



OFFICE OF INSPECTOR GENERAL
U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-20-36

MARCH 2020

**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**



Department of Energy
Washington, DC 20585

March 16, 2020

MEMORANDUM FOR THE MANAGER, BAY AREA SITE OFFICE

A handwritten signature in black ink, appearing to read "John E. McCoy II".

FROM: John E. McCoy II
Deputy Assistant Inspector General
for Audits and Inspections, West
Office of Inspector General

SUBJECT: INFORMATION: 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”

BACKGROUND

The University of California (University) has managed and operated Lawrence Berkeley National Laboratory (Berkeley Laboratory) under contract with the Department of Energy and its predecessors since 1943. Berkeley Laboratory is a member of the national laboratory system supported by the Department through its Office of Science. Berkeley Laboratory conducts unclassified research across a broad range of scientific disciplines. The following table illustrates the costs incurred and claimed by the University under Contract No. DE-AC02-05CH11231 from October 1, 2014, through September 30, 2017.

Fiscal Year	Incurred and Claimed Costs
2015	\$790,884,304
2016	\$802,852,085
2017	\$815,708,614
Total	\$2,409,445,003

The University’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. The University is required by its contract to account for all funds advanced by the Department annually on its Statement of Costs Incurred and Claimed, to safeguard assets in its care, and to claim only allowable costs. Allowable costs are incurred costs that are reasonable, allocable, and in accordance with the terms of the contract, applicable cost principles, laws, and regulations.

The Department’s Office of Inspector General (OIG), 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 that are claimed by contractors. Consistent with the strategy, the University is required by its contract to maintain an internal audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. In addition, the University 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 October 1, 2014, through September 30, 2017, were to determine, based on our limited sampling, whether:

- The University's Internal Audit (Internal Audit) conducted cost allowability audits that complied with professional standards and could be relied upon;
- The University conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- The University resolved questioned costs and internal control weaknesses affecting allowable costs that were identified in 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 from October 1, 2014, through September 30, 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 the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors. We did identify questioned costs related to conference and meeting expenses as a result of our independent tests of transactions. In addition, we identified certain audit standards that were not always followed, as discussed below. However, these issues did not affect the overall reliance on the cost allowability audits performed by Internal Audit. From October 1, 2014, through 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, we found that the University generally arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. However, we identified one subcontract that incurred costs totaling \$4,061,038 during fiscal year (FY) 2017 that had not been audited as required; we consider these costs unresolved, pending audit. Subsequent to our fieldwork, Internal Audit informed us that this subcontract audit is included in its FY 20 audit plan.

Questioned Costs

We questioned \$2,396 of costs related to conference and meeting expenses due to noncompliance with Federal Acquisition Regulations (FAR). FAR Subpart 31.2 (FAR 31.201-2), *Determining Allowability* states that costs are allowable when in compliance with the terms of the contract.

FY	Description of Costs Reviewed	Questioned Costs
2015	Conference and Meeting Expenses	\$566
2017	Conference and Meeting Expenses	\$1,830
	Total Questioned Costs	\$2,396

As a result of our independent tests of transactions, we questioned a total of \$2,396 related to conference and meeting expenses that did not follow terms established in the agreements between Berkeley Laboratory and the vendor. The vendor agreements stated that a 10 percent discount will be provided if Berkeley Laboratory used the vendor's audio and visual equipment for the meeting. However, the 10 percent discount was not applied to the invoices in 2015 for \$566, and in 2017 for \$1,830, despite the equipment being used for the meeting. Berkeley Laboratory's policy also required invoice certifiers to ensure that the invoices conformed to the terms and conditions of the purchase order prior to payment. Because the discount was not applied, we questioned the 10 percent discount and associated tax due to noncompliance with FAR 31.201-2, and deviation from Berkeley Laboratory's established policy.

Audit Standards Not Followed

Although we ultimately determined that we could rely on Internal Audit's work, we identified several instances in which Internal Audit did not always meet the Institute of Internal Auditors Standards in the areas of engagement supervision, quality assurance, and quality of communications.

Lack of Quality Assurance for Audit Workpapers and Reports

During our review of the cost allowability audit reports and the associated workpapers, we identified numerous instances of incorrect information such as different dollar amounts, quantities tested and/or sampling methodology in reports that did not match Internal Audit workpapers, and an incorrect application of dollar threshold used in determining subcontracts that are subject to audit. For example, in the FY 2015 Cost Allowability audit report, we identified an error in the amount of reported cost incurred of \$5,000,000.16. The audit report stated that the Berkeley Laboratory's recorded costs totaled \$795,884,304.52 when in fact the FY 2015 Statement of Costs Incurred and Claimed totaled \$790,884,304.36, as documented in the workpapers. For a detailed listing of the errors we identified in audit workpapers and reports, please see Attachment 3.

Based on the number of errors we identified, we concluded that engagements were not always adequately supervised and there was a lack of quality with communication methods, such as audit reports and workpapers. According to the Institute of Internal Auditors Standards 2340, *Engagement Supervision*, engagements must be properly supervised to ensure objectives are achieved and quality is assured. In addition, Institute of Internal Auditors Standards 1300, *Quality Assurance and Improvement Program*, requires a Quality Assurance and Improvement Program be developed and maintained, and the Institute of Internal Auditors Standards 2420, *Quality of Communications*,¹, states, in part, that communications must be accurate, free from errors and distortions, and faithful to the underlying facts. As evidenced by the numerous inaccuracies we found, the quality of the engagements is impacted by the lack of a quality assurance and improvement program that provides final product reviews and ensures the accuracy of facts and figures.

These issues occurred because Berkeley Internal Audit did not have a robust quality assurance program. Internal Audit explained that a checklist is used as a quality assurance tool. However, we found that the checklist does not assure the quality and factual accuracy of the report prior to issuance. We also found that the checklist does not ensure that the information presented in the audit reports are accurate and free from errors. In our view, having a robust quality assurance process in place will help eliminate and/or reduce the errors found in the audit reports, thus improving the quality of communications. In response to our concerns, Internal Audit has increased its efforts in the quality assurance and data accuracy of its reports. Internal Audit has committed to updating the checklist to include reports being cross-referenced to the supporting workpapers. Lastly, Internal Audit recently restructured its organization by adding an Audit Manager who will serve as an additional layer of supervision and quality monitor.

Subcontract Not Audited as Required

We found that the University generally conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor, as required by Department of Energy Acquisition Regulation 970.5232-3, *Accounts, Records, and Inspection*. However, we identified one Time and Materials subcontract totaling \$4,061,038 that had not been audited as required.

The University's subcontract audit process requires the procurement specialist to identify the subcontract for a post-performance or closeout audit immediately upon completion of cost-reimbursable subcontracts if the reimbursable costs paid under the subcontract exceed \$1 million. Because the Time and Material subcontract was still active by the end of FY 2017, the Procurement Department had not yet performed an analysis of reimbursable costs and had not requested a closeout audit at the time Internal Audit conducted its FY 2017 Cost Allowability Audit. However, while Internal Audit identified this subcontract as subject to audit in its FY 2017 Cost Allowability Audit, Internal Audit did not report these costs as unresolved given that the reimbursable costs had already reached the \$1 million threshold at that time. As a result, we

¹ The term "Communications" refers to the Internal Auditors Standards 2400, *Communicating Results*, where internal auditors must communicate the results of engagements.

consider these subcontract costs, totaling approximately \$4,061,038, as unresolved. Subsequent to our fieldwork, Internal Audit informed us that this subcontract audit is included in its FY 20 audit plan.

Other Matter

During our assessment of Internal Audit's electronic workpapers, we noted that Berkeley Laboratory's understanding of Personally Identifiable Information (PII) is not aligned with Department Order 206.1, *Department of Energy Privacy Program*, which is incorporated into the University's contract. Our review of Internal Audit's cost allowability audit work revealed that its working papers contained PII (i.e. employee's full name combined with their home addresses) that were not properly marked and/or labeled. Berkeley Laboratory officials stated they do not consider full names combined with home addresses as PII based on their understanding of the California Civil Code 1798.29, which the University follows for its definition of PII.

However, Internal Audit working papers are considered Government-owned records, per contract clause I.103 970.5232-3 Accounts, Records and Inspection (Dec 2010). The contract clause I.103 under Paragraph (d) states that "all financial and cost reports, books of account and supporting documents, system files, data bases, and other data evidencing costs allowable, collections accruing to the Contractor in connection with the work under this contract ... shall be property of the Government." Therefore, the Office of Management and Budget definition of PII as described in Department Order 206.1 applies in this case because Internal Audit acquired documentation containing PII as supporting evidence during its cost allowability audits.

It is important that Berkeley Laboratory be cognizant of the applicability of these two separate authorities for PII, the California Civil Code 1798.29 and Office of Management and Budget, in order for Internal Audit to properly recognize and safeguard supporting evidence with PII during its cost allowability audits in accordance with Department Order 206.1. We discussed our observation with Berkeley Laboratory officials, who subsequently agreed that full names combined with home addresses are considered PII but categorized at a lower gradation. Although Internal Audit's workpapers are maintained in a password-protected system, to address our concern, Internal Audit assured us that they will handle this information appropriately in future cost allowability audits and other engagements.

RECOMMENDATIONS

We recommend that the Manager, Bay Area Site Office, direct the Contracting Officer to:

1. Make an allowability determination on the questioned costs totaling \$2,396 and recover those amounts determined to be unallowable.

We also recommend that the Manager, Bay Area Site Office, direct the Contracting Officer to ensure that the University of California:

2. Properly supervises engagements to ensure quality is assured.

3. Enhance the existing quality assurance process to ensure that Internal Audit’s work is performed in accordance with Institute of Internal Auditors Standards.
4. Complete subcontract audits as required.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management concurred with the report’s recommendations and took corrective actions during the course of this assessment to address most of the issues identified in the report. We consider management’s completed and planned actions to be responsive to our recommendations.

Management’s comments are included in Attachment 2.

SCOPE AND METHODOLOGY

This assessment was performed from October 2018 to January 2020 at the Berkeley Laboratory, located in Berkeley and Emeryville, California². The assessment was limited to Internal Audit activities, subcontract audits, and the resolution of questioned costs and internal control weaknesses that impacted costs claimed by the University on its Statements of Costs Incurred and Claimed for October 1, 2014, through September 30, 2017. The assessment was conducted under the Office of Inspector General project number A19LL001.

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 overall internal audit strategy) compliance with applicable professional auditing standards, and interviews of auditors.
- Retested a sample of incurred cost transactions reviewed by Internal Audit in its FY 2017 allowable cost audit. We randomly selected two transactions for each of the following areas:

FY 2017 Transactions Reviewed by Internal Audit	Population Size
1. Payroll Payments	36
2. Payroll Overpayments	26
3. Non-Purchase Order Disbursements and Accruals	10
4. Travel – Guest Long Term Travel	20
5. Accounts Payable – Payments	10
6. Accounts Payable – Accruals	10
7. Accounts Payable – Federal Orders	12
8. Labor Resource Adjustments	43

² The Berkeley Laboratory Office of the Chief Financial Officer (OCFO) is located in Emeryville, California and provides financial and procurement stewardship to the Laboratory’s operations under the Department contract.

- Selected a non-statistical sample, and therefore, the results and overall conclusions are limited to the items retested and cannot be projected to the entire population or universe subject to audit.
- Included our own independent tests of transactions, not previously audited by Internal Audit. Specifically, we independently tested a judgmental sample of two transactions related to conference and meeting expenses from the FY 2017 Statement of Costs Incurred and Claimed to determine allowability, allocability reasonableness, compliance with contract terms, and established practices. Based on the exceptions we identified, we expanded our selection to review two additional transactions from the FY 2015 and FY 2016 conference and meeting expenses.
- Reviewed policies, procedures, and practices for identifying subcontracts that require audit and arranging such audits.
- Assessed subcontract audit status and retested a sample of subcontract transactions reviewed by Internal Audit in its Accenture Federal Services Subcontract audit and Time and Materials Subcontracts audit. We randomly selected 2 of the 33 FY 2015 transactions in the subcontract audit of Accenture Federal Services and 2 of the 48 FY 2017 transactions in the audit of Time and Materials Subcontracts for re-testing.
- Evaluated resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Internal Audit, and other organizations.

We conducted our assessment in accordance with generally accepted government auditing standards for attestation engagements. Those standards require that we plan and perform the review to obtain sufficient, appropriate evidence to provide a reasonable basis for our conclusions based on our objectives. We believe that the evidence obtained provides a reasonable basis for our conclusions based on our objectives. A review is substantially less in scope than an examination or audit where the objective is an expression of an opinion on the subject matter and accordingly, for this review, no such opinion is expressed. Also, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on computer-processed data to accomplish our audit objectives and determined that the computer-processed data was sufficiently reliable for the purposes of this review.

Management waived an exit conference on March 2, 2020.

This report is intended for the use of Department contracting officers and site 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 the University of California During Fiscal Years 2013 and 2014 Under Department of Energy Contract No. DE AC02 05CHI1231*](#) (OAI-V-16-10, June 2016). Based on our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Lawrence Berkeley National Laboratory's internal audit function (Internal Audit) for fiscal years 2013 and 2014 could not be relied upon. We 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 have been resolved or reimbursed to the Department of Energy. Further, we 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, we identified two subcontracts that incurred costs during fiscal years 2013 and 2014 that had not been audited. The two subcontracts incurred total costs of \$11,590,877. Lawrence Berkeley National Laboratory has arranged to have Internal Audit perform one of the subcontract audits, which accounts for more than 98 percent of the unresolved costs. Lawrence Berkeley National Laboratory is also working with the second subcontractor to ascertain the status of its Single Audit Act audit of fiscal year, ending June 30, 2014. However, we consider \$11,590,877 as unresolved pending audit.

FEEDBACK

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