



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

# Special Report

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## Management and Operating Contractors' Subcontract Audit Coverage

DOE/IG-0885

April 2013



## Department of Energy

Washington, DC 20585

April 17, 2013

### MEMORANDUM FOR THE SECRETARY

A handwritten signature in cursive script, reading "Greg Friedman".

FROM: Gregory H. Friedman  
Inspector General

SUBJECT: INFORMATION: Special Report on "Management and Operating Contractors' Subcontract Audit Coverage"

### BACKGROUND

The Department of Energy (Department) employs 28 Management and Operating (M&O) contractors that perform essential mission work under cost reimbursable contracts. To achieve the Department's mission, M&O contractors often utilize the services of subcontractors, which are also funded by the Department. When these subcontracts are structured as cost-type, including time and materials, and cost reimbursable subcontracts, M&O contractors are contractually required to ensure that associated costs incurred are audited to provide assurance that the costs are allowable. The M&O contractors may use their internal audit staff, engage contract auditors, or use the services of the Defense Contract Audit Agency (DCAA) to audit the subcontractors. Internally performed audits must, at a minimum, meet professional standards prescribed by the Institute of Internal Auditors. M&O contractors presumably rely on audits of subcontractors when completing required annual certifications that all of their incurred costs are allowable.

The Office of Inspector General identified contract management as a management challenge in its report on *Management Challenges at the Department of Energy* (DOE/IG-0874, October 2012). The Department has committed to improving contract management and we recognize that such a significant issue requires a concerted effort over time. Over the past few years, however, our reviews have shown that some M&O contractors have not provided sufficient audit coverage of their subcontracts. The objective of this report is to highlight the issues we identified in our previous reports and stress the need for a top-down emphasis to ensure that all M&O contractors develop robust procedures for subcontract audits.

### RESULTS

Between 2010 and 2012, the Office of Inspector General reported subcontract audit weaknesses with nine M&O contractors. Subcontracts valued in excess of \$906 million had not been audited or were reviewed in a manner that did not meet audit standards. Several examples included:

- \$398 million in subcontract costs at nine contractors that had not been audited as required by the M&O contracts. Of this amount, nearly \$160 million at the Yucca Mountain Project (Yucca Mountain) had not been audited at the time the program was terminated in 2010.

- \$165 million in subcontract costs that had not been subjected to audits that met required professional standards at Los Alamos National Laboratory (Los Alamos).
- Nearly \$343 million in subcontract costs at Los Alamos that should have been audited but did not require audit under a strategy approved by the Los Alamos Field Office.

The subcontract costs were not audited because the Department did not ensure that its M&O contractors developed and implemented procedures to meet their contractual requirements. Specifically, although the M&O contractors are contractually required to conduct or arrange for audits of their cost-type subcontracts, we determined that:

- Four of the nine M&O contractors that had not audited their subcontracts failed to develop an approach to meet their contractual requirement for audit. For example, at the Kansas City Plant we found that the contractor, although required to arrange for audits of its subcontractors, had almost \$21 million in subcontract costs that had not been audited because there were no internal procedures for auditing ongoing subcontracts.
- Five contractors that had defined approaches for conducting their subcontract audits did not follow them. For example, at Yucca Mountain, although the contractor relied on DCAA to audit its subcontracts, it had not arranged for these audits to be conducted, as required.
- One contractor conducted reviews of subcontract costs that did not meet audit standards because the contractor assigned the reviews to a non-audit entity. Specifically, at Los Alamos, the Laboratory's procurement group reviewed the subcontract costs but the audits did not meet professional standards for independence, objectivity, due professional care and documentation.
- Los Alamos' approved audit strategy only required audits of subcontracts with annual incurred costs that exceeded \$15 million. Under this threshold, only 2 of 1,404 subcontracts were required to be audited.

The failure to ensure that effective subcontract audit policies are developed and implemented substantially increases the risk that unallowable costs will be incurred and not detected in a timely manner. In addition to ensuring audits are arranged and conducted in accordance with professional standards, timeliness of audit completion is also critical. Notably, we learned that in most cases there is only a 3-year retention requirement for subcontractors to maintain cost data. As such, the lack of a timely audit increases the risk that records necessary to conduct an audit will not be available. Finally, as it pertains to audit timelines, the statute of limitations may prevent the M&O contractors from recovering unallowable costs if the audits are not performed within a reasonable time frame.

While unallowable costs and imprudent use of resources have always been important factors that have routinely been examined during audits, ensuring that funds are spent wisely has become even more critical in this period of shrinking budgetary resources. Audits are valuable for ensuring unallowable costs are quantified and, through recovery or denial of claims, making additional funds available for other pressing Departmental needs. To illustrate this point, the

subcontract audits performed during the period covered by our review identified over \$2.5 million in questioned costs. Also, as generally recognized, audits serve as a potent deterrent to the misuse of Federal resources.

We noted that while some sites have taken action in response to our reports, we believe that a greater Department-wide emphasis on auditing cost-type subcontracts is needed. Accordingly, we made recommendations to improve the subcontract audit function.

Based on our ongoing evaluation of contract audit coverage, the lack of audited contractor costs also appears to extend beyond subcontracts. In particular, the Department has recognized that with its increased use of non-M&O type contracts and difficulties in obtaining timely support from the agency responsible for providing audit support for those contracts, the DCAA, there is a need for additional audit policy guidance. In December 2012, the Director, Office of Policy, Office of Acquisition and Project Management noted that her Office and the Office of the Chief Financial Officer were working to develop new audit guidance for the Department's contracting officers. For its part, the Office of Inspector General is analyzing the impact of the current audit strategy on the timeliness of non-M&O contract audits. The issues identified and recommendations made in this report should be useful to the Department's ongoing review of its audit policy.

#### MANAGEMENT REACTION

Management concurred with the report's findings and recommendations and agreed to take corrective actions. Management's formal comments are included in their entirety in Appendix 2.

Attachment

cc: Deputy Secretary  
Chief of Staff  
Chief Financial Officer  
Director, Office of Management  
Acting Administrator, National Nuclear Security Administration

# **SPECIAL REPORT ON MANAGEMENT AND OPERATING CONTRACTORS' SUBCONTRACT AUDITS**

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## **TABLE OF CONTENTS**

### **Subcontract Management**

Details of Finding .....	1
Recommendations .....	6
Management Reaction and Auditor Comments .....	7

### **Appendix**

1. Office of Inspector General Reports .....	8
2. Management Comments .....	10

# MANAGEMENT AND OPERATING CONTRACTORS' SUBCONTRACT AUDITS

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## Background

The Department of Energy (Department) utilizes 28 Management and Operating (M&O) contracts as a means of completing its mission work at various sites. In accomplishing their tasks, M&O contractors employed a significant number of subcontractors. The M&O contractors are required to manage and administer each of the subcontracts they award, including ensuring necessary audits are conducted. M&O contracts are required to contain Department of Energy Acquisition Regulation Clauses 970.5232-3 and 970.5244-1, which require the contractors to either conduct or arrange for periodic audits of their cost-type subcontractors' costs.

M&O contractors must provide an Implementation Design Plan which, among other things, identifies their plan for post-award audits of subcontractors. M&O contractors may use their internal audit staff, engage contract auditors, or use the services of the Defense Contract Audit Agency (DCAA) to perform audits of their subcontractors. The internally performed audits must, at a minimum, meet the Institute of Internal Auditors (IIA) Standards. These standards include, among other things, requirements for auditors to meet certain independence and educational requirements, for work to be sufficiently documented and supervised, and for audit sampling methodologies that produce valid, representative results.

As part of its review of costs claimed by M&O contractors, the Office of Inspector General assesses the extent to which incurred cost audits are performed on subcontracts. During our periodic review of Statements of Cost Incurred and Claimed prepared annually by M&O contractors, we review incurred cost audits and evaluate whether necessary subcontract audits have been performed. This work has revealed a number of weaknesses with subcontract audit coverage. The objective of this report is to highlight the issues we identified in our previous reports and stress the need for a top-down emphasis to ensure that all M&O contractors develop robust procedures for subcontract audits.

## Identified Subcontract Management Issues

Since 2010, the Office of Inspector General has issued 10 separate reports that identified subcontract management weaknesses. Specifically, the total value of the subcontract costs that had not been audited, or were reviewed in a manner that did not meet standards, exceeded \$906 million. Because of the significance of the cost of these subcontracts and the seriousness of the weaknesses we identified, we developed this report to highlight key issues for management attention. Of the 10 reports we issued over the past 3 years, 9 disclosed a lack of audit coverage of subcontracts and 1 disclosed that subcontract reviews performed did not meet relevant audit standards. One report also disclosed that the M&O contractor's threshold for conducting audits was set at a level that effectively excluded virtually all of its cost-type subcontracts.

### Subcontract Audit Coverage

While audits of cost-type subcontracts are required to help ensure only allowable costs are reimbursed by the Government, we identified issues with inadequate audit coverage of cost-type

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subcontracts by nine M&O contractors. Our reports, which addressed subcontracts in effect between Fiscal Year (FY) 2001 and FY 2010, identified \$398 million in subcontract costs that had not been audited. The weaknesses we identified occurred with M&O contractors who manage National Nuclear Security Administration (NNSA), Office of Science and Office of Nuclear Energy sites. The following examples are indicative of the issues we identified. A full listing of these reports is included in Appendix 1.

In our report entitled *Audit Coverage of Cost Allowability for Bechtel SAIC Company, LLC during Fiscal Years 2004 through 2009 under Department of Energy Contract No. DE-AC28-01RW12101* (OAS-V-10-15, July 2010), we identified almost \$160 million in subcontractor costs that were not audited and considered unresolved pending audit when the Yucca Mountain Project (Yucca Mountain) was closed in 2010. The contractor relied on DCAA to perform audits of subcontractors; however, we identified at least 23 subcontracts in which we could not find evidence that the contractor had requested an audit. The Office of Civilian Radioactive Waste Management agreed to review the subcontracts we identified as requiring audit and committed to requesting the appropriate audit for those subcontracts for which it determined an incurred cost or closeout audit was required. As of November 2012, \$136 million had been resolved through a review of the costs, rather than an audit because documentation was not available for a full audit in many cases.

Additionally, in our report on *Audit Coverage of Cost Allowability for B&W Technical Services Y-12, LLC under Department of Energy Contract No. DE-AC05-00OR22800 during Fiscal Year 2010* (OAS-V-12-07, May 2012), we found that 504 of 518 subcontracts, with incurred costs in FY 2010 totaling \$86.3 million, had not been audited by B&W Technical Services Y-12 LLC (B&W Y-12). While labor costs related to time and material subcontracts were reviewed prior to payment, the reviews did not satisfy the requirements for an audit. In particular, periodic audits of time and materials subcontracts, which include floor checks of personnel, are important elements to ensuring the contractor actually provided the level of effort for which it was reimbursed. Our concern with this lack of audit coverage was consistent with that raised by the NNSA Field Chief Financial Officer, who noted that "While there have been measures taken to improve the related internal controls, Y-12 needs to ensure its subcontract costs are audited and resultant questioned costs are properly dispositioned."

Further, in our report on *Audit Coverage of Cost Allowability for Honeywell Federal Manufacturing & Technologies, LLC under Department of Energy Contract No. DE-AC04-01AL66850 for Fiscal Years 2007 and 2008* (OAS-V-10-11, May 2010), we found that although Honeywell Federal Manufacturing and Technology LLC (Honeywell) was required to arrange for audits of its subcontractors under its contract to operate the Kansas City Plant, almost \$21 million in subcontract costs had not been audited. The Contracting Officer told us that Honeywell's time and materials subcontract work instructions need to be strengthened to comply with the terms of its contract with the Department related to subcontract audits.

Finally, our report on *Audit Coverage of Cost Allowability for UChicago Argonne, LLC under Department of Energy Contract No. DE-AC02-06-CH11357 for Fiscal Year 2009* (OAS-V-11-07, March 2011) found that while UChicago Argonne arranged for closeout audits of completed cost-type subcontracts greater than \$650,000, it had a total of 24 open cost-type subcontracts

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greater than \$650,000 with a total value of approximately \$86 million that had not been audited while the subcontracts were active and incurring costs. Although it may have been impractical to audit every cost-type subcontract, especially those that had a low dollar value, we identified two multi-year subcontracts valued at approximately \$38 million that we believe should have been audited based on the large dollar value. Costs incurred during FY 2009 for these two subcontracts totaled nearly \$5.1 million.

These examples were consistent with issues we identified with five other contractors. In particular, we identified:

- \$17.4 million in subcontract costs that were subject to audit but unresolved pending completion of those audits at Los Alamos National Laboratory (Los Alamos);
- \$10.4 million in unaudited subcontractor costs at the Idaho National Laboratory (Idaho);
- \$8.4 million in unaudited subcontractor costs at the Pantex Plant;
- \$5.7 million in unaudited subcontractor costs at Lawrence Berkeley National Laboratory (Berkeley), which were audited subsequent to our report; and,
- \$3.6 million in unaudited subcontractor costs at Princeton Plasma Physics Laboratory.

Unless subcontract costs are audited in a timely manner there is a risk that audits will not be possible due to the lack of documentation. As previously noted, over \$136 million of Yucca Mountain costs were reviewed, but not audited due in large part because of the lack of documentation. Federal regulations require that contractors retain records for only 3 years after the contract period.

#### Audit Standards

We also identified one instance in which a contractor's review of subcontracts did not meet audit standards. At Los Alamos, we determined that, while \$165 million in subcontract costs were reviewed, the reviews did not meet the required standards. To ensure the integrity and reliability of contractor cost data, the Office of Inspector General, the Office of the Chief Financial Officer, and the Office of Acquisition and Project Management<sup>1</sup>, together with the Contractor Internal Audit Council developed the Cooperative Audit Strategy. The Cooperative Audit Strategy gives contractors the option of conducting audits of subcontractors or requesting audits by DCAA through the contracting officer. These audits must be performed in accordance with the IIA or equivalent standards.

In our report on *Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Years 2008 and 2009 under Department of Energy Contract No. DE-AC52-06NA25396*

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<sup>1</sup> The name of this office at the time of the Cooperative Audit Strategy was the Office of Procurement and Assistance Management. It has since changed to the Office of Acquisition and Project Management. For clarity, we will refer to it by its current name.

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(OAS-V-12-05, April 2012), we found that \$165 million in subcontract costs were reviewed by Los Alamos' Acquisition Services Management (ASM). However, the reviews conducted by this Division did not meet the required standards for organizational independence and work paper preparation and, therefore, were not done in accordance with the terms of the M&O contract. Additionally, our review determined that the work papers lacked sufficient evidence to support ASM's conclusions. Auditors considered the \$165 million as unresolved pending audit by the contractor's Internal Audit function.

### Excluded Subcontracts

We also found that, at Los Alamos, nearly \$343 million in subcontract costs should have been audited but did not require audit under a strategy approved by the Los Alamos Field Office. While we recognize that it is often not practical for a contractor to audit all cost-type subcontracts, many M&O contractors have developed viable approaches that limit the number of subcontracts that must be audited each year to a manageable number while still providing adequate audit coverage. However, in our previously identified report, we found that Los Alamos had adopted a subcontract audit strategy that effectively excluded 973 of its 975 cost reimbursable subcontracts and all of its 429 time and materials subcontracts from audit. Together, these subcontracts had almost \$343 million in incurred costs in FY 2008 and 2009.

### **Subcontract Audit Procedures**

The issues we found occurred because the Department did not ensure that contractors developed and implemented procedures to meet their contractual requirements despite the requirement included in the M&O contracts to provide for audit coverage. As a benchmark for our conclusions, we referred to the DCAA contract audit manual for subcontracts, which requires a risk-based approach for selecting subcontracts for audit. Under this approach, high-risk subcontracts over \$15 million are audited annually and the low-risk subcontracts below that threshold are audited once every 3 years. Additionally, audits are conducted according to professional standards.

However, contrary to the best practices outlined by DCAA, we identified a number of weaknesses, in some cases multiple weaknesses, in M&O contractors' approach to subcontract audits. In particular, four of the nine M&O contractors had not developed approaches for conducting audits. Another five contractors developed approaches, but did not implement them. In addition, one M&O contractor assigned the subcontract review function to a non-audit entity that did not perform audits in accordance with the required standards. This contractor also adopted an audit strategy that excluded almost all of its subcontracts from its audit requirement.

### Audit Procedures

Four of the nine M&O contractors did not provide sufficient audit coverage of their cost-type subcontracts because they either had not established an approach for selecting subcontracts for audit or did not require cost incurred audits during the subcontract performance period. The following examples highlight our concerns:

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- The contractor at Idaho, Battelle Energy Alliance, LLC, had not developed a procedure to meet its contractual obligation to provide audit coverage of subcontracts. Further, the contractor had not established a dollar threshold or other acceptable criteria for determining when subcontracts were subject to periodic audit.
  - Honeywell time and materials subcontract work instructions did not require audits of costs incurred during the subcontract performance period and only required closeout audits under certain limited circumstances.

In addition, while the remaining five contractors identified in this report had adopted an audit approach for identifying subcontracts for audit, we identified issues with their use of these approaches that adversely affected audit coverage. Two M&O contractors had not completed the analysis required to determine which subcontracts should be audited under the adopted audit approach. Additionally, two contractors did not apply the established threshold in identifying subcontracts for audit. Another contractor had applied the threshold but had not yet completed the audits. For example:

- At B&W Y-12, procedures stated that the scope and frequency of subcontract audits would vary based on a number of risk factors and the availability of audit resources. If risk factors were low and no specific areas of concern were identified, audits may have been waived. However, B&W Y-12 did not perform an analysis of the subcontracts to determine whether an audit should have been waived or the frequency in which audits should have been conducted.
- Berkeley's subcontract administration policy required a post award incurred cost audit of multi-year subcontracts when costs would exceed \$1 million in 1 year. However, Berkeley excluded time and materials contracts from this threshold, a universe that could amount to almost \$27 million for the 3 years covered by this report. Berkeley has since revised its policy to include time and material subcontracts to its universe of subcontracts subject to audit.

#### Non-Audit Organizations

Subcontract reviews at Los Alamos were not conducted according to professional standards because responsibility had been assigned to a non-audit organization. Subcontract audits must be performed in accordance with professional audit standards, which include requirements for independence, objectivity and due professional care. However, at Los Alamos, the subcontract reviews did not meet audit standards for organizational independence and work paper preparation because they were performed by ASM rather than Internal Audit. In fact, in 2008, Internal Audit performed an assessment of the ASM audit function and found issues with staffing, planning and reporting.

In response, Los Alamos Management returned the subcontract audit function to Internal Audit in August 2010. In December 2012, subsequent to our report, Los Alamos Internal Audit completed a second assessment of the subcontract reviews previously performed by ASM.

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Internal Audit found that, although the reviews contained certain weaknesses, the amount and type of testing performed by ASM was generally consistent with what would be done under a *Generally Accepted Government Auditing Standards* compliant audit.

### Subcontract Audit Strategy

The Los Alamos audit strategy did not require the majority of subcontracts to be audited because it established a threshold that was too high in relation to the audit population. Specifically, in 2009 Los Alamos adopted a subcontract audit strategy that was made retroactive to 2006, and was based on the DCAA contract audit manual.

However, that strategy only required audits for those subcontracts with annual costs incurred of \$15 million and was therefore inconsistent with DCAA requirements that also required an audit of lower risk (value) contracts once every 3 years. In 2010, Los Alamos transferred the subcontract audit function to Internal Audit and proposed a revised audit strategy that was expected to improve audit coverage.

### **Increased Risk**

The weaknesses we identified increased the risk of wasteful spending. The lack of subcontract audits by M&O contractors at Department sites increases the risk of the government paying unallowable costs for the work at these sites. Further, as previously discussed, there is a 3-year retention requirement for subcontractor cost data. Delays in conducting these audits increases the risk that subcontractors will be unable to produce the documentation necessary to support their costs incurred and conduct the audits. Finally, under certain circumstances the statute of limitations may prevent the M&O contractors from recovering unallowable costs due to the expiration of time if such costs are not identified through the performance of timely audits.

### **Positive Steps by Some Contractors**

Through our work on this issue, we identified some positive steps that have been taken or are planned. For example, some contractors planned to establish specific criteria that would trigger the need for the audit and reasonable thresholds for selecting subcontracts for audit. Additionally, Los Alamos has proposed an audit strategy to improve audit coverage and has moved the auditing function to Internal Audit. While these steps are likely to reduce the risk of unallowable costs being paid by the Government at these sites, there is a lack of Department-wide emphasis on the importance of subcontract auditing at all of the Department's 28 M&O contractor locations.

### **RECOMMENDATIONS**

Accordingly, we recommend that both the Department's Office of Acquisition and Project Management and NNSA's Associate Administrator for Acquisition and Project Management ensure that M&O contractors provide adequate audit coverage of cost-type subcontracts by:

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1. Adopting a documented approach for conducting audits with a reasonable threshold for selecting subcontracts that ensures sufficient audit coverage; and,
  2. Ensuring that audits meet the requirements of the IIA standards.

## **MANAGEMENT REACTION**

The Department's Office of Acquisition and Project Management concurred with the recommendations and stated that it plans to work with the Office of Inspector General, the Office of the Chief Financial Officer, and others to develop guidance on a risk-based approach to subcontract audits under M&O contracts. NNSA also concurred with the recommendations, stating that its Senior Procurement Executive will ensure M&O contractors adopt a documented approach consistent with the recommendation and will ensure audits performed by the contractors meet IIA standards.

## **AUDITOR COMMENTS**

Management comments are responsive to the report. We also incorporated suggested changes to the draft report into this report as appropriate. Management's comments are included in Appendix 2.

## Appendix 1

### OFFICE OF INSPECTOR GENERAL REPORTS

REPORT	IDENTIFIED ISSUES	SUBCONTRACT COSTS PENDING AUDIT
<b>Assessment of Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Year 2010 under Department of Energy Contract No. DE-AC52-06NA25396 (OAS-V-13-01, November 2012)</b>	During Fiscal Year (FY) 2010, Los Alamos transferred responsibility for subcontract auditing to its Internal Audit function. However, \$17.4 million of subcontract costs are under review by Internal Audit but are considered unresolved pending completion of those reviews.	\$17.4 Million
<b>Report on Audit Coverage of Cost Allowability for Lawrence Berkeley National Laboratory for the Period June 1, 2005 thru September 30, 2008 under Department of Energy Contract No. DE-AC02-05CH11231 (OAS-V-10-10, April 2010)</b>	Two Time and Materials Subcontracts met the threshold for audit according to Berkeley's subcontract administration plan. However, these subcontracts were not audited. The two subcontracts totaled approximately \$5.7 million.	\$5.7 Million
<b>Audit Coverage of Cost Allowability for B&amp;W Technical Services Y-12, LLC under Department of Energy Contract No. DE-AC05-00OR22800 during Fiscal Year 2010 (OAS-V-12-07, May 2012)</b>	The contractor did not always conduct or arrange for audits of its subcontractors when costs incurred were factor determining the amount payable to subcontractors.	\$86.3 Million
<b>Report on Audit Coverage of Cost Allowability for Babcock and Wilcox Technical Services Pantex, LLC During Fiscal Years 2006 Through 2009 under Department of Energy Contract No. DE-AC04-00AL66620 (OAS-V-11-03, January 2011)</b>	The contractor had not arranged for audits of all subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor.	\$8.4 Million
<b>Report on Audit Coverage of Cost Allowability for Honeywell Federal Manufacturing &amp; Technologies, LLC under Department of Energy Contract No. DE-AC04-01AL66850 for Fiscal Years 2007 and 2008 (OAS-V-10-11, May 2010)</b>	Auditors noted that cost reimbursable subcontracts were not audited despite audits being required by the Honeywell contract. Honeywell's subcontract work instructions did not require interim audits and only required closeout audits if daily time records were not approved by a buyer representative or mischarging was expected.	\$20.8 Million

## Appendix 1 (continued)

REPORT	IDENTIFIED ISSUES	SUBCONTRACT COSTS PENDING AUDIT
<p><b>Report on Audit Coverage of Cost Allowability for Battelle Energy Alliance, LLC under Department of Energy Contract No. DE-AC07-05ID14517 during Fiscal Year 2010 (OAS-V-12-09, August 2012)</b></p>	<p>The contractor did not provide sufficient audit coverage of cost reimbursable subcontracts. Specifically, 17 subcontracts with \$10.4 million in FY 2010 incurred costs were not audited. The contractor did not have a process in place to select cost reimbursable subcontracts for audit.</p>	<p>\$10.4 Million</p>
<p><b>Report on Audit Coverage of Cost Allowability For UChicago Argonne, LLC under Department of Energy Contract No. DE-AC02-06-CH11357 for Fiscal Year 2009 (OAS-V-11-07, March 2011)</b></p>	<p>Auditors noted that \$65,905 in questioned costs from previous audits had not been resolved. Additionally, two multi-year subcontracts valued at about \$38 million had not been audited on an interim basis. While UChicago Argonne arranged for closeout audits of subcontracts worth \$650,000 or more, there were no interim audits of ongoing subcontracts.</p>	<p>\$86 Million</p>
<p><b>Audit Coverage of Cost Allowability for Princeton Plasma Physics Laboratory during Fiscal Years 2009-2010 under Department of Energy Contract Numbers DE-AC02-76CH03073 and DE-AC02-09CH11466 (OAS-V-12-06, May 2012)</b></p>	<p>Princeton had not conducted or arranged for audits of two subcontracts totaling \$3.6 million. Princeton's policy was to audit subcontracts with costs totaling more than \$1 million, however, these two contracts met this threshold but were not audited.</p>	<p>\$3.6 Million</p>
<p><b>Report on Audit Coverage of Cost Allowability for Bechtel SAIC Company, LLC during Fiscal Years 2004 through 2009 under Department of Energy Contract No. DE-AC28-01RW12101 (OAS-V-10-15, July 2010)</b></p>	<p>Auditors identified over \$77 million in cost reimbursable subcontract costs that had not been audited. Additionally, \$82 million in previously identified unaudited subcontract costs was still considered unresolved pending audit.</p>	<p>\$159.9 Million</p>
<p><b>Audit Coverage of Cost Allowability for Los Alamos National Laboratory during Fiscal Years 2008 and 2009 under Department of Energy Contract No. DE-AC52-06NA25396 (OAS-V-12-05, April 2012)</b></p>	<p>During FYs 2008-2009, auditors found material weaknesses with the subcontract audit function. Subcontract reviews were not in compliance with Generally Accepted Government Auditing Standards as required. Auditors considered \$165 million in costs reviewed by Acquisition Services Management as unresolved pending audit by Internal Audit. Further, the audit strategy only required audits on subcontracts with annual incurred costs over \$15 million, which excluded all but 2 of the 1,404 subcontracts with \$343 million in incurred costs.</p>	<p>\$165 Million</p>

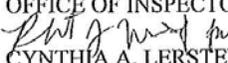


Department of Energy  
National Nuclear Security Administration  
Washington, DC 20585



March 20, 2013

MEMORANDUM FOR RICKEY R. HASS  
DEPUTY INSPECTOR GENERAL  
FOR AUDITS AND INSPECTIONS  
OFFICE OF INSPECTOR GENERAL

FROM:   
CYNTHIA A. LERSTEN  
ASSOCIATE ADMINISTRATOR  
FOR MANAGEMENT AND BUDGET

SUBJECT: Response to the Office of Inspector General Draft Special Report Titled  
*"Management and Operating Contractors' Subcontract Audit  
Coverage"* (A12ID005/2013-00208)

The National Nuclear Security Administration (NNSA) appreciates the opportunity to review the subject draft report. While we agree with the Inspector General's recommendations, we believe the language in several areas of the report may be misleading to the average reader. The attachment to this memorandum identifies specific actions NNSA will take to address each of the recommendations. In addition, to address the potentially misleading language, we have provided technical and general comments to improve the clarity and factual accuracy of the report.

If you have any questions regarding this response, please contact Dean Childs, Director, Internal Control, at (301) 903-1341.

Attachment



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**NNSA Response to  
Draft Special Report on Management and Operating Contractors'  
Subcontract Audit Coverage**

The Inspector General (IG) recommended the National Nuclear Security Administration (NNSA) Associate Administrator for Acquisition and Project Management ensure that management and operating contractors (M&O) provide adequate audit coverage of cost-type subcontracts by:

**Recommendation 1:** Adopting a documented approach for conducting audits with a reasonable threshold for selecting subcontracts that ensures sufficient audit coverage.

***Management Response: Concur***

The NNSA Senior Procurement Executive will ensure M&Os adopt a documented approach consistent with the IG recommendation. **The estimated completion date is December 31, 2013.**

**Recommendation 2:** Ensuring that audits meet the requirements of the Institute of Internal Auditors (IIA) standards.

***Management Response: Concur***

The NNSA Senior Procurement Executive will ensure audits performed by M&O contractors meet IIA standards. **The estimated completion date is December 31, 2013.**



### Department of Energy

Washington, DC 20585

March 27, 2013

MEMORANDUM FOR RICKEY R. HASS  
DEPUTY INSPECTOR GENERAL FOR AUDITS AND INSPECTIONS  
OFFICE OF INSPECTOR GENERAL

FROM: PAUL BOSCO   
DIRECTOR  
OFFICE OF ACQUISITION  
AND PROJECT MANAGEMENT

SUBJECT: Draft Report on "Management and Operating Contractors'  
Subcontract Audit Coverage"

The Office of Acquisition and Project Management has reviewed the subject draft report and has following comments:

**Technical Note:**

The Office of Acquisition and Project Management is referred to as the Office of Procurement and Assistance Management several times in the report. Please correct to reflect the "Office of Acquisition and Project Management."

**Recommendation 1:** We recommend that both the Department's Office of Acquisition and Project Management and National Nuclear Security Administration's (NNSA) Associate Administrator for Acquisition and Project Management ensure that Management and Operating (M&O) contractors provide adequate audit coverage of cost-type subcontracts by adopting a documented approach for conducting audits with a reasonable threshold for selecting subcontracts that ensures sufficient audit coverage.

**Management Response: Concur in Principle**

**Action Plan:**

The Office of Acquisition and Project Management will work with the Office of the Inspector General, the Office of the Chief Financial Officer, and others to develop guidance on a risk-based approach to subcontract audits under M&O contracts.

**Estimated Completion Date:** September 30, 2013

**Recommendation 2:** We recommend that both the Department's Office of Acquisition and Project Management and NNSA's Associate Administrator for Acquisition and Project Management ensure that M&O contractors provide adequate audit coverage of cost-type subcontracts by ensuring that audits meet the requirements of the Institute of Internal Auditors (IIA) standards.



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**Management Response: Concur in Principle**

**Action Plan:**

The Office of Acquisition and Project Management will work with the Office of the Inspector General, the Office of the Chief Financial Officer, and others to develop guidance on a risk-based approach to subcontract audits under Management and Operating contracts.

**Estimated Completion Date:** September 30, 2013

2

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