



OFFICE OF INSPECTOR GENERAL  
U.S. Department of Energy

# ASSESSMENT REPORT

DOE-OIG-20-48

July 2020

**AUDIT COVERAGE OF COST  
ALLOWABILITY FOR SANDIA  
CORPORATION FROM OCTOBER 1, 2015,  
TO APRIL 30, 2017, UNDER DEPARTMENT  
OF ENERGY CONTRACT NO.  
DE-AC04-94AL85000**



**Department of Energy**  
Washington, DC 20585

July 13, 2020

MEMORANDUM FOR THE MANAGER, SANDIA FIELD OFFICE

A handwritten signature in black ink, appearing to read "John E. McCoy II".

FROM: John E. McCoy II  
Deputy Assistant Inspector General  
for Audits  
Office of Inspector General

SUBJECT: INFORMATION: Assessment Report on "Audit Coverage of Cost Allowability for Sandia Corporation from October 1, 2015, to April 30, 2017, Under Department of Energy Contract No. DE-AC04-94AL85000"

BACKGROUND

From October 1, 1993, to April 30, 2017, Sandia Corporation, a Lockheed Martin Corporation, managed and operated the Sandia National Laboratories (Sandia) under contract with the Department of Energy's 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. On May 1, 2017, National Technology and Engineering Solutions of Sandia, LLC (NTESS), a wholly owned subsidiary of Honeywell International, Inc., assumed responsibility as the management and operating contractor of Sandia. Sandia Corporation incurred and claimed costs totaling approximately \$2.996 billion from October 1, 2015, through September 30, 2016, and \$1.742 billion from October 1, 2016, through April 30, 2017.

As a management and operating contractor, Sandia Corporation's financial accounts were required to be integrated with those of the Department, and the results of financial transactions were required to be reported monthly according to a reciprocal set of accounts. 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 Management, the integrated management and operating contractors, and other select contractors implemented a Cooperative Audit Strategy. This Cooperative Audit 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.

The objectives of our assessment for October 1, 2015, through April 30, 2017, were to determine, based on our limited sampling, 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
- Sandia Corporation resolved costs and internal control weaknesses affecting allowable costs that were identified in prior audits and reviews.

## RESULTS OF ASSESSMENT

During our assessment, nothing came to our attention to indicate that the allowable cost-related audit work performed by Sandia Corporation's, and now NTESS's<sup>1</sup>, Internal Audit for costs incurred from October 1, 2015, through April 30, 2017, could not be relied upon. We conducted our assessment as a review attestation. A review is substantially less in scope than an examination or audit. Our review was limited and would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. Based on our limited sampling, we did not identify any material internal control weaknesses with allowable cost audits, which generally met the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors. Further, Sandia's Contract Audit Department had conducted or arranged for audits of

---

<sup>1</sup> The costs were incurred under the Sandia Corporation Contract, which ended April 30, 2017. However, the costs were not audited until subsequent years under the NTESS contract starting on May 1, 2017.

subcontractors when costs incurred were a factor in determining the amount payable to a subcontractor. We observed that Sandia Corporation's Internal Audit identified \$372,311 in questioned costs in audits performed between October 1, 2015, and April 30, 2017, 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 \$6,755,738 in unresolved questioned costs identified by Sandia's Contract Audit Department.

Additionally, we observed \$413,885,127 of unaudited costs incurred and claimed under the Sandia Corporation contract. Specifically, we observed \$265,083,034 of subcontract costs pending audit by Sandia's Contract Audit Department. In addition, according to an NTESS official, there are \$144,565,069 of subcontract costs pending Defense Contract Audit Agency (DCAA) audit. Further, according to an NTESS official, there are \$2,618,938<sup>2</sup> from October 1, 2015, through September 30, 2016, and \$1,618,086<sup>3</sup> from October 1, 2016, through September 30, 2017, in Home Office Expenses pending DCAA audit. The OIG is reporting these costs as unresolved pending audit.

Because of the outstanding contract costs pending audit, the OIG plans to perform a followup assessment of these costs to ensure the statute of limitations per the Contract Disputes Regulation<sup>4</sup> is met.

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

- \$15,124,119 in unresolved potential overpayments of New Mexico gross receipts tax;
- \$34,097 in unresolved Sandia Contract Audit Department findings from audits performed from October 1, 2013, through September 30, 2015; and
- \$12,169,951 in prior period unresolved Home Office Expenses that, according to an NTESS official, are pending DCAA audit.

---

<sup>2</sup> The contract ceiling amount for Home Office Expenses from October 1, 2015, through September 30, 2016, is \$3,547,000.

<sup>3</sup> The contract ceiling amount for Home Office Expenses from October 1, 2016, through April 30, 2017, is \$2,123,365.

<sup>4</sup> Contract Disputes Regulation- 41 U.S.C. §7103(a)(4)(A) states, "In general.—Each claim by a contractor against the Federal Government relating to a contract and each claim by the Federal Government against a contractor relating to a contract shall be submitted within 6 years after the accrual of the claim."

## Current Period Unresolved Questioned Costs

### Contract Audit

Sandia's Contract Audit Department under Sandia Corporation, and currently under NTESS, questioned subcontract costs as follows: (See Attachment 1).

Year Audit was Performed by Sandia's Contract Audit Department <sup>5</sup>	Questioned Costs	Unresolved Questioned Costs <sup>6</sup>
October 1, 2015, through September 30, 2016	\$4,401,036	\$4,252,309
October 1, 2016, through September 30, 2017	\$3,575,843	\$357,264
October 1, 2017, through September 30, 2018	\$2,580,784	\$1,976,491
October 1, 2018, through March 31, 2019	\$174,037	\$169,674
<b>Total</b>	<b>\$10,731,700</b>	<b>\$6,755,738</b>

### Unresolved Costs Pending Audit

#### Unaudited Contract Audit Costs

Sandia's Contract Audit Department under Sandia Corporation, and currently under NTESS, conducted contract audits using a risk-based approach on a 3-year rotation. As a result, NTESS identified costs related to Sandia Corporation that have not yet been audited by Sandia's Contract Audit Department. The total outstanding unaudited contract audit costs are \$265,083,034 related to 3,868 Purchase Orders. We consider this total amount unresolved costs pending audit (See Attachment 1).

#### DCAA Contract Audit Backlog

Sandia's Contract Audit Department relies on DCAA to perform audits of subcontractors where the Department of Defense is the cognizant agency. However, over the past several years, DCAA has not performed many of its Department of Defense subcontract audits at Sandia. These Department of Defense subcontractors awaiting audit have resulted in, according to an NTESS official, \$144,565,069 of unaudited costs requiring audit. Therefore, we consider these amounts unresolved costs pending audit (See Attachment 1).

---

<sup>5</sup> The costs in this table were incurred under the Sandia Corporation Contract, which ended April 30, 2017. However, the costs were not audited until the years identified in the table. March 31, 2019, was the cutoff date for the scope of our review.

<sup>6</sup> Unresolved Questioned Costs as of May 2019.

## **Home Office Expenses**

The Department of Energy and Sandia Corporation had agreed that Home Office Expenses directly attributable to the performance of the contract were allowable if they met all other criteria for allowability. Sandia Corporation officials identified \$2,618,938 in Home Office Expenses from October 1, 2015, through September 30, 2016, and \$1,618,086 from October 1, 2016, through September 30, 2017. According to an NTESS official, 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. As stated above, in the DCAA Contract Audit Backlog section, DCAA has been unable to perform many of its audits, resulting in incurred costs that still require an audit. Therefore, we consider these amounts unresolved costs pending audit (See Attachment 1).

### **Prior Period Unresolved Questioned Costs**

In our March 2019 report, *Audit Coverage of Cost Allowability for Sandia Corporation During Fiscal Years 2014 and 2015 Under Department of Energy Contract No. DE-AC04-94AL85000* (DOE-IG-19-24), we identified \$16,507,885 in questioned or unallowable costs that were unresolved. As of May 2019, \$15,158,216 remains unresolved. These unresolved costs include:

- \$15,124,119 in potential overpayments of New Mexico gross receipts taxes from October 1, 2009, through September 30, 2011; and
- \$34,097 in subcontract audit findings from October 1, 2013, through September 30, 2015 (See Attachment 2).

### **Prior Period Unresolved Costs Pending Audit**

- According to an NTESS official, \$12,169,951<sup>7</sup> from October 1, 2010, through September 30, 2015, in Home Office Expenses are unresolved pending DCAA audit (See Attachment 2).

## **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;

---

<sup>7</sup> The contract ceiling amounts were \$2,714,000 from October 1, 2010, through September 30, 2011; \$2,725,300 for October 1, 2011, through September 30, 2012; \$2,772,000 for October 1, 2012, through September 30, 2013; \$2,460,000 for October 1, 2013, through September 30, 2014; and \$2,934,800 for October 1, 2014, through September 30, 2015.

2. Determine the allowability of allocations from Lockheed Martin Corporation to Sandia after DCAA completes its review of Home Office Expenses and Sandia's Contract Audit Costs, and the Defense Contract Management Agency negotiates a settlement; and
3. Ensure that the unresolved costs pending audit are audited within the statute of limitations and provide quarterly reports to the OIG on the progress of completing these audits.

## MANAGEMENT RESPONSE AND AUDITOR COMMENTS

Management concurred with the report's recommendations and indicated that corrective actions are planned to address the issues identified in the report. Management's comments and planned corrective actions are responsive to our recommendations.

## SCOPE AND METHODOLOGY

This assessment was performed from February 2019 to February 2020 at the Sandia Field Office 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 from October 1, 2015, through April 30, 2017. This assessment was conducted under the Office of Inspector General Project Number A19AL020. To accomplish our objectives, we:

- Assessed allowable cost audit work conducted by Internal Audit, which included 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.
- Assessed audits of subcontracts conducted by Sandia's Contract Audit Department, which included a review of audit reports, workpapers, auditor qualifications, audit planning, and compliance with applicable auditing standards.
- Retested a sample of incurred cost transactions tested by Internal Audit in its allowable costs audits. We judgmentally selected a sample of transactions that Internal Audit reviewed from fiscal years 2016 through April 30, 2017. Because the sample selection was not statistical, the results and overall conclusions are limited to the transactions retested and cannot be projected to the entire population of transactions.
- Retested a sample of incurred cost transactions tested by Sandia's Contract Audit Department. We judgmentally selected a sample of transactions that Sandia's Contract Audit Department reviewed from fiscal years 2016 through April 30, 2017. Because the sample selection was not statistical, the results and overall conclusions are limited to the transactions retested and cannot be projected to the entire population of transactions.

- Interviewed Sandia's Internal Audit and Contract Audit Department officials.
- 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. Additionally, because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our review. We relied on computer-processed data to 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 May 27, 2020.

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

<b>Summary of Questioned Costs and Unresolved Costs Pending Audit<sup>8</sup></b>		
<b>Current Audit Period</b>		
<b>Sandia Corporation</b>		
<b>Contract No. DE-AC04-94AL85000</b>		
	<b>Questioned</b>	<b>Unresolved</b>
<b><u>Contract Audit Findings:</u></b>		
October 1, 2015, through September 30, 2016 <sup>9</sup>	4,401,036	4,252,309
October 1, 2016, through September 30, 2017 <sup>10</sup>	3,575,843	357,264
October 1, 2017, through September 30, 2018 <sup>11</sup>	2,580,784	1,976,491
October 1, 2018, through March 31, 2019 <sup>12</sup>	174,037	169,674
<b>Total</b>	<b>10,731,700</b>	<b>6,755,738</b>
<b><u>Unresolved Costs Pending Audit:</u></b>		
Contract Audit		265,083,034
DCAA Backlog		144,565,069
Home Office Expense		4,237,024
<b>Total Unresolved Costs Pending Audit</b>		<b>413,885,127</b>

<sup>8</sup> This table summarizes costs at net value, consistent with the information provided by Sandia Corporation. In order to capture the full extent of costs questioned by Sandia, we will footnote these costs as absolute value.

<sup>9</sup> Absolute Value of October 1, 2015, through September 30, 2016, Total Questioned Costs \$5,335,450; Unresolved \$4,739,785.

<sup>10</sup> Absolute Value of October 1, 2016, through September 30, 2017, Total Questioned Costs \$5,286,173; Unresolved \$1,480,452.

<sup>11</sup> Absolute Value of October 1, 2017, through September 30, 2018, Total Questioned Costs \$2,897,766; Unresolved \$2,212,581.

<sup>12</sup> Absolute Value of October 1, 2018, through March 31, 2019, Total Questioned Costs \$295,565; Unresolved \$268,372.

<b>Summary of Questioned Costs and Unresolved Costs Pending Audit<sup>13</sup></b>		
<b>Prior Period</b>		
<b>Sandia Corporation</b>		
<b>Contract No. DE-AC04-94AL85000</b>		
	<b>Questioned</b>	<b>Unresolved</b>
<b>New Mexico Gross Receipts Tax:</b>	16,487,033	15,124,119
<b><u>Contract Audit:</u></b>		
October 1, 2013, through September 30, 2014 <sup>14</sup>	67,429	26,954
October 1, 2014, through September 30, 2015 <sup>15</sup>	34,752	7,143
<b>Subtotal</b>	<b>102,181</b>	<b>34,097</b>
<b>Total Questioned Costs</b>	<b>16,589,214</b>	<b>15,158,216</b>
<b><u>Unresolved Costs Pending Audit:</u></b>		
October 1, 2010, through September 30, 2011 Home Office Expenses		2,379,488
October 1, 2011, through September 30, 2012 Home Office Expenses		2,245,478
October 1, 2012, through September 30, 2013 Home Office Expenses		2,357,131
October 1, 2013, through September 30, 2014 Home Office Expenses		2,459,152
October 1, 2014, through September 30, 2015 Home Office Expenses		2,728,702
<b>Total Unresolved Costs Pending Audit</b>		<b>12,169,951</b>

<sup>13</sup> This table summarizes costs at net value, consistent with the information provided by Sandia. In order to be consistent with how the OIG reported these costs on the prior audit report and to accurately reflect the true amount of costs questioned by Internal Audit, we will provide absolute values in footnotes.

<sup>14</sup> Absolute Value of October 1, 2013, through September 30, 2014, Total Questioned Costs \$542,053; Unresolved \$27,048.

<sup>15</sup> Absolute Value of October 1, 2014, through September 30, 2015, Total Questioned Costs \$867,986; Unresolved \$169,565.

**PRIOR REPORT**

Assessment report on [\*Audit Coverage of Cost Allowability for Sandia Corporation During Fiscal Years 2014 and 2015 Under Department of Energy Contract No. DE-AC04-94AL85000 \(DOE-OIG-19-24, March 2019\)\*](#). This assessment noted that nothing came to our attention to indicate the allowable cost-related audit work performed by Sandia Corporation's Internal Audit for fiscal years (FY) 2014 and 2015 could not be relied on. We did not identify any material control weaknesses with the cost allowability audits, which generally met International Standards for Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors. Internal Audit questioned \$127,636, all of which had been resolved. In addition, we did not identify any material internal control weaknesses with either cost allowability or subcontract audit. However, we questioned \$183,928 of unresolved questioned costs identified by Sandia Corporation's Contract Audit Department in FY 2014 and \$211,285 in FY 2015. Further, we reported that \$2,459,152 in FY 2014 and \$2,728,702 in FY 2015 in Home Office Expenses remained unresolved pending audit by Defense Contract Audit Agency.

**MANAGEMENT COMMENTS**



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



May 05, 2020

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".

SUBJECT: Response to the Office of Inspector General Draft  
Report *Audit Coverage of Cost Allowability for Sandia Corporation, from October 1, 2015, to April 30, 2017, Under Department of Energy Contract No. DE-AC04-94AL85000 (A19AL020)*

Thank you for the opportunity to review and comment on the subject draft report. We appreciate the auditors' validation of the internal audit work performed by the management and operating contractor for the Sandia National Laboratories.

The National Nuclear Security Administration (NNSA) concurs with the report's recommendations for NNSA to resolve questioned costs and complete pending audit work. The attached management decision identifies the actions planned to address each of the recommendations. Subject matter experts have also provided technical comments for your consideration under separate cover to enhance the accuracy and completeness of information presented in the report. If you have any questions regarding this response, please contact Mr. Dean Childs, Director, Audits and Internal Affairs, at (301) 903-1341.

Attachment



Attachment

**NATIONAL NUCLEAR SECURITY ADMINISTRATION**  
**Management Decision**

*Audit Coverage of Cost Allowability for Sandia Corporation, from October 1, 2015, to April 30, 2017, Under Department of Energy Contract No. DE-AC04-94AL85000 (A19AL020)*

The Office of Inspector General (OIG) recommended that the Manager, Sandia Field Office, direct the Contracting Officer to:

**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 make a determination regarding the allowability of identified questioned costs and will recover any costs determined to be unallowable.

*Estimated Completion Date:* December 31, 2020

**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 Sandia's Contract Audit Department's Costs, and the Defense Contract Management Agency (DCMA) negotiates a settlement; and

*Management Response:* Concur. The Contracting Officer will monitor the completion of DCAA reviews and DCMA settlements in order to make allowability determinations on the questioned costs. As noted in the audit report, DCAA currently has a backlog of audits that have not been completed. As a result, the timeline for resolution of the remaining Home Office Expenses is expected to be extended.

*Estimated Completion Date:* December 31, 2023

**Recommendation 3:** Ensure that the unresolved costs pending audit are audited within the statute of limitations and provide quarterly reports to the OIG on the progress of completing these audits.

*Management Response:* Concur. Sandia's Subcontract Audit planning process prioritizes contracts reaching their statute of limitations regarding Sandia's right to audit. The management of audit resources is based on auditing contracts within a three year cycle, in alignment with "audit rights" timelines. As such, Sandia will have outstanding costs pending audit in any given year, and those audits approaching statute of limitations are identified and audited prior to losing audit rights. The costs identified in this report to be audited by Sandia's Contract Audit Department will be audited during fiscal years 2020 and 2021, prior to the expiration of the statute of limitations. Sandia will provide a quarterly status update to the Sandia Field Office for

Attachment

those contracts approaching the statute of limitations when submitting the quarterly report of audits completed. NNSA will continue to provide information on progress to the OIG through the Quarterly Departmental Audit Reporting System (DARTS) updates.

*Estimated Completion Date:* September 30, 2021

## **FEEDBACK**

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We aim to make our reports as responsive as possible and ask you to consider sharing your thoughts with us.

Please send your comments, suggestions, and feedback to [OIG.Reports@hq.doe.gov](mailto:OIG.Reports@hq.doe.gov) and include your name, contact information, and the report number. You may also mail comments to us:

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

If you want to discuss this report or your comments with a member of the Office of Inspector General staff, please contact our office at (202) 586-1818. For media-related inquiries, please call (202) 586-7406.