



OFFICE OF INSPECTOR GENERAL
U.S. Department of Energy

ASSESSMENT REPORT

OAI-V-17-05

July 2017

**AUDIT COVERAGE OF COST ALLOWABILITY
FOR CONSOLIDATED NUCLEAR SECURITY
LLC DURING JULY 1, 2014, THROUGH
SEPTEMBER 30, 2015, UNDER DEPARTMENT
OF ENERGY CONTRACT NO. DE-NA-0001942**



Department of Energy
Washington, DC 20585

July 20, 2017

MEMORANDUM FOR THE MANAGER, NATIONAL NUCLEAR SECURITY
ADMINISTRATION PRODUCTION OFFICE

A handwritten signature in black ink, appearing to read "Debra K. Solmonson".

FROM: Debra K. Solmonson
Deputy Assistant Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on "Audit Coverage of Cost Allowability for Consolidated Nuclear Security LLC during July 1, 2014, through September 30, 2015, under Department of Energy Contract No. DE-NA-0001942"

BACKGROUND

Since July 1, 2014, Consolidated Nuclear Security LLC (CNS) has managed and operated the Y-12 National Security Complex and Pantex Plant under contract with the Department of Energy. Both the Y-12 National Security Complex and the Pantex Plant are part of the Department's National Nuclear Security Administration, which has responsibilities that include ensuring the safety, security, and effectiveness of the nation's nuclear weapons stockpile. During the period of July 1, 2014, through September 30, 2014, and fiscal year (FY) 2015, CNS incurred and claimed costs of \$396,655,647 and \$1,640,090,371, respectively on its FY 2014 and FY 2015 statements of costs incurred and claimed.

As an integrated management and operating contractor, CNS' financial accounts are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. CNS is required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and to claim only allowable costs. Allowable costs are incurred costs that are reasonable, allocable, and in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

The Department's Office of Inspector General, Office of Acquisition Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy to make efficient use of available audit resources while ensuring that the Department's contractors claim only allowable costs. This strategy places reliance on the contractors' internal audit function (Internal Audit) to provide audit coverage of the

allowability of incurred costs that are claimed by contractors. Consistent with the strategy, CNS is required by its contract to maintain an Internal Audit activity with the responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, CNS is required to conduct or arrange for audits of its subcontractors when costs incurred are a factor in determining the amount payable to a subcontractor. To help ensure that audit coverage of cost allowability was adequate for the period of July 1, 2014, through September 30, 2015, the objectives of our assessment were to determine whether:

- Internal Audit conducted cost allowability audits that complied with professional standards and could be relied upon;
- CNS conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- CNS adequately resolved questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews.

RESULTS OF ASSESSMENT

Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by CNS' Internal Audit for the period of July 1, 2014, through September 30, 2015, could not be relied upon. We did not identify any material internal control weaknesses with the cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. During the period under review, Internal Audit identified questioned costs totaling \$36,706 in its cost allowability audits, all of which had been resolved. Additionally, we found that CNS conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. Internal Audit conducted 27 audits of subcontractors, identifying \$13,993,275 in questioned costs and two control weaknesses, all of which had been resolved. We noted that costs totaling \$1,482,161 for FY 2013 and \$517,604 for FY 2014 questioned in our previous report, *Assessment of Audit Coverage of Cost Allowability for Babcock and Wilcox Technical Services Y-12 LLC During Fiscal Years 2013 and 2014 Through June 30, 2014, Under Department of Energy Contract No. DE-AC05-00OR22800 (OAS-V-15-05)*, had been resolved. Finally, we determined that Internal Audit did not test executive compensation costs for allowability. As such, we consider \$4,012,957, the total compensation of CNS executives charged to the contract for the period under review, unresolved pending audit. This did not adversely affect our ability to rely on Internal Audit's work.

Executive Compensation Testing

Internal Audit did not perform testing to ensure that compensation of executives was approved and did not exceed applicable limits. The CNS audit program for the allowable cost audit requires Internal Audit to review the contract to determine expressly unallowable costs, costs with contractual limitations, and costs requiring Department approval. We found that CNS' contract includes a requirement for Contracting Officer approval of compensation and imposes limitations on executive compensation. Internal Audit performed payroll testing each FY as part

of the allowable cost audit, including statistical sampling of all employees. However, according to Internal Audit officials, executives were not selected as part of the sample. Internal Audit personnel stated that although they were aware that limits existed for executive compensation, a separate review of executive compensation was likely not conducted due to the low error rate observed during overall payroll testing. Internal Audit stated that due to our questioning, additional testing of executive compensation was performed in the FY 2016 allowable cost audit and would be included in future allowable cost audits, as appropriate. The additional testing performed in the FY 2016 allowable cost audit did not result in any findings related to executive compensation. In addition, Internal Audit anticipated that testing of executive compensation for the period from July 1, 2014, through September 30, 2015, would be completed by July 31, 2017. Due to the lack of sufficient executive compensation testing, we consider \$4,012,957, the total compensation of CNS executives charged to the contract for the period under review, unresolved pending audit.

RECOMMENDATION

We recommend that the Manager, National Nuclear Security Administration Production Office, direct the Contracting Officer to ensure CNS completes testing of executive compensation costs incurred from July 1, 2014, through September 30, 2015, and includes specific testing of executive compensation in future allowable cost audits.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management concurred with the report and recommendation. Management estimated that testing of executive compensation costs incurred from July 1, 2014, through September 30, 2015, would be completed by July 31, 2017. Management also stated that CNS included testing of executive compensation in the FY 2016 allowable cost audit, which did not result in any findings; and CNS would continue to audit those costs in future years. As noted in the report, we confirmed CNS' efforts to audit FY 2016 executive compensation. We consider Management's recent and planned actions to be responsive to our recommendation. Management Comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from September 2016 to July 2017, at the Y-12 National Security Complex, located in Oak Ridge, Tennessee; and the Pantex Plant, located in Amarillo, Texas. The assessment was limited to Internal Audit's activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that impact costs claimed by CNS on its Statements of Costs Incurred and Claimed for July 1, 2014, through September 30, 2015. The assessment was conducted under Office of Inspector General project number A16OR068.

To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit that included a review of allowable cost audit reports, work papers, auditor qualifications, independence, audit

planning, including risk assessments, and overall internal audit strategy, and compliance with applicable professional auditing standards, we also conducted interviews of auditors;

- Reviewed policies, procedures, and practices to identify subcontracts requiring audit and arrange for audits;
- Assessed subcontract audit status; and
- Evaluated resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Internal Audit, and other organizations.

We conducted our assessment in accordance with generally accepted Government auditing standards for attestation engagements. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objectives. 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. Also, 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. We relied on computer-processed data to accomplish our audit objectives. Based on recent reviews of Y-12 National Security Complex and Pantex Plant information technology controls performed by KPMG LLP on behalf of the Office of Inspector General, we determined that data was sufficiently reliable for the purposes of the review. An exit conference was waived on June 27, 2017.

This report is intended for the use of Department and National Nuclear Security Administration contracting officers and field offices in the management of their contracts and is not intended to be and should not be used by anyone other than these specified parties.

Attachments

PRIOR REPORT

Assessment report on [*Audit Coverage of Cost Allowability for Babcock and Wilcox Technical Services Y-12 LLC During Fiscal Years 2013 and 2014 Through June 30, 2014, Under Department of Energy Contract No. DE-AC05-00OR22800*](#) (OAS-V-15-05, September 2015).

Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Babcock and Wilcox Technical Services Y-12 LLC's (B&W Y-12) Internal Audit could not be relied upon. We did not identify any material internal control weaknesses with the cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. For fiscal years 2014 through June 30, 2014, we noted that \$761 in questioned costs had not been resolved, so we questioned this amount. We also found that B&W Y-12 conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to subcontractors. The subcontract audits identified questioned costs totaling \$3,223,992, of which all but \$1,516,033 had been resolved. Thus, we questioned this amount. In addition to the subcontract audits conducted by B&W Y-12, an audit conducted by the Defense Contract Audit Agency identified questioned costs of \$482,971 that remained unresolved. The costs were incurred during calendar years 2005 and 2006 and related to field and home office general and administrative expenses. Because the audit included subcontracts with B&W Y-12 as well as other contractors, the Contracting Officer was unable to provide the amount of questioned costs that pertained to the B&W Y-12 contract. We recommended that the Manager, National Nuclear Security Administration Production Office, direct the Contracting Officer to make a determination regarding the allowability of questioned costs identified by B&W Y-12 Internal Audit and the Defense Contract Audit Agency, and recover those amounts determined to be unallowable.

MANAGEMENT COMMENTS

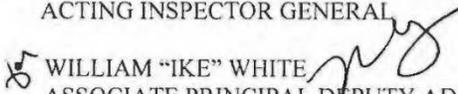


Department of Energy
National Nuclear Security Administration
Washington, DC 20585



June 7, 2017

MEMORANDUM FOR APRIL STEPHENSON
ACTING INSPECTOR GENERAL

FROM:  WILLIAM "IKE" WHITE
ASSOCIATE PRINCIPAL DEPUTY ADMINISTRATOR
AND CHIEF OF STAFF

SUBJECT: Comments on the Office of Inspector General Draft Report
Titled *Audit Coverage of Cost Allowability for Consolidated
Nuclear Security, LLC, [CNS] During
July 1, 2014, Through September 30, 2015*
[NNSA-2017-001126/A16OR068]

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the auditors' validation of CNS' internal audit work and recognition of their proactive efforts to self-identify questioned costs. The National Nuclear Security Administration (NNSA) concurs with the report's recommendation that CNS complete testing of executive compensation costs incurred from July 1, 2014, through September 30, 2015. The estimated completion date is July 31, 2017.

As noted in the report, CNS included testing of executive compensation in the fiscal year (FY) 2016 allowable cost audit, and will continue to audit those costs in future years. There were no findings related to executive compensation in the FY 2016 audit.

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

