

# Memorandum

DATE: November 5, 2010

Report Number: OAS-L-11-01

REPLY TO:

ATTN OF: IG-32 (A09AL024)

SUBJECT: Report on "Questioned, Unresolved and Potentially Unallowable Costs Incurred by Sandia Corporation during Fiscal Years 2007 and 2008"

TO: Manager, Sandia Site Office

## BACKGROUND

Since 1993, Sandia Corporation, a Lockheed Martin company, has operated Sandia National Laboratories (Sandia) under contract with the Department of Energy (Department). Sandia is part of the Department's National Nuclear Security Administration (NNSA) and has critical national security responsibilities, including helping ensure the safety, security, and reliability of the Nation's nuclear weapons stockpile. During Fiscal Years (FY) 2007 and 2008, Sandia claimed costs totaling \$3.0 billion.

As a "management and operating" contractor, Sandia's financial accounts are integrated with those of the Department, and the results of financial transactions are reported monthly according to a uniform set of accounts. Sandia is required by its contract to account for all funds advanced by the Department, to safeguard assets in its care, and to claim only allowable costs. Further, Sandia is required to account for costs incurred annually by issuing a Statement of Costs Incurred and Claimed (SCIC).

On October 5, 2010, we issued a separate contract audit report on "*Audit Coverage of Cost Allowability for Sandia Corporation during Fiscal Years 2007 and 2008 under Department of Energy Contract No. DE-AC04-94AL85000*" (OAS-V-11-01, October 2010). One of the objectives of the audit was to determine whether questioned costs and internal control weaknesses impacting allowable costs identified in prior audits and reviews had been adequately resolved. Among other observations, the audit report identified specific costs that had yet to be resolved under the contract.

## CONCLUSIONS AND OBSERVATIONS

We identified over \$10 million in questioned and unresolved costs claimed by Sandia during FYs 2007 and 2008. In addition, we noted other concerns which need to be addressed to ensure that only allowable costs are claimed by and reimbursed to Sandia.

### Unresolved Questioned Costs

The Department had not resolved \$10,324,001 in costs questioned by Sandia's internal audit function for FYs 2007 and 2008 (see Attachment 1). These costs included:

- Unresolved FY 2007 and 2008 prime contract costs totaling \$8,313,561. The majority of the costs involved purchase card transactions. In this context, Sandia's internal auditors identified weak enforcement of internal policies related to purchase card transactions, business meals, and expense vouchers. Common problems included lack of supporting documentation and lack of supervisory review.
- Unresolved FY 2007 and 2008 subcontract costs totaling \$2,010,440. Some of the underlying common issues leading to subcontract questioned costs included adjustments to indirect rates, costs not correctly allocated or claimed, and costs incurred outside of a subcontract's period of performance.

The Department's Contracting Officer (CO) indicated that unresolved questioned costs had not received the attention they needed due to other pressing work. To assist the CO in resolving the outstanding costs, the Sandia Site Office (Site Office) hired a Contract Specialist. According to the CO, much of the work needed to resolve the costs had been performed. The CO asserted that Sandia and the Department are close to resolving some of the costs. In this regard, NNSA management told us that it anticipates that all the questioned costs will be resolved by June 2011.

#### Unresolved Costs Pending Audit

The Department and Sandia have agreed that home office expenses directly attributable to the performance of the contract are allowable costs if they meet all other criteria for allowability. Sandia incurred \$3,405,908 in home office expenses in FYs 2007 and 2008. Before the CO can make a determination of cost allowability, she must wait on the Defense Contract Audit Agency (DCAA) to schedule and complete its review of Lockheed Martin Corporation's Corporate Office and the Defense Contract Management Agency (DCMA) must negotiate a settlement. According to the CO, because the Department of Defense is Lockheed Martin's predominant Federal contract sponsor, the Site Office has no control over when DCAA schedules and completes the audit. Recognizing these challenges, we consider amounts claimed for home office expenses as unresolved pending audit completion and resolution.

#### Unresolved Costs from Prior Years

We noted that \$1,995,544 of costs incurred by Sandia as long as 10 years ago and previously questioned by the Office of Inspector General (OIG) had not been resolved. The CO told us that they were working to resolve these costs, which cover items such as non-employee expense vouchers and business meals. In addition, home office expenses incurred during FYs 2000 through 2006 totaling \$9,601,236 were pending audit (see Attachment 2). Again the CO asserted that the Department was working to address these unresolved questioned costs. According to the CO, for some of the costs, the Site Office is in the end stages of processing a final settlement or is reviewing additional supporting

documentation provided by Sandia in June 2010. As previously stated, NNSA management stated that it anticipates that actions to resolve all the questioned costs will be completed by June 2011.

### Subcontract Oversight

Sandia's procurement function did not effectively review invoices or monitor contract performance periods to identify weaknesses that resulted in questioned costs for 13 subcontractors. The questioned costs were identified by Sandia's Contract Audit function but, in some cases, not for several years after the costs were incurred. For example, we found that Sandia retroactively amended three contracts with one supplier to allow charges for work performed outside the contracts' period of performance three to six years after the work was done. These weaknesses affected about 25 percent of the FY 2007 and 2008 contract audits that had questioned costs. We concluded that the Department's interest would be better protected if Sandia improved its review of subcontract invoices, specifically to ensure that potentially unallowable costs are identified and resolved in a timely manner.

### Compliance with Cost Accounting Standards

NNSA's Field Chief Financial Officer (CFO) has not signed the FY 2008 SCIC, as required by the Department's Accounting Handbook. The SCIC is to contain the Field CFO's signature, which attests that the contractor has established a system of accounting controls adequate to minimize the risk of incurring unallowable or unreasonable costs. On January 14, 2010, the Office of Field Financial Management (OFFM) issued a memorandum to the CO which stated that the FY 2008 SCIC was not approved by the Field CFO due to Sandia's potential noncompliance with Cost Accounting Standards (CAS 405, Accounting for Unallowable Costs). Specifically, OFFM was not confident that sufficient internal accounting controls were in place to prevent unreasonable or unallowable costs from being charged to government cost objectives during FY 2008. As of September 2010, OFFM continued to work with the CO and the Department to resolve this issue. Accordingly, the OIG will not sign the FY 2008 SCIC until corrective actions are completed and the requisite NNSA Field CFO's endorsement has been provided. The OIG takes a similar position with regard to the FY 2007 SCIC.

In our contract audit report on costs incurred by Sandia during FYs 2007 and 2008, we recommended that the Manager, Sandia Site Office, direct the Contracting Officer to:

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

3. Ensure that Sandia improves its oversight of subcontractors so that potentially unallowable costs are identified in a timely manner.

Management generally agreed with the report and concurred with the recommendations. Management's response included planned corrective actions to be taken in response to our recommendations along with milestones for completion. Management's comments are attached.



David Sedillo, Director  
NNSA & Science Audits Division  
Office of Inspector General

#### Attachments

cc: Director, Office of Internal Controls, NA-66  
Director, Office of Risk Management, CF-80  
Assistant Director, Office of Risk Management, CF-80  
Team Leader, Office of Risk Management, CF-80  
Audit Resolution Specialist, Office of Risk Management, CF-80

Summary of Questioned Costs and Unresolved Costs Pending Audit  
Fiscal Years (FY) 2007 and 2008  
Sandia Corporation  
Contract No. DE-AC04-94AL85000

Questioned Cost Category	FY 2007		FY 2008		Total	
	Questioned	Unresolved	Questioned	Unresolved	Questioned	Unresolved
<b>Internal Audit Findings:</b>						
Business Meals	\$765,881	\$687,790	\$290,637	\$289,010	\$1,056,518	\$976,800
Employee Travel	\$890,707	\$890,707	N/A	N/A	\$890,707	\$890,707
Non-Employee Expenses	\$236,080	\$82,531	\$93,526	\$53,431	\$329,606	\$135,962
Purchase Card Transactions	N/A	N/A	\$6,310,092	\$6,310,092	\$6,310,092	\$6,310,092
Subtotal	\$1,892,668	\$1,661,028	\$6,694,255	\$6,652,533	\$8,586,923	\$8,313,561
<b>Contract Audit Findings:</b>						
Subcontracts	\$2,958,276	\$498,440	\$3,206,375	\$1,512,000	\$6,164,651	\$2,010,440
<b>Other Questioned Costs:</b>						
Legal Settlement	\$2,131,198	\$0	N/A	N/A	\$2,131,198	\$0
Unallowable Corporate Flow-down Costs	\$543,635	\$0	N/A	N/A	\$543,635	\$0
Purchase Card Transactions <sup>1</sup>	\$374,286	\$0	N/A	N/A	\$374,286	\$0
<b>Total Questioned Costs:</b>	<b><u>\$7,900,063</u></b>	<b><u>\$2,159,468</u></b>	<b><u>\$9,900,630</u></b>	<b><u>\$8,164,533</u></b>	<b><u>\$17,800,693</u></b>	<b><u>\$10,324,001</u></b>
<b>Unresolved Costs Pending Audit</b>						
Home Office Expense		<b>\$1,792,898</b>		<b>\$1,613,010</b>		<b>\$3,405,908</b>

<sup>1</sup> These P-Card related questioned costs are from the Office of Inspector General (OIG) Inspection Report: *Sandia National Laboratory-California Procurement Card Program* (IG-0754, January 2007). Although the questioned costs have been resolved, they were not reported in previous OIG audits of Sandia Corporation costs incurred.

Summary of  
Unresolved Costs – Fiscal Years (FY) 2000 to 2006  
Sandia Corporation  
Contract No. DE-AC04-94AL85000

<b>Questioned Cost Category and Fiscal Year</b>		<b>Questioned</b>	<b>Unresolved</b>
<b>Internal Audit Findings:</b>			
<b>FY 2001</b>	Miscellaneous unallowable costs	\$20,489	\$16,396
<b>FY 2002</b>	Miscellaneous unallowable costs	\$44,444	\$30,947
<b>FY 2005</b>	Non-employee expense vouchers	\$1,016,258	\$932,348
<b>FY 2005</b>	Lack of support	\$1,812	\$1,812
<b>FY 2005</b>	Board of Directors	\$7,847	\$2,747
<b>FY 2006</b>	Non-employee expense vouchers	\$321,085	\$248,624
<b>FY 2006</b>	Employee expense vouchers	\$502,936	\$442,906
<b>FY 2006</b>	Business meals	\$225,960	\$217,650
<b>Subtotal</b>		<b>\$2,140,831</b>	<b>\$1,893,430</b>
<b>Contract Audit Findings:</b>			
<b>FY 2005</b>	Subcontracts	\$2,469,000	\$7,555
<b>FY 2006</b>	Subcontracts	\$2,045,528	\$94,559
<b>Subtotal</b>		<b>\$4,514,528</b>	<b>\$102,114</b>
<b>Total Questioned Costs:</b>		<b>\$6,655,359</b>	<b>\$1,995,544</b>
<b>Unresolved Costs Pending Audit</b>			
<b>FY 2000</b>	Home Office Expense		\$963,796
<b>FY 2001</b>	Home Office Expense		\$779,756
<b>FY 2002</b>	Home Office Expense		\$949,858
<b>FY 2003</b>	Home Office Expense		\$1,680,329
<b>FY 2004</b>	Home Office Expense		\$1,724,538
<b>FY 2005</b>	Home Office Expense		\$1,641,810
<b>FY 2006</b>	Home Office Expense		\$1,861,149
<b>Total Unresolved Costs Pending Audit</b>			<b>\$9,601,236</b>



Department of Energy  
National Nuclear Security Administration  
Washington, DC 20585



September 2, 2010

MEMORANDUM FOR: David Sedillo, Director  
NNSA and Science Audits Division  
Office of the Inspector

FROM: JoAnne Parker, Director  
Office of Internal Controls

SUBJECT: Comments to the IG's Draft Sandia cost Incurred Audit  
Report for FY 2007 and 2008; Proj. No. A09AL024;  
IDRMS No. 2009-02183

The National Nuclear Security Administration (NNSA) appreciates the opportunity to review the Inspector General's (IG) draft report, *Audit Coverage of Cost Allowability for Sandia Corporation during Fiscal Years 2007 and 2008 under Department of Energy Contract No. DE-AC04-941AL8500*. I understand that this audit was initiated to determine (1) if internal controls are adequate to assure that the costs claimed by Sandia Corporation (Sandia) are allowable under the DOE contract and (2) the extent to which the IG may rely under Sandia's internal audit work.

NNSA generally agrees with the report. There is one point within the report we would like to correct. On page 2, last bullet, is factually incorrect. The Cost allowability issue related to the reference lawsuit, which was an appeal to the United States civilian board of contract Appeals (USCBCA), has been settled. NNSA and Sandia signed a settlement agreement and filed a Joint Motion to dismiss the lawsuit with the USCBCA on March 12, 2010. Funds in the amount of \$1,162,608 were not reimbursed under the contract. We recommend that this bullet be deleted from the report as well as its reiteration in the Attachment 1, third heading.

NNSA agrees with the recommendations and will take the following action:

Recommendation 1: The Sandia Site Office (SSO) Contracting Officer will make a determination of allowability of the identified questions costs; and recover disallow costs. Action is anticipated to be completed by June 2011.

Recommendation 2: The SSO Contracting Officer will determine the allowability of allocations from Lockheed to Sandia after DCAA completes its review of Home Office Expenses and DCMA negotiates a settlement. Action is anticipated to be completed by June 2012.

Recommendation 3: The SSO Contracting Officer will provide guidance to Sandia to improve its oversight of subcontractors so potentially unallowable costs are identified in a timely manner. Action is anticipated to be completed by December 2010.



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cc: Patty Wagner, Manager, Sandia Site Office  
Joann Wright, Contracting Officer  
Lloyd DeSerisy, Assistant Manager, CABM  
Sandra Mees, Contracting Officer



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