresolved pending audit.

Management Response: Concur

Action Plan: The FY 2013 costs noted as unresolved will be reviewed in compliance with UT-Battelle's risk assessment approach and resolved accordingly. The Contracting Officer will make a determination of allowability for these questioned costs based on these results. The UT-Battelle risk assessment approach was approved by DOE in FY 2014.

Estimated Completion Date: January 31, 2016

Recommendation 2: We recommend that the OSO Manager ensure that questioned costs identified by the Defense Contract Audit Agency are resolved and recover those amounts determined to be unallowable.

Management Response: Concur

David Sedillo

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April 16, 2015

ASSESSMENT OF AUDIT COVERAGE OF COST ALLOWABILITY FOR UT-BATTELLE, LLC
(UT-BATTELLE) UNDER DEPARTMENT OF ENERGY (DOE) CONTRACT NUMBER
DE-AC05-00OR22725 DURING FISCAL YEAR (FY) 2013

Action Plan: UT-Battelle will resolve the identified subcontract questioned cost during the subcontract close-out process.

Estimated Completion Date: December 31, 2015

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

cc:

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