



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-23-37

September 2023

**UT-BATTELLE, LLC, COSTS CLAIMED
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-AC05-00OR22725
FOR FISCAL YEAR 2017**



Department of Energy
Washington, DC 20585

September 29, 2023

MEMORANDUM FOR THE DEPUTY CHIEF FINANCIAL OFFICER;
MANAGER, OAK RIDGE NATIONAL LABORATORY SITE
OFFICE

SUBJECT: Audit Report on UT-Battelle, LLC, Costs Claimed under Department of Energy
Contract No. DE-AC05-00OR22725 for Fiscal Year 2017

The attached report discusses our review of UT-Battelle, LLC's costs claimed for fiscal year 2017. This report contains six recommendations. Management concurred with Recommendations 1, 4, and 5. However, management nonconcurred with Recommendations 2, 3, and 6.

We conducted this audit from February 2018 through August 2021 in accordance with generally accepted government auditing standards. We appreciated the cooperation of your staff during this audit.

A handwritten signature in dark ink, appearing to read "Teri L. Donaldson", is positioned above the printed name.

Teri L. Donaldson
Inspector General

cc: Deputy Secretary
Chief of Staff
Director, Office of Science



**Department of Energy
Office of Inspector General**
**UT-Battelle, LLC Costs Claimed under Department of
Energy Contract No. DE-AC05-00OR22725 for
Fiscal Year 2017**
(DOE-OIG-23-37)

**WHY THE OIG
PERFORMED THIS
AUDIT**

In 2016, the Office of Inspector General began evaluating the Department of Energy's Cooperative Audit Strategy in a series of audits on costs incurred by management and operating contractors. This is the third audit in that series. This audit examined the fiscal year (FY) 2017 costs claimed by UT-Battelle, LLC (UT-Battelle), the management and operating contractor that operates the Department's Oak Ridge National Laboratory.

The objectives of our audit were to determine if UT-Battelle's FY 2017 costs claimed were allowable, allocable, and reasonable in accordance with the terms of the contract, applicable cost principles, laws, and regulations and to assess UT-Battelle's Internal Audit work on subcontract costs.

What Did the OIG Find?

We found that UT-Battelle's FY 2017 costs claimed may not have always been allowable, allocable, or reasonable. We identified issues with UT-Battelle's year-end indirect rate variance disposition practice and treatment of unallowable costs. As a result, we questioned \$20.8 million of over-recovered funds, \$11.1 million of under-recovered funds from year-end indirect cost pool variances, and \$33,815 of indirect cost burdens related to unallowable costs. We also identified a material control weakness in the subcontract audit function that resulted in our considering \$379.4 million in subcontract costs as unresolved, pending audit. Further, we questioned an additional \$5.6 million in costs related to unapproved real estate transactions and unallocable or unsupported subcontract costs. Finally, we identified issues related to travel costs, legal settlement costs, and UT-Battelle's Internal Audit peer reviews.

What Is the Impact?

The issues we identified could result in UT-Battelle charging significant amounts of unallowable costs to the Department that could go undetected.

What Is the Path Forward?

In response to the Office of Inspector General's Special Project Report, *The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed* (DOE-OIG-21-26, April 2021), the Office of the Inspector General and the Department have transitioned to an independent audit strategy that will not rely on contractor internal audit organization audits of costs claimed. Significant results of this audit were previewed in the Special Project Report. In our report here, we provide recommendations to the Department on addressing the questioned costs we identified from costs claimed for FY 2017.

BACKGROUND

Since fiscal year (FY) 2000, UT-Battelle, LLC (UT-Battelle), has managed and operated the Oak Ridge National Laboratory (ORNL) under Department of Energy contract number DE-AC05-00OR22725 valued at approximately \$21.7 billion. The ORNL is part of the Department's Office of Science.

As a management and operating contractor, UT-Battelle's financial accounts are integrated with those of the Department, and the results of transactions are reported monthly. UT-Battelle is required by contract to account for all net expenditures accrued annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and to claim only allowable costs. During FY 2017, UT-Battelle claimed costs totaling \$1,484,032,638.

The Department's Office of Inspector General (OIG), in consultation with the Chief Financial Officer, the Office of Acquisition Management, and the Contractor Internal Audit Council implemented a Cooperative Audit Strategy. The strategy placed reliance on the contractors' internal audit functions to provide audit coverage of the allowability of costs claimed by contractors. Consistent with this strategy, the Department required contractors to maintain an internal audit activity with the responsibility for conducting these audits. UT-Battelle was required to comply with the Department's Cooperative Audit Strategy, under which UT-Battelle internal auditors performed audits of the contractor, including the annual audit of costs claimed on the Statement of Costs Incurred and Claimed.

Beginning in FY 2016, the OIG selected one management and operating contractor each year to perform audits of the contractor Statement of Costs Incurred and Claimed in place of the internal audit group. For FY 2017, we selected UT-Battelle. The results of this audit were used in conjunction with the results of multiple other audits, inspections, and investigations in arriving at conclusions regarding the Cooperative Audit Strategy and providing recommendations to the Department in the OIG's Special Project Report on *The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed* (DOE-OIG-21-26, April 2021). The objectives of our audit were to determine if UT-Battelle's FY 2017 costs claimed were allowable, allocable, and reasonable in accordance with the terms of the contract, applicable cost principles, laws, and regulations and to assess UT-Battelle's Internal Audit (Internal Audit) work on subcontract costs. Although this audit was initially performed to evaluate the Cooperative Audit Strategy, which is no longer the Department's policy, we identified questioned costs and other findings where we make recommendations to Department officials that require us to communicate these matters in our report.

INDIRECT COST MANAGEMENT NOT COMPLIANT WITH STANDARDS

We identified UT-Battelle practices that were not compliant with Federal Cost Accounting Standards (CAS). Specifically, we found that UT-Battelle's year-end indirect rate variance practice was not compliant with CAS 418, *Allocation of Direct and Indirect Costs*, and we identified an instance where its unallowable costs were not burdened according to CAS 405, *Accounting for Unallowable Costs*. Department of Energy Acquisition Regulation 970.3002-1,

CAS Applicability, and UT-Battelle's contract require compliance with CAS, which include methods of distinguishing direct costs from indirect costs and the basis used for allocating indirect costs.

Year-End Variance Practice Not Compliant with CAS 418

We found that UT-Battelle's disposition of indirect cost and wage pool variances (rate variances) was not compliant with CAS 418. In particular, UT-Battelle did not dispose of material rate variances by allocating the variances to cost objectives within the wage pool or indirect cost pools, as required by CAS 418. Specifically, at year end, UT-Battelle had accumulated \$20.8 million in certain indirect cost pools, as shown in Chart 1.

Chart 1

Rate	Variance (Millions)	Actual Pool Costs (Millions)	Variance Percentage of Pool Costs	Department Participation in Base ¹
Laboratory Directed Research and Development	\$9.86	\$40.81	24%	83%
Wage Pools with Fringe	\$1.53	\$715.70	0%	85%
Material Acquisitions	\$0.18	\$9.89	2%	83%
Non-Material Acquisitions	\$1.65	\$10.03	16%	87%
Service Centers	\$7.58	\$500.65	2%	Various
Total Variance	\$20.80			

Instead of disposing of the positive variances within the respective indirect cost pools, UT-Battelle netted the positive variances with other unrelated cost pools, such as General and Administrative (G&A), Site Services, and Institutional that had negative variances. The total of the combined negative variances was \$11.14 million, as shown in Chart 2.

Chart 2

Rate	Variance (Millions)	Actual Pool Costs (Millions)	Variance Percentage of Pool Costs	Department Participation in Base ²
G&A	(\$3.85)	\$121.61	3%	85%
Site Services	(\$0.92)	\$81.10	1%	84%
Institutional	(\$5.47)	\$41.91	13%	84%
Work-For-Others Safeguards & Security	(\$0.75)	\$5.43	14%	0%
Management Fee	(\$0.03)	\$10.81	0%	86%
Program Office	(\$0.12)	\$10.30	1%	72%
Total Variance	(\$11.14)			

¹ The percentages listed in this column reflect the amount of overall Department funding. The remaining base would be attributed to other entities for which ORNL performs work under Strategic Partnership Projects.

² Ibid.

UT-Battelle's practice did not comply with the beneficial or causal relationship requirement between the final cost objective, which contributed to the indirect cost and the final cost objective benefiting from the actual costs. CAS 418-40(c), *Fundamental Requirements*, requires that pooled indirect costs be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives.³ CAS 418-50(g)(4), *Techniques for Application*, requires that when variances are material, these variances are to be disposed of by allocating the cost to cost objectives in proportion to the costs previously allocated to the cost objectives using pre-established rates.

Dispositioning of rate variances within the respective indirect cost pool maintains the integrity of the beneficial or causal relationship of each indirect cost pool to the final cost objectives in its associated base. This ensures that the final cost objectives pay only their proportionate share of UT-Battelle's indirect costs. Although UT-Battelle performed a variance analysis at year end, its analysis focused on materiality at the final cost objective level, rather than materiality at the rate variance level. Specifically, UT-Battelle netted all the rate variances together, and then determined that the effect to the final cost objectives was immaterial. As a result, UT-Battelle effectively circumvented the CAS 418 requirement to dispose of material variances in a reasonable proportion to the beneficial or causal relationship of pooled costs to cost objectives.

Further, we were particularly concerned with the \$9.86 million of over-recovered Laboratory Directed Research and Development (LDRD) funds that UT-Battelle recovered under special legal authorities unique to the Department's LDRD program. Specifically, UT-Battelle recovered \$50.67 million of LDRD funds through an indirect charge to the majority of final cost objectives, both Department and non-Department funded. LDRD funds were authorized using special legal authorities that were administratively codified in Department Order 413.2C, *Laboratory Directed Research and Development*. Department Order 413.2C stipulates that these funds must be used for projects in the forefront areas of science and technology relevant to the Department's mission. Moreover, all projects receiving LDRD funding must receive concurrence from the Department. We noted that Department Order 413.2C specifically forbids LDRD funds from being used to "fund general purpose capital expenditures." In addition, we found no written concurrence from the Department to permit the use of LDRD funds in this manner. The practice of netting rate variances greatly increases the risk that over-recovered LDRD funds could be spent on costs other than the required purpose. According to UT-Battelle, in FY 2019 it began distributing the LDRD pool variance separately to address this problem.

In response to our concerns, UT-Battelle performed an additional "what-if" analysis for FY 2017 to show that the difference in outcomes between its practice and the requirements of CAS 418 was not significant. However, the analysis did not address the fact that UT-Battelle received funding from multiple sources, such as Strategic Partnership Projects with other agencies (about 19 percent of funding) and funding from other Department offices, including the National Nuclear Security Administration (NNSA). UT-Battelle's variance policy creates an opportunity to inappropriately combine indirect expenses from multiple pools that are allocated from multiple funding sources and could cause the Department to use funds for unintended purposes.

³ CAS 402-30(a)(2), *Definitions*, defines a cost objective as a function, organizational subdivision, contract, or other work unit for which cost data is desired and for which provision is made to accumulate and measure the cost to processes, products, jobs, capitalized projects, etc.

Specifically, 31 United States Code § 1301, *Application*, paragraph (a), prohibits the use of appropriations for purposes other than those for which they were appropriated. Given the multi-sourced funding at ORNL, UT-Battelle's practice could result in inadvertent violations of the requirements provided by congressional controls, appropriation years, and Strategic Partnership Projects.

UT-Battelle's CAS 418 noncompliance occurred because its CAS Disclosure Statement did not sufficiently adhere to CAS 418 requirements, as written. Rather, UT-Battelle's Disclosure Statement focused on supporting rate stability for project management purposes and materiality at the final cost objective level. We also attributed this problem to weaknesses in Federal oversight of UT-Battelle's rate variance management practice for CAS 418 compliance. The Office of Science Consolidated Service Center, Office of Financial Services, which provides oversight to the UT-Battelle contract, reviewed this practice in FY 2013 and found the practice compliant with CAS 418 based on materiality considerations. While the report recommended that the Contracting Officer advise UT-Battelle to monitor the residual variances to ensure continued compliance with materiality considerations, it did not require formal corrective action at the time.

Due to UT-Battelle's CAS 418 noncompliant year-end indirect rate variance disposition practice, UT-Battelle's FY 2017 costs claimed were improperly allocated to some of its cost objectives. We questioned \$20.8 million of positive rate variances and \$11.14 million of negative rate variances that had accumulated by the end of FY 2017 as misallocated and noncompliant with CAS. According to Federal Acquisition Regulation (FAR) 31.201-2, *Determining Allowability*, costs are only allowable when, among other items, they are compliant with CAS requirements.

Unallowable Costs Not Properly Burdened

We found that UT-Battelle did not treat all unallowable costs in the same manner as allowable costs, as required by CAS 405. Specifically, we found that UT-Battelle included allowable costs in the LDRD allocation base and applied the LDRD indirect cost burden to those costs; however, UT-Battelle did not include \$1,046,913 of unallowable costs in the LDRD allocation base, and thus did not apply the LDRD indirect cost burden to the unallowable costs. CAS 405.40(e), *Fundamental Requirement*, states that all unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases.

This issue occurred because UT-Battelle officials thought that unallowable costs were not supposed to be included in the LDRD base. Specifically, UT-Battelle stated that according to CAS 418-40(c), costs should be allocated on a causal beneficial relationship. According to UT-Battelle, LDRD work was associated with the Department's mission and not UT-Battelle's corporate costs. We noted that CAS 405 states that costs incurred in carrying on the activities of an enterprise are allocable to the cost objectives with which they are identified based on their beneficial or causal relationships. However, as discussed, CAS requires that in circumstances where unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases. Additionally, we found that during FY 2017, UT-

Battelle included some unallowable G&A costs in its LDRD base, but not others. UT-Battelle explained that this was a result of discussions held during a 2007 audit, and it would be reevaluating this practice. We spoke to a Senior Advisor to the Department's Chief Financial Officer who did not think that a formal policy decision had been made regarding the applicability of the LDRD rate to unallowable costs. Further, the official noted that because of the unique nature of LDRD, he did not think that such contractor costs needed to be allocated to contract cost objectives and, therefore, was not a noncompliance for which a waiver would be required. While CAS 405 does not address unique circumstances such as LDRD, the requirement remains that all costs must be treated consistently, whether allowable or unallowable, unless specifically exempted by regulation or Department guidance.

As a result, G&A unallowable costs did not receive the appropriate allocation of LDRD costs, and the LDRD allocation base was incomplete. Applying the LDRD allocation of 3.23 percent to the \$1,046,913 of unallowable costs nets \$33,815.28 of costs that should be charged to the unallowable accounts. Accordingly, we questioned \$33,815.28. These questioned costs should be resolved in accordance with official guidance from the Office of the Chief Financial Officer.

UT-Battelle's Internal Audit Oversight of CAS

The audit procedures used by UT-Battelle's Internal Audit did not identify certain CAS noncompliance issues in UT-Battelle's cost accounting and management practices. Specifically, we identified issues with CAS relating to UT-Battelle's variance management practices and treatment of unallowable costs. Although Internal Audit had performed audits of CAS 405 and CAS 418 and identified some issues, it had not previously identified these issues. Further, the Office of Science Consolidated Service Center, Office of Financial Services completed a review of UT-Battelle's indirect rate variance allocation and distribution in FY 2013. The report identified the rate variance issue and found the practice compliant with CAS 418 based on materiality considerations. While the report recommended that the Contracting Officer advise UT-Battelle to monitor the residual variances to ensure continued compliance with materiality considerations, it did not require formal corrective action at the time.

UT-BATTELLE DID NOT FULFILL CONTRACTUAL REQUIREMENT

We identified a material control weakness in which UT-Battelle did not always fulfill its contractual requirement to audit subcontracts where costs incurred were a factor in determining the amount payable to the subcontractor. For FY 2017, Internal Audit reported that controls for the subcontract audit process were generally in place and operating, as intended. However, we found that while UT-Battelle had performed some limited procedures, no subcontract audits were completed for FY 2017 time and material (T&M) and fixed-price subcontracts. Specifically, we found the following:

- Internal Audit did not perform any audits of the \$106,528,800 incurred on T&M subcontracts in FY 2017. UT-Battelle's subcontract audit process called for its Assurance and Assessments Group (A&A) to forward T&M subcontracts identified as

high-risk to Internal Audit for consideration of additional audit work. Of the 1,142 T&M subcontracts with costs claimed during FY 2017, Internal Audit only performed limited testing on 2 high-risk subcontracts.

- The Office of Science Consolidated Service Center did not have a process for tracking audits on non-educational cost type subcontracts totaling \$35,851,092 in FY 2017. A&A's process was to perform a close-out review on all UT-Battelle cost-type subcontracts. During this process, A&A relied on audit work that could have been performed by other agencies, such as the Defense Contract Audit Agency (DCAA). A&A submitted requests for audit support, including DCAA audits, to the Office of Science Consolidated Service Center. However, the Office of Science Consolidated Service Center was unable to demonstrate that it had any method for tracking these subcontract audits. While UT-Battelle provided some email correspondence indicating that the DCAA would perform some audits of FY 2017 costs claimed totaling about \$25 million, without a documented system for tracking these requests, we could not confirm whether any other audit requests had been made and the status of those requests. Subsequent to our discussions with UT-Battelle, the Department provided FY 2017 audit reports for the contractors that incurred the previously mentioned \$25 million.
- We did not identify any audits for FY 2017 fixed-price contracts totaling \$272,914,716 that contained some flexibly-priced cost components. For fixed-price subcontracts, A&A performed a quarterly risk assessment and selected contracts for review. For contracts evaluated as medium- or high-risk, A&A sent the risk evaluation to Internal Audit for consideration of additional audit work. However, UT-Battelle did not perform or request any subcontract audits of its active 6,849 fixed-price subcontracts that contained cost elements.

While we did not identify any T&M audits of FY 2017 subcontract costs, UT-Battelle did have some controls in place related to subcontract costs. Specifically, Internal Audit performed annual audits of UT-Battelle's subcontract audit process. As part of this audit for FY 2017, Internal Audit conducted testing of all invoices related to the two high-risk T&M subcontracts. Additionally, Internal Audit reviewed various control activities performed by Payment Services personnel, Technical Project Officers, and A&A. As part of its review of control activities, Internal Audit noted that it randomly selected 50 T&M invoices and performed testing designed to validate the invoice review process. Although these procedures helped ensure a good system of controls, they did not replace an audit. Further, UT-Battelle did not perform key tasks designed to identify unallowable or questionable costs, typical of a subcontract audit. For example, Internal Audit did not evaluate the subcontractors' internal controls, accounting systems, processes, and procedures. For indirect costs, cost claimed audits typically include an evaluation of internal controls, composition and suitability of allocation bases and indirect cost pools, verification to financial records, and verification of rate computation accuracy to determine the allowability, allocability, and reasonableness of the costs charged to the subcontract. However, we found that Internal Audit did not perform these tasks or complete labor floor checks. Labor floor checks verify compliance with timekeeping procedures, such as

daily time recording and periodic time certification, to ensure that labor cost data can be relied on for billing purposes. Finally, Internal Audit did not hold entrance conferences, prepare subcontract audit programs, or issue subcontract audit reports.

UT-Battelle's prime contract includes Department of Energy Acquisition Regulation 970.5232-3, *Accounts, Records, and Inspection*, which requires that the contractor either conduct an audit of the subcontractor's costs or arrange that such an audit be performed through the Contracting Officer, where costs incurred are a factor in determining the amount payable to the subcontractor, including fixed-price, unit-price, and purchase orders. UT-Battelle's Internal Audit Implementation Design calls for pre-award and post-award audits of subcontracts to be coordinated by A&A. Based on established risk factors, A&A performs a review or requests an audit be performed. Additionally, the Implementation Design requires Internal Audit to conduct an annual audit of the contract review processes to include A&A activities, as well as Accounts Payable and Technical Project Officer activities related to review and payment of subcontracts.

These issues occurred because UT-Battelle relied on its internal control structure to replace the audit requirements of the contract, even though the internal controls did not address key elements needed to identify questioned and unallowable costs. UT-Battelle's procedure does not specifically require that Internal Audit perform T&M or fixed-price subcontract audits. Rather, it requires that A&A coordinate the subcontract audit process, while forwarding high-risk T&M, and medium- or high-risk fixed-price subcontracts to Internal Audit for "consideration" of additional audit work. Further, the process for ensuring cost-type subcontract audit performance was not clearly documented, and there was a lack of communication between UT-Battelle and the Office of Science Consolidated Service Center. UT-Battelle's current practice is to send requests for audit of cost-type subcontracts to the Office of Science Consolidated Service Center, which forwards the requests to the DCAA. While UT-Battelle provided some email correspondence indicating that the DCAA would perform some audits of FY 2017 costs claimed, we were unable to track the status of these requests. After our discussions with UT-Battelle, the Department provided audit reports for these requests.

By not fulfilling the requirement to audit its T&M and fixed-price subcontracts where costs incurred were a factor, UT-Battelle increased the risk that it was passing on unallowable costs from its subcontractors to the Department. During FY 2017, UT-Battelle incurred \$106,528,800 related to T&M subcontracts and \$272,914,716 related to fixed-price subcontracts where costs incurred could have been a factor in determining the amount payable to the subcontractor. Without independent and objective audits of subcontracts where costs incurred are a factor in determining the amount payable to the subcontractor, UT-Battelle could incur unallowable costs related to its subcontracts that might go undetected. Since subcontract audits had not been performed on T&M and fixed price subcontracts, we consider \$379,443,516 unresolved, pending audit. In addition, UT-Battelle incurred \$35,851,092 related to non-educational cost-type subcontracts in which there was no process to properly track audits.

Further, without a timely audit of these subcontracts, UT-Battelle is at risk of not recovering unallowable costs. Specifically, 41 United States Code, Chapter 71, *Contract Disputes*, imposes

a 6-year statute of limitations for the Government to seek recovery of unallowable costs that could be identified through subcontract audits; therefore, it is important that audits are completed in a timely manner.

OTHER SIGNIFICANT FINDINGS

Real Estate Transactions Not Approved by Department

UT-Battelle did not receive approval from a Department Certified Realty Specialist for some of its real estate transactions, as required by Department Order 430.1C, *Real Property Asset Management*. Specifically, both UT-Battelle's prime contract and Department Order 430.1C require that the Department review and approve all real estate actions that acquire, utilize, and dispose of real property. However, UT-Battelle did not submit its lease improvement actions with UT-Battelle Development Corporation (UTBDC), or its lease agreement with Battelle Memorial Institute (Battelle), to the Department Certified Realty Specialist for review or approval. Both UTBDC and Battelle are related parties of UT-Battelle.

Lease Improvement Costs

UT-Battelle did not receive Department approval for real estate transactions with UTBDC, as required by Department Order 430.1C. During our audit, we reviewed \$3.66 million of \$19 million in lease improvement costs related to two UTBDC leases. We found that although these actions exceeded UT-Battelle's \$10,000 purchasing authority, they were not reviewed and approved by the Department Certified Realty Specialist.

UTBDC is a non-profit organization that facilitates the revitalization of ORNL's infrastructure and manages buildings owned by Keenan Development Corporation. Battelle, the University of Tennessee, and UT-Battelle do not have any ownership interest in UTBDC; however, UT-Battelle employees complete all administrative work on behalf of UTBDC. In addition, UTBDC senior executives are UT-Battelle employees, as indicated in Chart 3.

Chart 3

UTBDC Role	ORNL (UT-Battelle) Role
President	Deputy for Laboratory Operations
Executive Vice President	Director of Facilities and Operations
Chief Financial Officer	Manager of Information and Process Management
General Counsel/Secretary	Prime Contract Administrator

This issue occurred because UT-Battelle officials thought that tenant improvements with UTBDC were not real estate actions as they did not result in the acquisition of additional space. However, we noted that UT-Battelle requested and received Department approval for a lease improvement with an unrelated third party. Further, a UT-Battelle official told us that the requirements of Department Order 430.1C did not automatically apply to contractors. However, UT-Battelle's prime contract requires that the contractor comply with Department requirements and guidance involving the acquisition, management, and disposal of real property assets.

Additionally, Department Order 430.1C states that when a Contracting Officer assigns responsibility for real property management to a contractor, the contractor is responsible for compliance with real property asset management requirements, regardless of the entity performing the work. Further, a Senior Department Realty Officer confirmed that the review requirement includes work performed in the existing space and is not limited to the creation of additional space.

Additionally, during our review, we found examples of a vendor overcharging for performance bond costs that were not identified by UT-Battelle along with inaccurate UTBDC overhead costs. UT-Battelle recovered \$4,930.39 related to these errors and reviewed additional invoices.

Lease Costs

UT-Battelle did not receive approval for lease costs associated with an agreement granting UT-Battelle access to Battelle office space in Washington, DC. We noted that the UT-Battelle Subcontract Administrator has purchasing authority for commitment values not to exceed \$10,000 for any real estate transaction. However, we found that for FY 2017, UT-Battelle's lease had a total commitment value of \$76,176. Nevertheless, the Department did not approve the annual lease costs, including a \$14,867 increase since the lease was initiated.

This occurred because UT-Battelle officials thought the agreement was under the purview of Battelle's Contracting and Realty Officers. UT-Battelle officials told us that when initially set up, the agreement was viewed as a simple transfer of funds between UT-Battelle and the parent company for general office space. While UT-Battelle provided email correspondence with the Department's Realty Office agreeing to this process, we noted that Department Order 430.1C requires that the Department review and approve all real estate actions that acquire, utilize, and dispose of real property.

Effect

Without the involvement of Department Realty personnel for real estate actions, UT-Battelle could be incurring unallowable costs. Specifically, the Department could be paying for unnecessary lease improvements and lease space, which might not support mission priorities. Additionally, the lack of Department review and approval of these transactions, as well as the lack of documentation supporting costs, was of greater concern because real estate transactions were with related parties. Transactions with related parties lacked cost control incentives that could exist in arm's-length transactions with unrelated parties. As such, we questioned FY 2017 lease improvement costs of \$3,656,881.39 and lease costs of \$76,176 for lack of Department approval.

Subcontract Costs Might Not Be Allocable to Prime Contract

UT-Battelle did not provide supporting documentation that all costs claimed were allocable to its contract. Specifically, we identified an instance where UT-Battelle acquired support services that appeared to directly support the Department. Because the services did not directly support ORNL's operations, they might not be allocable to UT-Battelle's contract. For example, we

identified \$1,846,336 in FY 2017 costs related to one basic ordering agreement that included numerous tasks that appeared to provide support services to NNSA, rather than supporting operations at ORNL. Included in that amount was one task, with \$585,637 in FY 2017 costs, which provided strategic planning support to an NNSA program office. Task descriptions included management, organization, and development support for strategic initiatives. Additionally, we identified a task to provide services and resources that support budget and financial controls for an NNSA program office, including data management and reporting. Although there were no expenses charged to this task in FY 2017, it further highlighted our concerns that potentially unallowable activities were included in this basic ordering agreement.

FAR Part 31.201-4, *Determining allocability*, states that a cost is allocable if it is assignable or chargeable to one or more cost objectives based on relative benefits received or other equitable relationship. Specifically, the cost is allocable if it is: (1) incurred specifically for the contract; (2) benefits both the contract and other work and can be distributed to them in reasonable proportion to the benefits received; or (3) is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown. Further, UT-Battelle's *Procurement Operating Practice 2.2.4.5, Support to DOE*, states that the procurement of consulting or other services directly supporting the Department is prohibited.

UT-Battelle officials did not provide specific information on the review and approval of the basic ordering agreement. According to UT-Battelle officials, a program team reviews efforts with a potential for actual or perceived direct support to Department staff. However, officials told us that there had been a complete turnover in staff involved in reviewing the tasks in question. UT-Battelle officials stated that because these tasks supported a work authorization issued under the prime contract, they were allocable. However, as noted, UT-Battelle's *Procurement Operating Practice* specifically prohibits the procurement of services directly for the Department.

Based on our review, we were concerned that UT-Battelle could have been claiming unallowable costs due to a lack of allocability to the prime contract. Specifically, UT-Battelle was procuring services that appeared to directly support the Department on a basic ordering agreement valued at more than \$10.9 million, as of July 2019. During FY 2017, UT-Battelle incurred \$1,846,336 of costs for eight tasks included in the basic ordering agreement; therefore, we questioned this amount.

Inadequate Supporting Documentation for Subcontract Costs

UT-Battelle did not require adequate supporting documentation to demonstrate the allowability of costs incurred on one invoice reviewed. During our review, we judgmentally sampled 32 transactions with a variety of dates on 12 of the 76 staff augmentation subcontracts with FY 2017 costs. According to UT-Battelle, a staff augmentation subcontract is defined as a subcontractor employee performing a specific function, rather than the subcontractor performing a defined scope and delivering a final product. Our sample included \$586,434 of the total \$6,743,062 staff augmentation population. We found that UT-Battelle did not require a detailed invoice, including labor hours or rates, to support \$30,577 charged to one subcontract. Rather, the subcontract's invoice for FY 2017 was paid based on a list of total compensation owed to each employee.

FAR 31.201-2, *Determining allowability*, states that “a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles.”

This situation occurred because UT-Battelle had not ensured compliance with its policies and procedures. UT-Battelle’s procedure, *Procurement Operating Practice*, requires that invoices be reviewed to ensure that they are in accordance with the subcontract’s provisions. The contract requires payment for actual hours worked at established rates, plus a markup for payroll tax. However, despite documentation of invoice review, we found that the invoice only included a list of employee names and each employee’s total compensation.

Without proper documentation, UT-Battelle would be unable to verify that the vendor costs were allowable and that payments were made in accordance with subcontract terms and procurement procedures. Accordingly, we questioned \$30,576.75 of staff augmentation costs for lack of supporting documentation.

Unallowable Cost Related to Legal Settlement

UT-Battelle did not reimburse the Department for costs explicitly deemed unallowable by the Contracting Officer. Specifically, we identified an \$8,000 transaction related to a legal settlement that was determined to be unallowable in October 2017. The Contracting Officer’s determination also included an additional \$4,500 from a related FY 2015 transaction. However, when we inquired in March 2019, UT-Battelle had not made the appropriate accounting entries to reflect the costs from either transaction as unallowable.

FAR 31.201-6(b), *Accounting for unallowable costs*, requires that costs designated as unallowable as a result of a written decision furnished by a Contracting Officer shall be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract. Additionally, in the October 2017 determination letter, the Contracting Officer directed UT-Battelle to make appropriate accounting entries to reflect the \$12,500 as unallowable.

According to UT-Battelle, as of April 2019, it had not made the appropriate accounting entries because its Legal Counsel and Prime Contract Administrator were still reviewing the Contracting Officer’s determination for additional discussions. This issue also occurred because the Department’s Contracting Officer did not have a method to ensure reimbursement of costs determined to be unallowable, other than those resulting from an audit. Consequently, the Contracting Officer was unaware that the costs had not been reimbursed. According to the Contracting Officer, the Department relied on the Cooperative Audit Strategy, working as intended, to provide assurance that only allowable costs were charged to the contract. However, we noted that FAR 1.602-2, *Responsibilities*, assigns the Contracting Officer as the responsible party to ensure performance of all necessary actions for effective contracting, ensure compliance with the terms of the contract, and safeguard the interests of the United States in its contractual relationships. Further, we did not consider reliance on the Cooperative Audit Strategy an appropriate substitute for effective controls.

Without confirmation of recovery for unallowable costs, the Department might not be reimbursed for those costs. After our discussions with UT-Battelle personnel and the Contracting Officer, UT-Battelle took action to reimburse the Department \$12,500 for costs related to these legal settlements.

Insufficient Documentation for Use of Rental Cars

UT-Battelle did not ensure compliance with its approved domestic travel policy regarding the use of rental cars. Specifically, during our audit, we reviewed 47 travel transactions, which included costs for 19 rental cars. As a result, we identified five examples in which a rental car was possibly unnecessary because other transportation options were available or the traveler was staying at, or very near to, the conference hotel.

UT-Battelle's domestic travel policy states that vehicles should be rented only when there is a clear requirement that cannot be met by other surface transportation, or there is a cost advantage for the company. Vehicles should not be rented for the employee's convenience.

This occurred because UT-Battelle had not implemented controls to ensure compliance with its travel policy. We concluded that Federal Travel Regulation, Part 301-10, *Transportation Expenses*, Subpart E, 301-10.450, provides a "best practice" of requiring specific authorization for rental cars. However, UT-Battelle did not require documented justification for the use of rental cars for travel. Rather, if the approved authorization included a rental car, no further verification of need was performed. A UT-Battelle official told us that its policy was to allow rental cars for business and conference travel. However, this explanation was incongruent with UT-Battelle's approved domestic travel policy.

Without proper justification, UT-Battelle would be unable to determine whether rental car costs were allowable in accordance with applicable criteria. After our discussions with UT-Battelle personnel, Internal Audit issued report IA2019-10, *Allowable Cost Review - Travel*, which found that expenses for a rental car and associated parking were reimbursed to a traveler who stayed at a training event hotel and, according to available information, only used the car to drive to and from the airport. Internal Audit recommended that management determine the allowability of the costs, as well as implement/enhance controls (e.g., require justification to be documented and approved) needed to reasonably ensure that costs related to rental vehicles were only reimbursed in accordance with FAR and UT-Battelle's travel policy. As a result, UT-Battelle updated its travel policy and reimbursed the Government for costs determined unallowable; therefore, we made no recommendation in this area.

Independent Peer Reviews Not Performed

During our review, we found that Internal Audit did not receive an external peer review, as required by the Cooperative Audit Strategy. According to the Cooperative Audit Strategy, peer reviews help to ensure compliance with applicable standards, appraise the quality of the internal audit activity, and make recommendations for improvement. Peer reviews were to be conducted every 5 years by a team led by the Chief Audit Executive of a non-affiliated contractor, or independent external reviewers. However, UT-Battelle conducted a self-assessment with

independent validation in its last two peer reviews, which were conducted in FY 2012 and FY 2017. Specifically, in FY 2017, the assessment was conducted by UT-Battelle's Chief Audit Executive and a Senior Auditor. Subsequently, a qualified, independent validator from the Institute of Internal Auditors reviewed and tested the self-assessment.

This occurred because Internal Audit followed International Standards for the Professional Practice of Internal Auditing that allowed for a self-assessment with independent validation. However, as previously noted, the Cooperative Audit Strategy specifically required peer reviews be performed by a non-affiliated contractor, or independent external reviewers. Self-assessments could lack adequate independence to ensure compliance with applicable standards and a high quality internal audit activity.

OTHER MATTERS

In April 2021, the OIG issued a Special Project Report on *The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed* (DOE-OIG-21-26, April 2021), 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. Significant results of this audit were included in the Special Project Report and informed its recommendations regarding the transition to an independent audit strategy. Given the expected cessation of future incurred cost audits by Internal Audit, we have excluded any recommendations regarding necessary improvements in Internal Audit's incurred cost auditing processes identified in this audit.

RECOMMENDATIONS

We recommend that the Deputy Chief Financial Officer:

1. Issue guidance on the applicability of CAS 405, *Accounting for Unallowable Costs*, to LDRD.

We recommend that the Manager, ORNL Site Office, direct the Contracting Officer to:

2. Ensure that UT-Battelle updates its variance policy and any other policies that deliberately offset expenses or inappropriately combine funding from different congressional controls, appropriation years, and Strategic Partnership Projects.
3. Determine the allowability of costs questioned in this report, as summarized in Appendix 2, and recover any amounts deemed unallowable.
4. Ensure that actions related to real estate are approved by appropriate Department personnel.

5. Implement a suitable method to track unallowable costs and ensure that those amounts are recovered.
6. Conduct a risk assessment of FY 2017 T&M contracts and fixed-priced contracts containing flexibly-priced components to determine the appropriate audit coverage necessary and arrange for those audits to be conducted.

MANAGEMENT RESPONSE

Management concurred with three of our six recommendations, including Recommendations 1, 4, and 5. The Acting Chief Financial Officer concurred with Recommendation 1, stating that the Office of Chief Financial Officer would provide guidance on the applicability of CAS 405 to LDRD. This guidance would reflect specific Congressional and legislative requirements that create unique costs accounting processes for LDRD. Subsequent to the issuance of our official draft, the ORNL Site Office Manager informed us that the Department had issued guidance on the applicability of CAS 405 to LDRD. Specifically, LDRD is not to be charged to unallowable costs, which is consistent with the UT-Battelle practice.

The ORNL Site Office Manager (Manager) generally non-concurred with the OIG's findings; however, the Manager concurred with Recommendations 4 and 5. To address Recommendation 4, the ORNL Site Office will evaluate its current tenant approval process and ensure that actions are approved appropriately. To address Recommendation 5, the Manager stated that when unallowable costs are identified in the future, the ORNL Site Office will ensure that they are tracked and recovered when the Contracting Officer transmits a final decision.

The Manager did not concur with Recommendations 2, 3, and 6. In response to Recommendation 2, related to UT-Battelle's variance policy, the Manager stated that the OIG's criteria for reviewing variances at pool levels and final cost objectives were not required by CAS 418. Further, the Manager asserted that CAS 418 did not require materiality assessment for year-end variance disposition at the pool variance level. As such, the Manager stated that updates to the variance policy were unnecessary. Subsequent to the issuance of our official draft, the Manager noted that the Department had issued updated guidance on cost accounting to include variances and materiality through its update to Chapter 15 of the *Financial Management Handbook*. UT-Battelle is currently reviewing its cost disclosure statement and will provide updates to the Department for its review and approval.

The Manager did not concur with Recommendation 3 to resolve questioned costs identified in the report because he disagreed with the associated findings that supported the questioned costs. Specifically:

- Positive and Negative Variances: The Manager thought that the contractor's current policies already considered all final cost objectives regardless of funding source, stating that the contractor demonstrated to the OIG during the audit that pooled indirect costs were allocated to cost objectives in reasonable proportion to the beneficial or causal relationship, thereby ensuring consistency with CAS 418-40(c).

- Lease Costs and Lease Improvement Costs: While the Manager concurred with the recommendation to ensure that actions related to real estate are approved by appropriate Department personnel, he considered the OIG's recommendation duplicated effort because these lease costs had already been reviewed by other Department personnel.
- Indirect Cost Burden for Unallowable Costs: The Manager referred to Department Order 413.2C, which states that the maximum funding level is based on 6 percent of the total operating and capital equipment budget of a Department laboratory for the year. The Manager stated that if the base used to determine the LDRD funding level included unallowable costs, the LDRD funding level would exceed the maximum level established by Congress and would violate law because the funding level must be based on funds made available by the Department. Therefore, its base does not include unallowable costs.
- Staff Augmentation: The Manager asserted that questioned costs were related to a performance-based subcontract rather than a staff augmentation subcontract. Further, the Manager stated that the contractor was able to determine that the amount was reasonable.
- Allocability of Subcontract Costs: The Manager stated that these costs were directly related to a specific work authorization that was accepted by management and issued under the prime contract. As such, the costs were incurred specifically for the contract and were allocable costs.

Regarding Recommendation 6, the Manager asserted that subcontract audit work is within the contract's scope and conducting a risk assessment is the method the contractor employs. The Manager asserted that risk assessments conducted as part of management and operating contractor subcontract audits is not a Federal function. The Manager asserted that ORNL's Internal Audit had not changed its approach or process since the previous assessment conducted by the OIG, *Audit Coverage of Cost Allowability for UT-Battelle, LLC During Fiscal Year 2015 Under Department of Energy Contract No. DE-AC05-00OR22725* (DOE-OIG-18-03, October 2017). In that report, OIG found that UT-Battelle conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor and had resolved all costs questioned in those audits. The Manager also expressed concern that an analysis of processes alone was an insufficient basis to consider an entire category of costs unresolved and conflicted with the OIG's own employed standard that non-statistical sampling cannot be projected to an entire population of costs.

Management comments are included in Appendix 4.

AUDITOR COMMENTS

Management agreed to take corrective actions in response to three of the report's six recommendations. Management's proposed corrective actions were responsive to Recommendations 1, 4, and 5.

Regarding Recommendation 2, we maintain that materiality should be assessed at the pool level and not at the final cost objective level. A rate is made up of a numerator and a denominator, with the numerator being the pool. CAS 418.50(g) discusses pre-established rates and what to do when those rates differ in a material way from actuals. Therefore, materiality should be evaluated by the change in the pool and the base of the rate. We noted that despite nonconcurring with Recommendation 2, the Manager has indicated that UT-Battelle has or will take action to address this recommendation. Specifically, as a result of updates to the Department's *Financial Management Handbook*, UT-Battelle is reviewing its cost disclosure statement and will provide updates to the Department for its review and approval. As such, we intend to keep the recommendation open and evaluate corrective actions once completed.

Regarding Recommendation 3, the OIG stands by its questioned costs as follows:

- Positive and Negative Variance: While the contractor's policy may consider the cost impact at the "cost objective" level, this is different and distinct from our finding. As described in our response to management's comment for Recommendation 2, we maintain that the contractor was not in compliance with CAS 418 when it considered materiality at the final cost objective level, rather than the pool level. Further, FAR 31.201-2 states that a cost is only allowable when it complies with CAS.
- Lease Costs and Lease Improvement Costs: Department Order 430.1C requires approval from a Department Certified Realty Specialist. While the lease improvements had been reviewed by Department management, they had not been approved by a Department Certified Realty Specialist, as required. For lease costs, management stated that the Department had reviewed the master lease held by Battelle. However, we maintain that UT-Battelle was unable to provide documentation to support the review of its costs, which was the scope of this audit.
- Indirect Cost Burden for Unallowable Costs: As noted in our report, CAS 405.40(e), *Fundamental Requirement*, states that all unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect-cost allocation base or bases, they shall remain in such base or bases. While CAS 405 does not address unique circumstances such as LDRD, the requirement remains that all costs must be treated consistently, whether allowable or unallowable, unless specifically exempted by regulation or Department guidance. As such, management should resolve the questioned costs in accordance with guidance to be issued by the Acting Chief Financial Officer.
- Staff Augmentation: This contract was provided by the contractor in response to a request for a universe of staff augmentation subcontracts. Therefore, it was included as a staff augmentation subcontract. No matter the type of contract, the contractor was unable to provide supporting documentation for the costs, as required by FAR 31.201-2 (noted on pages 10–11 of this report).

- Allocability of Subcontract Costs: As stated in this report, UT-Battelle's Procurement Operating Practice specifically prohibits the procurement of services directly for the Department. Despite the approved work authorization, the contractor was unable to provide any documentation to prove that the task orders on the contract were directly for the contract.

Regarding Recommendation 6, and as noted on page 6 of this report, we found that the contractor had not performed any subcontract audits for FY 2017 T&M and fixed-price subcontracts containing flexibly-priced components. In April 2021, the OIG issued a Special Project Report on *The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed* (DOE-OIG-21-26, April 2021), highlighting its concerns with the effectiveness of the Cooperative Audit Strategy in providing adequate audit coverage of contractors' costs, to include significant lapses in the audits of subcontracts. The Department of Energy Acquisition Regulation continues to require the management and operating contractor to either conduct an audit of each cost-reimbursement (including flexibly-priced contracts and subcontracts) subcontractor's costs or arrange for such an audit to be performed. Management's response asserted that subcontract audit work is within the contract's scope and conducting a risk assessment is the method the contractor employs. The Manager asserted that risk assessments conducted as part of management and operating contractor subcontract audits is not a Federal function. It is unclear what this statement means. It is the responsibility of the management and operating contractor to develop an annual audit plan, including plans for subcontractor audits. It is a joint responsibility of the Contracting Officer, the OIG, and the Office of the Chief Financial Officer to determine the appropriate level of subcontract audits necessary to support the claimed subcontractor costs. They are jointly responsible for determining whether the contractor's planning and execution of its planning have resulted in, and will continue to result in, provision of adequate audit coverage of its flexibly-priced subcontracts. Therefore, we maintain that it is appropriate for the Contracting Officer, in coordination with the OIG and the Office of the Chief Financial Officer, to determine the appropriate level of subcontract audits necessary each year to ensure that all subcontracts, where costs incurred is a factor, are audited as required by the Department of Energy Acquisition Regulation 970.4232-3(c).

Further, where management noted this report appears to contradict past OIG reports regarding subcontract audits, the OIG maintains that this audit did not have the same objective or scope as our previous review level engagements, and different procedures were used to identify potential gaps in Internal Audit's coverage of costs claimed. Specifically, the previous review states, "A review is substantially less in scope than an examination or audit where the objective is an expression of opinion on the subject matter and accordingly, for this review, no such opinion is expressed. Additionally, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review." The fact that a previous assessment-level review did not discover the issue identified in our current audit does not negate the existence of the issue.

Finally, the OIG's decision to consider all FY 2017 T&M and fixed-price subcontract costs unresolved pending audit was not based on the projection of a sample. Rather, it was based on the contractor's inability to provide even a single audit report related to those costs. When a

contractor has not conducted or arranged for subcontract audits, it has been the longstanding practice of the OIG to consider it a material control weakness and classify those costs as “unresolved pending audit.” Upon completion of future audits of these subcontract costs, the Contracting Officer may determine that some or all of the costs are indeed allowable. However, in the absence of such audits, we were unable to make that conclusion.

OBJECTIVE

We conducted this audit to determine if UT-Battelle, LLC's (UT-Battelle) fiscal year 2017 costs claimed were allowable, allocable, and reasonable in accordance with the terms of the contract, applicable cost principles, laws, and regulations and to assess UT-Battelle's Internal Audit work on subcontract costs.

SCOPE

The audit was performed from February 2018 through August 2021 at the Oak Ridge National Laboratory in Oak Ridge, Tennessee. The audit scope was limited to costs incurred during fiscal year 2017. We did not evaluate the technical aspects of UT-Battelle's performance. The audit was conducted under Office of Inspector General project number A18OR010.

METHODOLOGY

To accomplish our audit objective, we:

- Reviewed applicable laws, regulations, policies, and procedures.
- Reviewed relevant reports issued by the Office of Inspector General, Government Accountability Office, UT-Battelle's Internal Audit, Department of Energy, Office of Science Consolidated Service Center, and other entities.
- Conducted interviews with Federal and contractor personnel.
- Selected the following samples:
 - Statistically sampled 50 of 15,895 travel expense transactions and judgmentally sampled 3 credit transactions and 3 accrual transactions from those not included in our statistical sample universe. During our review, we found additional manual entries that skewed our statistical sample; therefore, the results and conclusions related to the sample are limited to the items tested and were not projected to the entire population or universe of costs.
 - Statistically sampled 50 of 38,655 materials transactions and judgmentally sampled 3 of 968 materials credit transactions and 3 of 2,520 material accrual transactions. There were no findings related to materials.
 - Judgmentally sampled the following: 12 of 707 Federal Strategic Partnership Projects and 12 of 493 non-Federal Strategic Partnership Projects; 12 of 85 staff augmentation subcontracts; 16 of 923 miscellaneous transactions; 10 of 116 Joint Faculty, Governor's Chair, and Distinguished Scientist agreements, and further selected 17 of 96 transactions for those 10 agreements; 8 of 1,539 student agreements, and further selected 17 of 122 transactions for those 8 student agreements; 8 of 21 leases for review. For these 8 leases, we further selected 16 lease costs and 21 lease

Appendix 1: Objective, Scope, and Methodology

improvement transactions; 25 of 40,255 cost transfer transactions; and 32 Department Payment and Collection system transactions from a universe of 9,168. Judgmental or non-statistical sample results and overall conclusions are limited to the items tested and cannot be projected to the entire population or universe of costs.

- Analyzed whether indirect rates were appropriately and consistently applied to allocation base costs.
- Evaluated indirect rate variance management practices by determining whether indirect rate variances were monitored, adjusted, and disposed of properly.
- Tested transactions using the requirements contained in the Federal Acquisition Regulation and in contract terms and conditions by tracing transactions to supporting records and documentation.
- Reviewed policies and procedures for identifying subcontracts that require audits and arranging such audits.

We conducted this performance 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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Accordingly, we assessed significant internal controls and compliance with laws and regulations to the extent necessary to satisfy the audit objectives. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. Finally, we relied on computer-processed data to accomplish our audit objectives. We assessed this data by tracing it to source documents and determined the data to be sufficiently reliable to provide a basis for our conclusions.

This report is intended for the use of Department Contracting Officers and field offices in the management of their contracts and is not intended to be used for and should not be used by anyone other than these specified parties.

We held an exit conference with management officials on February 21, 2023.

Appendix 2: Summary of Questioned Costs

	Questioned Costs		Unresolved Pending Audit
	Positive	Negative	
Variance (Positive)	\$20,806,240		
Variance (Negative)		\$11,138,206	
Lease Improvement Costs	\$3,656,881		
Lease Costs	\$76,176		
Indirect Cost Burden for Unallowable Costs	\$33,815		
Staff Augmentation	\$30,577		
Allocability of Subcontract Costs	\$1,846,336		
Subcontract Audits			\$379,443,516
Totals	\$26,450,025	\$11,138,206	\$379,443,516

Appendix 3: Prior Reports

- Special Project Report on [*The Transition to Independent Audits of Management and Operating Contractors' Annual Statements of Costs Incurred and Claimed*](#) (DOE-OIG-21-26, April 2021). Since 1994, the Cooperative Audit Strategy has placed the primary audit functions within the internal audit departments of the Department's management and operating contractors. As a result, the contractors' internal audit departments conducted the audits of their own annual Statements of Costs Incurred and Claimed. In addition, the Cooperative Audit Strategy allows these audits to rely upon auditing standards promulgated by the Institute of Internal Auditors, instead of GAGAS. From its inception, some stakeholders questioned the independence of the contractors' audits of their own Statements of Costs Incurred and Claimed pursuant to the Cooperative Audit Strategy. In 2017, the OIG initiated a 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. This Special Project Report was the culmination of this multi-year review and recommended that the OIG and the Department transition to an independent audit strategy. The recommendation was made due to systemic threats to auditor independence; the increased likelihood of fraud, waste, and abuse; significant lapses in the audits of subcontracts; and other major deficiencies.
- Audit Report on [*Battelle Energy Alliance, LLC Costs Claimed under Department of Energy Contract No. DE-AC07-05ID14517 for Fiscal Year 2016*](#) (DOE-OIG-20-02, October 2019). We identified Battelle Energy Alliance, LLC (BEA) practices that were not compliant with Cost Accounting Standards, other issues for which we were not always able to quantify the full monetary impact, and weaknesses in BEA's Internal Audit (Internal Audit) procedures. For fiscal year (FY) 2016, we questioned \$17.66 million of positive (over-recovered) funds and \$8.4 million of negative (under-recovered) funds from year-end indirect cost pool variances. We also questioned \$11,176 of Laboratory Directed Research and Development burdens. Also, for areas where Internal Audit had provided audit coverage in FY 2016 (e.g., subcontract costs), we reviewed its work to determine whether we could rely on the audit work in lieu of performing our own testing. Based on our review, we determined that Internal Audit work could be relied upon in the select areas reviewed and identified minor additional questioned costs of \$8,013. These issues occurred because BEA did not properly follow contract terms and conditions, including Federal Acquisition Regulation and Cost Accounting Standards, and did not sufficiently adhere to internal policy. We identified areas that require improvement by Internal Audit. The audit procedures used by Internal Audit did not identify certain Cost Accounting Standards noncompliance issues in BEA's cost accounting and management practices. We consider these areas to be fundamental for proper accounting of costs on Government contracts. Accordingly, we recommended certain corrective actions and additional oversight to ensure that these problems do not recur.
- Assessment Report on [*Audit Coverage of Cost Allowability for UT-Battelle, LLC During Fiscal Year 2015 Under Department of Energy Contract No. DE-AC05-00OR22725*](#) (DOE-OIG-18-03, October 2017). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by UT-Battelle,

LLC's (UT-Battelle) Internal Audit (Internal Audit) could not be relied upon. We did not identify any material internal control weaknesses with the allowable cost reviews UT-Internal Audit conducted, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. In audits performed since our last assessment, Internal Audit questioned \$44,171 in costs, which had all been resolved. Additionally, we found that UT-Battelle conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor and had resolved all costs questioned in those audits. While it did not impact our reliance on its work, we noted that as part of Internal Audit's risk-based planning approach, as approved by the Contracting Officer, Internal Audit did not review FY 2015 costs in each of UT-Battelle's four major disbursement categories. Beginning with its FY 2013 allowable cost reviews, Internal Audit had determined that the risk of unallowable costs only warranted testing on a rotational basis and alternated auditing UT-Battelle's major disbursement categories, auditing procurement and travel costs one year, and then non-procurement and payroll costs the next. Accordingly, Internal Audit conducted allowable cost audits on FY 2015 procurement and travel costs but did not conduct audits on payroll and non-procurement costs. Despite this change in approach, we noted that Internal Audit had relied on the same sampling approach it had used when it was performing annual audits of major disbursement categories. In particular, for FY 2015 costs, Internal Audit had selected and tested approximately 50 transactions in each disbursement category, as it had done with costs incurred since FY 2007 when it was performing annual audits in each category. As the risk of unallowable costs may change from year to year, we suggest that Internal Audit, in coordination with the Contracting Officer, continue to assess and validate whether the rotational transaction testing strategy provides for adequate audit coverage of incurred costs.

- Audit Report on [*Lawrence Livermore National Security, LLC Costs Claimed under Department of Energy Contract No. DE-AC52-07NA27344 for Fiscal Year 2015*](#) (DOE-OIG-18-12, December 2017). Based on our audit, we questioned costs totaling \$1,262,454.77, identified weaknesses in internal controls, and identified weaknesses in Lawrence Livermore National Security, LLC's (LLNS) Internal Audit (Internal Audit) procedures. Except for the reported questioned costs and internal control weaknesses, nothing came to our attention to indicate that other costs incurred by LLNS were not allowable. Also, based on our review of Internal Audit's work, we determined that it could be relied upon in the select areas reviewed and identified minor questioned costs of \$725.68. We did, however, identify internal control weaknesses in LLNS' accounting system that had not previously been reported by Internal Audit. Those weaknesses included LLNS' management of its Strategic Partnership Project cost overruns and underruns and unallowable costs. This occurred because LLNS did not properly follow contract terms and conditions, including the Federal Acquisition Regulation and Cost Accounting Standards. In addition, we identified two minor internal control weaknesses where LLNS did not maintain its own complete records of supplemental labor costs and demonstrated an incomplete understanding of supplemental labor cost documents. Further, LLNS did not always adhere to internal policy and contract requirements to properly allocate travel and associated labor costs to the same project(s). Finally, we identified areas that require improvement by Internal Audit in order for the Office of

Appendix 3: Prior Reports

Inspector General to continue to rely upon its work for future fiscal years under the Cooperative Audit Strategy. In our opinion, the audit procedures used by LLNS' Internal Audit did not identify certain internal control weaknesses in LLNS' cost accounting and management practices. As a result, we recommended that the Contracting Officer request an improvement plan from LLNS' Internal Audit to ensure that unallowable costs and internal control weaknesses identified in the report are properly audited in future incurred cost audits.

Appendix 4: Management Comments




Department of Energy

Washington, DC 20585

October 5, 2021

MEMORANDUM FOR: TERI L. DONALDSON
INSPECTOR GENERAL

FROM: CHRISTOPHER S. JOHNS
ACTING CHIEF FINANCIAL OFFICER 

SUBJECT: Response to CFO Recommendation in OIG Draft Report,
"UT-Battelle, LLC Costs Claimed under Department of Energy
Contract No. DE-AC05-00OR22725 for Fiscal Year 2017
(A18OR010)"

Thank you for the opportunity to review and comment on the subject draft report. The report contains one recommendation to the Acting Chief Financial Officer. We agree with the recommendation, as detailed in the enclosure.

If you have any questions regarding this response, please contact Thomas P. Griffin, Director, CFO Office of Financial Policy and Audit Resolution, at 202-586-1585.

Enclosure

Appendix 4: Management Comments

Enclosure

**Management Response
OIG Draft Report:
“UT-Battelle, LLC Costs Claimed under Department of
Energy Contract No. DE-AC05-00OR22725 for
Fiscal Year 2017 (A18OR010)”**

Recommendation #1: Issue guidance on the applicability of CAS 405, Accounting for Unallowable Costs, to Laboratory Directed Research and Development.

DOE Response: Concur

The Office of the CFO will provide guidance on the applicability of CAS 405 to Laboratory Directed Research and Development (LDRD) in planned updates to Chapter 15 of the DOE Financial Management Handbook, *Cost Accounting*. CFO guidance will reflect the specific Congressional and legislative requirements that create unique cost accounting processes for LDRD.

Estimated Completion Date: September 30, 2022

Appendix 4: Management Comments



Department of Energy

Office of Science

ORNL Site Office
P.O. Box 2008
Oak Ridge, Tennessee 37831-6269

October 20, 2021

MEMORANDUM FOR TERI L. DONALDSON
INSPECTOR GENERAL
IG-1

FROM: JOHNNY O. MOORE
MANAGER, ORNL SITE OFFICE
SC-OSO

A handwritten signature in blue ink, appearing to read "J. O. Moore", is placed next to the "FROM:" line.

SUBJECT: RESPONSE TO THE OFFICE OF INSPECTOR GENERAL (OIG) DRAFT
REPORT, *UT-BATTELLE, LLC (UT-BATTELLE) COSTS CLAIMED
UNDER DEPARTMENT OF ENERGY (DOE) CONTRACT NUMBER
DE-AC05-00OR22725 FOR FISCAL YEAR (FY) 2017*

The Office of Science (SC) Oak Ridge National Laboratory (ORNL) Site Office (OSO) appreciates the OIG interest in improving the operations of the DOE as outlined in this report. While OSO generally non-concurs with the underlying Findings, the OSO; OSO non-concurs (or non-concurs as written) with three of the six recommendations in the report and concurs (or concurs in principle) with three recommendations.

PAST OIG STATEMENT OF COST INCURRED AND CLAIMED (SCIC) ASSESSMENTS

This report contradicts DOE-OIG-18-03, *Audit Coverage of Cost Allowability for UT-Battelle, LLC During Fiscal Year 2015 Under Department of Energy Contract No. DE-AC05-00OR22725* (October 2017), which stated that:

"Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by UT-Battelle's Internal Audit could not be relied upon. We did not identify any material internal control weaknesses with the allowable cost reviews Internal Audit conducted, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing."

ORNL's Internal Audit has not changed its approach or process since the above statement.

Appendix 4: Management Comments

TERI L. DONALDSON

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October 20, 2021

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RESPONSE TO AUDIT FINDINGS AND RECOMMENDATIONS

OIG Finding 1: UT-Battelle's Management Of Indirect Costs Was Not Compliant With Federal Cost Accounting Standards (CAS)

OIG Sub-Finding 1: Year-End Variance Practice Not Compliant With CAS 418

Except for Laboratory Directed Research and Development (LDRD), OSO non-concurs with the finding. ORNL is not required to proportionally allocate rate variances back to cost objectives unless the variances are material. The OIG's application of materiality at the rate variance level is a new standard that significantly expands CAS 418.50(g)(5)(4) which states (emphasis added):

(g) *Use of preestablished rates for indirect costs.*

4. *Under paragraphs (g) (2) and (3) of this subsection **where variances of a cost accounting period are material**, these variances shall be disposed of by allocating them to cost objectives in proportion to the costs previously allocated to these cost objectives by use of the preestablished rates.*

OSO concurs with the LDRD portion of the finding and, starting in FY 2019, had ORNL change its policy to reflect the guidance the OIG is proposing.

Response to Recommendation

The OIG makes one recommendation associated with this sub-finding:

- Ensure that UT-Battelle updates its variance policy and any other policies that deliberately offset expenses or inappropriately combine funding from different congressional controls, appropriation years, and Strategic Partnership Projects. [Recommendation 2]

The criteria applied by the OIG to review variances at pool levels and final cost objectives are not required by CAS 418. CAS 418 does not require materiality assessment for year-end variance disposition at the pool variance level. As such, OSO non-concurs with the recommendation insofar as it is not necessary.

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OIG Sub-Finding 2: Unallowable Costs Not Properly Burdened

OSO non-concurs with the finding. DOE Order 413.2C, *Laboratory Directed Research and Development*, directs how to calculate the LDRD allocation base. The Order, which the OIG concurred on, was updated to reflect Congressional direction. Congress reaffirmed that direction in the FY 2021 National Defense Authorization Act. The OIG requested guidance from the Office of the Chief Financial Officer (CFO) in support of the LDRD Order to clarify this policy.

Response to Recommendation

The OIG makes one recommendation associated with this sub-finding:

- Issue guidance on the applicability of CAS 405, *Accounting for Unallowable Costs*, to LDRD. [Recommendation 1]

While OSO non-concurs on the finding, OSO supports the CFO in its efforts to develop guidance to address the applicability of CAS 405 to LDRD.

OIG Sub-Finding 3: UT-Battelle's Internal Audit Oversight Of CAS

OSO non-concurs that ORNL's Internal Audit, Office of Science Consolidated Service Center, Office of Financial Services, and the Contracting Officer (CO) have not sufficiently monitored or ensured compliance with CAS 405 and CAS 418. The comments in the draft report related to CAS 405 implied noncompliance is related to LDRD, and the contractor fully complies with the DOE order. ORNL has applied a materiality consideration for CAS 418 that is consistent with CAS.

OIG Finding 2: UT-Battelle did not always fulfill its contractual requirement to audit subcontracts where costs incurred were a factor in determining the amount payable to the subcontractor

In the DOE OIG report, OAS-V-13-11, *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC under Department of Energy Contract No. DE-AC05-00OR22725 during Fiscal Year 2010*, the OIG noted that "...some (contractors) use a risk-based approach to selecting subcontracts for audit. Although not in specific compliance with UT-Battelle's contract and the IA Implementation Design, we believe that such a risk-based approach is reasonable given existing resource constraints." As a result, UT-Battelle developed a risk-based approach for

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subcontract audit that was approved by DOE that ensures all subcontracts in the population are reviewed as part of the risk-based process. The OIG accepted this approach in subsequent SCIC assessments with the most recent assessment report, DOE-OIG-18-03, *Audit Coverage of Cost Allowability for UT-Battelle, LLC During Fiscal Year 2015 Under Department of Energy Contract No. DE-AC05-00OR22725*, issued in FY 2018 which is after the FY 2017 period that is currently being audited. The report states, "In audits performed since our last assessment, Internal Audit questioned \$44,171 in costs, which had all been resolved. Additionally, we found that UT-Battelle conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor and had resolved all costs questioned in those audits."

Response to Recommendation

The OIG makes one recommendation associated with this finding:

- We recommend that the Manager, ORNL Site Office, direct the Contracting Officer to conduct a risk assessment of FY 2017 time and materials contracts and fixed-priced contracts containing flexibly priced components to determine the appropriate audit coverage necessary and arrange for those audits to be conducted. [Recommendation 6]

OSO non-concurs with this recommendation. Subcontract audit is work within the contract's scope; conducting a risk assessment is the method of performance the contractor employs. Risk assessment conducted as part of M&O subcontract audit is not a federal function.

Other Significant Findings

The OIG identifies several other significant findings in its report.

Finding A: Real Estate Transactions Not Approved by Department

OSO non-concurs with the finding. The DOE entity responsible for oversight of the contractor liable for the lease approved the Washington, DC lease referenced in the report. As such, there is no need for a secondary DOE review to assess lease agreements previously approved for the ORNL contractor. Because the cognizant DOE authority approved the lease, there is no basis for questioning the \$76,176 for lease costs. Likewise, because OSO reviewed each facility improvement, a duplicative review would have delayed mission delivery; there is no basis for

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questioning the \$3,656,881 in lease improvement costs. OSO supports efficient government operations, not the OIG's implied recommendation that DOE duplicate effort.

Response to Recommendation

The OIG makes one recommendation associated with this finding:

- Ensure that actions related to real estate are approved by appropriate Department personnel. [Recommendation 4]

While OSO non-concurs with the finding, OSO concurs with the recommendation and will evaluate the current ORNL tenant improvement approval process and ensure that actions are approved appropriately. This review will be completed within one year of the draft report being issued in final form.

Finding B: Subcontract Costs might not be allocable to Prime Contract

OSO non-concurs with this finding. The OIG identified ORNL incurred costs for work that the National Nuclear Security Administration explicitly specified in a work authorization that OSO subsequently accepted. Without that work authorization, the funding would not have been obligated on the contract, the work authorized, and the expenses incurred. Since ORNL specifically incurred the costs for the contract, the costs are allocable to the contract under Federal Acquisition Regulation (FAR) 31.201-4, which provides that a cost is allocable to a government contract if incurred specifically for the contract.

Finding C: Inadequate supporting documentation for subcontract costs

The \$30,577 in question was not for a staff augmentation subcontract. Rather, it was a modification to a performance-based subcontract to provide cafeteria and catering services at ORNL. The services in question are largely event catering over and above the cafeteria services provided for employees. Selection by the contractor of the cafeteria subcontractor for these events is generally informed by competitive market pricing. The contractor was able to determine that the amount was reasonable based on prior negotiations and planning for this modification. Please note OSO's response to the associated portion of the general recommendation on questioned costs.

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Finding D: Unallowable cost related to legal settlement

As noted in the report, UT-Battelle took action to reimburse the Department \$12,500 for costs related to these legal settlements. Please note OSO's response to the general recommendations below with respect to tracking and recovering unallowable costs.

Finding E: Insufficient Documentation for Use of Rental Cars

As noted in the report, ORNL's Internal Audit issued report IA2019-10, *Allowable Cost Review - Travel*, which recommended that management determine the allowability of the costs, as well as implement/enhance controls (e.g., require justification to be documented and approved) needed to reasonably ensure that costs related to rental vehicles were only reimbursed in accordance with FAR and UT-Battelle's travel policy. As a result, UT-Battelle updated its travel policy and reimbursed the Government for costs determined unallowable. Please note OSO's response to the general recommendations below with respect to tracking and recovering unallowable costs.

Finding F: Independent peer reviews not performed

OSO non-concurs with the finding. ORNL's Internal Audit Implementation Design, Revision 4, issued in January 2017 and subsequently approved by the CO, fully described that the external peer review for FY 2012 had been conducted through the self-assessment with independent validation approach, and a copy of the external peer review report was attached. Moreover, the DOE OIG reviewed the 2012 external peer review report in its SCIC assessments conducted for FYs 2013, 2014, and 2015, and accepted this approach. Further, OIG has expressed concerns with the Cooperative Audit Strategy and recommended that the Department transition away from that strategy, which includes the current criteria for peer reviews.

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Response to General Recommendations

The OIG makes two recommendations associated with multiple findings:

OIG General Recommendation 3: Determine the allowability of costs questioned in this report, as summarized in Appendix 2, and recover any amounts deemed unallowable.

OSO non-concurs with the recommendation related to questioned costs.

Positive and Negative Variance: The contractor's current policies already consider all final cost objectives regardless of funding source. The contractor demonstrated to the OIG during the audit that pooled indirect costs are allocated to cost objectives in reasonable proportion to the beneficial or causal relationship to ensure consistency with CAS 418-40(c). Accordingly, it is OSO's position that the report has not established a basis to question the \$20,806,240 Positive Variance or (\$11,138,206) Negative Variance costs in the draft report's Appendix II.

Lease Costs and Lease Improvement Costs: OIG is recommending DOE duplicate effort. The Washington DC lease was approved through the DOE entity responsible for oversight of the contractor responsible for the lease. As such, there is no need for DOE to also review the access agreement to that previously approved lease for the ORNL contractor. Because the lease was approved through the cognizant DOE authority, there is no basis to question the \$76,176 for lease costs. Likewise, because ORNL facility improvement costs were incurred after the review of each project by OSO, a duplicative review would have delayed mission delivery, and there is no basis to question the \$3,656,881 in lease improvement costs. OSO has committed to review the current process in response to the draft report's Recommendation 4.

Indirect Cost Burden for Unallowable Costs: DOE O 413.2C states that the maximum funding level is based on 6% of the total operating and capital equipment budget of a DOE laboratory for the year. To ensure compliance with the statutory 6% limit, LDRD costs must be allocated to the same base that is used to calculate the LDRD budget for the year. The base that is used to calculate the LDRD budget for the year as required in the Order is the operating and capital equipment budget, which does not include unallowable costs. If the base used to determine the LDRD funding level included unallowable costs, but the base does not, the LDRD funding level would exceed the maximum level established by Congress and would violate law because the funding level must be based on funds made available by DOE. OSO does not have authority to direct the contractor to violate the law. Accordingly, the draft report does not demonstrate a basis to question \$33,815 related to LDRD burdens to unallowable costs.

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Staff Augmentation: As noted above, the \$30,577 in question was not for a staff augmentation subcontract. Rather, it was a modification to a performance-based subcontract to provide cafeteria and catering services at ORNL. The services in question are largely event catering over and above the cafeteria services provided for employees. Selection by the contractor of the cafeteria subcontractor for these events is generally informed by competitive market pricing. The contractor was able to determine that the amount was reasonable based on prior negotiations and planning for this modification.

Allocability of Subcontract Costs: The costs at issue are direct costs identified specifically with and incurred to support a specific work authorization from NNSA, accepted by OSO, and issued under the UT-Battelle prime contract with DOE. Without that work authorization, these expenses would not have been incurred. These costs were incurred in supporting the work and are correctly billed to the work authorization. Since the costs were incurred specifically for the contract, the costs are allocable to the contract pursuant to FAR 31.201-4 which provides that a cost is allocable to a government contract if it is incurred specifically for the contract.

Subcontract Audits: In the FY 2010 OIG SCIC report, issued in June 2013, OIG noted that some contractors use a risk-based approach to selecting subcontracts for audit. The OIG believed that such a risk-based approach was reasonable given existing resource constraints. As a result, the contractor developed a risk-based approach for subcontract audits approved by SC in consultation with OIG auditors based in Oak Ridge. The OIG accepted this approach in subsequent SCIC reviews, with the most recent OIG SCIC review of ORNL, DOE OIG 18-13, Audit Coverage of Cost Allowability for UT-Battelle, LLC During Fiscal Year 2015 Under Department of Energy Contract Number DE-AC05-00OR22725 (October 2017), after the FY that is the subject of this report. The October 2017 report stated that OIG found that UT Battelle conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor and had resolved all costs questioned in those audits.

OSO is also concerned that the OIG asserts quantifiable risks while relying only on an alternative assessment of those risks conducted by ORNL. The OIG solely lists a review of policies and procedures related to these costs. An analysis of processes alone is an insufficient basis to consider an entire category of costs unresolved (see draft report Appendix II, \$379,443,516 marked as unresolved concerning subcontract audits). Further, the OIG's conclusions conflict with OIG's own employed standard that non-statistical sampling cannot be projected to an entire population of costs.

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OIG General Recommendation 5: Implement a suitable method to track unallowable costs and ensure that those amounts are recovered.

OSO concurs with the Recommendation related to tracking unallowable cost recovery. In the future when unallowable costs are identified, OSO will ensure that unallowable costs are tracked and recovered when the CO transmits a final decision as described in FAR 33.211. By June 30, 2022, OSO will complete this action for cost allowability determinations beginning October 1, 2021.

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