



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-19-02

October 2018

**AUDIT COVERAGE OF COST
ALLOWABILITY FOR BATTELLE
MEMORIAL INSTITUTE UNDER ITS
CONTRACT TO MANAGE THE PACIFIC
NORTHWEST NATIONAL LABORATORY
DURING FISCAL YEARS 2015 AND 2016
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-AC05-76RL01830**



Department of Energy
Washington, DC 20585

October 23, 2018

MEMORANDUM FOR THE MANAGER, PACIFIC NORTHWEST SITE OFFICE

FROM: Bruce Miller
Assistant Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on the “Audit Coverage of Cost Allowability for Battelle Memorial Institute Under its Contract to Manage the Pacific Northwest National Laboratory During Fiscal Years 2015 and 2016 Under Department of Energy Contract No. DE-AC05-76RL01830”

BACKGROUND

Since 1965, Battelle Memorial Institute (Battelle) has operated the Pacific Northwest National Laboratory under contract with the Department of Energy. This Laboratory, as part of the Department’s Office of Science, performs research and innovations in the areas of environmental protection and cleanup, energy resources, and national security. The Laboratory is managed under a performance-based management contract through September 30, 2022. During fiscal years (FYs) 2015 through 2016, Battelle expended and claimed costs totaling \$1.7 billion. The following table illustrates Battelle’s annual costs during the period:

Fiscal Year	Incurred and Claimed Costs
2015	\$876,690,180.91
2016	\$842,584,627.69
Total	\$1,719,274,808.60

As a management and operating contractor, Battelle’s financial accounts are integrated with those of the Department, and the results of transactions are reported monthly according to a uniform set of accounts. Battelle 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 allowable in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

To help ensure only allowable costs are claimed by the Department's integrated contractors and to make efficient use of available audit resources, the Office of Inspector General, the Department's Office of Acquisition Management, the integrated management and operating contractors, and other select contractors have implemented a Cooperative Audit Strategy. This strategy places reliance on the contractors' internal audit function to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the Cooperative Audit Strategy, Battelle is required by its contract to maintain an internal audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, Battelle 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. During FYs 2015 through 2016, Battelle's Business Systems Directorate was responsible for pre-award and post-award subcontract audits.

To help ensure that audit coverage of cost allowability was adequate during FYs 2015 through 2016, the objectives of our assessment were to determine whether:

- Battelle's Internal Audit (Internal Audit) conducted cost allowability audits that complied with professional standards and could be relied upon;
- Battelle conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- Questioned costs and internal control weaknesses impacting allowable costs that were identified in prior audits and reviews have been adequately resolved.

RESULTS OF ASSESSMENT

Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Internal Audit for FYs 2015 through 2016 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing (IIA Standards). During FYs 2015 and 2016, Internal Audit identified \$577,325.68 in questioned costs. With the exception of the \$182,301.55 in parking-related costs, all questioned costs have been resolved. However, we identified the following issues that need to be addressed to ensure that only allowable costs are claimed by and reimbursed to the contractor. Specifically:

- Although we ultimately determined that we could rely on Internal Audit's work, due to the timing of improvements implemented in its FY 2016 audit files, we noted that work papers from FY 2015 audit reports did not always include adequate documentation of supervision. For example, work papers did not support supervision of audit work before report issuance. This issue was also raised in our prior Assessment Report, *Audit Coverage of Cost Allowability for Battelle Memorial Institute Under its Contract to Manage the Pacific Northwest National Laboratory During Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE-AC05-76RL01830* (OAI-V-17-04, May 2017). When we brought this to Internal Audit's attention during the FY 2013 –

FY 2014 assessment, corrective actions were put in place. However, these were instituted after the FY 2015 audit reports were issued. In our review of FY 2016 audit reports, work papers were reviewed before the issuance of the audit report.

- Although we ultimately determined that we could rely on Internal Audit's work, Internal Audit did not always document all potential impairments to auditor independence and objectivity. This issue was also raised in our prior May 2017 Assessment Report. In two out of the seven cost allowability audits we reviewed, an auditor did not document previous employment as a Business Manager during which he had purview of purchase card and travel transactions within 1 year prior to joining Internal Audit and working on the FY 2016 purchase card and travel audits.
- We identified a weakness in the implementation of Battelle's risk-based approach. Specifically, we found that for 18 of the 23 cost-type subcontracts, the Contracts Specialist did not submit a request for the Cost/Price Advocacy Group to conduct and provide documentation of a risk-based approach analysis.

Audit Documentation

Although we ultimately determined that we could rely on Internal Audit's work, we found instances where Internal Audit's FY 2015 work papers did not always contain sufficient documentation of supervision and independence. This issue was also identified in our FY 2013 – 2014 assessment. Specifically, in some cases, the Internal Audit work papers did not support supervision of audit work prior to report issuance. For example, in three of the four FY 2015 Allowable Cost audits, many of the work papers were not reviewed in the official internal audit documentation system until after the report was issued. In one of the audit reports from FY 2015 that we reviewed, all of the 276 fieldwork work papers were documented as being reviewed after the audit report had been issued. As required by IIA Standards, engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed. However, when we brought this to Internal Audit's attention in the FY 2013 – 2014 assessment, corrective actions were put in place. For the audit reports we reviewed for FY 2016, work papers were reviewed before Internal Audit issued the audit reports. Our future assessment of FY 2017 will fully evaluate the effectiveness of the corrective actions to demonstrate audit supervision.

Internal Audit did not always document all potential impairments to auditor independence and objectivity. In two of the seven cost allowability audits we reviewed, an auditor did not document previous employment as a Business Manager during which he had purview of purchase card and travel transactions within 1 year prior to joining Internal Audit and working on the FY 2016 Purchasing, Labor, and Other Costs, and Benefits allowable costs audits. This is a recurring issue that was also identified in our prior May 2017 Assessment Report. According to IIA Standards, "Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year."

In discussions with Internal Audit, officials stated that they were aware of the auditor's previous employment, had discussed appropriate assignments for the auditor because of the previous employment, and the auditor had completed a conflict of interest statement attesting that there was not a conflict of interest. However, Internal Audit did not document the auditor's prior employment on the conflict of interest form, nor did it document that a discussion about the potential conflict of interest took place. Although we did not find instances when the auditor reviewed his own prior work, we are concerned that the potential conflict of interest was not fully disclosed. We concluded that Internal Audit's controls over documenting conflicts of interest, especially documenting conversations regarding potential conflicts of interest, could be strengthened in this area.

Effectiveness of Battelle's Risk-Based Approach for Interim Subcontract Audits

We determined that Battelle's risk-based audit approach was generally effective in determining which subcontracts may require periodic post-award or interim audits. However, we identified a weakness with the implementation of the approach. Specifically, we found that for 18 of the 23 cost-type subcontracts reviewed, the Contracts Specialist did not submit a request for the Cost/Price Advocacy Group to conduct and provide documentation of a risk-based approach analysis, as required per the risk-based approach. Per Acquisition Guide 31, cost-type subcontracts where a burden is to be reimbursed at cost, which are not covered by Office of Management and Budget Circular (OMB) A-133, a risk-based approach shall be deployed to determine when interim annual audits shall be conducted. At the end of the first year of a subject subcontract, and annually thereafter during the life of the contract, the Contracts Specialist will submit a request for the Cost/Price Advocacy Group to conduct and provide documentation (a report) of a risk-based approach analysis. However, this did not always occur due to reasons such as inadvertent oversight and a misunderstanding of the requirement by the Contracts Specialist. We briefed Battelle Contracts Management, and they agreed with our assessment.

RECOMMENDATIONS

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

1. Strengthen Internal Audit's process to ensure potential impairments and conflicts of interest are properly documented; and
2. Develop guidance to ensure Contracts Specialists follow Acquisition Guide 31 procedures for cost-type subcontracts.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management agreed with the findings, concurred with the recommendations, and proposed planned corrective actions that were responsive to our recommendations.

Management's comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from March 2018 to October 2018 at Battelle's Pacific Northwest National Laboratory, located in Richland, Washington. The assessment was limited to Internal Audit's activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affect costs claimed by Battelle on its Statement of Costs Incurred and Claimed for FYs 2015 through 2016. This assessment was conducted under the Office of Inspector General Project Number A18RL025.

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;
- Conducted interviews with Department and Laboratory personnel;
- Reviewed policies, procedures, and practices for identifying subcontracts that require audit and arranging such audits;
- From a universe of 2,866 records of subcontracts that had been awarded, active, or closed in FYs 2015 through 2016, we judgmentally selected 31 subcontracts to determine if they contained pre-award, post-award, and closeout documentation. We also reviewed the selected subcontracts to determine whether the pre-award analyses included a documented risk-based process to identify subcontracts requiring periodic post-award and interim audits. Sample selection was judgmental based on subcontract type, dollar value, and vendor frequency; and
- Evaluated the 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 an 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 objectives. We determined that the computer-processed data was sufficiently reliable for the purposes of the review by comparing the data to source documents.

Management waived an exit conference on October 2, 2018.

This report is intended for the use of the Department 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 REPORTS

- Assessment Report on [*Audit Coverage of Cost Allowability for Battelle Memorial Institute Under its Contract to Manage the Pacific Northwest National Laboratory during Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE-AC05-76RL01830*](#) (OAI-V-17-04, May 2017). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Battelle Memorial Institute's (Battelle) Internal Audit could not be relied upon. Although we ultimately determined that we could rely on Battelle's Internal Audit work, we noted that work papers did not always include sufficient documentation. Battelle did not always conduct periodic post-award or interim audits of subcontracts. Additionally, we noted that Battelle did not have a documented risk-based approach for conducting periodic post-award or interim audits of cost reimbursement subcontractors in effect during fiscal year (FY) 2013 and most of FY 2014. We recommended that the Manager, Pacific Northwest Site Office, direct the Contracting Officer to ensure that Battelle's Internal Audit maintains sufficient documentation of audit supervision prior to Internal Audit report issuance. Finally, we recommended that Battelle evaluate the cost-type subcontracts requiring audit for FYs 2013 and 2014, before the risk-based approach was implemented, to determine if subcontracts may be subject to an interim audit.
- Assessment Report on *Audit Coverage of Cost Allowability for Pacific Northwest National Laboratory under Department of Energy Contract No. DE-AC05-76RL01830 during Fiscal Year 2012* (OAS-V-14-15, August 2014). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Battelle's Internal Audit could not be relied upon. However, we found that Battelle did not always conduct periodic post-award or interim audits of subcontracts. Battelle also did not have a documented risk-based approach for conducting periodic post-award or interim audits of cost reimbursement subcontractors. We recommended that the Manager, Pacific Northwest Site Office, direct the Contracting Officer to ensure that Battelle followup on the implementation of its corrective action plan in response to recommendations made in our prior assessment.
- Assessment Report on *Audit Coverage of Cost Allowability for Pacific Northwest National Laboratory under Department of Energy Contract No. DE-AC05-76RL01830 during Fiscal Years 2010 and 2011* (OAS-V-14-04, January 2014). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Battelle's Internal Audit could not be relied upon. However, we found that Battelle did not always conduct periodic post-award or interim audits of subcontracts. Battelle also did not have a documented risk-based approach for conducting periodic post-award or interim audits of cost reimbursement subcontractors. We recommended that the Manager, Pacific Northwest Site Office, direct the Contracting Officer to ensure that Battelle develop and implement a documented risk assessment process for determining when subcontracts should be subject to an interim or post-award audit, as well as ensure that Battelle audits or arranges for audits of subcontracts.

MANAGEMENT COMMENTS

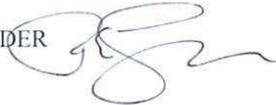


Department of Energy
Pacific Northwest Site Office
P.O. Box 350, K9-42
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OCT 09 2018

19-PNSO-0006

MEMORANDUM FOR BRUCE MILLER
ASSISTANT INSPECTOR GENERAL FOR AUDITS AND
INSPECTIONS
OFFICE OF INSPECTOR GENERAL
IG-301

FROM: ROGER E. SNYDER 
MANAGER

SUBJECT: DRAFT ASSESSMENT REPORT ON THE "AUDIT COVERAGE
OF COST ALLOWABILITY FOR BATTELLE MEMORIAL
INSTITUTE UNDER ITS CONTRACT TO MANAGE THE
PACIFIC NORTHWEST NATIONAL LABORATORY DURING
FISCAL YEARS 2015 AND 2016 UNDER DEPARTMENT OF
ENERGY CONTACT NO. DE-AC05-76RL01830"

Below is Pacific Northwest Site Office's response to the Office of Inspector General's recommendations:

Recommendation 1: We recommend that the Manager, Pacific Northwest Site Office, direct the Contracting Officer to strengthen Internal Audit's process to ensure potential impairments and conflicts of interest are properly documented.

Management Response: Concur.

Action Plan: The Contracting Officer will direct Battelle to strengthen Internal Audit's processes to ensure potential impairments and conflicts of interest are properly documented.

Estimated Completion Date: February 28, 2019

OCT 09 2019

Mr. Bruce Miller
19-PNSO-0006

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Recommendation 2: We recommend that the Manager, Pacific Northwest Site Office, direct the Contracting Officer to develop guidance to ensure Contracts Specialists follow Acquisition Guide 31 procedures for cost-type subcontracts.

Management Response: Concur.

Action Plan: The Contracting Officer will direct Battelle to develop guidance to ensure Contracts Specialists follow Acquisition Guide 31 procedures for cost-type subcontracts.

Estimated Completion Date: August 30, 2019

If you or your staff have any questions or concerns, please contact Ryan Kilbury, Contracting Officer at (509) 372-4030.

cc: N. J. Barker, ORO
E. Q. Harris, ORO
T. D. Fuller, CF-12
G. Gozum, CF-1250
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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

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