



**OFFICE OF INSPECTOR GENERAL**

U.S. Department of Energy

# AUDIT REPORT

DOE-OIG-20-06

November 2019

**BECHTEL NATIONAL, INC.'S  
SUBCONTRACT AUDIT PROGRAM**



**Department of Energy**  
Washington, DC 20585

November 12, 2019

MEMORANDUM FOR THE SECRETARY

A handwritten signature in cursive script, appearing to read "Teri L. Donaldson".

FROM: Teri L. Donaldson  
Inspector General

SUBJECT: INFORMATION: Audit Report on "Bechtel National, Inc.'s  
Subcontract Audit Program"

RESULTS IN BRIEF

We found that Bechtel National, Inc. (Bechtel), the contractor responsible for construction of the \$16.8 billion Waste Treatment and Immobilization Plant at the Department of Energy's Hanford Site, had not fulfilled its contractual requirement to audit flexibly-priced subcontracts. For example, since the start of its contract in December 2000, Bechtel had only ensured that audits had been conducted on 23 out of 110 flexibly-priced subcontracts that had received over \$1 million in funds. Further, when we reviewed the total number of years of performance for these 110 subcontracts, we found that only 102 out of 641 (16 percent) of the years of performance had been audited. Additionally, we found that many of the completed audits had not been effective or reliable. Bechtel's long-standing noncompliance with subcontract auditing requirements persisted, in part, because the Department had not always provided timely and proactive oversight of Bechtel's subcontract audit program. For example, we were unable to determine if the Department had taken active efforts prior to 2013 to monitor Bechtel's subcontract audit program from the time the contract was issued on December 2000. By not fulfilling the requirement to audit its flexibly-priced subcontracts, Bechtel increases the risk that it is passing on unallowable costs from its subcontractors to the Department.

BACKGROUND

The Waste Treatment and Immobilization Plant's mission is to treat and vitrify a majority of the 56 million gallons of waste amassed from decades of plutonium production at the Department's Hanford Site. To achieve its mission, Bechtel procures services and equipment, often using subcontractors. The Department's Office of River Protection manages the Bechtel contract while the Richland Operations Office provides administrative and financial oversight support to the Office of River Protection for Bechtel.

Many of these subcontracts are “flexibly-priced,” where the costs incurred are a factor in determining the amount payable to the subcontractor. These include Cost Reimbursable, Time & Material, and Labor Hour subcontracts. Between the start of the contract on December 11, 2000, and June 15, 2018, Bechtel paid \$1.98 billion for 392 flexibly-priced subcontracts.

For its flexibly-priced subcontracts, Bechtel’s contract with the Department contains a requirement to audit the subcontractors’ costs. Specifically, the contract includes Department of Energy Acquisition Regulation (DEAR) 970.5204-9(c), *Accounts, Records, and Inspection (May 2000)*, which requires Bechtel “to either conduct an audit of the subcontractor’s costs or arrange for such an audit to be performed by the cognizant Government audit agency through the Contracting Officer.” The Defense Contract Audit Agency typically performs audits requested through the Contracting Officer.

Several factors have led to concerns regarding the performance of subcontract audits and the associated costs. First, since 2013, the Department has had concerns about arranging for audit assistance from the Defense Contract Audit Agency due to a backlog of audits it had not been able to perform. This backlog resulted in the Defense Contract Audit Agency being prohibited from performing non-Department of Defense work for nearly a year beginning in November 2015. It also resulted in the Department formally reminding Bechtel in April 2013 of the contractual requirement to perform subcontract audits and requested Bechtel to submit audit results. Second, the *Contract Disputes Act of 1978* established a 6-year statute of limitations on the ability of the Government to make claims against a contractor. Because of these concerns, we initiated this audit to determine whether Bechtel is fulfilling its requirement to audit its flexibly-priced subcontracts.

## RESULTS OF AUDIT

We determined that Bechtel had not fulfilled the requirement within its contract to audit flexibly-priced subcontracts. Specifically, we found:

- Since the start of the contract on December 11, 2000, a significant number of flexibly-priced subcontracts have not been audited. Our audit determined that for a total of 110 subcontracts, which the subcontractor had been paid \$1 million or more in the aggregate, only 23 had been audited by either Bechtel or a cognizant Government audit agency. Additionally, each year of performance is required to be audited. When we reviewed the total number of years of performance for these 110 subcontracts, we found that only 102 out of 641 (16 percent) of the years of performance had been audited.
- Subcontract audits performed by Bechtel officials had not always been effective or reliable. In reviewing subcontract audits performed by Bechtel between April 2012 and July 2014, we found that out of the 24 subcontract audits performed, 23 stated that they were conducted in accordance with generally accepted government auditing standards. However, we noted that Bechtel’s corporate Internal Audit and the Department’s Richland Operations Office performed reviews in which they concluded that many of these audits did not fully comply with generally accepted government auditing standards and that there were deficiencies in performing the audits.

- Bechtel had not identified all flexibly-priced subcontracts that were subject to audit. In response to a Department request to determine if Bechtel had properly classified subcontracts as fixed or flexibly-priced, a Defense Contract Audit Agency audit determined that in a sample of 92 Bechtel subcontracts, 30 had not been properly identified as either fixed or flexibly-priced. Of the 30 misclassified subcontracts, Bechtel had identified 26 as fixed-priced when in fact the subcontracts were flexibly-priced.
- While Bechtel met a Department-established performance goal of completing at least 20 audits by the end of calendar year 2018, its efforts were not focused on those subcontracts that were at risk of exceeding the statute of limitations for submitting claims, as required by the Department.

Although both Bechtel and the Department have taken actions to improve the performance of subcontract audits, the issues we identified occurred because of weaknesses in Bechtel's administration of its subcontract audit program as well as deficiencies in the Department's oversight. For example, in administering its subcontract audit program, Bechtel did not develop formal policies and procedures until October 2015, and did not provide specific guidance for the audit process when developed. For those policies and procedures that were developed, Bechtel officials did not always adhere to them. Additionally, Bechtel relied upon its invoice review process to meet the audit requirements of the contract, even though the process did not address key elements needed to identify questioned and unallowable costs. Furthermore, the Department was not always timely or proactive in its oversight of Bechtel's subcontract audit program. For example, we were unable to determine if the Department had taken active efforts prior to 2013 to monitor Bechtel's subcontract audit program from the time the contract was issued on December 11, 2000. Beginning in 2017, Bechtel made efforts to have subcontract audits performed by third-party audit firms according to either generally accepted government auditing standards or the standards issued by the Institute of Internal Auditors. Additionally, the Department provided specific direction to Bechtel, established performance measures, and enforced the contract by withholding provisional fee<sup>1</sup> from the contractor. However, we have noted weaknesses in these efforts.

By not fulfilling the requirement to audit its flexibly-priced subcontracts, Bechtel increases the risk that it is passing on unallowable costs from its subcontractors to the Department. Between December 11, 2000, and June 15, 2018, Bechtel paid \$1.98 billion in costs to subcontractors with flexibly-priced contracts, yet a significant portion of these costs have not been audited. To highlight this risk, in June and July of 2018, Bechtel received final results on seven subcontract audits that identified nearly \$1.1 million in questioned costs, of which approximately \$194,000 impacted the Department through Bechtel's contract. The risk of the Department reimbursing unallowable costs is further increased by the fact that Federal statute sets a 6-year limit on the time period during which the Government can recoup questioned costs from contractors. To address the issues identified in this report, we have made three recommendations that, if fully implemented, should help ensure that Bechtel's subcontractor costs are adequately audited.

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<sup>1</sup> Provisional fee is the payment of an available fee as an incentive to a contractor for making progress toward meeting performance measures prior to making a final determination as to whether the contractor has earned the fee.

## MANAGEMENT RESPONSE

Management concurred with the report's recommendations and identified specific actions that were already in place to address them. For example, management stated that Bechtel had developed and/or revised its subcontract policies and procedures to address key requirements, had implemented its audit plan and communicated the audit requirements to all applicable employees, and that the Office of River Protection monitors Bechtel's performance.

Management's actions are responsive to our recommendations.

Attachment

cc: Deputy Secretary  
Chief of Staff  
Under Secretary for Science  
Senior Advisor for Environmental Management to the Under Secretary for Science

# BECHTEL NATIONAL, INC.'S SUBCONTRACT AUDIT PROGRAM

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# BECHTEL NATIONAL, INC.'S SUBCONTRACT AUDIT PROGRAM

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## BACKGROUND

To support construction of the Department of Energy's Waste Treatment and Immobilization Plant, Bechtel National, Inc. (Bechtel) uses subcontractors to obtain services and equipment using flexibly-priced contracts, where the costs incurred are a factor in determining the amount payable to the subcontractor. These include Cost Reimbursable, Time & Material, and Labor Hour subcontracts. Bechtel's contract contains a requirement to audit the costs on flexibly-priced subcontracts. Specifically, the contract includes Department of Energy Acquisition Regulation (DEAR) 970.5204-9(c), *Accounts, Records, and Inspection (May 2000)*, which requires Bechtel "to either conduct an audit of the subcontractor's costs or arrange for such an audit to be performed by the cognizant Government audit agency through the Contracting Officer." The Defense Contract Audit Agency (DCAA) typically performs audits requested through the Contracting Officer. Between the start of the contract on December 11, 2000, and June 15, 2018, Bechtel paid \$1.98 billion for 392 flexibly-priced subcontracts.

Several factors have led to concerns regarding the performance of subcontract audits. First, over the past several years, the Department had difficulties arranging for audits because DCAA was prohibited from performing non-Department of Defense work. Second, the *Contract Disputes Act of 1978* established a 6-year statute of limitations on the ability of the Government to make claims against a contractor.

## DETAILS OF FINDINGS

### Inadequate Subcontract Audit Coverage

Our review determined that Bechtel had not fulfilled its contract requirement to audit its flexibly-priced subcontracts. Specifically, since the beginning of its contract on December 11, 2000, a significant number of Bechtel's flexibly-priced subcontracts had not been audited. For those subcontracts previously audited by Bechtel officials, the audits were not reliable. Additionally, Bechtel had not always properly classified subcontracts as either fixed or flexibly-priced. Recently, Bechtel has revised its subcontract audit program to have audits performed by third-party audit firms, but weaknesses still exist.

### Audits Not Performed

Since the start of the contract on December 11, 2000, a significant number of flexibly-priced subcontracts have not been audited. As of June 15, 2018, Bechtel had paid \$1.98 billion for 392 flexibly-priced subcontracts. This includes \$1.94 billion spent on 110 subcontracts over \$1 million and approximately \$40 million on 282 subcontracts under \$1 million. On an individual subcontract basis, Bechtel has paid anywhere from less than \$1,000 to over \$788 million per contract. Both the Department and Bechtel established the requirement to perform audits of

subcontracts greater than or equal to \$1 million<sup>1</sup>, or any lesser dollar threshold that Bechtel determines necessary. Additionally, subcontract audits are to review each year of performance of the subcontract (i.e., auditable years<sup>2</sup>). In reviewing Bechtel's audit performance since the inception of the contract, we found that less than 16 percent (102 of 641) of the auditable years for subcontracts over \$1 million had been audited, as shown in the following table:

Subcontracts Over \$1 Million Audited

Audit Cognizance	Total Paid (as of June 15, 2018)	Total Number of Subcontracts	Total Number of Subcontracts Audited	Total Number of Auditable Years	Total Number of Auditable Years Audited
Federal	\$1.35 Billion	32	16	197	74
Bechtel	\$589 Million	78	7	444	28
<b>Total</b>	<b>\$1.94 Billion</b>	<b>110</b>	<b>23</b>	<b>641</b>	<b>102</b>

Additionally, many of these subcontracts have been closed out without audits. For the 110 subcontracts over \$1 million, 52 have been closed out of which 47 were closed without an audit, as shown in the following table:

Closed Subcontracts Over \$1 Million Audited

Audit Cognizance	Total Paid (as of June 15, 2018)	Number of Subcontracts Closed	Number of Closed Subcontracts Not Audited
Federal	\$69 Million	9	6
Bechtel	\$143 Million	43	41
<b>Total</b>	<b>\$212 Million</b>	<b>52</b>	<b>47</b>

Furthermore, although the Department has not specifically required Bechtel to perform audits of subcontracts under \$1 million, few of these contracts have been audited. Of the 282 subcontracts under \$1 million, Bechtel had audit cognizance for 239. As of June 29, 2018, Bechtel had audited only 2 of those 239 subcontracts.

### Audits Performed Not Reliable

We noted that independent reviews found that the audits performed by Bechtel have not always been effective or reliable in identifying unallowable costs. Although Bechtel subcontract audits stated they were conducted in accordance with generally accepted government auditing standards (GAGAS), reviews by Bechtel's corporate Internal Audit function (Internal Audit) and the Richland Operations Office's Finance Division found that these audits did not comply with GAGAS.

<sup>1</sup> In addition to the requirement to audit all subcontracts of \$1 million or greater, Bechtel plans to audit all subcontractors with multiple subcontracts that collectively exceed \$1 million. Although not a Department requirement, the Department has informally expressed to Bechtel that it expects Bechtel to adhere to this practice.

<sup>2</sup> Per direction from the Department to Bechtel on July 7, 2017, for subcontracts selected for audit, all years of the period of performance are to be audited. Here, the term auditable year refers to each year that a subcontract incurred and invoiced costs to Bechtel. Thus, a contract that incurred and invoiced costs to Bechtel over a 5-year period would have 5 auditable years.

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A December 2015 review by Bechtel's Internal Audit identified a number of weaknesses in the performance of these audits. Internal Audit reviewed a sample of 6 subcontract audits from the 24 issued between April 2012 and July 2014. The review identified issues with GAGAS compliance and a lack of internal controls in all six subcontract audits. Internal Audit found that the audits did not comply with GAGAS requirements regarding independence, auditor qualifications and continuing education, quality control and assurance, audit planning, supervisory review, and documentation of audit planning and results. For example, the subcontract auditor and cost/price analysts performing the audits reported directly to the Subcontract Manager. This line relationship raised the appearance of possible undue influence and impaired ability to perform the work and report the results impartially. In another example, Internal Audit found that Bechtel had no audit-related quality control procedures, and there was no internal or external peer review program. Finally, Internal Audit determined that Bechtel lacked a system of internal controls for conducting audits to ensure audit consistency, reliability, and quality, such as management involvement in audit planning and workpaper review and approvals.

In addition to the findings by Bechtel's Internal Audit, the Richland Operations Office's Finance Division performed an assessment that found similar issues with Bechtel's subcontract audits. In a report dated March 2016, the Finance Division reviewed 4 of 24 subcontract audit reports issued between April 2012 and July 2014. The Finance Division found that although Bechtel's subcontract audit reports stated the audits were performed according to GAGAS, there were a number of areas in which they did not comply with the standards. For example, the Finance Division identified that Bechtel's subcontract audits did not meet a number of critical requirements related to independence. The Finance Division also noted that none of the audits met requirements for documentation of supervisory review. In addition, the Finance Division identified several deficiencies in the audits' workpapers. For example, Bechtel's auditor had made adjustments to subcontractor General and Administrative and other indirect rates but provided no explanation for the adjustments on several audits. For one audit, Bechtel's auditor did not examine several categories of unallowable costs. For all four audits, there was no documentation regarding the assessment of fraud.

Although the Department's contract with Bechtel did not specify the use of a specific audit standard, the Department's position had been that the audits should be performed to either GAGAS or standards issued by the Institute of Internal Auditors (IIA) and formally directed Bechtel to do so in 2017. Furthermore, the adoption and application of audit standards are essential in ensuring that audit results can be relied upon. Audit standards provide a framework for conducting audits with competence, integrity, objectivity, and independence, and help ensure that unallowable costs are not being passed on to the Government. Thus, standards form the internal controls that govern the audit process. Furthermore, Bechtel adopted GAGAS as its audit standard when nearly all its self-performed subcontract audit reports stated that the audits were performed in accordance to GAGAS.

### **Subcontracts Not Properly Classified**

Bechtel had not identified all flexibly-priced subcontracts that were subject to audit. In November 2017, the Department requested DCAA to audit Bechtel's subcontract-type

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classification for subcontracts entered into by Bechtel from the inception of its contract through October 31, 2017. In its report issued in June 2018, DCAA found that in a sample of 92 Bechtel subcontracts, 30 had not been properly identified as either fixed or flexibly-priced. Of the 30 misclassified subcontracts, Bechtel had identified 26 as fixed-priced when in fact they were flexibly-priced. DCAA also reported that it had identified material weaknesses in subcontract classification in Bechtel's Procurement System and related policies and procedures, which did not allow Bechtel to comply with the subcontract audit clause in its contract. By misclassifying subcontracts as fixed-priced when they were flexibly-priced, Bechtel would have been unlikely to consider these subcontracts subject to audit.

### **Current Efforts**

Since May 2017, Bechtel had made efforts to improve its subcontract audit program and to meet a 2018 performance goal of completing at least 20 subcontract audits. Before this time, Bechtel had issued its last subcontract audit report in July 2014. Beginning in May 2017, Bechtel issued notices to proceed to third-party audit firms to perform subcontract audits with the requirement to perform the audits to either GAGAS or standards issued by IIA. However, Bechtel did not focus its current efforts on those subcontracts at risk of exceeding the statute of limitations for submitting claims, as directed by the Department. As a result, there is increased risk that the Department will miss opportunities to recover unallowable costs.

The Department's *2018 Performance Evaluation and Measurement Plan* set a requirement for Bechtel to complete a minimum of 20 subcontractor incurred cost audits to either GAGAS or standards issued by the IIA. The Department also required Bechtel to focus these audits on the subcontractor incurred cost submissions that were approaching the statute of limitations. As noted earlier in this report, the *Contracts Dispute Act of 1978* sets a 6-year limit on when a contractor or the Government can submit claims related to a contract.

Bechtel completed 24 subcontract audits in 2018, thus meeting its performance goal. However, Bechtel did not comply with the formal direction from the Department in that it did not focus its efforts on those subcontracts that were at risk of exceeding the 6-year statute of limitations. Rather, Bechtel focused on subcontracts that could be audited by the end of the year in order to meet the 2018 performance incentive. Bechtel officials stated that for many contracts, Bechtel had not obtained the necessary cost submissions from the contractors needed to perform the audits. Therefore, in order to meet the performance goal of 20 subcontract audits, it selected those subcontracts that were ready for audit instead of subcontracts approaching the statute of limitations.

### **Program Administration and Oversight**

Although both Bechtel and the Department have taken actions to improve the performance of subcontract audits by the contractor, the issues we identified occurred because of weaknesses in Bechtel's administration of the subcontract audit program as well as deficiencies in the Department's oversight. Specifically:

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- In administering its subcontract audit program, Bechtel did not develop formal policies and procedures until October 2015 and did not provide specific guidance for the audit process when developed.
  - For those policies and procedures that were developed, Bechtel officials did not always adhere to them.
  - Bechtel relied upon its invoice review process to meet the audit requirements of the contract, even though the process did not address key elements needed to identify questioned and unallowable costs.
  - The Department was not always timely or proactive in its oversight of Bechtel's subcontract audit program.

Beginning in 2017, Bechtel made efforts to have subcontract audits performed to either GAGAS or standards issued by the IIA by third-party audit firms. Additionally, the Department provided specific direction to Bechtel and established performance measures to make greater progress in its subcontract audit program, and enforced the contract by withholding provisional fee<sup>3</sup> from Bechtel starting in October 2017. However, we have noted weaknesses in these efforts.

### **Policies and Procedures Not Developed**

Bechtel did not develop desk instructions or formal policies and procedures, which Bechtel refers to as its subcontract audit plan, for the conduct of audits until October 2015. In December 2014, Bechtel informed the Department that it had conducted an internal assessment of its subcontract audit activity for the cost-type subcontracts for which it did not have audit cognizance. The internal assessment determined that Bechtel had not been consistently tracking the workflow or receiving status updates from its subcontractors or cognizant Federal audit agency. Subsequently, Bechtel issued its desk instructions and subcontract audit plan in October and November 2015, respectively, to address these issues, as well as its overall subcontract audit program. Between November 2015 and December 2017, Bechtel submitted and the Department rejected the first seven of eight subcontract audit plans “because each plan had not met the contract requirements and has shifted an unacceptable amount of risk to [the Department].” In addition, the Department had rejected Bechtel's subcontract audit plans for lack of independence of the subcontract audit function and for not adopting either GAGAS or standards issued by the IIA.

Moreover, Bechtel developed its subcontract audit plan and desk instructions as high-level documents, which did not contain specific guidance for the performance and oversight of subcontract audits. For example, Bechtel's subcontract audit plan required compliance with modified GAGAS standards but did not clearly define what constituted modified GAGAS. In addition, because the desk instructions were informal, Bechtel personnel were not required to comply with them.

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<sup>3</sup> Provisional fee is the payment of an available fee as an incentive to a contractor for making progress toward meeting performance measures prior to making a final determination as to whether the contractor has earned the fee.

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Internal Audit expressed concern with Bechtel's subcontract audit process. In December 2015, Internal Audit reported that Bechtel's audit procedures did not speak to the audit process itself and did not develop specific audit procedures, programs, or guidance. Also, as of September 2018, Bechtel did not have a formal risk assessment process for determining which subcontracts required audits and instead selected audits based on available incurred costs submissions.

Finally, Bechtel has not developed formal policies for the management and oversight of the third-party audit firms. Under its current subcontract audit plan, Bechtel will outsource all of its cognizant subcontract audits to third-party firms and apply an informal process to determine whether the audits meet GAGAS standards or standards issued by the IIA. In our opinion, this process should be formalized to ensure third-party audits conform to GAGAS or recognized industry standards.

### **Policies and Procedures Not Followed**

Even when Bechtel had established policies and procedures, it did not always follow them. Bechtel did not develop audit plans for individual subcontracts as required by its policies. For example, Bechtel's Time & Materials policy states, "...an audit plan is developed in advance of the audits, and shall be maintained in the audit file." In addition, Bechtel's cost-reimbursable policy states, "when audits are required, an audit plan will be developed in advance of the audits detailing the audit scope." However, when we asked Bechtel to provide subcontract audit plans for its flexibly-priced subcontracts valued over \$1 million, a requirement per its cost-reimbursable policy, Bechtel was unable to provide the required audit plans.

In addition, Bechtel did not always implement its requirements for performing various accounting and labor reviews prior to and after issuing cost-reimbursable subcontracts. Specifically, Bechtel's procedures require subcontractors to have adequate time charging systems and cost accounting systems to support the contracts. Furthermore, Bechtel's procedures for cost-reimbursement subcontracts require Bechtel to perform an accounting system review prior to issuing a cost-reimbursement subcontract in order to determine whether the vendor's accounting system is qualified to support a flexibly-priced subcontract. Bechtel's procedures also require it to periodically visit subcontractor facilities to evaluate compliance with timekeeping practices on all cost-reimbursement subcontracts. For a sample of six subcontractors we selected, Bechtel had not performed an accounting system review. In addition, Bechtel had not performed floor checks/labor verifications since November 2014. Finally, in December 2015, Internal Audit found that while policies and procedures did exist, Bechtel did not always comply with them, such as noncompliance in the preparation and execution of audit plans.

Furthermore, Bechtel did not consistently obtain the annual incurred cost submissions from its subcontractors. DEAR requirements as well as Bechtel's policies require subcontractors to provide annual incurred cost submissions, usually within 6 months following the end of the subcontractor's fiscal year. However, Bechtel did not include this flow-down regulation to 10 of 22 subcontracts that we reviewed. The requirement to flow-down regulations is addressed in DEAR 970.5204-78, *Laws, Regulations, and Department Directives (JUN 1997)*, Paragraph (d) which states:

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The Contractor is responsible for compliance with the requirements made applicable to this Contract, regardless of the performer of the work. The Contractor is responsible for flowing down the necessary provisions to subcontracts at any tier to which the Contractor determines such requirements apply.

The failure to require subcontractors to provide the submissions on time, or at all, is a key reason cited by Bechtel officials for why it did not focus audit efforts on subcontracts nearing the 6-year statute of limitations. Under the current audit plan, Bechtel will not obtain all outstanding subcontract incurred cost submissions. Rather, Bechtel will select subcontractors to audit and then obtain outstanding incurred cost submissions from those specific subcontractors.

### **Reliance on Invoice Reviews**

Bechtel officials have stated that Bechtel's invoice review process fulfills the requirements of the audit clause. Bechtel's invoice reviews fall short of meeting the intent of the audit clause. Specifically, invoice reviews do not review items that formal audits are designed to address, such as labor floor checks and incurred costs audits. Additionally, Bechtel's invoice review process has a number of weaknesses that further limit its effectiveness.

Bechtel's invoice review process did not contain key tasks that more formal audits are designed to perform that help identify unallowable or questionable costs. For example, labor floor check audits 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. For indirect costs, incurred cost audits include evaluation of internal controls, composition and suitability of allocation bases and indirect cost pools, verification to financial records, and verification of rate computation accuracy in order to determine the allowability, allocability, and reasonableness of the costs charged to the subcontract.

Finally, Bechtel's invoice review process contained a number of weaknesses that limited its effectiveness to identify unallowable or questioned costs. Bechtel's invoice review process consisted of a one-page checklist with the review performed by the Controller, Subcontract Administrator, and Subcontract Coordinator. In our opinion, this process did not meet the intent of the audit clause in Bechtel's contract, which, in our professional judgment, is to provide reasonable assurance that subcontractors do not pass unallowable costs to the Department. Many of the checklist items only verified the mathematical accuracy of the invoice itself. Steps were not included to determine whether the subcontractor adheres to its timekeeping practices or to trace indirect costs to accounting records. Those steps that did address determining adequacy of documentation or allowability of costs were generic in nature and did not provide specific instructions for determining whether costs are allowable. Additionally, Bechtel does not use the checklist for Time & Material or Labor Hour type subcontracts.

### **Department Oversight**

The Department has taken actions to address Bechtel's noncompliance with the subcontract audit requirements within its contract. Specifically, the Department provided detailed direction to Bechtel, established performance measures, and enforced the contract by withholding provisional

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fee from the contractor. These efforts have resulted in positive changes in Bechtel's subcontract audit program. However, the Department had not always been timely in its oversight. For example:

- We were unable to determine if the Department had taken active efforts prior to 2013 to monitor Bechtel's subcontract audit program from the time the contract was issued in December 2000. It was not until April 2013 that the Department formally reminded Bechtel of the contractual requirement to perform subcontract audits and requested Bechtel submit audit results.
- In July 2014, over a year later, the Department formally requested that Bechtel provide copies of all subcontract audit reports. However, it was not until March 2015 that Bechtel fully complied with the request.
- In July 2014, the Department first determined that Bechtel's subcontract audit program did not meet audit standards. However, it was not until the end of October 2017 that the Department took action to withhold provisional fee from Bechtel for noncompliance. Additionally, the Department did not include Bechtel's subcontract audit program as part of the contractor's performance evaluation until the calendar year 2018 performance period.<sup>4</sup>

In addition, the Department had not always been proactive in its approach to oversight to ensure subcontract audits were sufficient. Although the Department had identified deficiencies within Bechtel's subcontract audit program, it did not always take steps to monitor key aspects of Bechtel's efforts to meet its contractual requirements. For example:

- Bechtel's contract requires it to either perform audits of subcontracts or arrange for audits to be performed by the cognizant Government audit agency through the Contracting Officer. However, the Department did not formally begin tracking requests from Bechtel for audit assistance until July 2017.
- On two occasions, between December 2014 and November 2015, Bechtel officials formally notified the Department that Bechtel had performed self-assessments of its subcontract audit program, identified weaknesses, and taken action to correct them. When we asked Department officials if they had requested or received copies of either self-assessment, Department officials stated that they had not.
- Although the Department directed Bechtel to mitigate the risk of those subcontracts exceeding the 6-year statute of limitations, it had not taken efforts to specifically monitor Bechtel's efforts to do so until after we brought the issue to its attention.
- An October 2017 letter from the Department to Bechtel provided further indication that the Department had not always been proactive in its oversight. In an earlier letter from

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<sup>4</sup> A timeline of significant events related to the Department's oversight of Bechtel's subcontract audit program can be found in Appendix 4.

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Bechtel to the Department, the contractor claimed that the Department had never questioned its performance of its obligations under the contract clause and never questioned any of Bechtel's invoices for subcontractor costs. In the October 2017 letter, the Department responded that the reason it never questioned Bechtel's performance was that Bechtel had not provided the audit results of its subcontract audits to the Department until 2015, and at that time, it became "fully aware of the type of activities [Bechtel] was performing and considering to be audits."

## **Impact**

By not fulfilling the requirement to audit its flexibly-priced subcontracts, Bechtel increases the risk that it is passing on unallowable costs from its subcontractors to the Department. Between the start of the contract in December 11, 2000, and June 15, 2018, Bechtel paid \$1.98 billion to subcontractors with flexibly-priced contracts. Despite the contract requirement, significant portions of these costs have not been audited. As indicated by the following examples, these costs have the potential to contain unallowable or questioned costs. In June and July of 2018, Bechtel received results on seven subcontract audits that identified approximately \$1.1 million in questioned costs, of which approximately \$194,000 impacted the Department through Bechtel's contract. The questioned costs ranged from direct materials and other direct costs and costs allocated through indirect rates. Examples of questioned indirect costs were unallocable labor costs, over-accrued labor costs, building rent and occupancy costs, and employee bonuses. The risk of the Department reimbursing unallowable costs is further increased by the Federal statute that sets a 6-year limit on the time period during which the Government can recoup questioned costs from contractors. For a number of these unaudited subcontracts, the 6-year limit may already have been exceeded and additional subcontracts are at risk of exceeding the limit, potentially preventing the Government from recouping costs.

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## RECOMMENDATIONS

To address the concerns identified in this report, we recommend that the Senior Advisor for Environmental Management to the Under Secretary for Science direct the Managers of the Office of River Protection and the Richland Operations Office to ensure that:

1. Bechtel develops comprehensive policies and procedures that address key requirements for an effective subcontract audit program. These should address, but not be limited to, audit standards to be used, procedures to apply audit standards, and use of a risk-based approach for identifying audits to be performed.
2. Bechtel ensures that its personnel comply with policies and procedures related to its subcontract audit program.
3. The Department monitors Bechtel's subcontract audit program performance.

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## **MANAGEMENT RESPONSE**

In responding to the report and its recommendations, the Office of Environmental Management stated that it was committed to making continuous contract management improvements, and concurred with the recommendations to improve the subcontract audit program and oversight. For example, the Office of Environmental Management stated that policies and procedures for Bechtel's subcontract program have been developed and/or revised to address key requirements to include a risk-based approach. Additionally, starting in 2018, the Office of River Protection included a metric in the *Performance Evaluation and Measurement Plan* to incentivize performance of the required audits. The Office of Environmental Management also stated that Bechtel had implemented its audit plan and communicated the audit requirements to all applicable employees. Finally, the Office of Environmental Management stated that the Office of River Protection monitors Bechtel's performance through weekly interface and oversight, which includes reviewing Bechtel's completed audit submissions and evaluating Bechtel's adherence to the *Performance Evaluation and Measurement Plan*.

Management's comments are included in Appendix 3.

## **AUDITOR COMMENTS**

Management's actions are responsive to our recommendations.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

### **Objective**

We conducted this audit to determine whether Bechtel National, Inc. (Bechtel) is fulfilling its requirement to audit its flexibly-priced subcontracts.

### **Scope**

This audit was performed from March 2018 through July 2019. We conducted the audit at the Department of Energy's Richland Operations Office and Office of River Protection, and at Bechtel, all of which are located in Richland, Washington. This audit was conducted under the Office of Inspector General Project Number A18RL029.

### **Methodology**

To accomplish the audit objective, we:

- Reviewed Federal and Department laws and regulations to identify those relevant to the audit objective and determine if Bechtel complied with those deemed relevant;
- Interviewed Department and Bechtel officials;
- Reviewed Bechtel's subcontract audit reports to determine the extent of subcontract audit coverage;
- Reviewed Bechtel's subcontract audit reports to determine the audit standards used and the results of the audits;
- Reviewed two independent assessments of Bechtel's subcontract audits to determine what, if any, weaknesses were identified;
- Evaluated Bechtel's internal controls over its subcontract audit program to determine the effectiveness of its controls;
- Developed a timeline of events to evaluate the Department's oversight of Bechtel's subcontract audit program; and
- Judgmentally selected a sample of 28 subcontracts from a population of 317 for which Bechtel has audit cognizance to test for flow-down of requirements. Because the selection was based on a 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 subcontracts.

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 objective. Accordingly, we assessed significant internal controls and compliance with laws and regulations necessary to satisfy the audit objective.

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. We relied on computer-processed data to satisfy our objective related to Bechtel's subcontract audit program. To verify the accuracy of that data, we confirmed the validity and reliability by reviewing supporting documentation used to generate the computer-processed data. Based on our work, we determined that the data was sufficiently reliable for our purposes.

An exit conference was held with management officials on October 28, 2019.

## **RELATED REPORTS**

### **Office of Inspector General**

- Assessment Report on *Assessment of Audit Coverage of Cost Allowability for UT-Battelle, LLC under Department of Energy Contract No. DE-AC06-00OR22725 during Fiscal Year 2010* (OAS-V-13-11, June 2013). The assessment found several weaknesses in UT-Battelle, LLC's process that draw similar parallels with Bechtel National, Inc.'s subcontract audit program. UT-Battelle, LLC performed invoice reviews in place of audits for Time & Material contracts. An analysis of the invoice review process found that it did not address certain key risks such as verifying that labor hours billed were accurate and for the appropriate labor category. It also found that the invoice reviews did not include steps that would be included in an audit. The assessment also tested the effectiveness of the invoice review process and found that in its own review, as well as audits by two other organizations, questionable or unallowable costs were identified that were not identified by the invoice review. The assessment also found issues with UT-Battelle, LLC's close-out audit process, including lack of independence and audit qualifications.

### **Government Accountability Office**

- Report to the Subcommittee on Energy and Water Development, Committee on Appropriations, House of Representatives on [\*Hanford Waste Treatment Plant: Department of Energy Needs to Strengthen Controls over Contractor Payments and Project Assets\*](#) (GAO-07-888, July 2007). The Government Accountability Office review of the Department of Energy's internal controls over improper payments on the Waste Treatment and Immobilization Plant project determined that the controls were not sufficient to provide reasonable assurance that improper payments were not being paid by the Department. The primary issue was that the Department relied on audits performed by the Defense Contract Audit Agency, as well as Bechtel National, Inc.'s internal controls, without performing its own oversight. The report also found that there were a number of factors within the Waste Treatment and Immobilization Plant project that significantly increased the inherent risk that improper payments may occur.

MANAGEMENT COMMENTS



Department of Energy  
Washington, DC 20585

October 9, 2019

MEMORANDUM FOR TERI L. DONALDSON  
INSPECTOR GENERAL

FROM: WILLIAM I. WHITE   
SENIOR ADVISOR FOR ENVIRONMENTAL MANAGEMENT  
TO THE UNDER SECRETARY FOR SCIENCE

SUBJECT: Management Response: Draft Audit Report, Bechtel National,  
Inc.'s Subcontract Audit Program

The Office of Environmental Management (EM) appreciates the work done by the Department of Energy's Office of the Inspector General (OIG) in conducting a review of the Bechtel National, Inc. (Bechtel) Subcontract Audit Program. EM is committed to making continuous contract management improvements, and concurs with the recommendations to improve the subcontract audit program and oversight. The actions to strengthen Bechtel's subcontract audit program are consistent with those that have been, or/are being implemented by all Hanford site contractors, to include site review and monitoring of audit programs, plans and reports. Moreover, starting in 2018, a metric to incentivize performance of the required audits was included in Bechtel's Performance Evaluation and Measurement Plan.

The attachment details the specific actions taken to address your recommendations. If you have any questions regarding these actions, please contact Mr. Thomas Toon, Director, Finance, Richland Operations Office, at (509) 376-8515, or [thomas.toon@rl.doe.gov](mailto:thomas.toon@rl.doe.gov).

Attachment



Attachment

Management Response

OIG Draft Audit Report

Bechtel National, Inc.'s Subcontract Audit Program

**Response to Report Recommendations**

**Recommendation 1:** Ensure that Bechtel National, Inc. (Bechtel) develops comprehensive policies and procedures that address key requirements for an effective subcontract audit program. These should address, but not be limited to, audit standards to be used, procedures to apply audit standards, and use of a risk-based approach for identifying audits to be performed.

***Management Response: Concur***

Policies and procedures for Bechtel's subcontract program have been developed and or revised to address key requirements to include a risk-based approach. The Office of River Protection (ORP) requires Bechtel to submit an audit plan to ensure audits are conducted in accordance with contract requirements. ORP has reviewed this plan, determined it is acceptable and continuously monitors progress. Bechtel will audit all applicable subcontracts in accordance with Generally Acceptable Auditing Standards using independent auditors. In addition, starting in 2018 ORP included a metric in the Performance Evaluation and Measurement Plan to incentivize performance of the required audits.

***Estimated Completion Date:*** While the actions to address this recommendation have been completed, the milestone date for closure is January 31, 2020, to allow an additional quarter of performance to be reviewed by ORP.

**Recommendation 2:** Ensure that Bechtel ensures that its personnel comply with policies and procedures related to its subcontract audit program.

***Management Response: Concur***

Bechtel has implemented its audit plan and communicated the audit requirements to all applicable (i.e. Chief Financial Officer, Procurement, and Subcontracts) employees.

***Estimated Completion Date:*** While the actions to address this recommendation have been completed, the milestone date for closure is January 31, 2020, to allow an additional quarter of performance to be reviewed by ORP.

**Recommendation 3:** Ensure that the Department monitors Bechtel's subcontract audit program performance.

***Management Response: Concur***

ORP monitors Bechtel's performance through weekly interface and oversight, Bechtel submittals of completed audits, and Bechtel's performance as measured in the Performance Evaluation and Measurement Plan

***Estimated Completion Date:*** While the actions to address this recommendation have been completed, the milestone date for closure is January 31, 2020, to allow an additional quarter of performance to be reviewed by ORP.

## **TIMELINE OF EVENTS**

The following is a timeline of significant events related to the Department of Energy's oversight of Bechtel National, Inc.'s (Bechtel) subcontract audit program.

### 2013

- 4 April – Office of River Protection Contracting Officer reminds Bechtel of contract requirement to perform subcontract audits and requests the contractor to submit audit results.
- 24 July – Bechtel issues letter stating it is in compliance with requirement to provide the Department with results of audits.

### 2014

- 1 July – Department meets with Bechtel and requests the contractor to provide copies of its subcontract audit plan and audit reports.
- 8 July – Department Finance officials inform the Contracting Officer that Bechtel's subcontract audit process does not meet audit standards.
- 2 December – Bechtel issues letter stating it had performed a self-assessment that concluded it had not been consistently managing the coordination and communication of its subcontract cost submissions and audits with the Department and the Defense Contract Audit Agency.

### 2015

- 14 January – Bechtel provides approximately 10 audits, but the audits only go back to 2009.
- 13 February – Department directs Bechtel to provide all subcontract audits back to inception of contract.
- 12 March – Bechtel provides an additional 10 audits and states it has complied with the Department's request.
- 19 March – The Department begins an assessment of Bechtel's subcontract audit program due to concerns over the quality and small number of audits.
- 25 November – Bechtel issues first version of its subcontract audit plan.
- 15 December – Bechtel Corporate Internal Audit issues report stating that subcontract audits did not meet audit standards.

### 2016

- 13 June – Bechtel issues second version of subcontract audit plan.
- 26 October – The Department holds conference call with Bechtel to discuss issues with revised plan and provides a formal document outlining them.

### 2017

- 2 March – Bechtel issues third version of subcontract audit plan.
- 19 April – Department provides Bechtel a copy of the enclosure to the draft letter (see July 7, 2017, entry) outlining each noncompliance.
- 12 May – Bechtel issues fourth version of subcontract audit plan.

- 18 May – Department Office of Chief Counsel calls meeting of working group to discuss statute of limitations research.
- 20 June – Bechtel issues fifth version of subcontract audit plan.
- 27 June – Bechtel issues sixth version of subcontract audit plan.
- 7 July – Department issues letter to Bechtel listing 14 items that Bechtel’s subcontract audit plan must include and gives 30 days to comply. Letter also states that provisional fee<sup>1</sup> and a percentage of Bechtel submitted vouchers may be withheld.
- 31 August – Bechtel issues seventh version of subcontract audit plan.
- 31 October – Department notifies Bechtel that the contractor is still not in compliance with the terms of the contract and that the Department is withholding approximately \$3.6 million in provisional fee.
- 4 December – Bechtel issues eighth version of subcontract audit plan.
- 26 December – Department issues Bechtel’s *2018 Performance Evaluation and Measurement Plan*, which includes a goal of completing a minimum of 20 subcontractor incurred cost audits to standard.

### 2018

- 11 January – Department notifies Bechtel that it has rejected the eighth version of its subcontract audit plan.
- 22 February – Bechtel issues letter addressing how it will comply with the 14 items identified in the Department’s July 7, 2017, letter.
- 23 March – Department directs Bechtel to proceed with the subcontract audit approach outlined in its February 22, 2018, letter.
- 16 August – Bechtel issues ninth version of subcontract audit plan.

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<sup>1</sup> Provisional fee is the payment of an available fee as an incentive to a contractor for making progress toward meeting performance measures prior to making a final determination as to whether the contractor has earned the fee.

## **FEEDBACK**

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

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

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

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