



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

ASSESSMENT REPORT

Audit Coverage of Cost Allowability for Sandia Corporation During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC04-94AL85000

OAS-V-15-03

September 2015



Department of Energy
Washington, DC 20585

September 9, 2015

MEMORANDUM FOR THE MANAGER, SANDIA FIELD OFFICE

FROM:

A handwritten signature in dark ink, appearing to read "David Sedillo".

David Sedillo, Director
Western Audits Division
Office of Inspector General

SUBJECT:

INFORMATION: Assessment Report: "Audit Coverage of Cost Allowability for Sandia Corporation During Fiscal Year 2013 Under Department of Energy Contract No. DE-AC04-94AL85000"

BACKGROUND

Since October 1993, Sandia Corporation (Sandia), a Lockheed Martin Company, has managed and operated Sandia National Laboratories (SNL) for the Department of Energy (Department) and National Nuclear Security Administration (NNSA). SNL is a multiprogram laboratory with critical national security responsibilities, which include research and production to help ensure the safety, security, and reliability of the Nation's nuclear weapons stockpile. SNL is managed under a cost-reimbursement management and operating contract employing performance incentives. The contract runs from October 1, 1993, through April 30, 2016, with an option to extend the period of performance through April 30, 2017. Sandia incurred and claimed costs of \$2.6 billion in fiscal year (FY) 2013.

As an integrated management and operating contractor, Sandia's financial accounts are integrated with those of the Department, and the results of financial transactions are reported monthly according to a uniform set of accounts. In addition, Sandia's contract requires it to account for costs incurred annually on its Statement of Costs Incurred and Claimed (SCIC). The contract requires Sandia to account for all funds advanced by the Department, to safeguard assets in its care, and to claim only allowable costs. Allowable costs are incurred costs that are reasonable, allocable, and in compliance with the terms of the contract, cost principles, laws, and regulations.

The Department's Office of Inspector General, Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors have implemented a Cooperative Audit Strategy (Strategy) to make efficient use of available audit resources while ensuring that the Department's contractors claim only allowable costs. The Strategy places reliance on the contractors' internal audit functions to provide audit coverage of the allowability of incurred costs claimed by contractors. Sandia's Internal Audit (Internal Audit) and Contract Audit Departments are part of its Independent Audit, Ethics, and Business Conduct Center. Consistent with the Strategy, Sandia is required by its contract to maintain an internal audit activity with responsibility for conducting audits, including audits of the

allowability of incurred costs. The Strategy also requires that audits performed internally must, at a minimum, meet the standards prescribed by the Institute of Internal Auditors. In addition, Sandia is required to conduct or arrange for audits of its subcontractors when costs incurred are a factor in determining the amount payable to a subcontractor.

To help ensure that audit coverage of cost allowability was adequate for FY 2013, the objectives of our assessment were to determine whether:

- Internal Audit conducted a cost allowability audit that complied with professional standards and could be relied upon;
- Sandia conducted or arranged for audits of its subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor; and
- Questioned costs and internal control weaknesses affecting allowable costs that were identified in audits and reviews have been adequately resolved.

RESULTS OF ASSESSMENT

Based on our assessment, nothing came to our attention to indicate that the allowable cost audit work performed by Internal Audit for FY 2013 could not be relied on. We did not identify any material internal control weaknesses with cost allowability audits, which generally met International Standards for the Professional Practice of Internal Auditing. Further, Sandia Contract Audit had conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to the subcontractor. While we did not identify any material internal control weaknesses with either cost allowability or subcontract audit, we are questioning \$212,120 of costs identified and questioned by Internal Audit and Contract Audit that have not been resolved.

In addition, we are reporting:

- \$7,225,275 in prior period unresolved questioned costs, including \$6,952,490 in potential overpayments of New Mexico gross receipts tax and \$219,510 related to a Cost Accounting Standards violation involving an unallowable cost transfer to move labor costs from an overcost project to a different project (Attachment 2);
- \$2,357,131 in FY 2013 home office expenses, which are unresolved pending Defense Contract Audit Agency (DCAA) audit of the parent corporation, Lockheed Martin Corporation (Attachment 1);
- \$19,367,568 in prior period unresolved home office expenses that are pending DCAA audit (Attachment 2); and
- \$55,737 in prior period unresolved bad debt expenses identified as unallowable by the Sandia Field Office (Attachment 2).

Questioned Costs

Internal Audit questioned a total of \$11,522 during the period covered by this audit. Of this amount, \$4,011 was related to conference costs that were either incurred prior to receiving approval for conference attendance or were in excess of amounts submitted to the Department. The remaining amount, \$7,511 was the result of a procurement card transaction that was not allocable to the direct project to which it was charged. These costs remained unresolved as of April 2015; therefore, we are questioning them.

In addition, we noted that Sandia's Contract Audit Department questioned subcontract costs in FY 2013 totaling \$727,693, of which \$200,598¹ were unresolved as of February 2015. The unresolved costs included \$27,239 from one subcontract related to incorrect labor billing rates and labor categories outside of the subcontract scope and \$23,924 from another subcontract related to general and administrative expenses that were not applied in accordance with the subcontract terms and conditions, with the remaining \$149,435 questioned from 48 other subcontracts.

Home Office Expenses

The Department and Sandia have agreed that home office expenses directly attributable to the performance of the contract are allowable if they meet all other criteria for allowability. Sandia incurred \$2,357,131 in home office expenses in FY 2013. Before the Contracting Officer can make a determination of cost allowability, the DCAA must complete its review of the Corporate Office, and the Defense Contract Management Agency (DCMA) must negotiate a settlement. However, as noted in our February 2015 report on *Incurred Cost Audit Coverage of Non-Management and Operating Contractors* (DOE/IG-0934), over the past several years DCAA has been unable to perform many of its audits on a timely basis. These delays have resulted in a backlog of required audits of Sandia's Corporate Office. Therefore, we consider this amount unresolved pending audit.

Prior Period Questioned and Unresolved Costs

In our April 2014 report, *Assessment of Audit Coverage of Cost Allowability for Sandia Corporation under Department of Energy Contract No. DE-AC04-94AL85000 for Fiscal Years 2011 and 2012* (OAS-V-14-10, April 2014), we identified \$8,473,773 in questioned or unallowable costs that were unresolved. As of April 2015, \$7,281,012 remains unresolved. These unresolved costs include:

- \$219,510 in Internal Audit findings;
- \$6,952,490 in potential overpayments of New Mexico gross receipts tax in FY 2010;

¹ This amount represents cumulative unresolved audit findings that SNL tracks by purchase order. As such, it may include costs identified in interim audits that cover prior years.

- \$53,275 in subcontract audit findings; and
- \$55,737² in FY 2010 and FY 2011 bad debt expense.

In addition, \$19,367,568 in FY 2003 through FY 2012 Home Office Expenses are unresolved pending DCAA audit.

In response to our February 2013 report, *Assessment of Audit Coverage of Cost Allowability for Sandia Corporation during Fiscal years 2009 and 2010 under Department of Energy Contract No. DE-AC04-94AL85000* (OAS-V-13-07, February 2013), Sandia filed amended state tax returns for FYs 2009–2011 and received an \$8.9 million refund for FY 2009. Sandia performed a review to validate the taxability status of projects with costs through March 31, 2012, and is continuing to work with the State of New Mexico to settle the FY 2010 and FY 2011 amounts.

RECOMMENDATIONS

We recommend that the Manager, Sandia Field Office, direct the Contracting Officer to:

1. Make a determination regarding the allowability of questioned costs identified in this report and recover those costs determined to be unallowable; and
2. Determine the allowability of allocations from Lockheed Martin Corporation to Sandia after DCAA completes its review of Home Office Expenses and DCMA negotiates a settlement.

MANAGEMENT AND AUDITOR COMMENTS

Management agreed with the report and concurred with the recommendations. Management's proposed corrective actions are responsive to our recommendations. Management's comments are included in Attachment 3.

SCOPE AND METHODOLOGY

This assessment was performed from August 2014 to September 2015, at Sandia National Laboratories, located in Albuquerque, New Mexico. The assessment was limited to Internal Audit's activities, subcontract assessments, and resolution of questioned costs and internal control weaknesses that affect costs claimed by Sandia on its Statement of Cost Incurred and Claimed for FY 2013. The assessment was conducted under Office of Inspector General Project Number A14AL055. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit through a review of audit reports, workpapers, auditor qualifications, independence, audit planning including risk assessments and overall internal audit strategy, and compliance with applicable professional auditing standards;

² Although the costs have been determined unallowable by the contracting officer, Sandia is challenging the regulation and NNSA policy governing allowability of bad debt.

- Assessed audits of subcontracts conducted by Sandia through a review of contract audit workpapers, reports, audit planning and risk assessment, and compliance with applicable auditing standards;
- Interviewed Sandia Internal Audit and Contract Audit officials; and
- Evaluated resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Internal Audit, and other organizations.

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

This report is intended for the use of the Department contracting officers and Field Offices in the management of their contracts and is not intended to be and should not be used by anyone other than these specified parties.

Attachments

Summary of Questioned Costs and Unresolved Costs Pending Audit
 Fiscal Year 2013
 Sandia Corporation
 Contract No. DE-AC04-94AL85000

Questioned Cost Category	Questioned	Total Unresolved
Internal Audit Findings:		
Conference Costs	\$4,011	\$4,011
P-Card transactions	\$7,511	\$7,511
Subtotal:	\$11,522	\$11,522
Contract Audit Findings:	\$727,693	\$200,598
Total Questioned Costs:	\$739,215	\$212,120
Unresolved Costs Pending Audit:		
Home Office Expense	\$2,357,131	\$2,357,131

Summary of Prior Period Unresolved Costs – Fiscal Years 2003 through 2012
Sandia Corporation
Contract No. DE-AC04-94AL85000

Questioned Cost Category and Fiscal Year		Questioned	Unresolved
Internal Audit Findings:			
FY 2012	CAS 405	\$761,999	\$219,510
Subtotal:		\$761,999	\$219,510
Other Questioned Costs:			
FY 2009	Subcontractor Foreign Travel	\$47,997	\$0
FY 2010	Subcontractor Foreign Travel	\$30,211	\$0
FY 2010	Gross Receipts Tax Overpayment	\$6,952,490	\$6,952,490
Subtotal:		\$7,030,698	\$6,952,490
Subcontract Audit Findings:			
FY 2009	Subcontracts	\$983,533	\$0
FY 2010	Subcontracts	\$244,981	\$0
FY 2011	Subcontracts	\$2,394,669	\$1,230
FY 2012	Subcontracts	\$244,724	\$52,045
Other Unallowable Costs:			
FY 2010	Bad debt expense		\$40,187
FY 2011	Bad debt expense		\$15,550
Subtotal:		\$3,867,907	\$109,012
Total Questioned Costs:		\$11,660,604	\$7,281,012
Unresolved Costs Pending DCAA Audit:			
FY 2003	Home Office Expense ³		\$1,680,329
FY 2004	Home Office Expense		\$1,724,538
FY 2005	Home Office Expense		\$1,578,621
FY 2006	Home Office Expense		\$1,861,149
FY 2007	Home Office Expense		\$1,792,898
FY 2008	Home Office Expense		\$1,613,010
FY 2009	Home Office Expense		\$2,181,825
FY 2010	Home Office Expense		\$2,310,232
FY 2011	Home Office Expense		\$2,379,488
FY 2012	Home Office Expense		\$2,245,478
Total Unresolved Costs Pending Audit:			\$19,367,568

³ According to NNSA officials, DCAA has completed its audit of FY 2003 Home Office Expenses and DCMA subsequently reached a settlement agreement with the parent organization, Lockheed Martin Corporation, but the allocable remains unresolved.

MANAGEMENT COMMENTS



Department of Energy
Under Secretary for Nuclear Security
Administrator, National Nuclear Security Administration
Washington, DC 20585



August 24, 2015

MEMORANDUM FOR GREGORY H. FRIEDMAN
INSPECTOR GENERAL

FROM: FRANK G. KLOTZ *FK 8/24/2015*

SUBJECT: Comments on the Office of Inspector General Draft Report Titled
Assessment of Audit Coverage of Cost Allowability for Sandia
Corporation During Fiscal Year 2013 Under the Department of Energy
Contract DE-AC04-94AL85000 (A14AL055)

Thank you for the opportunity to review and comment on the subject draft report. The National Nuclear Security Administration concurs with the Office of Inspector General's recommendations to make final determinations regarding the allowability of unresolved questioned costs. As noted in the report, the majority of these costs are awaiting action by the Defense Contract Audit Agency and/or the Defense Contract Management Agency, which are experiencing an extensive backlog in completing requested audits. We will continue to closely monitor their progress.

The attachment to this memorandum details the actions planned to address the recommendations, as well as timelines for completion. In addition, we have provided technical and general comments for your consideration to enhance the clarity and factual accuracy of the report. If you have any questions regarding this response, please contact Dean Childs, Director, Audit Coordination and Internal Affairs, at (301) 903-1341.

Attachment



Attachment

Response to Report Recommendations

Draft Report on Assessment of Audit Coverage of Cost Allowability for
Sandia Corporation During Fiscal Year 2013 Under the Department of Energy Contract
DE-AC04-94AL85000

The Office of Inspector General (OIG) recommends the responsible Contracting Officer:

RECOMMENDATION 1: Make a determination regarding the allowability of questioned costs identified in this report and recover those costs determined to be unallowable

Management Response: Concur

The contracting officer will review the unresolved questioned costs, make allowability determinations and take action to recover any costs deemed unallowable as appropriate. Due to the complexity of the issues involved in resolving these costs, including coordination with other agencies, NNSA estimates the resolution date could extend to December 2017.

RECOMMENDATION 2: Determine the allowability of allocations from Lockheed Martin Corporation to Sandia after the Defense Contract Audit Agency (DCAA) completes its review of home office expenses and Defense Contract Management Agency negotiates a settlement

Management Response: Concur

Upon receipt of the DCAA audit reports and the Defense Contract Management Agency (DCMA) settlement agreements with Lockheed Martin Corporation, the contracting officer will review the home office costs and make an allowability determination. As noted in the draft report, NNSA is in receipt of the 2003 documentation, and the contracting officer is currently reviewing those costs. The estimated resolution date for 2003 home office costs is December 30, 2015. Given the uncertainty in DCAA and DCMA schedules for completing the remaining audit activities, NNSA cannot estimate a reliable completion date. NNSA will track to an initial target date of December 31, 2016, and adjust as necessary based on quarterly updates in the Departmental Audit Report Tracking System (DARTS).