

**Audit of Raytheon Polar Services Company's Costs  
Claimed For Fiscal Years 2003 to 2004**

**September 29, 2006  
OIG-06-1-023**



**National Science Foundation  
Office of Inspector General**

## EXECUTIVE SUMMARY

### BACKGROUND

The attached Defense Contract Audit Agency (DCAA) Audit Reports dated September 25, 2006 and September 26, 2006, detail the results of its audit of \$300.7 million in costs claimed for payment by Raytheon Polar Services Company (RPSC) under NSF Contract No. OPP-0000373 from January 1, 2003 through December 31, 2004. The contract consists of a five-year base period and five option periods for a total of ten years and valued at \$1.1 billion. The charges claimed against the contract averages at [REDACTED]. The attached audit reports include RPSC's response to the audit findings.

The United States Antarctic Program has, since 1971 when NSF assumed full responsibility, provided a permanent presence in Antarctica that oversees U.S. scientific interests. Today, the principal goals of the United States Antarctic Program are to (1) understand the Antarctic region and its ecosystems, (2) understand the effects of the region on global processes such as climate, as well as responses to those effects, and (3) use the region as a platform to study the upper atmosphere and space.

RPSC, headquartered in Centennial, Colorado, is a business unit of the Raytheon Technical Services Company. RPSC is under contract with NSF to provide science, operations, and maintenance support to sustain year-round research programs.

We previously provided DACS, on October 14, 2005, the results of the audit of RPSC's 2000-2002 incurred cost proposals that questioned \$33.4 million of \$363 million total claimed costs by RPSC<sup>1</sup>. The contract consists of a five-year base period and five option periods for a total of ten years and is valued at \$1.1 billion. The charges claimed against the contract average [REDACTED]. The attached reports provide the results of DCAA's audits of RPSC's incurred cost proposal submissions for FY 2003 and 2004.

### OBJECTIVES, SCOPE, AND METHODOLOGY

The Federal Acquisition Regulation (FAR) requires government contractors to submit annually a year-end final accounting of the costs incurred by the contractor in performing the work of the contract. At the request of NSF, we contracted with DCAA

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<sup>1</sup> NSF OIG Audit Report OIG-05-1-005 dated March 31, 2005 and amended October 14, 2005.

to audit the [REDACTED] of costs claimed by RPSC in performance of the NSF contract from January 1, 2003 through December 31, 2004.

The purpose of auditing the costs was to determine whether the costs claimed by RPSC for the period were allowable, allocable, and reasonable in accordance with the FAR and NSF’s contract requirements.

The DCAA audit was conducted in accordance with the Comptroller General’s *Generally Accepted Government Audit Standards* and included such tests of accounting records and other audit procedures necessary to fully address the audit objectives.

### AUDIT RESULTS

DCAA identified questioned costs amounting to [REDACTED], or [REDACTED], of the total [REDACTED] that RPSC claimed for payment for Fiscal Years 2003 and 2004. Of the questioned amount, [REDACTED] represents costs that RPSC charged incorrectly to NSF as direct costs when those costs should have been classified as indirect costs and recovered through RPSC’s indirect cost rates or exceeded the contract indirect cost ceiling amounts. The remaining \$1.5 million represents improperly charged direct costs for alcohol, gifts, and souvenirs and fringe benefit costs.

#### Costs Questioned by Year of Contract Performance

Description	FY 2003	FY 2004	Total
Overhead Indirect Costs Improperly Claimed Over Contract Allowed Ceilings	[REDACTED]	[REDACTED]	[REDACTED]
General and Administrative Indirect Costs Improperly Claimed Over Contract Allowed Ceilings	[REDACTED]	[REDACTED]	[REDACTED]
Fringe Benefits	[REDACTED]	[REDACTED]	[REDACTED]
Direct Costs	[REDACTED]	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]	[REDACTED]

Specifically, RPSC has standard procedures for classifying costs as Overhead or General and Administrative.<sup>2</sup> Overhead is a cost for the management of direct labor,

<sup>2</sup> Detailed information concerning RPSC’s indirect versus direct cost classification procedures is contained in “Raytheon Polar Services Company’s Indirect and Other Direct Costs Internal Controls,” NSF OIG Audit Report No. 06-1-004, issued March 27, 2006.

subcontractors, and direct materials used on the contract. General and Administrative costs are costs that Raytheon incurs for the general management and benefit of the corporation as a whole. [REDACTED]

[REDACTED]. The FAR requires that contractors of RPSC's size disclose to the federal government detailed definitions of the kinds of costs that it considers to be Overhead and General and Administrative costs. Upon approval of the disclosed definitions by the government, RPSC agrees to only bill the government for costs according to the disclosed definitions. However, in the claims submitted to NSF for payment, RPSC did not follow its disclosed definitions for billing indirect costs.<sup>3</sup> Instead, RPSC improperly classified and claimed [REDACTED] of indirect costs as direct costs. In addition, when NSF awarded RPSC the contract, RPSC agreed to limit its claim for Overhead and General and Administrative costs to certain prescribed ceilings.<sup>4</sup> The annual Overhead limitation is an amount not to exceed [REDACTED] of the contract's direct labor amount. The annual General and Administrative limitation is an amount not to exceed [REDACTED] of all the costs of the contract [REDACTED].

Prior to considering the misclassification of \$ 18.1 million of direct costs as indirect costs, DCAA identified [REDACTED] of indirect costs claimed by RPSC that are over the contract indirect cost ceiling limitations. DCAA removed the improperly classified [REDACTED] of indirect costs from RPSC's direct cost base, placed them in the correct Overhead or General and Administrative indirect cost pool, and then recalculated the correct indirect cost amounts using the NSF contract ceiling percentages. The recalculation increases the amount of indirect costs over ceiling that RPSC cannot claim from [REDACTED] and is therefore questioned as shown in the schedule above.

In addition, [REDACTED] of Fringe Benefit costs are questioned in FY 2003 because RPSC claimed budgeted fringe costs instead of the lower, audited fringe costs. Although RPSC did not know what the eventual audited fringe cost amount would be at the time the claim was prepared, it is nevertheless only entitled to the audited amount. The audit of the FY 2004 fringe benefit costs is still underway.

Finally, an additional \$1.37 million is questioned for expressly unallowable costs, such as gifts, entertainment, and alcohol.<sup>5</sup> RPSC is classifying and charging these costs to the NSF contract as allowable "other material costs." Instead, RPSC should charge

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<sup>3</sup> Detailed information concerning RPSC's failure to follow disclosed accounting practices is contained in "Raytheon Polar Services Company's Failure to File Required Cost Accounting Disclosure Statement," NSF OIG Audit Report No. 06-1-011, issued July 6, 2006 and "Audit of Raytheon Polar Services Company's Noncompliance with Cost Accounting Standard 418 -Allocation of Direct and Indirect Costs For Fiscal Years 2000 to 2002," NSF OIG Audit Report No. OIG-06-1-001, issued March 21, 2006.

<sup>4</sup> Detailed information concerning RPSC's billings and contract ceiling limitations is contained in "RTSC Polar Services Billing System Internal Controls," NSF OIG Audit Report No. 06-1-012, issued July 10, 2006.

<sup>5</sup> Detailed information concerning RPSC's expressly unallowable costs is contained in "Raytheon Polar Services Company-New Zealand Accounting System and Floor Check Reviews," NSF OIG Audit Report No. 06-1-017, issued September 29, 2006.

these costs to an unallowable cost account. According to RPSC, these items are for resale in Antarctic station facilities such as the store or bar, and are also being provided as bingo prizes. RPSC-NZ also stated that the revenue generated from these resale activities is properly credited to NSF on its quarterly expenditure reports. Accordingly, RPSC's only purpose for charging these costs to the NSF contract was for RPSC to receive a fee for supplying the alcoholic beverages. However, under FAR 31.205, expressly unallowable costs must be segregated from otherwise billable contract costs.

Consistent with the recommendations we made in our RPSC FY 2000-2002 claimed costs audit, we continue to recommend that NSF coordinate with and allow the Defense Contract Management Agency, the cognizant federal agency, to take the lead in resolving disclosed accounting practice deficiencies prior to entering into a final negotiation settlement to resolve the questioned [REDACTED] of indirect costs. NSF should resolve the remaining \$1.5 million of questioned costs. In addition, NSF should ensure that RPSC establishes adequate policies and procedures to preclude charges exceeding its Overhead and General and Administrative ceilings; ensure that RPSC establishes adequate policies and procedures to routinely adjust the amount of its claimed costs to reflect actual rather than budgeted fringe benefit costs; and ensure that RPSC establishes adequate policies and procedures to maintain adequate documentation of all its claimed costs in accordance with the FAR. Implementation of these recommendations will allow RPSC to report its costs correctly to NSF and provide adequate supporting documentation.

In its response to the draft of this report, RPSC did not agree with the DCAA questioned indirect costs. RPSC contended that the costs are in accordance with intent of the contract and/or instructions received from NSF. However, RPSC was unable to provide the DCAA auditors with documentation of the NSF instructions. The DCAA auditors contacted the NSF Contracting Officer, who stated that no instructions were provided to RPSC by NSF authorizing any deviation from RPSC's disclosed accounting practices. In addition, RPSC believes the alcohol, gift, and souvenir costs should be paid by NSF as direct costs of contract performance. Nevertheless, RPSC did agree with the DCAA auditor concerning questioned fringe benefit costs in FY 2003. The DCAA auditors after consideration of RPSC's response did not revise their audit findings and recommendations.

## **APPENDIX**

### **Defense Contract Audit Agency Audit Reports**

DCAA Audit Report No. 6161-2003P10100201-RTSC Polar FY 2003 Incurred Cost  
Audit, dated September 25, 2006.

DCAA Audit Report No. 6161-2004P10100201-RTSC Polar FY 2004 Incurred Cost  
Audit, dated September 26, 2006.

Performed By  
Herndon Branch Office  
Reston, Virginia



**DEFENSE CONTRACT AUDIT AGENCY**  
**AUDIT REPORT NO. 6161-2003P10100201**



September 25, 2006

**PREPARED FOR:** National Science Foundation  
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 Associate Inspector General for Audit  
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**SUBJECT:** Raytheon Polar Services FY 2003 Incurred Cost Audit

**REFERENCES:** Prime Contract No. OPP-0000373

**CONTRACTOR:** Raytheon Polar Services  
 Raytheon Technical Services Company  
 12160 Sunrise Valley Drive  
 Reston, VA 20191

**REPORT RELEASE RESTRICTIONS:** See Page 53

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**Audit Report No. 6161-2003P10100201**

4. We identified [REDACTED] of G&A costs in excess of the contract ceiling. The G&A rates were recalculated and compared to the claimed rates to determine the amounts in excess of the [REDACTED] contract ceiling rate.
5. We questioned \$603,887 as a result of alcoholic beverages, T-shirts, ornaments, hats, bobble heads, and glasses booked as material costs for FY 2003.
6. We reclassified [REDACTED] of ODC and \$1,468,272 of labor costs related to [REDACTED].
7. We reclassified \$3,463,706 of Corporate and RTSC allocations that were changed direct to the contract as Other Direct Costs (ODC).
8. We questioned [REDACTED] of RPSC allocations based on the Raytheon Corporate and RTSC assessments audit results (Audit Assignment No. 6161-2005T10160208).

**SCOPE OF AUDIT**

Except for the qualifications discussed below, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records evaluated are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall data and records presentation; and
- determining the need for technical specialist assistance

We evaluated the incurred cost proposal using the applicable requirements contained in the:

- Federal Acquisition Regulation, and
- Cost Accounting Standards.

**Audit Report No. 6161-2003P10100201**

For FY 2003, we considered RTSC accounting system to be inadequate in part for accumulating, reporting, and billing costs on Government contracts. As described in the Contractor Organization and Systems section of this report our examination of RTSC internal controls with respect to integrity and ethical values identified significant deficiencies which could have a material impact on the contractor's submission. The scope of our examination reflects the risk of unallowable costs being included in the submission and includes expanded testing to provide a reasonable basis for our opinion.

In addition, Raytheon Polar Services uses the Polar Operations Financial Management System (POFMS) to organize costs from the SAP accounting system and then bill the cost direct to the National Science Foundation. We have not reviewed POFMS or deemed the system adequate.

**QUALIFICATIONS:**

An analysis of available documentation in the contractor's files applicable to proposed subcontract costs showed that an evaluation by another DCAA office is needed to reach a definitive conclusion regarding the acceptability of the proposed subcontract costs. We requested an agreed upon procedures evaluation from a DCAA office cognizant of the selected subcontract. However, we did not receive the results in time for incorporation into this report. The results of the agreed upon procedures evaluation is considered essential to the conclusion of this examination. Therefore, the audit results are qualified to the extent that additional costs may be questioned based on the results of the agreed upon procedures evaluation.

On November 22, 2005, we sent a request to the DCAA Gulf Coast Branch Office to apply agreed upon procedures to Edison Chouest Offshore Inc. CY 2003 invoices to Raytheon Polar Services under Subcontract No. 4500098096 and Subcontract 4500098100. Upon receipt of the agreed upon procedures evaluation, we will provide a supplemental report if the assist audit include significant questioned costs.

**RESULTS OF AUDIT**

**Audit Report No. 6161-2003P10100201**

**AUDITOR'S OPINION:**

a. Indirect Rates. In our opinion, the contractor's proposed indirect rates are not acceptable as proposed. The examination results and recommendations are presented in the Exhibit B of this report.

b. Direct Costs. In our opinion, except for the unresolved costs in the amount of [REDACTED], the contractor's claimed direct costs are acceptable as adjusted by our examination. We questioned and/or reclassified [REDACTED] of direct costs proposed under the Polar Services contract. Questioned and/or reclassified direct costs by element are presented in Exhibit A, of this report. Direct costs not questioned are provisionally approved pending final acceptance. Final acceptance of amounts proposed under the Polar Services contract does not take place until performance under the contract is completed and accepted by the cognizant authorities and the audit responsibilities have been completed.

A schedule of the claimed and audited overhead and G&A costs in excess of the contractor's ceiling rates is included in Exhibit D of this report.

We discussed the results of our examination with [REDACTED] in an exit conference held on July 20, 2006. RPSC did not concur with our questioned costs. See Appendix 2 of this report for the contractor's response to our questioned costs.

**STATEMENT OF CONTRACTOR'S CLAIMED DIRECT COSTS  
AND RESULTS OF AUDIT  
RAYTHEON POLAR SERVICES CONTRACT NUMBER OPP-0000373  
Period January 1, 2003 through December 31, 2003**

<u>Cost Element</u>	<u>Claimed</u>	<u>Questioned</u>	<u>Unresolved</u>	<u>Ref.</u>
Direct Labor	██████████	██████████	\$ 0	Schedule A-1
Material	██████████	603,887		Schedule A-2
Subcontracts	██████████		██████████	Schedule A-3
Other Direct Costs	██████████	██████████	_____	Schedule A-4
Totals	██████████	██████████	██████████	

The claimed cost column represents amounts included in the contractor's certified indirect cost submission for the Polar Services contract. This column does not necessarily represent amounts that the contractor plans to claim for reimbursement under the contract.

Minor differences may exist in the supporting schedules due to rounding.



**RPSC FY 2003 DIRECT LABOR COSTS  
AND RESULTS OF AUDIT**

<u>Cost Element</u>	<u>Claimed Cost</u>	<u>Questioned Cost</u>	<u>Ref.</u>
Direct Labor	██████████	██████████	Note 1

EXPLANATORY NOTE:

1. Direct Labor

a. Summary of Conclusions:

We reclassified ██████████ of the contractor’s claimed direct labor associated with various indirect functions to the overhead pool based on its disclosed accounting practices.

b. Basis of Contractor’s Cost:

The contractor’s claimed labor costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

The contractor recorded ██████████ as direct labor for those labor costs associated with the indirect functions of Facility, Finance and Human Resources using the General Management WBS.

We could not locate facilities costs for the Colorado office which is the primary location for the Polar support functions. It was determined that a separate direct accumulation point for the facilities costs was developed. Upon further analysis, it was determined that the majority of the costs contained within the facilities WBS were solely for the facilities located at 7400 South Tucson Way, Centennial, Colorado 20191.

The finance costs for the Polar contract include not only financial reporting, but also central timekeeping, general accounting, and other cost accounting functions.



Furthermore, [REDACTED] dedicated to the Polar Services contract, the contract is still considered as having multiple cost objectives.

These functions specifically support [REDACTED] working on the Polar Services contract and, as such, should be treated as an indirect cost on the contract. In addition, the costs should be included in an indirect cost pool because the Polar Services contract has multiple final cost objectives also known as Work Breakdown Structures (WBS). Many of these WBS are restricted and require the contractor to segregate, accumulate, and report costs by WBS. As a result of these circumstances, the contractor's normal accounting practice is to treat costs related to these indirect functions as an indirect cost.

[REDACTED]

The reclassified [REDACTED] associated with the various indirect functions are as follows:

Work Breakdown Structure	WBS Description	[REDACTED] portion within FY 2003 Indirect Functions
R-PS30-207	[REDACTED]	[REDACTED]
R-PS40-207	[REDACTED]	[REDACTED]
Subtotal	[REDACTED]	[REDACTED]
R-PS30-212	[REDACTED]	[REDACTED]
R-PS43-238E01	[REDACTED]	[REDACTED]
Subtotal	[REDACTED]	[REDACTED]
R-PS20-208	[REDACTED]	[REDACTED]
R-PS30-208	[REDACTED]	[REDACTED]
R-PS40-208	[REDACTED]	[REDACTED]
Subtotal	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]

[REDACTED]

c. Contractor's Reaction:

RTSC disagrees that the locally incurred costs for functions like [REDACTED] should be charged indirect. As a result, RTSC does not agree with the reclassification of [REDACTED] of [REDACTED] to an indirect cost.

The complete text of the contractor's response to our audit findings is included as Appendix 2 of this report.

d. Auditor's Response:

In our opinion, RTSC position of claiming costs incurred under functions like [REDACTED] as direct costs does not comply with the Cost Accounting Standard (CAS) 418. These functions are clearly indirect costs that should not be treated as direct costs. CAS 418 requires the consistent classification of costs as direct or indirect. RTSC common practice is to charge functions like [REDACTED] as indirect costs. Furthermore, RTSC Disclosure Statement, Rev. 10A, dated January 1, 2003, [REDACTED]

In addition, the Polar RFP required the contractor's cost or pricing data to follow its disclosed cost accounting practices (CAS disclosure statement). As a result, the RFP (procurement) did not require any costs normally classified as indirect [REDACTED] to be treated as direct costs to the contract. The Polar RFP and its requirement for the contractor to follow disclosed cost accounting practices is consistent with the intent of the CASB when it published comments regarding this issue in Part II, Preambles to the Related Rules and Regulations Published by the Cost Accounting Standards Board, Preambles to Part 331, Contract Coverage, Comment No. 11, *Additional requirements by agencies*, states that:

*"...concern was expressed that Federal agencies might require the submission of cost proposals in ways inconsistent with the cost accounting practices of some or all of the potential offerors. The Board recognizes that this has happened in the past, but it notes that Board rules, regulations, and Cost Accounting Standards are to be used by relevant Federal agencies as well as by contractors and subcontractors, and it believes that henceforth requests for proposals must be fully consistent with such rules, regulations, and standards, although of course the Federal agency may ask for supplementary information to accompany proposals if this is needed to meet the agency's requirements."*

In summary, RTSC Polar Services should comply with its disclosed accounting practice which is a requirement of CAS 418-40(a).

**RPSC CLAIMED FY 2003 MATERIAL COSTS  
AND RESULT OF AUDIT**

<u>Element of Cost</u>	<u>Claimed</u>	<u>Questioned</u>	<u>Ref.</u>
Other Material	██████████	<u>\$ 603,887</u>	Note 1

EXPLANATORY NOTE:

1. Other Material Costs

a. Summary of Conclusions:

We questioned a total of \$603,887 of RPSC other material cost for FY 2003. From the \$603,887 questioned costs, \$56,748 were associated with alcoholic beverages, calendars, discovery hut ornaments, T-shirts, Garment Washed Chino Twill Cap, fleece hats multi colored styles with “SWEETLIDS, ANTARTICA” label, Antarctic bobble heads, and badminton rackets. We used the EZ Quant Statistical Analysis Sampling Program to project \$56,748 dollars of other material questioned cost to the R-PS32 other material project cost universe. This projection resulted in a total of \$593,932 other material questioned costs for FY 2003.

Furthermore, as a result of our transaction testing based on a judgmental sample we questioned \$9,955 associated with sunglasses. The following table summarizes the other material questioned cost transactions for FY 2003:



<u>Project</u>	<u>Document</u>	<u>No.</u>	<u>Description</u>	<u>Questioned</u> <u>Cost</u>
R-PS32	100962968		Red wine	\$ 142
R-PS32	101220104		USAP Calendar	19,295
R-PS32	101278852		Discovery Hut Ornaments	15,920
R-PS32	101614058		T Shirts	234
R-PS32	101444452		T Shirts	1,840
R-PS32	101588562		T Shirts	2,295
R-PS32	101588569		T Shirts	1,791
R-PS32	101444453		Garment Washed Chino Twill Cap	1,605
R-PS32	101606705		Fleece Hats	5,399
R-PS32	101358906		Antarctic Bobble Heads	4,775
R-PS32	101097132		Vodka Absolut, Glenfiddich, Wild Turkey, Jameson.	482
R-PS32	101570857		Glenfiddich Special Reserve Malt/Canis Cream Liquor Amarula, RHUM NEGRITA,	2,313
R-PS32	101280443		Ron Don Q Cristal.	216
R-PS32	101467095		FH STL Badminton Racket	65
R-PS32	101570880		Midori Melon Liqueur	375
			Sub-Total	\$ 56,748
			EZ-Quant Questioned Cost Projection	537,184
			Other Material Cost Questioned for R-PS32	\$ 593,932
R-PS33	101215642		Glasses (non-prescription sunglasses)	\$ 9,955
Total			FY 2003 Other Material Questioned Costs	\$ 603,887

Costs related to alcoholic beverages are unallowable based on FAR 31.205-51. Costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public are unallowable based on FAR 31.205-1. FAR 31.201-6 states “expressly unallowable costs are required to be segregated from otherwise billable contract costs” and can not be made allowable by any other FAR clause or contract requirement. All of these costs should be accumulated in an unallowable or otherwise non-billable WBS. The booking of these types of costs direct to a billable portion of the contract allows for two (2) conditions where the government is at risk:

- (1) Fee is being applied to expressly unallowable items, and
- (2) The government is assuming any loss associated with mismanagement of the on-ice facilities such as stores or bars. The offset of unallowable costs with generated revenue does not make the costs otherwise allowable, and therefore they should be segregated from billable costs.

b. Basis of Contractor’s Cost:

The contractor’s claimed other material costs are based on actual costs incurred as represented in the contractor’s SAP accounting System under project R-PS32 and R-PS33. According to the contractor, these items are for resale in on-ice facilities such as the stores or bars. The contractor also stated that the revenue associated with these activities is credited back to the contract on each of its quarterly expenditure reports. The purpose for booking the costs to the contract was to ensure that the contractor receives fee on these items since they were required to obtain and furnish items of this nature. The contract requires the contractor to provide the opportunity for persons working on the Antarctic program (both RTSC and Non-RTSC) to participate in morale, welfare, and recreation facilities such as social establishments. The function of providing the opportunity for these types of facilities like bars and stores are allowable based on the inherent nature of the contract; however, alcohol, and items for resale in gift shops should not be considered allowable and billable costs to the contract.

c. Audit Evaluation:

We obtained a detailed report of other material cost transactions (cost element 522010) from RPSC SAP Accounting System and performed a statistical sample selection of this cost for projects R-PS32 and R-PS37. We also performed a judgmental sample selection of other material costs for projects R-PS31, R-PS33 and R-PS34. The statistical and judgmental sample selections were performed to verify the allowability, allocability, and reasonableness of cost through transaction testing.

We performed transaction testing to confirm that Raytheon Polar Services follows RTSC Cost Accounting Standards, FAR and RPSC contract requirements.

d. Contractor's Reaction:

RTSC did not concur with the DCAA direct material questioned costs and its projection using the EZ-Quant Statistical Analysis Sampling Program. RTSC acknowledged that alcoholic beverages, T-shirts, ornaments, hats, bobble heads, and glasses are items in company stores being sold to the U.S. Antarctic Program participants as part of the overall morale program on the contract. The revenue that results from these products sales is credited back to the contract to offset the costs associated with purchasing these items. Even if costs of the above items were unbillable/unallowable costs, and they are not; (according to the contractor) the associated revenue must be credited against the allegedly unallowable costs.

Furthermore, the contractor did not agree with the questioned cost projection using the EZ-Quant methodology as the means of calculating questioned costs. RTSC did not concede that the total questioned amount accurately reflects the costs incurred for these items in FY 2003.

The complete text of the contractor's response to our audit findings is included as Appendix 2 of this report.

e. Auditor Response:

Government contracts are required to follow the Federal Acquisition Regulation (FAR). While we understand that the Polar contract was developed for a particular program with specific needs it still should comply with the FAR. Unallowable costs identified in the FAR can not be claimed as allowable costs under government contracts.

We disagree with RPSC and still believe that RPSC does not want to recognize that its FY 2003 claim includes costs which are expressly unallowable based on the Federal Acquisition Regulation.

Furthermore, we do recognize that RPSC credits back the revenue resulting from these product sales but not against contract costs. The contractor offsets the costs with revenue only on the quarterly expenditure report. The costs are not reduced by revenue in any final accumulation point. This practice allows the contractor to receive G&A burden and fee on what the FAR defines as expressly unallowable items.

The practice of booking unallowable costs direct to the contract makes the contractor in noncompliance with FAR 31.205. Specifically, FAR 31.205-14 states that:

*Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle. Costs of membership in social, dining, or country clubs or other organizations having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees.*

We believe that as long as RTSC Polar Services recognizes the fact that they are booking unallowable costs as allowable items they are noncompliant with Cost Accounting Standard (CAS) 405 – Accounting for Unallowable Costs. The CAS 405 contains guidelines on:

- (1) Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable and;
- (2) The cost accounting treatment to be accorded such identified unallowable costs to promote the consistent application of sound cost accounting principles covering all incurred costs.

In addition to the CAS and FAR noncompliances, there is also no visibility to determine if the contractor's revenues exceed the costs creating a profit situation or if the management of these costs is actually in a loss position which would create an effect of having the government subsidize the loss on the unallowable costs.

In summary, contracts can require a variety of provisions and supplies based on the basic contract agreement and further modifications. However, government contracts need to follow public law as defined by the Cost Accounting Standards and also the Federal Acquisition Regulation based on FAR Clause 52.230-2.

The FAR 31.201-1(b) states:

*“While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31 and applicable agency supplements”.*

Furthermore, the Statement on Auditing Standards (SAS) No. 39 states:

“The auditor should project the misstatement results of the sample to the items from which the sample was selected.”

**RPSC CLAIMED SUBCONTRACT COSTS  
AND RESULTS OF AUDIT**

<u>Element of Cost</u>	<u>Claimed</u>	<u>Unresolved</u>	<u>Ref.</u> _____
Subcontracts	██████████	██████████	Note 1

EXPLANATORY NOTE:

1. Subcontract – Unresolved

a. Summary of Conclusions:

We classified ██████████ of subcontract costs as unresolved pending receipt of requested agreed upon procedures evaluation from the DCAA Gulf Coast Branch office.

b. Basis of Contractor’s Costs:

The contractor’s claimed subcontract costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

We reviewed the contractor’s schedule J from the incurred cost submission to determine whether any subcontractors had significant claimed costs. We determined which DCAA office had cognizant over the selected subcontractor and requested an agreed upon procedure evaluation from the applicable office.

We requested an agreed upon procedure evaluation from the Gulf Coast Branch office on November 22, 2005 for purchase order 4500098096 and also for purchase order 4500098100. The purchase order was issued to ██████████. We have ██████████ unresolved costs related to purchase order 4500098096 and ██████████ unresolved costs related to purchase order 4500098100.





<u>Work Breakdown Structure W</u>	<u>BS Description</u>	<u>FY 2003 Questioned Pool Costs</u>
R-PS00-2A0100	[REDACTED]	[REDACTED]
R-PS00-2B0100	[REDACTED]	[REDACTED]
R-PS20-207	[REDACTED]	[REDACTED]
R-PS30-207	[REDACTED]	[REDACTED]
R-PS40-207	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS00-2A0014	[REDACTED]	[REDACTED]
R-PS00-2B0014	[REDACTED]	[REDACTED]
R-PS20-212	[REDACTED]	[REDACTED]
R-PS30-212	[REDACTED]	[REDACTED]
R-PS43-238E01	[REDACTED]	[REDACTED]
R-PS43-238E06	[REDACTED]	[REDACTED]
R-PS43-238E08	[REDACTED]	[REDACTED]
R-PS43-238E09	[REDACTED]	[REDACTED]
R-PS43-238E14	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS00-2A0120	[REDACTED]	[REDACTED]
R-PS00-2B0120	[REDACTED]	[REDACTED]
R-PS20-208	[REDACTED]	[REDACTED]
R-PS30-208	[REDACTED]	[REDACTED]
R-PS40-208	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
<b>Total</b>		[REDACTED]

Of the [REDACTED] Miscellaneous ODC questioned, [REDACTED] is related [REDACTED] from indirect to direct contract costs (see Table on page 19).



<u>Doc. No.</u>	<u>Journal Entry Description</u> WBS	<u>Element</u>	<u>Transaction Amount</u>
100094039	Polar Indirect-Direct Reclassification R-PS30-201D08BA		[REDACTED]
110399452	2003 Qtr 1 & 2 Polar Direct-Indirect	R-PS30-201D08BA	[REDACTED]
110450692	Polar Direct-Indirect	R-PS30-201D08BA	[REDACTED]
110539869	[REDACTED] Jan-June R-PS40-201E08BA		[REDACTED]
<b>FY 2003 Total Reclassified Allocations</b>			[REDACTED]

b. Basis of Contractor's Cost:

The contractor's claimed Miscellaneous ODC is based on actual costs incurred as represented in its accounting books and records.

[REDACTED] were booked direct to the Polar Services contract as part of the [REDACTED]. These costs when booked and billed as direct costs reduced the amount of overhead incurred on the contract.

Furthermore, the [REDACTED] charged on the Polar contract were obtained from the Raytheon Technical Services Incurred Cost submissions for fiscal year 2003.

c. Audit Evaluation:

We reviewed the Work Breakdown Structure (WBS) for the Polar contract and confirmed that the contractor was booking all local support functions as direct costs. The WBS listing was then reviewed to determine the various support functions that, in our opinion, were an indirect function of the program. We concentrated primarily on the support functions of [REDACTED].



**Pages 20-27 have been redacted in their entirety.**

b. Basis of Contractor's Cost:

The contractor's claimed costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

Polar Services demonstrated, through a prepared schedule and Annual Program Plan Cost Structure, the methodology used when recording allocated costs from Raytheon Corporate and Raytheon Technical Services (RTSC). Understanding the contractor's methodology and classification of costs direct vs. indirect is important since the contract includes a [REDACTED] overhead ceiling rate.

It was determined that Polar Services was recording allocations direct to the contract using the General Management WBS. The RTSC disclosure statement Revision

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The questioned amount is due to transactions selected for examination that the contractor was unable to adequately support. For these unsupported transactions, we questioned the associated costs in accordance with FAR 31.201-2(d) which requires the contractor to maintain records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles.

[REDACTED]

In addition, part of the questioned costs also includes promotional merchandise that is expressly unallowable in accordance with FAR 31.205-1(f)(6), which makes unallowable the costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public.

b. Basis of Contractor's Cost:

The RTSC and Corporate allocations charged on the Polar contract were obtained from the Raytheon Technical Services Incurred Cost submissions for fiscal years 2003.

c. Audit Evaluation:

The allocations in total were audited as part of the RTSC and Corporate Incurred Cost audits. As part of this audit, we are required to review the audit findings of the incurred cost submissions of RTSC and Raytheon Corporate. We reviewed these audits and determined that recommended adjustments were made to the claimed costs in those submissions and, as such, have incorporated the impact to Polar Services. These costs have been questioned in no other audit as they relate to RPSC. We have calculated the impact of our audit results on the allowable contract costs because the Polar Services contract has an overhead ceiling rate of [REDACTED] (See Exhibit D).

**FRINGE BENEFITS  
COMPUTATION OF AUDIT ADJUSTMENT**

Union Code	Fringe Pool	Audited Rate	Labor Base	Audited Fringe	Claimed Fringe	Questioned Costs/(Upward Adjustment)
RTQ	21925					
	21906					
RTT	21903					
RTL	20984					
RTA	20983					
RSE	20982					
RTK	20966					
RB	20915					
RTJ	20912					
R01	20900					
<b>Total</b>						
<b>Total Fringe Questioned/Audit Adjustment</b>						

EXPLANATORY NOTE:

1. Fringe Expenses

a. Summary of Conclusions:

An audit of the claimed fringe expenses resulted in questioned costs of \$138,757 for FY 2003. The questioned costs resulted from the application of audited RTSC rates as opposed to the contractor's claimed rates to the applicable fringe codes for Polar Services.

b. Basis of Contractor's Cost:

The contractor applies RTSC claimed fringe rates to the labor bases that the Polar program participates in. Participation is based on the various union codes applicable to the labor incurred.

c. Audit Evaluation:

The labor costs have been segregated based on the applicable fringe bases and contractor fiscal year. The RTSC audited fringe rates for FY 2003 were then applied to the labor according to the union code associated with the labor bases. The applied fringe was then compared to the claimed fringe from the contractor's incurred cost submission for the same time frame resulting in an over application of claimed fringe costs of [REDACTED] (See Schedule B-2).

d. Contractor's Response:

RTSC has reviewed the questioned fringe costs of [REDACTED] and determined that the Polar claimed fringe rates represented preliminary actual rates compiled shortly after year-end 2003, not the final fringe rates included in RTSC's incurred cost claim. RTSC agrees that these are not the correct rates; upon negotiation of the RTSC 2003 incurred cost claim, the Polar rates will be updated to reflect the appropriate negotiated rates.

**CLAIMED AND AUDITED G&A POOL, BASES AND RATE  
AND RESULT OF AUDIT**

<u>G&amp;A</u>	<u>Claimed Costs FY 2003</u>	<u>Questioned Costs FY 2003</u>	<u>Audited Costs FY 2003</u>	<u>Ref.</u>
Total Pool Polar VAB <b>Polar G&amp;A Rate</b>	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

EXPLANATORY NOTES:

1. G&A Pool Expenses

a. Summary of Conclusions:

Our examination of the Polar G&A pool resulted in questioned allocated cost of [REDACTED] resulting from the FY 2003 RTSC incurred cost audit results.

RTSC Audit Report No. 6161-2003T10100001 disclosed unallowable costs based on FAR 31.205-14 within the RTSC General Management expenses, unallowable costs within RTSC Legal, RTSC State Income Tax, and RTSC Restructuring. Raytheon Polar Services portion of the RTSC questioned costs is [REDACTED].

b. Basis of Contractor's Cost:

The contractor's costs for G&A were based primarily on [REDACTED]

RPSC G&A expense represent [REDACTED]

c. Audit Evaluation:

We reviewed RPSC G&A Summary Report on the contractor's SAP Accounting System and found no locally incurred G&A expenses. Moreover, RPSC G&A allocated costs to Raytheon Polar Services Company were audited in the FY 2003 Incurred Cost Audit.



Part of this audit consisted in reconciling the expenses representing allocations from the Raytheon Corporate office and the amounts included in the DCAA Raytheon Corporate office's audit report. The FY 2003 RTSC audit results of allocated G&A expenses were disclosed under Audit Report No. 6161-2003T10100001 which was performed by the Herndon Branch office. This audit report disclosed total questioned costs of [REDACTED] of unallowable G&A expenses from which [REDACTED] pertains to Raytheon Polar Services Company.

d. Contractor's Reaction:

RTSC agrees that the amounts applicable to Polar Services Company will be adjusted, if necessary, to reflect the final negotiated rates.

2. Value Added G&A Base

a. Summary of Conclusions:

The questioned G&A Base cost of [REDACTED] are solely related to the questioned fringe costs. [REDACTED]

b. Basis of Contractor's Cost:

The contractor's claimed costs are based on actual costs incurred as represented in its actual books and records.

c. Audit Evaluation:

The labor costs have been segregated based on the applicable fringe bases and contractor fiscal year. The RTSC audited fringe rates for FY 2003 were then applied to the labor according to the union code associated with the labor bases. The applied fringe was then compared to the claimed fringe from the contractor's incurred cost submission for the same time frame resulting in an over application of claimed fringe costs of [REDACTED] (See Schedule B-2).

**OVERHEAD AND G&A COSTS IN EXCESS OF CONTRACT RATE CEILINGS**

Polar Services Contract No. OPP-0000373

Period January 1, 2003 through December 31, 2003

[REDACTED]

[REDACTED]									
[REDACTED]									
[REDACTED]									
[REDACTED]								[REDACTED]	[REDACTED]

[REDACTED]

[REDACTED]									
[REDACTED]									
[REDACTED]									
[REDACTED]								[REDACTED]	[REDACTED]

EXPLANATORY NOTES:

1. Overhead and G&A Costs in Excess of Ceiling – Without Audit Adjustments
  - a. Summary of Conclusions:

We computed the overhead and G&A costs in excess of the ceiling rates. These amounts represent the cost in excess of the ceiling rates based on the contractor's claimed indirect rates and allocation bases, i.e., without any audit adjustments.

b. Basis of Contractor's Cost:

The contractor's claimed costs and indirect rates are based on its certified incurred cost submission.

c. Audit Evaluation:

We computed the overhead and G&A costs in excess of the ceiling rates but without including any audit adjustments. These amounts represent the costs in excess of the ceiling rates based on the contractor's claimed indirect rates and allocation bases. Any comparison to billed costs should be performed after final negotiations and resolution with the contractor.

2. Overhead and G&A Costs in Excess of Ceiling – With Audit Adjustments

a. Summary of Conclusions:

We computed the overhead and G&A costs in excess of the ceiling rates. These amounts represent the costs in excess of the ceiling rates that includes the audit adjustments discussed in this report.

b. Basis of Contractor's Cost:

The contractor's claimed costs and indirect rates are based on its certified incurred cost submission.

c. Audit Evaluation:

We computed the overhead and G&A costs in excess of the ceiling rates that reflects our audit adjustments. These amounts represent the costs in excess of the ceiling rates based on incorporating the audit adjustments made to the contractor's indirect cost pools and allocation bases. Any comparison to billed costs should be performed after final negotiations and resolution with the contractor.

d. Contractor's Reaction:

RTSC agrees with DCA A that these costs are not allowable on the contract. However, according to the contractor the costs are appropriately allocable to the contract and therefore need to be included in the incurred cost claim even though there is no intention in recovering these costs from the Polar customer.

RTSC stated that it has not included any of these over ceiling costs in the billings to date and has no intention of billing them in the future.

e. Auditor's Response:

We disagree that the contractor has not recovered the cost in excess of the ceiling rates. The contractor has billed and recovered the over ceiling amounts by reclassifying indirect costs as direct (e.g., Corporate/RTSC allocations, etc.). We reclassified these direct costs [REDACTED] to overhead and computed the amounts that exceeded the contract's ceiling rates.

CONTRACTOR ORGANIZATION AND SYSTEMS

(Perm. File,  
"Q" Drive)

I. Organization

RTSC's headquarters is located in Reston, VA. [REDACTED]

[REDACTED]

[REDACTED]

RTSC has a multi-disciplined workforce of approximately 10,000 employees. RTSC provides technical, scientific, and professional services to defense, federal, and commercial customers on all seven continents, including support for operations in space, at sea, and on land. RTSC had annual sales of approximately [REDACTED] in FY 2005, of which approximately [REDACTED] are primarily government prime contracts and subcontracts. Of the government contracts and subcontracts, approximately [REDACTED] are flexibly priced (i.e. cost type and time and materials (T&M) type).

[REDACTED]

**Page 38 has been redacted in its entirety**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

In Audit Report No. 6161-2006T11070301 dated September 5, 2006, DCAA examined the Control Environment and Overall Accounting System and the related internal control policies and procedures. Based on our examination, we concluded that the Control Environment and the Overall Accounting System and related internal control policies and procedures are adequate.

**Audit Report No. 6161-2003P10100201**

[REDACTED]

[REDACTED]

[REDACTED]

DCAA reviewed RTSC's Budget and Planning System and related internal control policies and procedures under Audit Assignment No. 6161-2006T11020301 dated September 8, 2006. Based on its review DCAA determined that the RTSC's Budget and Planning system and the related internal control policies and procedures are adequate.

[REDACTED]

[REDACTED]

**Page 41 has been redacted in its entirety**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

DCAA examined RTSC's Indirect and Other Direct Cost System of internal controls under Audit Assignment No. 6161-2005T14980301, with a reported issued on September 28, 2005. Based on its examination, DCAA determined that the RTSC Indirect/Other Direct Cost System is inadequate in part.

**Audit Report No. 6161-2003P10100201**

- 



Furthermore, in Audit Report No. 6161-2004T14980202, dated December 15, 2005, DCAA evaluated the Indirect and ODC Internal Controls for RTSC Polar Services and determined that the system is inadequate. A brief summary of the deficiencies are as follows:

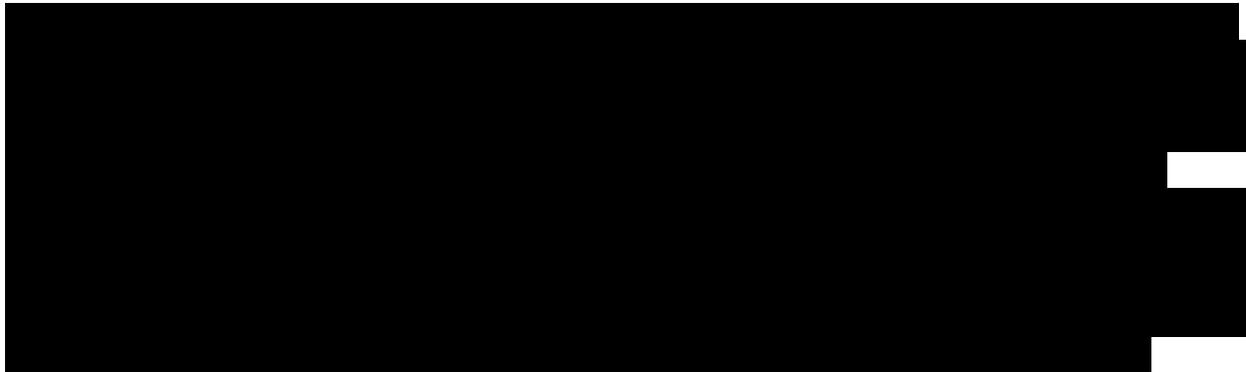
- The RTSC segment disclosure statement which defines the contractor's current accounting practice regarding indirect and ODC costs, excludes Raytheon Polar Services as of January 1, 2005. To date, a disclosure statement for Raytheon Polar Services has not been submitted to the Government.
- Policies and procedures regarding the allowability of selected costs are in noncompliance with the Federal Acquisition Regulation (FAR) Part 31.

**Audit Report No. 6161-2003P10100201**

Specifically, RPSC policies and procedures address certain costs as allowable which, in our opinion, are expressly unallowable based on applicable FAR provisions.

- Costs that are made expressly unallowable based on the FAR or RPSC/RTSC policies and procedures were charged as allowable, indicating that the contractor is not adequately complying with established controls to properly classify and record unallowable costs. The deficiencies represent a noncompliance with CAS 405-40(a), Accounting for Unallowable Costs, FAR Part 31, and established company policies and procedures.
- The contractor lacks policies and procedures regarding the training of employees in the Indirect/ODC system.
- The contractor has inadequate policies and procedures regarding periodic, independent management reviews and its associated compliance.
- We identified inadequacies that affect the allocability of costs indicating that the contractor lacks adequate controls to ensure the consistent classification of costs based on CAS 418, Allocation of Direct and Indirect Cost [CAS 418-40(a)].

DCAA will perform an RTSC Polar Services Indirect and ODC Internal Control follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations.



**Pages 45 through 47 have been redacted in their entirety**



CASB 9903.202-1: Audit Report No. 6161-2005T19200303, dated November 18, 2005, indicates that RTSC disclosed and established cost accounting practices are in noncompliance with CASB 9903.202-1, Disclosure Statement General Requirements. Specifically, effective January 1, 2005, RTSC Raytheon Polar Services Company (RPSC) business unit does not have a separate disclosure statement to describe its unique cost accounting practices used to account for direct and indirect costs. On April 5, 2006, the DACO issued an initial finding of noncompliance on this issue. We are awaiting RTSC's response to the finding.

CAS 418: Audit Report No. 6161-2005T19200001, dated June 23, 2005, indicates that the actual cost accounting practices of one of RTSC's business units, Raytheon Polar Services Company (RPSC), are in noncompliance with CAS 418 and with disclosed cost accounting practices. Specifically, during the period from January 1, 2000 through December 31, 2002, costs that were disclosed as indirect were recorded and charged direct to the Polar Services contract. Recording and charging these costs direct to the contract results in 100 percent recovery through contract billings to the government (i.e., National Science Foundation).

**Audit Report No. 6161-2003P10100201**

On September 28, 2005, the DACO issued an initial finding of noncompliance on this issue. The contractor's December 5, 2005 response was considered a non-response by the DACO. Therefore, on January 17, 2006, the DACO issued a request for response to the initial finding of noncompliance. The contractor's January 24, 2006 response is currently being evaluated by the DACO.

**The remainder of this page has been redacted**

**Pages 50 through 52 have been redacted in their entirety**

**Audit Report No. 6161-2003P10100201**

**DCAA PERSONNEL**

Telephone \_\_\_\_\_ No.  
Primary contact(s) regarding this audit:

[REDACTED]

[REDACTED]

Other contact(s) regarding this audit report:

[REDACTED]

[REDACTED]

FAX No.

[REDACTED]

E-mail Address

[REDACTED]

General information on audit matters is available at <http://www.dcaa.mil/>.

**AUDIT REPORT AUTHORIZED BY:**

/Signed/

LARRY TATEM

[REDACTED]

DCAA Herndon Branch Office

**Audit Report No. 6161-2003P10100201**

**AUDIT REPORT DISTRIBUTION AND RESTRICTIONS**

**DISTRIBUTION**

E-m  
National Science Foundation  
ATTN: Ms. Deborah Cureton,  
Associate Inspector General for Audit  
4201 Wilson Boulevard  
Arlington, VA 22230

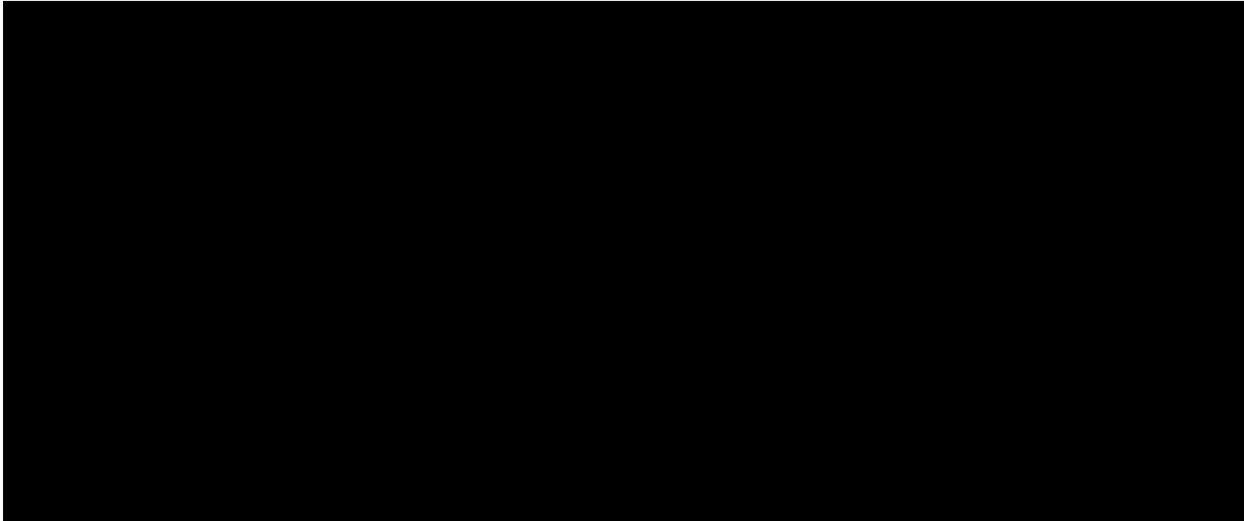
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Telephone No.  
(303) 312-7655

Raytheon Polar Services  
Raytheon Technical Services Company  
12160 Sunrise Valley Drive  
Reston, VA 20191

(Copy furnished thru ACO)

**RESTRICTIONS**



# **APPENDIX 1**

## **Certificate of Final Indirect Costs**

### CERTIFICATE OF FINAL INDIRECT COSTS

This is to certify that I have reviewed this proposal to establish final indirect cost rates and to the best of my knowledge and belief:

1. All costs included in this proposal ("Raytheon Technical Services Company 2003 Overhead Proposal" dated October 07, 2004) to establish final indirect rates for labor overhead, G&A, and fringe for fiscal year 2003, are allowable in accordance with the cost principles of the Federal Acquisition regulation (FAR) and its supplements applicable to the contracts to which the final indirect cost rates will apply; and
2. This proposal does not include any costs which are expressly unallowable under applicable cost principles of the FAR or its supplements.

Firm: Raytheon Technical Services Company

Signature: 

Name of Certifying Official: 

Title: 

Date of Execution: 10 / 17 / 04

**Audit Report No. 6161-2003P10100201**

## **APPENDIX 2**

**RPSC Letter Response to the DCAA Draft Audit Report No. 6161-2003P10100201, dated  
September 1, 2006**



Technical Services Company LLC  
Polar Services

7400 S Tucson Way  
Centennial, Colorado  
80112-3938 USA  
303.790.8606

August 31, 2006

To: Defense Contract Audit Agency  
Attn: Larry Tatem  
171 Elden Street  
Herndon, VA 20170-4810

Subject: Raytheon Polar Services Company – 2003 Incurred Cost Audit

Reference: Draft Audit Report No. 6161-2003P10100201 dated September 1, 2006

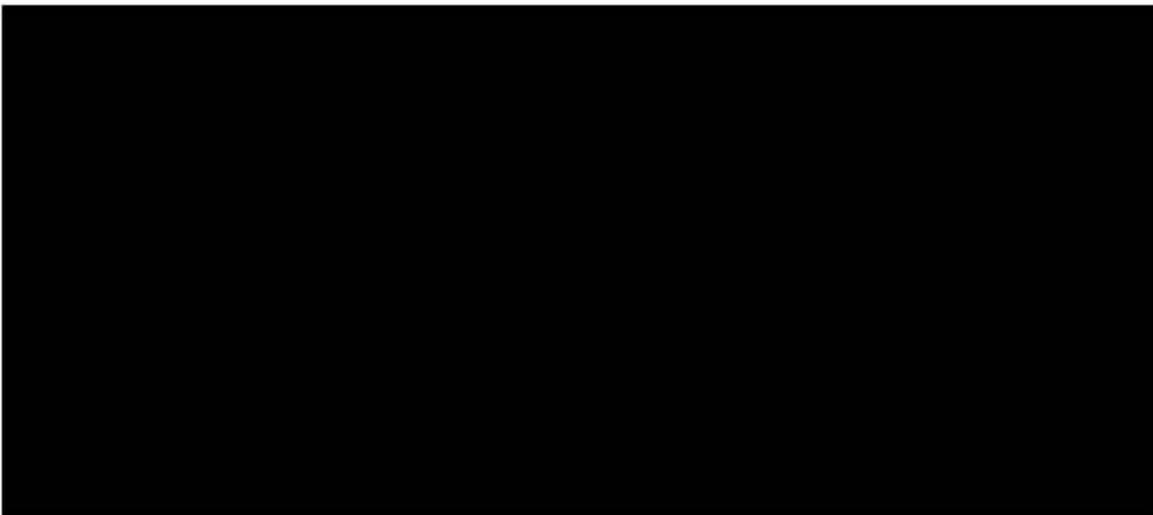
Please find below Raytheon's response to the points raised in the referenced audit report concerning the treatment of costs on the Polar Program.

Questioned Costs – Alcohol and Commemorative Items

Item number 5 in the Executive Narrative of the Audit report questions \$603,887 in alcoholic beverages, T shirts, ornaments, hats, bobble heads and glasses. RTSC appreciates DCAA's acknowledgement that the contract requires the contractor to provide the opportunity for persons working on the Antarctic program to participate in morale, welfare, and recreation facilities such as social establishments. RTSC has been directed by NSF through the authorization of the Annual Program Plan to budget for these types of costs and charge them direct to the contract. RTSC includes these items in company stores and sells them to U. S. Antarctic Program participants as part of the overall morale program on the contract. The revenue that results from these product sales is credited back to the contract to offset the costs associated with purchasing these items. Even if costs of the above items were unbillable/unallowable costs, and they are not, the associated revenue must be credited against the allegedly unallowable costs. Since revenue from these product sales exceed the items' purchase costs, excluding these items from the claim will not reduce the claim by the \$603,887 noted in the referenced DCAA audit report.

The audit report also notes the use of DCAA's EZ-Quant Questioned Cost Projection model to derive the amount of questioned costs for this item. RTSC takes exception to this methodology and does not concur that it is appropriate to use it as the means of calculating questioned costs. Having not seen the details of DCAA's sampling technique or its method of estimating total costs based on the sample, RTSC does not concede that the total questioned amount accurately reflects the costs incurred for these items in FY 2003. Based on what we do know about the sampling technique, it does not appear to be statistically valid. Only those costs specifically identified during audit (in this case, approximately \$66,000) should be considered as questioned costs.

the costs at issue exclusively benefit and are identified to the Polar contract and should be an allowable direct cost on the contract.



RPSC Allocations

Costs questioned in RTSC Audit Report No. 6161-2005T10160208 related to questioned costs within the RTSC 2003 incurred cost claim applicable to Raytheon Corporate and RTSC assessments. Upon negotiation of the RTSC incurred cost claim, the portion applicable to Raytheon Polar Services Company, [REDACTED] will be adjusted, if necessary, to reflect the appropriate negotiated rates.

Fringe Rates

RTSC has reviewed the questioned fringe costs of [REDACTED] and determined that the Polar claimed fringe rates represented preliminary actual rates compiled shortly after year-end 2003, not the final fringe rates included in RTSC's incurred cost claim. RTSC agrees that these are not the correct rates; upon negotiation of the RTSC 2003 incurred cost claim, the Polar rates will be updated to reflect the appropriate negotiated rates.

Unallowable Costs at RTSC level

Costs for this item relate to questioned costs for RTSC General Management expenses, RTSC Legal, RTSC State Income Tax, and RTSC Restructuring costs included in RTSC's 2003 incurred cost claim. The amounts questioned in the referenced audit report represent Raytheon Polar Services Company's share of these questioned costs. RTSC agrees that the amounts applicable to Polar Services Company will be adjusted, if necessary, to reflect the final negotiated rates.

Overhead and G&A Costs in Excess of the contract ceiling

RTSC agrees with DCAA that these costs are not allowable on the contract. However, as noted in our response to the 2000-2002 Polar incurred cost audit report, the costs are appropriately allocable to the contract and therefore need to be included in our incurred cost claim even though we have no intention of recovering these costs from the Polar customer. RTSC has not included any of these over ceiling costs in our billings to date and has no intention of billing them in the future.

If you have any questions or require any further information, please contact me at [REDACTED]

Sincerely, [REDACTED]  
[REDACTED]

Cc: [REDACTED] [REDACTED]



**DEFENSE CONTRACT AUDIT AGENCY**  
**AUDIT REPORT NO. 6161-2004P10100201**



September 26, 2006

**PREPARED FOR:** National Science Foundation  
 ATTN: Ms. Deborah Cureton  
 Associate Inspector General for Audit  
 4201 Wilson Boulevard  
 Arlington, VA 22230

**PREPARED BY:** DCAA Herndon Branch Office  
 171 Elden Street, Suite 305  
 Herndon, VA 20170  
 Telephone No. [REDACTED]  
 FAX No. [REDACTED]

E-mail Address [REDACTED]

**SUBJECT:** Raytheon Polar Services FY 2004 Incurred Cost Audit

**REFERENCES:** Prime Contract No. OPP-0000373

**CONTRACTOR:** Raytheon Polar Services  
 Raytheon Technical Services Company  
 12160 Sunrise Valley Drive  
 Reston, VA 20191

**REPORT RELEASE RESTRICTIONS:** See Page 47

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**Audit Report No. 6161-2004P10100201**

**SUBJECT OF AUDIT**

We examined the Raytheon Technical Services Company (RTSC) certified final indirect cost rate proposal dated June 30th, 2005 and related books and records for the reimbursement of Polar Services FY 2004 incurred costs. The purpose of the examination was to determine allowability of direct and indirect costs and recommend Contracting Officer-determined indirect cost rates for FY 2004. The proposed rates apply to prime contract OPP-0000373. A copy of RTSC Certificate of Final Indirect Costs, dated June 30, 2005 is included as Appendix 1 to this report.

The incurred cost proposal is the responsibility of the contractor. Our responsibility is to express an opinion based on our examination.

**EXECUTIVE SUMMARY**

Our examination of the \$158.2 million proposal related to Polar Services contract disclosed significant questioned costs, including the following significant items:

Treatment	ent Indirect Functions	
	Reclassified Corporate and RTSC Allocations	
	Expressly unallowable Costs	503,316
Other	Direct Cost	

**SIGNIFICANT ISSUES:**

1. We reclassified [REDACTED] of ODC and [REDACTED] of labor costs related to [REDACTED].
2. We reclassified [REDACTED] of Corporate and RTSC allocations that were charged direct to the contract as Other Direct Costs (ODC).
3. We questioned \$503,316 related to alcoholic beverages and T shirts booked on the Raytheon Polar Services claim as material cost.
4. We questioned [REDACTED] of Other Direct Costs based on FAR 31.201-3.
5. We identified [REDACTED] of G&A costs in excess of the contract ceiling. The G&A rates were recalculated and compared to the claimed rates to determine the amounts in excess of the [REDACTED] contract ceiling rate.

[REDACTED]

**Audit Report No. 6161-2004P10100201**

6. We identified [REDACTED] of overhead costs in excess of the contract ceiling. The overhead rates were recalculated and compared to the claimed rates to determine the amounts in excess of the [REDACTED] contract ceiling rate.

**SCOPE OF AUDIT**

Except for the qualifications discussed below, we conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether the data and records evaluated are free of material misstatement. An examination includes:

- evaluating the contractor's internal controls, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment;
- examining, on a test basis, evidence supporting the amounts and disclosures in the data and records evaluated;
- assessing the accounting principles used and significant estimates made by the contractor;
- evaluating the overall data and records presentation; and
- determining the need for technical specialist assistance.

We evaluated the proposal using the applicable requirements contained in the:

- Federal Acquisition Regulation; and
- Cost Accounting Standards.

For FY 2004, we considered RTSC Accounting System to be adequate for accumulating, reporting, and billing costs on Government contracts. As described in the Contractor Organization and Systems section of this report, our examination of RTSC internal controls with respect to integrity and ethical values identified significant deficiencies which could have a material impact on the contractor's submission. The scope of our examination reflects the risk of unallowable costs being included in the submission and includes expanded testing to provide a reasonable basis for our opinion.

In addition, Raytheon Polar Services uses the Polar Operations Financial Management System (POFMS) to organize costs from the SAP Accounting System and then bill the cost direct to the National Science Foundation. We have not reviewed POFMS or deemed the system adequate.

## **Audit Report No. 6161-2004P10100201**

### **QUALIFICATIONS:**

We evaluated auditable type Government subcontracts for FY 2004 issued by RPSC. We identified a subcontract awarded to Agunsa with a value of \$8,318,391 from which \$2,683,240 were incurred during FY 2004. Based on the NSF-OIG petition, an assist audit from the DCAA office with cognizant over Agunsa was not performed due to an investigation issue. Therefore, the results of our evaluation are qualified to the extent that the issuance of this report does not indicate final acceptance of the claimed subcontract costs.

Moreover, we did not receive the results of the FY 2004 RTSC Incurred Cost Audit in time for incorporation into this report. The results of the RTSC Incurred Cost Audit under Assignment No. 6161-2004T10100001 are considered essential to the conclusion of this examination. Therefore, the audit results are qualified to the extent that additional costs related to RTSC and Raytheon Corporate allocations, assessments and fringe costs to Raytheon Polar Services Company may be questioned based on the results of the RTSC Incurred Cost Audit. Upon receipt of the Audit Report No. 6161-2004T10100001, we will provide a supplemental report if the RTSC incurred cost audit report include any findings applicable to Raytheon Polar.

## **RESULTS OF AUDIT**

### **AUDITOR'S OPINION**

a. Indirect Rates. In our opinion, the contractor's proposed indirect rates are not acceptable as proposed. The examination results and recommendations are presented in the Exhibit B of this report.

b. Direct Costs. In our opinion, except for the unresolved costs in the amount of \$2,683,240, the contractor's claimed direct costs are acceptable as adjusted by our examination. We questioned and/or reclassified [REDACTED] of direct costs proposed under the Polar Services contract. Questioned and/or reclassified direct costs by element are presented in Exhibit A-1, of this report. Direct costs not questioned are provisionally approved pending final acceptance. Final acceptance of amounts proposed under Government contracts does not take place until performance under the contract is completed and accepted by the cognizant authorities, and the audit responsibilities have been completed.

We discussed the results of our examination with [REDACTED] in an exit conference held on July 20, 2006. RPSC did not concur with our questioned costs. See Appendix 2 of this report for the contractor's response to our questioned costs.

**STATEMENT OF CONTRACTOR'S CLAIMED DIRECT COSTS  
AND RESULTS OF AUDIT  
RAYTHEON POLAR SERVICES CONTRACT NUMBER OPP-0000373  
Period January 1, 2004 through December 31, 2004**

<u>Cost Element</u>	<u>Claimed</u>	<u>Questioned</u>	<u>Unresolved</u>	<u>Ref.</u>
Direct Labor	██████████	██████████	\$ 0	Schedule A-1
Material	██████████	503,316		Schedule A-2
Subcontracts	██████████	██████████	██████████	Schedule A-3
Other Direct Costs	██████████	██████████	_____	Schedule A-4
Totals	██████████	██████████	██████████	

The claimed cost column represents amounts included in the contractor's certified indirect cost submission for the Polar Services contract. This column does not necessarily represent amounts that the contractor plans to submit for reimbursement under the contract.

Minor differences may exist in the supporting schedules due to rounding.



**RPSC FY 2004 DIRECT LABOR COSTS  
AND RESULTS OF AUDIT**

<u>Cost Element</u>	<u>Claimed Cost</u>	<u>Questioned Cost</u>	<u>Ref.</u>
Direct Labor	██████████	██████████	Note 1

EXPLANATORY NOTE:

1. Direct Labor:

a. Summary of Conclusions:

We reclassified ██████████ of the contractor’s claimed direct labor associated with various indirect functions to the overhead pool based on its disclosed accounting practices.

b. Basis of Contractor’s Cost:

The contractor’s claimed labor costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

RPSC recorded ██████████ as direct labor for those labor costs associated with the indirect functions of Finance, Facility, and Human Resources using the General Management WBS.

The finance costs for the Polar contract include not only financial reporting, but also central timekeeping, general accounting, and other cost accounting functions. Furthermore, Human Resource functions related to the Polar Services contract are accumulated as a direct charge and billed accordingly on the contract. While the human resource function is dedicated to the Polar Services contract, the contract is still considered as having multiple cost objectives.

These functions specifically support direct labor personnel working on the Polar Services contract and, as such, should be treated as an indirect cost on the contract. In addition, the costs should be included in an indirect cost pool because the Polar Services



contract has multiple final cost objectives also known as work breakdown structures (WBS). Many of these WBS are restricted and require the contractor to segregate, accumulate, and report costs by WBS. As a result of these circumstances, the contractor's normal accounting practice is to treat costs related to these indirect functions as an indirect cost.

[REDACTED]

The reclassified [REDACTED] associated with the various indirect functions are as follows:

Work Breakdown Structure	WBS Description	Direct Labor portion within FY 2004 Indirect Functions
R-PS40-207	[REDACTED]	[REDACTED]
R-PS50-207	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS43-238E01	[REDACTED]	[REDACTED]
R-PS53-238	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS40-208	[REDACTED]	[REDACTED]
R-PS50-208	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
Total		[REDACTED]

d. Contractor's Reaction:

RTSC disagrees that the locally incurred costs for functions like [REDACTED] [REDACTED] should be charged indirect. As a result, RTSC does not agree with the reclassification of [REDACTED] to an indirect cost.

[REDACTED]

The complete text of the contractor's response to our audit findings is included as Appendix 2 of this report.

e. Auditor's Response:

In our opinion, RTSC position of claiming costs incurred under functions like [REDACTED] as direct costs does not comply with the Cost Accounting Standard 418. These functions are clearly indirect costs that should not be treated as direct costs. CAS 418 requires the consistent classification of costs as direct or indirect. It is RTSC common practice to charge functions like [REDACTED] as indirect costs. Furthermore, RTSC Disclosure Statement, Rev. 11, dated January 1, 2004, [REDACTED].

Moreover, the Polar RFP required the contractor's cost or pricing data to follow its disclosed cost accounting practices (CAS disclosure statement). As a result, the RFP (procurement) did not require any costs normally classified as indirect [REDACTED] to be treated as direct costs to the contract. The Polar RFP and its requirement for the contractor to follow disclosed accounting practices is consistent with the intent of the CASB when it published comments regarding this issue in Part II, Preambles to the Related Rules and Regulations Published by the Cost Accounting Standards Board, Preambles to Part 331, Contract Coverage, Comment No. 11, Additional requirements by agencies, states that:

*"...concern was expressed that Federal agencies might require the submission of cost proposals in ways inconsistent with the cost accounting practices of some or all of the potential offerors. The Board recognizes that this has happened in the past, but it notes that Board rules, regulations, and Cost Accounting Standards are to be used by relevant Federal agencies as well as by contractors and subcontractors, and it believes that henceforth requests for proposals must be fully consistent with such rules, regulations, and standards, although of course the Federal agency may ask for supplementary information to accompany proposals if this is needed to meet the agency's requirements."*

In summary, RTSC Polar Services should comply with its disclosed accounting practice which is a requirement of CAS 418-40(a).

**RPSC CLAIMED FY 2004 MATERIAL COSTS  
AND RESULT OF AUDIT**

<u>Element of Cost</u>	<u>Claimed</u>	<u>Questioned</u>	<u>Ref.</u>
Other Material	██████████	\$ <u>503,316</u>	Note 1

EXPLANATORY NOTE:

1. Other Material Costs:

a. Summary of Conclusions:

We questioned \$503,316 of RPSC other material costs considered unallowable per FAR 31.205. From the \$503,316 questioned costs, \$373,354 represents questioned projected costs related to the booking of screen printed t-shirts. Costs of souvenirs, models, imprinted clothing, buttons, and other mementos provided to customers or the public are unallowable based on FAR 31.205-1(f)(6).

In addition we questioned \$129,962 of costs related to hard liquor purchased for consumption in the Antarctic. Costs of alcoholic beverages are expressly unallowable based on FAR 31.205-51.

b. Basis of Contractor's Cost:

The contractor's claimed other material costs are based on actual costs incurred as represented in the contractor's SAP accounting system under several projects. According to the contractor, many of the material costs incurred are for resale in on-ice facilities such as stores or bars. The contractor also stated that the revenue associated with these activities is credited back to the contract on each of its quarterly expenditure reports. The purpose for booking the costs to the contract was to ensure that the contractor receive fee on these items since they were required to obtain and furnish items of this nature. The contract requires the contractor to provide the opportunity for persons working on the Antarctic program (both RTSC and Non-RTSC) to participate in morale, welfare, and recreation facilities such as social establishments. The function of providing the opportunity for these types of facilities like bars and stores are allowable based on the inherent nature of the contract; however, alcohol, and items for resale in gift shops should not be considered allowable and billable costs to the contract.



c. Audit Evaluation:

We obtained a detailed report of other material cost transactions (cost element 522010) from RPSC SAP Accounting System and performed a statistical sample selection of this cost for project R-PS42. We reviewed the supporting documentation for the transactions in our sample. The total of other material costs questioned was projected to the universe by using the EZ Quant Statistical Analysis Sampling Program.

Furthermore, we performed a judgmental sample selection of other material costs for the following work breakdown structures:

- R-PS42-223C22E09BA
- R-PS42-223C22E09BC
- R-PS42-224C22E09BC
- R-PS42-222C22E09AE

We also performed a judgmental sample selection of other material costs for project R-PS41. The statistical and judgmental sample selections were performed to verify the allowability, allocability and reasonableness of cost through transaction testing. We performed transaction testing to confirm that Raytheon Polar Services follows RTSC Cost Accounting Standards, FAR and RPSC contract requirements.

d. Contractor's Reaction:

████████████████████████████████████████ sent to DCAA a memorandum response on September 13, 2006 which states that RPSC did not incur the costs of alcohol and souvenirs for the benefit of itself or its own employees; nor were the store inventory items, including clothing and other souvenirs, acquired for either "public relations" or "advertising" purposes. Accordingly, these are not the type of costs that were intended to be treated as unallowable under FAR 31.205-1 or 31.205-51. Even if DCAA is correct that the costs are public relations costs covered by FAR 31.205-1, the costs are expressly allowable because they are clearly and specifically required under the contract.

The audit report also notes the use of DCAA's EZ-Quant Questioned Cost Projection model to derive the amount of questioned costs for this item. RTSC takes exception to this methodology and does not concur that it is appropriate to use it as the means of calculating questioned costs.

The complete text of the contractor's response to our audit findings is included as Appendix 2 of this report.

e. Auditor's Response:

It is DCAA responsibility to make sure that government contracts get paid what has been established under contract agreements but most important to assure that claimed costs comply with Federal regulations. We disagree with RPSC and still believe that RPSC does not want to recognize that its FY 2004 claim includes costs which are expressly unallowable based on the Federal Acquisition Regulation.

Furthermore, we do recognize that RPSC credits back the revenue resulting from these product sales but not against contract costs. The contractor offsets the cost with revenue only on the quarterly expenditure report. The costs are not reduced by revenue in any final accumulation point. This practice allows the contractor to receive G&A burden and fee on what the FAR defines as expressly unallowable items. The practice of booking unallowable costs direct to the contract makes the contractor in noncompliance with FAR 31.205. Specifically, FAR 31.205-14 states that:

*Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle. Costs of membership in social, dining, or country clubs or other organizations having the same purposes are also unallowable, regardless of whether the cost is reported as taxable income to the employees.*

The contractor has taken the position that the contract makes the subject costs expressly allowable and does not intend on removing them from the incurred cost submission. Therefore we find that the contractor is in noncompliance with Cost Accounting Standard (CAS) 405 – Accounting for Unallowable Costs.

In addition to the CAS and FAR noncompliances, there is also no visibility to determine if the contractor's revenues exceed the costs creating a profit situation or if the management of these costs is actually a loss position which would create an effect of having the government subsidize the loss on the unallowable costs.

In summary, contracts can require a variety of provisions and supplies based on the basic contract agreement and further modifications. However, government contracts need to follow public law as defined by the Cost Accounting Standards and also the Federal Acquisition Regulation as agreed to in the contract per FAR Clause 52.230-2. The FAR 31.201-1(b) states:

*“While the total cost of a contract includes all costs properly allocable to the contract, the allowable costs to the Government are limited to those allocable costs which are allowable pursuant to Part 31 and applicable agency supplements”.*

Furthermore, the Statement on Auditing Standards (SAS) No. 39 states:

“The auditor should project the misstatement results of the sample to the items from which the sample was selected”.

**RPSC CLAIMED SUBCONTRACT COSTS  
AND RESULTS OF AUDIT**

<u>Element of Cost</u>	<u>Claimed</u>	<u>Unresolved</u>	<u>Ref.</u>
Subcontracts	██████████	██████████	Note 1

EXPLANATORY NOTE:

1. Subcontract Cost:

a. Summary of Conclusions:

We classified ██████████ of subcontract cost as unresolved due to restrictions on the scope of audit imposed by the National Science Foundation (NSF).

b. Basis of Contractor's Cost:

The contractor's claimed subcontract costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

We reviewed the contractor's schedule J from the FY 2004 incurred cost submission to ascertain which subcontractors had costs in excess of ██████████. According to the NSF, we did not send an assist audit request to the DCAA office with cognizance over Agunsa due to an investigation issue. Based on the materiality of the Agunsa subcontract, we qualified our audit report due to the scope of audit restriction from NSF.

**CONTRACTOR’S CLAIMED OTHER DIRECT COSTS (ODC)  
AND RESULT OF AUDIT**

<u>Cost Element</u>	<u>Claimed</u>	<u>Questioned</u>	<u>Ref.</u>
Other Direct Cost	██████████	██████████	Note 1

EXPLANATORY NOTE:

1. Other Direct Costs

a. Summary of Conclusions:

We questioned a total of ██████████ of RPSC other direct cost for FY 2004. From this total ██████████ was associated with the contractor’s classification of indirect functions as direct contract costs, ██████████ is related to the contractor’s reclassification of Corporate allocations from indirect to direct contract costs and ██████████ represents questioned costs based on FAR 31.201-3.

Our analysis of each indirect function that, in our opinion, should be classified as an indirect cost is based on the RTSC Cost Accounting Standards Disclosure Statement Version 11, Part 4, Item 4.1.0.

Furthermore, the RTSC CAS Disclosure Statement, ██████████  
██████████  
██████████. No costs listed in the allocations that we reviewed were to be booked direct to a contract as an ODC.

The following table shows the breakdown of indirect functions classified as direct contract costs on RTSC Polar Services books and records.



Work Breakdown Structure	WBS Description	FY 2004 Cost to be reclassified to OH
R-PS00-2A0100	[REDACTED]	[REDACTED]
R-PS00-2B0100	[REDACTED]	[REDACTED]
R-PS20-207	[REDACTED]	[REDACTED]
R-PS30-207	[REDACTED]	[REDACTED]
R-PS40-207	[REDACTED]	[REDACTED]
R-PS50-207	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS00-2A0014	[REDACTED]	[REDACTED]
R-PS00-2B0014	[REDACTED]	[REDACTED]
R-PS20-212	[REDACTED]	[REDACTED]
R-PS30-212	[REDACTED]	[REDACTED]
R-PS43-238E01	[REDACTED]	[REDACTED]
R-PS43-238E06	[REDACTED]	[REDACTED]
R-PS43-238E08	[REDACTED]	[REDACTED]
R-PS43-238E09	[REDACTED]	[REDACTED]
R-PS43-238E14	[REDACTED]	[REDACTED]
R-PS53-238	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
R-PS00-2A0120	[REDACTED]	[REDACTED]
R-PS00-2B0120	[REDACTED]	[REDACTED]
R-PS20-208	[REDACTED]	[REDACTED]
R-PS30-208	[REDACTED]	[REDACTED]
R-PS40-208	[REDACTED]	[REDACTED]
R-PS50-208	[REDACTED]	[REDACTED]
Sub-Total	[REDACTED]	[REDACTED]
Total	[REDACTED]	[REDACTED]

In addition, the break down of the [REDACTED] questioned costs related to [REDACTED] from indirect to direct contract costs are as follows:



<u>Doc. No.</u>	<u>Journal Entry Description</u>	<u>WBS</u>	<u>Element</u>	<u>Transaction Amount</u>
110729690		R-PS40-201E08BA		
110752825		R-PS40-201E08BA		
110790063		R-PS40-201E08BA		
110594031		R-PS40-201E08BA		
110594031		R-PS40-201E08BA		
110618218		R-PS40-201E08BA		
110645318		R-PS40-201E08BA		
110674082		R-PS40-201E08BA		
110695593		R-PS40-201E08BA		
100172517		R-PS09-1C06		
100172517		R-PS09-1C06		
100172517		R-PS09-1C06		
<b>FY 2004 Total Reclassified Allocations</b>				

Moreover, we questioned \$115 associated with a late charge fee for the unpaid balance to Qwest Security Screen Services. We used the EZ Quant Statistical Analysis Sampling Program to project \$115 of other direct costs among the projects selected for transaction testing including project R-PS43, R-PS40, R-PS47, R-PS44, R-PS41, R-PS53, R-PS42, R-PS58, R-PS45 and R-PS33. The statistical sample projection resulted in a total of \$266,745 other direct costs questioned for FY 2004. This cost is not reasonable and we questioned this cost based on FAR 31.201-3.

b. Basis of Contractor's Cost:

The contractor's claimed Miscellaneous ODC's is based on actual costs incurred as represented in its accounting books and records.

Locally incurred cost/allocations were booked direct to the Polar Services contract as part of the General Management (PS-X0) and Polar Services Logistics Division (R-PS43 and PS53). These costs were booked as direct and reduced the overhead incurred on the contract.

Furthermore, the Corporate allocations charged on the Polar contract are based on Raytheon Technical Services manual journal entries for the months of January through

September to transfer allocation costs on the overhead pool (OH051) to other direct costs within project R-PS40-201E08BA.

c. Audit Evaluation:

RPSC total ODCs for FY 2004 based on Schedule H is [REDACTED] dollars. We obtained the cost detail of the ODC transactions for the identified universe and made a judgmental sample of the top ten project numbers with the highest ODC dollar amounts. From the total ODC's we excluded all the cost related to the WBS No. R-PS43-237D09E08AE (totaling [REDACTED]) and all the cost related to WBS No. R-PS58-251H09F08AE (totaling [REDACTED]). We excluded the costs related to the WBS mentioned above from our sample due to the fact that these costs were reclassified to another WBS as part of the Christchurch New Zealand petty cash process.

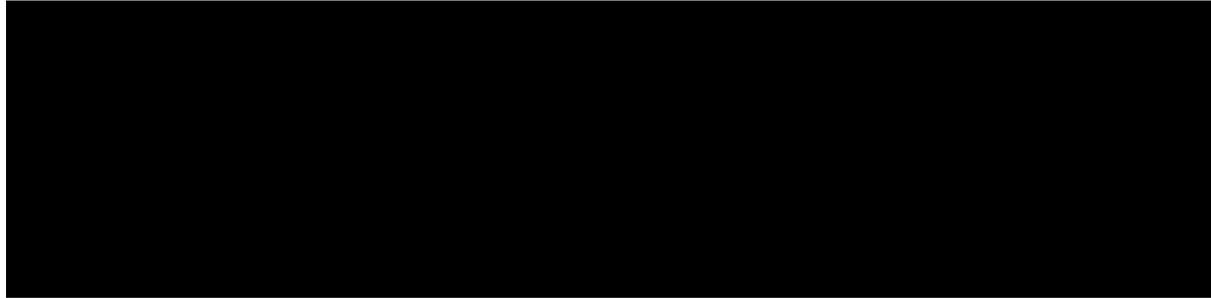
We developed a transaction testing plan and due to the large amount of transactions we performed a statistical sample selection of Miscellaneous ODCs within project: R-PS43, R-PS40, R-PS47, R-PS44, R-PS41, R-PS53, R-PS42, R-PS58, R-PS45 and R-PS33. We evaluated the transactions source documents by using the contractor's SAP Accounting System reports to verify completeness and accuracy, and determine the appropriateness of the charge with respect to terms of the contract and FAR/CAS.

Furthermore, we reviewed the work breakdown structure (WBS) for the Polar contract and confirmed that the contractor [REDACTED]. The WBS listing was then reviewed to determine the various support functions that, in our opinion, were an indirect function of the program. We concentrated primarily on the support functions [REDACTED] based on their materiality.

We have reclassified the costs associated with [REDACTED]. Our analysis of each indirect function that, in our opinion, should be classified as an indirect cost based on the RTSC Cost Accounting Standards Disclosure Statement, Version 11, Part 4, Item No. 4.1.0 is as follows:

[REDACTED]

**Pages 17-18 have been redacted in their entirety.**



Contractor's Reaction:

RTSC disagrees that the [REDACTED]. As a result, RTSC does not agree with the reclassification of [REDACTED] of ODC to an indirect cost. RTSC's disclosed accounting practices at the time of contract award through today have consistently stated that costs required to be charged direct in a specific contract may be charged direct even if they are normally indirect costs.

Furthermore, RTSC agrees that the late charge fee to Qwest Security Screen Services should not have been charged to the contract. RTSC requests the document number be provided by DCAA to RTSC so that a correcting journal entry may be completed to move the late charge fee to non billable. Once the journal voucher is posted and the fee cost is moved then RTSC considers all questioned costs to be allowable.

The complete text of the contractor's response to our audit findings is included as Appendix 2 of this report.

d. Auditor's Response:

RPSC continues to deny the nature of [REDACTED] costs when it is RTSC's common practice to accumulate these types of costs within the overhead pool. CAS 418-40(a) requires Polar Services to have a written statement of accounting policies and practices for classifying costs as direct and indirect and to apply those policies and practices consistently. These policies and practices are included in RTSC's CAS disclosure statement applicable to FY 2004, Part 3, of Revision 11, Item No. 3.1.0. [REDACTED]



[REDACTED]

The Polar RFP required the contractor's cost or pricing data to follow its disclosed cost accounting practices (CAS disclosure statement). As a result, the RFP (procurement) did not require any costs normally classified as indirect (e.g., locally incurred overhead, Raytheon allocations or RTSC allocations) to be treated as direct costs to the contract. The Polar RFP and its requirement for the contractor to follow disclosed accounting practices is consistent with the intent of the CASB when it published comments regarding this issue in Part II, Preambles to the Related Rules and Regulations Published by the Cost Accounting Standards Board, Preambles to Part 331, Contract Coverage, Comment No. 11, Additional requirements by agencies, states that:

*"...concern was expressed that Federal agencies might require the submission of cost proposals in ways inconsistent with the cost accounting practices of some or all of the potential offerors. The Board recognizes that this has happened in the past, but it notes that Board rules, regulations, and Cost Accounting Standards are to be used by relevant Federal agencies as well as by contractors and subcontractors, and it believes that henceforth requests for proposals must be fully consistent with such rules, regulations, and standards, although of course the Federal agency may ask for supplementary information to accompany proposals if this is needed to meet the agency's requirements."*

In summary, RTSC Polar Services should comply with the disclosed accounting practices of RTSC which is a requirement of CAS 418-40(a). RPSC initial disclosure statement dated April 17, 2006 has an effective date of January 1, 2005 and is therefore not applicable to this audit.

**STATEMENT OF CONTRACTOR'S CLAIMED INDIRECT COSTS AND RATES  
AND RESULTS OF AUDIT**

Polar Services Contract No. PRSS-0000373  
Period January 1, 2004 through December 31, 2004

	<u>Claimed</u>		<u>Questioned</u>		<u>Audited Ref.</u>	
<b><u>Overhead</u></b>						
Pool						
Base						
Rate						
<b><u>Fringe Benefits</u></b>						
Pool						
Base						
<b><u>G&amp;A</u></b>						
Pool						
RPSC VAB						
Rate						



**CONTRACTOR’S CLAIMED OVERHEAD POOL AND BASE COSTS  
AND RESULTS OF AUDIT**

	<u>Amount</u>	<u>Amount</u> Ref. _____	
<b>Claimed Overhead Pool</b>		██████████	
██████████			
██████████	██████████		Note 1
		██████████	Note 2
<b>Revised Pool</b>		██████████	
<b>Claimed Direct Labor Base</b>		██████████	
██████████			
	██████████		Note 1
		██████████	
<b>Revised Overhead Base</b>		██████████	

EXPLANATORY NOTES:

1. Overhead – Locally Incurred Costs/Functions

a. Summary of Conclusions:

Our examination of the overhead pool for locally incurred cost resulted in an increase in the overhead pool of ██████████. We found that RPSC did not always classify indirect functions and associated costs in accordance with its disclosed accounting practices. Instead, the contractor recorded all local support (indirect) functions to the Polar Services contract as direct costs. As a result, we reclassified ██████████ of Miscellaneous ODC and ██████████ of labor costs to the local overhead pool.



b. Basis of Contractor's Cost:

The contractor's claimed costs are based on actual costs incurred as represented in its accounting books and records. These costs were booked direct to the Polar Services contract as part of the General Management (PS-X0) and Polar Services Logistics Division (PS-43 and PS-53). These costs were booked as direct and reduced the overhead incurred on the contract.

c. Audit Evaluation:

The overhead pool was reviewed based on costs incurred and submitted in the contractor's incurred cost submission. The contract and the original proposal were reviewed to determine contract requirements for support functions during the term of the contract. The contractor's disclosure statement (disclosed accounting practices) was also reviewed for the treatment of costs regarding the functions as described. According to the contract, the contractor is required to follow its disclosed accounting practices. NSF RFP No. OPP98001, Amendment No. 8 required the contractor's cost or pricing data to follow its Cost Accounting Standards Board Disclosure Statement (Form CASB DS-1). We confirmed that the contractor was recording all local support functions to the Polar Services contract as direct costs. The WBS listing was then reviewed to determine the various support functions that were indirect to the program. The significant support functions reviewed that were indirect to the program were [REDACTED].

Our reclassification of labor costs to the local overhead pool is discussed in further detail in Schedule A-1, Note 1 of this report. Our reclassification of the Miscellaneous ODC is discussed in further detail in Schedule A-4, Note 1 of this report.

2. Corporate and RTSC Allocations

a. Summary of Conclusions:

Our examination of the overhead pool for allocated costs from RTSC and Raytheon Corporate resulted in an increase in the overhead pool by [REDACTED] with a proportionate decrease in ODC. The contractor's disclosed accounting practice accumulates and classifies these costs as indirect for subsequent allocation to cost objectives. As a result, we reclassified these RTSC and Corporate allocations to the overhead pool consistent with the contractor's disclosed accounting practices.

b. Basis of Contractor's Cost:

The contractor's claimed costs are based on actual costs incurred as represented in its accounting books and records.

c. Audit Evaluation:

Polar Services demonstrated, through a prepared schedule and Annual Program Plan Cost Structure, the methodology used when recording allocated costs from Raytheon Corporate and Raytheon Technical Services (RTSC). Understanding the contractor's methodology and classification of costs direct vs. indirect is important since the contract includes a [REDACTED] overhead ceiling rate.

It was determined that Polar Services was recording allocations direct to the contract using the General Management WBS. The RTSC disclosure statement Revision 9C Section 4.1.0 states that the Business Area Overhead major elements of costs include redistributed expenses which consists of "allocations from Raytheon Corporate, RTSC, and Business Unit Management for services provided that benefit the business area". The incurred costs submissions for Raytheon Technical Services requires that specific allocations are to be made to overhead while others are to be booked within the business unit G&A (B&P) pools. No costs listed in the allocations reviewed were to be booked direct to a contract as ODC.

Our reclassification of the RTSC and Corporate allocations to the local overhead pool is discussed in further detail in Schedule A-4, Note 1 of this report.

d. Contractor's Reaction:

RTSC continues to believe that inclusion of RTSC allocations as direct costs reflects an appropriate methodology to implement the original intent of the proposal, and subsequent contract, to charge normally indirect services as direct costs to the contract. RTSC's disclosure statement has consistently permitted items that are normally charged indirect to be charged as direct costs to the benefiting contract. [REDACTED]

[REDACTED]

[REDACTED]. We contend that this reclassification is in accordance with our disclosed practices and is consistent with the parties' original intent on the contract.

e. Auditor's Response:

[REDACTED]

[REDACTED]. We reclassified to the overhead pool all flow down costs to the Polar business unit that the contractor elected to charge direct to the contract. We are not aware of any other business units that judgmentally select certain allocations and charge the associated costs direct to the contract.

[REDACTED]

[REDACTED]

Fiscal Year 2004 Fringe

<u>Union Code</u>	<u>Claimed Fringe</u>	<u>Claimed Fringe Questioned</u>	<u>Audited Fringe</u>	<u>Labor Base Claimed</u>	<u>Labor Base Questioned</u>	<u>Labor Base Audited</u>
RTQ		\$ 0			\$ 0	
RTT						
RTJ						
R01						
<b>Total</b>		<u>\$ 0</u>			<u>\$ 0</u>	

EXPLANATORY NOTE:

1. Fringe Expense:

a. Summary of Conclusions:

The FY 2004 fringe rates are being audited under Assignment No. 2006T10160201. Therefore, we were not able to compare the total burdens to the applied fringe billed through FY 2004.

b. Basis of Contractor's Cost:

The contractor applies RTSC claimed fringe rates to the labor bases that the Polar program participates in. Participation is based on the various union codes applicable to the labor incurred.

c. Audit Evaluation:

We determined the applicable labor bases for each of the union codes that RPSC participates in. Once the FY 2004 RTSC incurred cost audit (under Assignment No. 6161-2004T10100001) is completed we will issue a supplemental report to reflect the application of the audited RTSC fringe rates to the Polar Services fringe bases.



**CLAIMED AND AUDITED G&A POOL, BASES AND RATE  
AND RESULT OF AUDIT**

<u>G&amp;A</u>	<u>Claimed Costs FY 2004</u>	<u>Questioned Costs FY 2004</u>	<u>Audited Costs FY 2004</u>	<u>Note</u>
Total Pool Polar VAB <b>Polar G&amp;A Rate</b>	[REDACTED]	[REDACTED]	[REDACTED]	Note 1

EXPLANATORY NOTE

1. G&A Pool Expenses

a. Summary of Conclusions:

We take no exceptions to RPSC allocated G&A pool costs for FY 2004.

b. Basis of Contractor's Cost:

The contractor's costs for G&A were based primarily on allocated costs from RTSC. No locally incurred G&A expenses were identified on the Polar program.

RPSC G&A expense represent residual costs allocated based on a value added base. The main costs categories included as segment G&A are RTSC general management, restructuring, and corporate allocations including legal and state income tax.

c. Audit Evaluation:

We reviewed RPSC G&A Summary Report on the contractor's SAP Accounting System and found no locally incurred G&A expenses. Moreover, RTSC G&A allocated costs to Raytheon Polar Services Company are being audited under assignment no. 6161-2004T10100001. Part of this audit consisted in reconciling the expenses representing allocations from the Raytheon Corporate office and the amounts included in the DCAA Raytheon Corporate office's audit report. The FY 2004 RTSC incurred cost audit is still in process therefore, we will issue a supplemental audit report to incorporate any findings from the RTSC Incurred Cost audit report applicable to Raytheon Polar.





b. Basis of Contractor's Cost:

The contractor's claimed costs and indirect rates are based on its certified incurred cost submission.

c. Audit Evaluation:

We computed the overhead and G&A costs in excess of the ceiling rates but without including any audit adjustments. These amounts represent the costs in excess of the ceiling rates based on the contractor's claimed indirect rates and allocation bases. Any comparison to billed costs should be performed after final negotiations and resolution with the contractor.

2. Overhead Costs in Excess of Ceiling – With Audit Adjustments

a. Summary of Conclusions:

We computed the overhead costs in excess of the ceiling rates. These amounts represent the costs in excess of the ceiling rates that includes the audit adjustments discussed in this report.

b. Basis of Contractor's Cost:

The contractor's claimed costs and indirect rates are based on its certified incurred cost submission.

c. Audit Evaluation:

We computed the overhead costs in excess of the ceiling rates that reflect our audit adjustments. These amounts represent the costs in excess of the ceiling rates based on incorporating the audit adjustments made to the contractor's indirect cost pools and allocation bases. Any comparison to billed costs should be performed after final negotiations and resolution with the contractor.

d. Contractor's Reaction:

RTSC agrees with DCAA that these costs are not allowable on the contract. However, according to the contractor the costs are appropriately allocable to the contract and therefore need to be included in the incurred cost claim even though there is no

intention in recovering these costs from the Polar customer. RTSC stated that it has not included any of these over ceiling costs in the billings to date and has no intention of billing them in the future.

e. Auditor's Response:

We disagree that the contractor has not recovered the cost in excess of the ceiling rates. The contractor has billed and recovered a portion of the over ceiling amounts by reclassifying indirect costs as direct [REDACTED]. We reclassified these direct costs [REDACTED] to overhead and computed the amounts that exceeded the contract's ceiling rates.

CONTRACTOR ORGANIZATION AND SYSTEMS

I. Organization

RTSC's headquarters is located in Reston, VA. [REDACTED]

[REDACTED]

[REDACTED]

RTSC has a multi-disciplined workforce of approximately 10,000 employees. RTSC provides technical, scientific, and professional services to defense, federal, and commercial customers on all seven continents, including support for operations in space, at sea, and on land. RTSC had annual sales of approximately [REDACTED] in FY 2005, of which approximately [REDACTED] are primarily government prime contracts and subcontracts. Of the government contracts and subcontracts, approximately [REDACTED] are flexibly priced (i.e. cost type and time and materials (T&M) type).

[REDACTED]

**Pages 32 through 33 have been redacted in their entirety**

**Audit Report No. 6161-2004P10100201**

In Audit Report No. 6161-2006T11070301 dated September 5, 2006, DCAA examined the Control Environment and Overall Accounting System and the related internal control policies and procedures. Based on our examination, we concluded that the Control Environment and the Overall Accounting System and related internal control policies and procedures are adequate.

[REDACTED]

[REDACTED]

[REDACTED]

DCAA reviewed RTSC's Budget and Planning System and related internal control policies and procedures under Audit Assignment No. 6161-2006T11020301 dated September 8, 2006. Based on its review DCAA determined that the RTSC's Budget and Planning system and the related internal control policies and procedures are adequate.

[REDACTED]

[REDACTED]

**Page 35 has been redacted in its entirety**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

V. Indirect and ODC System

DCAA examined RTSC's Indirect and Other Direct Cost System of internal controls under Audit Assignment No. 6161-2005T14980301, with a reported issued on September 28, 2005. Based on its examination, DCAA determined that the RTSC Indirect/Other Direct Cost System is inadequate in part.

[REDACTED]

**Audit Report No. 6161-2004P10100201**

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Furthermore, in Audit Report No. 6161-2004T14980202, dated December 15, 2005, DCAA evaluated the Indirect and ODC Internal Controls for RTSC Polar Services and determined that the system is inadequate. A brief summary of the deficiencies are as follows:

- The RTSC segment disclosure statement which defines the contractor's current accounting practice regarding indirect and ODC costs, excludes Raytheon Polar Services as of January 1, 2005. To date, a disclosure statement for Raytheon Polar Services has not been submitted to the Government.
- Policies and procedures regarding the allowability of selected costs are in noncompliance with the Federal Acquisition Regulation (FAR) Part 31

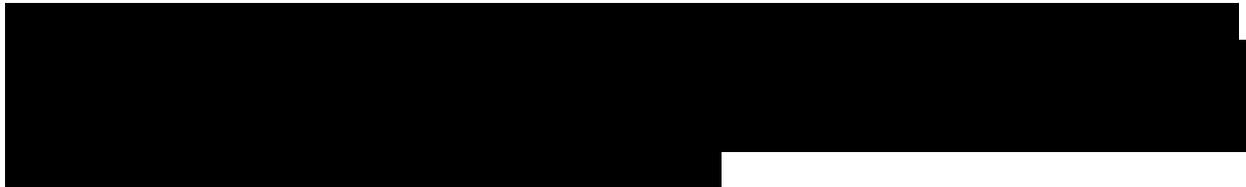
[REDACTED]

**Audit Report No. 6161-2004P10100201**

Specifically, RPSC policies and procedures address certain costs as allowable which, in our opinion, are expressly unallowable based on applicable FAR provisions.

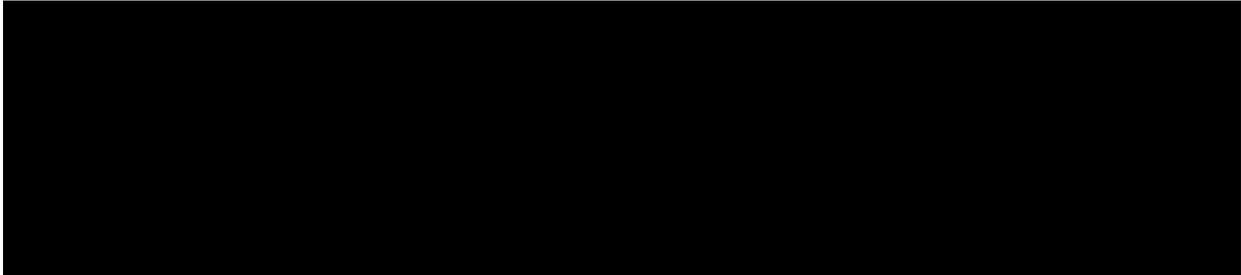
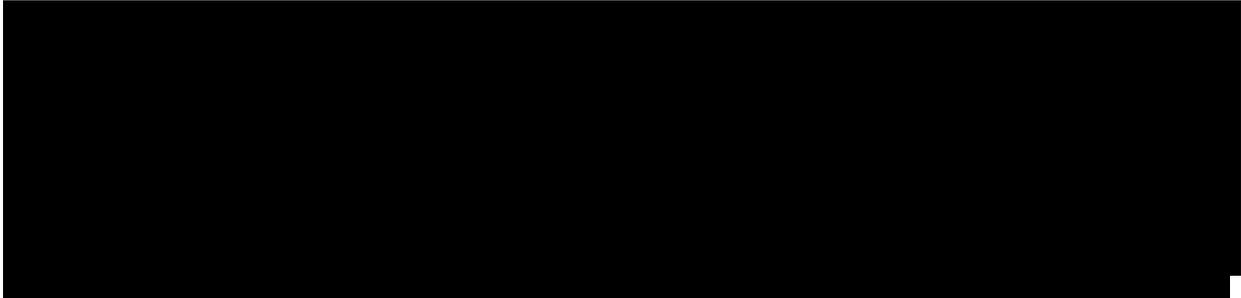
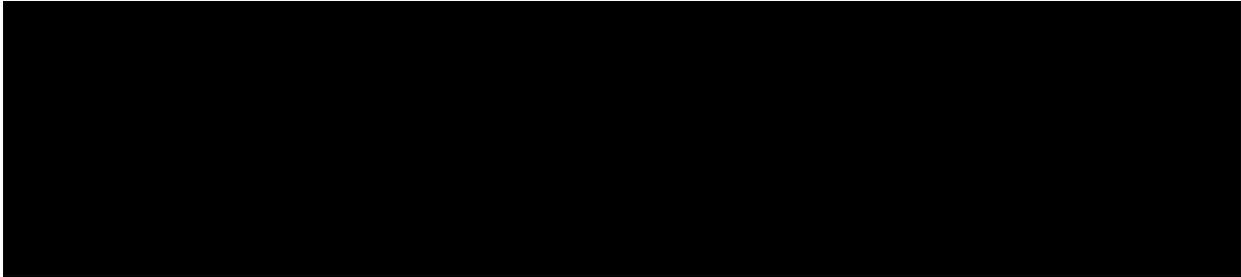
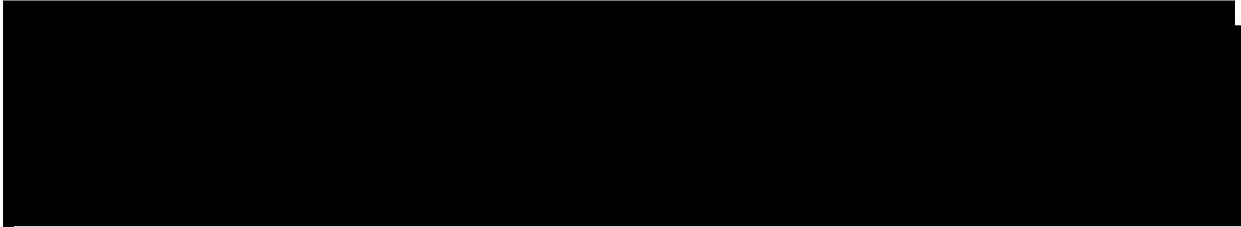
- Costs that are made expressly unallowable based on the FAR or RPSC/RTSC policies and procedures were charged as allowable, indicating that the contractor is not adequately complying with established controls to properly classify and record unallowable costs. The deficiencies represent a noncompliance with CAS 405-40(a), Accounting for Unallowable Costs, FAR Part 31, and established company policies and procedures.
- The contractor lacks policies and procedures regarding the training of employees in the Indirect/ODC system.
- The contractor has inadequate policies and procedures regarding periodic, independent management reviews and its associated compliance.
- We identified inadequacies that affect the allocability of costs indicating that the contractor lacks adequate controls to ensure the consistent classification of costs based on CAS 418, Allocation of Direct and Indirect Cost [CAS 418-40(a)].

DCAA will perform an RTSC Polar Services Indirect and ODC Internal Control follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations.



**Pages 39 through 41 have been redacted in their entirety**

**Audit Report No. 6161-2004P10100201**



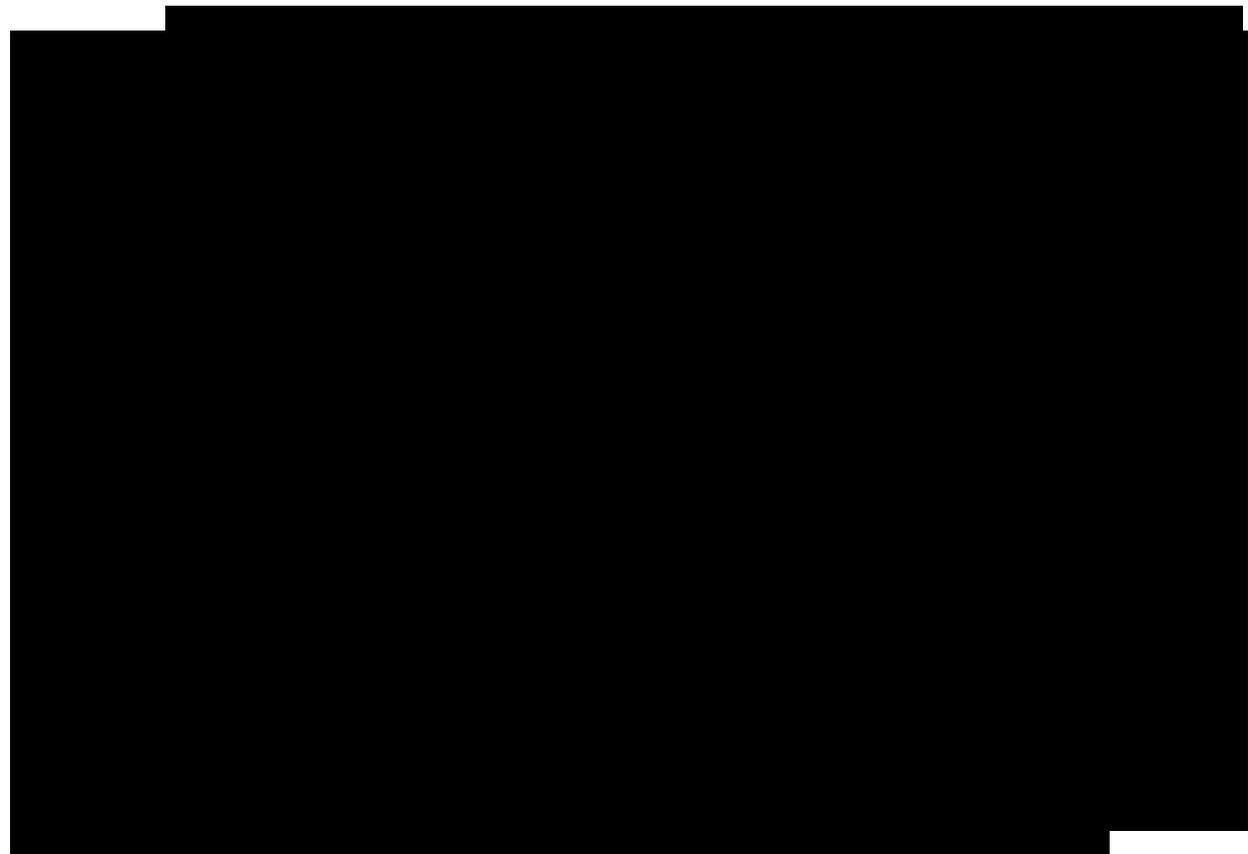
CASB 9903.202-1: Audit Report No. 6161-2005T19200303, dated November 18, 2005, indicates that RTSC disclosed and established cost accounting practices are in noncompliance with CASB 9903.202-1, Disclosure Statement General Requirements.



**Audit Report No. 6161-2004P10100201**

Specifically, effective January 1, 2005, RTSC Raytheon Polar Services Company (RPSC) business unit does not have a separate disclosure statement to describe its unique cost accounting practices used to account for direct and indirect costs. On April 5, 2006, the DACO issued an initial finding of noncompliance on this issue. We are awaiting RTSC's response to the finding.

CAS \_\_\_\_\_ 418: Audit Report No. 6161-2005T19200001, dated June 23, 2005, indicates that the actual cost accounting practices of one of RTSC's business units, Raytheon Polar Services Company (RPSC), are in noncompliance with CAS 418 and with disclosed cost accounting practices. Specifically, during the period from January 1, 2000 through December 31, 2002, costs that were disclosed as indirect were recorded and charged direct to the Polar Services contract. Recording and charging these costs direct to the contract results in 100 percent recovery through contract billings to the government (i.e., National Science Foundation). On September 28, 2005, the DACO issued an initial finding of noncompliance on this issue. The contractor's December 5, 2005 response was considered a non-response by the DACO. Therefore, on January 17, 2006, the DACO issued a request for response to the initial finding of noncompliance. The contractor's January 24, 2006 response is currently being evaluated by the DACO.



**Pages 44 through 45 have been redacted in their entirety**

**Audit Report No. 6161-2004P10100201**

**DCAA PERSONNEL**

Telephone \_\_\_\_\_ No.  
Primary contact(s) regarding this audit:

[REDACTED]

[REDACTED]

Other contact(s) regarding this audit report:

[REDACTED], Branch Manager

[REDACTED]

FAX No.  
[REDACTED]

E-mail Address  
[REDACTED]

General information on audit matters is available at <http://www.dcaa.mil/>.

**AUDIT REPORT AUTHORIZED BY:**

/Signed/

[REDACTED]  
Branch Manager  
DCAA Herndon Branch Office

[REDACTED]

**Audit Report No. 6161-2004P10100201**

**AUDIT REPORT DISTRIBUTION AND RESTRICTIONS**

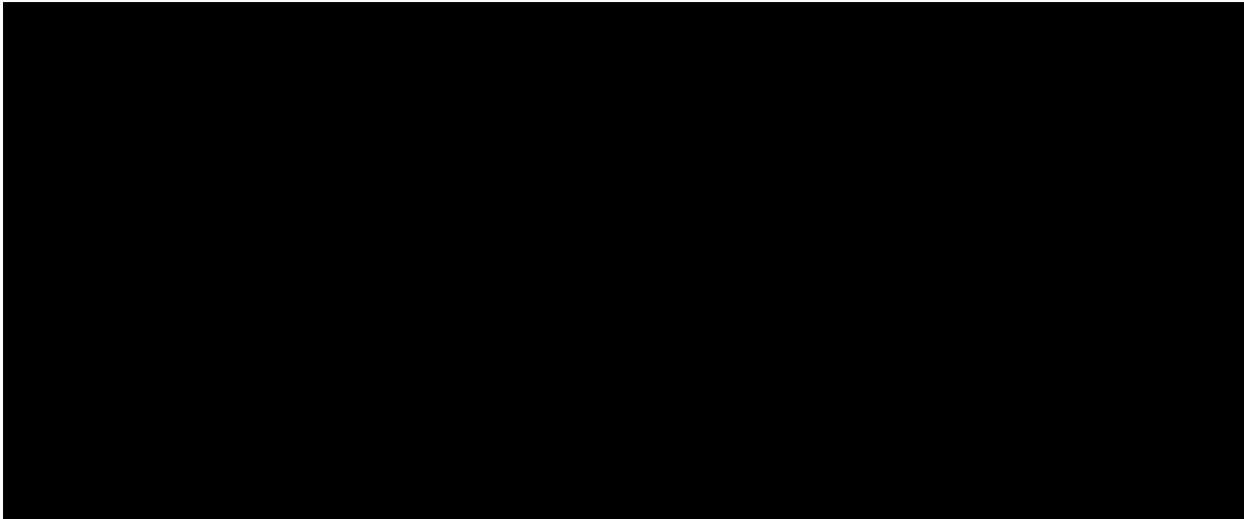
DISTRIBUTION

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Associate Inspector General for Audit  
4201 Wilson Boulevard  
Arlington, VA 22230

ail Address  
Kstagner@nsf.gov

Raytheon Polar Services  
Raytheon Technical Services Company  
12160 Sunrise Valley Drive  
Reston, VA 20191

(Copy furnished thru ACO)



# **APPENDIX 1**

## **Certificate of Final Indirect Costs**

## CERTIFICATE OF FINAL INDIRECT COSTS

This is to certify that I have reviewed this proposal to establish final indirect cost rates and to the best of my knowledge and belief:

1. All costs included in this proposal ("Raytheon Technical Services Company 2004 Overhead Proposal" dated June 30, 2005) to establish final indirect rates for labor overhead, G&A, and fringe for fiscal year 2004, are allowable in accordance with the cost principles of the Federal Acquisition regulation (FAR) and its supplements applicable to the contracts to which the final indirect cost rates will apply; and
2. This proposal does not include any costs which are expressly unallowable under applicable cost principles of the FAR or its supplements.

Firm: Raytheon Technical Services Company

Signature: [REDACTED]

Name of Certifying Official: [REDACTED]

Title: [REDACTED]

Date of Execution: 6 - 30 - 05

## APPENDIX 2

RPSC Letter Response to the DCAA Draft Audit Report No. 6161-2004P10100201, dated  
September 13, 2006



C:\Documents and  
Settings\aleimer\Desl

## Raytheon

Technical Services Company LLC  
Polar Services

7400 S Tucson Way  
Centennial, Colorado  
80112-3938 USA  
303.790.8606

September 13, 2006

To: Defense Contract Audit Agency  
Attn: Larry Tatem  
171 Elden Street  
Herndon, VA 20170-4810

Subject: Raytheon Polar Services Company – 2004 Incurred Cost Audit

Reference: Draft Audit Report No. 6161-2004P10100201 dated August 8, 2006

Please find below Raytheon's response to the points raised in the referenced audit report concerning the treatment of costs on the Polar Program.

### Questioned Costs – Alcohol and Commemorative Items

Item number 2 in the Executive Narrative of the Audit report questions \$503,316 in alcoholic beverages and T shirts. RTSC appreciates DCAA's acknowledgement that the contract requires the contractor to provide the opportunity for persons working on the Antarctic program to participate in morale, welfare, and recreation facilities such as social establishments. RPSC did not incur the costs of alcohol and souvenirs for the benefit of itself or its own employees; nor were the store inventory items, including clothing and other souvenirs, acquired for either "public relations" or "advertising" purposes. Accordingly, they are not the type of costs that were intended to be treated as unallowable under FAR § 31.205-1 or 31.205-51. Even if DCAA is correct that the costs are public relations costs covered by FAR § 31.205-1, the costs are expressly allowable because they are clearly and specifically required under the contract. RTSC has been directed by NSF through the authorization of the Annual Program Plan to budget for these types of costs and charge them direct to the contract. RTSC includes these items in company stores and sells them to U. S. Antarctic Program participants as part of the overall morale program on the contract. The revenue that results from these product sales is credited back to the contract to offset the costs associated with purchasing these items. Even if costs of the above items were unbillable/unallowable costs, and they are not, the associated revenue must be credited against the allegedly unallowable costs. Since revenue from these product sales exceed the items' purchase costs, excluding these items from the claim will not reduce the claim by the \$503,316 noted in the referenced DCAA audit report.

Furthermore, even if the costs were unallowable, the Government could not assess a penalty against RPSC for including these costs in its billings on the Polar contract. As a threshold matter, these are *direct* costs of the Polar contract, and the Penalties for Unallowable Costs clause permits the assessment of penalties if the contractor includes expressly unallowable costs in its *indirect* cost proposals. In any event, the circumstances under which RPSC incurred these costs are not the sort contemplated for imposition of a penalty. The Polar contract expressly requires RPSC to purchase alcohol and souvenirs for resale in the clubs, bars, and stores at the Antarctic stations. Not only are the costs not "expressly unallowable," they are expressly *allowable* under contractual provisions that could not be clearer. In any case, there is no basis for any argument that RPSC acted so unreasonably in including these costs in its vouchers for reimbursement that they should be subject to penalties.

The audit report also notes the use of DCAA's EZ-Quant Questioned Cost Projection model to derive the amount of questioned costs for this item. RTSC takes exception to this methodology and does not concur that it is appropriate to use it as the means of calculating questioned costs. Having not seen the details of DCAA's sampling technique or its method of estimating total costs based on the sample, RTSC does not concede that the total questioned amount accurately reflects the costs incurred for these items in FY 2004. Based on what we do know about the sampling technique, it does not appear to be statistically valid. Only those costs specifically identified during audit should be considered as questioned costs.



bid as direct costs to the Polar contract in accordance with this clause in the disclosure statement. Subsequently, upon contract award, RTSC and the Polar customer agreed via the Annual Program Plan that these locally incurred costs would be charged as direct costs on the Polar contract. Charging these types of costs as direct costs to the contract is also consistent with the charging practice of the prior contractor and has been used in similar situations in RTSC. The National Science Foundation accepted the bid by RTSC which included this basis and has, each year, approved the Annual Program Plan which budgets for these costs as direct costs to the contract. Also, the DCAA asserts that because the contract calls for separate work breakdown structures (WBS) to collect costs on the program that the contract has multiple final cost objectives. If this were the case, every contract issued by the government would have multiple final cost objectives because all contracts require WBS detail to budget and manage costs. Polar, like all contracts within RTSC, is a single final cost objective for CAS purposes. In summary, the costs at issue exclusively benefit and are identified to the Polar contract and should be an allowable direct cost on the contract.



Late charge fee of Unpaid Vendor

RTSC agrees that the late charge fee to Qwest Security Screen Services should not have been charged to the contract. RTSC requests the document number be provided by DCAA to RTSC so that a correcting journal entry may be completed to move the \$115 to non billable. Once the journal voucher is posted and the \$115 in cost is moved then RTSC considers all questioned costs, \$7,581,857, to be allowable.

The audit report also notes the use of DCAA's EZ-Quant Questioned Cost Projection model to derive the amount of questioned costs for this item. As discussed above, RTSC does not concur with the use of this methodology to calculate the amount of questioned costs.

Overhead and G&A Costs in Excess of the contract ceiling

RTSC agrees with DCAA that these costs are not allowable on the contract. However, as noted in our response to the 2000-2002 Polar incurred cost audit report, the costs are appropriately allocable to the contract and therefore need to be included in our incurred cost claim even though we have no intention of recovering these costs from the Polar customer. RTSC has not included any of these over ceiling costs in our billings to date and has no intention of billing them in the future.

If you have any questions or require any further information, please contact me at [redacted].

Sincerely,  
[redacted signature]

Cc: [redacted]