



U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

Audit Report

Home Office Expenses Submitted by Fluor
Federal Services, Inc., on Savannah River
Nuclear Solutions, LLC's U.S. Department of
Energy Management & Operating (M&O)
Contract No. DE-AC09-08SR22470



Department of Energy
Washington, DC 20585

April 19, 2013

MEMORANDUM FOR THE MANAGER, SAVANNAH RIVER OPERATIONS OFFICE

A handwritten signature in black ink, appearing to read "Rickey R. Hass".

FROM: Rickey R. Hass
Deputy Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Home Office Expenses Submitted by Fluor Federal Services, Inc., on Savannah River Nuclear Solutions, LLC's U.S. Department of Energy Management & Operating (M&O) Contract No. DE-AC09-08SR22470"

BACKGROUND

The attached report presents the results of an audit of home office expenses submitted by Fluor Federal Services, Inc. (Fluor) through invoices to Savannah River Nuclear Solutions, LLC, (SRNS) for loaned employees working on the Management and Operating (M&O) contract. The Department of Energy (Department) awarded M&O Contract No. DE-AC09-08SR22470 to SRNS, a for-profit joint venture, established between Fluor, Newport News Nuclear, Inc., and Honeywell International. SRNS commenced performance on the M&O contract on August 1, 2008. Fluor has a majority share in the joint venture.

The Office of Inspector General contracted with an independent certified public accounting firm, KPMG, LLP (KPMG), to assess the accuracy and completeness of the results and conclusions reported by SRNS Internal Audit on its *Corporate Reachback Floor Check Review* of invoices for loaned employees from Fluor. KPMG was also tasked with performing additional testing on an invoiced Fluor "loaned employee" to determine whether home office expenses were included in the invoiced costs, and if so, quantify the amount of questioned costs. The SRNS contract, Clause H-20, entitled *Home Office Expenses*, states "Home office expenses, whether direct or indirect, relating to activities of the Contractor are unallowable, except as otherwise specifically provided in the Contract or specifically agreed to in writing by the Contracting Officer consistent with DEAR 970.3102-3-70."

OBSERVATIONS AND CONCLUSIONS

KPMG concluded that the results and conclusions reported by SRNS Internal Audit on its *Corporate Reachback Floor Check Review* of invoices for loaned employees from Fluor was accurate and complete as they related to their audit objectives. The results of KPMG's work disclosed that SRNS' costs incurred for contract DE-AC09-08SR22470, for the period August 1, 2008 through August 21, 2012, included home office expenses of \$1,256,481 and \$36,763 in Facilities Capital Cost of Money resulting from its use of Fluor loaned employees.

MANAGEMENT COMMENTS AND AUDITOR RESPONSE

The Savannah River Operations Office indicated that it had no comments to the draft report. Subsequent to the completion of audit field work, the Savannah River Operations Office Contracting Officer initiated action to disallow the \$1,256,481 in home office expenses. Therefore, we are not making any recommendations in this report. Also, Savannah River Operations Office elected to waive the formal exit conference.

PERFORMANCE AUDIT

KPMG conducted this performance audit in accordance with generally accepted Government auditing standards. These standards require that KPMG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for its findings and recommendations based on the audit objectives. The procedures considered the SRNS' accounting system and internal controls as related to the audit objectives; however, KPMG was not engaged to, and did not render an opinion on SRNS' internal controls over financial reporting or over financial management systems.

The Office of Inspector General monitored the progress of the audit and reviewed the report and related documentation. Our review disclosed no instances where KPMG did not comply, in all material respects, with performance audit requirements. KPMG is responsible for the attached report dated April 16, 2013, and the conclusions expressed in the report.

Attachment

cc: Deputy Secretary
Acting Under Secretary of Energy
Chief of Staff

Performance Audit

Audit of Home Office Expenses Submitted by Fluor Federal Services, Inc., on Savannah River Nuclear Solutions, LLC's U.S. Department of Energy Management & Operating (M&O) Contract No. DE-AC09-08SR22470

Auditee: Savannah River Nuclear Solutions, LLC

As of Date: October 10, 2012

KPMG LLP
1801 K Street NW
Washington, DC 20006

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

EXECUTIVE SUMMARY

October 10, 2012

Mr. Mark Mickelsen
Contracting Officer's Representative
U.S. Department of Energy (DOE)
Office of Inspector General
1617 Cole Boulevard
Golden, CO 08401

Dear Mr. Mickelson:

This report presents the results of our audit of home office expenses submitted by Fluor Federal Services, Inc. (FFS) at the Savannah River Site (SRS) conducted to address the performance audit objective relative to Savannah River Nuclear Solutions, LLC (hereinafter referred to as “Auditee” or “SRNS”). Our work was performed during the period July 27, 2012 to October 10, 2012, and our results, reported herein, are as of October 10, 2012.

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and recommendations based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and recommendations based on our audit objective.

The audit objective was to assess the accuracy and completeness of the results and conclusions reported by SRNS Internal Audit on its Corporate Reachback Floor Check Review of invoices for loaned employees from FFS and to perform additional testing on an invoiced Fluor Federal Services “loaned employee” to determine whether home office expenses were included in the invoiced costs, and if so, recommend the amount of questioned costs for consideration by the U.S. Department of Energy (DOE). The audit was conducted in accordance with generally accepted auditing standards (GAAS) and the standards applicable to performance audits contained in *Government Auditing Standards* (GAS). The criteria we relied upon to conduct the audit included Federal Acquisition Regulation (FAR) Part 99, *Cost Accounting Standards*, FAR Part 31, *Contract Cost Principles and Procedures*, Department of Energy Acquisition Regulation (DEAR) 970.3102-3-70, 970.3102-05-6; DOE-SR Contract DE-AC09-08SR224407, Clauses H-20 and I-51(j); and DOE Acquisition Letters AL-2005-11 and AL-2012-04.

The DOE awarded Management and Operating (M&O) Contract No. DE-AC09-08SR22470 to SRNS, a for-profit joint venture, established between Fluor Federal Services, Inc. (FFSI), Newport News Nuclear, Inc. (NNN), and Honeywell International, to manage and perform the M&O contract at the SRS. SRNS submitted its proposal in response to DOE RFP No. DE-RP09-06SR22470 in June 2007. On August 1, 2008, SRNS commenced performance on the M&O contract. Amongst the joint venture companies, FFS has a majority share in the joint venture, SRNS.



The SRNS contract DE-AC09-08SR22470, Clause H-20, entitled *Home Office Expenses*, states “Home office expenses, whether direct or indirect, relating to activities of the Contractor are unallowable, except as otherwise specifically provided in the Contract or specifically agreed to in writing by the Contracting Officer consistent with DEAR 970.3102-3-70”. Clause I51(j), *Determining Allowable Costs*, of the SRNS contract states, “the Contracting Officer shall determine allowable costs in accordance with the Federal Acquisition Regulation subpart 31.2 and the Department of Energy Acquisition Regulation subpart 48 CFR 970.31 in effect on the date of this contract and other provisions of this contract.”

As further described in this report, our audit disclosed that the corporate reachback invoices submitted by FFS to SRNS (both segments of Fluor Corporation under common control) included an indirect (overhead support) burden, a G&A burden, and Facilities Capital Cost of Money (FCCOM) applied to the loaned labor costs. The FFS G&A pool contained costs that were allocated to it (as a Fluor segment) in accordance with CAS 403, *Allocation of Home Office Expenses to Segments*. The nature of the costs in question are home or corporate office general and administrative expenses incurred in the general management of the contractor's business as a whole and covered by the fee for management and operating contracts as described in DEAR 970 3102-3-70. As such, we noted “home office” expenses were included in the “reachback” labor costs through the application of FFS G&A burden billed to SRNS and in turn charged to DOE. FFS also included a FCCOM charge in its invoice to SRNS which has been included in billings to DOE.

Based upon the audit procedures performed and the results obtained, we have met our audit objective. We conclude that the results and conclusions reported by SRNS Internal Audit on its Corporate Reachback Floor Check Review of invoices for loaned employees from FFS was accurate and complete as relates their audit objectives. The results of our work disclosed that Savannah River Nuclear Solutions, LLC's costs incurred for contract DE-AC09-08SR22470, for the period August 1, 2008 through August 21, 2012, included home office expenses of \$1,256,481 and \$36,763 in FCCOM resulting from its use of Fluor Federal Services loaned employees. Subsequent to our review, the Savannah River Operations Office Contracting Officer initiated action to disallow the \$1,256,481 in home office expenses.

This performance audit did not constitute an audit of financial statements in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*. KPMG was not engaged to, and did not render an opinion on the Auditee's internal controls over financial reporting or over financial management systems. This report is intended solely for the information and use of the U.S. Department of Energy and management of the Auditee, and is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

KPMG LLP

BACKGROUND

On December 23, 2008, Savannah River Nuclear Services, LLC (SRNS or the Auditee) entered into Loaned Employee Agreements with Fluor Federal Services (FFS) and Newport News Nuclear, Inc. (NNN), and then with Honeywell International on February 11, 2009. The purpose of the Loaned Employee Agreements is to provide for “reachback” to the SRNS joint venture companies’ employee pool for critical skills needed in the performance of the Management and Operating (M&O) contract at the Savannah River Site (SRS). SRNS also entered into Cost Transfer Agreements with each joint venture company, stipulating the invoicing and payment procedures for employees loaned to SRNS under the “corporate reachback” arrangement.

FFS and SRNS are separate segments or business units, as defined in CAS 403, *Allocation of Home Office Expenses to Segments* within Fluor Corporation’s cost accounting structure, as described in Fluor Corporation’s CASB Disclosure Statement. The two segments above FFS and SRNS in the cost accounting hierarchy in ascending order are (1) Fluor Government Group Headquarters (FGG Hqs) and (2) Fluor Corporation (Corp HQ) which are considered an intermediate home office and home office, respectively. As such, Corp HQ and FGG Hqs allocate home office expenses to FFS and SRNS in accordance with CAS 403.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The audit objective related to the Auditee was to assess the accuracy and completeness of the results and conclusions reported by SRNS Internal Audit on its Corporate Reachback Floor Check Review of invoices for loaned employees from FFS, and to perform additional testing on an invoiced FFS “loaned employee” to determine whether home office expenses were included in the invoiced costs, and if so, recommend the amount of questioned costs for consideration by the U.S. Department of Energy (DOE).

The criteria we relied upon to conduct the audit included Federal Acquisition Regulation (FAR) Part 99, *Cost Accounting Standards*, FAR Part 31, *Contract Cost Principles and Procedures*, Department of Energy Acquisition Regulation (DEAR) 970.3102-3-70, 970.3102-05-6; DOE-SR Contract DE-AC09-08SR224407 Clauses H-20 and I-51(j); and DOE Acquisition Letters AL-2005-11 and AL-2012-04.

Scope

The scope of this performance audit was to review the Auditee’s corporate reachback costs charged to the SRS M&O contract to determine whether home office expenses had been included on FFS corporate reachback billings to SRNS, and to assess the accuracy and completeness of results and conclusions reached by SRNS Internal Audit in its Corporate Reachback Floor Check Review dated May 21, 2012 as it relates to FFS corporate reachback costs. The period under review was from inception of the contract award, August 1, 2008, to the most recent billing, August 21, 2012.

We conducted our performance audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to performance audits contained in *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 recommendations based on our

audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and recommendations based on our audit objective.

In performing our procedures, we considered the Auditee's accounting system and internal controls as related to our audit objective; however, we were not engaged to, and did not render an opinion on the Auditee's internal controls over financial reporting or over financial management systems.

SRNS is responsible for establishing and maintaining an acceptable accounting system, including internal controls, for accumulating, reporting, and billing costs. Our responsibility is to provide findings and recommendations based on the results of our performance audit.

Methodology

To accomplish our performance audit objective, we performed the following:

- Met with DOE representatives to gain an understanding of the history of the M&O contract and relevant background information
- Reviewed applicable rules, regulations, and guidance, as necessary
- Reviewed the Cost Accounting Standards (CAS) Disclosure Statements for SRNS and other Fluor entities contained within the Fluor Corporation cost accounting structure
- Reviewed relevant FFS Defense Contract Management Agency (DCMA) approved indirect rate agreements for the periods 2008 – 2012
- Reviewed the SRNS Internal Audit Report on Corporate Reachback Floor Check Review SR2012-06:
 - Discussed procedures performed with the SRNS Internal Audit personnel responsible for the audit and resulting report
 - Walked through methodology followed and procedures performed
 - Reviewed Internal Audit work papers
- Re-performed the procedures performed by Internal Audit during the Corporate Reachback Floor Check Review by selecting a separate Corporate Reachback employee to test and followed the same procedures used by SRNS Internal Audit in its audit SR2012-06
- Met with SRNS and FFS personnel to discuss home office and indirect costs, to gain an understanding of how such charges ultimately flow to the DOE through the SRNS billings
- Obtained detail of the FFS general and administrative (G&A) indirect cost rate and interviewed FFS and SRNS personnel regarding the cost accounting practices related to the cost elements within the G&A pool, to determine the nature of the functions, activities, and elements of cost and to determine whether home office costs are included in the G&A cost pool
- Determined the amount of home office expenses that were billed to DOE through the FFS G&A rate applied to loaned employees
- Prepared results of analyses and documented total recommended questioned costs

RESULTS

Our performance audit did not result in a finding related to the accuracy or completeness of SRNS Internal Audit's Corporate Reachback Floor Check Review SR2012-06. However, our work resulted in one finding regarding home office costs on FFS corporate reachback invoices submitted to SRNS. The Savannah River Operations Office elected not to have an exit conference given that we are not making any recommendations in this report.

Finding, Recommendation, and Responses

Finding No. 2012-14-SRNS-01 – Home Office Expense and Facilities Capital Cost of Money

Criteria:

- SRNS contract DE-AC09-08SR22470, Clause H-20, entitled *Home Office Expenses*, states “Home office expenses, whether direct or indirect, relating to activities of the Contractor are unallowable, except as otherwise specifically provided in the Contract or specifically agreed to in writing by the CO consistent with DEAR 970.3102-3-70.”
- CAS 403, *Allocation of Home Office Expenses to Segments*, Paragraph 30(a), states:
 - (2) Home office means an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.
 - (4) Segment means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.
- DEAR 970.3102-3-70, *Home Office Expenses*, states:
 - (a) For on-site work, DOE's fee for management and operating contracts, determined under the policy of and calculated per the procedures in 48 CFR 970.1504-1-3, generally provides adequate compensation for home or corporate office general and administrative expenses incurred in the general management of the contractor's business as a whole.
- DEAR 970.4402-3, *Purchasing from Contractor-affiliated Sources*

- FAR 52.215-17, *Waiver of Facilities Capital Cost of Money*
- Fluor Corporation Disclosure Statement Revision 18, effective January 1, 2012.
- Fluor Government Group Headquarters Disclosure Statement Revision 12, effective January 1, 2012.
- FFS Disclosure Statement Revision 10, effective January 1, 2011.

Condition:

SRNS and FFS are separate segments under the Fluor Corporation and Fluor Government Group Headquarters, and as a result, receive a share of home and intermediate home office cost allocations in accordance with CAS 403. SRNS' share of Corp HQ and FGG Hqs allocations were calculated on a "memorandum" basis for purposes of CAS 403, but are not transferred to SRNS' financial statements and were not charged to the DOE M&O contract. However, FFS' allocation of the Corp HQ and FGG Hqs were included in its G&A cost pool.

In accordance with the Loaned Employee Agreement and Cost Transfer Agreement between SRNS and FFS, employees loaned to SRNS by FFS under the corporate reachback arrangement were billed at actual cost plus applicable FFS burdens (fringe benefits and G&A costs). The fully burdened costs, including travel expenses for the employees under the corporate reachback arrangement, were billed to SRNS and charged to the M&O contract.

We reviewed the corporate reachback invoices submitted by FFS to SRNS to identify the types and amount of burdens applied to loaned labor, noting that FFS applied an indirect rate, a G&A rate, and FCCOM to the loaned labor costs. We also reviewed FFS' CASB Disclosure Statement to identify the major functions, activities, and elements of cost included in each of the burden pools included on the corporate reachback invoices, noting the following:

- Item No. 4.2.0 (a) General and Administrative Expense Pool includes FFS B&P and pursuits cost, Group Executives, Corporate & Government Group Allocations which includes base compensation labor, national domestic benefits distribution, and corporate and professional central services charges. All G&A is generated from allocations. This description indicates that the G&A costs in the pool are allocations from Fluor Corporation, Fluor Government Group Headquarters, or other directly assigned or central service charges.

We discussed the composition of the costs within the FFS G&A pool with the Fluor Director, Federal Cost and Pricing, and confirmed that the FFS G&A costs were included in the G&A rates charged for the FFS corporate reachback (i.e., loaned employees) costs invoiced to SRNS.

The FFS G&A costs are categorized as follows:

- Corporate Allocations (Residual)
- Corporate Sales & Marketing
- Group Executive – Government Services
- Fluor Government Group HQ – Management
- Fluor Government Group HQ – Sales & Marketing

- Bid & Proposal
- Pursuits

Our discussion also revealed that the “Bid and Proposal” and “Pursuits” categories included in the G&A pool were directly allocated to FFS G&A and therefore were not considered home office type expenses incurred for the general management of the corporation as a whole.

- FFS also applies a “field staff overhead rate” to the loaned labor cost billed to SRNS. This burden is for the benefit expense and support costs (as described in FFS CASB Disclosure Statement Item No. 4.1.0.2 and 4.1.0.3) incurred for the corporate reachback employees who receive Fluor fringe benefits and benefit from FFS support functions, such as payroll and human resources. These indirect cost burdens are separately identified and accounted for on the corporate reachback invoices submitted by FFS to SRNS.
- FCCOM was applied by FFS to the billings for labor and employee travel on the corporate reachback invoices, which were charged to the M&O contract by SRNS.

While the G&A costs applied to the corporate reachback costs were allocated to FFS in accordance with CAS 403, the origin of these costs within Fluor Corporation’s cost accounting structure and the functions performed for which those costs were incurred does not change. Moreover, FFSI (a Fluor entity) has a majority interest in the joint venture (SRNS). Based upon our analysis of FFS’ G&A costs applied to the corporate reachback invoices, the nature of the functions performed for which the costs were incurred and the origin of the costs within Fluor Corporation’s cost accounting structure (i.e., costs incurred at Corp HQ & FFG Hqs), fall within the definition of home and intermediate home office costs as described within CAS 403 and DEAR 970 3102-3-70. Those costs were incurred for management, supervisory, or administrative functions in support of the operations of the various segments (i.e., SRNS, FFS, and other segments); and were general and administrative expenses incurred in the general management of the contractor's business as a whole (i.e., Fluor Corporation’s business as a whole).

Because FFSI, a related Fluor entity, has a majority interest in the SRNS joint venture, the corporate reachback arrangement between SRNS and FFS is an agreement between affiliates under common control and not necessarily an “arms length” subcontract. According to SRNS, the corporate reachback program is a “human resources” function. Fluor’s majority interest in the SRNS joint venture and the manner in which the corporate reachback arrangement works shows the direct relationship of FFS and SRNS, both segments within the overall Fluor Corporation structure. All of the Fluor segments benefit from the “general and administrative expenses incurred in the general management of Fluor Corporation’s business as a whole” (i.e., home office costs).

The FFS G&A costs (except B&P and pursuits costs which were specifically incurred for FFS) included on the corporate reachback invoices submitted to SRNS, included home office costs from Fluor home and intermediate home offices. The M&O contract does not allow costs for home office expenses.

The FCCOM rate applied to the “corporate reachback” costs results in cost of money charges that may not be allowable costs to DOE under the M&O contract, because the FAR Cost Principles and the Agency Supplement DEAR 970.3102-3-70(a)1(ii) disallow those costs.

Cause:

SRNS management stated that the H-20 clause within M&O contract DE-AC09-08SR22470 and DEAR 970.3102-3-70 applies only to the DOE contractor, SRNS, and therefore, the fully burdened FFS corporate reachback costs (which include home office allocations from Fluor Corporation and Fluor Government Group Headquarters via the FFS G&A rate) charged by SRNS to the M&O contract were appropriate, because the FFS G&A costs are attributable to FFS and not SRNS.

Similarly, SRNS management stated that the FFS FCCOM rate that was charged to the M&O contract through SRNS was appropriate because FFS does not operate under an advance payment arrangement as SRNS does under the DOE M&O contract and that FAR 52.215-17, *Waiver of Facilities Capital Cost of Money* applies only to SRNS (the contractor).

Effect:

We reviewed FFS cumulative billings from August 1, 2008 through August 21, 2012, to determine the cumulative G&A costs billed to SRNS through the FFS corporate reachback arrangement. We also reviewed the cost elements that comprised the FFS G&A cost pool for each year (2008 through 2012). The cost element detail was derived from the FFS “Final Incurred Cost Proposal” data. We extracted the data from the pool that related to home office expenses to derive a G&A rate excluding those costs. Then, we applied the adjusted G&A rate to the cumulative billings and computed the variances between the G&A costs that were billed and what would have been billed if the adjusted G&A rate was applied. The variances shown in the table below are the home office costs charged through the FFS G&A rate and the FCCOM billed to SRNS on the FFS corporate reachback invoices and subsequently charged to the M&O contract.

Year	G&A	FCCOM	Total
2008	\$ 221,174	\$ 3,451	\$ 224,625
2009	455,915	13,763	469,678
2010	295,263	10,496	305,759
2011	197,764	6,136	203,900
2012	86,365	2,917	89,282
	\$1,256,481	\$ 36,763	\$ 1,293,244

Recommendation:

Subsequent to our review, the Savannah River Contracting Officer initiated action to disallow the \$1,256,481 in home office expenses cited in our report. Therefore, we are not making any recommendations in this report.

Management Response:

Below is the SRNS Management response to your Draft Notification of Finding and Recommendation regarding the audit of Home Office Expenses Submitted by Fluor Federal Services to SRNS.

Thank you for the opportunity to respond. SRNS respectfully disagrees with KPMG's finding and recommendation. The Draft Notification questions a portion of the labor costs for the "reachback" personnel acquired from Fluor Federal Services based on a misinterpretation of Clause H-20 and DEAR 970.3102-3-70. As further discussed below, the labor and related costs of the "reachback" personnel are not (and cannot be considered) "home office expenses" because that is a term specifically defined by the applicable regulations, and applies only to home office expenses allocated, directly or indirectly, *to* SRNS by *SRNS's* home office. The Draft Notification also contains factual errors that may have contributed to KPMG's misinterpretation of Clause H-20 and DEAR 970.3102-3-70.

Clause H-20, Home Office Expenses, states: "Home office expenses, whether direct or indirect, relating to activities of the Contractor are unallowable, except as otherwise specifically provided in the contract or specifically agreed to in writing by the CO consistent with DEAR 970.3102-3-70, 'Home Office Expenses.'" Although the *allowability* of home office expenses is governed by Clause H-20 and the Federal Acquisition Regulation ("FAR") cost principles, the direct and indirect *allocation* of home office expenses is governed by Cost Accounting Standard ("CAS") 403, Allocation of Home Office Expenses to Segments. *See, e.g., DIRECTV Group, Inc. v. United States*, 670 F.3d 1370, 1376 (Fed. Cir. 2012) ("Although the CAS governs allocability, *i.e.*, what portions of a cost are assigned to a particular segment or contract, the FAR generally governs whether a party may apply or recover that cost.") Indeed, the CAS Board, by statute, has the "*exclusive authority* to prescribe, amend, and rescind cost accounting standards, and interpretations of the standards ... governing measurement, assignment, and allocation of costs to contracts with the Federal Government." 41 U.S.C. § 1502(a)(1) (emphasis added). For that reason, the U.S. Court of Appeals for the Federal Circuit has "specifically held that, if there is any conflict between the CAS and the FAR as to an issue of allocability, the CAS governs." *Boeing North American, Inc. v. Roche*, 298 F.3d 1274, 1283 (Fed. Cir. 2002) (citing *United States v. Boeing Co.*, 802 F.2d 1390, 1395 (Fed.Cir.1986), and *Rice v. Martin Marietta Corp.*, 13 F.3d 1563, 1565 n. 2 (Fed. Cir. 1993)).

Both the FAR and CAS 403 contain the same definition of "home office," namely—

Home office means an office responsible for directing or managing two or more, but not necessarily all, segments of an organization. It typically establishes policy for, and provides guidance to the segments in their operations. It usually performs management, supervisory, or administrative functions, and may also perform service functions in support of the operations of the various segments. An organization which has intermediate levels, such as groups, may have several home offices which report to a common home office. An intermediate organization may be both a segment and a home office.

FAR 31.001; 48 C.F.R. § 9904.403-30(a)(2). Both also contain the same definition of "segment"—

Segment means one of two or more divisions, product departments, plants, or other subdivisions of an organization reporting directly to a home office, usually identified with responsibility for profit and/or producing a product or service. The term includes Government-owned contractor-operated (GOCO) facilities, and joint ventures and subsidiaries (domestic and foreign) in which the organization has a majority ownership. The term also includes those joint ventures and subsidiaries (domestic and foreign) in which the organization has less than a majority of ownership, but over which it exercises control.

Id.; *id.* § 9904.403-30(a)(4).

It is a fundamental requirement of CAS 403 that home office expenses “be allocated directly to segments to the maximum extent practical.” 48 C.F.R. § 9904.403-40(a)(1). Home office expenses that are not directly allocated must be allocated indirectly to the benefitting segments through either a homogeneous expense pool under CAS 403-40(b) or a residual cost pool under CAS 403-40(c). *Id.*

Applying the plain language of these provisions, it is clear that none of the home office expenses allocated to SRNS, either directly or indirectly, have been charged to DOE in contravention of Clause H-20.

Clause H-20 applies to “Home office expenses ... relating to activities of the Contractor....” The “Contractor” is Savannah River Nuclear Solutions, LLC, a South Carolina limited liability company created on May 18, 2007, to compete for award of the DOE Contract. In fact, the solicitation leading to award of the Contract specifically required that the “offeror” be a “single legal entity.” Thus, three companies formed and own SRNS: Fluor Federal Services, Inc. (“FFSI”)—48%; Newport News Nuclear, Inc. (“NNN”)—34%; and Honeywell International (“HI”)—18%. The Draft Notification confuses Fluor Federal Services (“FFS”), a CAS segment of Fluor Government Group Headquarters (“FGG Hq”), and FFSI, the legal entity that owns a 48% share of SRNS. The Draft Notification also mistakenly asserts that “FFS has majority ownership and leads the management and performance of the M&O contract with DOE.” FFS is not a legal entity and does not have *any* ownership interest in SRNS. Although FFSI owns the largest (48%) share of SRNS, neither FFSI nor the other two member companies has a majority ownership or controlling interest in SRNS within the meaning of the SRNS Operating Agreement.

SRNS is a segment that reports directly to an intermediate home office, FGG Hq, which in turn reports directly to a home office, Fluor Corporation (“Fluor”). Fluor allocates home office expenses to SRNS in accordance with CAS 403. FGG Hq, as an intermediate home office, also allocates home office expenses to SRNS in accordance with CAS 403. However, the home office expenses allocated to SRNS by Fluor and FGG Hq are *not* billed to DOE because they are treated as unallowable costs under Clause H-20.

By contrast, the “reachback” costs are the labor and related costs of FFS employees who are working under the Contract as seconded employees or employees on short or long term assignments. FFS is not a home office or an intermediate home office, does not have any segments, and does not allocate home office expenses either directly or indirectly—to SRNS or any other entity. Although the fully burdened labor rates for the “reachback” personnel include overhead and general and administrative (“G&A”) expenses, those costs are *not* “home office expenses ... relating to activities of the Contractor.” They are instead home office expenses allocated to—and relating to the activities of—FFS. Accordingly, by its plain language, Clause H-20 is not applicable to the “reachback” costs. Therefore, *there are no costs to disallow* under Clause H-20.

DEAR 970.3102-3-70, Home office expenses, is similarly inapplicable. It states:

- (a) For on-site work, DOE’s fee for management and operating contracts, determined under the policy of and calculated per the procedures in 970.1504-1-3, generally provides adequate compensation for home or corporate office general and administrative expenses incurred in the general management of the contractor’s business as a whole.

- (1) DOE recognizes that some Home Office Expenses are incurred for the benefit of a management and operating contract. DOE has elected to recognize that benefit through fee due to the difficulty of determining the dollar value applicable to any management and operating contract. The difficulty arises because:
 - (i) The general construct of a management and operating contract results in minimal Home Office involvement in the contract work, and
 - (ii) Conventional Home Office Expense allocation techniques that use bases such as total operating costs, labor dollars, hours etc., are not appropriate because they inherently assume significant contractor investment (in terms of its own resources, such as, labor, material, overhead, etc.). Contractor investments are minimal under DOE's operating and management contracts. The contracts are totally financed by DOE advance payments, and DOE provides government-owned facilities, property, and other needed resources.
 - (2) From time to time, the fee for a management and operating contract may not be adequate compensation for Home Office Expenses incurred for the benefit of the contract. An indication that such a case exists is the need for significant home office support to deal with issues at the site that occur without the fault or negligence of the contractor, for example, the need for home office legal support to deal with third party, environmental, safety, or health issues.
 - (3) In such a case, the contracting officer, after obtaining the HCA's approval, may consider a contractor request for additional compensation. The contractor may request—
 - (i) Fee in addition to its normal fee (but see 970.1504-1-3(b)(1) if the contract is for the management and operation of a laboratory); or
 - (ii) Compensation on the basis of actual cost.
 - (4) Because the contract's fee provides some compensation for Home Office Expenses, the contractor's request for additional compensation must always be for an amount less than the Home Office Expenses that are incurred for the benefit of the management and operating contract.
- (b) For off-site work, the DOE allows Home Office Expenses under architect-engineer, supply and research contracts with commercial contractors performing the work in their own facilities. Home Office Expenses may, however, be included for reimbursement under such DOE off-site architect-engineer, supply and research contracts, only to the extent that they are determined, after careful examination, to be allowable, reasonable, and properly allocable to the work.

Work performed in a contractor's own facilities under a management and operating or construction contract may likewise be allowed to bear the properly allocable portion of allowable Home Office Expenses.

For the same reason that the “reachback” costs are not “home office expenses ... relating to activities of the Contractor” under Clause H-20, they are also not “home or corporate office general and administrative expenses incurred in the general management of the contractor’s business as a whole” under DEAR 970.3102-3-70. Once again, the “contractor” is SRNS. The overhead and G&A allocations to FFS are not incurred in the general management of *SRNS’s* business as a whole. Moreover, the fact that the fully burdened “reachback” labor rates include overhead and G&A does not mean that *SRNS* is being allocated home office expenses. Put another way, transferring fully burdened labor is not a “Conventional Home Office Expense allocation technique” within the meaning of DEAR 970.3102-3-70(a)(1)(ii). Accordingly, by its plain language, DEAR 970.3102-3-70 is not applicable to the “reachback” costs. Therefore, *there are no costs to disallow* under DEAR 970.3102-3-70.

The labor costs of the “reachback” are instead governed—and permitted—by Clause I.56(e)(4), which states in pertinent part: “Allowable costs in the purchase or transfer from contractor affiliated sources shall be determined in accordance with 48 CFR 970.4402-3 and 48 CFR 970.3102-3-21(b).” DEAR 970.4402-3(b) states that subcontracts for performance of the contract work by a contractor-affiliated source requires DOE authorization and may involve an adjustment of the contractor’s fee, if any. DOE authorization for the “reachback” personnel was granted at the time of contract award, and was presumably taken into account when the parties agreed upon the contract fee. In accordance with DEAR 970.4402-3(b)(1), 970.4402-3(c)(1)(i) and FAR 31.205-26(e), the purchase or transfer of “reachback” services is based on cost. Accordingly, the “reachback” labor costs are permitted by the terms of the contract.

The FFS “reachback” employees working under the Contract are supported by and receive all of their fringe and other benefits from FFS. Their fully burdened labor rates include:

- Base Compensation Labor,
- National Payroll Burden Rate,
- Field Staff Overhead Rate (if not housed in a Fluor facility) or Home Office Overhead Rate¹ (if housed in a Fluor facility),
- Facilities Capital Cost of Money , and
- General and Administrative (“G&A”) Rate.²

SRNS’s intent to use these reachback employees—and a description of the costs included in their fully burdened labor rates—were fully disclosed and individually itemized in Section 2 of Volume III of SRNS’s proposal for the Contract. For example, Volume III, page 25 of SRNS’s proposal listed several “Key Estimating Assumptions, Clarifications, and/or Exceptions,” including that—

The proposed key personnel costs shown in the estimate summary worksheet “SUM Team” and SUM Key” include all indirect costs, including labor overhead, G&A and

¹ Even though this rate is named a “Home Office Overhead Rate”, it does not contain any home office allocations as defined by CAS 9904-403. Home office means the employees are located in a FFS facility and not in a project location.

² A complete description of these indirect cost pools and rates is found in the FFS CAS Disclosure Statement, Revision 10.

Cost of Money (COM). As required in the solicitation, the fringe benefit portion of labor overhead is included as part of annual compensation.

The costs included in the fully burdened labor rates for the FFS “reachback” employees were even more clearly described on page 29 of Volume III of SRNS’s proposal. It stated:

Basis of Data – Forward Pricing Rates

- All labor costs within this proposal are reconciled to the domestic field labor overhead rate of 54.30% effective as of April 10, 2007, as described above. The current Forward Pricing Rates are shown in Figure 2-22, FFS FY 07 Forward Pricing Rates/Factors as of 10APR2007. For the purposes of this estimate, it is assumed that the current forward pricing rates continue to apply for both FY 2007 and FY 2008.

FIGURE 2-22 – FFS FY 07 Forward Pricing Rates/Factors as of 10 APR 2007

Fluor Federal Services				
Effective	Description	Group Code	Rate or Factor	Application Base
21-Mar-07	Labor Overhead – domestic field	GF/GK	54.30%	Domestic field labor \$
21-Mar-07	Support Cost Rate		27.99%	
11-Nov-06	Burden and Benefit Rate		26.31%	
21-Mar-07	G&A		4.15%	Total Cost except COM
21-Mar-07	Facilities Capital Cost of Money (COM)		0.2060%	Total Cost except G&A

Importantly, the solicitation, like the Contract, included Clause H.20. Yet, DOE did not take issue with SRNS’s proposed labor rates for “reachback” personnel—even though the labor rates clearly include FFS G&A, which in turn includes home office expense allocations to FFS from Fluor and FGG Hq. To the contrary, DOE accepted SRNS Proposal DE-RP09-06SR2246 without exception upon Contract award to SRNS. See Ltr from Contracting Officer (“CO”) Angela S. Morton to SRNS, dtd. Jan. 10, 2008. Presumably, the reason DOE did not take exception to the proposed labor rates is that the CO correctly distinguished between the labor costs of FFS employees who are working under the Contract as seconded employees or employees on short or long term assignments, and home office expenses allocated either directly or indirectly to SRNS.

The Draft Notification misses the mark by examining the types of costs included in the FFS G&A pool to determine whether the costs are “native” to FFS or an allocation from Fluor. What matters is not what the costs represent *vis-à-vis* FFS, but what they represent in relation to SRNS. SRNS was billed for the fully burdened **labor rates** of the FFS employees providing services under the Contract. SRNS was not billed for any corporate allocations. In analogous circumstances, the Armed Services Board of

Contract Appeals rejected the Government's attempt to disallow a prime contractor's cost based on the nature of the cost in relation to the subcontractor. In *Johnson Controls World Services, Inc.*, ASBCA Nos. 46674 et al., 96-2 BCA ¶ 28,464, the Government argued that Johnson Controls World Services, Inc. ("JCWS") was not entitled to reimbursement of monies that its subcontractor, Support Services, Inc. ("SSI") paid to the Internal Revenue Service as interest on overdue taxes. The ASBCA found that FAR 31.205-20 bars reimbursement of interest levied for the late payment of taxes. However, the ASBCA held that that was an insufficient basis to disallow JCWS's costs because JCWS was billed for wages and employee tax withholding, not for interest. The ASBCA stated:

The Army, thus, is correct in asserting that there is a regulatory Cost Principle which bars reimbursement of interest assessed on overdue taxes.... However, to sustain its disallowance of the subcontractor cost, the Army cannot cite only to the Cost Principles and the fact the IRS treated a SSI payment as satisfying a particular obligation. The sole fact cited does not demonstrate that the subcontractor cost "invoiced" is of a type specifically made unallowable. JCWS contends that it reimbursed SSI for the cost of wages/employee FICA withholding that SSI incurred and accrued in performing services under the contracts and that it "invoiced" the Army for such cost.... The Army presents no evidence to the contrary, i.e., that the Army was "invoiced" for interest assessed to SSI.... The Cost Principles state that wages, such as those SSI paid its employees and withheld as employee FICA tax pursuant to 26 U.S.C. §§ 3101 and 3012, are "allowable," subject to specific criteria set forth in the Cost Principles.... The Army has not shown any specific criterion for allowability set forth that was not satisfied.... The Army therefore has failed to satisfy its burden of demonstrating that the subcontractor cost invoiced is of a type specifically made unallowable.

Similarly, here, SRNS was invoiced for the labor costs of the "reachback" employees, not for any corporate allocations.

Finally, the Draft Notification is mistaken in questioning *FFS's* Facilities Capital Cost of Money ("FCCM"). Clause I.1 of the Contract incorporates FAR 52.215-17, Waiver of Facilities Capital Cost of Money, which states: "The Contractor did not include facilities capital cost of money as a proposed cost of this contract. Therefore, it is an unallowable cost under this contract." SRNS, the Contractor, did not propose FCCM for this Contract in its proposal and has not invoiced DOE for FCCM. On the other hand, FFS *did* propose FCCM in its proposal contained in Section 2 of Volume III of SRNS's proposal for this Contract and did not waive reimbursement for FCCM. FFS is not the Contractor and therefore, is not subject to the above waiver clause. Thus, FFS may invoice and be reimbursed for FCCM under the Contract.

Thank you again for the opportunity to respond to the Draft Notification. For the reasons discussed above, we disagree with KPMG's finding and recommendation.

Auditors' Response:

In its response, SRNS clarified the difference between Fluor Federal Services (FFS) – a CAS segment of Fluor Government Group Headquarters ("FGG Hq"), and Fluor Federal Services, Inc (FFSI) - the legal entity that owns a 48% share of SRNS. As such, we have updated the related discussion of these entities in our report and finding.

While this clarification is appropriate, the following forms the basis for our finding:

- SRNS and FFS are segments (within the definition of CAS 403.30(a)(4)) reporting to an intermediate home office, Fluor Government Group Headquarters (FGG Hq) which in turn directly reports to a home office, Fluor Corporation (Fluor). SRNS confirms this understanding in its management response.
- In accordance with CAS 403.40, both SRNS and FFS receive home office expense allocations from Fluor and FGG Hq, home office and intermediate home office, respectively. According to management's response, SRNS' share of home office expense allocated to it under CAS 403 are not billed to DOE because they are treated as unallowable cost under Clause H-20. However, FFS' share of these home office expenses allocated to it by Fluor and FGG Hq are included in its G&A costs applied to "reachback" labor costs which are billed to SRNS and in turn billed to DOE.
- In its management response, SRNS states "SRNS's proposed labor rates for "reachback" personnel...clearly include FFS G&A, which in turn includes home office expense allocations to FFS from Fluor and FGG Hq. As such, SRNS acknowledges that "home office" expenses are included in FFS G&A rates, which in turn is billed to DOE through the FFS "reachback" labor costs billed to SRNS. However, we were not privy to and were not provided documentation regarding proposal evaluations, or any pre-award negotiations and/or advanced agreements with DOE regarding the proposed "reachback" labor rates.
- SRNS' management response states "Although the fully burdened labor rates for the "reachback" personnel include overhead and general and administrative ("G&A") expenses, those costs are *not* "home office expenses ... relating to activities of the Contractor...They are instead home office expenses allocated to—and relating to the activities of—FFS." Management's response goes on to state "the overhead and G&A allocations to FFS are not incurred in the general management of SRNS's business as a whole." SRNS' assertion that "G&A allocations to FFS are not incurred in the general management of SRNS's business as a whole" is questionable because in accordance with CAS 403.40, home office expenses are allocated to segments on the basis of the beneficial or causal relationship between supporting and receiving activities. Therefore, SRNS and FFS received "home office" expense allocations from Fluor and FGG Hq for benefits received from activities performed at Fluor (home office) and FGG Hq (intermediate home office) and such expenses were presumably incurred in the general management of the business as a whole rather than relating to the activities of FFS or SRNS, specifically. Therefore, these costs could be considered "home or corporate office general and administrative expenses incurred in the general management of the contractor's business as a whole" under DEAR 970.3102-3-70.
- SRNS' management response states "the labor costs of the "reachback" are instead governed—and permitted—by Clause I.56(e)(4), which states in pertinent part: "Allowable costs in the purchase or transfer from contractor affiliated sources shall be determined in accordance with 48 CFR 970.4402-3 and 48 CFR 970.3102-3-21(b)". The corporate reachback program is a "human resources" function according to SRNS' General Counsel. The "reachback" arrangement is executed through inter-organizational agreements called Loaned Employee Agreement and Cost Transfer Agreement. As such, the labor costs of the "reachback" are not governed by 48 CFR 970.4402-3. 48 CFR 970.4402-3(a) states "A management and operating contractor may purchase from sources affiliated with the contractor (any division, subsidiary, or affiliate of the contractor or its parent company) in the same manner as from other sources, provided...(3) Award is made in accordance with policies and procedures designed to permit effective competition which have been approved by the contracting officer". SRNS has not shown that the FFS reachback was a competitive procurement approved by the contracting officer.
- FAR 31.205-26(e) requires that, "Allowance for all materials, supplies and services that are sold or transferred between any divisions, subdivisions, subsidiaries, or affiliates of the contractor under a

common control shall be on the basis of cost incurred in accordance with this subpart (FAR 31.2).” FFS is an affiliate of SRNS under common control. In accordance with 31.205-10, FCCOM is an allowable contract cost, provided among other conditions, “The estimated facilities capital FCCOM is specifically identified and proposed in cost proposals relating to the contract under which the cost is to be claimed.” SRNS included FCCOM in its FFS affiliate cost proposal to DOE. However, FAR subpart 31.2 also requires the contractor to comply with applicable agency supplements (see 31.201-2(d). 48 CFR 970.4402-3(c)(2) requires that “When a purchase from a contractor-affiliated source is made non-competitively, FCCOM shall not be considered an allowable element of the cost of the contractor-affiliated source”.

We also note that the DOE M&O Contract DE-AC09-08SR22470, Clause I51(j), *Determining Allowable Costs*, states, “the Contracting Officer shall determine allowable costs in accordance with the Federal Acquisition Regulation subpart 31.2 and the Department of Energy Acquisition Regulation subpart 48 CFR 970.31 in effect on the date of this contract and other provisions of this contract.”

Conclusion

Based upon the audit procedures performed and the results obtained, we have met our audit objective. We conclude that the results and conclusions reported by SRNS Internal Audit on its Corporate Reachback Floor Check Review of invoices for loaned employees from FFS was accurate and complete as relates their audit objectives. The results of our work disclosed that Savannah River Nuclear Solutions, LLC’s costs incurred for contract DE-AC09-08SR22470, for the period August 1, 2008 through August 21, 2012, included home office expenses of \$1,256,481 and \$36,763 in FCCOM resulting from its use of Fluor Federal Services loaned employees. Subsequent to our review, the Savannah River Operations Office Contracting Officer initiated action to disallow the \$1,256,481 in home office expenses.

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