

MEMORANDUM

DATE:

TO: Bradley Poston, Interim Director
Division of Acquisition and Cooperative Support

FROM: Deborah H. Cureton
Associate Inspector General for Audit

SUBJECT: NSF OIG Audit Report No. OIG-06-1-004, Audit of Raytheon Polar Services Company's Indirect and Other Direct Costs Internal Controls

In response to your request for audit assistance we contracted with the Defense Contract Audit Agency (DCAA) to perform a series of audits of the Raytheon Polar Services Company's (RPSC) Calendar Year 2000-2004 incurred cost proposal submissions of costs claimed under NSF Contract OPP-0000373. As these audits are completed and issued to the NSF OIG by DCAA's Herndon Branch Office, we provide the results and our recommendations to the Division of Acquisition and Cooperative Support (DACS) for appropriate action. This DCAA audit report addresses RPSC's internal controls to account for and report indirect and other direct costs in accordance with its disclosed accounting practices and Federal and NSF contract requirements.

The objectives of the audit were to determine whether RPSC's internal controls over processing and claiming indirect and other direct costs under the NSF contract provide reasonable assurance that: 1) applicable laws and regulations are complied with, 2) the accounting system and cost data are reliable, 3) the risk of misallocations and mischarges are minimized, and 4) contract allocations and charges are consistent with invoice procedures.

DCAA performed the audit in accordance with Generally Accepted Government Auditing Standards.

Background

The United States Antarctic Program (USAP) has, since 1971 when NSF assumed full responsibility for USAP, provided a permanent presence and overseen U.S. scientific

interests in Antarctica. RPSC, located in Centennial, Colorado, is a unit of Raytheon Technical Services Company (RTSC) headquartered in Reston, Virginia. RPSC is under contract with NSF to provide science, operations, and maintenance support to sustain year-round research programs. 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].

Summary of Results

On December 15, 2005, DCAA Herndon Branch Office issued "Report on Audit of RTSC Polar Services Indirect and Other Direct Cost Internal Controls" (see Attachment). The auditors found that RTSC and RPSC lack adequate internal controls in all areas related to classifying NSF contract costs as either *Indirect Costs* or as *Other Direct Costs*. RPSC is incorrectly recording and charging indirect costs, which are subject to the NSF contract limitation of [REDACTED], as miscellaneous other direct costs. In addition, the auditors found that RPSC's internal controls did not ensure that supporting documents such as receipts and invoices were maintained for all costs claimed on the NSF contract. As a result, RPSC charged NSF over [REDACTED] of costs from 2000-2002 that RPSC was not entitled to recover under the terms of the NSF contract.¹

A brief summary of the DCAA audit findings concerning RPSC's inadequate indirect/other direct cost classification system follows:

- Undocumented Standard Accounting Practices Beginning January 1, 2005, RTSC excluded RPSC from its Cost Accounting Standard Board Disclosure Statement (Disclosure Statement). A Disclosure Statement identifies the standard accounting practices that a contractor represents that it uses to classify its costs as indirect or other direct costs in its accounting system and to bill costs to the federal government. RPSC is required by Federal and NSF contract requirements to maintain a Disclosure Statement with the U.S. Government. As of December 15, 2005, a Disclosure Statement for RPSC had not been submitted. Without the Disclosure Statement, there is no common understanding between RPSC and NSF and therefore, no basis to readily and clearly determine the correctness and accuracy of billings presented to NSF for payment. In effect, no accounting document, report, or billing from RPSC can be considered to be an accurate statement of NSF contract costs without a Disclosure Statement and an agreed upon basis for RPSC to account for, classify, and bill its costs to NSF.²
- Lack of Internal Compliance Monitoring RPSC did not have and/or did not implement adequate policies and procedures to ensure the allowability and allocability of the NSF contract costs recorded its accounting records for the 2000 to 2002 contract years. In addition, RPSC management did not periodically review the

¹ Previously reported in OIG Audit Report No. OIG-5-1-005 dated March 31, 2005.

² DCAA, in Audit Report No. 6161-2005T19200303 dated November 18, 2005, cited RPSC for inadequately disclosing its accounting practices to the government.

adequacy or the implementation of its policies and procedures for the accounting and billing of indirect and other direct costs. RPSC management did not 1) conduct regular reviews to identify outdated policies and procedures; 2) ensure that RPSC employees consistently adhere to policies and procedures in classifying indirect and other direct costs in the RPSC accounting records, in accordance with its disclosed accounting practices; 3) ensure that RPSC employees maintained adequate supporting documentation in accordance with government contract regulations; and 4) ensure RPSC employees properly allocated allowable costs to the NSF contract. As a result, RPSC charged NSF over [REDACTED] of costs from 2000-2002 that RPSC was not entitled to recover under the terms of the NSF contract.

In addition, without periodic reviews of its policies and operating procedures, RPSC could not ensure its own higher-level management or NSF that it had correctly recorded and billed contract costs in compliance with applicable Federal and NSF requirements. Such reviews would have ensured that RPSC's policies and procedures remained current and consistent with its disclosed accounting practices and applicable Federal and NSF contractual requirements.³

- Lack of Training RPSC does not have an employee-training program structured to produce trained employees with the necessary skills to consistently and accurately classify NSF contract costs as indirect or as other direct costs. The RPSC training policies and procedures need to address how an employee can accurately determine if a cost is both allowable for payment under government contracting regulations and correctly classified as an indirect or other direct cost. It is important that RPSC employees are well versed in the indirect/ other direct cost classification process in order to ensure accurate and proper classification of NSF contract costs for allowability and allocability.

Recommendations

The DCAA audit report makes a number of recommendations to improve RPSC's internal controls. Accordingly, we recommend that NSF's Director of the Division of Acquisition and Cooperative Support work with RTSC and RPSC to develop a corrective action plan to address all of the recommendations in the DCAA report and ensure that RPSC:

1. Discloses to the government its standard accounting practices.
2. Establishes adequate policies and procedures, including an internal compliance program and an employee training program, to comply with the requirements of government contracting regulations as identified in the DCAA audit report. Such programs will help ensure that RPSC employees both understand and consistently classify costs as either direct or indirect in accordance with RPSC's disclosed

³ DCAA, in Audit Report No. 6161-2005T19200303 dated November 18, 2005, cited RPSC for not disclosing its accounting practices to the government.

accounting practices and the requirements of applicable Federal and NSF contract requirements.

In addition, we recommend that NSF's Director of the Division of Acquisition and Cooperative Support:

3. Review all RPSC billings by requesting audits of public vouchers or quarterly expenditure reports. RPSC lacks adequate controls to ensure consistent classification of direct and indirect costs in accordance with RPSC's disclosed accounting practices and the requirements of applicable Federal and NSF contract requirements.
4. Withhold payments for any indirect costs that are incorrectly claimed by RPSC as other direct costs in violation of RPSC's disclosed accounting practices and applicable Federal and NSF contract requirements.

In its response to the draft of the DCAA report, RPSC agreed to update its policies and procedures, conduct adequate management compliance reviews, and standardize training requirements for RPSC employees. However, RPSC contends that some of the costs that were identified in the audit as unallowable were required by the contract and RPSC is willing to provide additional justification.

We consider the issues in the audit report to be significant. Accordingly, to help ensure the findings are resolved within six months of issuance of the audit report, please coordinate with our office during the resolution period to develop a mutually agreeable resolution of the audit recommendations. The findings should not be closed until NSF determines that all recommendations have been adequately addressed and proposed corrective actions have been satisfactorily implemented.

We are providing a copy of this memorandum to the Director of the Office of Polar Programs, the Director of Budget, Finance and Award Management, and the Director of the Division of Institution and Award Support. The responsibility for audit resolution rests with DACS. Accordingly, we ask that no action be taken concerning the report's findings without first consulting DACS at (703) 292-8242.

OIG Oversight of Audit

To fulfill our responsibilities under Government Auditing Standards, the Office of Inspector General:

- Reviewed DCAA's approach and planning of the audit;
- Monitored the progress of the audit at key points;
- Coordinated periodic meetings with DCAA and OIG management to discuss audit progress, findings, and recommendations;

- Reviewed the audit report, prepared by DCAA to ensure compliance with Government Auditing Standards and Office of Management and Budget Circulars; and
- Coordinated issuance of the audit report.

DCAA is responsible for the attached auditor's report on RPSC dated December 15, 2005 and the conclusions expressed in the report. The NSF OIG does not express any opinion on the conclusions presented in DCAA's audit report.

We thank you and your staff for the assistance that was extended to us during the audit. If you have any questions about the attached report, please contact Kenneth Stagner at (303) 312-7655 or Jannifer Jenkins at (703) 292-4996.

Attachment - DCAA Report on Audit of RTSC Polar Services Indirect and ODC Internal Controls dated December 15, 2005

cc: Karl Erb, Director, OPP
Thomas Cooley, Director, BFA
Mary Santonastasso, DIAS



DEFENSE CONTRACT AUDIT AGENCY
AUDIT REPORT NO. 6161-2004T14980202



December 15, 2005

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SUBJECT: Report on Audit of RTSC Polar Services Indirect and ODC Internal Controls

CONTRACTOR: Raytheon Polar Services Company
Raytheon Technical Services Company
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REPORT RELEASE RESTRICTIONS: See Page 36

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SUBJECT OF AUDIT

By submitting payment request under government Cost-Plus-Award Fee contracts, Raytheon Polar Services Company asserts that its internal controls are adequate to provide reasonable assurance that:

- Applicable laws and regulations are complied with;
- The accounting system and cost data are reliable;
- Risk of misallocations and mischarges are minimized; and
- Contract allocations and charges are consistent with invoice procedures.

We have examined the RPSC indirect cost and other direct cost system as of December 2005, to assure that contractor's system of indirect cost and other direct cost controls is adequate to provide indirect cost and other direct cost that are reasonable, compliant with applicable laws and regulations, and subject to applicable financial control systems, and to evaluate compliance with the system's internal control requirements.

Raytheon Polar Services is responsible for establishing and maintaining an adequate indirect cost and other direct cost system. Our responsibility is to express an opinion on the adequacy of the indirect cost and other direct cost system based on our examination.

EXECUTIVE SUMMARY

RPSC indirect and other direct cost system is inadequate. Our examination disclosed significant deficiencies in all four (4) of the control objectives (Allowability, Allocability, Management Compliance Reviews, and Training) applicable to the RPSC indirect and other direct cost system. Those deficiencies could result in unallowable or misallocated indirect and other direct costs in proposals, billings, and claims submitted to the U.S. Government.

SIGNIFICANT ISSUES:

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



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- 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)].

SCOPE OF AUDIT

We conducted our examination in accordance with generally accepted government auditing standards. Those standards require that we obtain a sufficient understanding of internal controls to plan financial audits and determine the nature, timing and extent of tests to be performed. An examination of internal controls includes:

- identifying relevant system control objectives and associated control activities;
- obtaining an understanding of all applicable components of internal control for the identified control objectives and activities;
- determining if the internal controls are adequate and in operation; and
- assessing control risk to use as a basis for planning the nature, timing and extent of substantive testing in other attestation audits.

We evaluated the RPSC Indirect and ODC system using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR), and
- Cost Accounting Standards (CAS)

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Our examination specifically tested the indirect cost and other direct cost system's internal control procedures associated with the following control objectives:

- Contractor Compliance Reviews
- Training
- Preparation of Indirect and ODC Submissions
- Allowability of Selected Indirect Cost/ODCs
- Allocability of Indirect Cost/ODCs

We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over the indirect cost and other direct cost system to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

RESULTS OF AUDIT

In our opinion, the indirect cost and other direct cost system and related internal controls of Raytheon Polar Services Company are inadequate.

Our examination identified certain significant deficiencies in the design or operation of the internal control structure. In our opinion, these deficiencies could adversely affect the organization's ability to record, process, summarize, and report indirect and ODC costs in a manner that is consistent with applicable government contract laws and regulations. These conditions are detailed in the "Statement of Conditions and Recommendations" on page 7 of this report and are summarized below:

Contractor Compliance Reviews. RPSC does not have sufficient compliance review requirements within its existing policies and procedures. RPSC has not demonstrated current control activities in the areas of self risk assessment or self monitoring activities as they relate to management compliance reviews.

The existence of strong internal controls as evidenced by management compliance reviews increases the reliance that can be placed on cost representations from the Indirect/ODC system. The compliance review control objective states that management should periodically perform independent reviews of the Indirect/ODC System policies and procedures to ensure that they comply with applicable laws and regulations, have been implemented, and are working effectively.

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Training. RPSC currently does not have adequate written policies and procedures on training employees involved in the Indirect/ODC system. RPSC provided us with policies and procedures but they only relate to the SAP accounting system and not to processing indirect and other direct costs for allowability, allocability, or reasonableness.

Well-trained Indirect/ODC employees will help to ensure accurate and proper classification of costs in terms of allowability, allocability, and reasonableness. The training control objective requires the contractor's system to ensure that assigned personnel have sufficient training, experience, and guidance to perform Indirect/ODC functions in accordance with established policies and procedures.

Preparation of Indirect/ODC Submissions. No reportable conditions were determined due to the limited scope of this control objective. RPSC does not participate in the process associated with the incurred cost submission. The incurred cost submission is the sole responsibility of the RTSC Home Office. A current Indirect/ODC system audit is being performed under Audit Assignment No. 6161-2005T14980301 for the RTSC Home Office. As a result, we did not perform any testing of the internal controls related to the incurred cost submission.

Allowability of Selected Indirect/ODC Costs. RPSC currently has policies and procedures in place that are in noncompliance with FAR 31.205 concerning the allowability of costs. In addition, the policies lack the requirement of management reviews for allowability and instead require approval only for those items which RPSC had pre-established as unallowable. Finally, the contractor's requirements for supporting documentation are not clearly defined. These conditions have resulted in the improper booking and billing of unallowable costs on the Raytheon Polar Services contract.

Adequate policies and procedures would help ensure that practices comply with federal regulations and there is a consistent application of approved practices. The Allowability of Selected Costs control objective requires the contractor to ensure that Indirect/ODCs are properly identified as allowable or unallowable, including directly associated cost, for U.S. Government contract costing, billing, and pricing purposes (CAS 405/FAR 31.201-2 and 31.201-6).

Allocability of Indirect/ODC Costs. RPSC currently has no disclosure statement or policies and procedures regarding the allocability of indirect and ODC costs to the RPSC contract. Specifically, costs that are disclosed and allocated by RTSC as indirect are recorded and charged direct to the Polar Services contract. Recording and charging these costs direct to the contract may result in 100% reimbursement through contract billings to the government of those costs that would be subject to the [REDACTED]. RPSC continued to operate under the RTSC disclosure statement through FY 2004. No major changes were made in the RTSC disclosure statement regarding the costs disclosed and allocated by RTSC as indirect but charged direct to the Polar Services contract. As of January 2005, RTSC

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segregated RPSC from its business unit disclosure statements and stated that an individual disclosure statement would be submitted for Polar Services. To date, RPSC has no policies, procedures, or disclosure statement in place to document current practices regarding costs typically charged indirect but charged direct to the Polar Services contract.

In addition, more than [REDACTED] of costs were questioned related to the misclassification as ODC, rather than subcontract costs, as part of the FY 2000-2002 incurred cost audits. The misclassification caused ODC costs to be overstated in the SAP accounting system. While the contractor stated that the costs were billed correctly, the overstatement of ODC costs resulted in an over allocation of RTSC and Raytheon corporate costs through an overstated value added G&A base. The contractor recognized the error and made a correction on the billings to NSF but failed to make the correction in its approved (SAP) accounting system.

The Allocability of Indirect/ODC control objective requires the contractor to ensure that Indirect/ODCs are classified consistently between direct and indirect (CAS 402/FAR 31.202 and 31.203(a)) and properly allocated to cost objectives in accordance with applicable FAR and CAS requirements.

We assessed the risk as high for all of the control objectives, and our audit effort in the following areas will be increased:

Incurred Indirect and Other Direct Costs. In our reviews of recorded indirect and other direct costs, additional audit effort will be performed due to lack of effective indirect and other direct cost internal controls in the areas of compliance reviews, training, cost allowability, and allocability.

Billings. The contractor lacks adequate controls to ensure consistent compliance in cost classification as direct or indirect based on its Disclosure Statement and the fundamental requirements of CAS 418-40(a), Allocation of Direct and Indirect Cost. Therefore, in our audits of public vouchers or quarterly expenditure reports, additional audit effort will be performed on any significant other direct cost elements billed to the government to ensure they are allocable as direct costs based on the contractor's Disclosure Statement.

Contract Reporting. The contractor is not adequately complying with Raytheon Company policies and procedures for specific cost elements designed for controlling cost and determining/documenting cost allowability and compliance with government regulations. Therefore, we plan to perform additional testing on any audits that involve contract reporting.

We examined only the indirect cost and other direct cost system. Accordingly, we express no opinion on the contractor's internal controls taken as a whole.

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We provided a draft copy of the Statement of Conditions and Recommendations to the contractor's representative for response. The contractor agreed to make changes to the controls related to the compliance reviews, training, and allowability of costs. The contractor further provided explanation for various unallowable costs which we identified in this report and recognized the need to improve the documentation process. The contractor did not recognize nor agree to any recommendations regarding the allocability of costs. In addition, the contractor's response was silent with respect to the deficiency related to the lack of a CASB required disclosure statement. The complete text of the contractor's response appears as an appendix to this report.

STATEMENT OF CONDITIONS AND RECOMMENDATIONS

STATEMENT NO. 1: MANAGEMENT COMPLIANCE REVIEWS

CONDITION:

RPSC does not have sufficient compliance review requirements within its existing policies and procedures. RPSC has not demonstrated current control activities in the areas of self risk assessment or self monitoring activities as they relate to management compliance reviews. The existence of strong internal controls as evidenced by management compliance reviews increase the reliance that can be placed on the cost representations from the Indirect/ODC system. The following policies and procedures identify some requirement for a periodic management review but are not considered adequate for ensuring adherence to polices and procedures through self monitoring.

Policy PS-CD-1522 (Rev 9) – Procurement Modes: Section 8.4 states that “*Several management reports and independent checks are provided to monitor controls and program effectiveness.*” However the success of the program depends on employee compliance with program requirements. Employees are empowered to perform complete transactions. While the program places a great deal of trust in Raytheon Employees, it also holds employees accountable for non-compliance with program requirements.” In addition, Section 10.1 states that “*the card administrator also performs audit functions and supports the accounting a reporting of the purchasing card information.*” No other details are provided.

Policy PS-D-1540 (Rev 3) – Public Law Compliance: This policy refers to procurement personnel. The policy refers to all of the laws applicable for TINA, CAS subcontract coverage, Small businesses, Byrd Amendment, Advance notification, EEO, and so forth. There is no information contained in the policy which specifies management review of compliance.

Policy FI-CDLMNPS-547 (Rev 0) – Accounting for Unallowable/Non-Billable costs to the OPP Contract: The responsibility section, page 1, specifies the employees’ responsibility for charging the costs and the Finance department’s responsibility for reconciling the unallowable WBS’ and providing management with that reconciliation. The policy discusses the responsibility of the employee for unallowable expenditures, and the requirement for management approvals for any charges made to an unallowable WBS. The policy does not require any type of compliance testing.

Policy FI-A-538 (Rev 3) – Business Meals, Entertainment, and Gifts: The purpose of the policy is to establish guidelines for how and when business meals, entertainment, and gifts can be reimbursed. The responsibility section states that “Employees that submit a reimbursement request for unallowable costs are responsible for obtaining the proper documentation and



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approval to support the reimbursement claim.” In addition, the first paragraph of the discussion section states that “Unallowable cost can be charged to the unallowable WBS to be paid for by the Raytheon Technical Services Company. The Program Manager must approve all costs billed to this WBS.” This policy does not require periodic management reviews.

Policy HR-DH-037 (Rev 6)– Achievement Awards: Under the responsibilities section of this policy, the Human Resources Manager and the Finance Manager are responsible for ensuring compliance with this policy. In addition, the Program Manager is responsible for understanding the policy and the responsibilities outlined therein.

Policy FI-DHLMPS-521 (Rev 9) – Employee Manual RTSC Expense Reports: The responsibilities section of the policy (page 2) specifies Division Directors, Managers, and Supervisors are responsible for ensuring that all personnel under their supervision comply with the procedures for incurring and reporting reimbursable employee expenses. In addition, the Finance Manager is responsible for ensuring appropriate staff review expense reports for compliance with procedures for reimbursement to employees. The final step on the policy dictates that “The expense report will be reviewed by Finance for math, receipts, per diem restrictions, and unallowable expenditures.”

Policy FI-DLMPS-548 (Rev 2) – Petty Cash Expense Procedure: This policy applies to all employees’ that submit a request for reimbursement for petty cash expenses. While the policy describes all criteria associated with petty cash transactions, it does not spell out a management review process to ensure compliance with the policy. Therefore, we believe that the policy is not adequate or sufficient; but needs to be expanded because it does not address essential attributes regarding periodic management reviews.

Policy HR-MPS-035 – Long-Duration Contract completion Bonus and Preparatory Leave – All Stations: This policy involves providing a completion bonus as an incentive for RTSC employees at McMurdo and South Pole stations to work a full year. The Manager of Human Resources is responsible for assuring compliance with the policy.

Periodic management compliance reviews covering the critical areas in the RPSC Indirect/ODC system will provide reasonable assurance that the policies and procedures relating to indirect/other direct cost claims (i.e. incurred cost submission) applicable to the Polar Services contract are established, currently in practice, understood, and effectively implemented by RPSC employees. The existence of strong internal controls increase the reliance that can be placed on the cost representations generated from the contractor’s accounting system.

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RECOMMENDATION:

We recommend that RPSC revise its current policies and procedures to incorporate detailed requirements of management compliance reviews as follows:

- **Ensure adherence to the FAR, CAS, Disclosure Statement, the contract, and policies:** Requirements for periodic reviews of current practices to ensure compliance with policies and procedures, CAS, FAR, the disclosure statement, and contract requirements.
- **Incorporate a requirement for periodic reviews:** Include a requirement for conducting a periodic review of policies and procedures to ensure compliance with applicable laws and regulations, disclosed practices and, that the policies and procedures have been implemented, and are working effectively.
- **Specify interval of time for which the reviews should be conducted:** The requirements for compliance reviews would ensure that management reviews are performed on a consistent basis.
- **Specify the person or position responsible for performing the review:** What level of management or position is responsible for conducting the reviews? Are the reviews delegated by a higher level of management and reported accordingly?
- **Document the review:** Require that documentation be maintained to evidence management compliance reviews were performed including the results of follow-up reviews. Identifying the requirement in the policies and procedures to maintain such documentation is important to facilitate the verification process during compliance testing by both the RTSC/RPSC internal audit and DCAA at a later time.
- **Follow-up review:** Require follow-up reviews be performed for any findings and recommendations identified during the review process. The policy should address tracking responses to and resolution of corrective actions. It should also provide that corrective actions are documented and verified.

The contractor's compliance review will provide reasonable assurance that policies and procedures relating to Indirect/ODC representations and submissions applicable to the Polar Services contract are established, currently in practice, understood, and effectively implemented by the employees involved in the Indirect/ODC system.

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CONTRACTOR'S RESPONSE:

“In respect to the noted deficiencies and recommendations RTSC – Polar Services agrees to update the Polar Services procedures to include adequate management reviews where required. In addition RTSC agrees to create a Polar Services Management Compliance Review Procedure to ensure proper oversight per the audit report recommendation. The procedures will be updated and the Management Compliance Review Procedure created by January 30, 2006.”

AUDITOR'S COMMENTS:

The contractor appears to agree that it needs to update and/or implement policies and procedures regarding management compliance reviews. However, the contractor's response is not detailed or descriptive enough for us to determine whether or its corrective actions will be adequate. We will perform a follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations. For us to evaluate the adequacy of the corrective actions for a follow-up review, the contractor should document and maintain the plan in sufficient detail to demonstrate how each of our recommendations was addressed.

STATEMENT NO. 2 - TRAINING

CONDITION:

RPSC currently does not have adequate policies and procedure covering the training of employees involved in the Indirect/ODC system. Well-trained Indirect/ODC employees will result in accurate and proper classification of costs in terms of allowability, allocability, and reasonableness.

RECOMMENDATION:

RPSC should either develop policies and procedures that require training of employees in the Indirect/ODC system or incorporate critical attributes of a training program into its existing policies and procedures. The policies and procedures should include at a minimum the following criteria:

- **Requirement for training:** Policies and procedures should require those personnel responsible for making specific determinations on whether costs should be claimed and/or billed receive training that introduces them to the problems of allowability, allocability, and reasonableness of costs as they relate to government contracts. The forms (formats) of the trainings can vary (e.g. training catalog, seminars, workshops, etc). RPSC may provide

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internal courses or opportunities for personnel (especially those with cost assignment responsibilities and reviewers of such cost assignments) to take outside education courses to cover the Indirect/ODC related topics; specifically, CAS and FAR. If internal courses are provided, the procedures should include a specific requirement that the training programs/materials be updated to cover current government rules and regulations and adjusted to comply with revisions to the RPSC Indirect/ODC system. Dissemination of such information to employees may be covered under more than one class, and some may be covered by memorandums, bulletins, or pamphlets.

- **Frequency of training:** Policies and procedures should clarify the frequency of training. The degree and frequency of training requirements should be specified to ensure that employees are kept up to date on all changes in CAS, FAR, and disclosure statement practices.
- **Documentation of training history:** Policies and procedures should provide requirements for documenting and maintaining the records of training to evidence the conduct and completion of the required training to facilitate compliance testing. Documentation of an employee's training history will also facilitate determination of required refresher training.
- **Topics of training:** Policies and procedures should provide the training topics (not specific course names, but topics) that are deemed critical in performing the RPSC Indirect/ODC functions. This will help identify the need for training not only for existing/experienced employees (especially those with cost assignment responsibilities and reviewers of such cost assignments), but also new employees.

In summary, we recommend that RPSC incorporate a training section in its policies and procedures to include and adequately address various types (formats) of training required for RPSC Indirect/ODC employees (including updating the internal course materials and dissemination of the updated/revised information if the internal courses are provided), clarify the frequency of training, identify a documentation requirement for the completed Indirect/ODC training, and provide training topics (FAR, CAS, RTSC and RPSC polices and procedures) to assist employees (existing employees and new employees) in identifying the training needs that are deemed critical and necessary in performing the Indirect/ODC functions (either as a cost assigner or reviewer/approver of the cost assignment).

CONTRACTOR'S RESPONSE:

RTSC provides all employees with the necessary training and or resources to perform their responsibilities. RTSC, through the Raytheon Learning Institute, provides courses designed to accompany the training employees have received within their respective departments. In addition, RTSC provides resource material on the company website to assist employees along

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with contact information for subject matter experts. The website also provides access to all Raytheon Company and RTSC Policies and Procedures for all functions (i.e. Finance, Contracts, Human Resources, Engineering, et al) for governance and compliance.

“RTSC believes in continued improvement in all areas including policies and procedures and training. As a result of the suggestions provided in this audit report we agree to implement a procedure designed to standardize to training requirements for Polar Service employees of appropriate policies and procedures and CAS and FAR statements. The procedure will be developed and implemented by March 31, 2006.”

AUDITOR’S COMMENTS:

The contractor has agreed to develop and implement a procedure that will standardize training requirements for Polar Service employees. However, the contractor’s response is not detailed or descriptive enough for us to determine whether or not its corrective actions will be adequate. We will perform a follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations. For us to evaluate the adequacy of the corrective action plan for a follow-up review, the contractor should document and maintain the plan in sufficient detail to demonstrate how each of our recommendations was addressed.

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STATEMENT NO. 3 - ALLOWABILITY OF SELECTED COSTS

CONDITION:

RPSC has policies and procedures in place that do not comply with FAR 31.205 concerning the allowability of costs. In addition, the policies lack the requirement of management to review expenses for allowability and instead only require approval of those items that RPSC had pre-established as unallowable. Finally, the contractor's requirement for supporting documentation is not clearly defined. As a result, we believe these conditions have resulted in the contractor improperly booking and billing unallowable costs on the Raytheon Polar Services contract. The following policies and procedures, in our opinion, do not comply with various FAR 31 provisions:

Accounting for unallowable/non-billable costs to the OPP contract (FI-CDLMNPS-547): The contractor's policy for accounting for unallowable costs states that "employees that plan to charge unallowable costs are responsible for obtaining the proper approval by the Program Manager (or designee) prior to incurring the unallowable expense". The policy also requires the employee to turn in documentation supporting his/her unallowable expense to finance. In addition, the unallowable costs are to be booked to a pre-determined unallowable WBS to be paid for by RTSC. On a monthly basis, the costs that were booked to the "unallowable" WBS need to be supported with documentation to the Finance Department within five (5) business days. Finance is responsible for reconciling the unallowable WBS each month and providing the reconciliation to the Finance Manager and Program Manager for review. The review of a given unallowable WBS does not ensure all unallowable costs are being booked to the unallowable WBS. It only ensures that those employees who book unallowable costs appropriately receive approval before doing so. The policy should address the review of all costs for allowability regardless of whether the employee defines the costs as unallowable or not. The policy then goes through an interpretation on many of the items contained in FAR 31.205. Upon review of the list of billable v. non-billable items, there are several items which the policy states are billable to the contract that are unallowable based on FAR 31.205. The sections of the policy and our associated FAR interpretation are as follows:

Employee Morale, Welfare, and Recreation:

1. "Reasonable cost of company events such as Friday afternoon cookouts, Wind down Fridays, etc that are intended to improve working conditions, employee employer relations, employee morale, or employee performance, excluding unallowable alcohol and entertainers are allowable".

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DCAA Interpretation:

FAR 31.205-13 provides examples of allowable activities designed to improve working conditions, employer-employee relations, employee morale, or employee performance. Those examples include House Publications, Health Clinics, Wellness/Fitness Centers, Employee Counseling Centers, and Dorm and Food Services.

In addition, FAR 31.205-14 states that “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sporting events, meals, rental, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

2. “Tickets to plays, sporting events, concerts, amusement parks, movies, or social events provided to employees for recognition of achievement or performance are billable.”

DCAA Interpretation:

FAR 31.205-14 states that “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sporting events, meals, rental, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

3. Reasonable costs of annual picnics or outings designed to improve employer-employee relations or employee morale that are company sponsored, segment sponsored, or segment – (plant) wide, excluding unallowable alcohol, or entertainment.

DCAA Interpretation:

FAR 31.205-14 states that “Costs of amusement, diversions, social activities, and any directly associated costs such as tickets to shows or sporting events, meals, rental, lodging, rentals, transportation, and gratuities are unallowable. Costs made specifically unallowable under this cost principle are not allowable under any other cost principle.”

Petty Cash policy (FI-DLMPS-548): We reviewed the contractor’s petty cash policy for the Denver Headquarters (HQ) office and did not see any direction as it pertains to the treatment of unallowable costs. We tested the contractor’s policy for petty cash against actual costs incurred through the petty cash process and determined that 60% of the transactions that flow through petty cash are unallowable based on FAR 31.205. Most of the items related to gifts and prizes



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for HQ personnel for non-contract type events such as an Extreme Cube Makeover, Photography Interest Group, Summer Picnic Food and Prizes, and Clean Your Workstation Day.

Unallowable - FAR 31.205-14, Entertainment Costs. The entertainment cost principle provides that if a cost is for amusement, diversions, social activities, and memberships in social clubs, or any associated costs, then the cost is unallowable. This is true even if the primary purpose of the entertainment is for compensation to an employee, selling or marketing, public relations, or any other purpose. No other cost principle may take precedence over the entertainment cost principle.

Business Meals, Entertainment and Gifts, FI-A-538: We reviewed the contractor's Business Meals, Entertainment, and Gifts procedure as it pertains to the controls associated with unallowable costs. The purpose of the procedure states that it is to "Establish guidelines for how and when business meals, entertainment, and gifts are to be reimbursed". It further provides that the employee is responsible for obtaining proper documentation and approval to support a reimbursement claim. The procedure then states that "unallowable costs can be charged to the unallowable WBS to be paid for by the Raytheon Technical Services Company. The Program Manager must approve all costs billed to this WBS".

The policy fails to *require* the employee to charge an unallowable cost to the unallowable WBS and lacks the requirement for review of costs by management or other trained personnel to ensure that all costs are classified correctly and booked accordingly. The policy simply requires that unallowable costs be approved.

The lack of sufficient and compliant controls has resulted in (1) numerous instances of expressly unallowable costs being charged to the government and, (2) insufficient documentation of transactions for costs incurred and billed to the contract for which the allowability of the costs to the contract can not be readily determined. Some examples of transactions that demonstrate the lack of internal controls are as follows:

- *An invoice from Harry & David's gourmet was reviewed which disclosed that a tower of chocolates was purchased as a holiday gift from the Program Manager to an unspecified recipient.*
- *Transactions related to items billed from a subcontractor were included stereo equipment for a gym, an espresso machine, and beer and wine.*
- *Booking of identified unallowable direct travel as a direct cost to the contract using the miscellaneous ODC account category and project R-PS27.*
- *Two (2) charges for Dave and Busters on a pro-card statement with no supporting documentation. The charges were for \$998.00 and \$972.57. This would have been considered entertainment expense based on FAR 31.205-14.*

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- *An invoice was reviewed from High Anxiety Wholesale which billed for fifty (50) fleece vests embroidered with the Antarctic star. These costs are not considered reasonable based on FAR 31.201-2(d). The purpose of the vests and to whom they were issued was also not disclosed which suggests potential unallowable costs based on FAR 31.205-1(f)(5) – Public relations and advertising costs.*
- *The contractor submitted a Lowes Home Improvement receipt with a pro-card statement for air conditioning supplies. The purpose of the purchase was not stated. The documentation is considered insufficient.*
- *The contractor paid charges on a pro-card statement for various amounts that were not supported and are likely personal purchases. Purchases at Virgin Body Care Inc. which sells herbal, nutritional and food supplement items. Purchases were also made at the Raining Rose which specialize in all natural, handcrafted body care products, soaps, shampoos, lotions, shower gels, and so forth. These costs are considered unallowable based on FAR 31.201-2(d). There was also a charge for a Colorado Restaurant Association membership. The association with the Polar Services contract was not established.*
- *The contractor submitted invoices related to the rental of tables, chairs, water barrels, and so forth for purposes of a barbeque. The rental equipment was provided by Butler Rents. The barbeque was catered by Franks Barbeque. No purpose was stated. The function was held around the time frame of the 4th of July. The charges were related to the pro-card statement. The credit card statement was approved by management and the amounts appear to be expressly unallowable although no purpose was stated for the costs.*
- *An invoice for 548 Souvenir Baseball caps was questioned. The invoice was presented with a purchase order which failed to identify the purpose of the baseball caps in relation to the performance of the contract. The invoice was initialed by a finance person and the purchase order was not signed. This cost is considered unallowable based on FAR 31.205-13(b).*
- *Several transactions related to the pre-season social to include wine, ice sculptures, quartets, flowers, and so forth were charged direct to the contract. These items while approved by management for reimbursement under the contract are unallowable based on FAR 31.205-13, FAR 31.205-14, and FAR 31-.205.51.*
- *The contractor incurred a penalty related to the payment of taxes for an employee to the New Zealand IRD. The penalty and taxes are considered expressly unallowable based on FAR 31.205-41.*

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- *The contractor purchased seventeen (17) gift certificates from various businesses and restaurants in the New Zealand area for the purposes of safety awards. There is no documentation of an award program, or whom the awards were being presented. This transaction was based solely on an e-mail request.*
- *Charges for an end of season barbeque were charged direct to the contract. These items had insufficient documentation and no business purpose.*

The lack of internal controls over unallowable costs has resulted in the contractor billing costs to the government that are either unallowable based on FAR 31.205 or for which the business purpose and relationship to the contract has not been identified as required by FAR 31.201-2(d). FAR 31.201-2(d) states that “a contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost which is inadequately supported.”

RECOMMENDATION:

The contractor has provided a project structure to ensure that unallowable Indirect/ODC, including directly associated costs, can be segregated from allowable costs, however, the controls required to ensure that unallowable costs are being accounted for in accordance with the FAR have not been implemented. There are several controls that should be documented and implemented within the contractor’s policies and procedures as follows:

- We recommend that the contractor revise its policies and procedures related to the definition and treatment of unallowable costs so they comply with FAR 31.205.
- We recommend that the contractor provide adequate training on FAR Part 31.205 to employees involved in determining the allowability of costs with emphasis on identifying and classifying unallowable expenses at the time the costs were incurred since point of entry screening is inherently more effective than after-the-fact screening/scrubbing for the identification and segregation of unallowable costs. In addition, policies and procedures should require those personnel responsible for making specific determinations concerning the treatment of costs receive training that introduces them to the problems of allowability, allocability, and reasonableness of costs as they relate to government contracts.
- We recommend that RPSC expand its policies and procedures to provide more guidance on the reasonableness of costs for some of the more frequently used sensitive accounts (e.g. Miscellaneous ODC) since reasonableness is a criteria (requirement) used in determining the allowability of the costs based on FAR 31.201-2(a).

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- We recommend that the contractor incorporate the requirement for review and approval of costs in the various policies and procedures related to Indirect/ODC. The requirement to review unallowable costs that are booked to the unallowable WBS does not ensure that all costs incurred are reviewed for allowability. RPSC should also ensure that its policies and procedures specifically provide documentation to evidence the required reviews and approvals. Adequate policies and procedures should also require there be a reviewer for every cost assignment.
- We recommend that the contractor develop and maintain policies and procedures regarding adequate and inadequate supporting documentation for transactions. The policies and procedures should require:
 - Supporting documentation should be self explanatory as to the details of each expense.
 - The requirement for and level of required approval of expenses should be clearly identified.
 - Transactions contain the applicable evidential matter required to demonstrate the applicability to the final cost objective to which they are being charged.

In summary, we recommend that RPSC develop policies and procedures or incorporate controls into existing policies and procedures to ensure that unallowable costs are being correctly identified, approved, charged, and ultimately removed from all costs that are charged to the government. These controls should include training of employees, review of expenditures, approval of costs and associated job charges, and detailed supporting documentation.

CONTRACTOR'S RESPONSE:

“RTSC provides annual guidance to all employees on the subject of Allowable and Unallowable Costs per the FAR. Also all employees are provided contact names for additional guidance, if required. Classes are offered by the Raytheon Company on the subjects of FAR, CAS and Principles for Financial Regulations. A course, specifically on Allowable and Unallowable Costs is being rolled out this month by the company. It will be offered to all Raytheon Company employees in a teacher training environment and also web-based training to ensure all employees have access to the materials.

With respect to suggestions regarding the Polar Services Program Policies and Procedures, RTSC agrees that these should be updated and will provide revised versions in alignment with Raytheon policies, no later than January 30, 2006. The revised Polar Services Program Policies and Procedures will also include a section on management approvals and oversight designed to

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ensure that proper reviews for allowable and unallowable costs are performed in accordance with FAR 31.205.

In review many of the examples provided in the audit report are required in the performance of the contract and are allowable costs. It appears that some costs may be unallowable based on the information provided in the audit report. Polar Services has addressed each of the examples below and we would appreciate scheduling a review of the documentation and supporting justification for allowability with you for each of the questioned items and withdraw the costs if appropriate.”

AUDITOR’S COMMENTS:

The purpose of this audit was to evaluate and test the internal controls related to the contractor’s Indirect/ODC system. Transactions were identified as unallowable costs as part of our FY 2000-2002 incurred cost audits and, in our opinion, represent weaknesses in the contractor’s internal controls over the allowability of costs. The NSF contracting officer is now in the negotiation/resolution stage regarding these and other transactions that were identified as unallowable costs during our incurred cost audits.

RPSC has agreed to implement certain recommendations related to the allowability of selected costs. However, the contractor’s response as it pertains to the internal controls related to the allowability of Indirect/ODC costs is not detailed or descriptive enough for us to determine whether or not any corrective actions will be adequate. We will perform a follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations. For us to evaluate the adequacy of the corrective action plan for a follow-up review, the contractor should document and maintain the plan in sufficient detail to demonstrate how each of our recommendations was addressed.

STATEMENT NO. 4 - ALLOCABILITY OF COSTS

CONDITION:

A CAS 418 noncompliance report identified costs that are disclosed as indirect but were recorded and charged direct to the Polar Services contract. Recording and charging these costs direct to the contract may result in 100% reimbursement through contract billings to the government of those costs that would be subject to the [REDACTED] rate ceilings (i.e., National Science Foundation).

RPSC continued to operate under the RTSC disclosure statement through fiscal year 2004. No major changes were made in the RTSC disclosure statement regarding this CAS noncompliance.

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As of January 2005, RTSC segregated RPSC from the RTSC business unit disclosure statements and stated that an individual disclosure statement would be submitted for Polar Services.

To date, RPSC has no policies, procedures, or disclosure statement in place to document its current practices regarding corporate allocations and locally incurred indirect functions. As part of our request for RPSC policies and procedures related to corporate and RTSC allocations, the contractor's representative stated,

“With respect to Corporate and RTSC Allocations please refer to the RTSC Disclosure Statement (DS) Part VIII – Home Office Expenses. A copy of the latest RTSC DS has been provided to DCAA. Please let me know if you need additional copies.”

The contractor's representative stated that a response would be provided at a later date for policies and procedures related to the allocability of Indirect/ODC. Subsequently, a response was provided by the RPSC Controller that stated Polar Services follows RTSC policies and procedures related to the allocability of Indirect/ODC. To date, no policies and procedures have been provided.

In addition, more than [REDACTED] was questioned related to misclassification as ODC, rather than subcontract costs, during the FY 2000-2002 incurred cost audits. The misclassification caused ODC costs to be overstated in the SAP accounting system. While the contractor stated that the costs were billed correctly, the overstatement of ODC [REDACTED]. The contractor recognized the error and corrected it in the billings to NSF but failed to make the correction in its SAP accounting system.

RECOMMENDATION:

We recommend that the contractor provide adequate training on the proper classification of costs (direct vs. indirect), and posting the transactions to the correct expense accounts (e.g. subcontract costs vs. Miscellaneous ODC). It is important to stress the adverse effect of the indirect burden applications when classified to an incorrect expense account.

In addition, we recommend that the contractor develop a CASB Disclosure Statement for FY 2005 and forward that complies with all cost accounting standards. Specifically, CAS 418-40(a) requires that a business unit shall have a written statement of accounting policies and practices for classifying costs as direct or indirect and they must be consistently applied. Once that Disclosure Statement is developed, the contractor should follow RPSC disclosed practices.

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Finally, we recommend that the contractor develop policies and procedures related to the allocability of Indirect/ODC that contain at a minimum, the following criteria:

- *The definitions of indirect and direct costs:* The policies and procedures should contain the definitions for indirect costs as well as the definition of direct costs to assist the employee in his/her determination of the correct classification of costs.
- *The definition of allocability:* Policies and procedures should contain the definition of allocability based on FAR 31.201-4 in order for the employees to understand the implications associated with the incorrect classification of costs either direct, indirect, to improper final cost objectives, or improper indirect cost pools. This FAR reference states:

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a government contract if it-

 - a. Is incurred specifically for the contract;
 - b. Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
 - c. Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.
- *Requirements for training of employees in the area of allocability:* Policies and procedures should require training on allocability to employees who are responsible for the booking of Indirect/ODC costs. The requirements should include the formats of training to be required, the frequency of the training requirements, requirement to maintain documentation for training history, and the topics of required training. The training should cover at a minimum:
 - *FAR requirements*
 - *CAS requirements*
 - *Disclosed Practices*
- *Requirements for management review and approval:* At a minimum, there should be a requirement for defined management oversight and approval on:
 - Transactions pertaining to the charging, allocation of or movement of costs into the Indirect/ODC system.
 - Policies and procedures that dictate the process by which costs are allocable to final cost objectives.
 - Training of personnel involved in Indirect/ODC processes.
 - Disclosure Statement development and maintenance.

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- Requirements for evidential matter on transactions to support booking of costs to a particular final cost objective or indirect cost pool: Policies and procedures should require that transactions contain sufficient evidential matter to support all job charges. Evidential matter would include documentation from a purchase order, program manager, or other supporting matter that proves the items purchased or costs being charged are actually allocable to the job charge (WBS) to which they are being assigned.

CONTRACTOR'S RESPONSE:

“The alleged deficiencies identified in Statement 4 of the Audit Report duplicate findings that have appeared in substantially the same way in previous audit reports, including DCAA’s draft incurred cost Audit Report No. 6161-2004P10160205 dated August 24, 2004. RTSC responded to that draft on December 13, 2004, and its position has not changed since that response was submitted. A copy of that response is attached.”

AUDITOR'S COMMENTS:

A copy of the response that the contractor mentioned as being attached was not provided. However, that response included the same comments the contractor provided to us during our FY 2000-2002 incurred cost audits and which we incorporated into the related incurred cost audit reports.

The contractor’s response does not adequately address our recommendations. We believe that the contractor still needs controls over indirect and direct costs, allocability, and so forth.

We will perform a follow-up review once the contractor has had sufficient time to implement adequate controls to correct the deficiencies and comply with our recommendations. For us to evaluate the adequacy of the corrective action plan for a follow-up review, the contractor should document and maintain the plan in sufficient detail to demonstrate how each of our recommendations was addressed.

CONTRACTOR ORGANIZATION AND SYSTEMS

I. Organization

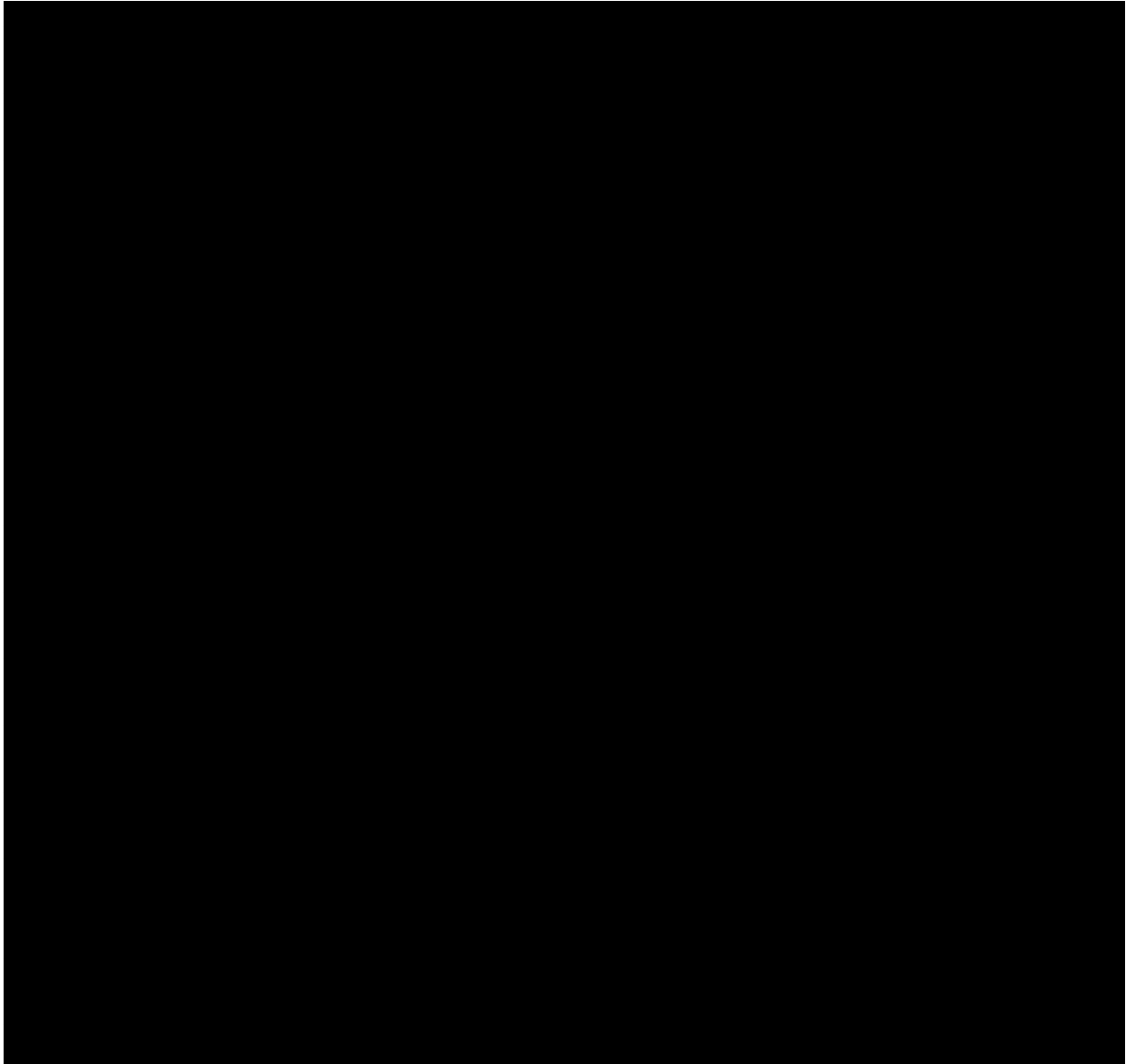
RTSC headquarters is located in Reston, VA. [REDACTED]

[REDACTED]

[REDACTED]

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RTSC has a multi-disciplined workforce of approximately [REDACTED]. 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 2004, of which over [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).



Pages 25 through 31 have been redacted in their entirety

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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. The DACO has not yet made an initial finding of noncompliance on this issue.

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.





CAS 405: Audit Report No. 6162-2003T19200204, dated June 5, 2003, indicates that the contractor's cost accounting practices are in noncompliance with CAS 405, Accounting for Unallowable Costs, and FAR Part 31. Specifically, RTSC is not adequately complying with established controls to properly classify and record unallowable costs. In addition, RTSC is not adequately complying with Raytheon Company policies and procedures for specific cost elements that were designed for controlling cost and determining/documenting cost allowability and compliance with government regulations. On December 12, 2004, the DACO withdrew his initial finding of noncompliance on this issue; stating that "Any potential cost impact associated with the Initial Finding will be resolved as part of the annual Incurred Cost negotiations." Nevertheless, we will continue to report DCAA's CAS 405 noncompliance audit report until after accomplishment of follow-up compliance and transaction testing performed as part of DCAA's comprehensive audit of RTSC during FY 2005 to ensure that the reported instances of noncompliance have ceased to exist.

CAS 418: Audit Report No. 6162-2003T19200205, dated June 5, 2003, indicates that the contractor's cost accounting practices are in noncompliance with CAS 418, Allocability of Direct and Indirect Costs. Specifically, RTSC lacks adequate written policies and procedures for monitoring the indirect/other direct cost system. In addition, RTSC employees responsible for performing indirect/other direct cost functions have not received adequate training in applicable government rules and regulations such as FAR and CAS. RTSC also lacks adequate controls to ensure consistent compliance in cost classifications as direct or indirect. On December 12, 2004, the DACO withdrew his initial finding of noncompliance on this issue stating that "Any potential cost impact associated with the Initial Finding will be resolved as part of the annual Incurred Cost negotiations." Nevertheless, we will continue to report DCAA's CAS 418 noncompliance audit report until after accomplishment of follow-up compliance testing performed jointly during DCAA's in-process FY 2005 CAS 418 Compliance and Indirect and Other Direct Cost Internal Control System examinations (reference DCAA Audit Assignment Nos. 6161-2005T19403300 and 6161-2005T14980300 respectively) to ensure that the reported instances of noncompliance have ceased to exist.

Pages 34 has been redacted in its entirety

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AUDIT REPORT AUTHORIZED BY:

/Signed/

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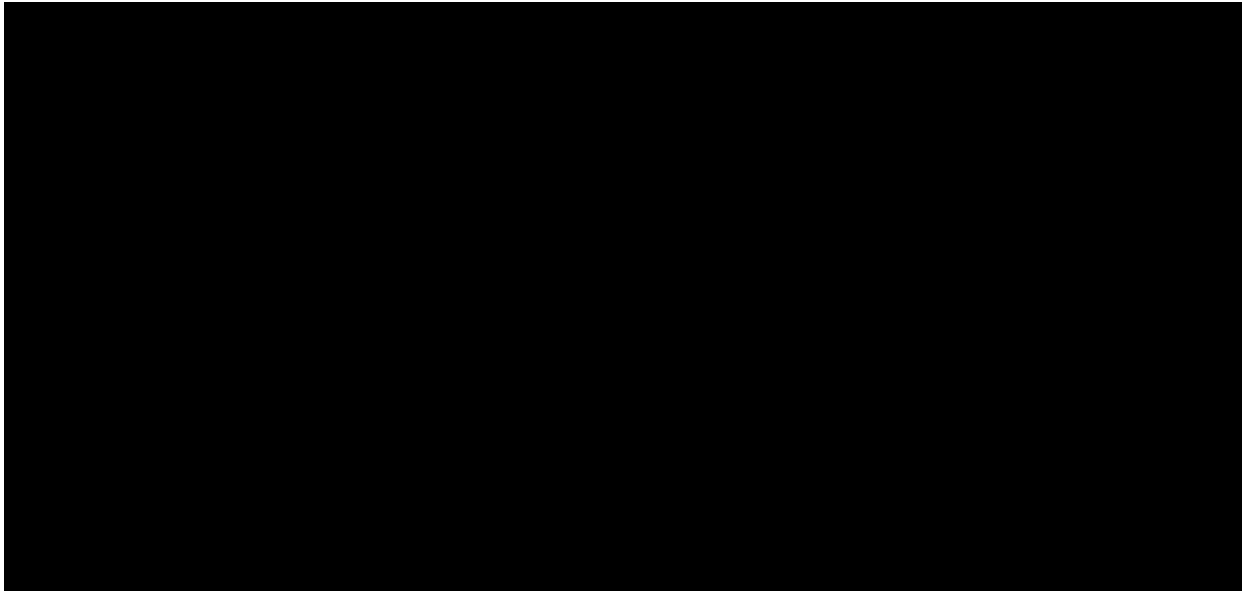
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Reston, VA 20191
(Copy furnished thru NSF Contracting Officer)



APPENDIX

Contractors Response to Statements of Condition and Recommendation Memorandum
Dated October 30, 2005



November 30, 2005

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

Subject: Raytheon Polar Services Company – Indirect/ODC System Review

Reference: 06-02L-002 (6161-2004T14980202)

Please find below Raytheon Polar Services response to the Statement of Conditions and Recommendations included in the subject letter dated October 31, 2005.

In summary, RTSC Finance strives for a World Class Internal Control Environment. In addition to Raytheon's Internal Controls Excellence (ICE) Initiative in response to the Sarbanes – Oxley Act, RTSC has actively dedicated resources to improve all areas of Internal Control and are confident that we've implemented a control environment that meets or exceeds DCAA's high standard of excellence.

First, to address the deficiencies in the control objectives:

Management Compliance Reviews

RTSC makes every effort to ensure that it complies with all regulations and standards required as a contractor to the U.S. Government.

In respect to the noted deficiencies and recommendations RTSC – Polar Services agrees to update the Polar Services procedures to include adequate management reviews where required. In addition RTSC agrees to create a Polar Services Management Compliance Review Procedure to ensure proper oversight per the audit report recommendation. The procedures will be updated and the Management Compliance Review Procedure created by January 30, 2006.

Training

RTSC provides all employees with the necessary training and or resources to perform their responsibilities. RTSC, through the Raytheon Learning Institute, provides courses designed to accompany the training employees have received within their respective departments. In addition, RTSC provides resource material on the company website to assist employees along with contact information for subject matter experts. The website also provides access to all Raytheon Company and RTSC Policies and Procedures for all functions (i.e. Finance, Contracts, Human Resources, Engineering, et al) for governance and compliance.

RTSC believes in continued improvement in all areas including policies and procedures and training. As a result of the suggestions provided in this audit report we agree to implement a procedure designed to standardize to training requirements for Polar Service employees of appropriate policies and procedures and CAS and FAR statements. The procedure will be developed and implemented by March 31, 2006.

Allowability of Selected Indirect Costs

RTSC provides annual guidance to all employees on the subject of Allowable and Unallowable Costs per the FAR. Also all employees are provided contact names for additional guidance, if required. Classes are offered by the Raytheon Company on the subjects of FAR, CAS and Principles for Financial Regulations. A course, specifically on Allowable and Unallowable Costs is being rolled out this month by the company. It will be offered to all Raytheon Company employees in a teacher training environment and also web-based training to ensure all employees have access to the materials.

With respect to suggestions regarding the Polar Services Program Policies and Procedures, RTSC agrees that these should be updated and will provide revised versions in alignment with Raytheon policies, no later than January 30, 2006. The revised Polar Services Program Policies and Procedures will also include a section on management approvals and oversight designed to ensure that proper reviews for allowable and unallowable costs are performed in accordance with FAR 31.205.

In review many of the examples provided in the audit report are required in the performance of the contract and are allowable costs. It appears that some costs may be unallowable based on the information provided in the audit report. Polar Services has addressed each of the examples below and we would appreciate scheduling a review of the documentation and supporting justification for allowability with you for each of the questioned items and withdraw the costs if appropriate.

- Invoice from Harry & David gourmet disclosed that a tower of chocolates was purchased as a holiday gift from the Program Manager to an unspecified recipient.

- Although still investigating the initial bookkeeping and final disposition, RTSC agrees this is an unallowable charge and will be corrected if found to be incorrectly charged to a billable WBS.
- Two (2) charges for Dave and Busters on a pro-card statement without any supporting documentation. The charges were for \$998.00 and \$972.57. This would have been considered entertainment expense based on FAR 31.205-14.
 - The purpose of these two charges were for recognition of the Information Technology (IT) department for their outstanding performance for the past season by the IT staff and allowable under FAR Part 31.205-13.
- The contractor submitted a Lowes Home Improvement receipt with a pro-card statement for air conditioning supplies. The purpose of the purchase was not adequately documented.
 - Agree to include documentation requirements in updated procedures.
- The contractor submitted invoices related to the rental of tables, chairs, water barrels etc for the purpose of a barbeque. The rental equipment was provided by Butler Rents. The barbeque was catered by Frank's Barbeque. The function was held around the time frame of July 4th and no purpose was provided for the charge. The credit card statement (pro-card) was approved by management although an unallowable job charge was not specified for the purchase.
 - The purpose of the event was to recognize all Polar Services employees for the past austral summer season accomplishments on the contract and allowable under FAR Part 31.205-13.
- Charges for an end of season barbeque were charged direct to the contract. These items were submitted without sufficient documentation or business purpose.
 - Polar Services agrees that in this case the supporting materials were not sufficient; however, Polar Services can provide documentation to support these costs as allowable under the contract. The lack of proper approval prior to purchase will be addressed in the revised procedures and training.
 - The following procedure applies to the proceeding five bullets. The pro-card procedure is a company-wide process with access to the program through the web.
 - The pro-card holder makes the initial purchase. The purchase defaults to one account number.
 - The pro-card holder has the ability during their reconciliation of their account, to allocate or distribute charges to other charge accounts.
 - The manager, also during their review has the opportunity to identify correct account information.
 - Polar Services, through their Performance/Quality Assurance department has instituted additional audit procedures to insure the proper assigning of accounts to purchases on the pro-card. Polar Services is testing 100% of all purchases of all card holders at least annually.

- Transactions related to items billed from a subcontractor included stereo equipment for a gym, an espresso machine, and beer/wine.
- An invoice from High Anxiety Wholesales which billed for fifty (50) Fleece vests embroidered with the Antarctic Star. These costs are not considered reasonable based on FAR 31.201-2(d). In addition, the purpose of the vests and to whom they were issued was not disclosed which suggests potential noncompliance with FAR 31.205-1(f)(5) – Public relation and advertising costs.
- The contractor paid charges on a pro-card statement for various amounts that were not supported and are likely personal purchases. Purchases at Virgin Body Care Inc. which sells herbal, nutritional, and food supplements. Purchases were also made at the Raining Rose which specialize in all natural, handcrafted body care products, soaps, shampoos, lotions, shower gels, etc. These costs are considered unallowable based on FAR 31.201-2(d). There was also a charge for a Colorado Restaurant Association membership. The association with the contract was not established.
- An invoice for 548 Souvenir Base caps was submitted. The invoice was presented with a purchase order which failed to identify the purpose of the baseball caps in relation to the performance of the contract. The invoice was initialed by a Finance department person and the purchase order was not signed at all. These costs are considered unallowable based on FAR 31.205-13(b).
 - The following procedure applies to the four proceeding bullets.
 - Polar Services is required under the contract with the NSF “to maintain and operate the recreation and retail operations at all of the Antarctic Stations.” Please see Attachment A, an example of the Contract Statement of Work.
 - An annual approved program plan between the NSF and Polar Services establishes budgets to supply and operate these facilities. Please see Attachment A for an example of the WBS narrative and level of budgeting.
 - Before Polar Services purchases such items, Polar Services is authorized by the NSF through the annual budgeting process.
 - Polar Services then follows normal purchasing process to procure items necessary to fulfill the contract requirements.
 - The objective for the retail operations is to break even. The NSF periodically adjusts prices for the retail operations to preclude a profit or loss position.
- Booking of identified unallowable direct travel direct to the contract using the miscellaneous ODC account category and project R-PS27.
 - The travel and living system automatically books over per diem to an unallowable account. This then has to be analyzed and then journalized to a billable WBS if proper documentation exist to be considered allowable.

- Polar Services charges to the contract direct for travel costs for hotels in excess of the authorized government per diem on an exception basis. Per the FAR, a Contractor can charge the contract for hotel costs in excess of the government per diem when it has been researched and determined that no other accommodations are available within per diem. Polar Services does this research and the Polar Services Travel Department requests approval of the Program Manager to book a traveler in a hotel over per diem. Only when this authorization is provided does Polar Services book the amount in excess of the government per diem to the contract.
 - Polar Services agrees to strengthen the documentation required to support the journal entry.
- Several transactions related to preseason social to include wine, ice sculptures, quartets, flowers, etc were charged direct to the contract. These items were approved by management for reimbursement under the contract but are unallowable based on FAR 31.205-13, FAR 31.205-14 and FAR 31.205-51.
 - Except for the prepayment for the NZ \$945.00, Polar Services did not charge the above costs to the contract. According to procedures, these costs were charged to a non-billable project R-PS09. The N Z \$945.00 was incorrectly charged to the contract and a journal entry has already been completed and the cost has been moved to the non-billable project along with the other costs related to this event.
- The contractor incurred a penalty related to the payment of taxes for an employee to the New Zealand IRD. The penalty and the taxes are considered expressly unallowable based on FAR 31.205-41.
 - An invoice was received with a total dollar amount to be paid. The penalty was identified in the details.
 - Polar Services believes that the payment of taxes is allowable under FAR 31-205-41(1)(a). These taxes were paid for an expatriate employee working in New Zealand on the contract with the NSF. The payment of taxes was for payment of employment taxes. Polar Services agrees that the penalty assessed by the New Zealand IRD is unallowable and should not be charged to the contract. Polar Services has already moved these costs to the non-billable project R-PS09.
- The contractor purchased seventeen (17) gift certificates from various businesses and restaurants in the New Zealand area for the purpose of safety awards. No documentation of an award program or who the awards were being presented to was included with the transaction. This transaction was based solely on an email request.
 - Polar Services agrees that in this case the supporting materials were not sufficient; however, Polar Services can provide documentation to support these costs as allowable under the contract. The lack of proper approval prior to purchase will be addressed in the revised procedures and training.

RTSC Polar Services Program recognizes that proper documentation of certain transactions must be documented and kept in the proper files for assessability. This will be addressed in more detail in the appropriate Polar Services policies and procedures.

Allocability of Costs

The alleged deficiencies identified in Statement 4 of the Audit Report duplicate findings that have appeared in substantially the same way in previous audit reports, including DCAA's draft incurred cost Audit Report No. 6161-2004P10160205 dated August 24, 2004. RTSC responded to that draft on December 13, 2004, and its position has not changed since that response was submitted. A copy of that response is attached.

Sincerely,

[REDACTED]
RPSC [REDACTED]

Cc: [REDACTED]

Attachment A:

Contract SOW:

C7.3.1.15 Retail, Recreational and Religious Services

The Contractor shall provide community service functions at McMurdo. Similar services, on a smaller scale, shall also be provided by the Contractor at the other stations. These functions are described below.

C7.3.1.15.1 Clubs

The Contractor shall operate and maintain three social centers (Buildings 76, 106 and 107) serving alcoholic and non-alcoholic beverages. Two of these facilities are bars (one allows smoking; the other is non-smoking) and the third is a coffeehouse that also serves wine. The Contractor shall manage the clubs; procure, store and restock inventories; recruit bartenders and other staff as needed (paid through the operating fund) from the population; and maintain financial records according to NSF approved accounting practices.

C7.3.1.15.2 Retail Store

The Contractor shall operate and maintain a retail store in Building 155. The Contractor shall manage the store; procure, store and restock inventories; recruit supplemental staff such as clerks (paid through the operating fund) from the population; and maintain financial records according to NSF approved accounting practices.

C7.3.2 Amundsen/Scott South Pole Station

C7.3.2.14 Retail and Recreational Services

The Contractor shall operate and maintain a small retail store and a bar at the station, and shall provide a limited range of recreational services. The Contractor shall ensure that recreational activities are conducted in a safe and responsible fashion.

C7.3.3 Palmer Station

C7.3.3.14 Retail and Recreational Services

The Contractor shall operate and maintain a small retail store and a bar at the station, and shall provide a limited range of recreational services. The Contractor shall ensure that recreational activities are conducted in a safe and responsible fashion.

Information from Annual Program Plan (example)

R-PS60-215A95

**MCMURDO STATION
BEVERAGE**

WBS Narrative:

This WBS contains the alcohol and soft drink order for McMurdo Station. These are sold through the retail outlets. This also includes the bar food supplied and other non-food and beverage supplies. (i.e. napkins straws etc.)

The winter supply, brought in on Vessel, includes enough quantity to cover the next early summer season.

Quantities and selections are based on historical data and community requests. The formula for McMurdo was derived by averaging three years of consumption reports by category and utilizing the same population projection used in the food budget. See below actual formula.

The Beverage, Recreation and Retail WBS's for McMurdo, South Pole and Palmer Stations are self sustaining when compared over a three year period.

WBS Summary:

Labor/Fringe/Bonus: Increase of [REDACTED] to Fringe rate difference.

Materials:

- McMurdo - [REDACTED] McM Bar Supplies (Straws, napkins, etc.)
- McMurdo - [REDACTED] for Alcohol and soft drinks order for the year
- McMurdo - [REDACTED] Coffee House Supplies (Redirected from the previous purchasing Recreation budget. This belong in Beverage)

See Consumption formula below for breakout.

Average Daily Consumption figures based on usage history at McMurdo.

Product Required	Average Daily Consumption	Man Days	Ave. Price each	Estimated Order
(Consumption*MD*Price)				
Soda Cans	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Beer Cans	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Wine Bottles	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Liquor Bottles	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
TOTAL	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

McMurdo Burger Bar and Bar Foods: This is an increase to the baseline. Traditionally the McMurdo beverage/recreation services has received food for the burger bar and over the counter sales services by utilizing food from the food services inventory. We are requesting to consolidate all bar drinks, supplies and foods in one WBS.