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

Audit Report

Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories

OAS-L-13-14

September 2013

Department of Energy
Washington, DC 20585

September 25, 2013

MEMORANDUM FOR THE MANAGER, SANDIA FIELD OFFICE

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

SUBJECT: INFORMATION: Audit Report on "Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

BACKGROUND

The attached report presents the results of the audit of Sandia National Laboratories' (Sandia) Fiscal Year (FY) 2011 Work for Others (WFO) Program. The Office of Inspector General contracted with an independent certified public accounting firm, KPMG, LLP (KPMG), to assess the internal control structure at Sandia and determine whether it is effective in achieving the current goals and objectives of the WFO Program.

The Department of Energy (Department) and its semi-autonomous National Nuclear Security Administration (NNSA) provide research and technical assistance to other Federal agencies on a reimbursable, full cost recovery basis through the WFO Program. WFO agreements are also used as a mechanism through which industry can utilize expertise and facilities at Sandia, a Federally Funded Research and Development Center. Entities may sponsor Sandia scientists to conduct research in a specific area if researchers can be identified with appropriate and unique capabilities, as well as interest and availability. For FYs 2009 to 2011, Sandia's WFO activities comprised between 33 and 39 percent of its annual funding. Specifically, WFO funding was $894.6 million in FY 2009, $925.4 million in FY 2010 and $790.8 million in FY 2011. However, these figures do not include classified WFO projects, which were not included in the scope of this audit.

RESULTS OF AUDIT

KPMG concluded that, except for the findings detailed in the attached report, Sandia implemented internal controls and compliance procedures in FY 2011 that met the Department's WFO Program requirements, as stated in Department regulations, guidance and applicable contract provisions. However, KPMG identified several opportunities to strengthen controls over WFO costs. Specifically, KPMG found that:

- Costs relating to Sandia's WFO support organizations were included in the general and administrative cost pool that was allocated to both WFO projects and other

Department projects on an organization-wide basis, rather than using an allocation base that bears a more direct causal beneficial relationship to the support organizations' costs. KPMG estimated that the Department would have an annual savings of approximately $2.3 million by implementing a separate indirect rate for these support organizations.[1] KPMG recommended that Sandia consider the cost-benefit of removing the WFO support organization costs from the general and administrative indirect cost pool, and establish a separate indirect cost pool for allocating these costs to WFO projects and other projects supported by the WFO support organization on a base that has a more direct causal beneficial relationship to the organizations' functions. This finding is similar to one identified by KPMG at Lawrence Berkeley National Laboratory (Berkeley) in our report on *Fiscal Year 2011 Audit of the Work Performed Under the Work for Others Program at Lawrence Berkeley National Laboratory,* (OAS-L-13-10, June 2013), which found that costs relating to Berkeley's WFO support organization were included in the general and administrative cost pool that is allocated to both WFO projects and other Department projects on an organization-wide basis. KPMG estimated that the annual savings to Department by implementing a separate indirect rate for this support organization at Berkeley would be approximately $400,000.

- Year-end indirect cost variances were not allocated to WFO projects, and variances were allocated to Department-funded projects on a net basis, rather than allocating variances in proportion to the amounts originally allocated for each indirect cost pool. KPMG estimated that in FY 2011, this practice resulted in approximately $900,000 of over-recovery of costs that benefitted Department projects, rather than WFO projects. KPMG recommended that Sandia analyze year-end indirect cost pool variances to ensure that its mid-year rate changes result in immaterial variances at the end of the year, or, in the case of material variances, adopt a different methodology for allocation to both Department-funded and WFO projects. In addition, Sandia should analyze the potential cost effects of allocating year-end variances separately for the various indirect cost pools, or for the more significant cost pool variances, so that significant variances are equitably allocated based on a more direct relationship to the original allocation.

- Pension costs of $15 million were transferred from fringe benefits to other indirect cost pools, contrary to Sandia's disclosed accounting practices. As such, the FY 2011 fringe benefit rate was understated and other indirect cost rates were overstated, which could have affected total indirect costs charged to WFO and other Department projects because the various indirect rates had different allocation bases. KPMG recommended that Sandia maintain consistency with cost accounting practices disclosed in its Cost Accounting Standards Board Disclosure Statement.

Further, KPMG noted that Sandia's Independent Audit & Advisory Services issued a Labor Floor Check report, dated October, 2, 2012, which identified findings related to inconsistent and inequitable charging of labor costs that could affect the accuracy of WFO project costs. Because Sandia agreed to the findings and has corrective action plans in process, KPMG did not repeat the related findings and recommendations in its report.

[1] Sandia's WFO/Cooperative Research and Development Agreement management organization is responsible for submitting proposals and accepting all awards from non-Department sponsors, and post award budgetary oversight is provided by the Budget and WFO Financial Management organization.

RECOMMENDATIONS

We recommend that the Manager, Sandia Field Office, ensure that Sandia:

1. Consider the cost-benefit of removing the WFO support organizations' costs from the general and administrative indirect cost pool and establish a separate indirect cost pool for allocating those costs to WFO projects and other projects supported by the WFO support organizations on a base that has a more direct causal beneficial relationship to the organizations' functions;

2. Analyze year-end indirect cost pool variances to ensure that its mid-year rate changes result in immaterial variances at the end of the year, or, in the case of material variances, adopt a different methodology for allocation to both Department-funded and WFO projects;

3. Analyze the potential cost effects of allocating year-end variances separately for the various indirect cost pools, or for the more significant cost pool variances, so that significant variances are equitably allocated based on a more direct relationship to the original allocation; and

4. Maintain consistency with cost accounting practices disclosed in its Cost Accounting Standards Board Disclosure Statement.

MANAGEMENT RESPONSE AND AUDITOR COMMENTS

NNSA generally concurred with the findings and recommendations. NNSA stated that it will direct Sandia's internal auditors to perform a follow-on assessment to confirm whether the WFO support organization costs meet the definition of general and administrative costs under paragraph 30(a)(6) of Cost Accounting Standard (CAS) 410 entitled *Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives.* If it is determined that some or all of the WFO support functions do not meet the definition of G&A, then an assessment will be made as to the treatment of the costs under CAS 418, *Allocation of Direct and Indirect Costs.* NNSA also stated that the assessment will be accomplished while taking into consideration the cost benefit of the change to include the materiality of the costs in relation to the total general and administrative pool cost and the administrative costs of managing a separate rate.

Concerning the allocation of year-end indirect cost variances to WFO projects (Recommendations 2 and 3), NNSA agreed that controls should be in place to ensure year-end variances are minimized and appropriately allocated as necessary. NNSA noted that Sandia currently utilizes a retroactive variance distribution process to dispose of indirect rate variances, and should continue their current practice of distributing immaterial year-end variances to DOE projects. NNSA will ensure that Sandia continues to monitor anticipated variances throughout the fiscal year to ensure year-end variances remain immaterial. In addition, NNSA stated that it believes the practice of distributing all year-end variances on a net basis is acceptable as long as the variances are immaterial. NNSA will request that Sandia formally document a process for allocating variances should they become material and ensure it complies with the Cost Accounting Standards.

Finally, regarding consistency with cost accounting practices, NNSA stated that it will continue to monitor Sandia's practices for consistency with CAS.

Management's corrective actions are responsive to our recommendations.

PERFORMANCE AUDIT

KPMG conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and the Department's Office of Inspector General Audit Manual as appropriate. *Government Auditing Standards* require that KPMG plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on the audit objective.

The Office of Inspector General monitored the progress of the audit and reviewed the report and related documentation. Our review disclosed no instances in which KPMG did not comply, in all material respects, with the audit requirements. KPMG is responsible for the attached report dated July 18, 2013, and the conclusions expressed in the report.

Attachment

cc: Deputy Secretary
Acting Administrator, National Nuclear Security Administration
Chief of Staff

Performance Audit

Fiscal Year 2011 Audit of the Work Performed Under the Work for Others Program

For the U.S. Department of Energy Office of the Inspector General

Auditee: Sandia National Laboratories

As of Date: July 18, 2013

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

July 18, 2013

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

Dear Mr. Mickelsen:

This report presents the results of our audit of Sandia National Laboratories' (hereinafter referred to as Auditee or SNL) Fiscal Year (FY) 2011 Work for Others (WFO) Program, conducted to address the performance audit objective described below. Our work was performed during the period June 15 to July 18, 2013, and our results, reported herein, are as of July 18, 2013.

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and the U.S. Department of Energy (DOE) Office of Inspector General Audit Manual, as appropriate. *Government Auditing 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 objective of our performance audit was to determine if SNL's WFO Program, in effect for FY 2011, met the internal control and compliance requirements established by DOE that are identified within:

- DOE Order 481.1c;
- DOE Guide 481.1-1;
- Contract Clauses;
- DOE Acquisition Regulations, as applicable, including DEAR 970.5217-1; and,
- Additional guidance issued by DOE/NNSA regarding the WFO Program.

These requirements and guidance are intended to ensure that the goals and objective of DOE's WFO Program are met.

We identified SNL's key controls related to WFO projects, determined if SNL's pricing and indirect cost structure was consistent with the WFO Program objectives of ensuring full cost recovery, and selected a statistical sample of 34 WFO projects that received new funding in FY 2011 for testing key internal control and compliance attributes identified in applicable DOE guidance.

In our sample of 34 WFO projects, we noted no findings related to the key internal control and compliance attributes identified in applicable DOE guidance for the WFO Program. However, as our performance audit report further describes, we identified the following non-project related findings as a result of the work performed:

(1) Costs relating to SNL's WFO support organizations were included in the general and administrative cost pool that was allocated to both WFO projects and other DOE projects on an organization-wide basis, rather than using an allocation base that bears a more direct causal beneficial relationship to the support costs. We estimated that the annual savings to DOE by implementing a separate indirect rate for this support department would be approximately $2.3 million.

(2) Year-end indirect cost variances were not allocated to WFO projects, and variances were allocated on a net basis, rather than allocating variances in proportion to the amounts originally allocated for each indirect cost pool. We estimate that in FY 2011, this matter resulted in approximately $900 thousand of over-recovery of costs that benefitted DOE projects, rather than WFO projects

(3) Pension costs of $15 million were transferred from the fringe benefits to other indirect cost pools, contrary to SNL's disclosed accounting practices. As such, the FY 2011 fringe benefit rate was understated and other indirect cost rates were overstated, which could have affected total indirect costs charged to WFO and other DOE projects, because the various indirect rates had different allocation bases.

Further, we noted that the SNL Independent Audit & Advisory Services issued a Labor Floor Check report, dated October, 2, 2012, that identified the following findings that could affect the accuracy of WFO project costs, including:

- SNL's policies over uncompensated overtime provided managers discretion in granting flextime to exempt full-time employees that work overtime, which resulted in inconsistent and inequitable charging of labor to both WFO and other DOE projects.

- Certain SNL employees did not charge their time accurately to projects, time spent on indirect activities was not charged consistently, and timekeeping practices were not consistently followed from one person to the next.

Because the SNL Independent Audit & Advisory Services findings and recommendations were agreed to by SNL management, and corrective action plans are in process, we did not repeat the related findings and recommendations in this report.

Based upon the performance audit procedures performed and the results obtained, we have met our audit objective. We conclude that, except for the findings noted above and detailed in this report, SNL implemented internal controls and compliance procedures in FY 2011 that met DOE's WFO Program requirements, as stated in DOE regulations, guidance, and applicable contract provisions.

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 overall internal controls.

This report is intended for the information and use of the DOE Office of the Inspector General and management of the Auditee. The report is not intended to be, and should not be, used by anyone other than these specified parties.

Sincerely,

KPMG LLP

BACKGROUND

Program Overview

The U.S. Department of Energy (DOE), and its semi autonomous National Nuclear Security Administration (NNSA) provide research and technical assistance to other Federal agencies on a reimbursable, full cost recovery basis through the Work for Others (WFO) Program. Pursuant to DOE's Work Order No. 2012-09 (Contract No. DE-AT01-07IG01539), dated June 15, 2012, KPMG was engaged to conduct a performance audit of Sandia National Laboratories' (SNL or the Auditee) WFO Program. This audit was focused on determining whether SNL met the internal control and compliance requirements established by DOE to achieve the goals and objectives of the WFO Program.

Auditee Overview

SNL is operated and managed by Sandia Corporation, a wholly owned subsidiary of Lockheed Martin Corporation. Sandia Corporation operates SNL as a contractor for the DOE/NNSA. As a Federally Funded Research and Development Center (FFDRC), SNL may perform work for industry, responding to certain types of solicitations.

Through the DOE/NNSA sponsored WFO Program, SNL provides technical resources and facilities to a variety of other federal agencies. The technology base developed through SNL's work for the DOE/NNSA provides expertise and capabilities not readily found in industry or in other government agencies. Therefore, the WFO Program is designed to contribute technological solutions to agencies and organizations other than the DOE/NNSA. These WFO projects must be consistent with and complementary to SNL and DOE/NNSA missions. Further, the work must not adversely impact SNL's execution of assigned DOE/NNSA programs or be in direct competition with the domestic private sector.

Within SNL, the WFO/Cooperative Research and Development Agreement (CRADA) Management organization is responsible for submitting proposals and accepting all awards from non-DOE sponsors, and post award budgetary oversight is provided by the Budget and WFO Financial Management organization.

The WFO activities have comprised between 32.7 percent and 39.5 percent of SNL's funding and costs, annually, for the past three fiscal years, as shown below:

Funding by Year *(000's)*			
	2009	**2010**	**2011**
WFO *(a)*	$894,609	$925,363	$790,831
Lab total	$2,400,710	$2,352,046	$2,415,411
Percent	*37.3%*	*39.3%*	*32.7%*

Costs by Year *(000's)*			
	2009	**2010**	**2011**
WFO *(b)*	$869,236	$917,114	$901,938
Lab total	$2,241,659	$2,322,641	$2,459,907
Percent	*38.8%*	*39.5%*	*36.7%*

(a) Authorized funding agreements signed during fiscal period
(b) Costs incurred during fiscal period

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of our performance audit was to determine if SNL's WFO Program, in effect for Fiscal Year (FY) 2011, met the internal control and compliance requirements established by DOE that are identified within:

- DOE Order 481.1c;
- DOE Guide 481.1-1;
- Contract Clauses;
- DOE Acquisition Regulations, as applicable, including DEAR 970.5217-1; and,
- Additional guidance issued by DOE/NNSA regarding the WFO Program.

These requirements and guidance are intended to ensure that the goals and objective of DOE's WFO Program are met.

Scope

As requested by DOE, the scope of this performance audit was restricted to WFO projects that received new funding between October 1, 2010 and September 30, 2011.

We conducted this performance audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and the DOE Office of Inspector General Audit Manual, as appropriate. *Government Auditing 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 Auditee is responsible for establishing and maintaining policies, procedures, systems and internal controls to account for WFO activities. Our responsibility is to provide findings and recommendations based on the results of our audit.

Methodology

We performed the following procedures as part of our audit:

- Obtained an understanding of SNL's WFO Program;
- Performed walk-throughs of SNL's WFO acceptance/performance process for Federal and non-Federal entities;
- Performed a risk assessment of SNL's WFO Program and identified significant risks;
- Identified key controls related to establishing and maintaining WFO projects;
- Determined if SNL's indirect cost structure was consistent with WFO objectives for recovering all costs incurred on WFO projects;
- Reviewed SNL's timekeeping and labor policies relevant to WFO activities;
- Reviewed SNL's actuarially-determined annual pension costs to test whether those costs were accurately included in the indirect rates charged to WFO projects; and,

- Selected a statistical sample of 34 WFO projects and performed attribute testing to assess whether SNL's controls and compliance procedures address the applicable DOE requirements, and were followed.

RESULTS

The results of our audit procedures are presented below:

1. Control Environment/Key Controls

   As a result of our procedures, we noted no finding relating to SNL's development of key controls and processes that met the compliance requirements of DOE's WFO Program.

2. Pricing and Indirect Cost Allocation

   Based on our test work, we determined that SNL was allocating costs related to the WFO/CRADA Management organization, and the Budget and WFO Financial Management organization, to both WFO projects and other DOE projects, rather than tracking and allocating these costs to WFO projects. This matter is discussed in finding **2012-SNL-WFO-01**. We further noted that the labor costs of primary project administrators and project managers supporting new project proposals for the WFO Program (e.g., proposal development costs) were included in the "division support" or "program management" for the division or strategic management unit that these professionals were coded to, and allocated to both WFO and non-WFO projects in those divisions/units. We considered that labor costs incurred to generate proposals for the WFO Program should have been fully allocated to the WFO projects; however, we estimated that the related proposal costs were likely less than $500,000, and the cost that would be necessary to implement a timekeeping system to track proposal development costs and to annually monitor the effects on various division/unit overhead rates would exceed the benefits to be derived, and as such, we are not proposing a recommendation relating to recording and allocating proposal development costs to be allocated over only the WFO projects.

   We also determined that SNL did not allocate the year-end indirect cost pool variance to WFO projects, and allocated variances based on a net basis, rather than allocating variances in proportion to the amounts originally allocated for each indirect cost pool, as noted in finding **2012-SNL-WFO-02**.

   Our procedures included obtaining an understanding of the defined benefit pensions applicable to SNL employees engaged in the performance of WFO and whether the actuarially determined annual pension costs were included in the indirect rates charged to WFO projects. Based on our test work, we determined that pension costs were included in the fringe rate and applied to all projects, although certain classes of employees did not earn pension benefits. Pension costs were included in the fringe benefit pool that was allocated on a labor base which included both pensionable and non-pensionable labor. As such, pension costs related to personnel working on WFO projects may not have been allocated proportional to the pension benefits earned by those employees, because certain classes of employees in the labor base are not eligible for pension benefits. SNL has taken the position that all fringe costs are a collective cost of the corporation for providing benefits to its employees and provides for a consistent charge for labor for employees within the same "pay band". We discussed this matter with SNL and agreed with its position that it may not be practical or efficient to establish separate fringe benefit pools and could incentivize project managers to make inappropriate staffing decisions based upon cost as opposed to qualifications/skills. As such, we did not propose a finding in this area.

We also determined that $15 million in pension costs were transferred from the fringe benefits to other indirect cost pools, contrary to SNL's disclosed accounting practices. As such, the fringe benefit rate was understated and other indirect cost rates were overstated, which could have affected total indirect costs charged to WFO and other DOE projects, because the various indirect rates had different allocation bases, as discussed in **2012-SNL-WFO-03**.

In addition, our procedures included obtaining an understanding of SNL's timekeeping and labor policies relevant to WFO activities. The SNL Independent Audit & Advisory Services conducted a Labor Floor Check audit, and issued its report in October 2012 (2012-1A-0012), which reported that some employees interviewed did not charge their time accurately to projects, and time practices were not consistently followed from one person to the next. Also, time spent on indirect activities (such as general training and all-hands meetings) was not charged consistently among individuals. For example the following items were noted, as reported by SNL Independent Audit and Advisory Services:

- Employees coded timesheets differently from the projects they said they were working on at the time of floor check interviews.
- Management set percentage time allocations or artificial caps that dictated how time was charged by employees.
- Support staff time was allocated to projects based on the time worked by the technical staff, rather than actual time worked by the support staff on specific projects.
- Employees randomly selected a project/task (P/T) to charge when the actual P/T worked on was closed.
- Employees charged time spent preparing bids or proposals to other direct projects.

That report also identified that SNL's policy regarding uncompensated overtime could result in inconsistent charging of labor to both WFO and DOE non-WFO projects. Specifically, the report noted that 17 out of 66 (25%) of individuals interviewed did not record uncompensated overtime. In addition, uncompensated overtime has not been factored in determining the hourly burdened standard labor rates used for WFO and non-WFO pricing. As a result, when employees earn and charge flex time, the total costs allocated to projects will exceed the employee's compensation. Further, if an employee works the same amount of overtime in two pay periods, and is allowed to earn flex time for the first pay period but not the second, the projects would be charged different labor costs for the same hours incurred. For example, if an employee worked 12 hours in one day on a project and was allowed to earn flex time, the project would be charged for 12 hours of labor. If the same employee was not allowed to earn flex time the project would only be charged 8 hours, at the same rate per hour.

SNL agreed with the SNL Independent Audit & Advisory Services report findings and stated, "Client management concurs with the finding. Management will be working on a memo to be sent from an Executive Vice President (EVP) to all employees about proper time charging practices and policies. Additional training may follow up to ensure clear guidance. Periodic self-assessments of subsets of the population will be conducted to ensure these practices and policies are being complied with."

Because there is a corrective action plan in place for these timekeeping matters, we did not repeat these findings and recommendations in our report.

3. WFO Project Sample for Internal Control and Compliance Testing

We statistically selected 34 WFO projects that received new funding between October 1, 2010 and September 30, 2011, for testing the key internal control and compliance attributes identified in applicable DOE guidance for the WFO Program.

We noted that one project selected for testing had subcontract costs of approximately 94% of total project costs and consisted of activities related to providing security services at the Tonopah Test Range (TTR), which SNL manages and controls for the DOE. We considered whether this activity should be classified as a WFO project, because it did not clearly meet the objectives of DOE Order 481.1C §1. However the related activity is allowable under the overall DOE contract and based on discussion with both SNL and the Sandia Field Office we conclude that the potential misclassification of this project as a WFO project would not have any direct financial effects. As a result, we did not consider this matter to be a finding. We noted no other exceptions with respect to the detailed test work on the selected 34 WFO projects.

Findings, Recommendations, and Auditee Responses

Our performance audit resulted in three findings, presented below. We discussed the results of the audit with SNL Management on December 20, 2012, and with the National Nuclear Security Administration on July 18, 2013.

Finding No. 2012-SNL-WFO-01

Criteria:

Per DOE Order 522.1, *Pricing of Departmental Materials and Services,* section 4.a.(1), non-DOE entities are required to be charged the full cost of materials and services provided by DOE. Full cost includes all direct costs incurred in performing work, all allocable costs, and a Federal Administrative Charge (FAC).

Cost Accounting Standards and the Federal Acquisition Regulation (FAR) Part 31 require that indirect costs be accumulated in logical cost groupings and be distributed to the cost objectives that benefit from the indirect costs.

Sandia National Laboratories, Cost Accounting Standards Board (CASB) Disclosure Statement, effective October 1, 2010.

Condition:

Costs incurred to support the WFO/CRADA Management organization and the Budget and WFO Financial Management organization were included in the general and administrative (G&A) indirect cost pool and allocated to both DOE and WFO projects on an organization-wide basis. Because these organizations were established to support the WFO Program, we considered that these costs should have been allocated to WFO projects.

Cause:

The WFO/CRADA Management organization and the Budget and WFO Financial Management organization costs were included in the G&A indirect cost pool. The G&A cost pool was allocated to all SNL projects based on a Modified Total Cost (MTC) input base. Including costs of these two organizations in the G&A cost pool caused a portion of WFO related costs to be allocated to DOE projects.

Effect:

We estimated that during FY 2011, approximately $2.3 million of the WFO/CRADA Management organization and the Budget and WFO Financial Management organization costs were inappropriately allocated to non-WFO projects.

Recommendation:

We recommend that SNL consider the cost-benefit of removing the WFO/CRADA Management organization and the Budget and WFO Financial Management organization costs from the G&A indirect cost pool, and establish a separate indirect cost pool for allocating these costs to WFO projects and other projects supported by the WFO support organization on a base that has a more direct causal beneficial relationship to the organizations' functions.

The cost of implementing a separate indirect rate for these WFO support organizations would be a one-time development cost, along with an ongoing annual cost for monitoring the resulting rate. As a result, we believe that there would be annual cost savings to DOE resulting from implementing this recommendation, assuming that the WFO activity remains at similar levels in the future.

Management Response:

Management generally concurred with the recommendation. NNSA agrees that Sandia should perform a follow-on assessment to confirm whether the WFO/CRADA management organization costs are appropriate to be incorporated into the G&A indirect cost pool, including consideration of whether costs related exclusively to WFO customers should be allocated across a base of only WFO customers. Sandia should assess whether such a cost accounting change would result in a better allocation of WFO cost in terms of compliance with Cost Accounting Standards (CAS) 418 and achieving a fair and equitable distribution of costs. This should be done while taking into consideration the cost benefit of the change to include considering the materiality of the costs in relation to the total G&A pool cost and the administrative costs of managing a separate rate. (See response to IG recommendation 2 of the draft report for action and estimated completion date.)

Auditor Response:

Management's comments are responsive to our recommendation.

Finding No. 2012-SNL-WFO-02

Criteria:

CAS 418-50 (g) states that pre-established rates, based on either forecasted actual or standard cost, may be used in allocating an indirect cost pool. Paragraph (4) states that if variances of a cost accounting period are material, these variances shall be disposed of by allocating them to cost objectives in proportion to the costs previously allocated to these cost objectives.

CFR Title 48, Part 9903, *Contract Coverage*, Subpart 9903.3 *CAS Rules and Regulations,* 305, *Materiality,* paragraph (d), states that in determining whether amounts of cost are material or immaterial an acceptable criteria is "the impact on Government funding. Changes in accounting treatment will have more impact if they influence the distribution of costs between Government and non-Government cost objectives than if all cost objectives have Government financial support."

Condition:

We noted the following two matters relating to allocation of indirect cost pool variances:

1. In FY 2011, indirect cost pool variances remaining at year-end, totaling an over-recovery of a net $2.5 million, were allocated only to open DOE-funded projects and not to the WFO projects. In FY 2012, SNL modified its variance allocation methodology so that *mid-year* rate changes are allocated to all projects (WFO and non-WFO projects) on a retrospective basis instead of a prospective basis, as was done in FY 2011 and prior. This change should reduce year-end variances. However, we understand that in FY 2012, subsequent to the period covered by our review, year-end variances continue to be allocated only to the DOE-funded projects.

2. In reviewing the components of the FY 2011 year-end over-recovery of a net $2.5 million, we observed that this was the net result of various pool overages and underages. For example, the fringe benefit pool year-end variance was an under-recovery of $5.9 million while the Corporate Taxes-NM pool had an over recovery of $4.6 million. (Note - these amounts represent 0.4% and 6.9% of the total costs of their respective pools.)

   SNL did not allocate individual indirect cost pool year-end variances to projects in proportion to the amounts previously allocated for each cost pool throughout the year. Instead, the individual indirect cost pool variances were aggregated into one amount that was allocated to the DOE-funded projects in proportion to the project's total indirect costs.

Cause:

SNL concluded that the year-end variances in individual indirect cost pools, and in total, were not material in relation to the aggregate cost pools. Therefore, in order to facilitate the accounting year-end close, SNL combined the variances and allocated the net amount based on each DOE-funded project's total indirect costs.

Effect:

Allocating year end indirect cost variances to only the DOE projects did not dispose of the variance in proportion to the costs previously allocated, which could result in DOE projects either benefiting from or bearing the cost of WFO activities. The FY 2011 year-end variance was an over-recovery of approximately $2.5 million, and was allocated to DOE-funded projects. WFO costs comprised approximately 36% of total SNL costs in FY 2011. Applying this percentage to the total net year end indirect cost variance of $2.5 million (which represents 0.11% of the total indirect costs incurred in FY 2011), results in our estimate that DOE projects benefited from WFO activities by approximately $900K, as a result of this allocation method.

In comparison, the year-end indirect cost variances for FY 2009 and 2010 were over-recoveries of $124 thousand and $2.1 million respectively. Although subsequent to the period covered by our review, we also noted that the year-end variance in FY 2012 was $1.3 million.

Further, because different indirect cost allocations have different drivers, the second condition will result in indirect cost allocations to projects that did not originally incur those costs.

Recommendations:

Considering that SNL recently changed its mid-year allocation process to allocate variances to all projects, which should reduce the amount of year-end variances, Sandia should analyze year-end indirect cost pool variances to ensure that its mid-year rate changes result in immaterial variances at the end of the year, or, in the case of material variances, adopt a different methodology for allocation to both DOE funded and WFO projects. Further, SNL should analyze the potential cost effects of allocating year-end variances separately for the various indirect cost pools, or for the more significant cost pool variances, so that significant variances are equitably allocated based on a more direct relationship to the original allocation.

Management Response:

Management concurred with the recommendation. Sandia currently utilizes a new variance distribution process to dispose of indirect rate variances that was implemented in FY 2012, and was not yet in place during the time period covered by the audit. Under the current processes, distributions are made to all open projects at month end for January, May, and July, as well as the last week of August. An additional redistribution is made at year-end to only DOE open projects.

The processes used by Sandia in performing multiple mid-year variance redistributions are intended to result in a minimal year-end variance required to be redistributed. During the development of the variance distribution process Sandia estimated the year-end variance for each year would be under $2 million. Consistent with this, the FY 2012 year-end variance redistributed to DOE open projects was $1.3 million per Sandia's FY 2012 Final Actual Costs and Rates Submission.

The year-end variance distribution is made only to DOE open projects due to the short period of time between year-end and the required transmittal of year-end STARS reporting data. Sandia has less than two days after year-end to provide this transmittal. An analysis performed by Sandia during the development of the retroactive variance distribution process determined that if Sandia is required to distribute year-end variances to WFO projects at the individual rate level it could require up to an extra week to close their books at year-end. Distributing variances to WFO customers would result in invoices being generated in Sandia's revenue system. Sandia reports that their books cannot be closed at year-end until burdened costs, revenues, and invoices are equal. The additional processing time required for this may jeopardize Sandia's ability to meet accounting close requirements.

NNSA does not believe a year-end variance of under $2M is material enough to jeopardize Sandia's ability to meet the accounting close deadlines. NNSA therefore believes that Sandia should continue their current practice of distributing immaterial year-end variances to DOE projects. Sandia should continue to monitor anticipated variances throughout the fiscal year to ensure year-end variances remain immaterial. If Sandia anticipates a material variance will occur at year-end, appropriate corrective actions must be taken.

NNSA agrees that WFO funds remaining at year-end cannot be kept by DOE and used for DOE projects. WFO funds remaining after year-end below a de minimis amount do not need to be returned to the appropriate WFO customers; however, the total of these remaining WFO funds should be returned to the United States Treasury as a miscellaneous receipt. Additionally, Sandia should implement processes which allow material positive variances to be returned to closed projects in order to correctly allocate such costs if necessary. Best practices in this area exist at other NNSA sites.

In FY 2012 the NNSA Office of Field Financial Management (OFFM) conducted a study that identified controls which could be put in place to further reduce the probability of a material negative year-end variance occurring which cannot be redistributed to WFO customers due to the WFO projects being closed. NNSA is pursuing implementation of the controls identified as a result of this study. (See response to IG recommendations 3 and 4 of the draft report for actions and estimated completion date.)

Auditor Response:

In general, management's comments are responsive to our recommendations.

By not including WFO projects in the year-end cost variance distribution, WFO project costs are not accurately bearing the full operating cost of the WFO program, as required by DOE WFO regulations, because these projects are not receiving their equitable share of applicable variances. While the percentage of the over/under recoveries may not be a significant percentage of the total indirect costs, the absolute dollar value is not inconsequential, and could vary significantly from year to year.

Further, while not addressed in management's response, we also continue to believe that cost variances should be analyzed by indirect pool, and that the larger variances should be allocated over the same basis as the original allocation.

We acknowledge that allocating variances to the WFO projects could have potential impacts to the timing of SNL's year-end close, but we believe that a process could be implemented whereby a summary level adjustment could be made to the WFO program as of year-end, with detailed entries to specific WFO projects in the subsequent period, to avoid over or under-allocating these variances to the DOE projects.

Finding No. 2012-SNL-WFO-03

Criteria:

CAS 418, 48 CFR 9904.418-50(b), states:

(1) An indirect cost pool is homogeneous if each significant activity whose costs are included therein has the same or similar beneficial or causal relationship to cost objectives as other activities whose costs are included in the cost pool. It is also homogeneous if the allocation of the costs of the activities included in the cost pool result in an allocation to cost objectives which is not materially different from the allocation that would result if the costs of the activities were allocated separately.
(2) An indirect cost pool is not homogeneous if the costs of all significant activities in the cost pool do not have the same or similar beneficial or causal relationship to the cost objectives

and, if the costs were allocated separately, the resulting allocation would be materially different.

FAR Part 31 - 48 CFR 31.201-2, *Determining Allowability*, states:

(a) A cost is allowable only when the cost complies with all of the following requirements:
  (1) Reasonableness.
  (2) Allocability.
  (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
  (4) Terms of the contract.
  (5) Any limitations set forth in this subpart.

FAR Part 31 - 48 CFR 31.201-3, *Determining Reasonableness*, states:

(a) A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business.
(b) What is reasonable depends upon a variety of considerations and circumstances, including—
  (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;
  (2) Generally accepted sound business practices, arm'slength bargaining, and Federal and State laws and regulations;
  (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
  (4) Any significant deviations from the contractor's established practices.

The *Pension Protection Act (PPA) of 2006* required the Cost Accounting Standards (CAS) Board to "harmonize" CAS 412 and 413 with PPA minimum funding requirements, which was implemented into the CAS via the *CAS Pension Harmonization Rule*, on December 27, 2011, with an effective date of February 27, 2012. The Harmonized CAS must be used for the next contractor fiscal year starting after June 30, 2012.

Condition:

In FY 2011, SNL funded $201.5 million to its defined benefit plans, as approved by the Sandia Site Office. This amount was based on the minimum required pension contributions determined by an actuary, plus additional amounts to contribute towards the unfunded accrued pension liability. The total unfunded accrued pension liability of the Retirement Income Plan (RIP) plan approximated $300 million at January 1, 2011, the date of the most recent actuarial valuation for FY 2011.

According to SNL's Cost Accounting Standards Board (CASB) Disclosure Statement, pension costs are a part of SNL's fringe benefits cost pool. However, we noted that of the $201.5 million in pension payments, $15 million was later transferred out of the fringe benefits cost pool to several other overhead pools, including the division support, program management, and G&A indirect cost pools.

According to SNL's CASB Disclosure Statement, the fringe rate was allocated to cost objectives on a labor base, comprised of standard payments to employees. However, the allocation base of the other cost pools to which the $15 million in pension costs were transferred differed from the fringe benefit allocation base.

Therefore, $15 million in pension costs that were ultimately included in other cost pools in FY 2011 appeared to be treated inconsistently with SNL's disclosed cost accounting practices.

SNL, in a letter dated March 2, 2011, informed the Sandia Site Office of its intent to use $15 million of overhead savings in order to make additional pension contributions. The March 2011 letter stated, "Generating pension contributions from other cost pools could be construed as a Cost Accounting Standard (CAS) violation, since historically Sandia has collected pension contributions exclusively through our fringe rates. However, this $15M is immaterial in relation to the pools the costs will be transferred to (DS/MOCC of $390M, PM of $97M, IES of $323M) and over a standard labor base of $1.2B." Therefore, SNL recorded the additional pension costs to other overhead pools, rather than recording the additional $15 million in pension contributions to the fringe benefits pool, which is where such pension costs should have been recorded, according to SNL's CASB Disclosure Statement.

Cause:

Based on discussions with SNL personnel, we understand that SNL strives to maintain a stabilized fringe rate for competitive reasons, which could have been the motivation for this pension cost transfer.

Effect:

The fringe benefits pool cost was understated for FY 2011, and other indirect cost pool costs were overstated by an offsetting amount. We noted that the transfer reduced the FY 2011 year-end actual fringe rate, based on actual costs, from 42.7% to 41.1%. The ultimate effect on final cost objectives, including WFO projects, cannot easily be determined because the various indirect pools have different allocation bases.

Recommendation:

We recommend that SNL maintain consistency with cost accounting practices disclosed in its CASB Disclosure Statement.

Management Response:

Management concurred with the recommendation. NNSA's Report on the Review of Sandia's FY 2011 Final Actual Costs and Rates Submission, dated September 11, 2012, identified that cost savings from non-fringe indirect rates were used to offset pension costs in FY 2011. In that report, NNSA approximated the amount of pension costs inappropriately charged to other indirect pools to be $15 million. The KPMG audit report validates NNSA's previous findings in this area.

NNSA has since coordinated with Sandia to clarify that the practice is not appropriate and to ensure this occurrence with charging pension costs to other indirect cost pools is not repeated in future years. (See response to IG recommendation 5 of the draft report for the official management decision.)

Auditor Response:

Management's comments are responsive to our recommendation.

In management's response, it acknowledges that this matter was raised in an internal review during FY 2012, and the practice that we noted was limited to FY 2011 and has not been repeated. However, we did not perform additional procedures to confirm whether corrective action has been taken.

Conclusion

Based upon the performance audit procedures performed and the results obtained, we have met our audit objective. We concluded that, except for the findings noted above and detailed in this report, SNL implemented internal controls and compliance procedures in FY 2011 that met DOE's WFO Program requirements, as stated in DOE regulations, guidance, and applicable contract provisions.

APPENDIX

List of Projects Tested

Sample #	Agreement #	Proposal #	Sponsor Type	Sponsor	Funded Amount
1	SIAA11ISNCTR10-0	069060628	Federal	DOS - DEPARTMENT OF STATE	$ 21,002,827
2	F2TSJA1159G002-0	057081203	Federal	AIR FORCE - US AIR FORCE	19,000,000
3	F2TSJA1020G002-0	057081203	Federal	AIR FORCE - US AIR FORCE	17,000,000
4	N0003011MP10016-3	021080812	Federal	NAVY - NAVY	10,614,000
5	N0003011MP10058-0	064081119	Federal	NAVY - US NAVY	10,249,000
6	N0003011MP10036-0	064081119	Federal	NAVY - US NAVY	9,527,000
7	HSSA0111X00136-0	089100319	Federal	DHS - DHS OTHER	7,541,972
8	MIPR0BO89CNAGK-0	054060223	Federal	ARMY - US SPACE AND MISSILE DEFENSE COMMAND	6,028,837
9	N6339411IP00009-0	054080228	Federal	NAVY - NAVAL SURFACE WARFARE CENTER	5,000,000
10	W81EWF10242000-0	053100524	Federal	ARMY - U.S. ARMY - CORPS OF ENGINEERS	4,024,000
11	MIPR1GO89CNA14-0	054060223	Federal	ARMY - US SPACE AND MISSILE DEFENSE COMMAND	3,195,602
12	N6339411IP00011-0	054080228	Federal	NAVY - NAVAL SURFACE WARFARE CENTER	2,500,000
13	F2TSJA1104G001-0	057081203	Federal	AIR FORCE - US AIR FORCE	2,100,000
14	W81EWF03148398-0	053100524	Federal	ARMY - U.S. ARMY - CORPS OF ENGINEERS	1,467,000
15	114513I-0	059080219	Federal	DTRA - DEFENSE THREAT REDUCTION AGENCY	1,050,000
16	F2TSJA1083GV01-0	057081203	Federal	AIR FORCE - US AIR FORCE	989,000
17	HSHQPM11X00008-0	063100915	Federal	DHS - SCIENCE AND TECHNOLOGY	968,000
18	HSHQPM10X00094-0	064080826	Federal	DHS - SCIENCE AND TECHNOLOGY	790,000
19	F1AF2W9110G001-4	064060913	Federal	AIR FORCE - AIR FORCE	740,400
20	MIPR1L9C702SAN-0	053110803A	Federal	ARMY - US ARMY	723,544
21	11A214-3	014100511	Federal	DARPA - DEFENSE ADVANCED RESEARCH PROJECTS AGENCY	656,250
22	W81EWF10313765-0	053100524	Federal	ARMY - U.S. ARMY - CORPS OF ENGINEERS	601,000
23	W10173-24	068051028	Federal	NASA - NATIONAL AERONAUTICS & SPACE AGENCY	515,000
24	HSFEHQ11X1040-0	081090915	Federal	DHS - FEDERAL EMERGENCY MANAGEMENT AGENCY	471,000
25	MIPR0A9C700SAN-0	053080805A	Federal	ARMY - US ARMY	422,000
26	11Y670-2	017100701	Federal	DARPA - DEFENSE ADVANCED RESEARCH PROJECTS AGENCY	405,000
27	F3G0CA0271G001-3	042090715	Federal	AIR FORCE - US AIR FORCE	356,833
28	MIPR1KO89CNA32-0	054090330	Federal	ARMY - US SPACE AND MISSILE DEFENSE COMMAND	300,000
29	MIPR0G9C395SNL-2	053080730	Federal	ARMY - US ARMY	276,137
30	A1I101947-0	067080220	Federal	DOJ - DEPARTMENT OF JUSTICE	236,000
31	FI063100616	063100616	Non-Fed	ARRA - WFO DRAKA FIBER EVAL	151,456
32	FI053110228	053110228	Non-Fed	BAE SYSTEMS	97,087
33	DWIA10061-0	026100111	Federal	ARMY - US ARMY	74,320
34	FI086091123	086091123	Non-Fed	HM NEF	36,636
				Total	**$ 129,109,902**

Department of Energy
National Nuclear Security Administration
Washington, DC 20585

August 15, 2013

MEMORANDUM FOR RICKEY R. HASS
DEPUTY INSPECTOR GENERAL
FOR AUDITS AND INSPECTIONS
OFFICE OF INSPECTOR GENERAL

FROM: CYNTHIA LERSTEN Howard E Glenn for Cindy Lersten
ASSOCIATE ADMINISTRATOR
FOR MANAGEMENT AND BUDGET

SUBJECT: Comments on the Office of Inspector General Draft Report Titled "Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories" (OAS-M-3-XX)

Thank you for the opportunity to review and comment on the subject draft report. I understand the Inspector General (IG) engaged the independent certified public accounting firm, KPMG, LLP (KPMG), to assess the internal control structure at Sandia and determine whether it is effective in achieving the current goals and objectives of the Work for Others (WFO) Program. The draft report provides five recommendations for NNSA action from the IG to help ensure effective accounting for the costs of the WFO program. These recommendations are supported by three detailed findings provided in the accompanying report by KPMG.

NNSA appreciates the auditors' time and efforts in reviewing this subject and believes the findings are helpful in efforts to continuously evaluate and monitor compliance with Cost Accounting Standards. NNSA concurred or partially concurred with the IG and KPMG recommendations. The attachment to this memorandum provides NNSA's specific actions and timelines to address each recommendation, including clarifications and qualifications on NNSA's concurrence as appropriate. We have also provided general and technical comments 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

National Nuclear Security Administration (NNSA)
Response to the Inspector General (IG) Draft Report Titled
"Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

Response to IG Recommendations

The IG recommended NNSA:

Recommendation 1: Review cost allocation policies regarding Work for Others (WFO) support organizations.

Management Response: N/A

NNSA understands the IG has agreed to delete this recommendation pending the results of a related audit at another site. As such, NNSA has not provided a management position.

Recommendation 2: Consider the cost-benefit of removing the WFO support organizations' costs from the General and Administrative (G&A) indirect cost pool and [consider establishing] a separate indirect cost pool for allocating those costs to WFO projects and other projects supported by the WFO support organizations on a base that has a more direct causal beneficial relationship to the organizations' functions.

Management Response: Concur in principle

NNSA will direct Sandia internal auditors to perform a follow-on assessment to confirm whether the WFO support organization costs meet the definition of G&A costs under paragraph 30(a)(6) of Cost Accounting Standard (CAS) 410 entitled *Allocation of Business Unit General and Administrative Expenses to Final Cost Objectives*. We do not agree with the removal of costs from the G&A pool that meet the definition of G&A.

CAS 402-40 states that all costs incurred for the same purpose, in like circumstances, shall be treated the same. Treating the WFO support costs differently than like support costs, as recommended by the auditors, would violate CAS 402.

If it is determined that some or all of the WFO support functions do not meet the definition of G&A, then an assessment will be made as to the treatment of the costs under CAS 418, *Allocation of Direct and Indirect Costs*. This will be accomplished while taking into consideration cost benefit of the change to include the materiality of the costs in relation to the total G&A pool cost and the administrative costs of managing a separate rate. The Office of Field Financial Management (OFFM) will review any proposed changes to Sandia's disclosed cost accounting practices. The estimated completion date for these actions is July 30, 2014.

Attachment

National Nuclear Security Administration (NNSA)
Response to the Inspector General (IG) Draft Report Titled
"Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

Recommendation 3: Analyze year-end indirect cost pool variances to ensure that [Sandia's] mid-year rate changes result in immaterial variances at the end of the year, or, in the case of material variances, adopt a different methodology for allocation to both Department-funded and WFO projects.

Management Response: Concur in principle

NNSA agrees that controls should be in place to ensure year-end variances are minimized and appropriately allocated as necessary. Sandia currently utilizes a retroactive variance distribution process to dispose of indirect rate variances, and should continue their current practice of distributing immaterial year-end variances to DOE projects. NNSA will ensure that Sandia continues to monitor anticipated variances throughout the fiscal year to ensure year-end variances remain immaterial. As this recommendation reflects an existing and on-going process, NNSA considers this recommendation closed.

Recommendation 4: Analyze the potential cost effects of allocating year-end variances separately for the various indirect cost pools, or for the more significant cost pool variances, so that significant variances are equitably allocated based on a more direct relationship to the original allocation.

Management Response: Concur

As stated in NNSA's response to Recommendation 3 above, in fiscal year 2012 Sandia implemented a new variance distribution process intended to result in a minimal year-end variance. NNSA believes the practice of distributing all year-end variances on a net basis is acceptable as long as the variances are immaterial. NNSA will request Sandia formally document a process for allocating variances should they become material and ensure it complies with the Cost Accounting Standards. The estimated completion date for this action is July 30, 2014.

Recommendation 5: Maintain consistency with cost accounting practices disclosed in its Cost Accounting Standards Board Disclosure Statement.

Management Response: Concur

NNSA will continue to monitor Sandia's practices for consistency with CAS. As this recommendation reflects an existing process and requirement, NNSA considers this recommendation closed.

Attachment

National Nuclear Security Administration (NNSA)
Response to the Inspector General (IG) Draft Report Titled
"Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

NNSA Responses to KPMG Detailed Findings/Recommendations
(Please Replace Current "Auditee Response" with this Official Response)

Finding No. 2012-SNL-WFO-01: KPMG Recommended SNL: a) consider removing the WFO/CRADA management organization costs from the G&A indirect Cost Pool, and b)[consider] establishing a separate indirect cost pool for allocating these costs to WFO projects.

Management Response: Concur in principle

NNSA agrees that Sandia should perform a follow-on assessment to confirm whether the WFO/CRADA management organization costs are appropriate to be incorporated into the G&A indirect cost pool, including consideration of whether costs related exclusively to WFO customers should be allocated across a base of only WFO customers. Sandia should assess whether such a cost accounting change would result in a better allocation of WFO cost in terms of compliance with Cost Accounting Standards (CAS) 418 and achieving a fair and equitable distribution of costs. This should be done while taking into consideration the cost benefit of the change to include considering the materiality of the costs in relation to the total G&A pool cost and the administrative costs of managing a separate rate. (See response to IG recommendation 2 of the draft report for action and estimated completion date)

Finding No. 2012-SNL-WFO-02: KPMG recommended Sandia: a) analyze year-end indirect cost pool variances to ensure that its mid-year rate changes result in immaterial variances at the end of the year, or, in the case of material variances, adopt a different methodology for allocation to both DOE funded and WFO projects; and b) analyze the potential cost effects of allocating year-end variances separately for the various indirect cost pools, or for the more significant cost pool variances, so that significant variances are equitably allocated based on a more direct relationship to the original allocation.

Management Response: Concur

Sandia currently utilizes a new variance distribution process to dispose of indirect rate variances that was implemented in FY 2012, and was not yet in place during the time period covered by the audit. Under the current processes, distributions are made to all open projects at month end for January, May, and July, as well as the last week of August. An additional redistribution is made at year-end to only DOE open projects.

The processes used by Sandia in performing multiple mid-year variance redistributions are intended to result in a minimal year-end variance required to be redistributed. During the development of the variance distribution process Sandia estimated the year-end variance for each year would be under $2 million. Consistent with this, the FY 2012 year-end variance

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National Nuclear Security Administration (NNSA)
Response to the Inspector General (IG) Draft Report Titled
"Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

redistributed to DOE open projects was $1.3 million per Sandia's FY 2012 Final Actual Costs and Rates Submission.

The year-end variance distribution is made only to DOE open projects due to the short period of time between year-end and the required transmittal of year-end STARS reporting data. Sandia has less than two days after year-end to provide this transmittal. An analysis performed by Sandia during the development of the retroactive variance distribution process determined that if Sandia is required to distribute year-end variances to WFO projects at the individual rate level it could require up to an extra week to close their books at year-end. Distributing variances to WFO customers would result in invoices being generated in Sandia's revenue system. Sandia reports that their books cannot be closed at year-end until burdened costs, revenues, and invoices are equal. The additional processing time required for this may jeopardize Sandia's ability to meet accounting close requirements.

NNSA does not believe a year-end variance of under $2M is material enough to jeopardize Sandia's ability to meet the accounting close deadlines. NNSA therefore believes that Sandia should continue their current practice of distributing immaterial year-end variances to DOE projects. Sandia should continue to monitor anticipated variances throughout the fiscal year to ensure year-end variances remain immaterial. If Sandia anticipates a material variance will occur at year-end, appropriate corrective actions must be taken.

NNSA agrees that WFO funds remaining at year-end cannot be kept by DOE and used for DOE projects. WFO funds remaining after year-end below a de minimis amount do not need to be returned to the appropriate WFO customers; however, the total of these remaining WFO funds should be returned to the United States Treasury as a miscellaneous receipt. Additionally, Sandia should implement processes which allow material positive variances to be returned to closed projects in order to correctly allocate such costs if necessary. Best practices in this area exist at other NNSA sites.

In FY 2012 the NNSA Office of Field Financial Management (OFFM) conducted a study that identified controls which could be put in place to further reduce the probability of a material negative year-end variance occurring which cannot be redistributed to WFO customers due to the WFO projects being closed. NNSA is pursuing implementation of the controls identified as a result of this study. (See response to IG recommendations 3 and 4 of the draft report for actions and estimated completion date)

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National Nuclear Security Administration (NNSA)
Response to the Inspector General (IG) Draft Report Titled
"Fiscal Year 2011 Work Performed Under the Work for Others Program at Sandia National Laboratories"

Finding 2012-SNL-WFO-03: KPMG recommended that SNL maintain consistency with cost accounting practices disclosed in its CASB Disclosure Statement.

Management Response: Concur

NNSA's Report on the Review of Sandia's FY 2011 Final Actual Costs and Rates Submission, dated September 11, 2012, identified that cost savings from non-fringe indirect rates were used to offset pension costs in FY 2011. In that report, NNSA approximated the amount of pension costs inappropriately charged to other indirect pools to be $15 million. The KPMG audit report validates NNSA's previous findings in this area.

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IG Report No. OAS-L-13-14

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3. What format, stylistic, or organizational changes might have made this report's overall message more clear to the reader?

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5. Please include your name and telephone number so that we may contact you should we have any questions about your comments.

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