OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-20-19

December 2019

AUDIT COVERAGE OF COST ALLOWABILITY FOR OAK RIDGE ASSOCIATED UNIVERSITIES, INC. FROM OCTOBER 1, 2015, THROUGH SEPTEMBER 30, 2017, UNDER DEPARTMENT OF ENERGY CONTRACT NOS. DE-AC05-06OR23100 AND DE-SC0014664

Department of Energy
Washington, DC 20585

December 26, 2019

MEMORANDUM FOR THE MANAGER, OAK RIDGE NATIONAL LABORATORY
SITE OFFICE

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

SUBJECT: INFORMATION: Assessment Report on "Audit Coverage of Cost Allowability for Oak Ridge Associated Universities, Inc. from October 1, 2015, through September 30, 2017, Under Department of Energy Contract Nos. DE-AC05-06OR23100 and DE-SC0014664"

BACKGROUND

Oak Ridge Associated Universities, Inc. (ORAU) has managed and operated the Oak Ridge Institute for Science and Education (ORISE) under contracts with the Department of Energy since 1992. ORISE advances science education and research programs, and creates opportunities for collaboration through partnerships with other Department contractors, Federal agencies, academia, and industry. ORISE 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 contract to continue operating ORISE. During fiscal years (FYs) 2016 and 2017, ORAU incurred and claimed costs totaling $537,883,702.81. The table below illustrates the costs incurred and claimed by ORAU under contracts DE-AC05-06OR23100 and DE-SC0014664 during FYs 2016 and 2017.

Fiscal Year	Contract Number	Incurred and Claimed Costs
2016	DE-AC-05-06OR23100	$154,784,489
2016	DE-SC0014664	$116,768,709
2017	DE-AC-05-06OR23100	-$79,944
2017	DE-SC0014664	$266,410,449
Total		**$537,883,703**

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 contracts 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 to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the strategy, ORAU is required by its contracts 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 the subcontractor.

The objectives of our assessment for FY's 2016 and 2017 were to determine, based on our limited sampling, whether:

- ORAU's Internal Audit (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 resolved questioned costs and internal control weaknesses affecting allowable costs that were identified in prior audits and reviews.

RESULTS OF ASSESSMENT

During our assessment, nothing came to our attention to indicate that allowable cost-related audit work performed by Internal Audit for FYs 2016 and 2017 could not be relied upon. We conducted our assessment as a review attestation. A review is substantially less in scope than an examination or audit. Our review was limited and would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. Based on our limited sampling, we did not identify any material internal control weaknesses with allowable cost audits, which generally met Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. Internal Audit identified $438.53 in unallowable costs during FYs 2016 and 2017, all of which had been resolved by the time of our assessment. In addition, Internal Audit used a risk-based approach for conducting audits of subcontracts during FYs 2016 and 2017. We found that Internal Audit conducted 16 audits of subcontracts and identified $25,978.80 in questionable costs under the ORISE contract. ORAU had resolved the questioned subcontract costs by the time of our assessment.

We also reviewed the status of recommendations made in our prior report, *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* (DOE-OIG-18-25, March 2018), which recommended that for future audits, Internal Audit perform statistical sampling in its cost allowability audits or fully describe the rationale for using judgmental sampling in the workpapers; and determine the allowability of $6,639.91 in transaction fees identified in the review and recover those amounts determined to be unallowable. As a result, ORAU revised its process for conducting the annual allowable cost audit and began using a statistical sampling process. Also, ORAU reimbursed the ORISE contract for $6,639.91 in bank service charges.

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 resolved. We did, however, identify issues regarding Internal Audit's risk assessment process and ORAU's use of the contract's Letter of Credit bank account that ORAU addressed during the course of our assessment. These issues did not impact our ability to complete the objectives of this assessment.

Risk Assessment Process

The risk assessment process used by Internal Audit could be improved. Specifically, Internal Audit's risk assessments did not clearly identify stipends, the largest expenditure type under the ORISE contract, as an area where risk was assessed. According to ORAU's 2016 Audit Implementation Design, Internal Audit's overall strategy was to ensure that risks are appropriately identified and managed. In addition, ORAU's Chief Audit Officer was to implement a comprehensive program of auditing based on risk in relation to factors such as cost, schedule, and activity level. Annual audit plans were to be developed based on risk, and audits were to be selected through a risk-based assessment that considered a number of attributes, including the following:

- Financial exposure/materiality;
- Public exposure;
- Quality of internal controls;
- Concerns about management; and
- New or changing controls, systems, programs, or operations.

When reviewing risk assessments for FYs 2016 and 2017, we noted that Internal Audit did not specifically identify stipends in the audit universe. According to the ORISE audited financial statements, stipends accounted for 78 percent (about $248 million) of expenditures in FY 2016, and 83 percent (about $255 million) of expenditures in FY 2017. The ORAU Accounting Manual defines stipends as payments to nonemployee participants in educational research programs for living expenses. Participants are assigned to a biweekly or monthly payment cycle and receive a predetermined stipend amount. Since stipends accounted for the majority of expenditures made in each fiscal year, we expected to see them clearly identified in the audit universe and risk assessments for each fiscal year.

Although stipends were not specifically identified in the ORAU risk assessment process, the program area (Scientific Assessment and Workforce Development) that managed stipends was covered. We also noted that stipends received some audit coverage. For example, ORAU's independent financial statement auditor reviewed 49 stipend payments as part of a payroll transaction sample in 2016. Additionally, in the FY 2017 allowable cost audit, Internal Audit tested 25 stipend-related transactions. During the course of our assessment, we noted that Internal Audit improved the risk assessment process to clearly identify stipend payments in the audit universe. Furthermore, Internal Audit's risk assessments for FYs 2018, 2019, and 2020 all identified stipend payments as an area where risk was assessed.

Other Matters

Letter of Credit

Due to ORAU's status as an integrated contractor, we examined several aspects related to the ORISE contract Letter of Credit financing arrangement. We noted that there was no contractual or regulatory requirement to include the Letter of Credit financing arrangement in the scope of Internal Audit's annual allowable cost audit. As such, Internal Audit did not review the Letter of Credit in its annual allowable cost audit. During the course of our assessment, we identified several issues related to the ORISE contract Letter of Credit financing arrangement.

Both ORISE contracts contained Department of Energy Acquisition Regulation clause 970.5232-2, *Payments and Advances*, which governs the payment of allowable costs and the special financial institution account (Letter of Credit bank account). This clause states that "…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." The Department authorized ORAU to commingle corporate funds in the ORISE contract Letter of Credit bank account and to use the ORISE contract Letter of Credit bank account to pay for shared resources between ORAU and ORISE due to the efficiencies gained from making payments from a single source.

The Department also required ORAU to maintain a compensating balance on deposit with the U.S. Department of the Treasury in a sufficient amount to provide a reasonable assurance that U.S. Government funds were not used for ORAU corporate activities. The Department's authorization also clearly stated that purely corporate expenses, including corporate accounts payable and payroll, would be paid exclusively out of the ORAU corporate bank account. We noted that ORAU increased the size of the compensating balance maintained in the ORISE contract's Letter of Credit bank account during March 2017, as a result of our previous audit. ORAU deposited an additional $700,000 into the U.S. Department of the Treasury that resulted in the compensating balance being increased from $800,000 to $1,500,000.

Compensating Balance

We assessed the compensating balance maintained by ORAU in the ORISE contract Letter of Credit bank account during FYs 2016 and 2017. We found that ORAU's month-end balance of accrued corporate expenses exceeded the compensating balance in 8 of the 24 months reviewed. For example, ORAU exceeded the compensating balance on an accrual basis in amounts that ranged from $1,564,488.97 in August 2016 to $43,984.72 in August 2017. ORAU also exceeded the compensating balance on a cash-expended basis in 2 of the 24 months reviewed. Specifically, ORAU exceeded the compensating balance on a cash basis by $354,053.86 in August 2016, and by $291,772.34 in December 2016. However, we noted that ORAU did not exceed the compensating balance at month-end on a cash expended basis after March 2017.

Bank Service Charges

At the time of our assessment, we found that ORAU had not reimbursed the ORISE contract for $5,787.04 in bank service charges incurred during FYs 2016 and 2017 from ORAU's use of the Letter of Credit bank account for shared resources. Additionally, ORAU had not implemented a process to ensure that bank service charges incurred as a result of ORAU's use of the ORISE contract Letter of Credit bank account would be reimbursed or repaid each fiscal year. In December 2018, ORAU updated its Accounting Manual by including the statement that ORAU shall maintain a balance of corporate funds in the Letter of Credit bank account to cover ORAU corporate expenses. ORAU also included a new requirement that the *pro rata* percentage of bank service charges are periodically analyzed, reconciled, and reimbursed to the Department.

However, despite the new requirement, ORAU took no action to reimburse or repay the ORISE contract for corporate's share of FY 2016 and 2017 bank service charges prior to our asking. Specifically, on August 24, 2018, we requested information from ORAU regarding the Letter of Credit bank account and the associated bank service charges. On August 28, 2018, ORAU prepared a journal entry, effective August 24, 2018, that moved $5,787.04 in bank service charges from the ORISE contract to the ORAU President's unallowable contract expense account. Additionally, during the course of our assessment, we noted that ORAU revised its fiscal year-end closing process. Specifically, the year-end closing checklist now contains a step requiring the Controller to prepare and record a journal entry to reimburse the ORISE contract's Letter of Credit bank account for ORAU corporate's share of bank service charges.

ORAU Foundation

We noted that ORAU paid the expenses of its wholly-owned subsidiary, the ORAU Foundation (Foundation), through the ORISE contract Letter of Credit bank account in FYs 2016 and 2017. According to a Letter of Credit analysis ORAU provided to the Department in September 2018, $118,890.84 in Foundation expenses were paid through the ORISE contract Letter of Credit bank account in FY 2016. In FY 2017, the amount of Foundation expenses paid through the ORISE contract Letter of Credit bank account increased to $237,731.73. In researching the Foundation, we found that the Foundation has a tax payer identification number separate from ORAU, has a separate business entity filing with the Tennessee Secretary of State, and files tax returns with the Internal Revenue Service separately from ORAU. This led us to conclude that the Foundation is a separate legal entity from ORAU.

We inquired if the Foundation had any contracts with or grants from the Department. Further, we inquired if the Department had authorized ORAU to pay Foundation expenses through the ORISE contract Letter of Credit Bank account. According to ORAU, the Foundation does not have any contracts with or grants from the Department. In addition, ORAU did not have any authorization or approval from the Department to pay Foundation expenses through the ORISE contract Letter of Credit bank account.

The payment of Foundation expenses through the ORISE contract Letter of Credit bank account violated prior Departmental direction. Specifically, the Department only authorized ORAU to use the ORISE contract Letter of Credit bank account for the payment of shared resources between ORAU and ORISE. The Department clearly stated that purely corporate expenses, including accounts payable disbursements and payroll, would be paid exclusively out of the ORAU corporate bank account. In the absence of a contract between the Department and the Foundation, or any specific approval from the Department, we questioned the appropriateness of paying Foundation expenses through the ORISE contract's Letter of Credit bank account. During the course of our assessment, ORAU revised its accounting process to ensure that Foundation expenses were no longer paid through the ORISE contract's Letter of Credit bank account. By April 2019, the revised process ensured that all Foundation accounting entries flowed through ORAU corporate accounts.

RECOMMENDATIONS

Since ORAU took corrective actions during the course of this assessment to address Internal Audit's risk assessment process, the bank service charges incurred from ORAU's use of the ORISE contract's Letter of Credit bank for shared resource costs, and the payment of ORAU Foundation expenses through the ORISE contract's Letter of Credit bank account, we are not making any formal recommendations.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management concurred with the report, as written, and did not provide any additional comments.

SCOPE AND METHODOLOGY

This assessment was performed from July 2018 through July 2019 at ORAU, located in Oak Ridge, Tennessee. The assessment was limited to Internal Audit activities, subcontract audits, Letter of Credit activities, and resolution of questioned costs and internal control weaknesses that impacted costs claimed by ORAU on the Statements of Costs Incurred and Claimed for FYs 2016 and 2017. The assessment was conducted under Office of Inspector General project number A18OR042.

To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit that included a review of allowable cost audit reports, workpapers, auditor qualifications, independence, audit planning (including risk assessments and the 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 the Letter of Credit usage 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 computer-processed data to a limited extent to accomplish our objectives and determined that it was sufficiently reliable for the purposes of our assessment by reviewing existing information about the data and the system that produced them.

Management waived an exit conference on September 15, 2019.

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.

Attachment

PRIOR REPORT

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* (DOE-OIG-18-25, March 2018). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Oak Ridge Associated Universities, Inc.'s Internal Audit (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 fiscal years 2012 through 2015 allowable cost reviews, all of which had been resolved by the time of our assessment. Also, we found that Internal Audit used a risk-based approach to auditing subcontracts. During fiscal years 2012 through 2015, Internal Audit conducted 14 audits of subcontracts, identified $770 in under-billings due back to subcontractors, and resolved those cost.

FEEDBACK

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