



U.S. Department of Energy  
Office of Inspector General  
Office of Audit Services

# Audit Report

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Department of Energy Contractor  
Home Office Expenses

**DOE/IG-0676**

**February 2005**



## Department of Energy

Washington, DC 20585

February 14, 2005

MEMORANDUM FOR THE SECRETARY

FROM: *Greg Friedman*  
Gregory H. Friedman  
Inspector General

SUBJECT: INFORMATION: Audit Report on "Department of Energy Contractor Home Office Expenses"

### BACKGROUND

The Department of Energy relies on a number of contractors to operate its major facilities, including the Department's national laboratory system. Generally, these contractors maintain a corporate or home office to support laboratory efforts, as well as the business needs of other segments of their organizations. Under the Department's acquisition regulations, and pertinent contract terms and cost principles, the Department is prohibited from reimbursing home office expenses that exceed the contractor's contribution to Government activities.

As noted in our audit on *Central Office Expenses for the Thomas Jefferson National Accelerator Facility* (DOE/IG-0629, December 2003), the lack of Federal oversight over contractor home office expenses that did not benefit the Government had a \$4.6 million negative impact on Departmental operations. Because of the significance of the issue, we initiated a broader review to determine whether Departmental payments to contractors for home office expenses were equitable.

### RESULTS OF AUDIT

We found that the Department did not always ensure that reimbursements to contractors were limited to an equitable share of their home office expenses. For example, the Department committed to compensate the University of California (contract operator of Lawrence Livermore National Laboratory, Lawrence Berkeley National Laboratory, and Los Alamos National Laboratory) for its home office support through the payment of certain actual expenses, a fee, and separate fixed payments of about \$55 million over the 5-year life of the current contracts. An examination of those arrangements and actual payments revealed that the Department:

- Will incur about \$21 million in unnecessary expenses over the 5-year life of the contracts because it used an incorrect allocation base to calculate the fixed payments for home office expenses;



- Inappropriately agreed to provide, as part of the fixed payments, reimbursements of about \$8 million, through Fiscal Year 2005, for a percentage of University operational costs that did not benefit Government-funded activities; and,
- Reimbursed about \$880,000 during Fiscal Years 2002 and 2003 for erroneously claimed expenses and for unallowable expenses such as costs for student recruitment.

Our review also identified practices at other contractors that contributed to excessive compensation for home office activities, including payments for specifically unallowable costs. In particular, we noted that the Department:

- Committed to pay the University of Chicago \$11 million without adequately assessing and documenting the contribution that the University's home office would provide to the Department's operations at Argonne National Laboratory; and,
- Reimbursed Universities Research Associates, Inc., the contractor for Fermi National Accelerator Laboratory, for about \$75,000 in unallowable expenses during Fiscal Years 2001 and 2002.

In these cases, the Department did not always provide adequate oversight of the award and administration of contractor home office expenses. For example, contracting officials did not adequately review contractor cost proposals to ensure that agreed-to amounts were commensurate with the benefits provided to the Government, nor did the Department require the University of California to report actual incurred expenses.

We identified, in the aggregate, nearly \$30 million in improper payments. These funds could have been used to expand the scientific programs of the laboratories or to address other pressing Department operational needs. Although the largest portion of this amount related to the Department's contracts with the University of California, effective financial review of home office expenses on a contract-by-contract basis is an essential contract administration tool.

While management initiated corrective actions in response to our previous audit report relating to Thomas Jefferson Laboratory, including the recovery of \$2.2 million in improper payments, additional effort is necessary to ensure that controls are in place and operating as intended. In this regard, we made specific recommendations to the Administrator, National Nuclear Security Administration and the Director, Office of Science, in conjunction with the Director, Office of Procurement and Assistance Management, designed to enhance oversight and recover overpayments.

## MANAGEMENT REACTION

Management generally concurred with the recommendations in the report, but did not concur with certain conclusions regarding the adequacy of financial reviews of the University of Chicago and Universities Research Associates home office costs. While we made revisions to the report where appropriate to address these concerns, we believe that the pattern of activity found confirmed that the Department's financial reviews of contractors' home office costs were not always adequate. For example, the Department could not demonstrate that agreed-to fixed payments to the University of Chicago were reasonable compensation for its home office contribution to the operations of Argonne National Laboratory.

Management's comments and our responses are summarized beginning on page 6 of the report and are included in their entirety in Appendix 3.

Attachment

cc: Administrator, National Nuclear Security Administration  
Director, Office of Science  
Director, Office of Procurement and Assistance Management

# REPORT ON DEPARTMENT OF ENERGY CONTRACTOR HOME OFFICE EXPENSES

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# HOME OFFICE EXPENSES

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## **Equitable Share Determination and Reimbursement**

Our review of five contracts for national laboratories disclosed that the Department of Energy (Department) agreed to provide fees, fixed payments, and/or reimbursements for actual home office expenses that were (1) potentially duplicative; (2) not adequately documented; (3) improperly calculated; and/or (4) for specifically unallowable items. For a home office expense to be allowable it must be reasonable, allocable, conform to limitations and exclusions set forth in the cost principles and in the contract, and be adequately documented.

### Compensation Structure

The Department agreed to a compensation structure for the University of California that may not reflect its actual contribution to Government activities. The Department's acquisition regulation states that management and operating contractors generally require minimal home office involvement because the Government reimburses all management costs associated with operations, and, consequently, care must be taken when determining the share of home office expenses that should be reimbursed.

Despite this guidance, we observed that the Department committed to pay the University of California three forms of compensation to cover part of the University's home office costs. These included actual home office expenses, a fee, and separate fixed payments of about \$55 million over a 5-year period. Contracting officials agreed to provide the separate fee and fixed payments even though the Department had committed to pay the actual expenses for operating the University of California's Office of the Vice President for Laboratory Management – the organization whose function is to oversee the contracts for operation of Departmental facilities. While calculations regarding the fixed payment agreement were documented, the Department did not document how all three forms of payment represented compensation for home office expenses' contribution to Government activities.

### Determination of Fixed Payments

The Department did not correctly calculate the agreed-to fixed payments for reimbursing home office expenses for

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the University of California. While the percentage used to determine the fixed payments was computed using a Cost Accounting Standards formula, the Department and the contractor incorrectly applied the formula. As a result, the percentage applied to home office expenses was significantly higher than it should have been, and by the end of Fiscal Year (FY) 2005, the Department will have overpaid about \$21 million for the 5-year contract period. Department contracting officials for the University of California contracts reviewed the contractor's proposal prior to determining the fixed payment amounts and found that the proposal had certain errors. As a result, they required University officials to modify the proposal. However, the Department's financial analyst for the cost proposal explained that the calculation error we discovered was not noticed and agreed that the amount had been incorrectly calculated.

In addition, the Department did not detect that the University of California's home office expense proposal included various academic-related expenses and other items that were unrelated to Department activities. For example, the Department agreed to provide reimbursement for a percentage of operational expenses such as:

- Maintaining a postsecondary education commission;
- Accounting expenses related to a hospital facility, endowments, and investments;
- Student-related information technology costs;
- Faculty-related home loan programs; and,
- Planning costs for university capital projects.

These academic-related expenses and those related to other university activities did not contribute to Department or laboratory operations. Reimbursement of such expenses is prohibited under Federal cost principles. Had these costs been appropriately excluded from the contractor's proposal, we estimated that by the end of FY 2005 the Department could have avoided more than \$8 million over the 5-year contract period.

In another case, the Department agreed to fixed payments of \$11 million over a 5-year contract period that ended September 30, 2004, for the University of Chicago without adequately assessing the contribution that the University's

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home offices would provide to Argonne National Laboratory. Prior to negotiating fixed payment amounts, the Department reviewed and reduced the University's cost proposal mainly by eliminating certain offices that the Department concluded would provide no benefit to the laboratory. However, the Department did not perform and document an analysis to determine whether the payments were a reasonable estimate of the contribution that the remaining offices would provide to the laboratory.

#### Reimbursements for Actual Home Office Expenses

The Department reimbursed two contractors nearly \$1 million over a 2-year period for expenses that were not allowed by cost principles or contract terms, or were erroneously charged. In the case of the University of California, the Department agreed to reimburse, up to an annual ceiling amount, actual expenses incurred by the University's Office of the Vice President for Laboratory Management. This Office was responsible for direct oversight of three Department laboratories. In FYs 2002 and 2003, the Department reimbursed the University about \$740,000 for expenses that were erroneously claimed and not actually incurred. Specifically, the University erroneously claimed as expenses in those years amounts that it had refunded to the Department because it had received reimbursements over actual costs in FYs 1999, 2000, and 2001. In the following period, the University charged the amount it returned to the Government as an expense and was subsequently reimbursed by the Department for the erroneous charge. In addition, based on our examination of a judgmental sample of expense transactions, we determined that the Department reimbursed about \$140,000 for expenses that were prohibited by cost principles and were therefore unallowable. For instance, these expenses included costs related to recruiting students for the University of California, donations, and for other miscellaneous inappropriate expenses.

We also determined that the Department reimbursed Universities Research Associates, Inc., the contractor for Fermi National Accelerator Laboratory, for inappropriate and unallowable home office related expenses. Based on our review of a judgmental sample of transactions in FYs 2001 and 2002, we identified about \$75,000 that the



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Department reimbursed for expenses that are generally prohibited by cost principles, such as expenses associated with managing an investment portfolio and other items.

**Departmental Contract Administration**

Problems with the award and administration of home office expenses occurred because the Department's contract administration activities were not always adequate. For the University of California contracts, contracting officials did not perform or document their analyses regarding what compensation structure to adopt or the contribution of home offices to Federally-funded activities. Before agreeing to fixed payments for home office expenses, adequate financial reviews of cost proposals were not conducted and documented to demonstrate how the Department's laboratories would benefit from the contractors' home office activities. In the case of the University of California, reviews by contracting officials of proposed fixed payment amounts were insufficient to detect errors in calculating an allocation percentage and the inclusion of inappropriate costs in the allowance.

We noted that subsequent to our audit field work, the Department modified its contract with the University of Chicago to eliminate fixed payments for home office expenses. Effective October 1, 2004, the modified contract provides for establishing ceiling reimbursement amounts and, if actual costs are less than the ceilings, requires the University to refund the difference. The Department also advised us that it has a plan for reviewing expenses prior to negotiating ceiling amounts and for reviewing historical costs each year. However, we did not review the plan to determine whether it includes an assessment of the contribution that central offices provide to the laboratory.

For the contractors we reviewed who were reimbursed for actual unallowable expenses, the Department did not perform adequate financial reviews of expenses claimed by the contractors to determine whether they were allowable. For example, the Department did not require the University of California to report actual incurred expenses. For Universities Research Associates, Inc., the Department had a process in place to review ceiling amounts and actual claimed home office costs. However, these reviews did not detect the questionable expenses we identified.

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**Operational Impacts**

As a result of the lack of adequate financial examination of home office expenses, we estimated that the Department will have reimbursed two contractors about \$30 million by the end of FY 2005 for unallowable and inappropriate costs. Such funds could have been better applied to mission needs of the Department's programs and activities. In addition to past mission impacts, the possibility for future overpayments exists as the Department moves forward with the competition and negotiation of several new management and operating contracts in the near future. Without effective financial reviews of home office expense proposals and actual costs, the Department could significantly overpay future contractors for home office expenses with little assurance that payments are equitable and reasonable. Detailed financial reviews of cost proposals would also help ensure that only allowable costs are reimbursed through fixed home office payment agreements and that the agreed-to amounts are commensurate with the planned level of home office involvement in contract activities.

**RECOMMENDATIONS**

We recommend that the Administrator, National Nuclear Security Administration and the Director, Office of Science, in conjunction with the Director, Office of Procurement and Assistance Management, direct contracting officers:

1. To enhance their financial oversight of management and operating contractors to ensure that:
  - a) Analyses are performed to determine the equitable amount and structure of home office compensation and that the adopted rationale be documented;
  - b) Payments for actual home office expenses receive timely review and exclude unallowable expenses; and,
  - c) Agreed-to fixed payment amounts for reimbursing home office expenses exclude unallowable expenses.

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2. Make a determination regarding the allowability of the home office expenses questioned in our audit and recover all overpayments.

## **MANAGEMENT REACTION**

The Office of Science (Science) concurred with our recommendations. Specifically, Science stated that its contracting officers will be required to perform and document analyses in order to determine an equitable amount and structure of home office compensation. In addition, Science stated that its contracting officers will be required to ensure that all payments for actual home office expenses are reviewed in a timely manner, and unallowable expenses are excluded from payments and reimbursement agreements. Science further stated that contracting officers will assure that all contract terms and conditions regarding home office expenses are implemented and that expenses questioned in our report will be reviewed to determine allowability.

The National Nuclear Security Administration (NNSA) generally agreed with our report and subsequent recommendations. NNSA acknowledged that, as an organization, it will continue building on its financial oversight strengths and include improved home office expense reviews. NNSA stated that it will reinforce the requirement for the respective contracting officers to perform due diligence as related to the recommendations to analyze, review, and exclude, as appropriate, cost issues associated with home office expenses. In addition, NNSA stated that its respective contracting officers will work together to ensure consistency in cost determination and recover any overpayments as appropriate.

The Office of Procurement and Assistance Management provided what we considered to be informal comments stating that it has no specific objections to our recommendations. However, the Office stated that the primary vehicle for identifying unallowable costs in contractor billings are contract cost audits and the Office of Inspector General (OIG) should provide greater focus on this area in future annual audit plans and in advice and instructions provided to contractor internal auditors.

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In addition, the Office of Procurement and Assistance Management and the Argonne and Fermi site offices raised several concerns about our findings and disagreed with our conclusions regarding the adequacy of financial reviews of the University of Chicago and Universities Research Associates home office costs. Management stated that financial reviews of the University of Chicago's cost proposal for fixed payments were performed and the proposal was significantly reduced. Management stated that financial reviews of the Universities Research Associates costs include a review of prior year's actual expenses and a comparison of such actual expenses with the next year's budget. Management further stated that any significant cost element increases are requested to be substantiated.

Management's comments are included in their entirety as Appendix 3.

#### **AUDITOR COMMENTS**

Management's comments were generally responsive to our recommendations. However, we do not agree with the position of the Office of Procurement and Assistance Management that OIG and contractor internal audits are the primary vehicle for identifying unallowable costs in contractor billings. While audits are an essential part of the equation, we do not agree that they are the primary vehicle to identify unallowable costs and prevent such costs from being reimbursed. Consistent with the Government Accountability Office's *Standards for Internal Control in the Federal Government*, internal controls that are management's responsibility, such as the Federal financial oversight of payments to contractors for home office expenses, are the first line of defense to ensure that unallowable costs are not reimbursed. OIG and contractor internal audits are performed to ensure that both contractor and Department internal controls are effective regarding unallowable costs. Because of our concerns that controls may not be functioning as intended, the OIG, in cooperation with the Department and contractor internal auditors, has recently revised the Cooperative Audit Strategy to enhance coverage of unallowable costs.

While we have made revisions to our report to address concerns raised by the Office of Procurement and

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Assistance Management and the Argonne and Fermi site offices regarding our findings and conclusions, we do not agree with their conclusion that adequate reviews were performed. For the Argonne fixed home office payments, we do not dispute that the University of Chicago's cost proposal was reviewed and reduced. However, in our opinion, the review of the proposal for the 5-year period ended September 30, 2004, was not adequate. As pointed out in the Department's acquisition regulation, management and operating contractors generally require minimal home office involvement because the Government reimburses all management costs associated with operations of the Government facility. In light of this fact, the review of the proposal should have included a documented analysis of whether the fixed payments were a reasonable estimate of the contribution that certain of the University's central offices would provide to Argonne. For the reimbursement of Fermi's actual home office expenses, we do not dispute that a limited review was performed of actual expenses. However, reviews need to be enhanced to ensure that questionable expenses such as those we identified are not reimbursed.

Management comments also stated that the compensation structure adopted for Fermi was documented and appropriate. We agree and never intended to question the support or appropriateness of Fermi's compensation structure. We have revised our report to eliminate any confusion over this issue.

# Appendix 1

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## **OBJECTIVE**

The objective of this audit was to determine whether payments to contractors for home office expenses were equitable.

## **SCOPE**

The audit was performed between November 2003 and January 2005 at Department Headquarters and included selected Department sites. For selected contractors, we performed a limited review of actual home office expenses claimed for the latest fiscal years completed. For fixed payment agreements, we reviewed supporting documentation for agreed-to amounts covering the latest contract period.

## **METHODOLOGY**

To accomplish our audit objective, we:

- Reviewed applicable laws, regulations, and cost principles pertaining to home office expenses;
- Reviewed contract clauses and other agreements to determine how home office expenses were reimbursed to contractors;
- Reviewed claimed expenses and performed a limited review of supporting documentation for selected contractors reimbursed for actual incurred home office expenses;
- Reviewed cost proposals, negotiation records, allocation methodology, and supporting documentation for selected contractors reimbursed for home office expenses through fixed payments; and,
- Discussed home office expenses and allocation methodologies with Department and contractor representatives.

The audit was conducted in accordance with Government auditing standards for performance audits and included tests of internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. We did not

## **Appendix 1 (continued)**

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identify any performance measures or goals required by the *Government Performance and Results Act* applicable to home office expenses. We relied on computer-processed data to accomplish the audit objective. When appropriate, we performed limited test work of data reliability during our audit and determined that we could rely on the computer-processed data.

We discussed the results of this audit with NNSA on January 26, 2005, and with the Offices of Science and Procurement and Assistance Management on February 7, 2005.

### PRIOR REPORTS

#### Office of Inspector General Reports

- *Audit on Central Office Expenses for the Thomas Jefferson National Accelerator Facility* (DOE/IG-0629, December 8, 2003). This audit questioned about \$4.6 million of the \$4.8 million claimed by and paid to the contractor for central office expenses from November 1999 to September 2002. Questioned costs included home office expenses that were specifically not allowable, as well as expenses that were not adequately supported or documented. Lack of attention by Federal administrators to contractor claims created an atmosphere in which the contractor sought and received reimbursement for unallowable and inadequately documented home office expenses. The Federal funds used to pay these claims should have been employed directly for advancing the scientific mission of the Jefferson Laboratory. An allowability determination has been completed, and the Department has recouped overpayments of \$2.2 million.
- *Management Controls Over Title X Claims Reimbursement at the West Chicago Thorium Processing Facility* (OAS-M-04-08, September 2004). This audit disclosed that the contractor had inappropriately claimed \$7.3 million in non-reimbursable costs, and we questioned \$14 million in overhead previously approved by the Department for 1994 through 2001.






Department of Energy  
National Nuclear Security Administration  
Washington, DC 20585



JAN 11 2005

MEMORANDUM FOR Rickey R. Hass  
Assistant Inspector General  
for Audit Operations

FROM: Michael C. Kane   
Associate Administrator  
for Management and Administration

SUBJECT: Comments to IG Draft Report on Contractor Home Office Expenses

The National Nuclear Security Administration (NNSA) appreciates the opportunity to have reviewed the Inspector General's (IG) draft report, "Contractor Home Office Expenses." We understand that the IG conducted this audit based on the results of a previous audit and to determine whether payments to contractors for home office expenses were equitable.

NNSA generally agrees with the report and subsequent recommendations. NNSA acknowledges that, as an organization, we will continue building on our financial oversight strengths and include improved home office expense reviews. Realizing that not all of the operating contracts are the same (different geographical locations/Site Offices; different corporate entities), we will reenforce the requirement for the respective contracting officers to perform due diligence as related to the recommendations to analyze, review, and exclude—as appropriate—cost issues associated to home office expenses. Additionally, in the case of making a determination of the allowability of costs for home office expenses, the respective contracting officers will work together to ensure consistency in the cost determination and then will recover any overpayments as appropriate.

Should you have any questions regarding this response, please contact Richard Speidel, Director, Policy and Internal Controls Management. He may be contacted at 202-586-5009.

cc: Robert Braden, Senior Procurement Executive  
Karen Boardman, Director, Service Center  
Dennis Martinez, Field Chief Financial Officer  
Patty Wagner, Manager, Sandia Site Office  
Camille Yuan-Soo Hoo, Manager, Livermore Site Office  
Ed Wilmot, Manager Los Alamos Site Office



## Appendix 3 (continued)

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Department of Energy  
Office of Science  
Washington, DC 20585

January 7, 2005

MEMORANDUM FOR RICKEY R. HASS  
ASSISTANT INSPECTOR GENERAL  
FOR AUDIT OPERATIONS  
OFFICE OF INSPECTOR GENERAL

FROM: MILTON D. JOHNSON *MDS*  
CHIEF OPERATING OFFICER  
OFFICE OF SCIENCE

SUBJECT: Office of Science Comments on IG Draft Report,  
"Contractor Home Office Expenses"

In response to your December 10, 2004, memo, the Office of Science (SC) has reviewed the subject draft report and concurs with the recommendations. Specific comments related to the facts and findings are noted in this memo and the attachment.

### RECOMMENDATIONS

We recommend that the Administrator, National Nuclear Safety Administration and the Director, Office of Science, in conjunction with the Director, Office of Procurement and Assistance Management, direct contracting officers to enhance their financial oversight of management and operating contractors by directing contracting officials to ensure that:

1. Analyses are performed to determine the equitable amount and structure of home office compensation and that the adopted rationale be documented.

Management Response: Concur. SC contracting officers will be required to perform analyses in order to determine an equitable amount and structure of home office compensation. The analysis and structure will be documented.  
Estimated Completion Date: November 1, 2005

2. Payments for actual home office expenses receive timely review and exclude unallowable expenses.

Management Response: Concur. SC contracting officers will be required to ensure that all payments for actual home office expenses will be reviewed in a timely manner and that payments will exclude unallowable expenses.  
Estimated Completion Date: November 1, 2005



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## Appendix 3 (continued)

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3. Agreed-to amounts for management allowances and other fixed agreements for reimbursing home office expenses exclude unallowable expenses.

Management Response: Concur. SC contracting officers will be required to ensure that fixed agreements and/or agreed-to amounts for management allowances exclude unallowable expenses.

Estimated Completion Date: November 1, 1005

4. The Department contracting officers make a determination regarding the availability of the home office expenses questioned in our audit and recover all overpayments.

Management Response: Concur. SC contracting officers will assure all terms and conditions of management and operating contracts are thoroughly implemented regarding home office expenses. The home office expenses questioned in this audit report will be reviewed to determine allowability.

Estimated Completion Date: November 1, 2005

Comments on draft Memorandum to the Secretary:

Background Section, second paragraph:

Revise paragraph to read "As noted in our audit on *Central Office Expenses for the Thomas Jefferson National Accelerator Facility*...programs of needed funds. In that instance, we found that the Department had not adequately reviewed the financial operations of the contractor and questioned the allowability of about \$4.6 million for expenses and for an inappropriate share of central home office expenses. An allowability determination has been completed, and the Department has recouped overpayments of \$2.2 million. Because of the significance of the issue...expenses were equitable."

The University of California operates two National Nuclear Security Administration (NNSA) laboratories (Livermore and Los Alamos) and one SC laboratory (Berkeley). Berkeley will coordinate with the two NNSA site offices to address the findings since they are corporate in nature and not site-specific. Since Berkeley was under the cognizance of NNSA during FY 2001 and 2002, NNSA will address any issues regarding Berkeley, and SC will be copied on their response. SC will work with NNSA on any required actions.

Detailed comments from the Argonne and Fermi Site Offices are attached.

Thank you for the opportunity to comment on this draft report.

If you have any questions regarding these comments, please contact John Alleva at either 202-586-6834 or 301-903-3064.

Attachment

## Appendix 3 (continued)

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### Comments on IG Draft Report "Contractor Home Office Expenses"

#### Argonne Site Office Comments

Based on our reading of the draft IG Report, there is a misunderstanding by the IG concerning what is included in the performance fee, central office expenses and board of governor's expenses, which has a direct impact on the IG conclusions. Consequently we disagree with the comments regarding whether the three forms of compensation were appropriate.

The negotiated performance fee was well below the maximum allowable fee per the DEAR 970 guidelines. The fee compensated the University of Chicago for the risks of allowable costs and liability associated with the management of the laboratory and for the University's role in management of the laboratory. The performance fee did not reimburse the costs of University personnel devoted to the operation of the lab such as management, faculty and staff provided by the University's campus operations, all of which were covered by the allowance for central office expenses. The performance fee also did not cover any of the board of governor's costs.

Central office expenses specified in clause H.35 of the M&O contract includes Argonne Laboratory management oversight by University officers including the President, Vice President for Research and other Vice Presidents and their staffs. There is also participation in Argonne Laboratory matters by the University trustees, the work of administrative personnel performing legal, accounting, research administration and technology transfer services. The central office expenses also include costs for the advice of the faculty, educational assistance to the Argonne staff and the availability to the Argonne staff of all University campus facilities, including libraries.

The reimbursement of University of Chicago's board of governors' expenses is also specified in clause H.35 of the M&O contract. The board's expenses are not duplicated in the central office expenses. The board's responsibilities include providing guidance, oversight, direction, and advice to Laboratory management with respect to scientific and technical issues, long-range objectives, budget and facility plans, cooperative research and development, outreach, and technical transfer. As part of these activities, the board implemented and supervised the University's peer-review process to provide an overall assessment of key programmatic areas and critical and general operations.

Regarding Departmental Contract Administration we disagree with the statement indicating that contracting officials did not perform or document their analysis of home office costs. We have a plan for reviewing the University of Chicago's central office expenses prior to negotiations as well as the historical costs each year. The contractor's proposal is usually in the \$7 million range and we negotiate an amount of approximately \$2 million per year. We have continually excluded costs that do not benefit the

## Appendix 3 (continued)

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laboratory and this reduced negotiated amount has resulted in a significant annual savings to the Department over the years. We do have support for these reductions; however the support does not meet the OIG yellow book standards.

We disagree with the monetary impact of \$10,000 for the University of Chicago's board of governor's expense. In February, 2003 DOE and the University of Chicago agreed to a decrement factor for FY 2002 costs based on a 100% review of FY 2001 board of governor's travel and subsistence accounts. Accordingly, FY 2002 boards of governor's costs were reduced by approximately \$4,000. Consequently the monetary impact should be \$6,000 not \$10,000.

### Fermi Site Office Comments

#### Financial Reviews

Pursuant to prime contract Clause H. 12, Contractor Corporate Office Expenses, the Fermi Site Office in conjunction with the Chicago Office has a plan for negotiation of the Universities Research Association, Inc. (URA) Central Office expenses. We review prior year's actual expenses and compare these actual expenses with the next year's budget. Any significant cost element increases are requested to be substantiated. In addition, based on account descriptions, costs are reviewed to ensure allowability. In past years, proposed central office expenses have been reduced in arriving at the negotiated yearly amount in the contract. In addition, the contractor voluntarily excludes unallowable expenses from their submission. For example, in FY 2003 the contractor voluntarily excluded unallowable costs of approximately \$808,000. Consequently, we disagree with the draft report statement which indicated that financial reviews were not performed prior to negotiation of amounts. Although our review may not be to the yellow book standard, we have a process (identified in the prime contract) in place to determine the negotiated annual ceiling for corporate office expenses and to facilitate the review of the year end actuals for allowability and allocability.

#### Contract Administration

With respect to the comments under Departmental Contract Administration, which states that contracting officials did not perform or document their analysis regarding what compensation structure to adopt or the contribution of home office to Federally-funded activities, we disagree. At the behest of President Lyndon Johnson's Science Advisory Committee and the National Academy of Sciences, the not-for-profit URA Corporation was founded in 1965 for management and operation of research facilities in the national interest. With few exceptions, URA allowable costs benefit Fermilab. URA provides operational oversight of the Fermilab Directorate, including the recruitment of the Fermilab Director. URA provides guidance for the Fermilab internal audit function and ensures proper corporate governance. Of great importance, URA arranges and sponsors scientific peer reviews to enhance the research effort at Fermilab. In addition, URA oversees the Fermilab legal function and provides technical guidance to the Fermilab accounting function. From time to time URA provides funding for activities at Fermilab,

## Appendix 3 (continued)

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both allowable and unallowable. An example of the former was the provision of \$300k in order to expedite the implementation of the Oracle Project Accounting module in FY 2003. Examples in the latter category are provision of facilities (Users Center, Gym, etc.) that enhance the off-hour conditions at the Lab for the many Users that stay at the Lab for extended periods while conducting research. URA also establishes Fermilab benefit plans and serves as liaison to DOE on behalf of Fermilab and the High Energy Physics community on a variety of issues.

### Alcoholic Beverages

In terms of the amount being questioned, alcoholic beverages would actually rank 12th out of the 13 categories of questioned costs. According to the documents provided, it appears that the two year costs associated with alcoholic purchases total about \$559.02, \$29.62 in FY 01 and \$529.40 in FY 02. The questioned costs associated with alcoholic purchases equate to about 1/10 of a percent or to be specific, 0.745% of the \$75,000 questioned. As currently written, I believe the pre-decisional draft sensationalizes the alcohol issue. I recommend that we put the issue in perspective by identifying the dollar amount associated with the concern.

It is URA's policy to exclude the purchase of alcoholic beverages from costs reimbursable under the prime contract. However, because of human error, alcohol purchases of \$559.02 were inadvertently charged against the contract during the audit period. URA will reimburse the Department for these costs.

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