



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-22-15

December 2021

**SUBCONTRACT ADMINISTRATION AT
THE KANSAS CITY NATIONAL
SECURITY CAMPUS**



Department of Energy
Washington, DC 20585

December 21, 2021

MEMORANDUM FOR THE MANAGER, KANSAS CITY FIELD OFFICE

SUBJECT: Audit Report on Subcontract Administration at the Kansas City National Security Campus

The attached report discusses our review of subcontract administration at the Kansas City National Security Campus. This report contains eight recommendations that, if fully implemented, should ensure that the administration of subcontracts complies with applicable regulations and policies. Management nonconcurred (or nonconcurred as written) with five of the eight recommendations and concurred or concurred in principle with three recommendations.

We conducted this audit from October 2019 through September 2020 in accordance with generally accepted government auditing standards. We appreciated the cooperation and assistance received during this evaluation.

A handwritten signature in black ink, appearing to read "Jennifer L. Quinones".

Jennifer L. Quinones
Deputy Inspector General
Office of Inspector General

cc: Deputy Secretary
Chief of Staff



Department of Energy Office of Inspector General

Subcontract Administration at the Kansas City National Security Campus (DOE-OIG-22-15)

WHY THE OIG PERFORMED THIS REVIEW

The Office of Inspector General has issued several audit reports that identified subcontract administration weaknesses. These reports found weaknesses in several areas, including not auditing flexibly-priced subcontracts, inaccurately listing subcontract awards, and completing subcontract reviews that did not meet auditing standards.

From fiscal year 2015 through fiscal year 2019, Honeywell Federal Manufacturing & Technologies, LLC (Honeywell) subcontract records totaled approximately \$2.72 billion. Given the significant amount of Honeywell subcontracts and ongoing concerns with subcontract administration, we initiated this audit to determine whether Honeywell administered subcontracts for the Kansas City National Security Campus in accordance with applicable regulations and policies.

What Did the OIG Find?

We determined that Honeywell allowed a third-party audit firm to perform reviews of subcontract costs, instead of audits as required, in the Honeywell contracts. We also found that of the 92 fixed-price subcontract records we reviewed, 16 (about 17 percent) were misclassified as flexibly-priced and inappropriately excluded from audit. Our review also identified unresolved costs of \$88,391,364.18 from subcontracts that were not audited and could include unallowable activities, such as a mutual nondisclosure agreement and potential lobbying activities. Finally, we identified questioned costs of \$142,638.49 for third-party review services, mobile phone charges, and subcontract labor costs that did not meet the requirements for allowability and contract requirements. The issues we identified occurred, in part, because Honeywell did not always administer subcontracts in accordance with applicable regulations and policies.

What Is the Impact?

Without adequate administration of its subcontracts, including conducting or arranging for audits of cost-reimbursement subcontracts, Honeywell could be charging unallowable subcontract costs to the Department of Energy.

What Is the Path Forward?

We made eight recommendations that, if fully implemented, should ensure that Honeywell's subcontract administration complies with applicable regulations and policies.

BACKGROUND

The Kansas City National Security Campus (National Security Campus) is an engineering and manufacturing facility serving the U.S. Department of Energy's National Nuclear Security Administration (NNSA). The National Security Campus is the lead production site providing over 80 percent of the non-nuclear components that go into U.S. nuclear weapons. From fiscal year (FY) 2015 through FY 2019, the National Security Campus was managed by Honeywell Federal Manufacturing & Technologies, LLC (Honeywell) under cost-reimbursement management and operating contracts.

Honeywell's contracts with the Department incorporated Federal Acquisition Regulation (FAR) 52.230-6, *Administration of Cost Accounting Standards* (June 2010), and Department of Energy Acquisition Regulation (DEAR) 970.5232-3, *Accounts, Records, and Inspection* (December 2010). FAR 52.230-6, *Administration of Cost Accounting Standards* (June 2010), defines fixed-price subcontracts as those subcontracts where the price is not adjusted based on actual costs incurred or final payment is not based on actual costs incurred; and flexibly-priced subcontracts as those subcontracts where the price may be adjusted based on actual costs incurred, or other factors, or where final payment is based on actual costs incurred. Additionally, DEAR 970.5232-3, *Accounts, Records, and Inspection* (December 2010), states that the contractor also agrees, with respect to any subcontracts (including fixed-price or unit-price subcontracts, or purchase orders) where, under the terms of the subcontract, costs incurred are a factor in determining the amount payable to the subcontractor of any tier to either conduct an audit of the subcontractor's costs or arrange for an audit to be performed by the cognizant Government audit agency through the Contracting Officer.

The Defense Contract Audit Agency (DCAA) typically performs audits of cost-reimbursable subcontracts that are requested through the Contracting Officer. For audits of time and material (T&M), labor hour, and fixed-price with variable cost elements subcontracts, Honeywell Procurement developed a risk-based approach to select subcontract audits, relying on Honeywell's Internal Audit (Internal Audit) and Le Compte, P.C. (Le Compte), a third-party audit firm, to perform the audits or reviews, as summarized below.

| Total Subcontract Value | Risk Assessment Score | Strategy |
|-------------------------|-----------------------|-------------------------------|
| < \$500,000 | ≥ 65 | Audited by Internal Audit |
| ≤ \$500,000 | ≤ 65 | Placed in a Pool ^a |
| ≥ \$500,000 | | Reviewed by Le Compte |

^a Internal Audit provides audit support for subcontracts where the total contract value is less than \$500,000. All other subcontract audits are outsourced to a third-party audit firm. Procurement provides Internal Audit a list of pooled subcontracts biannually. Internal Audit randomly selects one subcontract from the pool for audit.

From FY 2015 through FY 2019, Honeywell subcontract records totaled approximately \$2.72 billion. Given the significant total value of subcontracts, we initiated the audit to determine whether Honeywell administered subcontracts for the National Security Campus in accordance with applicable regulations and policies.¹

¹ The details of the objective, scope, and methodology are contained in Appendix 1, and prior reports are contained in Appendix 3.

Subcontract Administration Weaknesses

We determined that Honeywell did not always administer subcontracts in accordance with applicable regulations and policies. Specifically, we found:²

- Reviews of subcontract costs performed by Le Compte were not conducted in accordance with professional auditing standards. Le Compte issued seven reports that stated the review or engagement was performed in accordance with the American Institute of Certified Public Accountants (AICPA) Statement on Standards for Consulting Services (Consulting Services Standards). Therefore, we are questioning \$139,529.21 that was paid to Le Compte for conducting reviews instead of audits and identifying \$52,797,775.02 of subcontract costs reviewed by Le Compte as unresolved costs pending audits that comply with professional auditing standards.
- Honeywell had not identified all flexibly-priced subcontracts that were potentially subject to audit. Of the 92 fixed-price subcontract records we reviewed, 16 records totaling \$13,699,272.95³ should have been identified as flexibly-priced and the variable costs should have been considered for audit. We are questioning these costs as unresolved since the costs were misclassified and not audited.
- Interim audits of costs totaling \$48,136,964.13, which were incurred by a subcontractor from calendar year (CY) 2014 through CY 2017 under cost-reimbursement subcontracts, were waived; and the interim audits from CY 2018 through CY 2019, with incurred costs totaling \$21,894,316.21, were pending. We are questioning incurred costs from CY 2018 through CY 2019 as unresolved pending audit.
- Two professional services subcontracts with Statements of Work that could include activities unallowable under Federal regulations. Specifically, the Statements of Work state that it is critical that the National Security Campus accelerate development of high-value Government and commercial relationships for new opportunities. However, spending money to develop Government relationships is prohibited under FAR.
- Two professional services subcontracts with Statements of Work that incorporated a mutual nondisclosure agreement, which is unallowable by FAR.
- Questioned costs totaling \$1,379.53 for mobile phone services and labor costs totaling \$1,729.75 that did not meet FAR requirements for allowability.

Reviews of Subcontract Costs Did Not Meet Auditing Standards Requirements

Le Compte conducted reviews of subcontract costs instead of audits in accordance with professional auditing standards. The Department's *Acquisition Guide* Chapter 70.4 (March 2004), *Cooperative Audit Strategy*, states that audits performed by Internal Audit must, at a minimum, meet the audit standards prescribed by the Institute of Internal Auditors (IIA). The

² Appendix 2 provides a summary of questioned and unresolved costs.

³ Total subcontract records value included fixed-price and variable cost elements.

Acquisition Guide also states that to accomplish the audits of subcontracts, the contractor may use its internal auditors or contract auditors, or request through the Contracting Officer for DCAA assistance. In October 2013, the Department issued Acquisition Letter 2014-01, which states that it is imperative that each Contracting Officer ensures contractors perform or obtain audits that meet the requirements of IIA Standards.⁴

Additionally, the *Acquisition Guide*, Chapter 70.4 (March 2016), *Cooperative Audit Strategy*, states that independent contract audit support acquired by the management and operating contractor to audit its subcontracts must be conducted by qualified auditors and meet IIA Standards. Further, the Le Compte Scope of Work, dated August 14, 2015, required Le Compte to conduct work in compliance with professional auditing standards (generally accepted auditing standards, IIA Standards, or generally accepted government auditing standards), and that all reports state that work was conducted in compliance with these appropriate standards. However, the Scope of Work was revised on August 29, 2017, with the only change being the addition of “AICPA Consulting” to the example list of audit standards.

Compared to IIA Standards, AICPA Consulting Services Standards are significantly less stringent. According to AICPA Consulting Services Standards, consulting services differ fundamentally from the Certified Public Accountant’s function of attesting to the assertions of other parties. In an attest service, the practitioner expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, the asserter. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The IIA Standards set forth requirements for auditor independence, engagement work programs, and planning. In comparison, the AICPA Consulting Services Standards include requirements, such as planning the performance of professional services and obtaining sufficient relevant data but provide no guidance on how to meet those requirements. In addition, the AICPA Consulting Services Standards do not require a quality assurance and improvement program that includes internal and external assessments, which IIA Standards require. Most importantly, as opposed to IIA Standards, work performed under the AICPA Consulting Services Standards provides no opinion, attestation, or other form of assurance with respect to the work performed or the information upon which the work is based. According to IIA Standard 2410.A1, *Criteria for Communicating*, an opinion must take into account expectations of senior management, the board, and other stakeholders (e.g., the Department as defined in the *Cooperative Audit Strategy*), and must be supported by sufficient, reliable, relevant, and useful information.

As provided in the following table, Le Compte conducted reviews of subcontractor costs incurred and issued seven reports in which the Department did not receive the benefit of an actual audit. All seven reports specifically state that the review or engagement was performed in accordance with AICPA Consulting Services Standards. However, three of the seven reports added contradictory statements in the methodology section that Le Compte complied with the auditing requirements prescribed by IIA Standards. The IIA Standards require internal auditors to identify, analyze, evaluate, and document sufficient information to achieve the engagement’s objectives. In addition, IIA Standards require that internal audit activity must be independent and that internal auditors must be objective in performing their work. According to its three

⁴ The term “IIA Standards” refers to the IIA International Standards for the Professional Practice of Internal Auditing.

engagement letters, Le Compte states that its services would not constitute an audit or review in accordance with generally accepted auditing standards or attestation standards. Further, the letters state that Le Compte would not audit or otherwise verify the information received in connection with the engagement. The engagement letters further state that because Honeywell is responsible for determining the scope of Le Compte’s services, Le Compte would not be considered independent of Honeywell for the FYs subject to the engagement. Finally, Le Compte’s reports state that “we provide no opinion, attestation or other form of assurance with respect to our work or the information upon which our work is based.” From the statements made in its reports and engagement letters, we concluded that Le Compte did not follow auditing standards.

| Subcontracts Reviewed under AICPA Consulting Services Standards by Le Compte | Claimed Costs | Le Compte Invoices |
|---|------------------------|---------------------------|
| Superior Electrical Construction, Inc. 15044 ^a | \$8,730,360.00 | \$19,648.30 |
| Superior Electrical Construction, Inc. 47136 | \$22,736,902.00 | |
| RCT Systems, Inc. EP48783 | \$961,857.76 | \$9,189.00 |
| RCT Systems, Inc. N7861 | \$939,422.46 | \$13,723.44 |
| Facility Engineering Services KCP, LLC (FES) EP40076 & 16896 | \$7,040,667.00 | \$37,184.93 |
| Superior Electrical Construction, Inc. EP48746 | \$6,590,648.74 | \$30,009.67 |
| Superior Electrical Construction, Inc. EP28129 | \$5,797,917.06 | \$29,773.87 |
| Total | \$52,797,775.02 | \$139,529.21 |

^a Number associated with each subcontractor is the purchase order number.

In addition to the seven reports in this table, Honeywell engaged Le Compte to perform another review of subcontract costs. Specifically, an Office of Inspector General 2019 Assessment Report⁵ identified a T&M subcontract, totaling approximately \$1,545,078 that had been closed but not audited, as required. Accordingly, the Assessment Report recommends that Honeywell perform or arrange for an audit of the identified T&M subcontract. Honeywell requested that Le Compte perform an audit of the U.S. Electrical subcontract. However, since Le Compte is not independent from Honeywell, an audit cannot be performed, as claimed by Le Compte. During our audit, we discussed the issue with NNSA, Kansas City Field Office, and Honeywell officials. On July 14, 2020, Honeywell subsequently awarded the audit services subcontract to Reed & Associates, CPAs, Inc. The Honeywell Compliance Manager stated that any future subcontract audits will be conducted in accordance with professional auditing standards and that Reed & Associates, CPAs, Inc. will conduct the audit of the U.S. Electrical subcontract following these standards.

This issue exists because Honeywell did not follow its own requirement to monitor subcontractor performance to ensure compliance with all terms and conditions. Specifically, the Honeywell Buyer (Buyer) was unaware why Le Compte’s engagement letters and audit reports state that Le

⁵ *Audit Coverage of Cost Allowability for Honeywell Federal Manufacturing & Technologies, LLC from October 1, 2014, to September 30, 2015, Under Department of Energy Contract No. DE-NA0000622, and from October 1, 2015, to September 30, 2017, Under Department of Energy Contract No. DE-NA0002839 (DOE-OIG-20-18, December 2019).*

Compte performed reviews which used consulting standards instead of auditing standards, as required in the Scope of Work. When we inquired why Le Compte deviated from the requirements in the approved Scope of Work, the Honeywell Compliance Manager stated that issuing audit reports with an opinion requires the engagement be conducted under generally accepted government auditing standards, which would require that Le Compte be independent from Honeywell. Since Le Compte acknowledges in some of its engagement letters that it is not independent from Honeywell, and that no audit work would be performed and no opinions or conclusions would be made, neither Honeywell nor the Office of Inspector General can rely on subcontract reviews performed by Le Compte. Therefore, we questioned the following:

- \$52,797,775.02 of subcontract costs reviewed by Le Compte as unresolved costs pending audit that complies with professional auditing standards; and
- \$139,529.21 paid to Le Compte for performing seven reviews rather than audits of subcontract costs.

Flexibly-Priced Subcontracts Identified as Fixed-Price

We found that Honeywell did not always identify fixed-price subcontracts that were flexibly-priced and potentially subject to audit. From FY 2015 through FY 2019, Honeywell fixed-price subcontracts totaled \$2.52 billion (rounded), which is summarized below.

| Total | Fixed-Price Subcontracts Universe | Fixed-Price Subcontracts Reviewed |
|--|-----------------------------------|-----------------------------------|
| Dollar Value | \$2.52 billion (rounded) | \$46.5 million (rounded) |
| Number of Subcontract Records ^a | 69,142 | 92 |
| Number of Subcontracts | 54,186 | 91 |
| ^a A subcontract may consist of one or more records (i.e., the purchase order and, if any, modification(s)). | | |

Honeywell’s contracts require audit of flexibly-priced subcontracts where the costs incurred are a factor in determining the amount payable to the subcontractor. Specifically, Honeywell’s contracts incorporated FAR 52.230-6, *Administration of Cost Accounting Standards* (June 2010), which defines flexibly-priced subcontracts as those subcontracts where the price may be adjusted based on actual costs incurred or other factors or final payment is based on actual costs incurred. Additionally, Honeywell’s contracts incorporated DEAR 970.5232-3, *Accounts, Records, and Inspection* (December 2010), which requires audit of any subcontracts (including fixed-price subcontracts, unit-price subcontracts, or purchase orders) where, under the terms of the subcontract, costs incurred are a factor in determining the amount payable to the subcontractor of any tier. Fixed-price subcontracts where an audit is not required include, among others, firm-fixed-price contracts, contracts with economic price adjustments based on established prices, and orders issued under indefinite-delivery contract where the final payment is not based on actual costs incurred. For example, FAR 16.202-1, *Description*, states that a firm-fixed-price contract

provides a price that is not subject to any adjustment based on the contractor's cost experience in performing the contract. This contract type places maximum risk, full responsibility for all costs, and resulting profit or loss on the contractor. Further, it provides maximum incentive for the contractor to control costs and perform effectively and imposes a minimum administrative burden on contracting parties.

In prior reports by the Government Accountability Office and the DCAA, similar issues were identified with the misclassification of contracts. The Government Accountability Office report⁶ explains that contracts can be categorized as "firm-fixed-price" or "flexibly-priced." Firm-fixed-price contracts generally are not subject to price adjustments based on actual costs that the contractor incurs. FAR 30.001, *Definitions*, states that flexibly-priced contracts include, among others, cost-reimbursement contracts, orders issued under indefinite-delivery contracts where final payment is based on actual costs incurred, certain fixed-price subcontracts, and portions of T&M and labor hour contracts. Because the contractor's final payments may be adjusted based on actual costs incurred, flexibly-priced contracts typically do not provide incentives to the contractor for cost control or labor efficiency and are considered higher-risk. Further, due to these inherent risks, FAR emphasizes the need for appropriate oversight by the Government, including a detailed review of contractor invoices and supporting documentation during contract performance.

In a DCAA report⁷ on a Department contractor, the DCAA also found that the contractor incorrectly classified fixed-price and flexibly-priced subcontracts. For instance, the DCAA identified a subcontract with costs based on actual hours worked and travel expenses incurred that should have been classified as flexibly-priced because no firm value was determined. In another subcontract, the DCAA identified that quantities impacting the costs incurred were estimated (not fixed) and that the subcontract should have been classified as flexibly-priced. The DCAA stated that the subcontract price was calculated by the actual quantities times the unit price, which results in the actual costs (Actual Quantities * Unit Price = Actual Cost = Subcontract Price). The price of a truly fixed-price subcontract should not be affected or changed by the actual quantities incurred.

However, of the 92 fixed-price subcontract records we reviewed, 16 records (about 17 percent) totaling \$13,699,272.95⁸ should have been identified as flexibly-priced and considered for audit. For example, Honeywell entered into a fixed-price contract with a vendor for maintenance services of the monitoring wells and the pumping wells. Our review disclosed that the amounts payable to the subcontractor varied each month based on the quantity (e.g., number of monitoring wells serviced) and the type of service (e.g., well pad and housing replacement) performed by the subcontractor. The remaining subcontracts included reimbursable travel expenses based on actual costs incurred, fixed-unit rate with estimated quantities (not fixed), or a

⁶ *Contract Closeout: GAO has Taken Steps to Strengthen Contract Closeout Controls, but Additional Actions are Needed* (Office of Inspector General, Government Accountability Office Report OIG-18-5, August 2018).

⁷ *Bechtel National, Inc's Contract Type Classification of Waste Treatment and Immobilization Plant Subcontracts under Prime Contract DE-AC27-01RV14136* (DCAA Audit Report No. 4281-2018D17900001, June 2018).

⁸ Total subcontract records value includes fixed-price and variable cost elements.

modification to increase the subcontract amount based on actual costs without a change in the Scope of Work. As a result, we are questioning the 16 subcontract records costs as unresolved, as they were misclassified and inappropriately excluded from audit.

Fixed-price subcontracts with adjustable cost elements were not properly identified as flexibly-priced because some Buyers interpreted a fixed-unit rate quoted in a purchase order to mean the overall subcontract was fixed-price in nature, even though interim charges against the purchase order would vary based on the quantity billed by the vendor. We recognize that Honeywell is taking corrective actions for a related issue identified in the 2019 Assessment Report.⁸ Specifically, the 2019 Assessment Report identifies that Honeywell did not maintain an accurate list of subcontract awards but instead maintained a spreadsheet to track cost-type subcontracts and associated audits that did not list every cost-type subcontract. Accordingly, the 2019 Assessment Report includes a recommendation for Honeywell to ensure that the list of subcontracts requiring audit is accurate and complete. According to the Honeywell Compliance Manager, in response to the report's recommendation, Honeywell is implementing a significant Enterprise Resource Planning system upgrade. Additionally, Honeywell revised the *Buyer Checklist* to incorporate additional checks for variable cost contracts and updated the *Purchasing Reference Manual*.

Although Honeywell has taken action to properly identify the correct subcontract type for future subcontract awards, existing subcontracts not recorded correctly as flexibly-priced were not included in the process to determine whether an audit of costs incurred was necessary. Without incurred cost subcontract audits, Honeywell could be charging unallowable subcontract costs to the Department. To meet its contract requirement to audit subcontract costs, Honeywell should determine if those fixed-price subcontracts not properly identified as flexibly-priced prior to the implementation of the corrective actions require an audit of costs incurred.

Cost-Reimbursement Subcontract Not Audited

We found subcontract costs totaling \$48,136,964.13 from CY 2014 through CY 2017 that were not audited after being referred to the DCAA for an audit. The DCAA did not conduct an audit of the costs, as the subcontractor did not meet DCAA audit requirements and was considered low-risk. From FY 2015 through FY 2019, FES was the only Honeywell subcontractor defined as having a cost-reimbursement subcontract. Honeywell's contracts incorporated DEAR 970.5244-1, *Contractor Purchasing System* (January 2013), which requires Honeywell to provide periodic post-award audits of cost-reimbursement subcontractors. The most recent audit performed by the DCAA covered FES incurred cost proposals from CY 2011 through CY 2013.

As summarized in the following table, FES incurred costs from CY 2014 through CY 2019 totaling \$70,031,280.34.

⁸ *Audit Coverage of Cost Allowability for Honeywell Federal Manufacturing & Technologies, LLC from October 1, 2014, to September 30, 2015, Under Department of Energy Contract No. DE-NA0000622, and from October 1, 2015, to September 30, 2017, Under Department of Energy Contract No. DE-NA0002839 (DOE-OIG-20-18, December 2019).*

| FES CY 2014 – CY 2019 Incurred Costs | | |
|---|------------------------|---------------------|
| CY | Amount | Audit Status |
| 2014 | \$11,270,959.61 | Waived |
| 2015 | \$10,019,604.40 | Waived |
| 2016 | \$13,804,472.32 | Waived |
| 2017 | \$13,041,927.80 | Waived |
| 2018 | \$9,889,985.59 | Pending Audit |
| 2019 | \$12,004,330.62 | Pending Audit |
| Total | \$70,031,280.34 | |

According to the Contracting Officer, FES audits from CY 2014 through CY 2017 incurred costs proposals were waived based on several reasons (e.g., thorough review of the subcontract file, prior audits of FES' incurred costs from CY 2010 through CY 2013, internal cost analysis, or discussions with the DCAA), including the DCAA's determination that the FES subcontract was low-risk and did not meet the audit threshold. However, the Contracting Officer did not consider the accumulation of prior unaudited incurred costs during the risk assessment.

On April 10, 2020, the Contracting Officer stated that the Kansas City Field Office discussed the audit of FES incurred costs with NNSA's Management and Budget Office and the Pricing/Cost Estimating Branch to ensure that all requirements were being met and risks assessed. The Contracting Officer also stated that the Kansas City Field Office was unaware of any concerns that could trigger a full audit (e.g., billing issues, implementation of a new accounting system, or significant changes to existing internal controls). To the Kansas City Field Office and Honeywell's credit, on May 26, 2020, the Contracting Officer requested that the DCAA audit the FES subcontract CY 2018 through CY 2019 incurred costs and cited several factors that indicated a need for an audit (e.g., changes to indirect allocation methodology and potentially unreasonable compensation that was previously identified by the DCAA). Because we did not receive DCAA's audit results in time for our evaluation, we are questioning the FES subcontract CY 2018 through CY 2019 incurred costs totaling \$21,894,316.21 as unresolved pending audit.

In light of the DCAA's revised policy for sampling low risk-incurred costs proposals, there is potential that FES incurred costs proposals would not be selected for audit for many years. Specifically, the Office of Inspector General maintains that even though FES annual incurred costs meet the DCAA threshold for the low-risk sampling pool, the potential accumulation of unaudited costs puts FES at a higher-risk level where the costs should be audited. Therefore, Honeywell should ensure that interim incurred costs of cost-reimbursement subcontracts receive audit coverage periodically and that the accumulation of unaudited cost are considered as part of the Contracting Officer's risk assessment when waiving subcontract audits.

Statement of Work with Potential Lobbying Activities

We identified two professional services subcontracts in the following table with Statements of Work that could include activities prohibited by Federal regulations.

| | |
|--|--------------|
| Previs LLC (Previs) N000163506 | \$119,631.97 |
| RD Solutions LLC (RD Solutions) N000201036 | \$101,000.00 |

According to the Previs Statement of Work issued in 2015 and the RD Solutions Statement of Work issued in 2016, the National Security Campus facility was underutilized. Both subcontractors' Statements of Work state that to increase benefit of the Government while increasing facility utilization, it is critical that the National Security Campus accelerate development of high-value Government and commercial relationships for new opportunities. However, spending money to develop Government relationships is prohibited by FAR. Specifically, Honeywell's contracts incorporated FAR 52.203-12, *Limitation on Payments to Influence Certain Federal Transactions* (October 2010). FAR 52.203-12, *Limitation on Payments to Influence Certain Federal Transactions* (October 2010), prohibits a recipient of a Federal contract, grant, loan, or cooperative agreement from using appropriated funds to pay any person for influencing or attempting to influence an officer or employee of any agency, a Member of Congress, an officer or employee of Congress, or an employee of a Member of Congress in connection with any covered Federal actions.⁹

Our review of the monthly reports disclosed that Previs met with Federal Government officials from the Army, Navy, Defense Threat Reduction Agency, and the Office of the Secretary of Defense. According to these monthly reports, Previs professional services included marketing the National Security Campus capabilities and establishing relationships between the National Security Campus and the sponsors, groups, or decision makers from the Federal Government.

In addition, the Honeywell Business Development Status Reports, which compile activities reported by some Honeywell employees and subcontractors, disclosed that RD Solutions held multiple meetings with the Global Manufacturing & Innovation Office and the Manufacturing Technology Programs, both under the Office of the Secretary of Defense. For example, in a meeting with an Office of the Secretary of Defense official, the Business Development Status Report mentions advocacy and endorsement of the Independent Research & Development strategic investment initiative and strategic relationship design with the Global Manufacturing & Innovation Office.

Honeywell's Compliance Manager explained that the meetings supported the Strategic Partnership Projects, and the subject of the communications were for these potential projects. We recognized the exception under FAR 52.203-12, *Limitation on Payments to Influence Certain Federal Transactions* (October 2010), which allows a company to engage in discussions unrelated to a specific solicitation for any covered Federal action but that concern the qualities and characteristics of the company's products or services or the application or adaption of the company's products or services for an agency's use. However, there is no documentary evidence that Previs and RD Solutions directly supported the Strategic Partnership Project efforts (e.g., strategic introductions, pursuit development, relationship management, etc.) as claimed by Honeywell.

⁹ A covered Federal action refers to the following: awarding any Federal contract; making any Federal grant; making any Federal loan; entering into any cooperative agreement; or extending, continuing, renewing, amending, or modifying any Federal contract, grant, loan, or cooperative agreement.

The condition occurred because Honeywell did not ensure that the Previsé and RD Solutions Statements of Work clearly identified all activities prohibited by Federal regulation. Specifically, although the Statements of Work state that lobbying Congress is prohibited, they should have also included a statement that lobbying any Federal employee is prohibited. Additionally, the Previsé monthly reports and the Business Development Status Reports lacked details of the meeting, which hindered our ability to determine the nature of the discussions and of any ongoing Strategic Partnership Projects that would support the allowability of the costs paid to the professional service subcontractor. After we explained this to the Contracting Officer, the Contracting Officer suggested that Honeywell create a weekly or monthly status template and work activity reports be provided to consultants so that Honeywell receives necessary information for supporting allowability of costs.

According to the Honeywell Compliance Manager, in 2018 Honeywell identified the need to review its Terms and Conditions for subcontracts to ensure proper flow down of FAR and DEAR requirements from the Honeywell contract. While it is not applicable to the Previsé and RD Solutions subcontracts, Honeywell identified that FAR 52.203-12, *Limitation on Payments to Influence Certain Federal Transactions* (October 2010), was not being properly flowed down. According to the Honeywell Compliance Manager, Honeywell has since updated all Terms and Conditions documents to properly flow down this clause. Additionally, in 2019, the Honeywell Law and Contracts Department emphasized including the requirement in the Terms and Conditions, but not in the Scope of Work, to avoid ambiguity and conflicts.

Statement of Work with Mutual Nondisclosure Agreement

We also identified that the Previsé and RD Solutions Statements of Work incorporated a mutual nondisclosure agreement, which did not comply with FAR requirements. Specifically, FAR 3.909-1, *Prohibition*, states that the Government is prohibited from using FY 2015 and subsequent FY funds for a contract that requires confidentiality statements restricting employees or subcontractors from reporting waste, fraud, or abuse. However, the Previsé Statement of Work, dated May 2015, and the RD Solutions Statement of Work, dated June 2016, did not clearly identify that such nondisclosure agreements do not prohibit lawfully reporting waste, fraud, or abuse.

Additionally, our analysis of the mutual nondisclosure agreement between Honeywell and Previsé demonstrates that our concerns were warranted. For example, while the mutual nondisclosure agreement includes language that might provide Honeywell with an opportunity to discuss information with Federal Government officials without repercussions, no similar opportunity is provided to Previsé. In addition, the mutual nondisclosure agreement provides no exception for reporting a violation of law, rule, regulation, mismanagement, gross waste of funds, an abuse of authority, or a substantial and specific danger to public health or safety. Further, the requirement that Previsé must disclose the request to Honeywell so that Honeywell can determine the request's propriety, and vice versa, could further prevent a lawful disclosure.

According to the Compliance Manager, Honeywell agreed that the Previsé Statement of Work referenced a nondisclosure agreement that did not comply with FAR requirements. Also, the Compliance Manager stated that the RD Solutions Statement of Work also referenced a

nondisclosure agreement even though one did not exist. The Compliance Manager added that when the Honeywell Law and Contracts Department took ownership of the nondisclosure agreement process in 2018, it completed a review of the nondisclosure agreement templates. During its review, the Law and Contracts Department identified the noncompliance of the nondisclosure agreement templates and updated all nondisclosure agreement templates.

During our review, we discussed the issue with NNSA, Kansas City Field Office, and Honeywell officials. Honeywell's Compliance Manager stated that there was no contractual requirement to follow the FAR requirement since it was not incorporated into the contract until 2018. However, the contractor and subcontractors would still be obligated to follow the Federal statute despite the requirement not being in the contract since they receive appropriated funds per the class deviation for Public Law 113-235, *Title VII of the Consolidated and Further Continuing Appropriations Act, 2015*, as signed by the Department and NNSA officials in 2015. Honeywell's Compliance Manager further stated that Honeywell will conduct a full review of all professional and consulting services subcontracts and will require a new nondisclosure agreement for any subcontractors that currently have a noncompliant nondisclosure agreement.

Questioned Costs

During our review, we identified questioned costs totaling \$3,109.28 for mobile phone services and labor charges that did not meet Federal requirements for allowability. FAR 31.201-2, *Determining allowability*, states that a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles. Additionally, FAR 31.201-4, *Determining allocability*, states that a cost is allocable if it benefits both the contract and other work, or is necessary to the overall operation of the business. However, we found costs for mobile phone services in which Honeywell did not receive benefit and labor costs without supporting documentation.

Mobile Phone Services

During our review of DataXoom monthly invoices, we identified \$1,379.53¹⁰ for mobile phone services that Honeywell did not use or receive benefit. For example, the Honeywell Buyer did not terminate service for mobile phone lines that were no longer needed. We also noted that the Buyer or end user placed mobile phone lines in a suspended status for more than a year; however, monthly recurring costs were still charged to Honeywell. The questioned costs occurred because the Buyer did not always ensure that the amount charged by the subcontractor for mobile phone services were accurate during the review of invoices prior to payment. In addition, there was a lack of coordination between the mobile phone end users and the Buyer. The end users added mobile phone lines without coordinating with the Buyer.

Labor Costs

Honeywell paid for labor costs without supporting documentation. We identified a Siemens Industry, Inc. (Siemens) invoice totaling \$4,529.75 that included labor costs totaling \$1,729.75

¹⁰ During our audit, Honeywell recovered \$152 from DataXoom.

without proper documentation, which is required by FAR 31.201-2, *Determining allowability*, to ensure costs are allowable. According to the Honeywell Compliance Manager, the purchase order was based on a firm-fixed-price instead of the number of hours worked; therefore, the amount of labor hours was considered irrelevant. The Compliance Manager further stated that it was unnecessary for Siemens to include actual labor hours on the invoice because Siemens was to be paid a fixed price. We recognized that the purchase order had a “not to exceed amount” of \$7,141, which was the same as the Siemens’ proposed estimate. The Siemens *Field Service Authorization Form* states that in the absence of any official fixed-price quotation, subsequent purchase orders are considered an estimate only. Also, the Siemens *Field Service Authorization Form* states that labor will be invoiced based on timesheets documenting the actual work performed.

IMPROVEMENTS NEEDED TO HONEYWELL’S SUBCONTRACT ADMINISTRATION

Without adequate administration of its subcontract audit program, Honeywell could be charging unallowable subcontract costs to the Department. By not following professional auditing standards, the potential exists that Le Compte’s reviews of subcontract incurred costs did not address necessary key elements to identify questioned and unallowable costs.

Additionally, there is a risk that costs of fixed-price subcontracts that are not properly identified as flexibly-priced will not receive audit coverage. Also, without a full audit of the FES subcontract incurred costs for 4 consecutive years, no guarantee exists that costs claimed by FES were allowable. Finally, there is potential that Honeywell’s subcontract costs include activities prohibited by FAR or do not meet Federal requirements for allowability.

RECOMMENDATIONS

We recommend that the Manager, Kansas City Field Office, direct the Contracting Officer to:

1. Determine the allowability of costs paid to Le Compte for reviews of subcontract costs that did not meet professional auditing standards.
2. Determine the allowability of costs for two professional services subcontracts with Statements of Work which used imprecise language that may be viewed as permitting prohibited lobbying activities.
3. Determine the allowability of the questioned costs totaling \$3,109.28¹¹ for mobile phone charges and labor hours.
4. Ensure appropriate audit coverage over the life of cost-reimbursement subcontracts. Post award prior audit coverage should be taken into consideration when assessing risk and the need for an audit. This approach should be applied to the FES subcontract.

¹¹ During our audit, Honeywell recovered \$152 from DataXoom.

Additionally, we recommend that the Manager, Kansas City Field Office, direct Honeywell to:

5. Perform a risk assessment to determine if audit work is necessary to address the years covered by Le Compte work questioned in the report.
6. Ensure future subcontract incurred cost audits are completed in accordance with professional auditing standards.
7. Develop a corrective action plan to ensure that subcontracts are properly classified consistent with the FAR definitions, including recognition of other types of fixed-price subcontracts.
8. Identify and clarify imprecise language in other Honeywell subcontracts that may be viewed as permitting prohibited lobbying activities in the Statements of Work or applicable procurement documents. Also, avoid using similarly imprecise language in future Honeywell subcontracts.

MANAGEMENT RESPONSE

Management nonconcurred (or nonconcurred as written) with five of the eight recommendations and concurred or concurred in principle with three recommendations. Specifically, management nonconcurred with Recommendation 5 as written and concurred in principle with Recommendations 1 and 6. Management stated that it will conduct a review of Le Compte's work by September 30, 2021, document the results of the review, and determine whether further action is necessary. Additionally, management considers Recommendation 6 closed, as Honeywell awarded a purchase order for subcontract audit services explicitly requiring that all work be conducted in compliance with professional auditing standards and that all reports state that work was conducted in compliance with those standards.

Management nonconcurred with Recommendation 4 and considers it closed. Management stated that the Contracting Officer acted within authority to waive interim audits of FES incurred costs based on several factors, including past audit findings, a thorough review of the subcontract file, internal cost analysis, and discussions with the DCAA. Management also stated that Honeywell currently complies with DEAR 970.5244-1, *Audit of subcontractors*, by providing periodic post-award audits of its cost-reimbursement subcontracts.

Management also nonconcurred with Recommendations 2 and 8 and considers them closed. Management stated that the two Statements of Work task the subcontractor to meet with Government or commercial leaders to identify opportunities and support activities that better integrate capabilities of the National Security Campus with a goal of expanding utilization of the unique capabilities of the National Security Campus.

Management concurred with Recommendation 3 and stated the Contracting Officer will review the questioned costs for mobile phone charges and labor hours before making an allowability determination by July 31, 2021.

Management nonconcurred with Recommendation 7 and considers it closed. Management stated that when DEAR 970.5232-3(c) references “costs incurred,” it is speaking to costs incurred by the subcontractor, which are not implicated in fixed-unit price contracts where unit prices are negotiated before any costs are incurred by the subcontractor. Specifically, management stated that in the examples presented in the report, the rates were predetermined before any costs were incurred by the subcontractor; therefore, these examples are not subject to audit under DEAR 970.5232-3(c).

Management comments are included in Appendix 4.

AUDITOR COMMENTS

Management’s actions were generally not responsive to our recommendations, as not all our report issues were addressed and some of management’s proposed actions and actions already taken contradicted its own responses. Despite our efforts to discuss the report, verify information, and clarify requirements with NNSA audit liaisons and attorneys, management nonconcurred (or nonconcurred as written) with five of the eight recommendations and concurred or concurred in principle with three recommendations. As a result, we disagree with NNSA that several of the recommendations are closed. While NNSA management did not respond to our recommendations in the order presented, we will address management’s comments in the order that the recommendations were presented to action officials.

Management’s assertion that the report misinterprets and misapplies certain requirements is based on management misunderstanding the basic difference between requirements established in professional auditing standards and Consulting Services Standards promulgated by the AICPA. In addition, management misinterpreted DEAR requirements to conduct or arrange for audit when costs incurred are a factor in determining the amount payable to the subcontractor. Management also misinterpreted FAR, which clearly states that flexibly-priced subcontracts include fixed-price subcontracts that result in a final amount paid to the contractor based on the amount paid. Further, Le Compte, Honeywell’s subcontracted Certified Public Accountant and Financial Consultant, specifically states in some of its engagement letters and issued reports that professional auditing standards were not followed during its reviews. Since Le Compte is the best source to attest to what standards were followed, we did not conduct any further analysis of Le Compte’s work to determine if standards were met.

Management concurred in principle with Recommendation 1 and agreed that the Contracting Officer would determine the questioned cost paid to Le Compte after a review of Le Compte’s work. Since Le Compte’s engagement letters and final reports state that Le Compte did not meet professional auditing standards, management’s review does not change the fact that Le Compte’s work did not meet professional auditing standards. Management also disagreed that our report contained sufficient evidence to conclude that Le Compte’s audit work did not meet these standards. As previously stated, management misunderstands the basic difference between requirements established in professional auditing standards and Consulting Services Standards promulgated by the AICPA. In our response to Recommendation 5, professional auditing standards require auditors completing audits to be independent and to express an opinion on their

work. Since Le Compte could not meet these requirements, its Scope of Work was changed to allow engagements to be completed in accordance with AICPA Consulting Services Standards. We consider Recommendation 1 open until management's review is completed.

Management nonconcurred with Recommendation 2 as the two professional services subcontractors conducting Strategic Partnership Program work had Statements of Work that allow for the inclusion of covered Federal actions. Further, we recognize the exception under FAR 52.203-12, *Limitation on Payments to Influence Certain Federal Transactions* (October 2010), which allows a company to participate in discussions unrelated to a specific solicitation for any covered Federal action, but that concern the qualities and characteristics of the company's products or services or the application or adaptation of the company's products or services for an agency's use. However, no documentary evidence demonstrates that the interactions between Previsé and RD Solutions and Federal agencies directly supported the Strategic Partnership Project efforts (i.e., strategic introductions, pursuit development, relationship management, etc.) as claimed by Honeywell. We consider Recommendation 2 unresolved and open.

Management concurred with Recommendation 3 and agreed that the Contracting Officer would review the questioned costs for the mobile phone charges. We consider that Recommendation 3 should remain open until the Contracting Officer's review is completed.

NNSA nonconcurred with Recommendation 4 and disagrees that the accumulation of unaudited costs could increase the risk that unallowable costs were incurred and undetected. While we agree that the Contracting Officer had the right to waive the audits of the FES subcontract's incurred costs proposals from CY 2014 through CY 2017, we maintain that the Contracting Officer should consider the accumulation of unaudited incurred costs during the risk assessment process as a good management practice and as a steward of the taxpayer's interest. We also maintain that waiving the requirement under DEAR 970.5244-1, *Contractor Purchasing System* (January 2013), to audit FES incurred costs for 4 consecutive years and the potential accumulation of unaudited costs puts FES in a higher-risk level for fraud, waste, and abuse. We consider that Recommendation 4 should remain open until the Contracting Officer can take appropriate action once the DCAA audit is completed.

Management nonconcurred with Recommendation 5 as written and referred to insufficient evidence in our report that Le Compte's work did not meet professional auditing standards. We disagree and attribute this response to management's basic misunderstanding between requirements established in professional auditing standards and Consulting Service Standards promulgated by the AICPA regarding independence and expressing conclusions on the work performed. Le Compte itself has firsthand knowledge as to whether its work was conducted in accordance with professional auditing standards. As noted, Le Compte's engagement letters and issued reports state that professional auditing standards were not followed. Le Compte's engagement letters and final reports contain caveats that fully support our professional decision not to perform additional audit work since the Inspector General Act of 1978 requires that an audit is completed in accordance with professional auditing standards. As stated in

management's response, NNSA's field office and Honeywell will conduct a review of the work performed by Le Compte and document the results of the review. We consider Recommendation 5 unresolved and open.

Management concurred in principle with Recommendation 6, and in July 2020, Honeywell issued a purchase order to perform audit services in accordance with professional auditing standards, which supports our conclusion. Honeywell, in coordination with the Kansas City Field Office, has agreed to review Le Compte's work to determine if professional auditing standards were met and if the work can be relied upon. We consider Recommendation 6 closed.

Management nonconcurred with Recommendation 7. However, we maintain our position and disagree that this Recommendation is closed. The 16 subcontract records that were not properly identified as flexibly-priced included reimbursable travel expenses based on actual costs incurred, fixed-unit rates with estimated quantities (not fixed), or a modification to increase the subcontract amount based on actual costs without a change in the Scope of Work. Under FAR 52.230-6, *Administration of Cost Accounting Standards*, the definition of a flexibly-priced contract includes several different types of subcontracts where final payment is based on actual costs incurred, not just indefinite-delivery contracts. The report did not state that the 16 subcontracts were considered indefinite-delivery contracts as claimed by NNSA. Additionally, we did not question subcontracts with predetermined fixed-unit rates; it is the variable units purchased that impact the final actual cost paid (amount payable) that make a subcontract flexibly-priced. Therefore, our understanding of costs incurred per DEAR is defined by the final amount payable to the subcontractor or the costs incurred by the subcontractor. Proper categorization of contract types is important since it ensures the proper level of oversight. Specifically, as explained in our report, flexibly-priced contracts typically do not provide incentives to the contractor for cost control or labor efficiency and are considered higher-risk. Further, due to these inherent risks, FAR emphasizes the need for appropriate oversight by the Government, including a detailed review of contractor invoices and supporting documentation during contract performance. When subcontracts with flexibly-priced elements are improperly classified in the system as fixed-price, oversight may not be commensurate with actual level of risk. Management should ensure subcontracts are appropriately classified as defined by FAR to identify oversight as needed. We consider Recommendation 7 unresolved and should remain open due to the importance of correctly identifying the type of subcontracts awarded.

Management nonconcurred with Recommendation 8 and disagrees that the two professional services subcontracts' Statements of Work contain prohibited lobbying activities. As previously stated, the Statements of Work did not clearly identify all activities prohibited by Federal regulation. We stand by our position that clearly identifying prohibited activities by Federal regulations in the Statements of Work or applicable procurement documents may prevent misconceptions and make the subcontractor fully aware of the restriction. We consider Recommendation 8 unresolved and open.

Appendix 1: Objective, Scope, and Methodology

OBJECTIVE

We conducted this audit to determine whether Honeywell Federal Manufacturing & Technologies, LLC (Honeywell) administered subcontracts for the Kansas City National Security Campus in accordance with applicable regulations and policies.

SCOPE

The audit was performed from October 2019 through September 2020 at the Kansas City National Security Campus offices located in Kansas City, Missouri, and Overland Park, Kansas. The scope of the audit included subcontracts administered by Honeywell from fiscal year 2015 through fiscal year 2019. For the Facility Engineering Services KCP, LLC subcontract, we expanded our scope from calendar year 2014 through calendar year 2019. The audit was conducted under Office of Inspector General project number A19LV047.

METHODOLOGY

To accomplish our audit objective, we:

- Reviewed applicable regulations, contract requirements, policies, and procedures pertaining to subcontract administration activities.
- Held discussions with key Department of Energy and contractor officials to gain an understanding of the subcontract administration processes, as well as Department and contractor roles and responsibilities.
- Reviewed a judgmental sample of 34 and statistical sample of 58 fixed-price subcontract records, with a total value of approximately \$46.5 million. The samples were selected from a population of 69,142 fixed-price subcontract records, with a total value of approximately \$2.52 billion. During our review, we examined the subcontract files for each unit in the sample for proper classification and compliance with competition requirements. Because the risks were not the same across the sampling universe, the results and overall conclusions were not projected to the entire population.
- Reviewed Honeywell's strategy for identifying subcontracts that require audit to determine the extent of subcontract audit coverage.
- Reviewed Honeywell's third-party audit firm reports on subcontracts to determine the auditing standards used and the results of the reviews.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We assessed internal controls and compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed the internal control

Appendix 1: Objective, Scope, and Methodology

components and underlying principles significant to the audit objective. Specifically, we assessed the control environment component and underlying principles regarding Honeywell's establishment of structure, responsibility, and authority. We assessed the risk assessment component and the underlying principles of assessing fraud risk. We also assessed control activities and the underlying principles of implementing policies and procedures. Finally, we assessed the information and communication component regarding using quality information. However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit. We assessed the reliability of procurement data by: (1) reviewing supporting documentation used to generate the procurement data, and (2) interviewing contractor officials knowledgeable about the data. We determined that the data was sufficiently reliable for the purposes of this report.

Management officials waived an exit conference on May 18, 2021.

Appendix 2: Summary of Questioned and Unresolved Costs

SUMMARY OF QUESTIONED AND UNRESOLVED COSTS FOR HONEYWELL FEDERAL MANUFACTURING & TECHNOLOGIES, LLC

Table 1: Questioned Costs

| Category | Questioned Costs | Resolved | Unresolved |
|---|-------------------------|-----------------|-------------------|
| Le Compte, P.C. Incurred Costs Reviews | \$139,529.21 | \$0 | \$139,529.21 |
| Mobile Phone Services | \$1,379.53 | \$152.00 | \$1,227.53 |
| Labor Costs | \$1,729.75 | \$0 | \$1,729.75 |
| Total Questioned Costs | \$142,638.49 | \$0 | \$142,486.49 |

Table 2: Unresolved Costs

| Category | Unaudited Costs | Resolved | Unresolved |
|---|------------------------|-----------------|-------------------|
| Unaudited Flexibly-Priced Subcontracts | \$13,699,272.95 | \$0 | \$13,699,272.95 |
| Subcontract Costs Reviewed by Le Compte, P.C. | \$52,797,775.02 | \$0 | \$52,797,775.02 |
| Unaudited Facility Engineering Services KCP, LLC Subcontract Costs | \$21,894,316.21 | \$0 | \$21,894,316.21 |
| Total Unaudited Costs | \$88,391,364.18 | \$0 | \$88,391,364.18 |

Appendix 3: Prior Reports

- Assessment Report on [*Audit Coverage of Cost Allowability for Honeywell Federal Manufacturing & Technologies, LLC from October 1, 2014, to September 30, 2015, Under Department of Energy Contract No. DE-NA0000622, and from October 1, 2015, to September 30, 2017, Under Department of Energy Contract No. DE-NA0002839*](#) (DOE-OIG-20-18, December 2019). During our assessment,¹² nothing came to our attention to indicate that the allowable cost-related audit work performed by Honeywell Federal Manufacturing & Technologies, LLC Internal Audit from October 1, 2014, through September 30, 2017, could not be relied upon. The report did not identify any material internal control weaknesses with cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. However, the report noted that a time and material subcontract, with incurred costs totaling approximately \$1,545,078, required an audit but had not been audited. The report also noted inaccurate lists of subcontracts requiring audit.
- Audit Report on [*Subcontract Administration at the Mixed Oxide Fuel Fabrication Facility*](#) (DOE-OIG-20-16, December 2019). The audit found that MOX Services, LLC did not consistently administer the subcontracts selected for review in accordance with Federal Acquisition Regulation requirements for contract cost principles and procedures in the areas of subcontract modifications, labor premiums, supporting documentation, overtime billings, rework material costs, rework labor profits, and material reconciliations. As a result, the audit identified \$8.5 million in questioned costs and, based on the control weaknesses that led to the questioned costs, there is an increased risk that other unallowable subcontract costs may have been incurred by MOX Services, LLC and reimbursed by the National Nuclear Security Administration.
- Audit Report on [*Subcontract Management at the Strategic Petroleum Reserve*](#) (DOE-OIG-20-13, November 2019). The audit found that Fluor Federal Petroleum Operations, LLC had not always appropriately administered some subcontracts. Specifically, the audit found that none of the sampled subcontract files were fully and consistently maintained, and invoice approval was not always based on documentation sufficient to validate satisfactory subcontract performance. This occurred because Fluor Federal Petroleum Operations, LLC had not established adequate guidance or sufficient training regarding its subcontract administration.
- Special Report on [*Management Challenges at the Department of Energy – Fiscal Year 2020*](#) (DOE-OIG-20-09, November 2019). The Office of Inspector General’s management challenges list for fiscal year (FY) 2020 included Contract Oversight. Subcontract Management was identified as a subcomponent of Contract Oversight since the FY 2018 Management Challenges report and continues to be a challenge area for FY 2020. Work conducted during FY 2019 and prior years has indicated that the Department of Energy and its contractors had not always provided adequate oversight of subcontracts. For instance, during the past year, both the Government Accountability Office and the Office of Inspector General identified issues pertaining to the management of

¹² We conducted our assessment as a review attestation. A review is substantially less in scope than an examination or audit. Our review was limited and would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review.

Appendix 3: Prior Reports

subcontracts. Specifically, the Government Accountability Office reported that the Department did not always ensure that contractors audited subcontractors' incurred costs, as required in their contracts. The Government Accountability Office's review of 43 incurred-cost assessment and audit reports identified more than \$3.4 billion in subcontract costs incurred over a 10-year period that had not been audited as required, and some subcontracts remained unaudited or unassessed for more than 6 years.

- Audit Report on [*Bechtel National, Inc.'s Subcontract Audit Program*](#) (DOE-OIG-20-06, November 2019). The audit found that Bechtel National, Inc. (Bechtel) had not fulfilled the requirement within its contract to audit flexibly-priced subcontracts. Specifically, the audit found that since the start of the contract on December 11, 2000, a significant number of flexibly-priced subcontracts have not been audited; subcontract audits performed by Bechtel officials had not always been effective or reliable; Bechtel had not identified all flexibly-priced subcontracts that were subject to audit; and while Bechtel met a Department-established performance goal of completing at least 20 audits by the end of calendar year 2018, its efforts were not focused on those subcontracts that were at risk of exceeding the statute of limitations for submitting claims, as required by the Department.
- Audit Report on [*Subcontract Administration at Selected Department of Energy Management and Operating Contractors*](#) (OAS-M-15-07, July 2015). The audit was the first in a planned series of audits focusing on management and operating contractor subcontract administration. The report states that nothing came to our attention to indicate that the sites reviewed had not administered subcontracts substantially in accordance with established policies and procedures and contract terms. However, the report observed that a certain class of subcontracts had been noncompetitively awarded at the Kansas City Plant. Specifically, 8 of the 47 subcontracts reviewed, or \$10.2 million of \$33.7 million in subcontracts, were awarded on a sole-source basis without specific justification.

Appendix 4: Management Comments



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



April 15, 2021

MEMORANDUM FOR TERI L. DONALDSON
INSPECTOR GENERAL

FROM: CHARLES P. VERDON *Charles P. Verdon*
ACTING UNDER SECRETARY FOR NUCLEAR SECURITY
AND ADMINISTRATOR, NNSA

SUBJECT: Response to the Office of Inspector General Draft Report *Subcontract Administration at the Kansas City National Security Campus* (A19LV047)

Thank you for the opportunity to review and comment on the subject draft report. The National Nuclear Security Administration (NNSA) appreciates the auditors' efforts, which identified an area where additional review is necessary to validate the audit work of one of our subcontractors. We are concerned, however, that the remainder of the report misinterprets and misapplies certain requirements; leading to findings that are inaccurate or misleading. As a result, NNSA non-concurs (or non-concurs as written) with five of the eight recommendations in the report and concurs (or concurs in principle) with three recommendations.

The attached management decision provides NNSA's detailed response to each recommendation. Subject matter experts have also provided technical comments to the audit team under separate cover to address the issues noted above. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audits and Internal Affairs, at (301) 903-1341.

Attachment

NATIONAL NUCLEAR SECURITY ADMINISTRATION
Management Decision

Subcontract Administration at the Kansas City National Security Campus (A19LV047)

NOTE: For continuity, the recommendations have been rearranged to group related recommendations and provide greater coherence.

The auditors recommended that the National Nuclear Security Administration (NNSA):

Recommendations Regarding the Le Compte Auditing Subcontract:

Recommendation 5: Develop a plan to ensure that all subcontract costs, where incurred costs are a factor, including the subcontract costs assessed by Le Compte are audited as required by the Honeywell contract prior to or at closeout;

Management Response: Non-concur as written. The issue of subcontract audits where incurred costs are a factor in determining the amount payable to the subcontractor is fully addressed in recommendation 7.

In relation to audit work performed by Le Compte, we disagree that the IG audit report provides sufficient evidence to conclude that Le Compte's audit work did not meet standards. The findings in the report are based on inconsistencies in certain language contained in Le Compte engagement letters and audit reports regarding the standards used to conduct the subcontract audits. However, the report contains no analysis of whether the actual work performed by Le Compte met audit standards. Further, the examples in the draft report reflect a misapplication of certain audit standards, and also omit critical information contained in the Le Compte engagement letters and reports. Without additional review there is no basis to support expending additional resources to re-audit those costs.

NNSA agrees, however, that given the noted inconsistencies in the engagement letters and reports, further review is needed to determine whether Le Compte's audit work meets standards and can be relied upon. The Management and Operating Contractor (M&O) contractor, in coordination with the field office, will conduct a review of the work performed by Le Compte and document the results. The results of that review will be used to determine whether further actions are necessary. The review will be completed by September 30, 2021.

Recommendation 1: Determine the allowability of costs paid to Le Compte for reviews of subcontract costs that did not meet professional auditing standards.

Management Response: Concur in Principle. The recommendation suggests making an allowability determination without sufficient review or evidence to support the claim that the Le Compte audit work did not meet appropriate standards and could not be relied

Appendix 4: Management Comments

upon. Following completion of the review described in response to recommendation 5, the Contracting Officer (CO) will determine whether there is sufficient evidence to formally question and make a determination on the allowability of Le Compte audit costs. The estimated completion date for this action is November 30, 2021.

Recommendation 6: Ensure future subcontract incurred cost audits are completed in accordance with professional auditing standards.

Management Response: Concur in Principle. We disagree that the IG audit report provides sufficient evidence to conclude that prior subcontract audit work did not meet audit standards. We do, however, agree that the statements of work, engagement letters, and audit reports for any third party contract auditors should clearly reflect compliance with appropriate audit standards. In July 2020, Honeywell awarded a purchase order for subcontract audit services to a Certified Public Accounting firm explicitly requiring that all work be conducted in compliance with professional audit standards and that all reports state that work was conducted in compliance with those standards. NNSA considers this recommendation closed.

Recommendations Regarding Facility Engineering Services KCP, LLC (FES):

Recommendation 4: Ensure that cost-reimbursement subcontracts are documented and any accumulation of unaudited costs are included when determining whether periodic audits are warranted. This approach should be applied to the current FES subcontract.

Management Response: Non-concur. The M&O contractor is currently in compliance with Department of Energy Acquisition Regulation (DEAR) 970.5244-1, *Audit of subcontractors*, by providing periodic post-award audits of its cost-reimbursement subcontracts. When determining whether interim audits should be waived, the CO follows established processes and considers appropriate risk factors in consultation with NNSA's Office of Management and Budget, NNSA's Office of Acquisition and Project Management, and DCAA.

The CO acted within their authority to waive selected years' interim audits of FES incurred costs, and did so after considering several risk factors, including past audit findings, a thorough review of the subcontract file, internal cost analysis, and discussions with the Defense Contract Audit Agency (DCAA). As discussed with the auditors, DCAA and NNSA consider FES to represent a low audit risk. The draft report provides no objective evidence to support the auditors' conclusion that the accumulation of prior year unaudited costs represented a significant or increased risk of unallowable costs to justify expending additional resources. By contrast, the CO's risk analysis for fiscal years (FY) 2016-2017 noted that DCAA audit findings have not resulted in any unallowable costs in FES contracts across the Government.

DCAA is, however, currently auditing FY 2018-2019 incurred costs for FES. Should additional information be identified during that audit to warrant an audit of prior year

Appendix 4: Management Comments

incurred costs, the CO will take appropriate action. NNSA considers this recommendation closed.

Recommendations Regarding Requirements for Lobbying and Prohibited Activities:

Recommendation 2: Determine the allowability of costs for two professional services subcontracts with Statements of Work which used imprecise language that may be viewed as permitting potential lobbying activities.

Management Response: Non-concur. NNSA disagrees that the two professional services subcontract statements of work (SOW) noted in the report contain prohibited lobbying activities. NNSA found that the two subcontracts identified in the OIG report are appropriate for the M&O contractor to use in conducting their Strategic Partnership Programs (SPP) work. As detailed in the legal opinion previously provided to the auditors, the OIG report reflects an overly broad interpretation of FAR 52.203.12, *Limitation on Payments to Influence Certain Federal Transactions*. The clause defines “covered Federal action” to mean awarding a Federal contract, grant, loan, cooperative agreement, or extension thereof.

SPP work does not fit within any of these categories, and are actually inter-agency agreements between the Department of Energy (DOE)/NNSA and the requesting agency to provide the requested service. DOE guidance is clear that the Department is a critical partner with other government entities in providing unique capabilities in support of National security interests and must collaborate and interact with those agencies in providing access to these capabilities. The two SOW identified in the IG report task the subcontractor to meet with government and/or commercial leaders to identify opportunities and support activities that better integrate capabilities of the Kansas City National Security Campus with a goal of expanding utilization of the unique capabilities of the National Security Campus. This goal is consistent with DOE’s Strategic Partnership Program goals and objectives and does not violate the referenced FAR provision regarding payments to influence Federal transactions. NNSA considers this recommendation closed.

Recommendation 8: Identify and clarify imprecise language in other Honeywell subcontracts that may be viewed as permitting prohibited lobbying activities in the Statements of Work and/or applicable procurement documents. Also, avoid using similarly imprecise language in future Honeywell subcontracts.

Management Response: Non-concur. Please see response to Recommendation 2 above. NNSA disagrees that the two professional services subcontract SOW contain prohibited lobbying activities. NNSA considers this recommendation closed.

Other Recommendations:

Appendix 4: Management Comments

Recommendation 3: Determine the allowability of the questioned costs totaling \$3,109.28 for mobile phone charges and labor hours.

Management Response: Concur. The Contracting Officer will review the questioned costs for mobile phone charges and labor hours and make an allowability determination by July 31, 2021.

Recommendation 7: Develop a corrective action plan to ensure that flexibly-priced subcontracts are properly classified and receive audit coverage.

Management Response: Non-concur. The M&O contractor currently complies with Department of Energy Acquisition Regulation (DEAR) 970.5232-3(c), *Audit of subcontractors' records*, which requires that the M&O contractor either conduct or arrange for an audit of a subcontractor's costs when costs incurred are a factor in determining the amount payable to the subcontractor. The examples presented in the IG report misinterpret the requirement triggering audit of subcontracts. When DEAR 970.5232-3(c) references "costs incurred," it is speaking to costs incurred by the subcontractor, which are not implicated in fixed unit price contracts where unit prices are negotiated before any costs are incurred by the subcontractor. The report appears to confuse "costs incurred" with an indefinite quantity contract with fixed unit pricing where the final price paid varies based on the number of units purchased. In the examples presented in the report, the rates were predetermined before any costs were incurred by the subcontractor and, therefore, are not subject to audit under DEAR 970.5232-3(c). NNSA considers this recommendation closed.

FEEDBACK

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions, and feedback to OIG.Reports@hq.doe.gov and include your name, contact information, and the report number. You may also mail comments to us:

Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at 202-586-1818. For media-related inquiries, please call 202-586-7406.