NATIONAL SCIENCE FOUNDATION
4201 Wilson Boulevard
ARLINGTON, VIRGINIA 22230

OFFICE OF INSPECTOR GENERAL

MEMORANDUM

DATE: SEP 12 2007

TO: David A. Elizalde, Director
Division of Acquisition and Cooperative Support

FROM: Deborah H. Cureton
Associate Inspector General for Audit

SUBJECT: NSF OIG Audit Report No. 07-1-017 - Supplemental Report to NSF OIG Audit Report No. OIG-06-1-023, Audit of Raytheon Polar Services Company's Costs Claimed For Fiscal Years 2003 to 2004

In response to NSF's 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) Fiscal Year (FY) 2000-2004 incurred cost proposals submitted 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. We previously provided your office with Defense Contract Audit Agency's (DCAA) original RPSC audit reports for FYs 2003 and 2004 that questioned [redacted] of [redacted] in costs claimed for payment by RPSC under NSF Contract No. OPP-0000373 from January 1, 2003 through December 31, 2004.[1] We also previously transmitted the results of DCAA's audit of RPSC's FY 2004 Fringe Benefits wherein DCAA increased its questioned costs by [redacted][2] so total questioned costs became [redacted] for FYs 2003 and 2004.

The purpose of this memorandum is to transmit DCAA's supplemental audit reports covering RPSC's claimed incurred costs for FYs 2003 and 2004. DCAA made changes to its original reports because the auditors inadvertently double counted questioned labor costs as questioned ODC in certain schedules of the original audit reports [i.e., Executive Summary, Exhibit A, Schedule A-3 or A-4 (Note 1a), and Schedule B-1 (Note 1a)]. The overstatement in questioned ODC was [redacted] for FY 2004 and [redacted] for FY 2003, for a total overstatement of [redacted] DCAA issued its supplemental RPSC incurred cost audit reports for FYs 2003 and 2004 to correct its overstatements of questioned ODC in the aforementioned schedules.

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[1] Reference NSF OIG Report No. 06-1-023 dated September 29, 2006.
[2] Reference NSF OIG Report No. 07-1-015 dated March 30, 2007.

DCAA explains in these supplemental reports that, while there were overstatements in questioned Other Direct Costs (ODC) in certain schedules of the original reports, the overstatements did not impact DCAA's calculation of the audited indirect rates.[3] Likewise, there was no effect on the total amount of indirect costs questioned, since DCAA did not misstate the amounts it reclassified to indirect in computing indirect costs questioned in excess of contract ceilings.[4]

The only effect of DCAA's changes to its original reports, therefore, is in how the indirect costs questioned in excess of contract rate ceilings were originally distributed between costs classified as "locally incurred costs"[5] (originally overstated) and the remainder of costs in excess of ceiling (correspondingly understated). This distribution is important because the "locally incurred costs" issue is part of Raytheon's noncompliance with Cost Accounting Standards (CAS) 418, *Allocation of Direct and Indirect Costs*, and with its disclosed cost accounting practices.[6] The responsibility for CAS administration and resolution remains with the Defense Contract Management Agency (DCMA) as the cognizant federal agency, whereas the remainder of costs in excess of ceiling represents a contractual noncompliance to be resolved by NSF after settlement of the CAS noncompliance.

OIG previously transmitted to NSF the corrected distribution of questioned indirect costs between "locally incurred costs" and the remainder of costs in excess of ceiling.[7]

We continue to recommend that NSF coordinate with and allow DCMA, the cognizant federal agency, to take the lead in resolving disclosed accounting practice deficiencies prior to entering into a final negotiation settlement to resolve the questioned [redacted] of indirect costs. NSF should resolve the remaining [redacted] of questioned costs. In addition, NSF should ensure that RPSC establishes adequate policies and procedures to preclude charges exceeding its Overhead and General and Administrative ceilings; ensure that RPSC establishes adequate policies and procedures to routinely adjust the amount of its claimed costs to reflect actual rather than budgeted fringe benefit costs; and ensure that RPSC establishes adequate policies and procedures to maintain adequate documentation of all its claimed costs in accordance with the Federal Acquisition Regulations. Implementation of these recommendations will allow RPSC to report its costs correctly to NSF and provide adequate supporting documentation.

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[3] Reference attached DCAA Report Nos. 6161-2003P10100201-S1 and 6161-2004P10100201-S1, *Subject of Supplemental Audit* and *Results of Supplemental Audit* paragraphs, and confirmed by Exhibit B, Schedule B-1, *Contractor's Claimed Overhead Pool and Base Costs and Results of Audit.*

[4] Reference attached DCAA Report Nos. 6161-2003P10100201-S1 and 6161-2004P10100201-S1, Exhibit C, *Overhead Costs in Excess of Contract Rate Ceilings.*

[5] Locally incurred costs are reported under "Treatment of Indirect Functions" in the Executive Summary of DCAA's original and supplemental incurred cost audit reports. These are the [redacted]

[6] Reference NSF OIG Audit Report No. 07-1-010, *Transmittal of DCMA and DCAA Findings of RPSC's Noncompliance with CAS 418 and Failure to Follow Disclosed Cost Accounting Practices Applicable to NSF Contract OPP-0000373 for FYs 2003 and 2004 dated March 6, 2007.*

[7] Reference NSF OIG Audit Report No. 07-1-006, *Cost Impact Analysis of Raytheon's CAS Noncompliance and Raytheon Polar Services Company's Cost Accounting Standards Board Disclosure Statement* dated January 11, 2007.

We consider the issues in both DCAA audit reports 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 audit 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 supplemental audit reports on RPSC's FY 2003 and 2004 incurred costs and the conclusions expressed in the reports. The NSF OIG does not express any opinion on the conclusions presented in DCAA's supplemental audit reports.

We also want to bring to your attention that DCAA has briefly discussed the results of several other audits performed at Raytheon Technical Services Company, RPSC's corporate headquarters, reporting the "Contractor Organization and Systems" sections of each attached DCAA report. Many of the reports have information that may be useful to NSF in administering its USAP contract with RPSC. If NSF desires a complete copy of any of the referenced DCAA reports, please contact David Willems at (703) 292-4979.

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 reports, please contact David Willems or Jannifer Jenkins at (703) 292-4996.

Attachments:

DCAA Audit Report No. 6161-2004P10100201-S1, *Supplement to Report on Audit of Raytheon Polar Services FY 2004 Incurred Cost Audit*, dated December 14, 2006
DCAA Audit Report No. 6161-2003P10100201-S1, *Supplement to Report on Audit of Raytheon Polar Services FY 2003 Incurred Cost Audit*, dated December 14, 2006

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

DEFENSE CONTRACT AUDIT AGENCY

AUDIT REPORT NO. 6161-2004P10100201-S1

December 14, 2006

PREPARED FOR: National Science Foundation
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Associate Inspector General for Audit
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Arlington, VA 22230

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SUBJECT: Supplement to Report on Audit of Raytheon Polar Services FY 2004 Incurred Cost Audit

REFERENCES: Prime Contract No. OPP-0000373

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

REPORT RELEASE RESTRICTIONS: See Page 56

CONTENTS:

[redacted]

Audit Report No. 6161-2004P10100201-S1

SUBJECT OF SUPPLEMENTAL AUDIT

This supplemental report revises the questioned Other Direct Costs (ODC) applicable to the treatment of indirect functions in our original report dated September 25, 2006 because of an overstatement in the amounts that we reclassified as indirect functions on certain schedules of that report. The overstatement did not impact our calculation of the audited indirect rates. In addition, we have incorporated the results of our audit of the RTSC and Raytheon Corporate allocations, assessments and fringe benefits to Raytheon Polar Services Company.

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

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

EXECUTIVE SUMMARY OF SUPPLEMENTAL AUDIT

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

Treatment Indirect Functions	$ [redacted]
Reclassified Corporate and RTSC Allocations	
Expressly unallowable Costs	503,316
Other Direct Cost	[redacted]

SIGNIFICANT ISSUES:

1. We reclassified $2,860,347 of ODC and $1,607,681 of labor costs related to locally incurred indirect functions such as Finance, Facility, and Human Resources.

2. We reclassified $2,847,084 of Corporate and RTSC allocations that were charged direct to the contract as Other Direct Costs (ODC).

[redacted]

3. We questioned $503,316 related to alcoholic beverages and T shirts booked on the Raytheon Polar Services claim as material cost.

4. We questioned $[redacted] of Other Direct Costs based on FAR 31.201-3.

5. We identified $[redacted] of G&A costs in excess of the contract ceiling. The G&A rates were recalculated and compared to the claimed rates to determine the amounts in excess of the [redacted]% contract ceiling rate.

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

SCOPE OF SUPPLEMENTAL AUDIT

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

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

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

- Federal Acquisition Regulation; and
- Cost Accounting Standards.

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

unallowable costs being included in the submission and includes expanded testing to provide a reasonable basis for our opinion.

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

QUALIFICATIONS:

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

The audit report includes unresolved costs related to travel expenses. All travel cost incurred by RTSC employees are processed through Raytheon Finance Shared Services (FSS) in Greenville, TX. The DCAA Richardson Branch Office is responsible for auditing travel costs, processed through FSS, for all Raytheon segments. As of the date of this report we have not received the assist audit results from the DCAA Richardson Branch and therefore have classified the travel costs claimed by RTSC as unresolved. Therefore, the results of our evaluation are qualified pending the receipt of the assist audit on travel expenses.

The contractor's segment G&A cost includes $[redacted] Homeland Security allocation from Raytheon Intelligence & Information Systems (IIS). The DCAA South Central Branch Office is responsible for auditing the IIS Homeland Security allocation and providing an assist audit report. Therefore, the results of our evaluation are qualified pending the receipt of the assist audit on the Homeland Security allocation.

RESULTS OF SUPPLEMENTAL AUDIT

Total questioned Other Direct Costs (ODC) of $[redacted] in our original report applicable to treatment of indirect functions are revised to $[redacted] because of an overstatement in the amounts that we reclassified as indirect functions on certain schedules of that report. The overstatement did not impact our calculation of the audited indirect rates. In addition, we have incorporated the results of the RTSC and Raytheon Corporate allocations, assessments and fringe benefits to Raytheon Polar Services Company.

This supplemental report replaces our original report in its entirety.

AUDITOR'S OPINION

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

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

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

EXHIBIT A

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

Cost Element	Claimed	Questioned	Unresolved	Ref.
Direct Labor	$ [redacted]	$ [redacted]	$ 0	Schedule A-1
Material				Schedule A-2
Subcontracts			[redacted]	Schedule A-3
Other Direct Costs		[redacted]		Schedule A-4
Totals	$ [redacted]	$ [redacted]	$ [redacted]	

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

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

[redacted]

SCHEDULE A-1

RPSC FY 2004 DIRECT LABOR COSTS AND RESULTS OF AUDIT

Cost Element	Claimed Cost	Questioned Cost	Ref.
Direct Labor	$ [redacted]	$ [redacted]	Note 1

EXPLANATORY NOTE:

1. Direct Labor:

a. Summary of Conclusions:

We reclassified $ [redacted] of the contractor's claimed direct labor associated with various indirect functions to the overhead pool based on its disclosed accounting practices.

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

The finance costs for the Polar contract include not only financial reporting, but also central timekeeping, general accounting, and other cost accounting functions. Furthermore, [redacted] is dedicated to the Polar Services contract, the contract is still considered as having multiple cost objectives.

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

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

[redacted]

The reclassified direct labor costs associated with the various indirect functions are as follows:

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

d. Contractor's Reaction:

RTSC disagrees that the locally incurred costs for functions like Finance, Facility, and Human Resources should be charged indirect. As a result, RTSC does not agree with the reclassification of $[redacted] of labor costs to an indirect cost.

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

e. Auditor's Response:

In our opinion, RTSC position of claiming costs incurred under functions like [redacted] as direct costs does not comply with the Cost Accounting Standard 418. These functions are clearly indirect costs that should not be treated as direct costs. CAS 418 requires the consistent classification of costs as direct or indirect. It is RTSC common practice to charge functions like [redacted]. Furthermore, RTSC Disclosure Statement, Rev. 11, dated January 1, 2004, Part III, Item 3.1.0 describes the criteria to determine whether costs are charged directly or indirectly to Federal contracts.

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

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

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

SCHEDULE A-2

RPSC CLAIMED FY 2004 MATERIAL COSTS AND RESULT OF AUDIT

Element of Cost	Claimed	Questioned	Ref.
Other Material	$[redacted]	$ 503,316	Note 1

EXPLANATORY NOTE:

1. Other Material Costs:

a. Summary of Conclusions:

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

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

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

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

d. Contractor's Reaction:

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

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

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

e. Auditor's Response:

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

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

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

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

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

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

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

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

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

SCHEDULE A-3

RPSC CLAIMED SUBCONTRACT COSTS AND RESULTS OF AUDIT

Element of Cost	Claimed	Unresolved	Ref.
Subcontracts	$ [redacted]	$ [redacted]	Note 1

EXPLANATORY NOTE:

1. Subcontract Cost:

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

SCHEDULE A-4

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

Cost Element	Claimed	Questioned	Ref.
Other Direct Cost	$ [redacted]	$ [redacted]	Note 1

EXPLANATORY NOTE:

1. Other Direct Costs

a. Summary of Conclusions:

We questioned a total of $[redacted] of RPSC other direct cost for FY 2004. From this total $[redacted] was associated with the contractor's classification of indirect functions as direct contract costs, $[redacted] is related to the contractor's reclassification of Corporate allocations from indirect to direct contract costs and $266,745 represents questioned costs based on FAR 31.201-3.

[redacted]

Furthermore, the RTSC CAS Disclosure Statement, Version 11, Section 4.1.0

[redacted]

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

[redacted]

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SCHEDULE A-4

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

In addition, the break down of the $[redacted] questioned costs related to the contractor's reclassification of Corporate allocations from indirect to direct contract costs are as follows:

[redacted]

SCHEDULE A-4

Doc. No.	Journal Entry Description	WBS Element	Transaction Amount
110729690	July 2004 Corporate Allocations	R-PS40-201E08BA	$
110752825	August 2004 Corporate Allocations	R-PS40-201E08BA	
110790063	Sept 2004 Corporate Allocations	R-PS40-201E08BA	
110594031	January 2004 Corporate Allocations	R-PS40-201E08BA	
110594031	February 2004 Corporate Allocations	R-PS40-201E08BA	
110618218	March 2004 Corporate Allocations	R-PS40-201E08BA	
110645318	April 2004 Corporate Allocations	R-PS40-201E08BA	
110674082	May 2004 Corporate Allocations	R-PS40-201E08BA	
110695593	June 2004 Corporate allocations	R-PS40-201E08BA	
FY 2004 Total Billable Allocations to Raytheon Polar OH			**$**
100172517	October 2004 Corporate Allocations	R-PS09-1C06	
100172517	November 2004 Corporate Allocations	R-PS09-1C06	
100172517	December 2004 Corporate Allocations	R-PS09-1C06	
Total Non-Billable Allocations to Raytheon Polar OH			**$**
FY 2004 Total Reclassified Allocations			**$**

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

b. Basis of Contractor's Cost:

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

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

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

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SCHEDULE A-4

Doc. No.	Journal Entry Description	WBS Element	Transaction Amount
110729690	July 2004 Corporate Allocations	R-PS40-201E08BA	$ [redacted]
110752825	August 2004 Corporate Allocations	R-PS40-201E08BA	
110790063	Sept 2004 Corporate Allocations	R-PS40-201E08BA	
110594031	January 2004 Corporate Allocations	R-PS40-201E08BA	
110594031	February 2004 Corporate Allocations	R-PS40-201E08BA	
110618218	March 2004 Corporate Allocations	R-PS40-201E08BA	
110645318	April 2004 Corporate Allocations	R-PS40-201E08BA	
110674082	May 2004 Corporate Allocations	R-PS40-201E08BA	
110695593	June 2004 Corporate allocations	R-PS40-201E08BA	
FY 2004 Total Billable Allocations to Raytheon Polar OH			**$** [redacted]
100172517	October 2004 Corporate Allocations	R-PS09-1C06	
100172517	November 2004 Corporate Allocations	R-PS09-1C06	
100172517	December 2004 Corporate Allocations	R-PS09-1C06	
Total Non-Billable Allocations to Raytheon Polar OH			**$** [redacted]
FY 2004 Total Reclassified Allocations			**$** [redacted]

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

b. Basis of Contractor's Cost:

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

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

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

[redacted]

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

c. Audit Evaluation:

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

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

Furthermore, we reviewed the work breakdown structure (WBS) for the Polar contract and confirmed that the contractor was booking local support functions as direct costs. The WBS listing was then reviewed to determine the various support functions that, in our opinion, were an indirect function of the program. We concentrated primarily on the support functions of Finance, Facilities, and Human Resources based on their materiality.

We have reclassified the costs associated with the Finance, Facilities, and Human Resources indirect functions. Our analysis of each indirect function that, in our opinion, should be classified as an indirect cost based on the [redacted]

(1) Finance:

[redacted]

[redacted]

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[redacted]

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[redacted]

d. Contractor's Reaction:

RTSC disagrees that the locally incurred costs for functions like Finance, Facility and Human Resources should be charged indirect. As a result, RTSC does not agree with the reclassification of $ of ODC to an indirect cost. RTSC's disclosed accounting practices at the time of contract award through today have consistently stated that costs required to be charged direct in a specific contract may be charged direct even if they are normally indirect costs.

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

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

e. Auditor's Response:

RPSC continues to deny the nature of costs when it is RTSC's common practice to accumulate these types of costs within the overhead pool. CAS 418-40(a) requires Polar Services to have a written statement of accounting policies and practices for classifying costs as direct and indirect and to apply those policies and practices consistently. These policies and practices are included in RTSC's CAS disclosure statement applicable to FY

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

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

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

EXHIBIT B

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

Polar Services Contract No. PRSS-0000373

Period January 1, 2004 through December 31, 2004

	Claimed	Questioned	Audited	Ref.
Overhead				
Pool	$ [redacted]	$ [redacted]	$ [redacted]	Schedule B-1
Base	[redacted]			
Rate	[redacted]			
Fringe Benefits				
Pool	$ [redacted]	$ [redacted]	$ [redacted]	Schedule B-2
Base	[redacted]			
G&A				
Pool	$ [redacted]	$ [redacted]	$ [redacted]	Schedule B-3
RPSC VAB	[redacted]	[redacted]	[redacted]	
Rate	[redacted]		[redacted]	

[redacted]

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SCHEDULE B-1

CONTRACTOR'S CLAIMED OVERHEAD POOL AND BASE COSTS AND RESULTS OF AUDIT

	Amount	Amount	Ref.
Claimed Overhead Pool		$ [redacted]	
Reclassified Costs:			
Locally Incurred Costs	$ [redacted]		Note 1
Corporate & RTSC Allocations	[redacted]		Note 2
Total Questioned Pool Costs		[redacted]	
Revised Pool		**$** [redacted]	
Claimed Direct Labor Base		$ [redacted]	
Reclassified Costs:			
Locally Incurred Labor Costs	$ [redacted]		Note 1
Total Questioned Base Costs		[redacted]	
Revised Overhead Base		**$** [redacted]	

EXPLANATORY NOTES:

1. Overhead – Locally Incurred Costs/Functions

   a. Summary of Conclusions:

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

[redacted]

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

2. Corporate and RTSC Allocations

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

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

d. Contractor's Reaction:

RTSC continues to believe that inclusion of RTSC allocations as direct costs reflects an appropriate methodology to implement the original intent of the proposal, and subsequent contract, to charge normally indirect services as direct costs to the contract. RTSC's disclosure statement has consistently permitted items that are normally charged indirect to be charged as direct costs to the benefiting contract. As was the case with the locally incurred costs, RTSC believes that services performed by other entities within Raytheon which benefit the Polar program, as well as system costs for systems in use on the Polar contract, may also be appropriately collected as direct costs to the contract even if those cost are allocated to Polar as flow downs from RTSC and Corporate.

It is important to emphasize that Polar has not reclassified any G&A expense flow downs from Raytheon or RTSC as direct costs even though the actual G&A rate has consistently exceeded the program's capped rate since program inception. Nor has RTSC reclassified all overhead flow downs from Raytheon and RTSC as direct costs. We contend that this reclassification is in accordance with our disclosed practices and is consistent with the parties' original intent on the contract.

e. Auditor's Response:

We recognize that RPSC and RTSC have not reclassified all allocations direct to the contract but that does not justify the treatment of allocations that they did charge direct. The contractor judgmentally selected certain RTSC and Corporate allocations (flow-down costs) to charge direct to the Polar contract while others remained indirect. The contractor's actual and disclosed accounting practice is to accumulate all of these RTSC and Corporate flow costs in its overhead pool (not just certain flow-down costs) for subsequent allocation to business units. We reclassified to the overhead pool all flow down costs to the Polar business unit that the contractor elected to charge direct to the contract. We are not aware of any other business units that judgmentally select certain allocations and charge the associated costs direct to the contract.

We believe that RTSC and Corporate allocations should be part of the overhead based on RTSC Disclosure Statement, Rev. 11, dated January 1, 2004, Item 4.1.0. If RTSC Disclosure Statement specifically states that [redacted]

[redacted]

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SCHEDULE B-3

FRINGE BENEFITS
COMPUTATION OF AUDIT ADJUSTMENT

Union Code	Fringe Pool	Audited Rate	Labor Base	Audited Fringe	Claimed Fringe	Questioned Costs (Upward Adjustment)
RTQ	21925	[redacted]	$ [redacted]	$ [redacted]	$ [redacted]	$ [redacted]
RTT	21903					
RTJ	20912					
R01	20900					
Total			$ [redacted]	$ [redacted]	$ [redacted]	$ [redacted]

Total Fringe Questioned/Audit Adjustment **$ [redacted]**

EXPLANATORY NOTE:

1. Fringe Expense:

   a. Summary of Conclusions:

   An audit of the claimed fringe expenses resulted in questioned costs of $[redacted] for FY 2004. The questioned costs resulted from the application of audited RTSC rates as opposed to the contractor's claimed rates to the applicable fringe codes to Polar Services.

   b. Basis of Contractor's Cost:

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

   c. Audit Evaluation:

   We determined the applicable labor bases for each of the union codes that RPSC participates in. The RTSC audited fringe rates for FY 2004 were applied to the labor according to the union code associated with the labor bases. The applied fringe was then compared to the claimed fringe from the contractor's incurred cost submission for the

[redacted]

same time frame resulting in an over application of claimed fringe cost of $[redacted] (See Schedule B-2).

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

G&A	Claimed Costs FY 2004	Questioned Costs FY 2004	Audited Costs FY 2004	Unresolved Cost	Note
Total Pool	$ [redacted]	$ [redacted]	$ [redacted]	$ [redacted]	Note 1
Polar VAB	[redacted]		[redacted]		Note 2
Polar G&A Rate	[redacted]		[redacted]		

EXPLANATORY NOTE

1. G&A Pool Expenses

a. Summary of Conclusions:

Our examination of the Polar G&A pool resulted in questioned allocated cost of $15,094 and unresolved costs in the amount of $[redacted] resulting from the FY 2004 RTSC incurred cost audit.

The RTSC Incurred Cost Audit Report No. 6161-2004T10100001 disclosed penalty and interest questioned costs based on FAR 31.205-15, which states "penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, local, or foreign laws and regulations, are unallowable…" The Audit Report No. 6161-2004T10100001 also disclosed questioned costs related to equipment capitalization based on FAR 31.201-4, Allocability. The RTSC FY 2004 incurred cost audit also disclosed unresolved costs based on the DCAA Raytheon Corporate Office Audit Report No. 2671-2004A10100001, dated April 27, 2006.

In addition, the contractor's segment G&A cost includes [redacted] allocation from [redacted]. The DCAA South Central Branch Office is responsible for auditing [redacted] and issuing an assist audit on the Homeland Security costs. Pending receipt of the assist audit, we have unresolved the claimed cost.

We also have unresolved travel expenses included in the segment G&A. All travel costs incurred by RTSC employees are processed through Raytheon Finance Shared Services (FSS) in Greenville, TX. The DCAA Richardson Branch Office is responsible for auditing travel costs, processed through FSS, for all Raytheon segments. As of the date of this report we have not received the assist audit results from the DCAA Richardson Branch and therefore have classified the travel costs claimed by RTSC as unresolved.

b. Basis of Contractor's Cost:

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

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

c. Audit Evaluation:

We reviewed RPSC G&A Summary Report on the contractor's SAP Accounting System and found no locally incurred G&A expenses. Moreover, RTSC G&A allocated costs to Raytheon Polar Services Company were audited in the FY 2004 Incurred Cost Audit. Part of this audit consisted in reconciling the expenses representing allocations from the Raytheon Corporate office and the amounts included in the DCAA Raytheon Corporate office's audit report. The FY 2004 RTSC audit results of allocated G&A expenses were disclosed under Audit Report No. 6161-2004T10100001, dated September 29, 2006. This audit report disclosed unallowable G&A expenses in the amount of $ [redacted] from which $[redacted] pertains to RPSC. The Audit Report No. 6161-2004T1010001 also disclosed unresolved G&A expenses in the amount of $[redacted] from which $[redacted] pertains to RPSC.

2. Value Added G&A Base

a. Summary of Conclusions:

The questioned G&A base cost of $[redacted] are solely related to the questioned fringe costs. Since the contractor uses a value added G&A base, a reduction in fringe costs has an equal effect on the G&A base.

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

The labor costs have been segregated based on the applicable fringe bases and contractor fiscal year. The RTSC audited fringe rates for FY 2004 were then applied to the labor according to the union code associated with the labor bases. The applied fringe was then compared to the claimed fringe from the contractor's incurred submission for the same time frame resulting in an over application of claimed fringe cost of $[redacted] (See Schedule B-2).

[redacted]

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EXHIBIT C

OVERHEAD COSTS IN EXCESS OF CONTRACT RATE CEILINGS

Polar Services Contract No. PRSS-0000373

Period January 1, 2004 through December 31, 2004

Overhead:

Claimed Rate (Exhibit B)	(-)	Ceiling Rate	(=)	Rate Delta	(x)	Claimed Base (Exhibit B)	(=)	Total	Ref.
[redacted]	-	[redacted]	=	[redacted]	x	$ [redacted]	=	$ [redacted]	Note 1

Audited Rate (Schedule B-1)	(-)	Claimed Rate (Exhibit B)	(=)	Rate Delta	(x)	Audited Base (Schedule B-1)	(=)		
[redacted]	-	[redacted]	=	[redacted]	x	$ [redacted]	=	[redacted]	Note 2

Overhead Costs in Excess of Ceiling **$** [redacted]

G&A:

Claimed Rate (Exhibit B)	(-)	Ceiling Rate	(=)	Rate Delta	(x)	Claimed Base (Exhibit B)	(=)	Total	Ref.
[redacted]	-	[redacted]	=	[redacted]	x	$[redacted]	=	$ [redacted]	Note 1

***No adjustment to the G&A rate is recommended at this time. The claimed rate is equivalent to the audited rate.**

EXPLANATORY NOTES:

1. Overhead and G&A Costs in Excess of Ceiling – Without Audit Adjustments

   a. Summary of Conclusions:

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

[redacted]

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

d. Contractor's Reaction:

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

[redacted]

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

e. Auditor's Response:

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

[redacted]

CONTRACTOR ORGANIZATION AND SYSTEMS

I. Organization

RTSC's headquarters is located in Reston, VA.

REDACTED

RTSC has a multi-disciplined workforce of approximately 10,000 employees. RTSC provides technical, scientific, and professional services to defense, federal, and commercial customers on all seven continents, including support for operations in space, at sea, and on land. RTSC had annual sales of approximately $[redacted] in FY 2005, of which approximately [redacted] percent 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 35 through 37 have been redacted in their entirety.

REDACTED

In Audit Report Number 6161-2006T11510301, dated September 26, 2006, DCAA examined the RTSC information technology (IT) system and related internal control policies and procedures. Based on our examination we concluded that the IT system general internal controls are adequate.

IV. Budget and Planning System

[redacted]

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

[redacted]

[redacted]

[redacted]

Pages 40 and 41 have been redacted in their entirety.

REDACTED

B. Raytheon Polar Services Company

DCAA examined RPSC's Indirect and Other Direct Cost System of internal controls under Audit Assignment No. 6161-2004T14980202, with a report issued on December 15, 2005. Based on its examination, DCAA determined that the RPSC Indirect and Other Direct Cost System was inadequate. The 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. A brief summary of the deficiencies are as follows:

- The RTSC segment disclosure statement which defines the contractor's current accounting practice regarding indirect and ODC costs, excludes Raytheon Polar Services as of January 1, 2005. To date, a disclosure statement for Raytheon Polar Services has not been submitted to the Government.

- Policies and procedures regarding the allowability of selected costs are in noncompliance with the Federal Acquisition Regulation (FAR) Part 31. Specifically, RPSC policies and procedures address certain costs as allowable which, in our opinion, are expressly unallowable based on applicable FAR provisions.

- Costs that are made expressly unallowable based on the FAR or RPSC/RTSC policies and procedures were charged as allowable, indicating that the contractor is not adequately complying with established controls to properly classify and record unallowable costs. The deficiencies represent a noncompliance with CAS 405-40(a), Accounting for Unallowable Costs, FAR Part 31, and established company policies and procedures.

- The contractor lacks policies and procedures regarding the training of employees in the Indirect/ODC system.

- The contractor has inadequate policies and procedures regarding periodic, independent management reviews and its associated compliance.

- We identified inadequacies that affect the allocability of costs indicating that the contractor lacks adequate controls to ensure the consistent classification of costs based on CAS 418, Allocation of Direct and Indirect Cost [CAS 418-40(a)].

As a result of these deficiencies we have assessed control risk as high for control objectives related to compliance reviews and training, and moderate for control objective related to preparation of indirect and other direct cost submissions. Therefore, our audit effort will be increased in the following review areas: contract pricing (forward pricing rates and bid proposals); defective pricing; incurred indirect and other direct costs, and contract reporting.

Page 44 has been redacted in its entirety.

B. Raytheon Polar Services Company

DCAA examined Raytheon Polar Services Company's (RPSC's) billing system internal controls under Audit Assignment No. 6161-2005P11010001, with a report issued on April 3, 2006. Based on its examination, DCAA determined that the RPSC Billing System and related internal control policies and procedures are inadequate in part. The examination disclosed seven (7) significant deficiencies in two (2) separate internal control objectives (Management Reviews and Policies and Procedures) in the RPSC Billing System that results in a reduction of the Government reliance on RPSC direct and indirect cost billing to the Government. A brief summary of the deficiencies are as follows:

- The RPSC Quarterly Expenditure Report and Advance Payment Requests do not show evidence of Management Reviews prior to submission to the government.

- RPSC has no formal training process for reporting expenditures. In addition, RPSC has no training process to assist employees in identifying and monitoring restricted funds and unallowable costs.

- RPSC did not brief the contract upon award of the Polar Services contract. Adequate preparation and maintenance of contract briefs as part of the billing process is necessary to disclose all significant requirements and all current and relevant changes to the contract for billing and other RPSC personnel requiring contract specific information.

- RPSC has no written policies and procedures requiring segregation of duties between the employee who prepares, approves or certifies the Advance Payment Requests and the Quarterly Expenditure Reports.

- RPSC did not provide adequate supporting documentation of an actual process that monitors cost incurred and subsequently billed on restricted Work Breakdown Structures (WBS). We found no process in place to identify, select and approve costs incurred applicable to WBS with restricted funds.

- RPSC did not provide any evidence of reconciliations performed between the Quarterly Expenditure Reports and the source of cost (SAP Accounting System). Furthermore, RPSC provided no evidence of comparisons between the actual rates to the billed ceiling rates to ensure that the lower of those rates are always billed.

- RPSC did not provide adequate supporting documentation on how it monitors the adequacy of the subcontractor's accounting and billing systems in a timely manner.

REDACTED

Pages 47 through 50 have been redacted in their entirety

Audit Report No. 6161-2004P10100201-S1

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. In a letter dated August 22, 2006, the DACO issued a final determination that found Raytheon Polar Services was in noncompliance with its disclosed accounting practices and CAS 418. In response to the DACO's final determination, RPSC submitted a cost impact statement on October 24, 2006. Our office has scheduled an examination of that cost impact statement to be performed in GFY 2007.

The remainder of this page has been redacted

Pages 52 through 54 have been redacted in their entirety

DCAA PERSONNEL

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AUDIT REPORT AUTHORIZED BY:

/Signed/

LARRY TATEM
Branch Manager
DCAA Herndon Branch Office

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APPENDIX 1

Certificate of Final Indirect Costs

CERTIFICATE OF FINAL INDIRECT COSTS

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

1. All costs included in this proposal ("Raytheon Technical Services Company 2004 Overhead Proposal" dated June 30, 2005) to establish final indirect rates for labor overhead, G&A, and fringe for fiscal year 2004, are allowable in accordance with the cost principles of the Federal Acquisition regulation (FAR) and its supplements applicable to the contracts to which the final indirect cost rates will apply; and

2. This proposal does not include any costs which are expressly unallowable under applicable cost principles of the FAR or its supplements.

Firm: Raytheon Technical Services Company

Signature: [redacted]

Name of Certifying Official: [redacted]

Title: [redacted]

Date of Execution: 6 - 30 - 05

APPENDIX 2

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

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Raytheon

Technical Services Company LLC
Polar Services

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Centennial, Colorado
80112-3938 USA
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September 13, 2006

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

Subject: Raytheon Polar Services Company – 2004 Incurred Cost Audit

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

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

Questioned Costs – Alcohol and Commemorative Items

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

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

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

Locally incurred indirect functions

RTSC disagrees that the locally incurred costs for functions like Finance, Facility, and Human Resources should be charged indirect. As a result, RTSC does not agree with the reclassification of [redacted] ODC and [redacted] of labor costs to an indirect cost. RTSC's disclosed accounting practices at the time of contract award through today have [redacted]. During the proposal on Polar, locally incurred [redacted] costs were

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

Corporate and RTSC allocations charged Direct

The alleged deficiency identified in Number 3 of the Executive Narrative of the Audit Report duplicates 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. The only difference is that these costs are for 2004. As described in our previous audit response, RTSC continues to believe that inclusion of these costs as direct costs reflects an appropriate methodology to implement the original intent of the proposal, and subsequent contract, to charge normally indirect services as direct costs to the contract. As described previously, RTSC's disclosure statement has consistently permitted items that are normally charged indirect to be charged as direct costs to the benefiting contract. As was the case with the locally incurred costs. RTSC believes that services performed by other entities within Raytheon which benefit the Polar program, as well as system costs for systems in use on the Polar contract, may also be appropriately collected as direct costs to the contract even if those costs are allocated to Polar as flow downs from RTSC and corporate.

It is important to emphasize that Polar has not reclassified any G&A expense flow downs from Raytheon or RTSC as direct costs even though the actual G&A rate has consistently exceeded the program's capped rate since program inception. Nor has RTSC reclassified all overhead flow downs from Raytheon and RTSC as direct costs. We contend that this reclassification is in accordance with our disclosed practices and is consistent with the parties' original intent on the contract.

Late charge fee of Unpaid Vendor

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

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

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

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

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

Sincerely,

[redacted]

Cc: N. Luyando Martinez (DCAA)
R. Jones (DCAA)
[redacted]

DEFENSE CONTRACT AUDIT AGENCY

AUDIT REPORT NO. 6161–2003P10100201-S1

December 14, 2006

PREPARED FOR: National Science Foundation
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Associate Inspector General for Audit
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SUBJECT: Supplement to Report on Audit of Raytheon Polar Services FY 2003 Incurred Cost Audit

REFERENCES: Prime Contract No. OPP-0000373

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

REPORT RELEASE RESTRICTIONS: See Page 58

CONTENTS:

[redacted]

Audit Report No. 6161-2003P10100201-S1

SUBJECT OF SUPPLEMENTAL AUDIT

This supplemental report revises the questioned Other Direct Costs (ODC) applicable to the treatment of indirect functions in our original report dated September 25, 2006 because of an overstatement in the amounts that we reclassified as indirect functions on certain schedules of that report. The overstatement did not impact our calculation of the audited indirect rates.

We examined the Raytheon Technical Services Company (RTSC) certified final indirect cost rate proposal dated October 13, 2004 and related books and records for the reimbursement of Polar Services FY 2003 incurred costs. The purpose of the examination was to determine allowability of direct and indirect costs and recommend Contracting Officer-determined indirect cost rates for FY 2003. The proposed rates apply to prime contract OPP-0000373. A copy of RTSC Certificate of Final Indirect Costs, dated October 13, 2004 is included as Appendix 1 to this report.

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

EXECUTIVE SUMMARY OF SUPPLEMENTAL AUDIT

Our examination of the $142.5 million proposal related to Polar Services contract disclosed significant questioned costs, including the following significant items:

Treatment of Indirect Functions	$ [redacted]
Reclassified Corporate and RTSC Allocations	[redacted]
Expressly Unallowable Costs	[redacted]
RPSC Share of Questioned Allocations	[redacted]
G&A Pool Questioned Costs	[redacted]
Fringe Benefits	[redacted]

SIGNIFICANT ISSUES:

1. We questioned $[redacted] related to the application of audited RTSC fringe rates as opposed to the contractor's claimed rates to the applicable fringe codes for Polar Services.

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

[redacted]

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

4. We identified $[redacted] of G&A costs in excess of the contract ceiling. The G&A rates were recalculated and compared to the claimed rates to determine the amounts in excess of the [redacted] contract ceiling rate.

5. We questioned $[redacted] as a result of alcoholic beverages, T-shirts, ornaments, hats, bobble heads, and glasses booked as material costs for FY 2003.

6. We reclassified $[redacted] of ODC and $[redacted] of labor costs related to [redacted]

7. We reclassified $[redacted] of Corporate and RTSC allocations that were changed direct to the contract as Other Direct Costs (ODC).

8. We questioned $[redacted] of RPSC allocations based on the Raytheon Corporate and RTSC assessments audit results (Audit Assignment No. 6161-2005T10160208).

SCOPE OF SUPPLEMENTAL AUDIT

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

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

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

- Federal Acquisition Regulation, and
- Cost Accounting Standards.

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

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

[redacted]

RESULTS OF SUPPLEMENTAL AUDIT

Total questioned Other Direct Costs (ODC) of $5,802,718 in our original report applicable to treatment of indirect functions are revised to $4,334,446 because of an overstatement in the amounts that we reclassified as indirect functions on certain schedules of that report. The overstatement did not impact our calculation of the audited indirect rates.

This supplemental report replaces our original report in its entirety.

AUDITOR'S OPINION:

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

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

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

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

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

Cost Element	Claimed	Questioned	Ref.
Direct Labor	[redacted]	[redacted]	Schedule A-1
Material			Schedule A-2
Subcontracts			
Other Direct Costs		[redacted]	Schedule A-3
Totals	[redacted]	[redacted]	

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

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

RPSC FY 2003 DIRECT LABOR COSTS AND RESULTS OF AUDIT

Cost Element	Claimed Cost	Questioned Cost	Ref.
Direct Labor	[redacted]	[redacted]	Note 1

EXPLANATORY NOTE:

1. Direct Labor

a. Summary of Conclusions:

We reclassified $[redacted] of the contractor's claimed direct labor associated with various indirect functions to the overhead pool based on its disclosed accounting practices.

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

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

Furthermore, [redacted]. While the Human Resource function is dedicated to the Polar Services contract, the contract is still considered as having multiple cost objectives.

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

[redacted]

The reclassified direct labor costs associated with the various indirect functions are as follows:

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

d. Contractor's Reaction:

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

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

e. Auditor's Response:

In our opinion, RTSC position of claiming costs incurred under functions like [redacted] as direct costs does not comply with the Cost Accounting Standard (CAS) 418. These functions are clearly indirect costs that should not be treated as direct costs. CAS 418 requires the consistent classification of costs as direct or indirect. RTSC common practice is to charge functions like Finance, Facility, and Human Resources as indirect costs. Furthermore, [redacted]

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

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

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

[redacted]

RPSC CLAIMED FY 2003 MATERIAL COSTS AND RESULT OF AUDIT

Element of Cost	Claimed	Questioned	Ref.
Other Material	$[redacted]	$ 603,887	Note 1

EXPLANATORY NOTE:

1. Other Material Costs

a. Summary of Conclusions:

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

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

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

[redacted]

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

(1) Fee is being applied to expressly unallowable items, and

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

[redacted]

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

d. Contractor's Reaction:

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

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

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

e. Auditor Response:

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

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

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

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

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

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

(1) Identification of costs specifically described as unallowable, at the time such costs first become defined or authoritatively designated as unallowable and;

(2) The cost accounting treatment to be accorded such identified unallowable costs to promote the consistent application of sound cost accounting principles covering all incurred costs.

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

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

The FAR 31.201-1(b) states:

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

[redacted]

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

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

[redacted]

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

Cost Element	Claimed	Questioned	Ref.
Other Direct Costs	$ [redacted]	$ [redacted]	Note 1

EXPLANATORY NOTES:

1. Other Direct Costs

   a. Summary of Conclusions:

   We questioned $[redacted] of RPSC miscellaneous other direct costs (ODC) for FY 2003. Of this amount $[redacted] is related to the contractor's classification of indirect functions as direct contract costs (see Table on page 18).

Work Breakdown Structure	WBS Description	FY 2003 Questioned Pool Costs
R-PS00-2A0100	[redacted]	$ [redacted]
R-PS00-2B0100		[redacted]
R-PS20-207		
R-PS30-207		
R-PS40-207		
Sub-Total		$ [redacted]
R-PS00-2A0014	[redacted]	$ [redacted]
R-PS00-2B0014		[redacted]
R-PS20-212		
R-PS30-212		
R-PS43-238E01		
R-PS43-238E06		
R-PS43-238E08		
R-PS43-238E09		
R-PS43-238E14		
Sub-Total	[redacted]	$ [redacted]
R-PS00-2A0120	[redacted]	$ [redacted]
R-PS00-2B0120		[redacted]
R-PS20-208		
R-PS30-208		
R-PS40-208		
Sub-Total		
Total		**$** [redacted]

Of the $[redacted] Miscellaneous ODC questioned, $[redacted] is related to the contractor's reclassification of Corporate and RTSC allocations from indirect to direct contract costs (see Table on page 19).

Doc. No.	Journal Entry Description	WBS Element	Transaction Amount
100094039	Polar Indirect-Direct Reclassification	R-PS30-201D08BA	$ [redacted]
110399452	2003 Qtr 1 & 2 Polar Direct-Indirect	R-PS30-201D08BA	[redacted]
110450692	Polar Direct-Indirect	R-PS30-201D08BA	[redacted]
110539869	FY 2003 Raytheon Polar Allocation Adjustment Jan-June	R-PS40-201E08BA	[redacted]
FY 2003 Total Reclassified Allocations			**$** [redacted]

b. Basis of Contractor's Cost:

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

Locally incurred cost/allocations were booked direct to the Polar Services contract as part of the General Management (PS-X0) and Polar Services Logistics Division (PS-43 and PS-53). These costs when booked and billed as direct costs reduced the amount of overhead incurred on the contract.

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

c. Audit Evaluation:

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

Pages 19 through 23 have been redacted in their entirety.

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

Polar Services Contract No. OPP-0000373

Period January 1, 2003 through December 31, 2003

	Claimed	Questioned	Audited	Ref.
Overhead				
Pool	$ [redacted]	$ [redacted]	$ [redacted]	Schedule B-1
Base				
Rate				
Fringe Benefits				
Pool	[redacted]	[redacted]	[redacted]	Schedule B-2
Base				
G&A				
Pool	[redacted]	[redacted]	[redacted]	Schedule B-3
RPSC VAB				
Rate				

CONTRACTOR'S CLAIMED OVERHEAD POOL AND BASE COSTS AND RESULTS OF AUDIT

	Amount	Amount	Ref.
Claimed Overhead Pool		[redacted]	
Reclassified Costs:			
Locally Incurred Costs	$[redacted]		Note 1
Corporate & RTSC Allocations	[redacted]		Note 2
RPSC Share of Questioned Allocations			Note 3
Total Questioned Pool Costs		[redacted]	
Revised Pool		**$** [redacted]	
Claimed Direct Labor Base		$ [redacted]	
Reclassified Costs:			
Locally Incurred Labor Costs	[redacted]		Note 1
Total Questioned Base Costs		[redacted]	
Revised Overhead Base		[redacted]	

EXPLANATORY NOTES:

1. Overhead – Locally Incurred Costs/Functions

   a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

Our reclassification of labor costs to the local overhead pool is discussed in further detail in Schedule A-1, Note 1 of this report. Our reclassification of the Miscellaneous ODC is discussed in further detail in Schedule A-3, Note 1 of this report.

2. Corporate and RTSC Allocations

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

Our reclassification of the RTSC and [redacted] to the [redacted] is discussed in further detail in Schedule A-3, Note 1 of this report.

3. RPSC Share of Questioned Allocations

a. Summary of Conclusions:

We have questioned $[redacted] related to the FY 2003 audit of Corporate and RTSC assessments (Audit Assignment No. 6161-2005T10160208).

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

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

FRINGE BENEFITS
COMPUTATION OF AUDIT ADJUSTMENT

Union Code	Fringe Pool	Audited Rate	Labor Base	Audited Fringe	Claimed Fringe	Questioned Costs/(Upward Adjustment)
RTQ	21925			$	$	$
	21906					
RTT	21903					
RTL	20984					
RTA	20983					
RSE	20982					
RTK	20966					
RB	20915					
RTJ	20912					
R01	20900			542,138		
Total						

Total Fringe Questioned/Audit Adjustment

EXPLANATORY NOTE:

1. Fringe Expenses

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

d. Contractor's Response:

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

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

G&A	Claimed Costs FY 2003	Questioned Costs FY 2003	Audited Costs FY 2003	Ref.
Total Pool	$ [redacted]	$ [redacted]	$ [redacted]	Note 1
Polar VAB				Note 2
Polar G&A Rate				

EXPLANATORY NOTES:

1. G&A Pool Expenses

a. Summary of Conclusions:

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

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

b. Basis of Contractor's Cost:

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

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

c. Audit Evaluation:

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

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

d. Contractor's Reaction:

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

2. Value Added G&A Base

a. Summary of Conclusions:

The questioned G&A base cost of $[redacted] are solely related to the questioned fringe costs. Since the contractor uses a value added G&A base, a reduction in fringe costs has an equal effect on the G&A base.

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

OVERHEAD AND G&A COSTS IN EXCESS OF CONTRACT RATE CEILINGS
Polar Services Contract No. OPP-0000373
Period January 1, 2003 through December 31, 2003

Overhead:

Claimed Rate (Exhibit B)	(-)	Ceiling Rate	(=)	Rate Delta	(x)	Claimed Base (Exhibit B)	(=)	Total	Ref.
[redacted]	-	[redacted]	=	[redacted]	x	[redacted]	=	[redacted]	Note 1

Audited Rate (Schedule B-1)	(-)	Claimed Rate (Exhibit B)	(=)	Rate Delta	(x)	Audited Base (Schedule B-1)	(=)		
[redacted]	-	[redacted]	=	[redacted]	x	[redacted]	=	[redacted]	Note 2

Overhead Costs in Excess of Ceiling [redacted]

G&A:

Claimed Rate (Exhibit B)	(-)	Ceiling Rate	(=)	Rate Delta	(x)	Claimed Base (Exhibit B)	(=)	Total	
[redacted]	-	[redacted]	=	[redacted]	x	[redacted]	=	[redacted]	Note 1

Audited Rate (Exhibit B)	(-)	Claimed Rate (Exhibit B)	(=)	Rate Delta	(x)	Audited Base	(=)		
[redacted]		[redacted]	=	[redacted]	x	[redacted]	=	[redacted]	Note 2

G&A Cost in Excess of Ceiling [redacted]

EXPLANATORY NOTES:

1. Overhead and G&A Costs in Excess of Ceiling – Without Audit Adjustments

   a. Summary of Conclusions:

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

[redacted]

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

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

a. Summary of Conclusions:

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

b. Basis of Contractor's Cost:

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

c. Audit Evaluation:

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

d. Contractor's Reaction:

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

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

e. Auditor's Response:

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

[redacted]

CONTRACTOR ORGANIZATION AND SYSTEMS

I. Organization

RTSC's headquarters is located in Reston, [redacted]

[redacted]

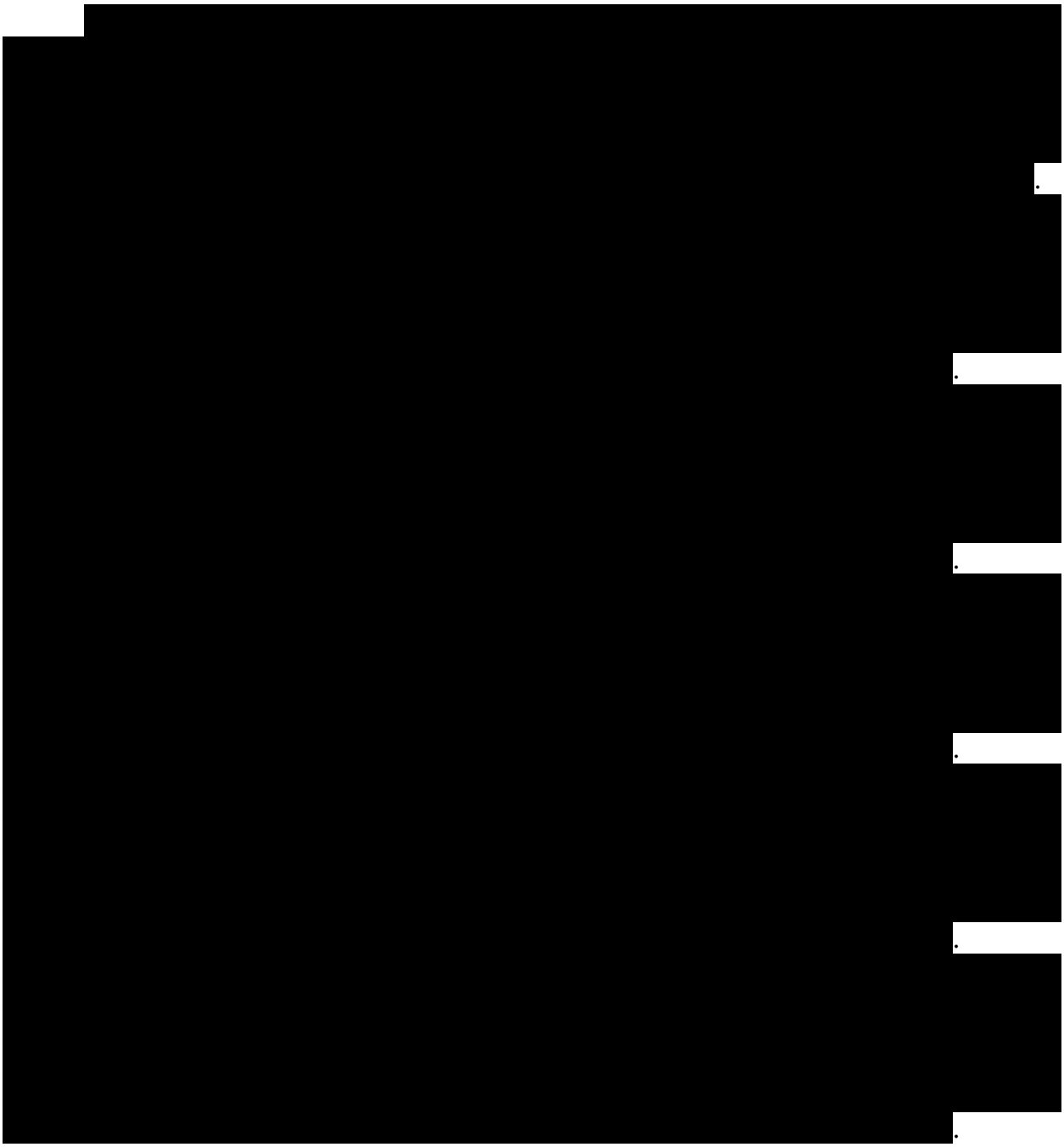
RTSC has a multi-disciplined workforce of approximately 10,000 employees. RTSC provides technical, scientific, and professional services to defense, federal, and commercial customers on all seven continents, including support for operations in space, at sea, and on land. RTSC had annual sales of approximately [redacted] in FY 2005, of which approximately [redacted] percent 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).

Page 37 has been redacted in its entirety

[redacted]

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

Page 39 has been redacted in its entirety



In Audit Report Number 6161-2006T11510301, dated September 26, 2006, DCAA examined the RTSC information technology (IT) system and related internal control policies and procedures. Based on our examination we concluded that the IT system general internal controls are adequate.

[redacted]

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

[redacted]

Page 42 has been redacted in its entirety

[redacted]

VIII. Indirect and ODC System

A. Raytheon Technical Services Company

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

[redacted]

B. Raytheon Polar Services Company

DCAA examined RPSC's Indirect and Other Direct Cost System of internal controls under Audit Assignment No. 6161-2004T14980202, with a report issued on December 15, 2005. Based on its examination, DCAA determined that the RPSC Indirect and Other Direct Cost System was inadequate. The 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. A brief summary of the deficiencies are as follows:

- The RTSC segment disclosure statement which defines the contractor's current accounting practice regarding indirect and ODC costs, excludes Raytheon Polar Services as of January 1, 2005. To date, a disclosure statement for Raytheon Polar Services has not been submitted to the Government.

- Policies and procedures regarding the allowability of selected costs are in noncompliance with the Federal Acquisition Regulation (FAR) Part 31. Specifically, RPSC policies and procedures address certain costs as allowable which, in our opinion, are expressly unallowable based on applicable FAR provisions.

- Costs that are made expressly unallowable based on the FAR or RPSC/RTSC policies and procedures were charged as allowable, indicating that the contractor is not adequately complying with established controls to properly classify and record unallowable costs. The deficiencies represent a noncompliance with CAS 405-40(a), Accounting for Unallowable Costs, FAR Part 31, and established company policies and procedures.

- The contractor lacks policies and procedures regarding the training of employees in the Indirect/ODC system.

- The contractor has inadequate policies and procedures regarding periodic, independent management reviews and its associated compliance.

- We identified inadequacies that affect the allocability of costs indicating that the contractor lacks adequate controls to ensure the consistent classification of costs based on CAS 418, Allocation of Direct and Indirect Cost [CAS 418-40(a)].

[redacted].

Page 46 has been redacted in its entirety

B. Raytheon Polar Services Company

DCAA examined Raytheon Polar Services Company's (RPSC's) billing system internal controls under Audit Assignment No. 6161-2005P11010001, with a report issued on April 3, 2006. Based on its examination, DCAA determined that the RPSC Billing System and related internal control policies and procedures are inadequate in part. The examination disclosed seven (7) significant deficiencies in two (2) separate internal control objectives (Management Reviews and Policies and Procedures) in the RPSC Billing System that results in a reduction of the Government reliance on RPSC direct and indirect cost billing to the Government. A brief summary of the deficiencies are as follows:

- The RPSC Quarterly Expenditure Report and Advance Payment Requests do not show evidence of Management Reviews prior to submission to the government.

- RPSC has no formal training process for reporting expenditures. In addition, RPSC has no training process to assist employees in identifying and monitoring restricted funds and unallowable costs.

- RPSC did not brief the contract upon award of the Polar Services contract. Adequate preparation and maintenance of contract briefs as part of the billing process is necessary to disclose all significant requirements and all current and relevant changes to the contract for billing and other RPSC personnel requiring contract specific information.

- RPSC has no written policies and procedures requiring segregation of duties between the employee who prepares, approves or certifies the Advance Payment Requests and the Quarterly Expenditure Reports.

- RPSC did not provide adequate supporting documentation of an actual process that monitors cost incurred and subsequently billed on restricted Work Breakdown Structures (WBS). We found no process in place to identify, select and approve costs incurred applicable to WBS with restricted funds.

- RPSC did not provide any evidence of reconciliations performed between the Quarterly Expenditure Reports and the source of cost (SAP Accounting System). Furthermore, RPSC provided no evidence of comparisons between the actual rates to the billed ceiling rates to ensure that the lower of those rates are always billed.

- RPSC did not provide adequate supporting documentation on how it monitors the adequacy of the subcontractor's accounting and billing systems in a timely manner.

The remainder of page 48 has been redacted

Pages 49 through 52 have been redacted in their entirety

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. In a letter dated August 22, 2006, the DACO issued a final determination that found Raytheon Polar Services was in noncompliance with its disclosed accounting practices and CAS 418. In response to the DACO's final determination, RPSC submitted a cost impact statement on October 24, 2006. Our office has scheduled an examination of that cost impact statement to be performed in GFY 2007.

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Pages 54 through 56 have been redacted in their entirety

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AUDIT REPORT AUTHORIZED BY:

/Signed/

LARRY TATEM
Branch Manager
DCAA Herndon Branch Office

[redacted]

Audit Report No. 6161-2003P10100201-S1

AUDIT REPORT DISTRIBUTION AND RESTRICTIONS

DISTRIBUTION

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Raytheon Polar Services Raytheon Technical Services Company 12160 Sunrise Valley Drive Reston, VA 20191	(Copy furnished thru ACO)

RESTRICTIONS

[redacted]

APPENDIX 1

Certificate of Final Indirect Costs

[redacted]

CERTIFICATE OF FINAL INDIRECT COSTS

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

1. All costs included in this proposal ("Raytheon Technical Services Company 2003 Overhead Proposal" dated October 07, 2004) to establish final indirect rates for labor overhead, G&A, and fringe for fiscal year 2003, are allowable in accordance with the cost principles of the Federal Acquisition regulation (FAR) and its supplements applicable to the contracts to which the final indirect cost rates will apply; and

2. This proposal does not include any costs which are expressly unallowable under applicable cost principles of the FAR or its supplements.

Firm: Raytheon Technical Services Company

Signature: [redacted]

Name of Certifying Official: [redacted]

Title: [redacted]

Date of Execution: 10/12/04

APPENDIX 2

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

Raytheon

Technical Services Company LLC
Polar Services

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

August 31, 2006

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

Subject: Raytheon Polar Services Company – 2003 Incurred Cost Audit

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

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

Questioned Costs – Alcohol and Commemorative Items

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

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

Locally incurred indirect functions

RTSC disagrees that the locally incurred costs for functions like Finance, Facility, and Human Resources should be charged indirect. As a result, RTSC does not agree with the reclassification of $4,334,446 of ODC and $1,468,272 of labor costs to an indirect cost. RTSC's disclosed accounting practices at the time of contract award through today have consistently [redacted] During the proposal on Polar, locally incurred [redacted] costs were bid as direct costs to the Polar contract in accordance with this clause in the disclosure statement. Subsequently, upon contract award, RTSC and the Polar customer clearly and explicitly agreed that these locally incurred costs would be charged as direct costs on the Polar contract. Charging these costs as direct costs to the contract is also consistent with the charging practice of the prior contractor and has been used in like situations throughout RTSC. The National Science Foundation accepted the bid by RTSC which included this basis and has, each year, approved the Annual Program Plan which budgets for these costs as direct costs to the contract. Also, the DCAA asserts that because the contract calls for separate work breakdown structures (WBS) to collect costs on the program that the contract has multiple final cost objectives. If this were the case, every contract issued by the government would have multiple final cost objectives because all contracts require WBS detail to budget and manage costs. Polar, like all contracts within RTSC, is a single final cost objective for CAS purposes. In summary,

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

Corporate and RTSC allocations charged Direct

The alleged deficiency identified in Number 7 of the Executive Narrative of the Audit Report duplicates 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. The only difference is that these costs are for 2003. As described in our previous audit response, RTSC continues to believe that inclusion of these costs as direct costs reflects an appropriate methodology to implement the original intent of the proposal, and subsequent contract, to charge normally indirect services as direct costs to the contract. As described previously, RTSC's disclosure statement has consistently permitted items that are normally charged indirect to be charged as direct costs to the benefiting contract. As was the case with the locally incurred costs, RTSC believes that services performed by other entities within Raytheon which benefit the Polar program, as well as system costs for systems in use on the Polar contract, may also be appropriately collected as direct costs to the contract even if those costs are allocated to Polar as flow downs from RTSC and corporate.

It is important to emphasize that Polar has not reclassified any G&A expense flow downs from Raytheon or RTSC as direct costs even though the actual G&A rate has consistently exceeded the program's capped rate since program inception. Nor has RTSC reclassified all overhead flow downs from Raytheon and RTSC as direct costs. We contend that this reclassification is in accordance with our disclosed practices and is consistent with the parties' original intent on the contract.

RPSC Allocations

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

Fringe Rates

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

Unallowable Costs at RTSC level

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

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

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

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

Sincerely,

[redacted]

Cc: N. Luyando Martinez (DCAA)
R. Jones (DCAA)
[redacted]