



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

ASSESSMENT REPORT

Audit Coverage of Cost Allowability for
Babcock and Wilcox Technical Services Y-12,
LLC, During Fiscal Years 2013 and 2014
Through June 30, 2014, Under Department of
Energy Contract No. DE-AC05-000R22800

OAS-V-15-05

September 2015



Department of Energy
Washington, DC 20585

September 30, 2015

MEMORANDUM FOR THE MANAGER, NNSA PRODUCTION OFFICE

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

FROM: Debra K. Solmonson, Director
Eastern Audits Division
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report: "Audit Coverage of Cost Allowability for Babcock and Wilcox Technical Services Y-12, LLC, During Fiscal Years 2013 and 2014 Through June 30, 2014, Under Department of Energy Contract No. DE-AC05-00OR22800"

BACKGROUND

Babcock and Wilcox Technical Services Y-12, LLC, (B&W Y-12) managed and operated the Y-12 National Security Complex (Y-12) under contract with the Department of Energy (Department) from August 31, 2000, through June 30, 2014. Y-12 is part of the Department's National Nuclear Security Administration (NNSA), which has responsibilities that include ensuring the safety, security, and effectiveness of the Nation's nuclear weapons stockpile. During fiscal years (FYs) 2013 and 2014 through June 30, 2014, B&W Y-12 incurred and claimed \$1,030,375,777 and \$771,905,330, respectively.

Because B&W Y-12 is an integrated management and operating contractor, its financial accounts are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. B&W Y-12 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 in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

The Department's Office of Inspector General, Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy (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, B&W Y-12 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, B&W Y-12 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 FYs 2013

and 2014 through June 30, 2014, Internal Audit was generally responsible for ensuring postaward audits of subcontractors were conducted. To help ensure that audit coverage of cost allowability was adequate for FYs 2013 and 2014 through June 30, 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;
- B&W Y-12 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 B&W Y-12'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 FYs 2013 and 2014 through June 30, 2014, audits of cost allowability, Internal Audit identified questioned costs totaling \$499 and \$32,825, respectively. All FY 2013 questioned costs had been resolved. For FY 2014 through June 30, 2014, we noted that \$761 had not been resolved, so we are questioning this amount.

We also found that B&W Y-12 conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to subcontractors. Specifically, B&W Y-12 used a risk-based approach to audit subcontracts. During FYs 2013 and 2014 through June 30, 2014, B&W Y-12 Internal Audit conducted 14 subcontract audits and 10 subcontract audits, respectively. The subcontract audits identified questioned costs totaling \$3,223,992, of which all but \$1,516,033 had been resolved. Thus, we are questioning this amount.

In addition to the subcontract audits conducted by B&W Y-12, an audit conducted by the Defense Contract Audit Agency identified questioned costs of \$482,971 that remained unresolved. The costs were incurred during calendar years 2005 and 2006 and related to field and home office general and administrative expenses. Because the audit included subcontracts with B&W Y-12 as well as other contractors, the Contracting Officer was unable to provide the amount of questioned costs that pertained to the B&W Y-12 contract.

RECOMMENDATION

We recommend that the Manager, NNSA Production Office, direct the Contracting Officer to make a determination regarding the allowability of the questioned costs identified by B&W Y-12

Internal Audit and the Defense Contract Audit Agency totaling \$1,482,161 for FY 2013 and \$517,604 for FY 2014 through June 30, 2014, and recover those amounts determined to be unallowable.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management agreed with the report and recommendation, and their planned actions are responsive to our recommendation. Management stated that the estimated date for resolving all questioned costs is December 30, 2015. Attachment 1 contains Management Comments.

SCOPE AND METHODOLOGY

This assessment was performed from February 2015 to September 2015, at Y-12, 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 B&W Y-12 on its Statements of Costs Incurred and Claimed for FYs 2013 and 2014 through June 30, 2014. The assessment was conducted under Office of Inspector General project number A15OR018. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit that 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 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 Y-12'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 September 21, 2015.

This report is intended for the use of Department and NNSA 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

MANAGEMENT COMMENTS



Department of Energy
Under Secretary for Nuclear Security
Administrator, National Nuclear Security Administration
Washington, DC 20585



September 25, 2015

MEMORANDUM FOR GREGORY H. FRIEDMAN
INSPECTOR GENERAL

FROM: FRANK G. KLOTZ 

SUBJECT: Comments on the Office of Inspector General Draft Report
Titled *Assessment of Audit Coverage of Cost Allowability for
Babcock and Wilcox Technical Services Y-12, LLC during
Fiscal Years 2013 - 2014 (A15OR018 / 2015-00168)*

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the auditors' validation of the B&W Y-12 internal audit work and recognition of their proactive efforts to self-identify questioned costs. NNSA concurs with the report's recommendation to complete the Contracting Officer's determination on the allowability of the remaining questioned costs, and recover any costs deemed unallowable as appropriate. The estimated date for resolving all questioned costs is December 30, 2015.

If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audit Coordination and Internal Affairs, at (301) 903-1341.

