



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

INSPECTION REPORT

DOE-OIG-21-38

September 2021

**THE CLOSURE OF SAVANNAH RIVER
NUCLEAR SOLUTIONS, LLC'S FISCAL
YEAR 2016 ALLOWABLE COST
INTERNAL AUDIT**



Department of Energy
Washington, DC 20585

September 17, 2021

MEMORANDUM FOR THE MANAGER, SAVANNAH RIVER OPERATIONS OFFICE

SUBJECT: Inspection Report on “The Closure of Savannah River Nuclear Solutions, LLC’s
Fiscal Year 2016 Allowable Cost Internal Audit”

The attached report discusses our review of the facts and circumstances regarding the closure of the fiscal year 2016 allowable cost internal audit. This report does not contain recommendations or suggested actions. Therefore, no management response is required.

We conducted this review from January 2020 through August 2021 in accordance with the Council of the Inspectors General on Integrity and Efficiency’s *Quality Standards for Inspection and Evaluation*. We appreciated the cooperation and assistance received during this evaluation.

A handwritten signature in black ink, appearing to read "Jack Rouch", with a long horizontal flourish extending to the right.

Jack Rouch
Deputy Assistant Inspector General
for Audits
Office of Inspector General

cc: Deputy Secretary
Chief of Staff
Acting Assistant Secretary for Environmental Management



Department of Energy Office of Inspector General

The Closure of Savannah River Nuclear Solutions, LLC's Fiscal Year 2016 Allowable Cost Internal Audit (DOE-OIG-21-38)

WHY THE OIG PERFORMED THIS REVIEW

In October 2019, the President of Savannah River Nuclear Solutions, LLC (SRNS) closed the fiscal year (FY) 2016 allowable cost internal audit being conducted by SRNS' Internal Audit Department prior to its completion. The Internal Audit Department's draft report included about \$1.2 million in questioned costs.

Since 2008, SRNS has managed and operated the Department of Energy's Savannah River Site located near Aiken, South Carolina. SRNS' Internal Audit Department was required to conduct annual cost allowability audits on costs included on SRNS' annual Statement of Costs Incurred and Claimed.

We initiated this inspection to determine the facts and circumstances regarding the closure of SRNS' FY 2016 allowable cost internal audit.

What Did the OIG Find?

Due to conflicts between an internal auditor and SRNS management, the required FY 2016 allowable cost internal audit was closed. An internal auditor filed a whistleblower complaint with the Department alleging that SRNS management exhibited unprofessional behavior during internal audit briefings and pressured staff to remove findings from the internal audit report. When deciding to close the internal audit, the President cited concerns that the internal auditor's objectivity appeared to be impaired and that the audit exceeded budgeted hours. Upon closing the internal audit, the President indicated that the draft report and working papers had been provided to the Department's Contracting Officer. The Contracting Officer directed an independent review of the internal audit's findings in this case, determined the findings were sound, and subsequently issued a *Notice of Intent to Disallow Costs* for the \$1.2 million in questioned costs.

What Is the Impact?

Closing this internal audit exposed an inherent problem in the Department's Cooperative Audit Strategy. The ability of a management official to close an ongoing internal audit required by contract indicates that the Internal Audit Department lacked sufficient organizational independence.

What Is the Path Forward?

In April 2021, the Office of Inspector General issued a Special Project Report, *The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed*, highlighting its concerns with the effectiveness of the Cooperative Audit Strategy in providing adequate audit coverage of contractors' costs. The results of this inspection and associated recommendations were incorporated into the Special Project Report. Accordingly, we have made no separate recommendations in this report.

BACKGROUND

Since 2008, Savannah River Nuclear Solutions, LLC (SRNS) has managed the Department of Energy's Savannah River Site located near Aiken, South Carolina under a performance-based management and operating contract. The Savannah River Site is tasked with processing and storing nuclear materials, developing and deploying technologies to treat nuclear and hazardous wastes, and performing environmental management. As a management and operating contractor, SRNS' financial accounts were required to be integrated with those of the Department. Further, SRNS was required 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. The Department obligated \$13.8 billion on the SRNS contract from August 2008 through June 2020, which included the contractor's award and incentive fees.

The Department's Office of Inspector General (OIG), Office of Acquisition Management, integrated management and operating contractors, and other select contractors implemented a Cooperative Audit Strategy in 1994. The Strategy placed reliance on the contractors' internal audit functions to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with this Strategy, the Department required contractors, such as SRNS, to maintain an internal audit activity with the responsibility for conducting these audits. Under its contract with the Department, the SRNS Internal Audit Department was required to annually conduct an independent and objective review of the contractor's Statement of Costs Incurred and Claimed to assess the allowability of incurred contract costs. Any questioned costs were to be reported to the Contracting Officer in the internal audit report. Notably, contractor internal auditors did not perform audits in compliance with generally accepted government auditing standards (GAGAS), but rather SRNS' internal audit activity was required to adhere to Institute of Internal Auditors (IIA) Standards and be independent and objective.

SRNS' Internal Audit Department initiated a required allowable cost internal audit in November 2017 of the \$922 million charged to the contract in fiscal year (FY) 2016. In October 2019, the SRNS President closed the internal audit prior to completion, citing the time expended on the audit and the compromised appearance of an auditor's objectivity. The President stipulated that SRNS left the draft report "as is" to ensure open and transparent communication with the Department. The President noted that a copy of the draft report and associated internal audit workpapers had been provided to the Contracting Officer.

We initiated this inspection to determine the facts and circumstances regarding the closure of SRNS' FY 2016 allowable cost internal audit.

RESULTS OF INSPECTION

We found that due to conflicts between the internal auditor and SRNS management, the required FY 2016 allowable cost internal audit was closed, which resulted in the President of the audited organization becoming involved and ultimately deciding to close the internal audit after a draft report had been provided to the Contracting Officer. These conflicts also resulted in the internal auditor filing a whistleblower complaint with the Department alleging that SRNS management

had exhibited unprofessional behavior toward internal audit staff while being briefed on internal audit findings and pressured the staff to remove internal audit findings from the internal audit report, among other issues.

After filing the whistleblower complaint, the internal auditor provided a draft of the audit report to the Internal Audit Director for review. The draft internal audit report questioned approximately \$1.2 million in costs as unsupported or otherwise unallowable, including approximately \$868,000 in variable pay and retention program costs, \$314,000 in relocation and interviewee costs, and \$7,500 in procurement card transactions. Under the Internal Audit Department's typical process, the Internal Audit Director reviews the draft report submitted by the internal auditor, the report is finalized, and the final report is issued to management and the Contracting Officer. Additionally, the findings and recommendations are entered into an audit tracking database and the internal audit staff follows up with management on the recommendations to verify that corrective actions were completed. However, this process was not followed for the FY 2016 allowable cost internal audit.

Instead of reviewing and finalizing the draft report, the Internal Audit Director sought the President's assistance in handling the draft internal audit report prepared by the internal auditor even though the President was responsible for the entity being audited. The Internal Audit Director stated that she did not want to issue the report, as written, because of its tonal nature. Due to the complaint, she feared that any actions taken to revise the draft report would be seen as retaliation by the internal auditor. The Internal Audit Director stated that since she reported administratively to the President and deemed these issues to be sensitive, personnel-type issues, she addressed her concerns with the President instead of with the board of directors or audit committee.

In response to the SRNS Internal Audit Director's request for assistance, the President closed the internal audit upon receiving the draft report. According to the President, he conferred with the board of directors to discuss the issue, and ultimately decided, due to the whistleblower complaint, that closing the internal audit was the most practical response. In a letter to the Contracting Officer, the President states that the time to complete the internal audit's fieldwork and prepare a draft report exceeded budgeted hours by 768 hours, and it appeared that the auditor's objectivity was impaired, in fact or appearance, contrary to IIA Standards and as evidenced in the draft report. Additionally, the President expressed concern that any actions taken by management to suggest changes to the report would potentially draw allegations that it was attempting to unduly influence the internal auditor or manipulate the outcome of a final report, which was his reason for leaving the report "as is."

We did not attempt to reconstruct or opine on the merits of the complaint or other disputes which arose during the internal audit. In most cases, the conflicts had been resolved at the time of our review. Yet, these unusual circumstances resulted in the President of the audited organization becoming involved and ultimately deciding to close the audit. At the time of our work, we found there was general acceptance by all parties of the findings presented in the draft report. In fact, the President stated that he did not question the results of the internal audit work, and that management had begun addressing each finding in the draft report. Rather, he stated that he was concerned with the report's tone and questioned the auditor's objectivity.

The Department's Savannah River Operations Office also agreed with the findings. The Contracting Officer directed an independent review of internal audit's findings, determined the findings were sound, and subsequently issued a *Notice of Intent to Disallow Costs* for the \$1.2 million in costs questioned in the draft report. At the time of our review, the Contracting Officer was in the process of reviewing SRNS management's response to the *Notice of Intent to Disallow Costs*.

IMPAIRMENTS TO INTERNAL AUDIT'S INDEPENDENCE AND OBJECTIVITY

The ability of an SRNS management official to close an ongoing internal audit required by SRNS' contract with the Department indicates that the Internal Audit Department lacked sufficient organizational independence. IIA Standards and the Cooperative Audit Strategy both emphasize the requirement for internal audit departments to be independent. As such, the SRNS Internal Audit Department was required to be free from interference in determining the scope of internal auditing, performing work, and communicating results, and to report to a level in the organization that allowed it to fulfill its responsibilities.

Also of concern is the fact that the President's decision to close the FY 2016 allowable cost internal audit was made without consulting outside parties who would rely on the audit, including the Savannah River Operations Office and the OIG. However, we recognize that the President took steps to minimize the adverse impact of the closure. For instance, as with a formalized final report, SRNS management prepared a response to address the draft report's findings and recommendations and implemented corrective actions. Further, the President provided the internal audit results, reflected in the draft report, to the Contracting Officer who would ultimately determine the allowability of the costs questioned in the draft report.

The internal auditor stated, and we corroborated, that most of the audit fieldwork had been completed at the time the complaint was filed, and the Internal Audit Director had reviewed and approved the audit work supporting the issues cited in the draft report. We found that after the President had closed the report, an independent reviewer at the Savannah River Operations Office determined that the report and findings were sound. The independent reviewer noted that nothing in the report supported the President's assertion in the closure memo that the auditor's independence was impaired, as evidenced in the draft report.

COOPERATIVE AUDIT STRATEGY

The closure of the SRNS FY 2016 allowable cost internal audit exposed an inherent problem in the Department's overall Cooperative Audit Strategy. Specifically, the Cooperative Audit Strategy relied on internal audit departments to provide the primary audit coverage of incurred costs on Department contracts when the audit departments were organizationally aligned with the contractors they audit. While the SRNS Internal Audit Department reported functionally to a board of directors as required, in the case of the FY 2016 allowable cost internal audit, this functional arrangement did not preclude the President's decision to close the internal audit. As required, SRNS' Internal Audit Director met quarterly with the board of directors or audit committee to discuss the internal audit findings and status of the FY 2016 allowable cost internal audit. According to the audit committee chairman, the committee had been aware of the internal

audit findings and some of the problems encountered and realized that the Internal Audit Director was in a difficult position due to the complaint. The audit committee was aware that the report might be issued “as is” but was not involved in the decision to close the internal audit. The audit committee chair stated that he and the board of directors agreed with the President’s decision.

The facts and circumstance of this incident called into question whether the Internal Audit Department could be truly independent for an internal audit relied upon by outside parties such as the Department, when management, the very entity being audited, could exert control over the outcome of the internal audit. If the Department could not rely on the independence and objectivity of internal audit departments, then the commitment of the Cooperative Audit Strategy to provide audit coverage of contractors’ costs was compromised. This finding is consistent with the conclusions found in our multi-year review to assess the validity, accuracy, and effectiveness of the contractors’ internal audits of their Statements of Costs Incurred and Claimed under the Cooperative Audit Strategy. Specifically, we concluded that an auditee closing an incurred cost internal audit was a significant example of an undue influence threat under GAGAS and that the President’s ability to close an ongoing audit raised concerns about the independence of the contractor’s internal audits. In the case of SRNS, which had claimed \$922 million in costs in FY 2016, it is of paramount importance to ensure that incurred cost internal audits can be performed without obstruction or interference from senior SRNS management.

OTHER MATTERS

In April 2021, the OIG issued a Special Project Report, *The Transition to Independent Audits of Management and Operating Contractors’ Annual Statements of Costs Incurred and Claimed*, highlighting its concerns with the effectiveness of the Cooperative Audit Strategy in providing adequate audit coverage of contractors’ costs. The report recommended that the OIG and the Department transition to an independent audit strategy due to identified systemic threats to auditor independence; the increased likelihood of fraud, waste, and abuse; significant lapses in the audits of subcontracts; and other major deficiencies. The report notes that the Cooperative Audit Strategy allowed contractors to perform incurred costs audits under auditing standards promulgated by the IIA instead of GAGAS. The OIG determined that unlike IIA Standards, GAGAS sets forth a more robust framework designed to ensure auditor independence. Specifically, GAGAS identifies threats to independence, including self-interest threats, familiarity threats, undue influence threats, and management participation threats. The results of this inspection and associated recommendations were included in the Special Project Report. Accordingly, we have made no separate recommendations in this report.

Appendix 1: Objective, Scope, and Methodology

OBJECTIVE

We conducted this inspection to determine the facts and circumstances regarding the closure of Savannah River Nuclear Solutions, LLC's (SRNS) fiscal year (FY) 2016 allowable cost internal audit.

SCOPE

This inspection was conducted from January 2020 through August 2021 at the Department of Energy's Savannah River Site located near Aiken, South Carolina. Our scope included activities related to SRNS internal audit's FY 2016 allowable cost internal audit. The inspection was conducted under Office of Inspector General project number S20OR012.

METHODOLOGY

To accomplish the inspection objective, we:

- Reviewed applicable regulations, directives, policies, and procedures related to management and operating contractor internal audit activities;
- Interviewed the Department's Savannah River Operations Office officials and SRNS management and personnel;
- Determined the timeline of events that led to the President of SRNS deciding to close the FY 2016 allowable cost internal audit prior to its completion;
- Determined what actions Savannah River Operations Office officials took in response to SRNS' decision to close the FY 2016 allowable cost internal audit prior to its completion; and
- Determined the status of questioned costs identified in SRNS internal audit's FY 2016 allowable cost internal audit draft report.

We conducted our inspection in accordance with the *Quality Standards for Inspection and Evaluation* as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions.

Management waived the exit conference on August 23, 2021.

FEEDBACK

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