OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-21-21 April 2021

FISCAL YEAR 2018 EVALUATION OF INCURRED COST COVERAGE AT THE LAWRENCE BERKELEY NATIONAL LABORATORY

Department of Energy
Washington, DC 20585

April 8, 2021

MEMORANDUM FOR THE MANAGER, BAY AREA SITE OFFICE

SUBJECT: Audit Report on "Fiscal Year 2018 Evaluation of Incurred Cost Coverage at the Lawrence Berkeley National Laboratory"

The attached report discusses our review of incurred cost coverage during fiscal year 2018 for selected areas at the Lawrence Berkeley National Laboratory. This report contains five recommendations. Management generally concurred with the recommendations.

We conducted this audit from November 2019 through October 2020 in accordance with generally accepted government audit standards. We appreciated the cooperation and assistance received during this evaluation.

Jennifer L. Quinones
Deputy Inspector General
Office of Inspector General

cc: Deputy Secretary
Chief of Staff

DOE-OIG-21-21

Department of Energy
Office of Inspector General

Fiscal Year 2018 Evaluation of Incurred Cost Coverage at the Lawrence Berkeley National Laboratory

(DOE-OIG-21-21)

WHY DID OIG PERFORM THIS REVIEW?

In 1994, the Office of Inspector General (OIG), Department of Energy officials, and internal audit directors from selected sites, with management and operating contractors, implemented the Cooperative Audit Strategy, which allows management and operating contractors to audit their own incurred costs. Based on recent work conducted by the OIG and concerns expressed by external stakeholders, such as the Government Accountability Office, the OIG is evaluating the Cooperative Audit Strategy. As part of that effort, the OIG commenced six audits in fiscal year 2020 to review certain contractors' incurred cost coverage of selected areas. We initiated this audit to evaluate incurred cost coverage of selected areas during fiscal year 2018 at the Lawrence Berkeley National Laboratory.

What Did OIG Find?

We found that Lawrence Berkeley National Laboratory's allowable cost audit for fiscal year 2018 did not adequately evaluate incurred costs for allowability, allocability, and reasonableness. We noted weaknesses in Lawrence Berkeley National Laboratory Internal Audit's design of the audit risk assessment, sampling approach, and documentation. We also identified issues with year-end indirect rate variance disposition. Further, we determined that the Department's Statement of Costs Incurred and Claimed is an inadequate information submission of the management and operating contractor's claim and certification of costs incurred during the year.

What Is the Impact?

Given the large amount of taxpayer funding used for Department management and operating contracts, and the reliance on contractor internal audit functions to audit such funds, weaknesses in the annual evaluation of incurred costs could result in significant amounts of unallowable costs being charged to the Department and going undetected.

What Is the Path Forward?

The results of this audit will be used in conjunction with the results of multiple other audits, inspections, and investigations in arriving at conclusions regarding the Cooperative Audit Strategy and providing recommendations to the Department in an upcoming report.

BACKGROUND

The Regents of the University of California has managed and operated Lawrence Berkeley National Laboratory (LBNL) under contract with the Department of Energy and its predecessors since 1943. LBNL is a member of the national laboratory system supported by the Department through its Office of Science. LBNL conducts unclassified research across a broad range of scientific disciplines. LBNL incurred and claimed costs totaling approximately $858 million for fiscal year (FY) 2018, which is the period from October 1, 2017, to September 30, 2018.

As a management and operating contractor, LBNL's financial accounts were integrated with those of the Department, and the results of financial transactions were required to be reported monthly according to a reciprocal set of accounts. LBNL was required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed (SCIC), 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.

In 1994, the Office of Inspector General (OIG), Department officials, and internal audit directors from selected sites with management and operating contractors implemented the Cooperative Audit Strategy. The Cooperative Audit Strategy places reliance on the contractors' internal audit function to provide operational and financial audits, including allowable cost audits, as well as assessing the adequacy of management control systems. The Cooperative Audit Strategy requires that audits performed internally must, at a minimum, meet the Institute of Internal Auditors *International Standards for the Professional Practice of Internal Auditing* (IIA Standards). The OIG relies upon the contractors' internal audit activities and provides guidance to cognizant Contracting Officers, Heads of Contracting Activity, Department site managers, and cognizant Chief Financial Officers on the sufficiency of the design and operation of internal audit activities, particularly as they support the SCIC. Consistent with the Cooperative Audit Strategy, LBNL was required by its contract to maintain an internal audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. To assist internal audit activities, the OIG provided a sample allowable cost audit program through its OIG Audit Manual with the expectation that internal auditors would exercise professional judgment when creating an audit program appropriate for its operating environment.

The objective of this audit was to evaluate incurred cost coverage of selected areas during FY 2018 at LBNL. Therefore, we did not specifically evaluate individual incurred costs for allowability, allocability, and reasonableness.[1]

[1] The objective, scope, and methodology are contained in Appendix 1, and prior related work is contained in Appendix 2.

INTERNAL AUDIT'S ALLOWABLE COST AUDIT WAS INADEQUATELY DESIGNED

LBNL Internal Audit's (Internal Audit) allowable cost audit was not designed to adequately evaluate incurred costs for allowability, allocability, and reasonableness. The IIA Standards require that internal auditors exercise due professional care by considering the relative complexity, materiality, or significance of matters to which assurance procedures are applied, and to be alert to the significant risks that might affect objectives, operations, or resources. Under the Cooperative Audit Strategy, the Department and OIG rely upon the contractor's internal audit activity to review the allowability of costs claimed on the SCIC in accordance with the audit program approved by the OIG. The Department implements the Cooperative Audit Strategy through Department of Energy Acquisition Regulation contract clause 970.5232-3, *Accounts, Records, and Inspection*. We identified the following areas that were not adequately addressed:

- Direct and indirect costs were not fully considered in Internal Audit's risk assessment and transaction testing;
- Sampling was not always adequate to conclude incurred costs were allowable, allocable, and reasonable; and
- Workpaper documentation was inadequate to support work performed.

Costs Were Not Fully Considered in Assessing Risk and Transaction Testing

Internal Audit did not evaluate the substantial risks of indirect costs separate from direct costs in its allowable cost audit. This is significant because LBNL's indirect costs totaled $506 million, of which $383 million or 45 percent is included in the $858 million reported on the SCIC for FY 2018. The OIG Audit Manual, Chapter 14, *Guidelines for Contractor Internal Auditors*, includes procedures to evaluate the risks associated with direct and indirect costs. A direct cost is any cost that specifically supports a single cost objective.[2] On the other hand, an indirect cost is any cost that supports two or more cost objectives, is grouped with similar costs, and then allocated to multiple cost objectives based on relative benefits received or another equitable relationship. Accordingly, indirect costs are inherently riskier when compared to direct costs. The OIG Audit Manual, Chapter 14, also states that Internal Audit should evaluate changes in direct and indirect charging practices, changes in Cost Accounting Standards Disclosure Statements (Disclosure Statement), and fluctuations in direct and indirect labor charges, as well as verify that costs are properly classified by expense category, are consistently treated, and comply with Cost Accounting Standards. While we observed some limited reviews, such as comparing total direct and total indirect costs from the prior FY to the current FY, Internal Audit did not differentiate between direct and indirect costs to adequately evaluate indirect costs. For example, Internal Audit compared the FY 2017 and FY 2018 rates that were in the Office of Chief Financial Officer Annual Financial Report. Internal Audit also reviewed the LBNL rate handbook for changes in direct/indirect charging procedures and practices. However, we found

[2] Cost Accounting Standard 402-30, *Definitions*, defines a "cost objective" as a function, organizational subdivision, contract, or other work unit for which cost data is desired and for which provision is made to accumulate and measure the cost of processes, products, jobs, capitalized projects, etc.

no evidence that auditors attempted to review the nature of costs (i.e., direct or indirect), and how the costs were included in their respective pools and bases. Instead, Internal Audit focused its testing of costs at the account level (e.g., travel, accounts payable, etc.). Internal Audit did not always perform substantive testing to ensure that indirect costs were accumulated in indirect cost pools that were homogeneous, or that pooled costs were allocated to cost objectives in a reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives, as required by Cost Accounting Standards.

These issues occurred for a couple of reasons. According to the Chief Audit Executive, management did not typically raise indirect rates as a risk topic during annual audit planning meetings, but the Chief Audit Executive noted that Internal Audit considered indirect rates on a cyclical basis. When further questioned about these issues, Internal Audit stated that it followed the methodologies contained in the OIG Audit Manual. However, the OIG Audit Manual does not set forth detailed procedures for the allowable cost audit. Instead, the OIG Audit Manual makes it clear that internal auditors must exercise professional judgment and ensure procedures are applicable to their operating environment.

Sampling Was Not Adequate to Evaluate Allowability, Allocability, and Reasonableness

Internal Audit did not always perform adequate sampling in its allowable cost audit to determine whether incurred costs were allowable, allocable, and reasonable. OIG Audit Manual, Chapter 14, states that it is expected that a recognized statistical sampling methodology will be used to sufficiently reach a conclusion on the allowability of costs and permit the projection of unallowable costs. If not statistical, it states that the rationale for using judgmental sampling should be clearly documented in the auditor's workpapers. However, we identified concerns with Internal Audit's sampling methods regarding sample sizes and evaluation of sample test results. Internal Audit based its sample sizes of 10, 25, or 50 transactions on its assessed risk levels, which were low, medium, or high, respectively. We found that the sample sizes used did not always correspond with the associated risk assessments. For example, Internal Audit sampled 10 travel transactions corresponding to a low-risk level, but the risk assessments showed that travel was considered medium- to low- and even high-risk.

Also, Internal Audit's set sample sizes were not valid for use in its statistical Monetary Unit Sampling test work. Monetary Unit Sampling determines sample sizes based on factors, such as the confidence level, materiality level, and expected total errors. However, Internal Audit did not consider these factors in establishing its set sample sizes of 10, 25, or 50, which compromised the statistical validity of the testing. To illustrate, Internal Audit's sample of 10 accounts payable transactions, valued at about $551,000, which was less than 1 percent of the population of $338 million, would not be statistically valid. As a comparison, we calculated Monetary Unit Sampling sizes of over 90 transactions for each of the populations Internal Audit tested using a 95 percent confidence level, 5 percent materiality level, and 1 percent expected error rate. Because Internal Audit's samples were non-statistical, or judgmental in nature, the results and overall conclusions would be limited to the transactions tested and not projectable to the entire population of incurred costs.

In addition, Internal Audit did not evaluate the results of its Monetary Unit Sampling test work to determine if the account was materially misstated and to project the findings to the population. Internal Audit did not complete the statistical evaluation on any of its statistical samples as required under Monetary Unit Sampling. Internal Audit also did not document why it judgmentally expanded testing when it found errors in its statistical samples as opposed to evaluating the samples to project the unallowable costs to the population. For example, in one statistical sample, Internal Audit found an unallowable late payment and decided to limit its review to other reimbursements made to the employee associated with the late payment. Internal Audit performed this judgmental sampling without documenting its explanation on why the error was not representative of the population.

This occurred because Internal Audit did not follow the OIG Audit Manual when selecting and documenting its sampling approach and also lacked sufficient procedures. As mentioned previously, per the OIG Audit Manual, Chapter 14, a recognized statistical sampling methodology should be used to sufficiently reach a conclusion on the allowability of costs and permit the projection of unallowable costs; if statistical sampling is not used, the rationale for using another approach should be clearly documented in the auditor's workpapers. Internal Audit stated that it had sufficient reasons for the risk levels associated with its sampling procedures but failed to always document them. Regarding sample sizes, Internal Audit followed its own sampling policy developed in 2013 because it believed that the approach would make better use of resources and increase coverage in areas of high risk. However, its sample sizes were a fraction of the sizes we calculated to provide minimal coverage of incurred costs. Internal Audit further stated that coverage for incurred costs was provided by other audits, but we did not find documentation in the cost allowability audit workpapers or the audit report that explained how the other audit work impacted cost allowability transaction testing. This also occurred because LBNL lacked sufficient procedures. LBNL's *Internal Audit Manual* states that the scope, sampling methodology, and degree of testing to achieve the audit objective must be prepared in advance. However, we did not identify any Internal Audit procedures that helped auditors determine whether the appropriate sampling technique to use was judgmental or statistical, describe how statistical sampling would be conducted and evaluated, or explain how errors would be handled through expanded testing.

Workpaper Documentation Was Not Adequate to Support Work Performed

Internal Audit did not always adequately document support for its work within its workpaper files. Internal Audit's charter states that it shall comply with IIA Standards. The IIA Standards state that internal auditors must document sufficient, reliable, relevant, and useful information to support the engagement results and conclusions. However, we found instances where Internal Audit workpapers lacked support for work performed. For example, Internal Audit stated it conducted a reconciliation of claimed costs to the SCIC, but the workpapers only included a summary of the reconciliation. Internal Audit told us that the reconciliation was kept outside the workpapers in offline storage, but that information was not documented in the workpaper file. Also, while Internal Audit included the Audit Command Language script it used to extract data from LBNL's general ledger, it did not note in the workpaper file that it kept the large extract files that were necessary to validate the data outside the workpapers in offline storage. When we discussed this issue with Internal Audit, it recognized areas where it could have done a better job when documenting its work.

STATEMENT OF COSTS INCURRED AND CLAIMED IS INADEQUATE

Department of Energy Acquisition Regulation 970.5232-2, *Payments and Advances,* Alternate III, requires contractors with integrated accounting systems to annually prepare, submit, and certify the SCIC, and requires that the SCIC be audited. In addition, Chapter 23 of the Department's Financial Management Handbook, *Statement of Costs Incurred and Claimed*, states that the SCIC serves as the contractor's claim and certification that the contractor's costs are allowable, allocable, and reasonable under the contract.

Further, Department of Energy Acquisition Regulation 970.3002-1, *CAS Applicability,* requires integrated contractors to follow Cost Accounting Standards. Cost Accounting Standard 418, *Allocation of Direct and Indirect Costs* (CAS 418), -40, *Fundamental Requirements,* requires indirect costs to be accumulated in homogenous indirect cost pools and that pooled costs be allocated to cost objectives in reasonable proportion to the beneficial or causal relationship of the pooled costs to cost objectives. Due to these requirements, in order for the internal auditors to evaluate integrated contractors' claimed indirect costs for compliance with Cost Accounting Standards and adequately test all claimed costs for allowability, allocability, and reasonableness, integrated contractors should prepare, maintain, and audit adequately detailed indirect cost information.

The Defense Contract Audit Agency has established a benchmark that it requires of an indirect cost submission that would allow for meaningful audit. In addition, Federal Acquisition Regulation 52.216-7, *Allowable Cost and Payment* (FAR 52.216-7), section (d), *Final Indirect Cost Rates,* establishes the data that an adequate indirect cost submission must include. While FAR 52.216-7 was not a LBNL contractual requirement, it is a representation of the type of data considered necessary for indirect cost certification and audit.

Both the Department and the OIG relied on the contractors' internal auditors to perform their audits to test for allowability, allocability, and reasonableness of costs under the contract, as well as compliance with Cost Accounting Standards. As discussed previously, however, Internal Audit did not always design its audit procedures appropriately. We found no evidence that Internal Audit questioned the format and usefulness of the SCIC in facilitating an effective cost allowability audit.

When we evaluated the Department's SCIC form against the Defense Contract Audit Agency's *Checklist for Determining Adequacy of Contractor Incurred Cost Proposal* and FAR 52.216-7, we found a number of areas that were not explicitly addressed by the SCIC. For example, claimed pools and allocation bases by element of cost, used to accumulate and distribute indirect costs, were not included. The omission of this data would limit the Department's visibility into the composition of the pools and allocation bases, and limit the Department's ability to understand how indirect costs were allocated in order to make an accurate determination on allowability, allocability, and reasonableness.

This occurred for a couple of reasons. First, the Cooperative Audit Strategy relies significantly on integrated contractors to audit themselves. The Department's SCIC form only requires a high-level summary of costs claimed for the year, and it does not explicitly require submission of the detail necessary to evaluate indirect costs. Along the same lines, the Department requires its integrated contractors to submit an Institutional Cost Report that shows indirect costs by category at a summary level, but again, does not explicitly require submission of the details for individual costs in each category. Despite the generality of these forms, it is important to note that nothing within the Department's SCIC form, or the Department's Institutional Cost Report, excused the obligation for Internal Audit to perform its audits to test for compliance with the acquisition regulations or the applicable Cost Accounting Standards. In exercising due professional care, Internal Audit should have concluded that the format of the SCIC was not adequate to facilitate an effective audit and should have recommended this issue be corrected.

This situation also occurred because even though the Department was required to review and approve the SCICs submitted by the contractors, the Department's review and approval process was limited in scope and did not constitute an audit. The OIG also had the responsibility to "assess" these SCIC submissions. However, the OIG SCIC assessments were also limited in scope and did not constitute an audit. These assessment activities were not designed to replace the allowable cost audit that should have already been conducted by the internal auditors. As a result, the errors described in our report went undetected by the Department and the OIG.

VARIANCE DISPOSITION DID NOT COMPLY WITH COST ACCOUNTING STANDARDS

In FY 2018, LBNL did not disposition its year-end indirect rate variances in a manner that complied with the requirements in Cost Accounting Standards. Per CAS 418, when pre-established indirect rates are used, the costs must be allocated in reasonable proportion to the beneficial or causal relationship of the pooled costs to the cost objectives. Under CAS 418, contractors must distribute material variances to each cost objective in the same proportion as the contractor previously charged those objectives. For example, if actual costs were materially more than initially recovered using the pre-established rates, each cost objective should be charged its proportionate share of the additional costs. On the other hand, if actual costs were materially less than initially recovered using the pre-established rates, then each cost objective should be repaid its proportionate share of the overpayment. In addition, Cost Accounting Standard 406, *Cost Accounting Period* (CAS 406), establishes the contractor's FY as its cost accounting period for purposes of accumulating indirect costs into pools and establishing its allocation bases. However, LBNL's FY 2018 year-end indirect rate variances were not properly dispositioned to each cost objective or recognized in the proper accounting period. The table below depicts the FY 2018 indirect rate variances by individual cost pool.

LBNL Indirect Cost Pool Recoveries (Under)/Over* for FY 2018			
Indirect Cost Pools	**Variance**	**Actual Pool Costs**	**Pool Percentage**
General and Administrative** FY 2017 Carryover Variance (net)	$ 3.241M		
General and Administrative**	$ (1.543)M	$ 191.788M	0.80%
Procurement	$ .410M	$ 14.000M	2.93%
Laboratory Directed Research and Development	$ .028M	$ 20.317M	0.14%
Institutional General Plant Projects	$ .408M	$ 8.921M	4.57%
Travel	$ .061M	$ 1.331M	4.58%
Organization Burdens (net)	$ .215M	$ 58.516M	0.37%
Recharges (net)	$ (.239)M	$ 45.067M	0.53%
Payroll Burden	$ .945M	$ 164.588M	0.57%
Office of Homeland Security	$ .004M	$ .233M	1.72%
Safeguards and Security Charge	$ .000M	$ .831M	0.00%
Federal Administrative Charge	$ (.004)M	$ .970M	0.41%
Total* **	**$ 3.526M**	**$ 506.561M**	**0.70%**

*Under-recovered indirect costs are indicated by parentheses
**The General and Administrative pool is the sum of LBNL's General and Site Support pools
***Immaterial rounding

As shown in the table, LBNL carried over a $3.241 million net variance from FY 2017 in its FY 2018 General and Administrative (G&A) pool and had a $3.526 million overall net variance at the end of FY 2018. Instead of dispositioning the indirect cost rate variances to the individual bases in the proper accounting period, as required by CAS 418 and CAS 406, LBNL has been carrying over net variances of over- or under-recovered costs to the subsequent accounting period through a series of accounting entries. To illustrate, at the close of FY 2018, LBNL netted the individual positive and negative pool variances (over- and under-recovered costs) and accrued the net $3.526 million over-recovered cost variance to the G&A pool, with a corresponding entry to the accrued expenses balance sheet account. Therefore, LBNL accrued costs that were not associated with any actual product or service received in FY 2018, which was an improper accounting recognition of an expense. Furthermore, at the beginning of FY 2019, LBNL reversed the FY 2018 year-end accrual entry, with a credit to the FY 2019 G&A pool of $3.526 million, which completed the disposition of the FY 2018 net variance. This practice dispositioned the individual FY 2018 indirect rate variances to the G&A base of FY 2019, which was not the proper accounting period. Similarly, the FY 2018 G&A cost pool began with a credit of $3.241 million from the over-recovered indirect rate variance from FY 2017, so that amount was also not reflected in the proper accounting period.

We determined that LBNL's variance disposition practice did not maintain the integrity of beneficial or causal relationships within the respective indirect cost pools and their bases, as required by CAS 418. For example, as shown in the table above, LBNL netted variances of unrelated pools, such as the Procurement, Laboratory Directed Research and Development, and Travel pools to the G&A pool, as if the final cost objectives benefited equally from them. In addition, as described in CAS 406, contractors are to use the same accounting period for accumulating pool costs as for establishing the allocation bases. LBNL did not comply with CAS 406 when it dispositioned the individual indirect rate variances of one FY to the G&A base of the subsequent FY. This CAS 406 noncompliance potentially further impacted the beneficial or causal relationship between LBNL's pools and bases because the G&A base may be substantially different from the base or bases that contributed to the variances from the previous cost accounting period.

This issue occurred because LBNL officials did not consider the year-end indirect rate cost variances to be material and stated the variances would require extensive effort to resolve. When we discussed the FY 2018 year-end variances with LBNL officials, they stated that they considered the variances to be immaterial on both a pool and total costs claimed basis. They also stated that $3.526 million variance at the end of FY 2018 should be netted against the $3.241 million carried forward from FY 2017, a difference of about $285,000. They further stated that the $3.526 million variance had less than a 0.30 percent impact at the Budget and Reporting level. LBNL's analysis showed the impact of dispositioning the FY 2018 net variance to the FY 2018 G&A base compared to the FY 2018 individual base of each indirect rate. We concluded that the impact comparison should have used the FY 2019 G&A base because that was the actual base used to dispose of the FY 2018 net variance. Further, LBNL officials stated that adjusting the rates to actuals would be an intensive and iterative process involving millions of transactions. As mentioned previously, the variance should be dispositioned appropriately to preserve beneficial or causal relationships between pools and bases, as well as to reflect the proper accounting period, as required by Cost Accounting Standards.

THE DEPARTMENT APPROVED A NONCOMPLIANT PRACTICE

The Department approved LBNL's FY 2018 Disclosure Statement despite it containing a practice noncompliant with Cost Accounting Standards. LBNL's FY 2018 Disclosure Statement described its practice of netting variances against other unrelated pool variances and then carrying forward the net indirect variance amount by reinstating the net variance to the G&A pool in the subsequent year. Yet, the Bay Area Site Office Contracting Officer approved the Disclosure Statement without questioning this practice that, according to LBNL officials, had been in place since 2006, or over 13 years.

This situation occurred because the Department did not fully consider the aggregated impact of LBNL's proposed variance disposition practice. The Bay Area Site Office Contracting Officer approved, in conjunction with review provided by the Department's Office of Science Consolidated Service Center, LBNL's Disclosure Statement after LBNL satisfactorily addressed its areas of concern. The Contracting Officer approved the variance disposition practice in the Disclosure Statement provided the variances were immaterial. However, the Department's reasoning did not consider the consequences to the allocation of costs from carrying forward the variances from year to year.

THERE IS AN INCREASED RISK OF UNALLOWABLE CLAIMED COSTS AND IMPROPER COST ALLOCATION

As a result of the issues identified above, there is an increased risk that LBNL charged unallowable costs to the Department, and LBNL's FY 2018 incurred costs were improperly allocated to some of its cost objectives. Weaknesses in the design of the allowable cost audit increased the risk that LBNL claimed unallowable costs because the level of testing and substantive procedures performed were adversely impacted, particularly regarding indirect costs. This is significant because LBNL's indirect costs totaled $506 million, of which $383 million or 45 percent is included in the $858 million reported on the SCIC for FY 2018. Overall, the weaknesses we identified in Internal Audit's allowable cost audit design lessened the value of Internal Audit's determination that incurred costs were allowable, allocable, and reasonable.

As a result of the SCIC's inadequacies, Internal Audit, the OIG, and the Department have not had ready access to indirect cost details to ensure claimed costs were allowable, allocable, and reasonable. Further, an inadequate indirect cost submission limits the Department's visibility into the composition of the indirect cost pools and allocation bases, and therefore its ability to manage costs. Overall, this limits the Department's ability to evaluate its indirect costs. Because in many cases indirect costs are significant, this is a serious issue.

Finally, due to LBNL's CAS 418 and CAS 406 noncompliant year-end indirect rate variance disposition practice, some of LBNL's FY 2018 incurred costs were improperly allocated to some of its cost objectives. Of the $858 million LBNL incurred in FY 2018, Department-funded projects accounted for $750 million and non-Department-funded projects, such as Strategic Partnership Projects, totaled $108 million. LBNL's noncompliant practice of netting variances and rolling the net variance into the next year's G&A pool has continued for over 13 years. We did not attempt to quantify the overall impact of this practice due to our limited audit scope. According to a Department official, LBNL's practice was indicative of a larger Departmental problem in that the practice does not recognize the individuality of congressional controls, appropriation years, and Strategic Partnership Projects. Combining indirect costs from multiple pools that were applicable to multiple funding sources may have caused the Department to use funds for unintended purposes. Specifically, 31 U.S. Code § 1301(a), the purpose statute, which can be applied to indirect and direct activities, prohibits the use of appropriations for purposes other than those for which they were appropriated.

RECOMMENDATIONS

This audit was performed as part of the OIG's overall initiative to review the Cooperative Audit Strategy. The results of this audit will be used in conjunction with the results of multiple other audits, inspections, and investigations in arriving at conclusions regarding the Cooperative Audit Strategy and providing recommendations to the Department in an upcoming report. In the meantime, to address the issues identified in this report, we recommend that the Manager, Bay Area Site Office, work with the Department and LBNL to address the following:

1. Ensure the appropriate design and execution of allowable cost audits;

2. Require the proper use and documentation of sampling in allowable cost audits;

3. Require proper documentation in allowable cost audits;

4. Revise policies, procedures, and disclosures related to the process of year-end indirect rate variance disposition to be consistent with Cost Accounting Standards and ensure procedures recognize the individuality of congressional controls; and

5. Work with the Department to examine the SCIC submission and its ability to adequately evaluate costs.

MANAGEMENT RESPONSE

Management generally concurred with the report's recommendations and identified corrective actions it would take to address the issues included in the report. While disagreeing over the findings, management stated it would work with the Department and LBNL officials to change or update practices and requirements, as appropriate.

Management's comments are included in Appendix 3.

AUDITOR COMMENTS

Management has generally agreed with the report's recommendations and has identified corrective actions it will take to address the issues included in the report. Management's proposed corrective actions were generally responsive to our recommendations.

With regard to the disagreement over the findings, the OIG stands by its findings and has significant concerns with the manner in which Internal Audit performed its allowable cost audit risk assessment, sampling approach, and documentation.

Further, where management noted this report appears to contradict past OIG reports, the OIG maintains that this audit did not have the same objective or scope as our previous review level engagements, and different procedures were used to identify potential gaps in Internal Audit's coverage of incurred costs.

Where management disputes the finding regarding indirect costs by asserting that it did sample such costs, the OIG notes on page 2 that Internal Audit did not differentiate indirect costs from direct costs when developing its reviews. In addition, the OIG clearly demonstrates why indirect costs are riskier than direct costs.

Where management disputes the finding about the adequacy of sampling, the OIG notes on page 3 that the LBNL sample sizes used did not always correspond with the associated risk assessments, and when Internal Audit did choose statistical sampling methodologies, the OIG found that it did not calculate statistically valid sample sizes and limited its conclusions to the transactions tested. Thus, even the performed statistical samples provided limited incurred cost coverage.

Where management disputes the finding about the adequacy of workpaper documentation, the OIG notes on page 4 of that Internal Audit's workpapers lacked support or were not present in the audit files reviewed. Further, OIG auditors required regular verbal interactions with the internal auditors when reviewing workpapers to get adequate understandings and to arrive at the same conclusions.

Where management nonconcurs with the finding about the SCIC format being inadequate by claiming that the DEAR clauses in its contract do not require greater details, its claim that additional data is available if needed seems to be a contradiction. In order to effectively audit the incurred costs, more detailed information is necessary than what is required in the current SCIC format, which the Department appears to agree with by stating that additional data is available if needed. The report does not state that the DEAR clauses currently require greater details. Page 5 explains that the OIG finds the SCIC format inadequate because it limits the Department's ability to understand how indirect costs were allocated impacting determinations on allowability, allocability, and reasonableness.

Where management disputes the finding that Internal Audit should have concluded that the format of the SCIC was not adequate to facilitate an effective audit, page 6 notes Internal Audit does have a responsibility to exercise due professional care in its activities. Experienced auditors could have identified this issue just as the OIG did and should have recommended that this be corrected.

Where management disputes the finding of year-end indirect rate variance disposition, the OIG found that the LBNL practice does not conform with Cost Accounting Standards related to maintaining a beneficial or causal relationship. On page 7 the OIG explains that "LBNL is netting unrelated pools such as the Procurement, Laboratory Directed Research and Development, and Travel pools, to the G&A pool, as if the final cost objectives benefitted equally from them." The OIG notes that management is not taking issue with our description of its practices but rather claiming it complied with Cost Accounting Standards under an immateriality exception despite the millions of dollars involved. The OIG also found that LBNL has not provided a cost impact statement to demonstrate that compliant practices would have a negative cost impact to the Government or be significantly less convenient.

Where management nonconcurs with our statement that there is an increased risk of unallowable claimed costs and improper cost allocation due to the design of the allowable cost audit, the OIG notes on page 9 that our conclusion is based on a flawed allowable cost audit design, inadequate indirect cost submission, and a noncompliant year-end indirect rate variance disposition practice. The culmination of these findings lessened Internal Audit's ability to make adequate determinations that incurred costs were allowable, allocable, and reasonable.

Finally, the OIG recognizes that the details of the Cooperative Audit Strategy provided by management as Attachment 1 of their comments is material quoted from the Acquisition Guide and a 1992 memorandum, as well as information pertaining to the Steering Committee for Quality Audits. The OIG is aware of this information, and we considered all of this, and much more, while conducting our review. As mentioned on page 9, the results of this audit will be used in conjunction with the results of multiple other audits, inspections, and investigations in arriving at conclusions regarding the Cooperative Audit Strategy and providing recommendations to the Department in an upcoming report.

OBJECTIVE

We conducted this audit to evaluate incurred cost coverage of selected areas during fiscal year 2018 at the Lawrence Berkeley National Laboratory (LBNL).

SCOPE

The audit was performed from November 2019 through October 2020 at LBNL and the Bay Area Site Office in Berkeley, California. The audit scope included costs incurred and claimed by The Regents of the University of California for fiscal year 2018. The audit was conducted under Office of Inspector General project number A20CH008.

METHODOLOGY

To accomplish our audit objective, we:

- Reviewed applicable Federal laws and regulations, United States Code, Cost Accounting Standards, Department of Energy and LBNL policies and procedures, LBNL contract provisions, and other legal requirements related to the audit objective.

- Interviewed Department officials and LBNL personnel, including LBNL's Internal Audit (Internal Audit), responsible for management and oversight of incurred costs.

- Reconciled LBNL's underlying accounting system data to the amounts contained in the Statement of Costs Incurred and Claimed and compared the information to the Letter of Credit.

- Identified related-party disclosure procedures and determined whether LBNL was properly disclosing related parties and following applicable procedures.

- Reviewed LBNL's Cost Accounting Standards Disclosure Statements for significant cost accounting changes and assessed the adequacy of the Department's review process.

- Reviewed monthly indirect rate variance reports and evaluated disposition of the variances.

- Reviewed project cost over- and underruns, and evaluated whether direct and indirect costs were consistently charged to projects.

- Evaluated unallowable costs for proper inclusion in allocation bases and removal from claimed costs.

- Evaluated whether beneficial and causal pool/base relationships existed within LBNL's indirect rate structure.

- Assessed whether LBNL personnel responsible for evaluating subcontract costs adequately evaluated costs, resolved questioned costs, and reported questioned costs to the Contracting Officer.

- Reviewed and evaluated Internal Audit's risk assessment process for preparing its annual audit plan and conducting its cost allowability audit.

- Reviewed the Internal Audit files that supported reports with questioned costs to determine if all questioned costs had been reported.

- Reviewed and evaluated LBNL's Internal Audit performance regarding sampling, workpaper documentation, and supervisory review.

- Used judgmental sampling throughout the project and adequately documented the applicable details in the relevant workpapers. 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 costs.

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 objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We assessed internal controls and compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed the internal control components and underlying principles significant to the audit objective. Specifically, we assessed the control environment component and underlying principles regarding LBNL's establishment of structure, responsibility, and authority. We assessed the risk assessment component and the underlying principles of identifying, analyzing, and responding to risk. We also assessed control activities as implemented through policies and information systems design. Further, we assessed the information and communication component regarding using quality information. Finally, we assessed monitoring and the underlying principle of performing monitoring activities. However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit.

We assessed the reliability of LBNL's fiscal year 2018 financial cost data by reconciling underlying database information to the Statement of Costs Incurred and Claimed. We validated a portion of the database transactions by reviewing documentation supporting the data and the system that produced the data, and interviewing LBNL officials knowledgeable about the data. We determined that the data was sufficiently reliable for the purposes of this report.

Management officials waived an exit conference on April 1, 2021.

- Assessment Report on *Audit Coverage of Cost Allowability For University of California From October 1, 2014 To September 30,2017, Under Department of Energy Contract No. DE AC02 05CH11231* (DOE-OIG-20-36, March 2020). During the assessment,[3] nothing came to the Office of Inspector General's (OIG) attention to indicate that the allowable cost-related audit work performed by Lawrence Berkeley National Laboratory's (LBNL) internal audit function (Internal Audit) from October 1, 2014, to September 30, 2017 could not be relied upon. The OIG did not identify any material internal control weaknesses with the cost allowability audits, which generally met the *International Standards for the Professional Practice of Internal Auditing* prescribed by the Institute of Internal Auditors. The OIG identified questioned costs related to conference and meeting expenses as a result of its independent tests of transactions. In addition, the OIG identified certain audit standards that were not always followed. However, these issues did not affect the overall reliance on the cost allowability audits performed by Internal Audit. From October 1, 2014, to September 30, 2017, Internal Audit identified $53,985 of questioned costs as part of its allowable cost audits and other reviews, all of which had been resolved. Further, the OIG found that LBNL generally arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. However, the OIG identified one subcontract that incurred costs totaling $4,061,038 during fiscal year (FY) 2017 that had not been audited as required; therefore, the OIG considered those costs unresolved pending audit. The OIG made recommendations to address the issues identified.

- Assessment Report on *Audit Coverage of Cost Allowability for the University of California During Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE AC02 05CH11231* (OAI-V-16-10, June 2016). Based on the OIG's assessment,[4] nothing came to its attention to indicate that the allowable cost-related audit work performed by LBNL's Internal Audit for FYs 2013 and 2014 could not be relied upon. The OIG did not identify any material internal control weaknesses with the cost allowability audits, which generally met the *International Standards for the Professional Practice of Internal Auditing* prescribed by the Institute of Internal Auditors. Internal Audit identified $12,900 in questioned costs as part of its allowable cost audits and other reviews, all of which had been resolved or reimbursed to the Department of Energy. Further, the OIG found that the University of California generally arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. The subcontract audits did not identify any questioned costs. However, the OIG identified two subcontracts that incurred costs during FYs 2013 and 2014 that had not been audited. The two subcontracts incurred total costs of $11,590,877. LBNL arranged to have Internal Audit perform one of the subcontract audits, which accounted for more than 98 percent of the unresolved costs. LBNL was also working with the second subcontractor to ascertain the status of its Single Audit Act audit of FY ending June 30, 2014. However, the OIG considered $11,590,877 as unresolved pending audit. The OIG made a recommendation to address the issues identified.

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[3] 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.
[4] Ibid.

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March 30, 2021

MEMORANDUM FOR JENNIFER L. QUINONES
DEPUTY INSPECTOR GENERAL
OFFICE OF INSPECTOR GENERAL

FROM: PAUL M. GOLAN 3/30/2021
SITE OFFICE MANAGER

SUBJECT: OIG AUDIT: FISCAL YEAR 2018 EVALUATION OF INCURRED COST COVERAGE AT LAWRENCE BERKELEY NATIONAL LABORATORY (LBNL)

The Office of Science (SC) Bay Area Site Office (BASO) strongly supports the Office of Inspector General's (OIG) objective to improve the operations of the Department of Energy (DOE). BASO also supports efforts to ensure that reviews of incurred costs are transparent and effective.

As the OIG noted, the Cooperative Audit Strategy was developed and implemented by the Department of Energy in collaboration with the OIG as well as with officials and internal audit directors from selected management and operating contractors (M&O).

For many years, we have worked together in this endeavor and the OIG has played a key role in this process. Therefore, addressing concerns about the implemented strategy's ongoing effectiveness should include an assessment of the entire process, including the role of the OIG.

PAST OIG SCIC ASSESSMENTS
This report appears to contradict past OIG reports including DOE-OIG-20-36 "Audit Coverage of Cost Allowability for the University of California from October 1, 2014, to September 30, 2017" (March 16, 2020) which stated that:

> *During our assessment, nothing came to our attention to indicate that allowable cost-related audit work performed by Internal Audit from October 1, 2014, through September 30, 2017, could not be relied upon. Based on our limited sampling, we did not identify any material internal control weaknesses with allowable cost audits, which generally met the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors.*

LBNL's Internal Audit has not changed its approach or process since the above, and three previous OIG reports issued since 2010. It appears that the OIG may have changed its policy and/or procedures for assessing the Department's long-standing cooperative audit strategy.

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RESPONSE TO AUDIT FINDINGS AND RECOMMENDATIONS

OIG Finding 1: INTERNAL AUDIT'S ALLOWABLE COST AUDIT WAS NOT ADEQUATELY DESIGNED

BASO non-concurs on the main finding and the three sub-findings. BASO specifically disagrees with the report's statement that:

> "*LBNL Internal Audit's (Internal Audit) allowable cost audit was not designed to adequately evaluate incurred costs for allowability, allocability, and reasonableness.*"

LBNL's Internal Audit exercised due professional care, and from their long experience, they inherently understand the complexity, materiality, and significance of matters related to LBNL's operations. Past reports by LBNL's Internal Audit demonstrate that the auditors are alert to significant risks that might affect LBNL's objectives, operations, or resources.

***Sub-Finding a**: Direct and Indirect Costs Were Not Fully Considered in Assessing Risk and Transaction Testing*

BASO non-concurs on the sub-finding; LBNL's Internal Audit included indirect costs in their sample. If the OIG does not believe enough indirect costs were considered, then perhaps the OIG should revise its sample audit program or mandate a specific assessment of indirect expenses and how they contribute to the Department's costs.
The report states that indirect costs are inherently riskier when compared to direct costs. The OIG offered no basis for this opinion; no independent study, no analysis of issues related to direct and indirect costs, or any examples from other laboratories where indirect costs are more problematic. Previous OIG Assessment Reports did not reference this point.

***Sub-Finding b**:* Sampling Was Not Adequate to Evaluate Allowability, Allocability, and Reasonableness

BASO non-concurs on this sub-finding. While statistical sampling may be the OIG's preferred sampling methodology for incurred cost audits, judgmental sampling is not prohibited. LBNL's Internal Audit followed the *DOE OIG Audit Manual, Chapter 14, Sample Audit Program for Allowable Cost Reviews*, that states:

> ***The audit steps are general guidance and should be expanded or eliminated as necessary to fit the contractor's audit environment and risk assessment****. The program is intended to provide a logical sequence to the audit fieldwork and to reflect a mutual understanding between the auditor and supervisor as to the scope required to meet auditing standards and the audit's objectives for allowable costs reviews. It is expected that those portions of the audit that are covered in other audits will be referenced and incorporated in this review.*

The guidance for sampling in the OIG Audit Manual does not mandate a sampling methodology, nor does it prescribe specific sample sizes. Per OIG guidance, the sample size is determined using the audit environment, risk assessment, and coverage from other audits. LBNL's Internal Audit considered these factors in their sampling.

Auditing standards do not mandate statistical or non-statistical sampling nor a specific sample size. LBNL's Internal Audit determined the appropriate sampling methodology and sample size based on its professional judgment on risks, resources, and effectiveness, consistent with auditing standards and guidance. The following auditing standards apply in this situation:

- Institute of Internal Auditors, Practice Advisory 2320-3 – The auditor may use non-statistical (judgment) sampling to confirm a condition.
- Accounting Oversight Board, General Auditing Standards 2315 Audit Sampling – The auditor chooses between statistical or non-statistical sampling that provides sufficient audit evidence after considering their relative cost and effectiveness. Conditions leading to a smaller sample size include a low assessed level of inherent or control risk and risk associated with other relevant substantive procedures.
- American Institute of Certified Public Accountants Auditing Standards Board, Statement on Auditing Standards 39 Audit Sampling - The auditor is not required to select a specific number of items comparable to the statistical sample size. If their experience with a subject matter has been good, the auditor might continue to use sample sizes proven effective.

Sub-Finding c: Workpaper Documentation Was Not Adequate to Support Work Performed

BASO non-concurs with this sub-finding. The location of sizeable, detailed data files vs. summary documentation is insufficient to support this finding. LBNL's Internal Audit provided sufficient detail for an experienced auditor, having no previous connection to the audit, to understand the audit documentation. The inclusion of the script used to generate the data is a notable positive as it provides a greater understanding of the audit procedures than just making the data available. The actual data location is ancillary to an outside auditor understanding the audit procedures performed, the audit evidence obtained, and the conclusions reached.

BASO will provide direction on audit documentation when the Department clarifies and updates the internal audit function requirements on data storage.

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Response to Recommendations

The OIG makes three recommendations associated with this finding.

1. Ensure the appropriate design and execution of allowable cost audits.
2. Require the proper use and documentation of sampling in allowable cost audits.
3. Require proper documentation in allowable cost audits.

While BASO non-concurs with the finding, we support the associated recommendations. We ask that the OIG consider a change to the Department's audit requirements and revise the Audit Manual to align with the summary of Chapter 14 provided in the report. BASO will work with the SC, Consolidated Service Center (CSC), Office of Financial Services (OFS) to assist the OIG in updating the Audit Manual and the Department's internal audit function requirements.

BASO will explore ways to clarify for outside readers the work performed by LBNL's Internal Audit on direct and indirect costs. BASO does not support an update to the allowable cost audits that adds the review of indirect cost pools for homogeneity and the beneficial or causal relationship of the pooled costs to cost objectives.

BASO will work with LBNL's Internal Audit to assess the need for statistical sampling. The methodology will need to be in the Government's best interest, cost-effective, and provide actionable results.

J. L. Quinones Page 5

OIG Finding 2: STATEMENT OF COSTS INCURRED AND CLAIMED IS INADEQUATE FOR IDENTIFICATION OF ALL COSTS INCURRED

BASO non-concurs with the finding. The OIG used FAR 52.216-7 as its criteria for determining the adequacy of the SCIC, even while it acknowledged that the clause was not a contractual requirement.

M&O contractors are not subject to the cited clause. Guidance for clauses included in DOE M&O contracts are outlined in the Department of Energy Acquisition Regulation (DEAR) 970.52 Solicitation Provisions and Contract Clauses for Management and Operating Contracts. Specifically, LBNL is subject to DEAR 970.5232-2 Payments and Advances (prescribed by DEAR 970.3270(a)(1), and subsection (k) of Alternate III explicitly calls out the SCIC requirement as follows:

> *(k) Review and approval of costs incurred. The Contractor shall prepare and submit annually as of September 30, a "Statement of Costs Incurred and Claimed" (Cost Statement) for the total of net expenditures accrued (i.e., net costs incurred) for the period covered by the Cost Statement.*

Use of FAR 52.216-7 conflicts with the required DEAR clause. The DOE Financial Management Handbook Chapter 23 states in 1(a) Requirements and Applicability (emphasis added):

(1) *The Statement of Costs Incurred and Claimed (SCIC), is prepared and certified by DOE's integrated contractors annually after they have submitted their financial statements and related information to their cognizant field elements (Attachment 23-1). This requirement applies to individual DOE contracts that include the contract clause at 48 CFR 970.5232-2 (alternate iii).* ***The costs reported on this statement should be consistent with the contractors' financial statements****. The SCIC form is provided as an attachment to this chapter; detailed descriptions of the SGL accounts listed on the form are kept by the Office of Financial Controls and Reporting. Deviations from the form and procedures established by this chapter must be approved by the cognizant contracting officer.*

(2) *The Statement of Costs Incurred and Claimed is not a payment voucher.* ***It is the contractor's accounting for all costs incurred for the year covered by the Statement.*** *By submission of the Statement, the integrated contractor summarizes its costs incurred during the year specified*

(3) *The Statement of Costs Incurred and Claimed serves as the contractor's claim and certification that the contractor's costs it covers have been incurred and (to the best of the Certifying Official's knowledge and belief) are allowable, allocable, and reasonable (hereinafter referred to as allowable) under the contract.*

The OIG's evaluation of DOE's SCIC form against the Defense Contract Audit Agency's Checklist for Determining Adequacy of Contractor Incurred Cost Proposal and FAR 52.216-7 to cite LBNL with inadequate identification of costs incurred is not appropriate. The use of the SCIC format does not preclude the auditors from obtaining claimed pools and allocation bases, including supporting information. In fact, LBNL supplied the OIG auditors with the requested pool and base data during their review.

The OIG annually signs the current SCIC form, which was last revised in November 2012, so LBNL's Internal Audit should not have to determine or question that a form approved by the OIG was inadequate for identifying all costs incurred. The Department designed the SCIC form to report a high-level summary of costs claimed for the year. LBNL maintains detailed supporting information that is available to auditors.

Response to Recommendation

The OIG makes the following recommendation associated with this finding.

4. Work with the Department to examine the SCIC submission and its ability to adequately evaluate costs.

BASO non-concurs with the finding but supports the recommendation. BASO will work with OFS to assist the OIG, as Chair of the Steering Committee for the Cooperative Audit Strategy (SCCAS) to address any concerns with the SCIC. BASO will also support OFS in implementing any changes made to the SCIC.

OIG Findings 3:

VARIANCE DISPOSITION DID NOT COMPLY WITH COST ACCOUNTING STANDARDS

THE DEPARTMENT APPROVED A NONCOMPLIANT PRACTICE IN LAWRENCE BERKELEY NATIONAL LABORATORY'S DISCLOSURE STATEMENT

BASO non-concurs with the findings. As demonstrated by previous audits, BASO and OFS predecessors did not in FY06 approve a noncompliant Cost Accounting Standards (CAS) practice. LBNL is not required to proportionally allocate rate variances back to cost objectives unless the variances are material. The OIG may not have considered the materiality aspect of the standard. CAS 418.50(g)(5)(4) states (emphasis added):

(g) *Use of preestablished rates for indirect costs.*

(4) Under paragraphs (g) (2) and (3) of this subsection ***where variances of a cost accounting period are material****, these variances shall be disposed of by allocating them to cost objectives in proportion to the costs previously allocated to these cost objectives by use of the preestablished rates.*

As a result, the risk of unallowable claimed costs and improper payments is minimal in that it follows CAS standards.

BASO and OFS predecessors supported LBNL's accounting practice change in FY06 by stating that indirect rate variances would be monitored and adjusted to ensure year-end rate variances are immaterial. LBNL analyzes the variance to ensure no material impact to final cost objectives. The report does not state the standard for or if the OIG found the variances material.

48 CFR § 9903.305 establishes the criteria for materiality. Examples of the criteria include dollar amount involved, the amount compared to the contract value, the relationship between the amount and a cost objective, impact on Government Funding. Federal Acquisition Regulation's (FAR) fundamental approach to addressing materiality allows for interpretation and judgment.

Similarly, CAS 406 provides for the use of a different period for establishing an allocation base when agreed-to by the parties. Mismatched periods require four conditions; 1) significant administrative convenience, 2) practice is consistently followed, 3) period used represents the activity, and 4) not materially different distribution to cost objectives of the cost accounting period. LBNL has met these conditions.

As written, the finding represents a final determination of CAS noncompliance, which is contrary to FAR 30.605, which states that CAS determinations are the Cognizant Federal Agency Official's responsibility. The OIG should provide an opinion on CAS noncompliance, not a determination.

Response to Recommendation

The OIG makes the following recommendation associated with this finding.

5. Revise policies, procedures, and disclosures related to the process of year-end indirect rate variance disposition to be consistent with Cost Accounting Standards and ensure procedures recognize the individuality of Congressional controls.

BASO will work with LBNL to determine the significance of the recommended practice change and work with OFS to determine the best value for the government and the continued applicability of the materiality exceptions. If the OIG provides them, BASO and OFS reaffirm our position to use OIG provided materiality determination calculations. The materiality calculation should be consistent with 48 CFR § 9903.305 and not based on arbitrary factors.

OIG Finding 4: THERE IS AN INCREASED RISK OF UNALLOWABLE CLAIMED COSTS AND IMPROPER COST ALLOCATION

BASO non-concurs with the finding. The OIG has not provided any objective evidence to support this finding.

It is not accurate to state that Internal Audit, the OIG, and the Department have not had ready access to indirect cost details to ensure claimed costs were allowable, allocable, and reasonable. LBNL has provided this information when requested, including during regular biennial reviews conducted by the CSC.

The OIG finding states that the significance of this risk is determined by their calculation of LBNL's indirect costs in FY18 at 59 percent of the $858 million incurred, which is inaccurate and overstated due to a possible double counting of indirect cost pools. The accurate amount of total indirect costs claimed in the SCIC is $383M, or 45 percent of total cost. The error in this calculation may be due to an incomplete understanding of M&O indirect cost structures and applications.

It should be noted that CAS standards were developed to ensure that the Federal Government did not pay more than their appropriate share for indirect costs where Contractors had both federal and non-federal contracts. Through the incorporation of DEAR 970.5235-1 in its contract with DOE, LBNL is a Federally Funded Research and Development Centers (FFRDC). As defined in FAR 35.017, an FFRDC performs a federal mission, but allows for work to be performed for non-federal sponsors.

> *(a)(2) An FFRDC meets some special long-term research or development need which cannot be met as effectively by existing in-house or contractor resources. FFRDC's enable agencies to use private sector resources to accomplish tasks that are integral to the mission and operation of the sponsoring agency. An FFRDC, in order to discharge its responsibilities to the sponsoring agency, has access, beyond that which is common to the normal contractual relationship, to Government and supplier data, including sensitive and proprietary data, and to employees and installations equipment and real property. The FFRDC is required to conduct its business in a manner befitting its special relationship with the Government, to operate in the public interest with objectivity and independence, to be free from organizational conflicts of interest, and to have full disclosure of its affairs to the sponsoring agency. It is not the Government's intent that an FFRDC use its privileged information or access to installations equipment and real property to compete with the private sector. However, an FFRDC may perform work for other than the sponsoring agency under the Economy Act, or other applicable legislation, when the work is not otherwise available from the private sector.*

Further, M&O Contractors are performing a federal mission as defined by FAR 17.601:

> *Management and operating contract means an agreement under which the Government contracts for the operation, maintenance, or support, on its behalf, of a Government-owned or -controlled research, development, special production, or testing establishment*

> *wholly or principally devoted to one or more major programs of the contracting Federal agency.*

In FY18, the proportion of LBNL costs that were not attributable to federal funding sources was 7%. Therefore, the potential risk of misallocation between federal and non-federal funds may be overstated as it includes other Federal Sponsors in its measure of Strategic Partnership Projects.

Response to Recommendation

The OIG did not make any specific recommendation on this finding. The OIG has played a key role in the development of the current SCIC and Audit Manual. The OIG has forums for addressing concerns with the SCIC that include updating the Audit Manual, bringing issues before the SCCAS, requesting policy changes, providing guidance (as required in the Cooperative Audit Strategy), and engaging the Department in a meaningful way.

If you have any questions or if we can be of further assistance, please contact Mercedes Downing at 510-486-4346, or mercedes.downing@science.doe.gov.

ATTACHMENT 1: BACKGROUND OF THE COOPERATIVE AUDIT STRATEGY

The Department established the Cooperative Audit Strategy to ensure an effective and efficient audit of M&O contractor claimed costs. DOE's Acquisition Guide, chapter 70.42.101, section 2.2, Background, describes the Cooperative Audit Strategy as:

> *The Office of Inspector General, in consultation with the Office of the Chief Financial Officer, the Office of Acquisition Management, and the Contractor Internal Audit Council, developed and implemented the Cooperative Audit Strategy in October 1992 to maximize the overall audit coverage at management and operating (M&O) contractors and fulfill its responsibility for auditing the costs incurred by the Department's major facilities contractors.*

Section 2.4 defines OIG responsibilities as follows:

> *The Office of Inspector General (OIG): The OIG develops audit policy for the Department's programs and operations. In that capacity, the OIG is the cognizant auditor for the Department's major facilities contractors. The OIG relies upon the contractors' Internal Audit Activities to support the Cooperative Audit Strategy. The OIG provides guidance to cognizant COs, HCAs, Department site or office managers, and Cognizant Chief Financial Officers on the sufficiency of the design and operation of Internal Audit Activities, particularly as they support the SCIC. Representatives of the OIG periodically evaluate the actions of the contractors' Internal Audit Activities and audits using the American Institute of Certified Public Accountants' Statement on Auditing Standard No. 65 or its successor. The OIG will coordinate these evaluations and audits with the cognizant COs, HCAs, and Cognizant Chief Financial Officers in order to avoid duplication of effort and ensure that all issues are addressed.*

Following the Steering Committee for Quality Audits' initial meeting, on August 26, 1992, John Layton, Inspector General, and Gorden Harvey, Committee Chairman and Assistant Inspector General for Audits, issued a Memorandum for the Record. This memorandum stated:

> *It was agreed that the Office of Inspector General (OIG) would compile data on issues needing resolution and that it would bring such issues to the Steering Committee for discussion and disposition.*

The Steering Committee for Quality Audits (now known as SCCAS) stated purpose is to serve as an integrating activity for fostering communications, promoting lessons learned, and ensuring the Cooperative Audit Strategy's continued success. The Deputy IG for Audits is the designated federal Co-chair for SCCAS. The Co-Chairs are responsible for establishing an agenda for each SCCAS meeting that is supposed to be convened at a minimum semi-annually. The OIG held the last SCCAS meeting in April 2019 that discussed possible Departmental steps on the Cooperative Audit Strategy.

The OIG should consider updating OIG policies and guidance, reconvene SSCAS, and engage Departmental elements to affect change in internal audit function requirements. The Incurred

Cost Audit Coverage reports would not contain most of the Internal Audit findings if the OIG followed this practice, as agreed to in the Cooperative Audit Strategy requirements and further outlined in the SCCAS agreement.

FEEDBACK

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