



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-20-59

September 2020

**AUDIT COVERAGE OF COST
ALLOWABILITY FOR BECHTEL MARINE
PROPULSION CORPORATION
FROM OCTOBER 1, 2013,
TO SEPTEMBER 30, 2018,
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-NR0000031**



Department of Energy
Washington, DC 20585

September 30, 2020

MEMORANDUM FOR THE MANAGER, NAVAL REACTORS LABORATORY
FIELD 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
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on “Audit Coverage of Cost Allowability for Bechtel Marine Propulsion Corporation from October 1, 2013, to September 30, 2018, Under Department of Energy Contract No. DE-NR0000031”

BACKGROUND

Since 2009, the Bechtel Marine Propulsion Corporation (BMPC) has operated the Bettis Atomic Power Laboratory in West Mifflin, Pennsylvania; the Kesselring site in West Milton, New York; the Naval Reactors Laboratory at the Idaho National Laboratory; and the Knolls Atomic Power Laboratory in Niskayuna, New York, under contract with the Department of Energy. BMPC was established solely to operate the aforementioned sites, collectively known as the Naval Nuclear Laboratory, on behalf of the Naval Nuclear Propulsion Program, which is a joint Navy-Department program responsible for the research, design, construction, operation, and maintenance of U.S. nuclear-powered warships. During the period of fiscal years (FYs) 2014 to 2018, BMPC expended and claimed over \$5.664 billion in costs incurred.

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

The Department’s Office of Inspector General (OIG), Office of Acquisition Management, integrated management and operating contractors, and other select contractors have implemented a Cooperative Audit Strategy. This strategy places reliance on the contractors’ internal audit function to provide audit coverage of the allowability of incurred costs claimed by contractors. Consistent with the strategy, BMPC was 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, BMPC was required to conduct or arrange for audits of its cost-type subcontractors when costs incurred were a factor in determining the amount payable to the subcontractor.

The governance structure of Naval Reactors Laboratory Field Office (Field Office), which oversees the operations of BMPC, is unique from other Department facilities. Specifically, the Field Office maintains an Audit Division that employs Federal auditors that perform some functions normally conducted by management and operating internal audit activities, such as the allowability of incurred costs audits, under the Cooperative Audit Strategy. Field Office auditors and BMPC Internal Audit conducted their audits in accordance with generally accepted government auditing standards and the *Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing*, respectively. Additionally, each audit conducted by the Field Office Audit Group and BMPC Internal Audit included steps that reviewed the allowability of costs.

The objectives of our assessment for the period of FYs 2014 to 2018 were to determine, based on our limited sampling, whether:

- Field Office Audit Group and BMPC Internal Audit conducted cost allowability audits that complied with professional standards and could be relied upon;
- BMPC conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- BMPC resolved questioned costs and internal control weaknesses affecting allowable costs that were identified in prior audits and reviews.

RESULTS OF ASSESSMENT

During our assessment, nothing came to our attention to indicate that allowable cost-related audit work performed by the Field Office Audit Group and BMPC Internal Audit for the period of FYs 2014 to 2018 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 for audits produced by BMPC Internal Audit and government auditing standards for audits produced by the Field Office Audit Group. During FYs 2014 through 2018, the Field Office Audit Group and BMPC Internal Audit identified over \$911,000 in unallowable costs, all of which had been resolved. In addition, BMPC Internal Audit used a risk-based approach for conducting or requesting audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. Nothing came to our attention to indicate that questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews, had not been resolved.

Although nothing came to our attention to indicate we could not rely on the work conducted by BMPC Internal Audit, we found we could not always verify that the Field Office Audit Group's continuing professional education hours met professional auditing standards for the assessment period. Additionally, we found that the Field Office Audit Group did not fully comply with the quality control and assurance standards.

External Peer Review

Generally accepted government auditing standards require audit organizations performing audits in accordance with the standards to meet quality control and assurance standards. Specifically, as part of the quality control and assurance standard, an audit organization needs to obtain an external peer review at least once every 3 years. Our assessment of allowable-cost audits conducted by the Field Office Audit Group did not identify any errors and concluded that we could accept the work performed; however, we found that the Audit Group did not have an external peer review conducted during our assessment period to meet their established professional auditing standards. The Field Office Audit Group has been unable to identify a method to meet the requirement of receiving an external peer review at least once every 3 years as required because they do not currently have access to an established peer review program within the Department or within the Naval Reactors programs and have not actively pursued other outside contracting possibilities. To their credit, officials have over the past year reached out to other Department laboratories, as well as the OIG, to determine what resources are available to obtain an external peer review. As they continue to assess options for addressing the external peer review deficiency, the Field Office has started to include a qualifying statement within their reports asserting that the audit conducted is in accordance with generally accepted government auditing standards except for the external peer review standard. The Audit Manager has also established internal controls as part of the system of quality control, including an annual general standards review and internal assessment, to test compliance with government auditing standards using the peer review checklists issued by the Council for Inspectors General on Integrity and Efficiency.

Other Observations

We found minor discrepancies regarding auditors maintaining the required number of continuing professional education hours. Generally accepted government auditing standards require auditors to maintain their professional competence through continuing professional education (CPE). Specifically, each auditor should complete, every 2 years, at least 24 hours of CPE that directly relate to government auditing, the government environment, or the unique environment the audited entity operates. In addition, each auditor should obtain an additional 56 hours of CPE, for a total of 80 hours every 2-year cycle. Our analysis of CPEs included a review of three 2-year cycles where we found that one auditor did not fully meet the required CPE hours. Specifically, we could not verify CPE hours during one of the 2-year cycles. While a summary spreadsheet indicated CPE hours had been earned, no documentation was available to verify that training had occurred.

This occurred because the Field Office Audit Group did not have a standard practice for ensuring training documentation or certificates were retained for individuals that had separated from the organization. In November 2019, the Field Office Audit Manager published an Auditor's

Handbook that outlines the procedures to be followed by audit personnel to ensure they meet generally accepted government auditing standards, which includes meeting professional education standards.

We also found that the Field Office Audit Manager, who was hired in November 2018, did not fully meet the required CPE hours for a 2-year cycle time period. Although the Manager was hired after the scope of our assessment, we still reviewed the complete 2-year cycle that included 2018 and 2019, and found that the Manager's required prorated CPEs were not met. The deficiency occurred because the summary spreadsheet was inadvertently overwritten with the CPE hours of another auditor, which showed all CPE hours completed. In February 2020, the Field Office Audit Manager identified this error and informed the OIG of the deficiency. As of May 21, 2020, the Field Office Audit Manager completed additional training to correct the deficiency. While the Field Office Audit Manager agreed the deficiency was not corrected within the 2-month window outlined by the General Accountability Office, it was corrected as quickly as possible upon identification. Recognizing the need for more controls over this process, the Field Office Audit Manager included in the Auditor's Handbook procedures for routinely monitoring compliance with continuing professional education requirements.

Since the deficiencies were considered minimal and corrective actions are currently being addressed, we concluded that we could rely on the work conducted by the Field Office Audit Group and we will not be making any recommendation regarding this issue.

RECOMMENDATIONS

We recommend that the Manager, Naval Reactors Laboratory Field Office, direct the Audit Manager to:

1. Continue to identify the noncompliance of the external peer review by including a qualifying statement in all audits conducted by the Field Office Audit Group until a path forward for satisfying the standard is resolved; and
2. Establish and implement a path forward for addressing the external peer review deficiency in prior audit reports issued by the Field Office Audit Group since the last external peer review.

MANAGEMENT RESPONSE

Management concurred with our recommendations. Specifically, management stated the Field Office Audit Division will continue to assess compliance with audit standards and include the appropriate compliance statement, as required by generally accepted government auditing standards. Management also stated that in an exit conference, OIG officials acknowledged a "peer review relationship" existed between the OIG and Naval Reactor Laboratory Field Office in the FY 2013 OIG engagement on coverage of the statement of cost incurred and claimed. Management indicated that the Audit Manager will continue to assess options for receiving an

external peer review and that the Field Office Audit Group will develop and implement a path forward to review audit reports, and address any peer review deficiencies that may have existed since the last external peer review.

Management comments are included in Attachment 2.

AUDITOR COMMENTS

Management's comments and planned actions are responsive to our recommendations; however, the OIG does not agree that a peer review relationship exists when the OIG conducts a review of the statement of costs incurred and claimed. Our past assessment was performed as an attestation engagement and was substantially less in scope than an audit. The scope of the attestation was limited to a review of audit activities, subcontract audits and reviews, and the resolution of questioned costs and internal control weaknesses that affect costs claimed; it did not include steps specifically designed to meet the requirements of conducting an external peer review. While management waived an exit conference for this assessment, management referred to a discussion held in our prior attestation engagement that OIG officials acknowledged that there was a "peer review relationship" between the OIG and Naval Reactor Laboratory Field Office. We agree that in a 2014 discussion, the Naval Reactor Audit Division Director at that time, suggested that our engagement could be considered as an external peer review. However, there is no evidence the OIG officials agreed that our attestation engagement would replace an external peer review, and during this engagement in a discussion with management, we clearly stated that our SCIC engagements would not meet the external peer review requirement.

SCOPE AND METHODOLOGY

This assessment was performed from September 2019 to June 2020 at the Field Office and the Bettis Atomic Power Laboratory, located in West Mifflin, Pennsylvania. The assessment was limited to the Field Office and Internal Audit activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that impacted costs claimed by BMPC on its Statement of Costs Incurred and Claimed for the period of October 1, 2013, through September 30, 2018. The assessment was conducted under Office of Inspector General Project Number A19PT049.

To accomplish our objectives, we did the following:

- Assessed allowable cost audit work conducted by the Field Office Audit Group and BMPC Internal Audit that included a review of allowable cost audit reports, workpapers, auditor qualifications, independence, audit planning (including risk assessments and the overall internal audit strategy), and compliance with applicable professional auditing standards.
- Conducted interviews of Field Office and BMPC key management officials and audit staff members as well as members of the Field Office Acquisition and Contracts Divisions.

- Retested a sample of incurred cost transactions reviewed by the Field Office Audit Group in the FY 2018 cost allowability audit. We judgmentally selected and reviewed 10 transactions from the BMPC Invoice Register, as well as 5 transactions from each of the following cost categories: relocation costs; public relations and advertising costs; employee welfare and morale costs; professional and consultant services and purchased labor costs; legal and other proceedings costs; cost transfers; and service award costs. We reviewed the transactions to evaluate whether they were allowable under the contract and Federal regulations. Because the sample selection was not statistical, the results and overall conclusions are limited to the transactions retested and cannot be projected to the entire population.
- Reviewed policies, procedures, and practices to identify subcontracts requiring audit and arranging for audits.
- Assessed subcontract audit status.
- Evaluated resolution of questioned costs and internal control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the OIG, Field Office Audit Group, BMPC 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 opinion on the subject matter, and accordingly, for this review, no such opinion is expressed. Additionally, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on computer-processed data to a limited extent to accomplish our objectives and determined that it was sufficiently reliable for the purposes of our assessment by reviewing existing information about the data and the system that produced them.

Management waived an exit conference on August 7, 2020.

This report is intended for the use of the Department's Contracting Officers and field offices in the management of their contracts and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the cooperation of the Field Office and BMPC staff members, as well as their time and assistance.

Attachments

PRIOR REPORT

Assessment Report on [*Audit Coverage of Cost Allowability for Bechtel Marine Propulsion Corporation During October 1, 2012, Through September 30, 2013, Under Department of Energy Contract No. DE-NR0000031*](#) (OAS-V-15-01, November 2014). Based on our assessment,¹ nothing came to our attention to indicate that the allowable cost-related audit work performed by the Naval Reactors Laboratory Field Office auditors and the Bechtel Marine Propulsion Corporation (BMPC) Audit Group did not meet generally accepted government auditing standards and Institute of Internal Auditors standards, respectively, and could not be relied upon. In addition, we found BMPC had adequately addressed the subcontract audit concerns identified previously. Specifically, BMPC developed Operating Instructions for Cost Incurred Audits on Cost-Reimbursable Subcontracts, which established a formal, risk-based approach to performing interim or post award audits of cost-reimbursable contracts. Further, costs questioned in the allowable cost audit conducted by the Naval Reactors Laboratory Field Office auditors and BMPC Audit Group had been adequately resolved. We identified no other audits that reported questioned costs and/or internal control weaknesses affecting the allowability of costs claimed for October 1, 2012, through September 30, 2013.

¹ 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.

MANAGEMENT COMMENTS



DEPARTMENT OF ENERGY
NAVAL REACTORS LABORATORY FIELD OFFICE
POST OFFICE BOX 109
WEST MIFFLIN, PENNSYLVANIA 15122-0109

NRLFO:MGR:20-058
20 July 2020

MEMORANDUM FOR John E. McCoy II
Deputy Assistant Inspector General for Audits
Office of the Inspector General

SUBJECT Management Response to Draft Assessment Report on
"Audit Coverage of Cost Allowability for Bechtel Marine
Propulsion Corporation from October 1, 2013, to September
30, 2018, Under Department of Energy Contract No.
DE-NR0000031"

Thank you for the opportunity to review and comment on the subject assessment report. The report provided two recommendations for the Naval Reactors Laboratory Field Office to consider in strengthening its compliance with Government Auditing Standards related to cost allowability audits.

It is worth noting that over the last 18 months, NRLFO Audit has substantially improved internal controls over audit processes. Specifically, an Audit Handbook was developed and implemented with standardized engagement steps that will help ensure consistency throughout the Audit Group. Additionally, NRLFO Audit centralized training records and instituted an annual compliance review that will provide reasonable assurance of NRLFO Audit compliance with Government Auditing Standards.

The enclosure to this memorandum provides NRLFO's response to the report recommendations. If you have any questions regarding this response, please contact Melissa Quealy, Audit Director at (412) 476-7274.

Sincerely,

A handwritten signature in blue ink, appearing to read "MJB", is written over a faint blue line.

M. J. Brott
Manager

Enclosure: NRLFO Response to Inspector General Report

Copy to:
T. M. Minvielle, NA-30
V. L. Rutt, DOE OIG

NRLFO:MGR:20-058
Enclosure

NRLFO Response to Inspector General Report

Assessment Report on "Audit Coverage of Cost Allowability for Bechtel Marine Propulsion Corporation from October 1, 2013, to September 30, 2018, Under Department of Energy Contract No. DE-NR0000031"

Recommendation 1: We recommend that the Manager, Naval Reactors Laboratory Field Office, direct the Audit Manager to continue to identify the noncompliance of the external peer review by including a qualifying statement in all audits conducted by the Field Office Audit Group until a path forward for satisfying the standard is resolved.

Management Response: Concur.

The Field Office Audit Division will continue to assess compliance with audit standards for every engagement and include the appropriate compliance statement based on that assessment, as required by GAGAS. The Audit Manager will also continue to assess options for receiving an external peer review.

Recommendation 2: We recommend that the Manager, Naval Reactors Laboratory Field Office, direct the Audit Manager to establish and implement a path forward for addressing the external peer review deficiency in prior audit reports issued by the Field Office Audit Group since the last external peer review.

Management Response: Concur.

As discussed in the exit conference, OIG officials acknowledged there was a "peer review relationship" between the OIG and NRLFO, in that the OIG's assessment on the audit of coverage of the statements of cost incurred and claimed satisfied Government Auditing Standards external peer review requirement for NRLFO. The OIG conducted its last assessment of cost incurred and claimed for FY 2013, then delayed its next assessment until FY 2018, creating a 5-year period during which NRLFO Audit did not have an external peer review. NRLFO Audit will develop and implement a path forward to review audit reports and address any peer review deficiencies that may have existed since the last external peer review.

FEEDBACK

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