

United States Government

Department of Energy

memorandum

DATE: July 23, 2009

Audit Report Number: OAS-L-09-11

REPLY TO: IG-32 (A09LL012)
ATTN OF:

SUBJECT: Audit of Implementation of the Cooperative Audit Strategy by National Nuclear Security Administration Managed Contractors

TO: Director, Office of Acquisition and Supply Management, NA-63
Director, Office of Field Financial Management, NZ
Acting Director, Policy and Internal Controls Management, NA-66

INTRODUCTION AND OBJECTIVE

The Cooperative Audit Strategy (Strategy) was developed by the Office of Inspector General (OIG) in consultation with the Office of the Chief Financial Officer (CFO), the Office of Procurement and Assistance Management, and the Contractor Internal Audit Council. The Strategy was developed in response to a 1992 Inspector General (IG) report which found that the quality of the Management and Operating (M&O) contractors' internal audit functions work was inconsistent and unsatisfactory and could not be relied upon as part of the Department of Energy's (Department) internal control structure. Since its implementation in 1992, the Strategy's objective has been to maximize the overall audit coverage of contractors, including coverage of the costs incurred by contractors in managing and operating the Department's facilities.

The Strategy identifies the expectations for M&O contractors' internal audit organizations to plan, perform, and report on their audit activities in accordance with recognized professional standards. The Strategy requires contractors to develop an Internal Audit Implementation Design and to annually provide Audit Plans and an Annual Audit Report. These requirements were added to *Department of Energy Acquisition Regulation* 970.5203-1, Management Controls, and 970.5232-3, Accounts, Records, and Inspections. Further, the Strategy, through Acquisition Letter 2005-04, became a contractual requirement after November 2004 upon modification of the M&O contracts during fee negotiations or new solicitations. The Department revised the Acquisition Guide, Chapter 70.4, *Cooperative Audit Strategy*, to provide guidance for implementing the Strategy.

According to the Acquisition Guide, the Department's contracting officers, in conjunction with the OIG and CFO are responsible for monitoring the M&O contractor's performance under the Strategy. The OIG periodically assesses, during its review of controls over costs reported on the Statement of Costs Incurred and Claimed, the reliability of the work performed by each M&O contractor's internal audit function. The assessments evaluate the quality of internal audit's work and provide the basis for a conclusion about whether the work of internal audit can be relied upon by the IG.

The objective of this audit was to provide an assessment of the effectiveness of seven major M&O contractors, managed by the National Nuclear Security Administration (NNSA), in implementing the requirements of the Strategy. Contractors managed by the Department's Office of Science, Environmental Management, and Energy Efficiency and Renewable Energy were not included in this review but were the subject of a separate review, the results of which were reported to the Department's Procurement Executive in our "Report on Effectiveness in Implementing the Cooperative Audit Strategy" (OAS-L-09-08, June 2009).

CONCLUSIONS AND OBSERVATIONS

The NNSA M&O contractors that we reviewed had, for the most part, effectively implemented the requirements of the Strategy. We concluded that, generally, the Strategy was meeting its overall goal of improving accountability of NNSA contractors. At a limited number of sites, however, we found that contractors had not fully satisfied all requirements set forth in the Strategy implementation guidance. While worthy of discussion and resolution, these issues standing alone were not by themselves sufficient to affect our overall conclusion on the effectiveness of the Strategy. Our testing identified the following issues with certain contractors. Specifically, we noted that certain contractor internal audit departments did not always provide details in their Annual Reports on their sampling methods, allowable cost audit methodology, or audit finding resolution process.

In addition, one internal audit department had not prepared an Implementation Design because the contractor rejected the Department's attempt to add the revised audit clause to its contract. The contracting officer was not aware the revised audit clause was a standard financial management clause and that it was required in all M&O contracts. The contracting officer stated that the revised clause would be added to the next contract. With the exception of the one Implementation Design, we found that the contractor generally addressed the required attributes of the Strategy.

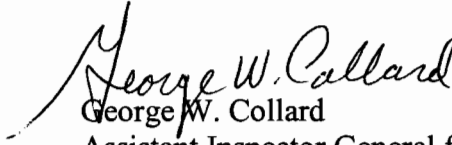
We also identified several issues regarding subcontract cost audits. For example, we identified that subcontract costs were not always closed out; questioned subcontract costs were not resolved in a timely manner; and potentially non-independent procurement groups were conducting subcontract cost audits. The subcontract issues were not sufficiently material to affect our overall conclusion about the efficacy of the Strategy.

SUGGESTION FOR IMPROVEMENT

To facilitate the Strategy's continued success, we suggest that the Director, Office of Field Financial Management, in conjunction with the Director for the Office of Acquisition and Supply Management, and the Contracting Officers at each site, take action to ensure that contractors comply with all requirements of the Strategy as part of the M&O contractor performance and evaluation process.

Specific information regarding our findings was discussed with each internal audit director or manager, and the cognizant contracting officer during the course of our review.

We appreciate the cooperation of your staff during our review. Because no formal recommendations are being made in this report, a formal response is not required.


George W. Collard
Assistant Inspector General for
Performance Audits
Office of Inspector General

cc: Chief of Staff
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SCOPE AND METHODOLOGY

This audit was performed between November 2008 and April 2009. Our audit included reviewing the Internal Audit activities at seven of the NNSA's M&O contractors for Fiscal Years 2006 through 2008. The seven M&O contractors were from the following sites: Lawrence Livermore National Laboratory; Los Alamos National Laboratory; Sandia National Laboratories; the Nevada Test Site; the Pantex Plant; the Kansas City Plant; and the Y-12 National Security Complex.

To accomplish the audit objective, we:

- Reviewed applicable laws, regulations and Departmental Guidance pertaining to the Strategy;
- Reviewed prior audit plans and annual reports prepared by the internal audit functions;
- Reviewed the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing regarding the operation of an internal audit activity;
- Obtained and reviewed documentation and information from NNSA M&O contractors in response to a questionnaire about their application of the Strategy; and,
- Interviewed Departmental site office contracting officers regarding internal audit staff size and the effectiveness of the Strategy.

This performance audit was conducted in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit included tests of controls and compliance with laws and regulations necessary to satisfy 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. Also, we considered the establishment of performance measures in accordance with the Government Performance and Results Act of 1993 as they related to the audit objective; however, we did not identify any measures related to the Cooperative Audit Strategy. We did not rely on computer-processed data in order to accomplish our audit objective.

Department officials waived an exit conference.