



OFFICE OF INSPECTOR GENERAL

U.S. Department of Energy

AUDIT REPORT

DOE-OIG-22-16

December 2021

**SANDIA NATIONAL LABORATORIES
SUBCONTRACT CLOSEOUT PROCESS**



Department of Energy
Washington, DC 20585

December 21, 2021

MEMORANDUM FOR THE SECRETARY AND ADMINISTRATOR, NATIONAL
NUCLEAR SECURITY ADMINISTRATION

SUBJECT: Audit Report on Sandia National Laboratories Subcontract Closeout Process

The attached report discusses our review of Sandia National Laboratories' subcontract closeout process. This report contains four recommendations that, if fully implemented, should improve subcontract management and reduce the risk of reimbursing unallowable subcontractor costs. Management concurred with Recommendations 1, 2, 3c, 3d, and 4. However, management nonconcurred with Recommendation 3a. Recommendation 3b has been removed.

We conducted this audit from October 2019 through September 2020 in accordance with generally accepted government auditing standards. We appreciated the cooperation and assistance received during this evaluation.

A handwritten signature in black ink, appearing to read "Teri L. Donaldson".

Teri L. Donaldson
Inspector General

cc: Deputy Secretary
Chief of Staff
Chief of Staff, National Nuclear Security Administration
Director, Office of Acquisition Management



**Department of Energy
Office of Inspector General
Sandia National Laboratories
Subcontract Closeout Process
(DOE-OIG-22-16)**

**WHY THE OIG
PERFORMED THIS
REVIEW**

The Department of Energy spends approximately 90 percent of its annual budget on contracts to operate its sites and acquire capital assets. However, the Department's contract management has been designated as high-risk since 1990, including both contract and subcontract management. A Sandia National Laboratories (SNL) official reported that SNL awarded over 1 million subcontracts valued at nearly \$6 billion from fiscal year 2014 through fiscal year 2019.

This audit was initiated to determine whether cost-type subcontracts issued by SNL were audited, decisions on questioned costs were fully supported, and Federal oversight provided assurance that questioned costs were properly resolved in accordance with acquisition regulations.

What Did the OIG Find?

We found that SNL misclassified and inappropriately excluded subcontracts from audit. Specifically, we found that 10 of 60 subcontracts were classified as firm-fixed-price but had flexibly-priced elements. In addition, SNL's decisions not to sustain subcontract costs questioned by its own Contract Audit office were not fully supported by appropriate and relevant evidence, clearly showing the questioned costs were allowable, allocable, and reasonable, as required. Specifically, 54 of 61 subcontract closeout records contained insufficient evidence to demonstrate why questioned costs were not sustained.

Further, we found that Federal oversight did not ensure that subcontract costs questioned by SNL's Contract Audit were resolved in accordance with requirements. Specifically, Federal staff provided minimal direct transactional oversight and instead relied heavily on the contractor to provide assurance that questioned costs were resolved in accordance with requirements.

We attributed these issues to: (1) weaknesses in the contractor's subcontract administration training, and (2) the Department of Energy Acquisition Regulation providing insufficient guidance for the Contracting Officers to protect the Department's interests by being involved timely in the resolution of costs questioned by the contractors' audits.

What Is the Impact?

Without adequate administration of its subcontracts, the Department may be reimbursing SNL for unallowable costs.

What Is the Path Forward?

To address the issues identified in this report, we made four recommendations that, if fully implemented, should improve subcontract management and reduce the risk of reimbursing unallowable subcontractor costs.

BACKGROUND

The Department of Energy is the largest civilian contracting agency in the Federal Government and spends approximately 90 percent of its annual budget on contracts to operate its scientific laboratories, engineering and production facilities, and environmental restoration sites, and to acquire capital assets. The Sandia National Laboratories (SNL) management and operating (M&O) contract, and Department of Energy Acquisition Regulation (DEAR) 970.5232–3(c), requires SNL to audit subcontractors' records, with respect to any subcontracts (including fixed-price or unit-price subcontracts), where, under the terms of the subcontract, costs incurred are a factor in determining the amount payable to the subcontractor. At SNL, subcontractors are audited by SNL's Contract Audit (Contract Audit), and subcontract audit findings, such as questioned costs, are resolved by SNL Subcontract Closeout's Subcontract Administrators. The National Nuclear Security Administration's (NNSA) Sandia Field Office oversees SNL, and the Sandia Field Office's Contracting Officers (Federal Contracting Officers) are responsible for the oversight of SNL's procurement activities, including subcontract management and subcontract closeout. In our Special Report, *Management Challenges at the Department of Energy — Fiscal Year 2020* (DOE-OIG-20-09, November 2019), we note that according to the Office of Acquisition Management, the Department's M&O contractors reported over \$1.3 billion in subcontracts during fiscal year (FY) 2019.

Since 1990, the Government Accountability Office (GAO) has designated the Department's contract management as a high-risk area. In January 2009, the GAO narrowed the focus of the Department's high-risk designation to two Department program elements, one of which was NNSA. In our Special Report, we continue to identify Contract Oversight, which encompasses both Contractor Management and Subcontract Management, as a management challenge. This report states that both the GAO and the Office of Inspector General (OIG) identified issues pertaining to the management of subcontracts, and the GAO reported that the Department did not always ensure that contractors audited subcontractors' incurred costs as required in their contracts.

Major Criteria

To reiterate, DEAR 970.5232–3(c) requires SNL to audit subcontractors' costs (including fixed-price or unit-price subcontracts), where, under the terms of the subcontract, costs incurred are a factor in determining the amount payable to the subcontractor. DEAR does not require SNL to audit firm-fixed-price (FFP) subcontracts if costs incurred are not a determining factor in the amount payable, because FFP contract types place full responsibility for all costs and resulting profit or loss on the subcontractor.

In addition, DEAR 970.5244–1 requires M&O contractors, like SNL, to determine whether subcontract costs are allowable, allocable, and reasonable in accordance with the cost principles of Title 48 Code of Federal Regulations (CFR) 31. Further, Title 48 CFR 31.201–2, *Determining Allowability*, states that a cost must comply with the terms of the contract to be allowable.

Audit Objectives

Because of the large volume and dollar value of subcontracts issued by SNL, we initiated this audit to determine:

- If SNL was auditing all of its cost-type subcontracts as required by DEAR 970.5232–3(c);
- Whether SNL’s decisions not to sustain subcontract questioned costs were fully supported by appropriate and relevant evidence in accordance with DEAR 970.5244–1 and Title 48 CFR 31; and
- How Federal oversight provided assurance that SNL resolved subcontract questioned costs in accordance with DEAR 970.5244–1 and Title 48 CFR 31.

SANDIA NATIONAL LABORATORIES MISCLASSIFIED SUBCONTRACT TYPES

We found that SNL misclassified and inappropriately excluded subcontracts from audit. Specifically, we identified 10 of 60 subcontracts (17 percent) that SNL classified as FFP but had flexibly-priced elements. These subcontracts should have been classified as flexibly-priced, not FFP, since they contained flexible elements and, therefore, the subcontracts should have been subject to audit by Contract Audit.

Criteria

DEAR 970.5232–3(c), *Audit of subcontractors’ records*, requires SNL to audit subcontractors’ costs (including fixed-price or unit-price subcontracts), where, under the terms of the subcontract, costs incurred are a factor in determining the amount payable to the subcontractor. In addition, Federal Acquisition Regulation (FAR) 52.230–6, *Administration of Cost Accounting Standards*, defines fixed-price subcontracts as those subcontracts where the price is not adjusted or based on actual costs incurred. These Standards define flexibly-priced subcontracts as those subcontracts where the price may be adjusted based on actual costs incurred. Further, FAR 16.202–1 states that an FFP contract provides for a price that is not subject to any adjustment on the basis of the contractor’s cost experienced in performing the contract. Finally, FAR 30.001 states that flexibly-priced contracts include, among others, certain fixed-price subcontracts. Because the contractor’s payments may be adjusted, flexibly-priced contracts typically do not provide incentives to the contractor for cost control or labor efficiency and are considered higher risk. The proper classification of subcontract types relies on trained and experienced procurement personnel.

SNL’s Procurement Policy and Resource Guide 102, *Impacting Subcontract Type and Pricing Arrangement Selection*, provides guidance to help SNL Subcontracting Professionals select the appropriate contract type for the procurement action. According to the Resource Guide, FFP contracts should be selected when the negotiated price is based on a unit of product or measure, a lot of product or material, a lump sum for total subcontract performance, an attainment of milestones, or work phases. Per FAR, the FFP contract type places full responsibility for all

costs and resulting profit or loss on the contractor. It also provides maximum incentive for the contractor to control costs and perform effectively. As a result, DEAR does not require SNL to audit FFP subcontracts.

Additionally, FFP contracts have the lowest administrative burden when compared to other contract types. As such, FFP subcontracts were SNL's preferred method of subcontracting according to SNL's Resource Guide 102, which specifically states, "The use of FFP arrangements is preferred above all other pricing types."

In short, any contract or subcontract with a flexibly-priced component should be characterized as a flexibly-priced contract. This flexibly-priced component could be in the form of a variation in quantity or a variation in unit-price. Failing to adhere to this standard exposes the contractor, and by extension, the Government, to improper and/or inefficient spending.

Condition Details

From FY 2014 through FY 2019, SNL awarded 641,603 subcontracts, valued at nearly \$4 billion and classified as FFP. Of these, we found 27,745 of the subcontracts classified as FFP, with a combined value of \$1.3 billion, had revisions that changed the award value. We focused our review on these 27,745 subcontracts classified as FFP due to the increased risk that the revisions may have introduced a variable pricing aspect to the subcontract. From these 27,745 FFP subcontracts, we judgmentally sampled¹ 60, valued at approximately \$150 million, for review. Based on our analysis, we found that 10 of the 60 subcontracts classified as FFP, valued slightly over \$33 million, were not performing as FFP subcontracts.

The GAO's OIG² and the Defense Contract Audit Agency³ (DCAA) identified similar issues with the misclassification of subcontracts at other sites. The GAO OIG report explains that contracts can be categorized as FFP or flexibly-priced contracts. FFP contracts generally are not subject to price adjustments based on actual costs the contractor incurs, and flexibly-priced contracts are considered higher risk because the price may be adjusted based on actual costs or hours incurred. Further, flexibly-priced contracts typically do not provide incentives to the contractor for cost control or labor efficiency and are considered higher risk. Due to these inherent risks, FAR emphasizes the need for appropriate oversight by the Government, including a detailed review of contractor invoices and supporting documentation during contract performance. Similarly, the DCAA report on a Department prime contractor found that the contractor did not classify FFP and flexibly-priced subcontracts correctly. Specifically, the DCAA report identifies subcontracts with costs based on actual hours worked, travel expenses incurred, and estimated quantities, which should have been classified as flexibly-priced subcontracts because no firm value was determined. In addition, DCAA reports that subcontracts with quantities impacting the cost incurred, where the quantities were estimated (not fixed), should also have been classified as flexibly-priced. For example, DCAA reports that

¹ Because we judgmentally, versus statistically, selected this sample, the results of the sample cannot be extrapolated to the entire population.

² GAO Report: OIG-18-5 (August 2018).

³ DCAA Report No. 4281-2018D17900001 (June 2018).

for one subcontract, the price was calculated by the actual quantities times the unit-price, which resulted in actual costs (actual quantities * unit-price = actual cost = subcontract price). The price of a truly FFP subcontract should not be affected or changed by the actual quantities incurred.

For each subcontract in our sample, we reviewed the subcontract documents to determine whether the subcontract functioned as an FFP or as a flexibly-priced subcontract. Of the 60 subcontracts classified as FFP that we reviewed, we found 10 subcontracts (17 percent) were not functioning as an FFP because of flexibly-priced elements in the subcontracts. For example, we found:

- A subcontract to procure cell phone equipment and service was awarded as an FFP subcontract. However, while the subcontract had a fixed rate established for calling minutes and text messages, there was no firm predetermined quantity of cell phone minute or text message usage established in the subcontract. Instead, the costs to SNL varied each billing cycle based on the quantity of cell phone minutes used and text messages sent by end users. The inclusion of these variable costs, which needed to be reviewed and verified by SNL, was inconsistent with FFP principles.
- A subcontract to provide acute care, an international travel clinic, occupational medicine, and drug testing laboratory collection services at SNL was awarded as an FFP subcontract. However, the costs associated with this subcontract were based on the level of effort hours, or work hours, of subcontracted personnel, which varied over a 4- to 6-week period. This required SNL to assign resources to determine subcontractor work hours needed and to monitor the total labor costs, which varied based on the fluctuating quantity of service hours provided. The inclusion of these variable elements, which needed to be reviewed and verified by SNL, was inconsistent with FFP principles.

While these subcontracts had fixed elements, at least one element was not fixed. Since there were flexibly-priced elements in 10 of 60 subcontracts classified as FFP, these subcontracts were no longer functioning as FFP subcontracts. As a result, these improperly excluded subcontracts were not provided to Contract Audit and subject to DEAR 970.5232-3(c).

All flexibly-priced subcontracts, as defined in FAR 52.230-6, are subject to audit. However, if the contract type is misclassified as FFP, the costs incurred are not subject to audit; the subcontractor's books and records are not available for review in accordance with FAR 52.215-2, *Audits and Records – Negotiation*; and the costs incurred may not be in compliance with FAR 31, *Contract Cost Principles and Procedures*. As stated in FAR 52.215-2(b), *Examination of Costs*:

If this is a cost-reimbursement, incentive, time-and-materials, labor-hour, or price redeterminable contract, or any combination of these, the Contractor shall maintain and the Contracting Officer, or an authorized representative of the Contracting Officer, shall have the right to examine and audit all records and other evidence sufficient to reflect properly all costs claimed to have been incurred or anticipated to be incurred directly or indirectly in performance of this contract. This right of examination shall include

inspection at all reasonable times of the Contractor's plants, or parts of them, engaged in performing the contract.

DECISIONS NOT TO SUSTAIN QUESTIONED COSTS LACKED SUPPORT

We found that SNL's decisions not to sustain subcontract costs questioned by Contract Audit were not fully supported as required by DEAR 970.5244-1 and Title 48 CFR 31. Specifically, we found that SNL's subcontract closeout records did not have sufficient, appropriate, and relevant evidence to demonstrate that the costs questioned by Contract Audit were actually allowable, allocable, and reasonable, per the subcontract terms in 54 of 61 closeout records sampled (89 percent) in which questioned costs were not sustained.

Criteria

DEAR 970.5244-1 requires M&O contractors, like SNL, to determine whether subcontract costs were allowable, allocable, and reasonable for cost-type subcontracts in accordance with the cost principles of Title 48 CFR 31. Further, Title 48 CFR 31.201-2, *Determining Allowability*, states that a cost must comply with the terms of the contract to be allowable. In addition, a contractor is responsible for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed comply with applicable cost principles. The Contracting Officer may disallow all or part of a claimed cost that is not adequately supported.

Department Order 243.1B, *Records Management Program*, defines adequate and proper documentation as documentation that is complete and accurate to the extent required to document decisions and essential transactions, and is designed to furnish the necessary information to protect the legal and financial rights of the Government. According to SNL Procurement Policy 501, *Subcontract Closeout*, the closeout process is required for all cost-type subcontracts that have been audited by Contract Audit.

Condition Details

At SNL, the decisions on whether to sustain or not sustain a Contract Audit questioned cost was performed during the subcontract closeout process by SNL Subcontract Closeout's Subcontract Administrators. Once Contract Audit performed the subcontract audit and issued a report, a closeout record was generated for each audited subcontract. Each closeout record was assigned to a Subcontract Administrator who was responsible for the resolution of any questioned costs identified by Contract Audit, as well as the completion of the closeout record. In addition to the Subcontract Administrator, the subcontract closeout process involved those charged with the day-to-day administration of the subcontract and other procurement officials. At SNL, the Subcontracting Professionals determined the subcontract type, awarded the subcontract, and administered the subcontract with the help of Sandia Delegated Representatives (SDRs). The SDRs were not procurement professionals but instead were generally technical staff who worked in the program area. The SDRs typically handled the day-to-day interaction with the subcontractors and reviewed and approved invoices. In addition, the Subcontract Administrators worked with the Subcontracting Professionals and SDRs to provide information and evidence on whether Contract Audit's identified questioned costs were allowable, allocable, and reasonable.

From FY 2014 through FY 2019, SNL processed 27,583 closeout records of which only 3,250⁴ closeout records had costs questioned by Contract Audit. Since our focus was on SNL's decisions not to sustain questioned costs, we further refined our universe to the 263 closeout records where questioned costs were not sustained. We judgmentally selected a sample⁵ of 61⁶ of the 263 closeout records to review. We found that 54 of the 61 sampled records (89 percent) with \$2,093,155 in questioned costs did not have sufficient, appropriate, and relevant evidence to demonstrate that the costs questioned by Contract Audit were, in fact, allowable, allocable, and reasonable. For example, we found:

- A closeout record where Contract Audit questioned \$120,326 in costs related to unsupported labor charges and associated travel costs, but SNL sustained \$0. Specifically, the subcontractor did not follow SNL's instruction for maintaining timecards and, therefore, could not provide any supporting documentation, as explicitly required by the subcontract terms, to support that the costs were allowable at the time of the audit. Thus, the subcontractor was unable to establish that any of the labor costs and associated travel were allowable per FAR. While an email in the subcontract closeout file stated the invoices had been reviewed, the closeout record did not contain any other documentation to support the review. Instead, the closeout record simply contained a statement that the SDR attested to having reviewed the hours worked without any evidence to support the SDR's review.
- A closeout record where Contract Audit questioned \$5,318 in costs related to charges incurred outside of the subcontract's period of performance, and SNL sustained \$0. Specifically, the costs questioned by Contract Audit were incurred prior to the subcontract's period of performance start date of October 24, 2012. According to the closeout record, the SDR incorrectly thought the subcontractor's prior contract was still in effect and, therefore, the costs were within the period of performance. The support for not sustaining all of the questioned costs was emails that stated the SDR authorized the work due to extenuating circumstances. However, given the SDR indicated that he was not even aware that the subcontract was outside the period of performance, we question what extenuating circumstances existed at the time the SDR authorized the work. In response to Contract Audit's finding, the subcontractor offered to split the questioned cost amount with SNL. Instead, SNL chose not to sustain any of the questioned costs (i.e., not to recover any of the questioned costs).

⁴ We initially identified 3,429 total closeout records that had \$11,195,547 (absolute value) of costs questioned by Contract Audit. Due to ongoing investigations by the OIG's Office of Investigations, we excluded 179 of the 3,429 closeout records from the list of closeout records with questioned costs, leaving 3,250 closeout records. The 3,250 closeout records had \$11,116,157 (absolute value) of costs questioned. We used the absolute value of questioned costs because Contract Audit questioned costs both in favor of the subcontractor (i.e., positive questioned costs) and SNL (i.e., negative questioned costs). Using the net value of questioned costs would not provide a clear picture of the total amount of costs that were questioned by Contract Audit.

⁵ Because we judgmentally, versus statistically, selected this sample, the results of the sample cannot be extrapolated to the entire population.

⁶ Our sample of 61 closeout records had \$6,056,488 (absolute value) of costs questioned by Contract Audit and \$5,395,455 of these questioned costs had not been sustained. One closeout record had questioned costs with an absolute value of \$2,916,326 of which \$2,573,270 was not sustained. Since the subcontract had been modified to address the questioned cost, we did not include this record in our 54 records that did not have adequate evidence.

- A closeout record where Contract Audit questioned \$20,100 in costs due to the subcontractor not following the terms and conditions of the subcontract, but SNL sustained \$0. Specifically, the subcontract explicitly prohibited the subcontractor to further subcontract out the work. However, despite the subcontract's terms, 100 percent of the work was further subcontracted to another company. The only support in the subcontract closeout record for not sustaining the Contract Audit questioned costs was an email from the SDR stating that SNL received benefit and that the costs were allowable, allocable, and reasonable. There was no corroborating evidence supporting that the cost principles of allowability, allocability, and reasonableness were met. The Contract Audit report associated with this closeout record also included 14 other closeout records in our sample where the documentation supporting the decision not to sustain Contract Audit's findings were identical. The total questioned costs for all 15 closeout records were \$337,378 of which SNL sustained \$0.

Given the lack of appropriate and relevant evidence for the 54 subcontracts in our sample to demonstrate that costs questioned by Contract Audit were allowable, allocable, and reasonable, we are questioning \$2,093,155 in subcontract costs questioned by Contract Audit that were not sustained by SNL.

FEDERAL OVERSIGHT DID NOT ENSURE THAT QUESTIONED COSTS WERE RESOLVED APPROPRIATELY

We found that Federal oversight did not ensure that subcontract costs questioned by SNL's Contract Audit were resolved in accordance with DEAR 970.5244-1 and Title 48 CFR 31. Specifically, we found that the Federal Contracting Officers provided minimal direct transactional oversight and instead relied heavily on the contractor's self-assurance that questioned costs were resolved in accordance with requirements. However, the reports SNL provided to its Federal overseers on resolution of questioned costs did not include enough information on which to base an independent assessment of SNL's resolution decisions. For example, the Federal Contracting Officer required a quarterly subcontract closeout report as part of the Federal Contracting Officer's approval of SNL's Purchasing System. However, the quarterly report generally focuses on closeout records in process and not on the decisions SNL made in response to Contract Audit's findings.

Criteria

DEAR 970.5244-1 states:

The Contractor shall develop, implement, and maintain formal policies, practices, and procedures to be used in the award of subcontracts consistent with this clause and 48 CFR subpart 970.44. The Contractor's purchasing system and methods shall be fully documented, consistently applied, and acceptable to the [Department] in accordance with 48 CFR 970.4401-1. The Contractor shall maintain file documentation which is appropriate to the value of the purchase and is adequate to establish the propriety of the transaction and the price paid.

It goes on to state that the Department will conduct periodic appraisals of the Contractor's management of all facets of the purchasing function, including the Contractor's compliance with its approved system and methods. It also states that the responsibility to determine the costs allowable under each cost-reimbursement subcontract remains with the Contractor or next higher-tier subcontractor. However, it further states that the Contractor shall provide, in appropriate cases, for the timely involvement of the Contractor and the Contracting Officer in resolution of the subcontract cost allowability. It does not provide a definition or description of what is meant by "appropriate cases."

Condition Details

Federal oversight did not ensure that subcontract questioned costs, identified by Contract Audit, were resolved by SNL in accordance with requirements. Specifically, the Federal Contracting Officers relied heavily on SNL to self-assess and provide assurance that subcontract questioned costs were resolved in accordance with the requirements. However, the reports provided by the contractor did not include enough information on which to base an independent assessment of SNL's resolution decisions. For example, the Federal Contracting Officer required a quarterly subcontract closeout report as part of the Federal Contracting Officer's approval of SNL's Purchasing System. However, the quarterly report generally focuses on closeout records in process and not on the decisions SNL made in response to Contract Audit's findings.

In addition, the Federal Contracting Officers also received the Annual Summaries of Contract Audit Observations, which included the procurement officials' responses to Contract Audit's summary of its findings. While these summaries provide a description of Contract Audit's findings, they did not always include the associated subcontract numbers, the amount of questioned costs, or information on the resolution of the questioned costs. Our analysis of procurement's responses in the Annual Summaries of Contract Audit Observations revealed that responses were often simply a statement that Contract Audit's findings were isolated and did not warrant corrective action. A Federal Contracting Officer told us that she did not think it was necessary to follow up with SNL based on the information provided in individual Annual Summaries of Contract Audit Observations but instead waited until she had 3 years' worth of data to analyze for trends before determining what followup was needed, if any. The Federal Contracting Officer provided us with her analysis of the three Annual Summaries of Contract Audit Observations and noted that some of the issues dismissed by SNL's procurement officials as isolated were, in fact, recurring issues.

We commend the Federal Contracting Officer for performing this analysis and identifying what appeared to be systemic issues that were not properly identified by SNL procurement officials. However, the fact that neither the quarterly report nor the Annual Summaries of Contract Audit Observations include detailed information on Contract Audit's questioned costs and SNL's resolution decisions resulted in the Federal Contracting Officer receiving insufficient information from SNL to determine whether there were problems related to SNL's resolution of questioned cost decisions.

Based on issues that the Federal Contracting Officer identified during oversight activities and issues we identified during our review, the Federal Contracting Officers changed the reporting

requirements for SNL related to the subcontract closeout process. These changes added new reporting requirements meant to provide more targeted information and reduce the amount of time the Federal Contracting Officers spent on fact-finding or further research. For example, one of the new requirements included briefings to the Sandia Field Office when subcontract questioned costs greater than \$25,000 were not sustained. We recognize and appreciate that the Federal Contracting Officers were working to improve the information provided by SNL, and we encourage them to continue refining the requirements with SNL to find the right type and amount of information for effective oversight of all aspects of SNL's subcontract processes.

The reason we concluded that additional refinement of oversight needs to continue is we noticed anomalies that the Federal Contracting Officers were not aware of despite the information they received from SNL. For example, we noticed that SNL's sustainment rates varied significantly. Specifically, when Contract Audit questioned costs in favor of subcontractors (i.e., SNL owed money to subcontractors) and the subcontractor agreed with the questioned amount, SNL sustained 99 percent of the questioned costs. When Contract Audit questioned costs in favor of SNL (i.e., subcontractors owed money to SNL), and the subcontractor disagreed with the questioned amount, SNL sustained only 25 percent of the questioned costs. However, the most surprising sustainment rate was when Contract Audit questioned costs in favor of SNL, and the subcontractor agreed with the questioned amount. Given Contract Audit questioned whether the costs were not allowable, allocable, or reasonable, and the subcontractor agreed with the Contract Audit's findings, we would have expected the sustainment rate to be close to 100 percent. Surprisingly, the actual sustainment rate for this category was only 68 percent. The Federal Contracting Officers were unaware of this situation until we brought it to their attention.

WEAKNESSES IDENTIFIED IN TRAINING AND GUIDANCE

The issues identified above occurred because of weaknesses in SNL subcontract administration training and a lack of clarity in DEAR 970.5244-1 to ensure that the Department's Contracting Officers were involved timely in the resolution of Contract Audit questioned costs. Specifically:

- The SDR position did not require any specific education, experience, or certifications other than the completion of SNL's *SDR Roles and Responsibilities* training module.
- Subcontract Administrators working on the Closeout Team were not required to take job-specific training that covered the cost principles of allowability, allocability, and reasonableness. In addition, Subcontract Administrators were not required to have any contracting experience prior to their appointment to compensate for this lack of training.
- SNL identified learning opportunities for Subcontracting Professionals during its Team Evaluation and Approval Meeting Review Process, but due to repeat findings, it appears that the corrective actions taken may be ineffective.
- DEAR 970.5244-1 lacks clarity on when the Department's Contracting Officer should be involved in the resolution of subcontract cost allowability.

Sandia Delegated Representatives Had Insufficient Training

According to SNL officials, the SDR position did not require any specific education, experience, or certifications other than the completion of SNL's *SDR Roles and Responsibilities* training module. Per SNL officials, this training module was significantly updated in April 2018 in response to the 2016 SNL Internal Audit⁷ report, *SDR and Requester Roles and Responsibilities*, which identifies issues with SDR subcontract management. Specifically, the 2016 Internal Audit report, *SDR and Requester Roles and Responsibilities*, identifies several issues, which include SDRs not understanding or appropriately performing their responsibilities for monitoring the performance of subcontracts. For example, Internal Audit found that SDRs had not always ensured that: (1) suppliers invoiced for costs in accordance with contract terms; (2) goods and services were purchased or delivered within the specified time period per the contract terms; or (3) invoices contained a sufficient level of detail or contractually required information. In response to Internal Audit, SNL: (1) performed a root cause analysis; (2) implemented 21 corrective actions; and (3) performed deep-dive self-assessments on 3 of the 21 corrective actions to validate the effectiveness of those actions.

However, per SNL officials, the 3,491 SDRs were only required to complete the training on a 2-year cycle. Therefore, it would take 2 years for all the SDRs to receive any updated training. We found that 2,999 of 3,491 SDRs had taken the SDR training since May 2018. We also found that 381 of the remaining 492 SDRs had not maintained the 2-year retraining interval as required. Given the significant updates made to the training in response to issues identified by SNL's own Internal Audit group, we question the value of not requiring the SDRs to take the updated training sooner than the standard 2-year retraining interval.

In its April 2020 validation assessment report, SNL concluded that the corrective actions were effective and had significantly improved the conditions noted in the 2016 Internal Audit report. According to an SNL official, Internal Audit planned to perform a validation audit in FY 2020 or FY 2021 to assess whether the actions SNL took prevented recurrence of the identified issues.

In our review of closeout records, we found examples of SDRs inappropriately directing suppliers to work outside the subcontract's period of performance and approving invoices for charges not in accordance with subcontract terms and conditions. Based on our observations, it appears that rather than penalize a subcontractor for an SDR mistake, SNL would not sustain Contract Audit identified questioned costs associated with the SDR's inappropriate actions. In addition, although SNL may have decided not to penalize subcontractors for SNL employees' errors, its business decision does not make these questioned subcontract costs reimbursable to SNL by the Department.

⁷ SNL Internal Audit conducts audits on business and information technology operations whereas Contract Audit conducts subcontract audits, subcontractor accounting system reviews, and cost price analyses. Both Internal Audit and Contract Audit are part of SNL's Independent Audit organization.

Subcontract Administrators Lacked Training and Contracting Experience

According to SNL officials, Subcontract Administrators working in Subcontract Closeout were not required to take job-specific training that covered the cost principles of allowability, allocability, and reasonableness. In addition, Subcontract Administrators were not required to have any contracting experience prior to their appointment to compensate for this lack of training. According to SNL officials, Subcontract Administrators received on-the-job training, and the officials considered SNL's Resource Guide 501, *Subcontract Closeout*, to be a training manual. SNL officials also stated that managers might require Subcontract Administrators to take the "New Buyer Training," which included cost price analysis. However, decisions on whether to sustain questioned costs were not made by the Subcontract Administrators alone.

When a Subcontract Administrator is in the process of resolving Contract Audit's questioned cost, Resource Guide 501 directs the Subcontract Administrator to email the subcontract's SDR asking the SDR if SNL received benefit from the services provided by the subcontractor and if the costs of the services were allowable, allocable, and reasonable. If the questioned costs that were not sustained were greater than \$25,000, the Subcontract Administrator's decision is reviewed by a manager. For some items in our sample, the email between the Subcontract Administrator and the SDR was the only evidence in the subcontract closeout record to support the decision not to sustain the questioned costs. Although SDRs told the Subcontract Administrators that the costs were allowable, allocable, and reasonable, we question whether the SDRs or the Subcontract Administrators fully understood these cost principles. For example, Contract Audit questioned costs of labor hours claimed in excess of 40 hours per week because the subcontract terms stated no hours in excess of 40 hours per week were allowed. The Subcontract Administrator emailed the subcontract's SDR to ask if SNL received benefit from the subcontractor-provided service and if the subcontractor-billed costs were allowable, allocable, and reasonable.⁸ In the SDR's email response to the question on allowability, the SDR stated that there was an "awful lot of legal talk" before explaining that while the contract stated no overtime, the work charged was in accordance with the "intent" of the contract. Again, per Title 48 CFR 31.201-2, *Determining Allowability*, a cost must comply with the terms of the contract to be allowable, not the undocumented and undefined intent.

Subcontracting Professionals Training Was Ineffective

SNL identified learning opportunities for Subcontracting Professionals during its Team Evaluation and Approval Meeting Review process. Specifically, the Team Evaluation and Approval Meeting Review report from FY 2013 through FY 2015 identifies that Subcontracting Professionals "do not read or understand the [subcontract's] Statements of Work and do not justify the price adequately" as recurring issues. According to SNL's Resource Guide 102, *Impacting Subcontract Type and Pricing Arrangement Selection*, "The choice of which type of contract to use is dependent upon the nature of the work and the specificity with which the Statement of Work can be defined." The Team Evaluation and Approval Meeting Reviews were a quality control activity intended to identify issues of subcontract noncompliance with

⁸ The email from the Subcontract Administrator to the SDR included language defining the cost principles of allowability, allocability, and reasonableness.

requirements before the subcontracts were issued. However, these same issues continued in the Subcontract File Reviews, which served as a quality control activity on subcontracts that had been awarded. Our review of the Subcontract File Reviews identified that the same problems remained in documentation, along with cost and pricing data, despite SNL identifying the issue 7 years earlier. Our finding brings into question the effectiveness of SNL’s recommendations for control or process improvements to mitigate recurring issues.

DEAR Provides Insufficient Guidance for the Department’s Contracting Officers

DEAR 970.5244–1, *Contracting Purchasing System*, lacks clarity on when the Department’s Contracting Officer should be involved in the resolution of subcontract cost allowability. Specifically, DEAR 970.5244–1(e)(2), states:

Responsibility for determining the costs allowable under each cost-reimbursement subcontract remains with the Contractor or next higher-tier subcontractor. The Contractor shall provide, in appropriate cases, for the timely involvement of the Contractor and the [Department] Contracting Officer in resolution of subcontract cost allowability.

DEAR lacks clarity in defining what it means by “appropriate cases” in which the Department’s Contracting Officer(s) should be involved. The inclusion of “appropriate cases” indicates there are circumstances in which the Department’s Contracting Officer(s) involvement is expected; however, DEAR provides no indication as to those circumstances in which the Contractor, or SNL in this case, needs to involve the Department’s Contracting Officer. Also, DEAR appears to suggest that “appropriate cases” is defined by the Contractor rather than the Department. However, we found no definition of “appropriate cases” in SNL’s approved purchasing system.

INCREASED RISK OF REIMBURSING UNALLOWABLE COSTS

The Department might have reimbursed SNL for unallowable costs. Specifically, because: (1) SNL had not always properly classified subcontracts and, as a result, had not been auditing all of its subcontracts, and (2) SNL’s decisions not to sustain subcontract questioned costs identified by Contract Audit were not fully supported by appropriate and relevant evidence, the Department lacked assurance that only allowable costs were reimbursed to SNL. In addition, we found that Federal oversight did not ensure that subcontract questioned costs identified by Contract Audit were resolved in accordance with requirements. As a result of these issues, the Department might have reimbursed SNL for unallowable costs associated with over \$5.8 million in subcontract questioned costs, identified by Contract Audit from FY 2014 through FY 2019, which were not sustained.

OTHER MATTERS

In April 2021, the OIG issued a Special Project Report on *The Transition to Independent Audits of Management and Operating Contractors’ Annual Statements of Costs Incurred and Claimed* (DOE-OIG-21-26, April 2021), highlighting its concerns with the effectiveness of the Cooperative Audit Strategy in providing adequate audit coverage of contractors’ costs. The

report recommends that the OIG and the Department transition to an independent audit strategy due to identified systemic threats to auditor independence; the increased likelihood of fraud, waste, and abuse; significant lapses in the audits of subcontracts; and other major deficiencies. Results of this audit were included in the Special Project Report and informed the report's recommendations regarding the transition to an independent audit strategy. Given the cessation of the OIG's reliance on contractor performed incurred cost audits, we excluded any recommendations regarding necessary improvements in the incurred cost auditing processes identified in this audit.

RECOMMENDATIONS

To improve SNL's subcontract management, we recommend that the Federal Contracting Officers:

1. Assess the revised reporting requirements and continue to refine the requirements, as needed, to increase the Federal Contracting Officer's knowledge of SNL's subcontract closeout decisions.
2. Determine the allowability of the \$2,093,155 in subcontract questioned costs since FY 2014.
3. Direct SNL to:
 - a. Develop a corrective action plan to ensure that subcontracts are properly classified consistent with the FAR definitions, to include recognition of other types of fixed-price contracts.
 - b. The recommendation to ensure subcontracts containing flexibly-priced elements are included in the universe subject to audit in accordance with DEAR has been removed due to the OIG no longer relying on M&O contractor-performed incurred costs audits. For a detailed discussion for removal of this recommendation, please see "Other Matters" on page 12.
 - c. Implement corrective actions to make improvements in the determination of: (1) cost allowability, allocability, and reasonableness; (2) the appropriate contract type for the procurement; and (3) sufficient documentation for not sustaining audited questioned costs.
 - d. Complete Internal Audit's planned validation audit on the SDR's roles and responsibilities.

In addition, to reduce the risk of the Department reimbursing unallowable subcontractor costs, we recommend that the Director, Office of Acquisition Management:

4. Direct the Office of Policy to clarify DEAR to ensure that the Department's Contracting Officers are involved timely in the resolution of subcontractor questioned costs.

MANAGEMENT RESPONSE

In response to our re-issued Official Draft, management acknowledged the removal of Recommendation 3b but informed us that it did not wish to revise its original comments. Management concurred with Recommendations 1, 2, 3c, 3d, and 4. However, management nonconcurred with Recommendation 3a. As stated above, Recommendation 3b has been removed. In addition, management pointed out that the costs questioned in this report represented approximately 0.033 percent of Sandia's incurred subcontract costs over the audit period. Finally, management asserted that the report misinterpreted DEAR 970.5232-3(c) as it relates to flexibly-priced subcontracts and requested that the report be modified to be consistent with NNSA's legal interpretation of the DEAR clause.

Management comments are included in Appendix 4.

AUDITOR COMMENTS

Management's proposed corrective actions for Recommendations 1, 2, 3c, 3d, and 4 were generally responsive to our recommendations.

Management nonconcurred with Recommendation 3a, asserting that the report did not provide sufficient evidence to conclude that the M&O contractor is not in compliance with DEAR 970.5232-3(c) and that the examples in the report misinterpret the requirement triggering audit of subcontracts. However, as indicated in the Other Matters section of our report, given the cessation of the OIG's reliance on contractor performed incurred cost audits, we excluded any recommendations regarding necessary improvements in the incurred cost auditing processes identified in this audit. Recommendation 3a remained in the report because we identified 10 of 60 subcontracts that SNL classified as FFP but had flexibly-priced elements. Therefore, these subcontracts should have been classified as flexibly-priced, not FFP, since they contained flexible elements. Proper categorization of contract types is important since it ensures the proper level of oversight. Specifically, as explained in our report, in FFP, costs incurred are not a determining factor in the amount payable because FFP contract types place full responsibility for all costs and resulting profit or loss on the subcontractor. Therefore, these contract types pose the lowest level of risk to the Government and require the lowest level of oversight. When subcontracts with flexibly-priced elements are improperly classified in the system as FFP, oversight may not be commensurate with actual level of risk. As a result, we stand by our findings and continue to assert that implementing Recommendation 3a is necessary.

Further, management's statement that the costs questioned in this report represent approximately 0.033 percent of incurred subcontract costs over the audit period is misleading since it misrepresents the subject of our audit. Specifically, as noted in our report, the focus of our audit was SNL's decisions on whether to sustain or not sustain Contract Audit's questioned costs during the subcontract closeout process. Therefore, the total incurred subcontract costs were outside this audit's scope and objective. Using that figure for analysis would only result in misleading conclusions. Staying within our scope, the total value of costs questioned by Contract Audit for the subcontracts closed during the audit period was \$11,116,157, of which we

questioned \$2,093,155. Therefore, in the context of this review, the costs questioned represent approximately 19 percent of Contract Audit's questioned costs.

Appendix 1: Objective, Scope, and Methodology

OBJECTIVE

We initiated this audit to determine:

- If Sandia National Laboratories (SNL) was auditing all of its cost-type subcontracts as required by Department of Energy Acquisition Regulation 970.5232–3(c);
- Whether SNL’s decisions not to sustain subcontract questioned costs were fully supported by appropriate and relevant evidence in accordance with Department of Energy Acquisition Regulation 970.5244–1 and Title 48 Code of Federal Regulations 31; and
- How Federal oversight provided assurance that SNL resolved subcontract questioned cost in accordance with Department of Energy Acquisition Regulation 970.5244–1 and Title 48 Code of Federal Regulations 31.

SCOPE

This audit was conducted from October 2019 through September 2020 at SNL in Albuquerque, New Mexico and covered firm-fixed-price (FFP) subcontracts awarded from fiscal year (FY) 2014 through FY 2019 and all closeouts completed from FY 2014 through FY 2019. This audit was conducted under Office of Inspector General project number A19LA050.

METHODOLOGY

To accomplish our audit objectives, we:

- Reviewed applicable policies, procedures, laws, regulations, and contract requirements relevant to our audit objectives.
- Obtained from SNL all FFP subcontracts awarded from FY 2014 through FY 2019.
- Selected a judgmental sample of 60 of 27,745 FFP subcontracts awarded from FY 2014 through FY 2019 with revisions that changed the subcontract value. Since we were testing for existence, a nonstatistical sample design was selected due to the otherwise large minimum population size required to satisfy statistical materiality. Sample selection was stratified based on such factors as: (1) subcontracts with the largest percentage of dollar increase as a result of revisions; (2) subcontracts with the largest dollar increase as a result of revisions; (3) subcontracts with the greatest number of revisions; (4) subcontracts with an award value of \$0; (5) subcontracts with an award dated after the subcontract’s period of performance had ended; and (6) subcontracts with an award dated after the subcontract’s period of performance had begun, and the award date was in a different FY. Because selection was based on a judgmental or nonstatistical sample, results and overall conclusions are limited to the items tested and cannot be projected to the entire population or universe of FFP subcontracts.

Appendix 1: Objective, Scope, and Methodology

- Obtained all closeout records from SNL that were completed from FY 2014 through FY 2019.
- Selected a judgmental sample of 61 closeout records from the universe of 263 closeout records completed from FY 2014 through FY 2019 in which subcontract costs questioned by SNL's Contract Audit were not sustained. A nonstatistical sample design was chosen because of the relatively small size of the universe. Sample selection was stratified based on such factors as: (1) closeout records in which the subcontract questioned costs not sustained were \$25,000 or more; (2) closeout records in which less than 50 percent of the subcontract questioned costs were sustained; and (3) closeout records in which 50 percent or more of the subcontract questioned costs were sustained. Because selection was based on a judgmental or nonstatistical sample, results and overall conclusions are limited to the items tested and cannot be projected to the entire population or universe of closeout records where subcontract costs questioned were not sustained.
- Reviewed FFP subcontract files to determine if flexible elements were added to the subcontracts.
- Reviewed subcontract closeout records for documentation supporting SNL's decisions not to sustain subcontract costs questioned by SNL's Contract Audit.
- Assessed the reliability of subcontract data and the closeout records data by: (1) reviewing prior assessments of the systems; (2) tracing the selected samples to the source documents (subcontract files and closeout files); and (3) interviewing SNL procurement officials knowledgeable about the data. We determined that the data was sufficiently reliable for the purposes of this report.
- Reviewed SNL's process for not sustaining costs questioned by SNL's Contract Audit.
- Reviewed SNL's process for monitoring subcontracts.
- Determined the roles, qualifications, and training requirements of SNL's Subcontract Administrators, Subcontracting Professionals, and Sandia Delegated Representatives.
- Reviewed Sandia Field Office's policies and activities, evaluated the quality of information SNL provided to the Sandia Field Office in quarterly reports, and determined the Sandia Field Office's level of oversight of SNL's subcontract costs.
- Interviewed key personnel at SNL, the Sandia Field Office, and the National Nuclear Security Administration.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We assessed internal controls and

Appendix 1: Objective, Scope, and Methodology

compliance with laws and regulations necessary to satisfy the audit objective. In particular, we assessed the internal control components and underlying principles significant to the audit objective (Appendix 2). However, because our review was limited to these internal control components and underlying principles, it may not have disclosed all internal control deficiencies that may have existed at the time of this audit. Finally, we relied on computer-processed data to some extent to satisfy our objectives on FFP classification and on the sustainment of subcontract questioned costs. We assessed the reliability of our two data sets, as appropriate, by reviewing source documents and conducting interviews. We determined that the data was sufficiently reliable.

We held an exit conference with management officials on October 12, 2021.

Appendix 2: Internal Control Components and Principles Assessed

AUDIT OBJECTIVES

- 1) To determine if Sandia National Laboratories was auditing all of its cost-type subcontracts as required by Department of Energy Acquisition Regulation 970.5232–3(c).
- 2) To determine whether Sandia National Laboratories’ decisions not to sustain subcontract questioned costs were fully supported by appropriate and relevant evidence in accordance with Department of Energy Acquisition Regulation 970.5244–1 and Title 48 Code of Federal Regulations 31.
- 3) To determine how Federal oversight provided assurance that Sandia National Laboratories resolved subcontract questioned costs in accordance with Department of Energy Acquisition Regulation 970.5244–1 and Title 48 Code of Federal Regulations 31.

We assessed the following internal control components and underlying principles significant to the audit objective:

Internal Control Component	Internal Control Principle
Control Environment	Exercise Oversight Responsibility
	Establish Structure, Responsibility, and Authority
	Demonstrate Commitment to Competence
Control Activities	Design Control Activities
	Implement Control Activities
Information and Communication	Communicate Externally
Monitoring	Perform Monitoring Activities

Office of Inspector General

- Special Report on [*Management Challenges at the Department of Energy — Fiscal Year 2020*](#) (DOE-OIG-20-09, November 2019). The report disclosed what the Office of Inspector General (OIG) considers to be the most significant management challenges facing the Department of Energy. The OIG's goal is to focus attention on significant issues with the objective of working with Department managers to enhance the effectiveness of agency programs and operations. Based on the results of the OIG's body of work over the past year, the management challenges list for fiscal year 2020 remains largely consistent with that of the previous year. These challenges include Contract Management, as oversight of the Department's contracts is necessary to ensure that contractors meet the established requirements, from contract award through completion or termination. The goal of effective contract oversight is to ensure that the Government receives procured products and services, and the public interest is effectively protected. The OIG's investigative work and referrals to the OIG Hotline have identified continued vulnerabilities with less than adequate contract and subcontract oversight. Because of these issues and the large number of contracts and subcontracts managed by the Department, the OIG continues to believe the area of Contract Oversight, which encompasses both Contractor Management and Subcontract Management as sub-components, remains a management challenge.

Government Accountability Office

- Report to Congressional Requestors on [*Department of Energy Contracting: Actions Needed to Strengthen Subcontract Oversight*](#) (GAO-19-107, March 2019). The Government Accountability Office (GAO) found that almost the entire \$30 billion Department budget goes to contracts, most of which have subcontracts. The Department and National Nuclear Security Administration did not always ensure that contractors audited subcontractors' incurred costs as required in their contracts. The GAO's review of 43 incurred-cost assessment and audit reports identified more than \$3.4 billion in subcontract costs incurred over a 10-year period that had not been audited as required, and some subcontracts remained unaudited or unassessed for more than 6 years. Completing audits in a timely manner is important because of a 6-year statute of limitations to recover unallowable costs that could be identified through such audits. Department Headquarters has not issued procedures or guidance that requires local offices to monitor contractors to ensure that required subcontract audits are completed in a timely manner, consistent with Federal standards for internal control. Without such procedures or guidance, unallowable costs may go unidentified beyond the 6-year limitation period of the Contract Disputes Act, preventing the Department from recovering those costs. The GAO made six recommendations, including that the Department develop procedures that require local offices to monitor contractors to ensure timely completion of required subcontract audits. The Department partially concurred with five of the GAO's six recommendations but disagreed to independently review subcontractor ownership information.



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



April 15, 2021

MEMORANDUM FOR TERI L. DONALDSON
INSPECTOR GENERAL

FROM: CHARLES P. VERDON *Charles P. Verdon*
ACTING UNDER SECRETARY FOR NUCLEAR SECURITY
AND ADMINISTRATOR, NNSA

SUBJECT: Response to the Office of Inspector General Draft Report *Sandia
National Laboratories Subcontract Closeout Process (A19LA050)*

Thank you for the opportunity to review and comment on the subject draft report. This memorandum provides a consolidated response on behalf of the National Nuclear Security Administration (NNSA) and the Department of Energy, Office of Acquisition Management. We appreciate the auditors' work in highlighting opportunities for improvement in documentation related to resolving questioned costs and closing subcontracts at Sandia National Laboratories. While the costs questioned by the auditors only represent approximately .033 percent of Sandia's incurred subcontract costs over the audit period, we agree that it is important to ensure that the resolution of questioned costs is transparent and supported by appropriate documentation. We concur with, and will be taking action to address, the related recommendations in the report. NNSA would, however, like to provide clarification in one area.

The report misinterprets Department of Energy Acquisition Regulation (DEAR) 970.5232-3(c) as it relates to flexibly priced subcontracts, and we are requesting the report be modified consistent with NNSA's legal interpretation of the requirement. Specifically, the noted DEAR clause is not applicable to the subcontract examples provided in the report, and the related finding and recommendations should be deleted. We non-concur with the related recommendations pending resolution of this issue.

The attached management decision provides a detailed response to each recommendation. Subject matter experts have also provided technical comments under separate cover for the auditors' consideration to address the issues noted above and enhance the accuracy and clarity 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

NATIONAL NUCLEAR SECURITY ADMINISTRATION
Management Decision

Sandia National Laboratories (SNL) Subcontract Closeout Process (A19LA050)

The Office of Inspector General (OIG) recommended that NNSA:

Recommendation 1: Assess the revised [subcontract closeout] reporting requirements and continue to refine the requirements, as needed, to increase the Contracting Officer's (CO) knowledge of SNL's subcontract closeout decisions.

Management Response: Concur. The CO has implemented updated reporting requirements that require the contractor to provide a quarterly report identifying the reasons for not sustaining questioned costs, and to conduct briefings when subcontract questioned costs greater than \$25,000 are not sustained. Sandia Field Office has also created an oversight guide to document procedures and reinforce oversight of subcontract closeout activities. The CO will review the report provided by the Management and Operating contractor for the first quarter of FY 2021 and determine whether additional reporting metrics are necessary by June 30, 2021.

Recommendation 2: Make a determination on the allowability of the \$2,093,155 in subcontract questioned costs since FY 2014.

Management Response: Concur. The CO will review the questioned costs that were not sustained and make an allowability determination by December 31, 2021.

Recommendation 3a: Review the population of Firm Fixed Price (FFP) subcontracts for those with variable elements (either unit price or quantity) and ensure such subcontracts are correctly reclassified as not FFP subcontracts.

Management Response: Non-concur. The report does not provide sufficient evidence to conclude that the M&O contractor is not in compliance with DEAR 970.5232-3(c), *Audit of subcontractors' records*, which requires that the M&O contractor either conduct or arrange for an audit of a subcontractor's costs when costs incurred are a factor in determining the amount payable to the subcontractor. The examples presented in the IG report misinterpret the requirement triggering audit of subcontracts.

When DEAR 970.5232-3(c) references "costs incurred," it is speaking to costs incurred by the subcontractor, which are not implicated in fixed unit price contracts where unit prices are negotiated before any costs are incurred by the subcontractor. The report appears to confuse "costs incurred" with an indefinite quantity contract with fixed unit pricing where the final price paid varies based on the number of units purchased. In the examples presented in the report, the rates were predetermined before any costs were

Appendix 4: Management Comments

incurred by the subcontractor and, therefore, are not subject to audit under DEAR 970.5232-3(c). NNSA considers this recommendation closed.

Recommendation 3b: Direct SNL to ensure subcontracts containing flexibly-priced elements are included in the universe subject to audit in accordance with the Department of Energy Acquisition Regulations (DEAR).

Management Response: Non-concur. The report does not provide sufficient evidence to conclude that the M&O contractor is not in compliance with DEAR 970.5232-3(c), *Audit of subcontractors' records*, which requires that the M&O contractor either conduct or arrange for an audit of a subcontractor's costs when costs incurred are a factor in determining the amount payable to the subcontractor. The examples presented in the IG report misinterpret the requirement triggering audit of subcontracts.

When DEAR 970.5232-3(c) references "costs incurred," it is speaking to costs incurred by the subcontractor, which are not implicated in fixed unit price contracts where unit prices are negotiated before any costs are incurred by the subcontractor. The report appears to confuse "costs incurred" with an indefinite quantity contract with fixed unit pricing where the final price paid varies based on the number of units purchased. In the examples presented in the report, the rates were predetermined before any costs were incurred by the subcontractor and, therefore, are not subject to audit under DEAR 970.5232-3(c). NNSA considers this recommendation closed.

Recommendation 3c: Direct SNL to implement corrective actions to make improvements in the determination of: (1) cost allowability, allocability, and reasonableness; (2) the appropriate contract type for the procurement; and (3) sufficient documentation for not sustaining audited questioned costs.

Management Response: Concur. The CO has directed the M&O to identify corrective actions for the issues reported by the OIG and other observations made by Sandia Field Office related to the management of subcontract types; timely resolution of questioned costs; and lack of clear documentation to justify not sustaining questioned costs, by December 31, 2020. Once corrective actions are identified, the CO will continue monitoring subcontract administration and closeout activities to ensure that corrective actions are implemented by June 30, 2021.

Recommendation 3d: Direct SNL to complete Internal Audit's planned validation audit on the Sandia Delegated Representatives' (SDR) roles and responsibilities.

Management Response: Concur. Internal Audit is currently performing the validation audit on the SDR roles and responsibilities. This action will be validated for closure by June 30, 2021.

Appendix 4: Management Comments

The OIG also recommended that the Department of Energy, Director of Acquisition Management:

Recommendation 4: Direct the Office of Policy to clarify the DEAR to ensure that COs are involved timely in the resolution of subcontractor question costs.

Management Response: Concur. The Office of Policy will clarify the DEAR in the impending DEAR update. The clarification will emphasize that the responsibility for determining the allowability of costs under each cost-reimbursement subcontract remains with the Contractor or next higher-tier subcontractor. The update will also clarify that nothing in the Contractor's subcontract audit arrangements precludes the CO's determination of the allowability or unallowability of the subcontract costs the Contractor claims for reimbursement. If necessary, the Office of Policy will issue interim guidance (via Acquisition Letter, Guide Chapter, etc.). The DEAR update is expected to be completed by August 1, 2021.

FEEDBACK

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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.