



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-18-25

March 2018

**AUDIT COVERAGE OF
COST ALLOWABILITY FOR
OAK RIDGE ASSOCIATED UNIVERSITIES,
INC. DURING FISCAL YEARS 2012
THROUGH 2015
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-AC05-06OR23100**



Department of Energy
Washington, DC 20585

March 14, 2018

MEMORANDUM FOR THE MANAGER, OAK RIDGE NATIONAL LABORATORY
SITE OFFICE

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 Oak Ridge Associated Universities, Inc. During Fiscal Years 2012 Through 2015 Under Department of Energy Contract No. DE-AC05-06OR23100”

BACKGROUND

Since 1992, Oak Ridge Associated Universities, Inc. (ORAU) has managed and operated the Oak Ridge Institute for Science and Education (ORISE) under a contract with the Department of Energy. ORISE advances science education and research programs and creates opportunities for collaboration through partnerships with other Department contractors, Federal agencies, academia, and industry. The entity was managed under a cost-plus-award-fee Federal Acquisition Regulation contract, which ended December 31, 2015.¹ On March 10, 2016, the Department competitively awarded ORAU a new ORISE contract. During fiscal years (FYs) 2012 through 2015, ORAU incurred and claimed costs totaling \$1,003,914,318.94. The table below illustrates the amount of costs claimed by ORAU under Contract No. DE-AC05-06OR23100 from FYs 2012 through 2015:

Fiscal Year	Claimed Costs
2012	\$263,928,405.53
2013	\$235,803,717.98
2014	\$238,113,856.06
2015	\$266,068,339.37
Total	\$1,003,914,318.94

ORAU’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. ORAU utilizes a

¹ The contract was extended from December 31, 2015, for 6 months and was only applicable to several Strategic Partnership Projects that needed to be run until June 30, 2016, or until completed earlier than June 30, 2016.

Letter of Credit to perform drawdowns of funds from the Federal Reserve through a special bank account. ORAU 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.

The Department's Office of Inspector General, Office of Acquisition Management, 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 claimed by contractors. Consistent with the Cooperative Audit Strategy, ORAU 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, ORAU 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 FYs 2012 through 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;
- ORAU conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- ORAU adequately resolved questioned costs and internal control weaknesses affecting allowable costs that were identified in prior 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 ORAU Internal Audit could not be relied upon. We did not identify any material internal control weaknesses with the allowable cost reviews, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. Internal Audit identified \$3,340.74 in unallowable costs during its FYs 2012 through 2015 allowable cost reviews, all of which had been resolved by the time of our assessment.

In addition, we reviewed the recommendations from our prior report, *Audit Coverage of Cost Allowability for Oak Ridge Associated Universities, Inc. under Department of Energy Contract No. DE-AC05-06OR23100 for Fiscal Years 2007-2011* (OAS-V-13-12, July 2013), which recommended ORAU establish a formal risk-based approach to auditing subcontracts. ORAU finalized a policy on auditing subcontracts and the Department approved it in November 2013.

We found that, under the risk-based approach, during FYs 2012 through 2015, Internal Audit had conducted 14 audits of subcontracts, and identified \$770 in under-billings due back to subcontractors, all of which had been resolved.

Finally, nothing came to our attention to indicate that questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews had not been adequately resolved. We did, however, identify issues regarding Internal Audit's documentation of their sampling methodology and ORAU's use of the contract's Letter of Credit bank account that need to be addressed. These issues did not adversely affect our ability to rely on Internal Audit's work or the costs claimed in the Statements of Costs Incurred and Claimed. However, we are questioning \$6,639.91 in transaction fees for ORAU's use of the Letter of Credit bank account for its corporate use of shared resources.

Sampling Methodology

Internal Audit used judgmental sample sizes and random sampling for testing certain transactions in their cost allowability audits; however, they did not adequately document the rationale for doing so in their workpapers. In addition, the results of this approach could not be projected to the entire universe to adequately support conclusions on the overall allowability of costs. The Cooperative Audit Strategy established guidance and an expectation that internal auditors employ a recognized statistical sampling methodology sufficient to reach a conclusion on the allowability of costs and permit the projection of unallowable costs. When a judgmental sampling methodology is used, the rationale for its use should be clearly documented in the audit workpapers. Internal Audit judgmentally selected sample sizes ranging from 20 - 50 random transactions from certain expenditure types, but did not adequately document its justification for the sample size in their workpapers. Although Internal Audit subsequently provided a written explanation during our assessment that described their general approach to sampling, the workpapers reviewed as part of this assessment did not fully support why judgmental samples were more appropriate than statistical samples. While the subsequent explanation explained Internal Audit's use of judgement sampling, it does not replace the need for adequate documentation in the workpapers; therefore, we are recommending that in the future, Internal Audit provide additional documentation in the workpapers specific to the sample selected.

Other Matters

Letter of Credit

During the course of our assessment, and due to ORAU's status as an integrated contractor, we examined several aspects related to ORAU's unique use of the ORISE contract's Letter of Credit financing arrangement. As a result, we identified several issues related to ORAU's use of the Letter of Credit bank account for shared corporate expenses. Although we selected to review the Letter of Credit in this assessment of Internal Audit, there was not a contractual or regulatory requirement to include ORAU's use of the Letter of Credit financing arrangement in the scope of Internal Audit's annual allowable cost audit. As such, we noted that the Letter of Credit was not reviewed by Internal Audit in any of the allowable cost audits we assessed.

Shared Corporate Payments

We found that during the contract period covering our review, ORAU did not receive an approval or waiver from the Contracting Officer for a contract clause to use the Letter of Credit bank account for shared corporate payments. According to ORISE Contract Clause 970.5232-2 *Payments and Advances Alternate I, Alternate II, and Alternate III, Special Financial Institution Account-Use*, "...no part of the funds in the special financial institution account shall be commingled with any funds of the Contractor or used for a purpose other than that of making payments for costs allowable and, if applicable, fees earned under this contract, negotiated fixed amounts, or payments for other items specifically approved in writing by the Contracting Officer." In a 1999 memo referenced as part of a previous contract between ORAU and the Department, ORAU and the Department recognized the unique and beneficial nature of the use of shared resources, particularly the efficiency of operating matrixed staff from a single payment source. ORAU stated that because work under the ORISE contract had traditionally constituted about 95 percent of total ORAU activities, the Department agreed through a waiver that corporate payments, including shared payments, could be made using the Letter of Credit bank account, thus commingling funds. However, the waiver was never granted for this contract that has since ended and has been replaced by a new contract with ORAU. Since the previous contract had ended, the Contracting Officer addressed the issue in the current contract.

Semi-annual Analysis

We found that ORAU Financial Operations Department had not conducted reviews of the adequacy of the compensating balance, as instructed by the Department in a 2012 memo. ORAU established a deposit of \$160,000 in 1991 in the Federal Reserve as a "compensating balance" to cover corporate (non-ORISE) expenses, and agreed to make prompt, periodic (monthly) deposits into the special bank account of an amount equivalent to ORAU's responsibility. Due to rising corporate expenses, ORAU has increased the compensating balance three times since its establishment to \$250,000 in 2000, \$350,000 in 2002, and to \$800,000 in 2006. In the memo, the Department instructed ORAU to provide a semi-annual analysis that demonstrated the adequacy of funds on deposit for each 6-month period. The Department did not receive nor follow up with ORAU on the analysis until we brought it to their attention.

Compensating Balance

During our period of review, we found that for 14 out of the 48 months, ORAU's monthly accrued corporate expenses exceeded the compensating balance from as little as \$7,000 to more than \$950,000; potentially leading to the short term use of Government funds for corporate expenses. Absent the adequacy of funds analysis, we requested ORAU perform the analysis for those months. In order to determine if ORAU had exceeded the compensating balance on a cash basis for the months identified, we requested that ORAU adjust the accrued costs to the actual cash balances. This analysis showed that at the end of February 2015, ORAU had exceeded the compensating balance for the month by more than \$137,000. According to ORAU, after processing payroll they reimbursed their portion to the compensating balance approximately 7-10 days later resulting in the use of Government funds for corporate expenses during that period.

Transaction Fees

Finally, we found that ORAU did not reimburse the Department \$6,639.91 in transaction fees for ORAU's use of the Letter of Credit bank account for its corporate use of shared resources. Shared resources included matrixed employees (those with time split between ORISE contract work and ORAU corporate work) and distributed overhead pool costs shared between ORISE contract work and ORAU corporate work. Transaction fees associated with these shared resources were fully charged to the ORISE contract and not separated out from ORAU corporate transactions.

Actions Taken

We notified Department officials of our findings, and as a result, on April 20, 2017, the Contracting Officer issued a letter approving ORAU to use the Letter of Credit bank account for the current ORISE contract. In addition, ORAU increased the compensating balance to \$1.5 million on March 10, 2017, and will be responsible for maintaining and replenishing it as often as necessary. Finally the Contracting Officer directed ORAU to conduct a monthly analysis on the compensating balance to ensure that it was adequate to cover corporate expenses, and provide the analysis to the Department on a quarterly basis. After we questioned ORAU about the use of the Letter of Credit and associated costs, they transferred \$6,639.91 of questioned bank transaction fees to a corporate unallowable cost account pending a final determination of allowability by the Contracting Officer.

RECOMMENDATIONS

We recommend that the Manager, Oak Ridge National Laboratory Site Office, direct the Contracting Officer to:

1. Ensure that for future audits, Internal Audit performs statistical sampling in its cost allowability audits or fully describes the rationale for using judgmental sampling in the workpapers; and
2. Determine the allowability of \$6,639.91 in transaction fees identified in this review, and recover those amounts determined to be unallowable.

MANAGEMENT RESPONSE

Management agreed with the findings and concurred with the recommendations. Management's planned and completed corrective actions are responsive to our recommendations.

Management's comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from September 2016 to March 2018, at ORAU, located in Oak Ridge, Tennessee. The assessment was limited to ORAU Internal Audit activities, subcontract audits, Letter of Credit activities, and resolution of questioned costs and internal control

weaknesses that affect costs claimed by ORAU on its Statement of Costs Incurred and Claimed for FYs 2012 through 2015. The assessment was conducted under Office of Inspector General project number A16OR064.

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;
- Reviewed policies, procedures, and practices to identify subcontracts requiring audit and arranging for audits;
- Assessed subcontract audit status;
- Evaluated resolution of questioned costs and internal control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, ORAU's Internal Audit, and other organizations; and
- Reviewed their use of the Letter of Credit, due to ORAU's unique nature of being an integrated, Non-Management and Operating Contractor.

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. Additionally, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on limited computer-processed data to accomplish our objectives and determined that it was sufficiently reliable for the purposes of the review by reviewing existing information about the data and the system that produced them and interviewing ORAU and Departmental officials knowledgeable about the data.

An exit conference was held with Oak Ridge National Laboratory Site Office, Oak Ridge Office, and Oak Ridge Associated Universities, Inc. officials on January 17, 2018.

This report is intended for the use of the Department's 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 of Audit Coverage of Cost Allowability for Oak Ridge Associated Universities, Inc. under Department of Energy Contract No. DE-AC05-06OR23100 for Fiscal Years 2007-2011 (OAS-V-13-12, July 2013). The assessment identified issues that needed to be addressed to ensure that only allowable costs are claimed by, and reimbursed to, the contractor. Notably, Oak Ridge Associated Universities did not always conduct or arrange for audits of its subcontractors when costs incurred were a factor in determining the amount payable to subcontractors. Additionally, Oak Ridge Associated Universities Internal Audit did not correctly identify all unallowable lobbying costs, which resulted in \$256 in questioned costs that were subsequently resolved.

MANAGEMENT COMMENTS




Department of Energy

ORNL Site Office
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December 14, 2017

MEMORANDUM FOR DEBRA K. SOLMONSON
DEPUTY ASSISTANT INSPECTOR GENERAL
FOR AUDIT AND INSPECTIONS
IG-303

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

SUBJECT: RESPONSE TO THE OFFICE OF INSPECTOR GENERAL'S (OIG) DRAFT
ASSESSMENT REPORT, *AUDIT COVERAGE OF COST ALLOWABILITY OAK
RIDGE ASSOCIATED UNIVERSITIES, INC. DURING FISCAL YEARS 2012
THROUGH 2015 UNDER DEPARTMENT OF ENERGY CONTRACT NO.
DE-AC05-06OR23100, (A16OR064)*

Thank you for the opportunity to review and comment on the subject draft report. We agree with the OIG's Findings, and our response to the recommendations follow below.

Recommendation 1: We recommend that the Manager of the Oak Ridge National Laboratory (ORNL) Site Office (OSO) direct the Contracting Officer (CO) to ensure that for future audits, Internal Audit performs statistical sampling in its cost allowability audits or fully describe the rationale for using judgmental sampling in the workpapers.

Management Response: Concur.

Action Plan: The ORISE CO will confirm Internal Audit has established policies and procedures to ensure cost allowability audit workpapers include sampling plans describing the statistical sampling approach or fully describe the rationale for using judgmental sampling.

Estimated Completion Date: February 28, 2018

DEBRA K. SOLMONSON

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December 14, 2017

RESPONSE TO THE OFFICE OF INSPECTOR GENERAL'S (OIG) DRAFT ASSESSMENT REPORT, *AUDIT COVERAGE OF COST ALLOWABILITY OAK RIDGE ASSOCIATED UNIVERSITIES, INC. DURING FISCAL YEARS 2012 THROUGH 2015 UNDER DEPARTMENT OF ENERGY CONTRACT NO. DE-AC05-06OR23100, (A16OR064)*

Recommendation 2: We recommend that the Manager of OSO direct the CO to determine the allowability of \$6,639.91 in transaction fees identified in this review and recover those amounts determined to be unallowable.

Management Response: Concur.

Action Plan: In a memorandum dated September 15, 2017, to the ORISE CO, the ORAU President stated the following: ORAU management agrees that the non-ORISE portion of the Department of Energy (DOE) Special Bank transaction fees identified should be deemed unallowable to the ORISE Contract DE-AC05-06OR23100. On May 23, 2017, ORAU transferred these fees totaling \$6,639.91 from the ORISE Overhead General Ledger account to ORAU's General Ledgers in the President's Office Unallowable Contract Expense account. Evidence of this transfer has been provided to the OIG. OSO considers this recommendation closed.

Estimated Completion Date: Completed September 15, 2017

If there are any questions or additional information is required, please contact Claire Sinclair at (865) 576-7710.

cc:

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