

**Incurring Costs Audit for
Fiscal Year Ended March 31, 2002**

March 2004

Reference Number: 2004-1C-078

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

March 30, 2004

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: Incurred Costs Audit for Fiscal Year Ended March 31, 2002
(Audit #20041C0224)

The Defense Contract Audit Agency (DCAA) examined the contractor's November 18, 2002, certified final indirect cost rate proposal and related books and records for reimbursement of Fiscal Year (FY) 2002 incurred costs. The purpose of the examination was to determine the allowability of direct and indirect costs and to establish audit-determined indirect cost rates for April 1, 2001, through March 31, 2002. The proposed rates apply primarily to flexibly priced contracts.

The DCAA questioned costs of approximately \$30.4 million in the contractor's claimed fringe, overhead, and general and administrative (G&A) expenses. The DCAA believes indirect costs questioned in this examination are subject to penalties provided in the Federal Acquisition Regulation (FAR). The questioned costs include approximately \$22.9 million in claimed overhead executive compensation costs for FY 2002. In addition, the questioned executive compensation costs resulted in \$781,786 of questioned overhead allocation to the G&A pool. The DCAA indicated that the questioned costs resulted from a comparison of executive compensation to that of comparable positions published in executive market pay surveys. The DCAA questioned the executive compensation costs based on application of the reasonableness criteria of the FAR Part 31.

The questioned costs also include approximately \$5.9 million in claimed corporate allocation cost. This questioned cost is the result of the DCAA's reconciliation of the claimed corporate allocations to the contractor's FY 2002 corporate audit report. The

contractor concurred with DCAA's results except for the finding and recommendations relating to executive compensation and related overhead costs applied to the questioned executive compensation.

The DCAA opined that the contractor's indirect rates are not acceptable as proposed. However, claimed direct costs, subject to the qualifications discussed below, are acceptable and 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. 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 and exclude expressly unallowable costs from its incurred cost submission. A final determination on this noncompliance may lead to additional questioned costs.

The information in this report should not be used for purposes other than those intended without prior consultation with the Treasury Inspector General for Tax Administration 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.