



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

ASSESSMENT REPORT

Audit Coverage of Cost Allowability for
Stanford University During Fiscal Years 2012
and 2013 Under Department of Energy
Contract No. DE-AC02-76SF00515

OAS-V-15-04

September 2015



Department of Energy
Washington, DC 20585

September 21, 2015

MEMORANDUM FOR THE MANAGER, SLAC SITE OFFICE

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

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

SUBJECT: INFORMATION: Assessment Report: "Audit Coverage of Cost Allowability for Stanford University During Fiscal Years 2012 and 2013 Under Department of Energy Contract No. DE-AC02-76SF00515"

BACKGROUND

Since 1962, Stanford University (Stanford) has managed the SLAC National Accelerator Laboratory (SLAC) for the Department of Energy's (Department's) Office of Science under contract number DE-AC02-76SF00515. SLAC is 1 of the 10 Office of Science laboratories. It is home to one of the world's largest particle accelerators and revolutionary x-ray laser, and its science programs span from ultrafast atomic scale research to cosmology and dark matter. During fiscal years (FYs) 2012 and 2013, Stanford incurred and claimed costs totaling \$362,928,586 and \$352,559,959 respectively.

As an integrated management and operating contractor, Stanford'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. Stanford 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 (OIG), Office of Acquisition and Project Management, and the 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. The Cooperative Audit Strategy places reliance on the contractors' internal audit function to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the Cooperative Audit Strategy, Stanford 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, Stanford is required to conduct or arrange for audits or reviews of its subcontractors when costs incurred are a factor in determining the amount payable to a

subcontractor. In FY 2012, Stanford's Procurement Department was responsible for preaward and postaward subcontract reviews. Then in FY 2013, Stanford's Internal Audit Department (Internal Audit) assumed the responsibility for conducting postaward subcontracts audits.

To help ensure that audit coverage of cost allowability was adequate for FYs 2012 and 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;
- Stanford conducted or arranged for audits or reviews 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 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 Internal Audit for FYs 2012 and 2013 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 Standards prescribed by the Institute of Internal Auditors (IIA Standards). Further, Stanford reported that no questioned costs were identified in other reviews performed by Internal Audit, SLAC, and the Department.

However, we identified issues that need to be addressed to ensure that only allowable costs are claimed and reimbursed to the contractor. Specifically, we found that:

- Internal Audit's workpapers did not always include documentation to support their conclusions;
- Although Stanford's subcontract audit and reviews did not identify any unallowable costs, it did not ensure that all cost type subcontracts, specifically nonuniversity subcontracts, were subject to an audit as required; and
- Stanford was found to be noncompliant with Cost Accounting Standards (CAS) 405.

Audit Documentation

Although we ultimately determined that we could rely on Internal Audit's work, our review identified issues with the adequacy of supporting documentation. Government Auditing Standards require auditors to perform procedures that provide a sufficient basis for reliance, such as reperforming Internal Audit's work. In doing so, we reviewed and retested Internal Audit's cost allowability transaction tests of specific accounts to determine if costs were allowable, allocable, and reasonable. In reviewing Internal Audit's work, we found that Internal Audit's

workpapers did not include sufficient documentation to support their conclusions. Specifically, during our retesting of nine transactions previously tested by Internal Audit, we did not find sufficient documentation in the workpapers that would allow us to reach the same conclusions that costs were allowable, allocable, and reasonable.

After discussing our concerns with Internal Audit, we were provided additional documentation that supported their conclusions. With the additional documentation, we were able to reach the same conclusions as Internal Audit. As required by IIA Standards, sufficient documentation is necessary to achieve the engagement's objectives and to support the conclusions. As a result, Internal Audit agreed to provide additional documentation in their workpapers and include sufficient information to support their conclusions in future audits.

Subcontract Audits

Consistent with our previous assessment report *Assessment of Audit Coverage of Cost Allowability for SLAC National Accelerator Laboratory for the period October 1, 2007 thru September 30, 2011 under Department of Energy Contract No. DE-AC02-76-SF00515 (OAS-V-13-13, July 2013)*, we identified a weakness with Internal Audit's subcontract audit administration that needs to be addressed to ensure that only allowable costs are claimed by and reimbursed to the contractor. Specifically, Internal Audit did not ensure that all cost type subcontracts were subject to audit, as required by its contract. Stanford's contract and its Internal Audit Implementation Design Plan require incurred cost audits of cost reimbursable subcontracts. However, Stanford's accounting system was unable to provide a cost summary of subcontract costs by contract type for FYs 2012 and 2013, thus we have no assurance that Stanford was able to identify the universe of cost reimbursable subcontracts subject to audit.

The inability to identify cost reimbursable subcontracts from its financial records was a recurring deficiency that was to be corrected in FY 2015 when Stanford implemented an updated accounting system. However, when Stanford updated their system, transactions from the prior years were not transferred to the updated accounting system. Stanford asserted that the only way they could identify all cost type subcontracts in FYs 2012 and 2013 was to manually review each subcontract file to identify the individual subcontract type. Because of the volume of subcontracts, Stanford only included subcontracts that were awarded to universities in its universe of auditable subcontracts. Further, Stanford explained that they did not know if all cost type subcontracts subject to audit were identified because their financial records were not configured in a way that would allow them to sort and identify cost reimbursable subcontracts. Consequently, there is a potential for unallowable costs to have been incurred and claimed for nonuniversity subcontracts. Accordingly, approximately \$199 million of subcontract costs covering FYs 2012 and 2013 are considered unresolved until Stanford can provide evidence that all cost type subcontracts during those years have been identified and have been subjected to an audit.

CAS 405 Noncompliance

During our fieldwork, we identified a 2012 review, performed by the Oak Ridge Office Financial Evaluation and Accountability Division, which found Stanford to be noncompliant with

CAS 405. CAS 405 states: "All unallowable costs shall be subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases."

Specifically, the 2012 review found that Stanford did not apply applicable indirect cost allocations to unallowable costs as required by CAS 405. The noncompliant practice of not applying the appropriate indirect cost allocations to unallowable costs was an accounting practice that was in place for a number of years. The noncompliance occurred due to Stanford's disclosure statement not requiring unallowable costs to receive the appropriate indirect cost allocation as prescribed by CAS 405. As a result, in October 2012, Stanford revised its CAS disclosure statement to include the requirement that the appropriate share of indirect costs be applied to unallowable costs.

Stanford estimated that more than \$1.5 million of unallowable costs that were incurred during FYs 2011, 2012, and 2013 received no indirect cost allocations. The 2012 review did not estimate the cost impact of indirect costs not being applied to unallowable costs for all the years in which Stanford was noncompliant. Stanford's accounting practice resulted in increased costs being paid by the Department as a result of the noncompliance. The Federal Acquisition Regulation states that indirect cost rates may be adjusted retroactively to prevent overpayment of costs by the Department. To its credit, Stanford is in the process of determining the cost impact of not applying proper indirect cost rates to unallowable costs.

RECOMMENDATIONS

To address the issues identified, we recommend that the Manager, SLAC Site Office, direct the Contracting Officer to ensure:

1. Stanford Internal Audit provide sufficient documentation in its workpapers to support conclusions reached in future cost allowability audits;
2. Stanford Internal Audit provide evidence that all cost type subcontracts have been identified and have been subjected to an audit; and
3. Stanford complete its cost impact proposal to quantify the additional indirect costs paid by the Department due to the noncompliance with CAS 405 and seek repayment of any overpayments.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management agreed with the report and concurred with the recommendations. Management's proposed corrective actions are responsive to our recommendations. Management's comments are included in Attachment 1.

SCOPE AND METHODOLOGY

This assessment was performed from October 2014 to September 2015, at SLAC, located in Menlo Park, California. The assessment was limited to Internal Audit activities, relevant criteria, prior audits and reviews, subcontract audit, and resolution of questioned costs and internal control weaknesses that affect costs claimed by Stanford on its Statement of Cost Incurred and Claimed for FYs 2012 and 2013. The assessment was conducted under OIG project number A15LL006. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit, which included review of audit reports, workpapers, auditor qualifications, independence, audit planning (including risk assessments and overall internal audit strategy), compliance with applicable professional auditing standards;
- Conducted interviews of auditors;
- Assessed subcontract audit and reviews conducted by Stanford;
- Randomly selected nine transactions previously tested by Internal Audit to evaluate whether they were allowable under the contract and Federal regulations; and
- Evaluated resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the OIG, Internal Audit, and other organizations.

We conducted this 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 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. Based on a recent review of Stanford's information technology controls performed by KPMG, LLP, on behalf of the OIG, we determined that the data was sufficiently reliable for the purposes of the review. Management waived an exit conference.

This report is intended for the use of the Department, contracting officers, and site 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



U.S. DEPARTMENT OF
ENERGY | Office of
Science

SLAC Site Office

SLAC National Accelerator Laboratory
2575 Sand Hill Road, MS-8A
Menlo Park, CA 94025

Date: September 11, 2015

MEMORANDUM FOR DAVID SEDILLO
DIRECTOR
WESTERN AUDITS DIVISION
OFFICE OF INSPECTOR GENERAL, IG-323

FROM: PAUL M. GOLAN 
MANAGER
SLAC SITE OFFICE, SC-SSO

SUBJECT: DRAFT ASSESSMENT REPORT: "AUDIT COVERAGE OF COST
ALLOWABILITY FOR STANFORD UNIVERSITY DURING FISCAL YEARS 2012
AND 2013 UNDER DEPARTMENT OF ENERGY CONTRACT NO.
DE-AC02-76SF00515"

Thank you for the opportunity to review and comment on the subject draft report. Based on the recommendations in the draft report, the SLAC Site Office (SSO) is providing the following comments.

Recommendation 1: To address the issues identified, we recommend that the Manager, SLAC Site Office, direct the Contracting Officer to ensure Stanford Internal Audit provide sufficient documentation in its work papers to support conclusions reached in future cost allowability audits.

Management Response: Concur.

Action Plan: SSO has directed Stanford University to require internal auditors of the SLAC National Accelerator Laboratory (SLAC) to continue to adhere to Institute of Internal Auditors Standards that provide for work papers with sufficient documentation to support their conclusions.

Estimated Completion Date: October 1, 2015

David Sedillo

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DRAFT ASSESSMENT REPORT: "AUDIT COVERAGE OF COST ALLOWABILITY FOR STANFORD UNIVERSITY DURING FISCAL YEARS 2012 AND 2013 UNDER DEPARTMENT OF ENERGY CONTRACT NO. DE-AC02-76SF00515"

Recommendation 2: To address the issues identified, we recommend that the Manager, SLAC Site Office, direct the Contracting Officer to ensure Stanford Internal Audit provide evidence that all cost type subcontracts have been identified and have been subjected to an audit.

Management Response: Concur.

Action Plan: SSO has directed Stanford University to ensure and provide evidence that all SLAC cost reimbursable subcontracts have been identified and have been subjected to an incurred cost audit, as required by the Contract and Stanford's Internal Audit Implementation Design Plan.

Estimated Completion Date: June 30, 2016

Recommendation 3: To address the issues identified, we recommend that the Manager, SLAC Site Office, direct the Contracting Officer to ensure Stanford complete its cost impact proposal to quantify the additional indirect costs paid by the Department due to the noncompliance with CAS 405 and seek repayment of any overpayments.

Management Response: Concur.

Action Plan: SSO has directed Stanford University to calculate the amount of SLAC indirect costs that should have been applied to unallowable costs for FY10 through FY13 and to reimburse SLAC for the overpayment by the Department.

Estimated Completion Date: March 31, 2016

cc:

Joseph McBrearty, SC-3, FORS
Merley Lewis, CF-50, FORS
Janet Venneri, SC-41.1, GTN
Ernest Maune, SC-SSO
Katherine Woo, SC-SSO
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