

# Defense Contract Audit Agency



United States  
Department of Defense



August 29, 2011

## Independent Audit on Parts of Price Adjustment Proposal Submitted by Supreme Foodservice GmbH Related to Premium Outbound Transportation Effort to Forward Operating Bases in Afghanistan

**AUDIT REPORT NO. 2191-2011M17200001**

### RESTRICTIONS:

1. The contents of this audit report should not be released or disclosed, other than to those persons whose official duties require access in accordance with DoD 5200.1-R, Information Security, January 1997, Appendix 3, paragraph AP3.2.3. This document may contain information exempt from mandatory disclosure under the Freedom of Information Act. Exemption 4, of the Freedom of Information Act, which addresses proprietary information, may apply.

It is not practical to identify during the conduct of the audit those elements of the data which are proprietary. Proprietary determinations should be made in the event of an external request for access. Unauthorized disclosure of proprietary information violates 18 U.S.C. 1905 and, if the information is contractor bid or proposal or source selection information, 41 U.S.C. 423. Any person who unlawfully discloses such information is subject to penalties such as fines, imprisonment, and/or removal from office or employment.

2. Under the provisions of Title 32, Code of Federal Regulations, Part 290.7(b), DCAA will refer any Freedom of Information Act requests for audit reports received to the cognizant contracting agency for determination as to releasability and a direct response to the requestor.

3. The Defense Contract Audit Agency has no objection to the release of this report, at the discretion of the contracting agency, to authorized representatives of Supreme. However, do not release the Government technical evaluation report included as Appendix 2 of our report to Supreme without approval of Defense Logistics Agency (DLA) Headquarters.
4. Do not use the information contained in this audit report for purposes other than action on the subject of this audit without first discussing its applicability with the auditor.

## DEFENSE CONTRACT AUDIT AGENCY

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**REFERENCES:** Contract No. SPM300-05-D-3130  
Relevant Dates: See Page 87

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## **SUBJECT OF AUDIT OF PARTS OF PROPOSAL**

As you requested on October 15, 2010, we attempted to examine Supreme Foodservice, GmbH's (Supreme) [REDACTED] price adjustment proposal for premium outbound transportation (POT) performed outside the scope of the original base contract to determine if the proposal is acceptable as a basis for negotiation. However, due to the DLA Troop Support imposed time constraint, we only examined the Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts), Consultancy Fees, and Financing Costs portion ([REDACTED]) of Supreme's price adjustment proposal to determine if the parts of the proposal examined are acceptable as a basis for negotiation. Specifically, the proposal, which is based on costs recorded as incurred from November 2005 through August 2010, is related to a contract change, which occurred after contract award but prior to the beginning of contract performance, which required the delivery of Class I (food and water) and Class IV (construction materials) to forward operating base (FOB) locations in Afghanistan. Supreme submitted the proposal, dated October 15, 2010, under Contract No. SPM300-05-D-3130 to establish the applicable distribution rates to FOB locations. This contract initially provided for distribution of food and water to four non-forward operating bases (NFOB) only.

The proposed price adjustment for Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts), Consultancy Fees, and Financing Costs and related information other than cost or pricing data are the responsibility of the contractor. Our responsibility is to express an opinion on the parts of the proposal based on our examination.

## **EXECUTIVE SUMMARY OF PARTS OF PROPOSAL**

We do not believe the parts of the proposal examined are an acceptable basis for negotiation. We have questioned the majority of the proposed amount of the parts of the proposal examined because (i) the information other than cost or pricing data submitted in support of the proposal is inadequate and (ii) the proposal was not prepared in all respects in accordance with the appropriate provisions of FAR Part 31. At your request, we have, nevertheless, evaluated the Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts), Consultancy Fees, and Financing Costs to the extent possible in the circumstances. Because of the significance of the audit findings, should you decide to negotiate the pricing action based on the current proposal, we recommend that you invite a DCAA representative to attend the negotiation conference. We noted the following significant issues during our examination.

### **SIGNIFICANT ISSUES**

1. Supreme failed to comply with the Defense Logistics Agency (DLA) Troop Support instructions for preparation of the proposal. As a result, Supreme did not (i) identify and exclude unallowable costs; (ii) estimate costs through the contract performance period; (iii)

exclude Consultancy Fees previously determined to be unallowable; or (iv) identify NFOB distribution fees to estimate the credit applicable to FOB destinations.

2. Supreme failed to provide requested fuel sales data resulting in a formal denial of access to records. Without adequate supporting documentation, Supreme failed to demonstrate the reasonableness, allowability, and allocability of the proposed fuel costs.
3. Supreme failed to provide adequate supporting documentation to include truck manifests, vendor invoices, contracts, price analyses, and correct flight plans. Without adequate supporting documentation, Supreme failed to demonstrate the reasonableness, allowability, and allocability of the proposed costs.
4. Supreme did not maintain original source documentation for all transactions selected for testing (i.e., invoices, truck manifests). Further, according to Supreme, support provided included documentation received by Supreme in an electronic format (invoices received via email). Because the proposed costs relate to FYs 2005/2006 through August 2010, we are unable to evaluate Supreme's process for maintaining the integrity of documents received electronically. Accordingly, we were unable to determine whether reliance could be placed on the copies provided and relied on during our audit.

Further, due to the DLA Troop Support imposed time constraint, the scope of our work was not sufficient to enable us to express an opinion on whether the following proposed costs are in all material respects, based on FAR Part 31 and DFARS requirements, and therefore, acceptable as a basis for negotiation:

- Parking Fees;
- Allocated Overheads, excluding Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts; and
- Central Overhead (General and Administrative) Rates.

### **SCOPE OF AUDIT OF PARTS OF PROPOSAL**

We limited our audit to an examination of the proposed Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts), Consultancy Fees, and Financing Costs. We conducted our examination in accordance with Generally Accepted Government Auditing Standards (GAGAS), except DCAA does not currently have an external opinion on its quality control system as required by GAGAS 3.55. The most recent external quality control review opinion expired on August 26, 2009. GAGAS require that we plan and perform the examination to obtain reasonable assurance about whether the parts of the price adjustment proposal examined are free of material misstatement. An examination includes:

- obtaining an understanding of 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 for the parts of price adjustment proposal examined;
- assessing the accounting principles used and significant estimates made by the contractor in developing the proposed amounts for the parts of the proposal examined;
- evaluating the overall price adjustment proposal presentation for those parts; and
- determining the need for technical specialist assistance for the parts of the proposal examined and quantifying the results of a Government technical evaluation.

We evaluated the proposed Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts), Consultancy Fees, and Financing Costs using the applicable requirements contained in the:

- Federal Acquisition Regulation (FAR),
- Defense FAR Supplement (DFARS), and
- DLA Troop Support Proposal Preparation Instructions included in letter dated August 31, 2010.

Due to the DLA Troop Support imposed time constraint, we were not able to obtain sufficient competent evidential matter on which to base an opinion on the following proposed costs:

- Parking Fees;
- Allocated Overheads, excluding Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts; and
- Central Overhead (General and Administrative) Rates.

The time that was provided for performance of the audit did not allow us to apply auditing procedures to satisfy ourselves as to the acceptability of these costs.

Further, the DLA Troop Support imposed time constraint affected the evaluation of (i) the methodologies used to split Allocated Overheads between FOB and NFOB as well as between modes of delivery, (ii) weights used to calculate final distribution fees, (iii) exchange rates, and (iv) Central Overhead rates. Refer to Scope of Audit, Limitation No. 10 Methodology to Split Allocated Overheads Between FOB and NFOB on page 10, Limitation No. 11 Methodology to Split Allocated Overhead FOB Costs Between Modes of Delivery on page 11, Limitation No. 12 Exchange Rates on page 11, and Limitation No. 13 Weights Used to Calculate Final Distribution Fees on page 11.

Contract No. SPM300-05-D-3130 was awarded based on adequate price competition without the submission of cost or pricing data. Further, the cost accounting standards board

(CASB) rules have not been incorporated into subsequent contract modifications. Therefore, the contract is exempt from all cost accounting standard (CAS) requirements under 48 CFR 9903.201-1(b)(15).

Our assessment of control risk reflects that we have not specifically tested the effectiveness of Supreme's systems and related internal controls. See the Contractor Organization and Systems on page 86 of this report. The scope of our examination reflects our assessment of control risk and includes audit tests designed to provide a reasonable basis for our opinion.

## LIMITATIONS

### 1. Denial of Access to Records

We first requested data to evaluate the proposed fuel costs on February 2, 2011. On February 7, 2011, Supreme initially agreed to provide support by February 26, 2011. However, on February 24, 2011 Supreme forwarded a letter stating that it would not provide the requested support in its entirety. In response to Supreme's letter, we issued a formal written request for supporting documentation on February 28, 2011 and subsequently issued a formal denial of access to records on March 4, 2011. Supreme subsequently agreed to provide the requested fuel data (at their facility), and on March 15, 2011 we met with representatives from the Supreme Fuels Division to review the data and confirm its validity by comparing it to original data in Supreme's accounting system, [REDACTED]. The data provided by Supreme consisted of printed spreadsheets detailing by customer, by fuel type, by month, the average monthly fuel sales rate. However, Supreme was unable to demonstrate the data reconciled to its accounting books and records; the variance was in the millions of U.S. dollars. As a result, the data was returned in its entirety as unreliable. On April 23, 2011 Supreme provided revised fuel sales data and demonstrated that FY 2010 figures reconciled to data in its accounting books and records. Nevertheless, the revised fuel sales data remained inadequate because:

- the average fuel sales price included negative sales amounts and significant variances;
- the total sales amounts included differences (in the millions of U.S. dollars) between the sales history and the financial statements;
- manual account adjustments were not supported or explained; and
- Supreme refused to provide the complete financial statements (other than the sales amount), and we were unable to determine the reliability/basis of the fuel quantity and sales data without the balance sheet and notes to the statements.

In the absence of adequate and reliable fuel sales data, we attempted to obtain additional fuel information on May 3, 2011. Specifically, we requested Supreme demonstrate compliance with FAR 31.205-26, Material Costs, Paragraph (e) and provide responses to additional questions related to fuel. In a letter dated May 6, 2011, Supreme formally responded to our request stating that records already provided demonstrate that Supreme consistently transfers fuel at a price. As a result, Supreme stated the Government "... does not need access to the details of the factors ..." considered by Supreme when setting the transfer price. As a result, on May 12, 2011, we

issued a second denial of access to records letter in response to Supreme's formal refusal to provide additional information.

Without a response to our inquiry or documentation demonstrating compliance with FAR 31.205-26, Material Costs, Paragraph (e), we questioned the fuel costs in their entirety. The direct fuel costs are estimated to be approximately [REDACTED] as noted on Exhibits B [REDACTED] and C [REDACTED] beginning on pages 30 and 46, respectively; and approximately [REDACTED] as noted on Exhibit E beginning on page 71. Our audit results are impacted to the extent that our questioned costs would have differed had Supreme provided adequate supporting documentation.

## 2. Technical Specialist Assistance

The proposed aviation (i.e., Rotary and Fixed Wing) costs consist primarily of: (i) aircraft lease costs, (ii) fuel costs, and (iii) life support costs. The aircraft lease costs are calculated by multiplying a rate by the number of block hours (i.e., flight time which is the time the aircraft engine is on). The fuel costs are calculated by multiplying the fuel consumption/usage by the fuel rate. The flight time and fuel consumption/usage are based on flight plans (referred to as Supreme Aviation (SAVN) flight plans) completed by third-party aircraft pilots. During our detailed analysis of the aviation costs we identified concerns with the accuracy of the recorded fuel usage quantities and flight times.

Supreme has stated that it initially preprinted the estimated flight time and fuel quantity on the flight plans as a check figure to be used in comparison to the actuals recorded by the pilots. However, upon request to demonstrate how the standards were developed, implemented, and monitored, Supreme stated it had not retained any documentation on the standards. Further, Supreme stated that it later stopped preprinting the time and fuel quantity estimates on the flight plans because it believes the pilots were merely matching the preprinted estimates rather than recording the actual fuel usage and flight times. In addition, Supreme stated the fuel tanks in the aircraft register the fuel level in 100-liter increments. In order to accurately measure the amount of fuel consumed, the fuel tank should be physically observed before and after each trip taken by an aircraft. Supreme has no written procedures or guidance for the pilots on how to track and record actual fuel usage. Supreme believes the pilots used discretion in rounding or, in many instances, estimating the amount of fuel consumed.

Due to our concern with the validity of flight time and fuel quantities recorded on Supreme flight plans we requested technical specialist assistance to determine their reasonableness. We received the technical specialist report which questioned flight hours and accepted fuel quantities. In fact, the technical analysis noted Supreme's recorded fuel quantities further supported the technical conclusion that the flight hours are overstated. We applied the results of the questioned flight hours to the sample items reviewed. Nevertheless, the technical specialist was unable to evaluate all flight routes in the given sample. For that reason, we calculated an average flight time decrement based on the results of all other flights with questioned differences and applied the decrement to flights and their related hours not reviewed by the technical specialist. Our



audit results are impacted to the extent that had the technical specialist been able to evaluate all flight routes our questioned costs would have differed. For a detailed discussion of proposed flight hours and fuel quantities, refer to Exhibit B and C beginning on pages 46 and 59, respectively.

### 3. Inconsistent Classification of Costs

Supreme did not consistently classify and record its fuel costs by account for the years proposed. Specifically, Supreme recorded fuel costs within multiple accounts. For example, vehicle fuel costs are recorded within the vehicle fuel account (Account No. 52401) as well as within the security account (Account No. 51003). Further, in FY 2010 Supreme did not separately identify the Rotary and Fixed Wing fuel and lease cost within its proposal; the costs were combined. Because of the inconsistent classification of costs Supreme was unable to demonstrate the total fuel costs proposed by fuel type and amount. As described in Limitation No. 1 Denial of Access, on page 4 we have questioned all known fuel costs. Further, as described in Limitation No. 11 Lack of Adequate Time on page 12, we did not have sufficient time to evaluate the security account (Account No. 51003). Consequently, our audit results are impacted to the extent that our questioned costs would have differed had we been able to determine the total amount of fuel costs proposed. For a detailed discussion on the consistent classification of costs, refer to Exhibits B, C, and E beginning on pages 30, 46, and 71, respectively.

### 4. Irreconcilable Differences

The proposed direct and allocated overhead costs do not readily reconcile to Supreme's accounting books and records. Supreme prepared its proposal from summary reports which do not include adjustments made at the transaction level, after the books were closed. Although proposed costs are supported by costs recorded as incurred, there are numerous differences between the amounts proposed and the ledgers (with transaction level detail) provided by Supreme. Because our testing was performed at the transaction level, an additional adjustment may have been required to derive our total questioned costs. For example, if the proposed costs for a specific account were greater than the total costs recorded in the ledgers for that account, in addition to any costs questioned based on the testing of specific transactions, there was a bottom line adjustment added to calculate the total questioned costs. Consequently, our audit results are impacted to the extent that our questioned costs would have differed had Supreme been able to reconcile the proposal to its general ledger. For a detailed discussion on the various irreconcilable differences, refer to Exhibits B, C, D, and E beginning on pages 30, 46, 59, and 71, respectively.

### 5. Lack of Price Analysis

During our examination we found Supreme did not perform adequate price analyses on its Road or Aviation vendors. Although Supreme initially performed a price analysis on Road vendors in December 2007, it did not select the lowest price vendor or retain documentation for

the basis of its selection. Further, Supreme performed no follow-up analysis of its Road vendors even though the requirement was stipulated in the original vendor contract. As a result, we developed a decrement factor that was applied to all proposed sampled Road costs in FYs 2008 through 2010. In addition, Supreme did not perform any price analyses on Rotary or Fixed Wing (aviation) vendors during the proposal period. In fact, even though Supreme began performance on this contract in November 2005, Supreme did not make an effort to perform price analyses on its Aviation vendors until December of 2010. Although the December 2010 price analysis is not applicable to the proposal period (FY 2005/2006 through August 2010), the December 2010 price analysis and tender process negotiated lower overall rates for the helicopter types solicited. As a result of the lack of adequate price analyses, the contractor is unable to demonstrate and we are unable to determine through other means the reasonableness of the proposed costs as required by FAR 31.201-3, Determining Reasonableness. Consequently, our audit results are impacted to the extent that our questioned costs would have differed had Supreme performed adequate price analyses to demonstrate the reasonableness of proposed costs. For a detailed discussion on the price analysis performed, refer to Exhibits B, C, and D beginning on pages 30, 46, and 59 respectively.

#### 6. Lack of Adequate Supporting Documentation

During our audit of the proposed Rotary, Fixed Wing, and Road costs Supreme was unable to locate a significant number of source documents. Specifically, Supreme was unable to locate: truck manifests, invoices, contracts, and correct flight plans. The truck manifest, which is signed by the customer upon delivery, is the only document that demonstrates the trip was actually made. The invoices document the costs billed to Supreme by third party vendors and the contracts detail the rates/costs for individual trips. Further, the flight plans document information needed to determine the flight cost, including but not limited to (i) the aircraft type/tail no., (ii) origin and destination of trip, (iii) the flight date, (iv) fuel burned during trip, (v) engine on and off times, and (vi) the flight take off and land times. Supreme's failure to maintain adequate supporting documentation results in noncompliance with FAR 31.201-2, Determining Allowability, Paragraph (d). For those sample transactions (trips) selected for testing that Supreme was unable to provide the truck manifest, invoices, contracts, or the correct flight plan, the proposed Rotary, Fixed Wing, and Road costs were questioned in their entirety. Consequently, our audit results are impacted to the extent that our Rotary, Fixed Wing, and Road questioned costs would have differed had Supreme provided adequate supporting documentation. For a detailed discussion on the missing source documents, refer to Exhibits B, C, and D beginning on pages 30, 46, and 59, respectively.

#### 7. Noncompliances with FAR Part 31

During our examination of the price adjustment proposal, we identified significant FAR Part 31 unallowable costs included in the proposed costs. Specifically, we have questioned proposed costs based on the following FAR clauses:

- FAR 31.201-2, Determining Allowability

- FAR 31.201-3, Determining Reasonableness
- FAR 31.201-4, Determining Allocability
- FAR 31.201-5, Credits
- FAR 31.201-6, Accounting for Unallowable Costs
- FAR 31.205-3, Bad Debts
- FAR 31.205-10, Cost of Money
- FAR 31.205-26, Material Costs
- FAR 31.205-47, Costs related to Legal and Other Proceedings

Supreme failed to follow DLA Troop Support proposal preparation instructions included in Addendum 1 to DLA Troop Support's August 31, 2010 letter requesting Supreme to submit a revised Premium Outbound Transportation proposal. Supreme was informed that the objective of the audit of the proposal would be to determine allowable, allocable, and reasonable costs incurred based on application of FAR Part 31 cost concepts. As a result, compliance with FAR Part 31 would require excluding unallowable costs from the proposal. However, Supreme failed to exclude FAR Part 31 unallowable costs from its proposal. Supreme included Consultancy Costs for FYs 2006-2007 even though Addendum 1, the paragraph on Submission of Direct Costs, states "Do not include Consultancy Fees which were previously determined unallowable on the DCAA audit for fiscal years 2006-2007." Further, in Addendum 1, the Indirect Costs paragraph, DLA Troop Support cautioned Supreme to monitor costs questioned by DCAA during the audit of the FYs 2006 – 2007 costs. Regardless, as Supreme considered its proposal to be a total cost proposal, no adjustment for FAR Part 31 unallowable costs was made.

FAR 31.201-6, Accounting for Unallowable Costs, requires "that costs that are expressly unallowable or mutually agreed to be unallowable ... shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract." Further, FAR 31.201-2, Determining Allowability, Paragraph (d) states:

A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

Because of the significance of the identified FAR Part 31 noncompliances, without a 100 percent evaluation of proposed costs, there is no assurance that other significant FAR Part 31 unallowable costs are excluded in the proposed costs. Consequently, our audit results are impacted to the extent that our questioned costs would have differed had Supreme adequately identified and excluded unallowable costs as instructed. Details on the noncompliances are explained within the individual explanatory notes included within the exhibits and schedules throughout the report.

## 8. Lack of Original Source Documentation

During our examination, we were informed that original source documentation resided in both Dubai and Afghanistan. When originals were located in Afghanistan, our evaluation was based on copies of the documentation provided in Dubai. In order to determine reliance on the copies provided, we requested an assist audit from the DCAA Afghanistan Branch Office to verify the existence of the original source documents and the accuracy of the copies we reviewed. We selected a sample of transactions supported by original source documentation located in Afghanistan for testing by the DCAA Afghanistan Branch Office. The assist audit noted no exceptions between the copies we reviewed in Dubai and the originals provided in Afghanistan. However, Supreme was unable to provide original documents for a significant number of transactions as detailed below:

- Vendor Invoices to support proposed Rotary and Fixed Wing costs were not provided for 100 percent of the sample items. Specifically, original vendor invoices were not provided to support the proposed lease and life support costs. Supreme personnel in Afghanistan stated the original documentation is located in Dubai; however, our review of the documents in Dubai indicated the source documents provided to us were copies. Based upon follow up with Supreme personnel in Dubai, we were informed that Supreme's office in Dubai received the vendor invoices through e-mail, but Supreme could not provide the e-mails as requested as it was not Supreme's policy to maintain the email.
- Truck Manifests to support proposed Road costs were not provided for 29 percent of the sample items.
- Product (Sales) Invoices to support proposed Road costs were not provided for 41 percent of the sample items.

Because the proposed costs relate to FYs 2005/2006 through August 2010, we are unable to evaluate Supreme's process for maintaining the integrity of the documents received electronically. Accordingly, our results are impacted to the extent that there could be deficiencies in Supreme's process that could have altered documents relied on during our audit. Furthermore, our results are impacted to the extent that our questioned costs would have differed had we reviewed original documents for all sample transactions. Refer to refer to Exhibits B (page 30), C (page 46), and D (page 59).

## 9. Distribution Fee Credit

DLA HQ, in a letter dated August 31, 2010, requested Supreme to submit a revised Premium Outbound Transportation proposal that could be used to definitize the distribution fees/rates for Rotary, Fixed Wing, and Ground Transportation (Road). The distribution fees/rates cover all costs for delivery of food and water from Supreme's warehouse(s) in Afghanistan to the operating bases in Afghanistan. Addendum 1 to the letter detailed applicable FAR and DFARS requirements as well as specific instructions for preparing the proposal. Included in the Addendum 1 was a paragraph titled "Distribution Fee Credit" stating that

Supreme needed "... to provide information other than cost and pricing data showing actual costs and profit making up the NFOB distribution fees so that DCAA is able to evaluate the correct amount of credit applicable." However, Supreme did not provide the requested cost and profit data with its revised proposal.

The contract as originally awarded provided for the distribution of food and water to four NFOBs. However, after contract award but prior to the beginning of the contract performance, the contract was modified to provide for distribution of food and water to 68 FOBs in Afghanistan using air and road modes of transportation. Today, the contract provides for distribution of food and water to 239 FOBs in Afghanistan. In order to perform on the original contract, Supreme required warehouse space as well as personnel and associated costs like life support, equipment, and vehicles. However, no consideration was given for the fact that certain costs would have been included in, and thus recovered by, the NFOB distribution fees originally negotiated.

Supreme accumulated all costs incurred against the contract without segregation or identification of the costs as being applicable to NFOB or FOB; the costs were just contract costs. Further, with the exception of its Central Overhead [General and Administrative (G&A)] rates, Supreme did not develop final indirect expense rates for allocation of costs to its contracts. Instead, Supreme accumulated the costs as direct contract costs. It is noted that certain types of costs were allocated between contracts; for example warehouse costs were allocated based on square meters. As a result, Supreme developed a methodology whereby costs were allocated between FOB and NFOB based on average net weights delivered to FOB versus NFOB. There was no adjustment (credit) made for the costs already recovered through the NFOB rates originally negotiated, prior to allocating the costs between FOB and NFOB. Without identification of the actual cost and profit included in the NFOB distribution fees, we are unable to determine the significance of duplicated costs included in the calculation of the proposed FOB rates. Consequently, our audit results are limited to the extent that we are unable to evaluate the amount and impact of credit due on the proposed FOB distribution fees/rates. Refer to Exhibit E on page 71 for further details

#### 10. Methodology to Split Allocated Overheads Between FOB and NFOB

We examined the following elements included within the Allocated Overheads: (i) Premises (Warehouse) Rental, (ii) Generator Fuel, (iii) Vehicle Fuel, (iv) certain Legal and Tax Advice costs, and (v) Bad Debts. Supreme's proposed Allocated Overhead costs were derived by allocating the net operating expenses (NOE) between FOB and NFOB cost objectives based on the annual average net weight of water and food moved. We did not evaluate the average net weights used to allocate the Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, and Bad Debts between the FOB and NFOB cost objectives due to the requestor's required timeframe. This does not impact our audit opinion related to the examined Allocated Overheads questioned in their entirety (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, and Bad Debts). However, as we only examined a portion of the proposed Legal and Tax Advice costs, our audit results related to the proposed Legal and Tax

Advice costs are impacted to the extent that our questioned costs would have differed had we evaluated the annual average net weight used to allocate the costs to the FOB cost objective. For a detailed discussion on Supreme's allocation method, refer to the note in Exhibit E on page 71.

#### 11. Methodology to Split Allocated Overhead FOB Costs Between Modes of Delivery

Supreme allocated the FOB costs between Road and Aviation based on the average net weight of water and food weights of water and food moved between air and road. We did not evaluate the average net weights used to split the Allocated Overhead costs between the modes of delivery due to the requestor's required timeframe. This does not impact the Rotary, Fixed Wing, or Road costs as those costs are identified to the mode of delivery. Also, this does not impact our audit opinion related to the examined Allocated Overheads questioned in their entirety (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, and Bad Debts). However, as we only examined portion of the proposed Legal and Tax Advice costs, our audit results related to the proposed Legal and Tax Advice costs are impacted to the extent that our questioned costs would have differed had we evaluated the average net weight used to allocate the costs to the modes of delivery. For a detailed discussion on Supreme's allocation method, refer to the note in Exhibit E on page 71.

#### 12. Exchange Rates

Supreme converted the Allocated Overhead costs incurred in Euro to U.S. Dollar using the exchange rate for the month the cost was incurred. We did not evaluate the exchange rates used due to the requestor's required timeframe. This does not impact our audit opinion related to the examined Allocated Overheads questioned in their entirety (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, and Bad Debts). However, as we only examined portion of the proposed Legal and Tax Advice costs, our audit results related to the proposed Legal and Tax Advice costs are impacted to the extent that our questioned costs would have differed had we evaluated the exchange rates used to convert the currency. Refer to Results of Audit, Note 2 to Statement of Amounts Proposed, Examined, Not Examined, and Audit Results on page 17 and Exhibit E on page 71 for further details.

#### 13. Weights Used to Calculate Final Distribution Fees

This pricing action will result in the negotiation of distribution fees (rate per pound for items delivered). The driver of the distribution fees is the pool costs; it is the pool costs that represent the costs to be recovered through application of the rates. In reality, for this pricing action, it is the pool costs that are being negotiated. Although we have examined parts of the proposed costs, we did not evaluate the weights used in the calculation of the final distribution fees due to the DLA Troop Support imposed time constraint. As coordinated with DLA Troop Support, we obtained the actual weights billed, to the extent that information exists. Because we did not examine the accounting records provided to support either the proposed or actual weights billed, we offer no opinion on the weights. Consequently, our audit results are impacted to the extent that the evaluation of the weights would have identified exceptions. For a further discussion on

the weights used to calculate the distribution fees refer to Results of Audit section, Note 5 to Statement of Amounts Proposed, Examined, Not Examined, and Audit Results on page 18 for further details.

#### 14. Lack of Adequate Time

In order to meet DLA Troop Support's negotiation/definitization schedule of December 2011, we were unable to complete our examination of the following proposed costs:

- Parking Fees amounting to [REDACTED];
- Certain Allocated Overheads amounting to [REDACTED]; and
- Central Overhead (General and Administrative) Rates representing [REDACTED].

Further, as discussed under the Denial of Access to Records paragraph on page 4, fuel costs are questioned in their entirety due to the denial of access to records. However, due to insufficient time, we were unable to pursue quantifying fuel costs included in other than a fuel account, like security. In addition, we questioned the premise (warehouse) rental costs based on a lack of supporting documentation for contract usage of the warehouses. However, the proposed static security guard costs are allocated over the same usage base as premise (warehouse rental) costs. Due to insufficient time, we were unable to pursue quantifying the static guard costs included in the security costs. Finally, we did not have sufficient time to review contract files to determine if information included in the contract files may have an impact on audit scope.

The additional time required to complete an examination of the unaudited costs, primarily Allocated Overheads, is estimated to be significant based on experience from examining the direct Road, Fixed Wing and Rotary costs. Significant time is estimated to be required because Supreme: (i) required significant time to locate original documents; (ii) incorrect documents are consistently provided; and (iii) incomplete records exist. For a detailed discussion on each proposed costs not examined refer to Results of Audit section, Note 3 to Statement of Amounts Proposed, Examined, Not Examined, and Audit Results on page 17. For a detailed discussion on the contractor delays, refer to Exhibits B and C beginning on pages 30 and 46, respectively.

### **RESULTS OF AUDIT OF PARTS OF PROPOSAL**

In our opinion, the information other than cost or pricing data submitted by Supreme to support the proposed Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, Legal and Tax Advice, Bad Debts), Consultancy Fees, and Financing Costs amounting to [REDACTED] are not adequate. Refer to comments on (i) Rotary on page 30, Exhibit B, Note 1; (ii) Fixed Wing on page 46, Exhibit C, Note 1, (iii) Road on page 59, Exhibit D, Note 1, (iv) Allocated Overhead on page 71, Exhibit E, Note 1, (v) Consultancy Fees on page 82, Exhibit F, and (vi) Financing Costs on page 84, Exhibit G. In addition, Supreme denied access to data needed to evaluate the

proposal, as described in the Scope of Audit section of the report. Specifically, Supreme denied access to adequate and reliable fuel sales data necessary to demonstrate compliance with FAR 31.205-26, Material Costs, Paragraph (e). The amounts proposed for Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, Legal and Tax Advice, Bad Debts), Consultancy Fees, and Financing Costs were not prepared in all respects in accordance with appropriate provisions of FAR Part 31 and the DFARS. Refer to comments on (i) Rotary on page 30, Exhibit B, Note 1; (ii) Fixed Wing on page 46, Exhibit C, Note 1, (iii) Road on page 59, Exhibit D, Note 1, (iv) Allocated Overhead on page 71, Exhibit E, Note 1, (v) Consultancy Fees on page 82, Exhibit F, and (vi) Financing Costs on page 84, Exhibit G). Because the noncompliances and inadequacies are considered to have a significant impact on the parts of the proposal examined, we do not believe the parts of the proposal examined are an acceptable basis for negotiation, as discussed with [REDACTED], DLA Troop Support Contracting Officer, by [REDACTED] and [REDACTED] of our office on April 29, 2011 and as confirmed in our memorandum to you dated April 29, 2011. To make the information other than cost or pricing data adequate Supreme should comply with DLA's instructions for submitting an adequate proposal as stated in Addendum 1 of the request for proposal. Specifically, Supreme should (i) identify and exclude FAR unallowable costs, (ii) estimate costs through the contract performance period, (iii) exclude Consultancy Fees previously determined to be unallowable; and (iv) identify NFOB distribution fees to estimate the credit applicable to FOB destinations. At your request, we have, nevertheless, evaluated the parts of the proposal to the extent possible in the circumstances.

This report is limited to Rotary, Fixed Wing, Road, Allocated Overheads (only including Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, Legal and Tax Advice, Bad Debts), Consultancy Fees, and Financing Costs. Accordingly, we express no opinion on the contractor's proposal taken as a whole.

Due to the DLA Troop Support imposed time constraint discussed in the Scope of Audit section, Lack of Adequate Time paragraph on page 12, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on whether the following proposed costs are in all material respects, based on FAR Part 31 and DFARS, and, therefore, acceptable as a basis for negotiation:

- Parking Fees amounting to [REDACTED];
- Certain Allocated Overheads amounting to [REDACTED]; and
- Central Overhead (General and Administrative) Rates representing [REDACTED].

We have questioned [REDACTED] of the [REDACTED] proposed for Rotary, Fixed Wing, Road, certain elements within the Allocated Overheads (Premises (Warehouse) Rental, Generator Fuel, Vehicle Fuel, certain Legal and Tax Advice costs, Bad Debts), Consultancy Fees, and Financing Costs. Our summary of results of audit is presented on the following page. The table included in this summary of results of audit identifies the overall audit results by mode of delivery by fiscal year. Exhibits and schedules, starting on page 20, support the overall results of audit table. The exhibits and schedules include the following:



Exhibit or Schedule	Description	Page No.
Exhibit A	Provides a table summarizing, by mode of delivery, the combined FYs 2005/2006 through August 2010 total costs proposed, examined, not examined, and questioned by cost element.	20
Schedule A-1	Provides a table summarizing the total costs proposed, examined, not examined, and questioned by cost element. The table enables the reader to determine the total questioned cost contribution by each cost element.	24
Schedule A-2	Provides tables summarizing by fiscal year, by mode of delivery, the costs proposed, examined, not examined, and questioned by cost element.	25
Exhibit B	Rotary Costs	30
Schedule B-1	Rotary Lease Costs	37
Schedule B-2	Rotary Fuel Costs	42
Exhibit C	Fixed Wing Costs	46
Schedule C-1	Fixed Wing Lease Costs	53
Schedule C-2	Fixed Wing Fuel Costs	57
Exhibit D	Road Costs	59
Schedule D-1	High Dollar Sample	64
Schedule D-2	Randomly Selected Sample	68
Exhibit E	Allocated Overheads	71
Schedule E-1	Provides a table summarizing by mode of delivery by fiscal year, the total Allocated Overhead costs proposed, examined, not examined, and questioned.	81
Exhibit F	Consultancy Fees	82
Exhibit G	Financing (Cost of Money)	84

Our audit conclusions incorporate the dollar effect of the flight time and fuel usage recommendations in the related Government report of technical evaluation performed by the DLA Headquarters. The technical evaluation took exception to the proposed Rotary and Fixed Wing flight times (refer to Schedule B-1, Note 3, page 39 and Schedule C-1, Note 3, on page 54). See Appendix 2 on page 92 for a copy of the technical report.

Due to their voluminous nature, the [REDACTED] spreadsheets detailing the audit of the transactions selected for testing and the calculations of the questioned costs are not included within this audit report. However, the spreadsheets are available upon request.

We discussed the results of audit with Supreme representatives in an exit conference held on August 25, 2011. Supreme representatives attending the exit conference included: (i) [REDACTED], (ii) [REDACTED]

[REDACTED] (iii) [REDACTED]  
[REDACTED], and (iv) [REDACTED], attended the exit conference. We discussed factual matters related to the audit but did not provide the dollar impact of our findings. Specific factual matters discussed include Supreme's failure to follow DLA Troop Support proposal preparation instructions, identification of FAR Part 31 noncompliances during the audit, incorporation of results of requested technical evaluation, and lack of supporting documentation to include contracts, invoices, and flight plans. Further, during the exit conference Supreme was informed that the audit report will only opine on proposed Rotary lease and fuel costs, Fixed Wing lease and fuel costs, a portion of the Allocated Overheads, Consultancy Fees, and Financing costs. At the conclusion of the exit conference Supreme requested and was granted until August 26, 2011 to provide a response. However, on August 25, 2011 Supreme provided a response via email. In response to the exit conference Supreme stated that as it has not seen the audit report, it reserved comment about specific findings. Further, Supreme reiterated its objection to the use of FAR Part 31 criteria to definitize the contract, stating that comparable commercial prices are most appropriate for negotiating the rates. A complete copy of Supreme's response is included as Appendix 3 on page 93.

The results of our examination are based on the contractor's submitted price adjustment proposal. If the contractor submits a claim consistent with the Contract Disputes Act of 1978 (41 U.S.C. 601-613), or the current proposal is deemed to constitute a claim, we recommend that the auditor be notified so the impact of the change on the results of our examination can be considered.

Because of the significance of the audit findings, should you decide to negotiate the pricing action based on the current proposal, we recommend that you invite a DCAA representative to attend the negotiation conference.