OFFICE OF INSPECTOR GENERAL
U.S. Department of Energy

AUDIT REPORT

DOE-OIG-21-22 April 2021

FISCAL YEAR 2017 EVALUATION OF INCURRED COST COVERAGE AT THE SLAC NATIONAL ACCELERATOR LABORATORY

Department of Energy
Washington, DC 20585

April 8, 2021

MEMORANDUM FOR THE MANAGER, BAY AREA SITE OFFICE

SUBJECT: Audit Report on "Fiscal Year 2017 Evaluation of Incurred Cost Coverage at the SLAC National Accelerator Laboratory"

The attached report discusses our review of incurred cost coverage during fiscal year 2017 for selected areas at the SLAC National Accelerator Laboratory. This report contains six recommendations. Management generally concurred with the recommendations.

We conducted this audit from November 2019 through November 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

Department of Energy
Office of Inspector General

Audit Report on Fiscal Year 2017 Evaluation of Incurred Cost Coverage at the SLAC National Accelerator Laboratory

(DOE-OIG-21-22)

WHY OIG PERFORMED 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 2017 at the SLAC National Accelerator Laboratory (SLAC).

What Did OIG Find?

We found that Stanford University's allowable cost audit at SLAC for fiscal year 2017 did not adequately evaluate incurred costs for allowability, allocability, and reasonableness. We noted weaknesses in Stanford University Internal Audit's design of the audit risk assessment, sampling approach, and informal handling of questioned costs. In addition, we identified noncompliant treatment of unallowable costs and weaknesses in labor internal controls. Further, we determined 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

Since 1962, Stanford University (Stanford) has managed and operated the SLAC National Accelerator Laboratory (SLAC) for the Department of Energy's Office of Science. SLAC is 1 of the 10 Office of Science laboratories and is home to a 2-mile-long particle accelerator, an x-ray laser, and a broad range of scientific research and experiments. Stanford incurred and claimed costs totaling approximately $590 million from October 1, 2016 to September 30, 2017, which is fiscal year (FY) 2017.

As a management and operating contractor, Stanford's SLAC financial accounts were required to be 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. Stanford 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 officials 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*. 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, Stanford 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 2017 at SLAC. Therefore, we did not specifically evaluate individual incurred costs for allowability, allocability, and reasonableness.[1]

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

INTERNAL AUDIT'S ALLOWABLE COST AUDIT WAS INADEQUATELY DESIGNED

Stanford Internal Audit's allowable cost audit was not designed to adequately evaluate incurred costs for allowability, allocability, and reasonableness. The *International Standards for the Professional Practice of Internal Auditing* requires 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 (DEAR) 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 determine whether incurred costs were allowable, allocable, and reasonable; and
- Lack of formal, written reporting of questioned costs.

Costs Were Not Fully Considered in Assessing Risk and Transaction Testing

Internal Audit did not fully consider the substantial risks of indirect costs separate from direct costs in its allowable cost audits. At SLAC, indirect costs of approximately $222 million accounted for about 37.6 percent of the approximately $590 million incurred during FY 2017, reported on the SCIC. 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, consistently treated, and comply with Cost Accounting Standards. However, we noted that Internal Audit did not perform a comparative analysis of indirect costs with prior years and budgets, consider cost shifting between indirect pools, document Cost Accounting Standards considerations, determine materiality with regards to significant cost elements, or review labor mix and sensitive labor amounts.

[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.

Further, Internal Audit's allowable cost audit transaction testing did not always differentiate the total incurred costs reported on the SCIC between direct and indirect costs. For example, Internal Audit's transaction testing was at the major disbursement category level (e.g., Accounts Payable, P-Cards) and did not break down costs to "auditable entities," such as indirect cost pools.

These issues occurred for a couple reasons. When 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. In addition, Internal Audit stated that it audited indirect costs in separate Cost Accounting Standards specific audits where it reviewed the Disclosure Statement and did not note any significant issues. However, Cost Accounting Standards audits are only done periodically at SLAC and have a different objective; namely, they do not examine costs for allowability or reasonableness.

Sampling Was Not Always 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. Also, Internal Audit's sampling policy requires statistical sampling when its work will be directly relied upon by external auditors or when extrapolating the results to the entire population is useful, and that the sampling methodology and its justification be documented in the workpapers. However, we noted concerns with Internal Audit's sampling methods. For example, in the FY 2017 Allowable Cost audit, Internal Audit did not perform statistical sampling or adequately document its rationale for using other sampling methodologies. The following table illustrates the details of some of the sampling performed by Internal Audit.

Cost Element	Transactions Selected	Transaction Universe	Dollar Value Selected	Dollar Value Universe	Dollar Value Coverage	Exceptions Noted
Payroll	45	145,404	$247,773	$158,032,180	0.16%	5
P-Card	30	16,171	$109,908	$8,075,717	1.36%	7
Travel	30	5,593	$126,364	$5,720,311	2.21%	2

In each of the above non-statistical samples, Internal Audit did not expand testing within the sample, clarify the error level when sampling would be expanded, or document how the results of its sample were representative of the population in order to reach a conclusion on the allowability of costs and project unallowable costs. According to Internal Audit's sampling policy, the auditor should specify the types of errors that are significant and document when testing should be expanded. In a number of Internal Audit's samples, it identified exceptions;

however, Internal Audit never expanded testing within any of the samples and did not document why. Further, Internal Audit focused on testing internal controls over the major disbursement categories; however, the primary purpose of the allowable cost audit, as noted in the OIG Audit Manual, is to determine whether the costs are allowable, allocable, and reasonable, which is not specifically addressed when testing internal controls.

This occurred because Internal Audit did not follow its own policy or the OIG Audit Manual when selecting and documenting its sampling approach. 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 asserted that the decision to use a non-statistical sampling methodology is a professional judgment, and it allowed Internal Audit to have broad coverage of the adequacy and effectiveness of internal controls over the major disbursement categories. While a non-statistical sampling methodology can be acceptable, Internal Audit did not document the justification for its sampling approach in its workpapers and how approaching its testing from an internal control perspective provides sufficient coverage to determine the allowability, allocability, and reasonableness of the costs. In addition, Internal Audit did not follow its own policy for expanding testing.

Informal Handling of Questioned Costs

We found weaknesses in Internal Audit's handling of questioned costs identified during the FY 2017 Allowable Cost audit. Internal Audit did not include $17,626 of questioned costs identified in its working papers in its audit report to the Contracting Officer for the allowable cost audit or the Annual Audit Report.[3] Internal Audit coordinated these questioned costs with SLAC management during the performance of the audit, and the costs were written off to unallowable accounts. Also, Internal Audit verbally communicated the questioned costs to the Contracting Officer; however, the OIG was not notified of the questioned costs at the time. The success of the Cooperative Audit Strategy depends on the OIG and Internal Audit working closely with the Contracting Officer and the Chief Financial Officer. Because the OIG relies on Internal Audit to support the Cooperative Audit Strategy, it is imperative that Internal Audit include all identified questioned costs in its official audit reports and the Annual Audit Report, whether or not they have been resolved, so that a formal, written record is maintained, and all findings are properly communicated to all stakeholders. Without formal, written communication, there is an increased risk that questioned costs are not adequately resolved in a timely manner, as well as reduced visibility into potential risk areas. This is especially important given the OIG's consideration of the resolution of questioned costs and control weaknesses impacting allowable costs identified in prior audits when conducting its annual risk-based selection methodology for major contractor cost statement reviews.

This occurred because Internal Audit concluded that the costs were low-risk and immaterial, and therefore did not need to include the costs in the FY 2017 Allowable Cost audit report or the Annual Audit Report. Specifically, Internal Audit concluded that the costs were low-risk and

[3] The Annual Audit Report is a report submitted by Internal Audit each year that summarizes audit activities undertaken during the previous fiscal year.

immaterial because it coordinated with Stanford management during the audit, Stanford management took action, and Internal Audit verbally communicated the findings to the Contracting Officer.

STATEMENT OF COSTS INCURRED AND CLAIMED IS INADEQUATE

DEAR 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, DEAR 970.3002-1, *CAS Applicability*, requires integrated contractors to follow Cost Accounting Standards. Cost Accounting Standard 418-40, *Fundamental Requirements,* requires that indirect costs 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 CAS, 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 (DCAA) has established a benchmark that it requires of an indirect cost submission that would allow for meaningful audit. In addition, Federal Acquisition Regulation (FAR) 52.216-7, *Allowable Cost and Payment*, 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 Stanford 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. However, as discussed previously, 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 allowable cost audit.

When we evaluated the Department's SCIC form against the DCAA *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, which were 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 management and operating 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 their 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 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.

INCORRECTLY APPLIED INDIRECT COST BURDEN FOR UNALLOWABLE COSTS

We identified a noncompliance with Cost Accounting Standard 405*, Accounting for Unallowable Costs* (CAS 405), where SLAC did not correctly apply an indirect cost burden to all of its unallowable costs. Specifically, SLAC did not include all unallowable costs in the Common Site Support, General and Administrative, and Laboratory Directed Research and Development indirect cost allocation bases, which understated these allocation bases by approximately $794,000 in FY 2017. According to FAR 31.203, *Indirect Costs,* paragraph (d) and CAS 405-40, *Fundamental Requirement*, paragraph (e), all unallowable costs are subject to the same cost accounting principles governing cost allocability as allowable costs. In circumstances where these unallowable costs normally would be part of a regular indirect cost allocation base or bases, they shall remain in such base or bases. When we discussed these costs with a SLAC official, they agreed that had the costs been allowable they would have been included in the appropriate allocation bases and would have received the appropriate indirect cost burden.

This occurred, in part, because SLAC's cost accounting system did not have adequate controls to ensure that all unallowable costs received their appropriate burdens. We found that SLAC considered the unallowable costs it recorded in Stanford's accounting records as not attributable to SLAC. Also, SLAC did not follow its disclosed practices. Disclosure Statement, paragraph 1.6.0, *Unallowable Costs*, states that unallowable costs are specifically identified and recorded separately in the formal financial accounting records. However, the majority of SLAC-related unallowable costs are incurred at Stanford on behalf of SLAC and not transferred or specifically identified and recorded in SLAC's accounting records. In addition, the Contracting Officer did not fully enforce CAS 405 requirements at SLAC. However, the unallowable costs were incurred on behalf of SLAC and are therefore, per Cost Accounting Standards and FAR, allocable and attributable to SLAC. Additionally, using allowability of a cost as a determinate factor for whether a cost should be included in an allocation base is inappropriate, as required by CAS 405.

WEAKNESSES IN LABOR INTERNAL CONTROLS

We identified weaknesses in SLAC's labor charging practices. Specifically, we found that SLAC did not monitor its labor charging practices to ensure their effective implementation. Also, SLAC did not maintain adequate segregation of duties within its timekeeping functions.

Insufficient Monitoring of Labor Charging Practices

SLAC did not adequately monitor its labor charging practices in FY 2017. Specifically, SLAC did not ensure that its primary controls for labor charging were operating effectively or as intended. SLAC's primary internal controls for labor charging are certification by the employee to the accuracy of the information and approval by an authorized official. However, during our review, we noted timesheets in both of SLAC's timekeeping systems were not always properly certified or approved. Specifically, we found 2,603 timesheets in SLAC's "It's About Time" (iAT) timekeeping system for FY 2017 that were not approved by an authorized official, of which 420 were not certified by the employee either. In addition, we noted 1,332 timesheets that were approved by an authorized official but were not certified by the employee.

Monitoring is an essential component of any organization's internal control structure. The Government Accountability Office, *Standards for Internal Control in the Federal Government*, Principle 16, *Performing Monitoring*; the American Institute of Certified Public Accountants Auditing Standards, Appendix B, *Internal Control Components*; and DEAR 970.5203-1, *Management Control*s, paragraph (a)(4), provide for the expectation that monitoring activities should be established to monitor internal control systems and evaluate the results.

In FY 2016, Internal Audit similarly identified 4 out of 15 timesheets from SLAC's Facilities Asset Management Information System (FAMIS) timekeeping system in its review that did not have evidence of approval by an authorized official. In addition, during its FY 2017 Allowable Cost audit, Internal Audit found 3 out of 15 timesheets in its review from FAMIS and 2 out of 30 from its iAT timekeeping system that did not have evidence of approval by an authorized official. SLAC took action to decommission FAMIS, which occurred in FY 2018; however, SLAC continues to use the iAT timekeeping system. These exceptions were not formally reported, and testing was not expanded to determine the extent of the issue within the iAT timekeeping system.

In FY 2017, SLAC did not adequately monitor its internal controls over labor charging because it did not have policies and procedures in place to do so. Although Internal Audit performed a time charging practice review in FY 2016, SLAC did not have policies and procedures to continuously monitor whether its labor charging practices were operating effectively. SLAC maintains that it relies on a variety of mitigating controls to verify the accuracy of labor charges, such as providing detailed cost reports to project managers and unapproved timesheet reports.

While such mitigating controls are useful from a project management standpoint, they do not replace the primary internal controls and their effective implementation because they do not provide certification and validation of the labor charges. Further, we found no evidence that unapproved timesheets were reviewed and subsequently approved. To its credit, SLAC implemented a labor floor check procedure in 2019; however, we did not evaluate the efficacy of the procedure.

Inadequate Segregation of Duties

SLAC's gatekeepers, timekeepers, and financial analysts are allowed to both edit and approve timesheets. The Government Accountability Office, *Standards for Internal Control in the Federal Government*, Principle 10, *Segregation of Duties*, and American Institute of Certified Public Accountants Audit Standards, AU-C Section 315, Appendix B, *Internal Control Components*, establish the expectation of assigning different people responsibilities for recording and authorizing transactions. Segregation of duties is intended to reduce opportunities that allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties. When SLAC employees' timesheets are amended, the employees receive an email notifying them that a change was made and to review and certify the change. However, there are no controls in place to ensure that employees actually certify changes to their timesheets.

This occurred because SLAC management did not implement standard segregation of duties in its internal control structure. Specifically, SLAC management did not have assurance that a single individual was incapable of editing and approving a timesheet.

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 Stanford charged unallowable costs to the Department. Weaknesses in the design of the allowable cost audits increased the risk that Stanford claimed unallowable costs because the level of testing and substantive procedures performed were adversely impacted, particularly regarding indirect costs. This is significant because Stanford's indirect costs at SLAC totaled approximately $222 million, or 37.6 percent of the approximately $590 million incurred during FY 2017. In addition, regarding handling of questioned costs, when identified questioned costs are not formally included in the audit report, it increases the risk that the costs are not dispositioned appropriately and lessens stakeholder visibility. 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.

As a result of the CAS 405 noncompliance, SLAC-driven unallowable costs did not receive the appropriate allocation of indirect costs. Specifically, approximately $107,600 of unallowable burdens were not applied and charged to SLAC unallowable projects.

As a result of inadequacies in SLAC's labor charging process, there is an increased risk that labor costs are unallowable, being mischarged, and/or misallocated. SLAC's total labor charges were approximately $158 million, or about 27 percent of the total costs claimed that year.

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 Stanford 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. Ensure appropriate reporting of questioned costs in allowable cost audits;
4. Revise policies, procedures, and disclosures related to identification and treatment of unallowable costs to be consistent with Cost Accounting Standards;
5. Ensure that SLAC establishes policies and procedures to monitor the effectiveness of its labor charging practice, including its new floor-check procedure and proper access controls for editing and approving timesheets; and
6. Reexamine the SCIC submission and the Department's ability to adequately evaluate costs.

MANAGEMENT RESPONSE

Management concurred with all but one of 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 SLAC officials to change or update practices and requirements, as appropriate. Management did not concur with our recommendation to ensure that SLAC establish policies and procedures to monitor the effectiveness of its labor charging practice to include its new floor-check procedure and proper access controls for editing and approving timesheets. However, management stated that it will review the current state of SLAC's multi-layered timekeeping and monitoring process and recommend changes when it is in the Government's best interest.

Management comments are included in Appendix 3.

AUDITOR COMMENTS

Management generally agreed with the report's recommendations, other than Recommendation 5, and 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, despite management's non-concurrence with Recommendation 5, as they agreed to review the current state of SLAC's timekeeping and monitoring process and recommend changes. We will follow up regarding the review of the timekeeping and monitoring process to ensure that any necessary changes are made in a timely manner.

With regard to the disagreement over the findings, the OIG stands by its findings and has significant concerns with the way Internal Audit performed its allowable cost audit risk assessment, sampling approach, and handled questioned costs.

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 it did sample such costs, the OIG explains on page 3 that Internal Audit did not differentiate indirect costs from direct costs when developing its reviews or breaking down the costs into auditable entities such as indirect cost pools. The OIG also found that Internal Audit did not perform various tests to assess indirect costs. In addition, the OIG clearly demonstrates on page 2 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 Internal Audit did not perform statistical sampling nor did it adequately document its rationale for not using statistical sampling, as prescribed in the OIG Audit Manual and Internal Audit's own sampling policy. In addition, Internal Audit did not expand sampling, clarify the point at which sampling would be expanded, or document how the results of its samples were representative of the population in order to conclude on the allowability of costs.

Where management disputes the finding about the informal handling of questioned costs, the OIG notes on page 4 that Internal Audit did not notify the OIG of the questioned cost identified. Further, it is imperative that Internal Audit include all identified questioned costs in its official audit reports and its Annual Audit Report so that there is a formal, written record and proper communication to all stakeholders.

Where management nonconcurs with the finding about the SCIC format being inadequate by claiming 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. The report on page 5 explains that the OIG finds the SCIC format inadequate because it limits the Departments 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 this be corrected.

Where management disputes the finding of not applying an indirect cost burden to all unallowable costs, the OIG found that management's practice does not conform with Cost Accounting Standards related to burdening unallowable costs in the same manner as allowable costs. The OIG notes on page 7 that the costs were incurred on behalf of SLAC. These costs would not have been incurred if SLAC did not exist. Further, a management official agreed that had the costs been allowable, they would have been included in the appropriate allocation bases and would have received the appropriate indirect costs burden.

Where management disputes the finding of weaknesses in labor internal controls, the OIG explains on page 7 that despite SLAC's primary internal controls for labor charging being employee certification and approval by an authorized official, that was not always occurring. Further, as stated on page 8, although SLAC asserts it relies on a variety of mitigating controls for labor charges, these mitigating controls do not take the place of the primary controls because they do not provide certification and validation of the labor charges. In addition, as stated on page 8, certain individuals at SLAC are allowed to both edit and approve timesheets. This goes against one of the principles of internal controls, which is segregation of duties. While SLAC stated that employees receive an email alerting them when a change is made to their time, there are no controls in place to ensure the employees actually review and certify such changes.

Where management nonconcurs with the OIG's 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 pages 8 and 9 that its conclusion is based on a flawed allowable cost audit design, inadequate indirect cost submission, and a noncompliant practice with regards to not applying burdens to unallowable costs. 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 notes that the details of the Cooperative Audit Strategy provided by management as Attachment 1 of its 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 (FY) 2017 at the SLAC National Accelerator Laboratory.

SCOPE

The audit was performed from November 2019 through November 2020 at the SLAC National Accelerator Laboratory in Menlo Park, California. The audit scope included costs incurred and claimed by Stanford University (Stanford) for FY 2017. The audit was conducted under Office of Inspector General project number A20ID007.

METHODOLOGY

To accomplish our audit objective, we:

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

- Reviewed and evaluated Internal Audit's FY 2017 cost allowability audit to include the risk assessment and audit performance regarding sampling, workpaper documentation, and reporting of questioned costs.

- Interviewed Department officials and Stanford personnel, including Stanford Internal Audit, responsible for management and oversight of incurred costs.

- Reviewed the Statement of Costs Incurred and Claimed as an adequate claim and certification of costs incurred at the management and operating contractor during the year.

- Reconciled Stanford'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.

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

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

- Evaluated whether beneficial and causal pool/base relationships existed within Stanford's FY 2017 indirect rate structure.

- Interviewed Stanford management personnel to identify internal controls over labor reporting, including monitoring of labor charging activities and segregation of duties.

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

- Reviewed related-party disclosure and cost allowability procedures and evaluated whether Stanford was following applicable procedures.

- Reviewed Stanford's Cost Accounting Standards Disclosure Statement for significant cost accounting changes.

- We 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 and the underlying principles regarding Stanford's demonstration of a commitment to integrity and ethical values, exercise of oversight responsibility, and demonstration of commitment to competence. We also assessed monitoring and the underlying principle of establishing and performing monitoring activities. Further, we assessed control activities and the underlying principle of implementing policies and procedures. 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 Stanford's FY 2017 financial cost data by reconciling underlying database information to the Statement of Costs Incurred and Claimed and comparing database information to bank statements. We also validated a portion of the database transactions by reviewing documentation supporting the data and the system that produced the data, and interviewing Stanford 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 Stanford University During Fiscal Years 2014 and 2015 Under Department of Energy Contract No. DE-AC02-76SF00515 (DOE-OIG-18-16, February 2017)*. The assessment[4] determined that the allowable cost-related work performed by Stanford University's (Stanford) Internal Audit for costs incurred from October 1, 2013 to September 30, 2015 could be relied upon. Based on its limited sampling, the Office of Inspector General (OIG) did not identify any material internal control weaknesses with allowable cost audits, which generally met the *Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing* prescribed by the Institute of Internal Auditors. Further, Stanford's Internal Audit reviewed subcontracts when costs incurred were a factor in determining the amount payable to the subcontractor. The OIG observed that Stanford Internal Audit identified internal control weaknesses and $3,128 in questioned costs in its fiscal year 2015 audit, which had been resolved by the Department. While the OIG did not identify any material internal control weaknesses with either cost allowability or subcontract audit, the OIG identified $990 in questioned costs related to printing expenses, which were resolved.

- Assessment Report on *Audit Coverage of Cost Allowability for Stanford University During Fiscal Years 2012 and 2013 Under Department of Energy Contract No. DE-AC02-76SF00515 (OAS-V-15-04, September 2015)*. The assessment[5] determined that the allowable cost-related work performed by Stanford's Internal Audit for costs incurred from October 1, 2011 to September 30, 2013 could be relied upon. Based on its limited sampling, the OIG did not identify any material internal control weaknesses with allowable cost audits, which generally met the *Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing* prescribed by the Institute of Internal Auditors. While the OIG did not identify any material internal control weaknesses, it identified issues that need to be addressed to ensure only allowable costs would be claimed and reimbursed to the contractor. Specifically, Stanford Internal Audit's workpapers did not always include documentation to support its conclusions, Stanford did not ensure that all cost type subcontracts were subject to an audit as required, and Stanford was noncompliant with Cost Accounting Standard 405, *Accounting for Unallowable Costs*. The noncompliance occurred due to Stanford's Cost Accounting Standards Disclosure Statement not requiring unallowable costs to receive the appropriate indirect cost allocation. Stanford estimated that more than $1.5 million of unallowable costs that were incurred during fiscal years 2011 to 2013 received no indirect cost allocations. The OIG made three recommendations to address the issues identified.

[4] 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.
[5] Ibid.

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Menlo Park, CA 94025

Date: March 30, 2021

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

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

SUBJECT: OIG AUDIT: FISCAL YEAR 2017 EVALUATION OF INCURRED COST COVERAGE AT SLAC NATIONAL ACCELERATOR LABORATORY

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 (CAS) 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-18-16 "Audit Coverage of Cost Allowability for Stanford University During Fiscal Years 2014 and 2015 Under Department of Energy Contract No. DE-AC02-76SF00515" (February 7, 2018), which stated that:

> *Nothing came to our attention during our assessment to indicate that Internal Audit's allowable cost–related audit work for FYs 2014 and 2015 could not be relied upon. We did not identify any material internal control weaknesses with the allowable cost audits, which generally met the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.*

Stanford University's Internal Audit has not changed its approach or process since the FY14/15 report or for that matter 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 CAS.

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:

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

Stanford's Internal Audit exercised due professional care, and from their long experience, they inherently understand the complexity, materiality, and significance of matters related to SLAC's operations. Past reports by Stanford's Internal Audit demonstrate that the auditors are alert to significant risks that might affect SLAC'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; Stanford'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 raise this as an issue or reference this point.

Sub-Finding b: Sampling Was Not Always 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 allowed. Stanford'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*

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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. SLAC's Internal Audit considered these factors in their sampling.

Auditing standards do not mandate statistical or non-statistical sampling nor a specific sample size. Stanford'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: Informal Handling of Questioned Costs
BASO non-concurs with this sub-finding. Chapter 14 of the OIG's Audit Manual does not require Internal Audit to report questioned costs in the allowable cost audit report or notify the OIG. BASO was involved in the discussion of the questioned costs during the exit conference with SLAC.

Stanford's Internal Audit documented all the conditions associated with the questioned cost, the ultimate resolution of the questioned costs, and the reasons for determining why the questioned costs did not present a material risk in their working papers. Despite reviewing the working papers, the report did not note any of these steps taken by Stanford's Internal Audit. Stanford's Internal Audit worked closely with the BASO and SLAC's Chief Financial Officer on questioned costs.

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<u>Response to Recommendations:</u>
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. Ensure appropriate reporting of questioned costs in allowable cost audits.

While BASO non-concurs with the finding, we support the associated recommendations. We ask that the OIG should 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 auditors the work performed by Stanford'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 Stanford'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.

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, SLAC 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.*

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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 SLAC 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, SLAC 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 Stanford'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. SLAC maintains detailed supporting information that is available to auditors.

Response to Recommendation

The OIG makes the following recommendation associated with this finding.

4. Reexamine the SCIC submission and the Department's 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 Finding 3: INCORRECTLY APPLIED INDIRECT COST BURDEN FOR UNALLOWABLE COSTS

BASO non-concurs with the finding. The Department approved SLAC's methodology that considers unallowable costs recorded in Stanford's accounting records as not attributable to SLAC. BASO is unaware of any other situation where national laboratory corporate parents' expenses are laboratory costs.

DOE O 413.2C, Laboratory Directed Research and Development (LDRD), directs how to calculate the LDRD allocation base. The Order, which the OIG concurred on, was updated to reflect Congressional direction. Congress reaffirmed that direction in the FY 2021 National Defense Authorization Act. If the OIG disagrees with this DOE directed cost accounting practice, it should direct those concerns to the Department.

As written, the finding represents a final determination of Cost Accounting Standards (CAS) noncompliance, which is contrary to Federal Acquisition Regulation 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 identification and treatment of unallowable costs to be consistent with CAS.

The SLAC accounting department is in active discussions with OFS regarding the CAS requirements applicable to the subject costs. BASO will continue to support efforts to ensure SLAC's appropriate treatment and burdening of the costs. BASO will also direct SLAC to evaluate Stanford's unallowable unburdened costs under the current contract.

OIG Finding 4: WEAKNESSES IN LABOR INTERNAL CONTROLS
BASO non-concurs on the main finding and both sub-findings.

Sub-Finding a: Insufficient Monitoring of Labor Charging Practices
BASO non-concurs with the sub-finding. The OIG may not have fully considered SLAC's multilayered monitoring of labor charging practices. SLAC does have policies and procedures to monitor labor charging practices. The OIG did not consider SLAC's mitigating controls as only appropriate for providing detailed cost reports from a project management standpoint. Additionally, the OIG did not identify any concerns regarding SLAC's monitoring of labor charges practices in FY17 during the FY15 SCIC Assessment.

Stanford's Internal Audit used appropriate judgment in determining that timecard issues did not produce unallowable, unallocable, and unreasonable costs. Despite reviewing Stanford's Internal Audit's work papers on this issue, the OIG did not uncover any unallowable labor cost.

Sub-Finding b: Inadequate Segregation of Duties
BASO non-concurs with the sub-finding. No one person in SLAC's labor charging system can unilaterally edit or approve timesheets without a change notification to the staff member. SLAC has thoroughly explained and documented its internal controls for labor charging. At every step, there is a check and balance.

Response to Recommendation

The OIG makes the following recommendation associated with this finding.

6. Ensure that SLAC establishes policies and procedures to monitor the effectiveness of its labor charging practice, including its new floor-check procedure and proper access controls for editing and approving timesheets.

BASO non-concurs with the recommendation. SLAC has established policies and procedures to monitor the effectiveness of its labor charging practice. BASO also disagrees that the labor charging practices in FY17 were ineffective or that SLAC did not have labor charging policies and procedures. BASO will review the current state of SLAC's multilayered timekeeping and monitoring process and recommend changes when it is in the government's best interest.

OIG Finding 5: 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. SLAC has provided this information when requested, including during regular biennial reviews conducted by the CSC.

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, SLAC 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 FY17, the proportion of SLAC costs that were not attributable to federal funding sources was 3%. Therefore, the potential risk of misallocation between federal and non-federal funds may

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be overstated by the OIG 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.

BASO is committed to work with OFS to assist the OIG in using these forums to address any concerns and issues.

If you have any questions or we can be of further assistance, please contact Ernest Maune at 650-926-4168, or ernest.maune@science.doe.gov.

Sincerely,

Paul M. Golan
Site Manager

Attachment:
ATTACHMENT 1: BACKGROUND OF THE COOPERATIVE AUDIT STRATEGY

cc:
Justin Fontaine, SC, DDFO
Steve Jones, SC-44, Director of Acquisition Management
Tara Fuller, Financial Policy and Audit Resolution, CF-20
Janet Venneri, Management Analyst, SC-21.1
Ron Sissel, Assistant Manager, Office of Financial Services, SC-CSC
Vicki Keith, Deputy Manager, Office of Financial Services, SC-CSC
Erin Harris, Team Leader, Audit and Review Team, SC-CSC
James Gotchie, Director, Financial Evaluation Division, SC-CSC
Tina Pooler, Management Analyst, SC-CSC
Katherine Woo, BASO-SLAC
Kyong Watson, BASO-SLAC
Hanley Lee, BASO-SLAC
Ron Shimkowski, BASO
Hanley Lee, BASO
Ernest Maune, BASO-SLAC

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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Office of Inspector General (IG-12)
Department of Energy
Washington, DC 20585

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