

**Report on Examination of  
Direct and Indirect Costs and Rates for  
Fiscal Year Ended March 31,1999**

**December 2003**

**Reference Number: 2004-1C-020**

**This report has cleared the Treasury Inspector General For Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

December 3, 2003

MEMORANDUM FOR DAVID A. GRANT  
DIRECTOR OF PROCUREMENT  
INTERNAL REVENUE SERVICE

*Daniel R. Devlin*

FROM: Daniel R. Devlin  
Assistant Inspector General for Audit (Headquarters Operations  
and Exempt Organizations Programs)

SUBJECT: Report on Examination of Direct and Indirect Costs and Rates for  
Fiscal Year Ended March 31, 1999 (Audit #20041C0211)

The Defense Contract Audit Agency (DCAA) examined the contractor's July 23, 1999, certified final indirect cost rate proposal and related books and records for reimbursement of Fiscal Year (FY) 1999 incurred costs. The purpose of the examination was to determine the allowability of direct costs and indirect cost rates and to establish audit-determined indirect cost rates for April 1, 1998, through March 31, 1999. The proposed rates apply primarily to flexibly priced contracts.

The DCAA questioned costs of approximately \$11.1 million in the contractor's claimed labor overhead and general and administrative expenses. The questioned costs include approximately \$10.5 million in claimed executive compensation costs for the contractor's FY 1999. Of this amount, approximately \$1.6 million is expressly unallowable based on the executive limitation of the Federal Acquisition Regulation (FAR) Part 31, and approximately \$8.9 million is considered unreasonable based on the criteria of FAR Part 31. The DCAA indicated the questioned costs resulted from a comparison of the contractor's executives' compensation to comparable executive positions published in executive market pay surveys. The contractor did not concur with the DCAA's position on executive compensation.

The DCAA stated that the contractor's proposed indirect rates, subject to the qualifications discussed below, are not acceptable as proposed. However, claimed direct costs, subject to the qualifications discussed below, are provisionally approved pending final acceptance.

The DCAA qualified its audit report because results of the assist audits for the subcontract costs had not been received. The results of the assist audits may disclose additional questioned costs. Also, the DCAA indicated that the contractor's home office has been cited as being in noncompliance with Cost Accounting Standard 405 for failing to identify expressly unallowable costs from its incurred cost submission. A final determination on this noncompliance may lead to additional questioned costs. Additionally, the DCAA noted that subsequent audits or reviews on insurance, pension, and other fringe benefits may supplement the findings in this report.

Although this DCAA report is dated December 20, 2001, we did not receive a copy of the report until November 2003. Neither the Internal Revenue Service (IRS) nor the Treasury Inspector General for Tax Administration (TIGTA) are shown on the DCAA report distribution list, even though two IRS-administered contracts were included in the scope of the DCAA report.

The information in this report should not be used for purposes other than those intended without prior consultation with the TIGTA regarding their applicability.

If you have any questions, please contact me at (202) 622-8500 or John R. Wright, Director, at (202) 927-7077.

Attachment

# NOTICE:

The Office of Inspector General for Tax Administration has no objection to the release of this report, at the discretion of the contracting officer, to duly authorized representatives of the contractor.

The contractor information contained in this report is proprietary information. The restrictions of 18 U.S.C. § 1905 must be followed in releasing any information to the public.

This report may not be released without the approval of this office, except to an agency requesting the report for use in negotiating or administering a contract with the contractor.

*The TIGTA seal was removed due to its size.*