



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

ASSESSMENT REPORT

DOE-OIG-19-24

March 2019

**AUDIT COVERAGE OF
COST ALLOWABILITY FOR
SANDIA CORPORATION
DURING FISCAL YEARS 2014 AND 2015
UNDER DEPARTMENT OF ENERGY
CONTRACT NO. DE-AC04-94AL85000**



Department of Energy
Washington, DC 20585

March 29, 2019

MEMORANDUM FOR THE MANAGER, SANDIA FIELD OFFICE

A handwritten signature in black ink, appearing to read "Bruce Miller".

FROM: Bruce Miller
Assistant Inspector General
for Audits and Inspections
Office of Inspector General

SUBJECT: INFORMATION: "Audit Coverage of Cost Allowability for Sandia Corporation During Fiscal Years 2014 and 2015 Under Department of Energy Contract No. DE-AC04-94AL85000"

BACKGROUND

From October 1993 to April 30, 2017, Sandia Corporation, a Lockheed Martin Company, managed and operated the Sandia National Laboratories (Sandia) under contract with the Department of Energy and National Nuclear Security Administration (NNSA). Sandia is a multi-program 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. Sandia was managed by Sandia Corporation under a cost-reimbursement management and operating contract employing performance incentives which ran from October 1, 1993, through April 30, 2017. During fiscal years (FYs) 2014 and 2015, Sandia Corporation incurred and claimed costs totaling approximately \$2.66 billion and \$2.78 billion, respectively.

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

To help ensure only allowable costs were claimed by the Department's integrated contractors and to make efficient use of available audit resources, the Office of Inspector General (OIG), the Department's Office of Acquisition and Project Management, and the integrated management and operating contractors and other select contractors implemented a Cooperative Audit Strategy. This strategy places reliance on the contractors' internal audit function to provide audit

coverage of the allowability of incurred costs claimed by contractors. Consistent with the Cooperative Audit Strategy, Sandia Corporation was required by its contract to maintain an internal audit activity with responsibility for conducting audits, including audits of the allowability of incurred costs. The Cooperative Audit Strategy also requires that audits performed internally must, at a minimum, meet the standards prescribed by the Institute of Internal Auditors. In addition, Sandia Corporation was 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 during FYs 2014 and 2015, the objectives of our assessment were to determine whether:

- Sandia Corporation's Internal Audit (Internal Audit) conducted cost allowability audits that complied with professional standards and could be relied upon;
- Sandia Corporation 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 impacting allowable costs that were identified in prior 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-related audit work performed by Sandia Corporation's Internal Audit for FYs 2014 and 2015 could not be relied upon. We did not identify any material internal control weaknesses with cost allowability audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing. Further, Sandia Corporation's Contract Audit Department (Contract Audit) had conducted or arranged for audits of subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. We observed that Sandia Corporation's Internal Audit identified \$127,636 in questioned costs in FY 2014 and \$4,802 in FY 2015, which have been resolved and reimbursement has been made to the Department. While we did not identify any material internal control weaknesses with either cost allowability or subcontract audit, we are questioning \$183,928 of unresolved questioned costs identified by Contract Audit in FY 2014 and \$211,285 in FY 2015, which remained unresolved as of February 2018. The OIG is reporting these unresolved costs in FY 2014 and 2015 as absolute values, while in previous years, we reported those costs as a net amount. We chose to use absolute values instead of a net amount because it gives a more accurate picture of all costs that were questioned by Sandia Corporation.

In addition, we are reporting \$2,459,152 in FY 2014¹ and \$2,728,702 in FY 2015² in home office expenses, which remained unresolved as of February 2018 since these costs were pending Defense Contract Audit Agency's (DCAA) audit of the parent corporation, Lockheed Martin Corporation (Attachment 1).

¹ The contract ceiling amount for home office expenses in FY 2014 is \$2,460,000.

² The contract ceiling amount for home office expenses in FY 2015 is \$2,934,800.

Further, we are reporting on prior questioned and unresolved costs. Specifically:

- \$16,487,033 in unresolved potential overpayments of New Mexico gross receipts tax, which remained unresolved at the time of our review;
- \$20,852 in unresolved Contract Audit findings from FY 2012 and FY 2013, which remained unresolved as of February 2018; and
- \$6,982,097³ in unresolved home office expenses from FYs 2011 through 2013 that were included in our previously issued audit report (OAS-V-15-03, September 2015) and remained unresolved as of September 2018 while either undergoing or pending DCAA's audit (Attachment 2).

Questioned and Unresolved Costs

Contract Audit

Sandia Corporation's Contract Audit Department questioned subcontract costs totaling \$542,053 in FY 2014 and \$867,986 in FY 2015. As of February 2018, \$183,928 and \$211,285 of the questioned subcontract costs were unresolved in each year, respectively. The unresolved costs included \$34,558 from one subcontract related to travel costs and application of indirect labor rates, and \$23,940 from another subcontractor for incorrect labor, travel, and equipment costs.

Home Office Expenses

The Department and Sandia Corporation have agreed that home office expenses directly attributable to the performance of the contract are allowable if they meet all other criteria for allowability. As of February 2018, Sandia Corporation reported that it had incurred \$2,459,152 in home office expenses in FY 2014 and \$2,728,702 in FY 2015. Before the Contracting Officer can make a determination of cost allowability, DCAA must complete its review of the Corporate Office, and the Defense Contract Management Agency must resolve any findings and make a final determination of cost allowability. However, as noted in our February 2015 report on *Incurring 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 Corporation's Corporate Office. Therefore, we consider these amounts unresolved pending audit.

Prior Period Questioned and Unresolved Costs

In our September 2015 report, *Assessment of 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), we identified \$7,281,012 in questioned or unallowable costs that were unresolved. At the time of our review, the prior reported amount

³ The contract ceiling amounts for home office expenses are \$2,714,000 for FY 2011, \$2,725,300 for FY 2012, and \$2,772,000 for FY 2013.

increased, resulting in \$16,507,885 that remains unresolved. The increase was due to increases in potential overpayments of New Mexico gross receipts taxes in FYs 2010 and 2011. These unresolved costs include:

- \$16,487,033 in potential overpayments of New Mexico gross receipts taxes in FY 2010 and FY 2011. In a 2015 OIG report, *Assessment of Audit Coverage of Cost Allowability for Sandia Corporation during Fiscal Year 2013 under Department of Energy Contract No. DE-AC04-94AL85000* (OAS-V-15-3, September 2015), the OIG questioned Sandia Corporation's FY 2010 Gross Receipts Tax Overpayment. In response to the OIG's work, Sandia Corporation conducted a review to validate the taxability status of projects with costs from FY 2009 through March 31, 2012, concluding that the FY 2010 Gross Receipt Tax Overpayment should have been reported as \$13,331,708.48. Sandia Corporation filed a request for refund with the state of New Mexico to recover the overpayment; however, the New Mexico Taxation & Revenue Department (NMTRD) denied most of the refund. Based on NMTRD's decision, Sandia Corporation amended its refund claim for the remaining balance.⁴ In addition, the Sandia Corporation review resulted in a \$3,351,289.93 estimated gross receipts tax overpayment in FY 2011. Sandia Corporation is in the process of resolving a refund claim for that amount as well.
- \$20,852 in subcontract audit findings in FY 2012 and FY 2013.
- \$6,982,097 in FY 2011 through FY 2013 in unresolved home office expenses where we validated the amounts remained unresolved in April 2018, and remained unresolved in September 2018 while either undergoing or pending DCAA's audit.

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 Corporation after DCAA completes its review of home office expenses and Defense Contract Management Agency makes a final determination of allowability.

MANAGEMENT RESPONSE

Management concurred with the report's two recommendations. Management went on to state that the Sandia Contracting Officer already resolved the questioned costs identified by Internal Audit and considers these recommendations closed. In addition, resolution of the remaining questioned costs for home office expenses is estimated by December 31, 2019.

Management's comments are included in Attachment 4.

⁴ NMTRD only allowed \$195,965.35, plus \$6,136.67 in interest. As a result, Sandia Corporation amended its refund claim for the remaining balance, so the amount under protest is \$13,135,743.13.

AUDITOR COMMENTS

We consider management's comments and corrective actions to be responsive to our recommendations. We commend them for taking action without waiting for a formal report.

SCOPE AND METHODOLOGY

This assessment was performed from September 2017 to March 2019 at Sandia Corporation, located in Albuquerque, New Mexico. The assessment was limited to Internal Audit's activities, subcontract audits, and resolution of questioned costs and internal control weaknesses that affect costs claimed by Sandia Corporation on its Statement of Costs Incurred and Claimed for FYs 2014 through 2015. This assessment was conducted under the Office of Inspector General Project Number A17AL049. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit, which included a review of audit reports, work papers, auditor qualifications, independence, audit planning (including risk assessments and overall internal audit strategy), and compliance with applicable professional auditing standards;
- Assessed audits of subcontracts conducted by Sandia Corporation through a review of Contract Audit work papers, reports, audit planning and risk assessment, and compliance with applicable auditing standards;
- Interviewed Sandia Corporation Internal Audit and Contract Audit officials; and
- Evaluated the resolution of questioned costs and control weaknesses affecting cost allowability that were identified in prior audits and reviews conducted by the Office of Inspector General, Internal Audit, and other organizations.

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

Management waived the exit conference on February 19, 2019.

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 2014
Sandia Corporation
Contract No. DE-AC04-94AL85000**

Questioned Cost Category	Questioned	Total Unresolved
Contract Audit Findings:	\$542,053	\$183,928
Total Questioned Costs	\$542,053	\$183,928
Unresolved Costs Pending Audit:		
Home Office Expense		\$2,459,152

**Summary of Questioned Costs and Unresolved Costs Pending Audit
Fiscal Year 2015
Sandia Corporation
Contract No. DE-AC04-94AL85000**

Questioned Cost Category	Questioned	Total Unresolved
Contract Audit Findings:	\$867,986	\$211,285
Total Questioned Costs	\$867,986	\$211,285
Unresolved Costs Pending Audit:		
Home Office Expense		\$2,728,702

Summary of Prior Period Unresolved Costs Fiscal Years 2010 through 2013		
Sandia Corporation		
Contract No. DE-AC04-94AL85000		
Questioned Cost Category and Fiscal Year	Questioned	Unresolved
Other Questioned Costs		
FY 2010 Gross Receipts Tax Overpayment	\$6,952,490	\$13,135,743
FY 2011 Gross Receipts Tax Overpayment	\$3,351,290	\$3,351,290
Subtotal:	\$10,303,780	\$16,487,033
Contract Audit Findings		
FY 2012 Contracts	\$52,045	\$429
FY 2013 Contracts	\$200,598	\$20,423
Subtotal:	\$252,643	\$20,852
Total Questioned Costs:	\$10,556,423	\$16,507,885
Unresolved Costs Pending DCAA Audit		
FY 2011 Home Office Expense		\$2,379,488 ¹
FY 2012 Home Office Expense		\$2,245,478 ²
FY 2013 Home Office Expense		\$2,357,131
Total Unresolved Cost Pending Audit		\$6,982,097

¹ Sandia Corporation has submitted proposed settlements to the Department/NNSA/Sandia Field Office for unresolved home office expenses for FY 2011.

² Sandia Corporation has submitted proposed settlements to the Department/NNSA/Sandia Field Office for unresolved home office expenses for FY 2012.

PRIOR REPORTS

- Assessment Report on [*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). Based on our assessment, nothing came to our attention to indicate that the allowable cost audit work performed by Sandia Corporation's Internal Audit (Internal Audit) for fiscal year (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 Corporation's Contract Audit Department (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 questioned \$212,120 of costs identified and questioned by Sandia Corporation's Internal Audit and Contract Audit that had not been resolved.

In addition, we reported:

- \$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;
 - \$2,357,131 in FY 2013 home office expenses, which were unresolved pending Defense Contract Audit Agency's (DCAA) audit of the parent corporation, Lockheed Martin Corporation;
 - \$19,367,568 in prior period unresolved home office expenses that were pending DCAA's audit; and
 - \$55,737 in prior period unresolved bad debt expenses identified as unallowable by the Sandia Field Office.
- Assessment Report on *Assessment of Audit Coverage of Cost Allowability for Sandia Corporation under Department of Energy Contract DE-AC04-94AL85000 for Fiscal Years 2011 and 2012* (OAS-V-14-10, April 2014). Based on our assessment, nothing came to our attention to indicate that the allowable cost audit work performed by Internal Audit for FYs 2011 and 2012 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, 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 questioned \$1,061,115 of costs identified and questioned by Internal Audit and Contract Audit that had not been resolved.

In addition, we reported:

- \$55,737 in unresolved FY 2010 and FY 2011 bad debt expenses identified as unallowable by the Sandia Field Office;
- \$4,624,966 in FY 2011 and FY 2012 home office expenses, which were unresolved pending DCAA's audit of the parent corporation, Lockheed Martin Corporation;
- \$7,356,921 in prior period unresolved questioned costs, including a \$6,952,490 overpayment of gross receipts tax; and
- \$14,742,602 in prior period unresolved home office expenses that were pending DCAA's audit.

MANAGEMENT COMMENTS



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



January 31, 2019

MEMORANDUM FOR TERI L. DONALDSON
INSPECTOR GENERAL

FROM:

LISA E. GORDON-HAGERTY

A handwritten signature in black ink, appearing to read "Lisa E. Gordon-Hagerty", written over the printed name.

SUBJECT:

Comments on the Office of Inspector General Draft Report,
"Audit Coverage of Cost Allowability for Sandia Corporation
During Fiscal Years 2014 and 2015" (A17AL049)

Thank you for the opportunity to review and comment on the subject draft report. The Sandia Contracting Officer has already resolved the \$395,213 in questioned costs identified by Sandia Internal Audits (SIA), and considers recommendation one closed. Based on the current schedule for Defense Contract Audit Agency (DCAA) audits of home office expenses, Sandia estimates resolution of the remaining \$5,187,854 in questioned costs referenced in recommendation two by December 31, 2019.

We appreciate the auditors' validation of SIA's work. NNSA subject matter experts have also provided technical comments under separate cover to enhance the accuracy of the report. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audits and Internal Affairs, at (301) 903-1341.



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