



SRC, Inc.

Report on Federal Awards in Accordance with
Title 2 U.S. *Code of Federal Regulations* Part 200,
Uniform Administrative Requirements, Cost Principles,
and Audit Requirements for Federal Awards (Uniform
Guidance)

September 30, 2019

SRC, Inc.

Report on Federal Awards in Accordance with the Uniform Guidance

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Section

1



SRC, Inc. and Subsidiaries

Consolidated Financial Statements
with Supplemental Schedules
Years Ended September 30, 2019 and 2018

SRC, Inc. and Subsidiaries

Consolidated Financial Statements with Supplemental Schedules
Years Ended September 30, 2019 and 2018

SRC, Inc. and Subsidiaries

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Independent Auditor's Report

Board of Trustees
SRC, Inc. and Subsidiaries
Syracuse, New York

We have audited the accompanying consolidated financial statements of SRC, Inc. and Subsidiaries, which comprise the consolidated statements of financial position as of September 30, 2019 and 2018 and the related consolidated statements of activities and change in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SRC, Inc. and Subsidiaries as of September 30, 2019 and 2018 and the changes in their net assets and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information on pages 27 and 28 is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of activities of the individual entities and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

BDO USA, LLP

McLean, Virginia
December 13, 2019

Consolidated Financial Statements

SRC, Inc. and Subsidiaries

Consolidated Statements of Financial Position

<i>September 30,</i>	2019	2018
Assets		
Current assets		
Cash and cash equivalents	\$ 27,709,467	\$ 37,296,553
Investments	180,624,594	194,302,832
Accounts receivable, net of reserve for uncollectible accounts of \$201,381 and \$201,129 for 2019 and 2018, respectively	29,902,847	26,504,276
Accounts receivable - unbilled	33,800,453	26,122,694
Inventory, net	71,103,751	69,520,970
Deferred contract costs	6,208,268	10,625,153
Prepaid expenses and other assets	11,339,252	8,603,737
Total current assets	360,688,632	372,976,215
Property, buildings, and equipment, net	56,703,293	46,309,605
Other assets	5,720,485	5,867,598
Goodwill, net	5,351,070	1,820,488
Deferred income taxes	2,515,530	4,238,077
Total assets	\$ 430,979,010	\$ 431,211,983
Liabilities and Net Assets		
Current liabilities		
Lines-of-credit	\$ 5,994,052	\$ 12,007,705
Accounts payable	17,377,195	16,132,800
Accrued expenses	27,421,688	23,528,255
Billings in excess of revenue recognized	10,116,164	8,656,787
Long-term debt - current portion	1,182,500	1,132,500
Total current liabilities	62,091,599	61,458,047
Long-term debt, net of current portion and unamortized debt issuance costs	10,538,500	11,693,000
Other long-term liabilities	9,239,912	8,546,375
Total liabilities	81,870,011	81,697,422
Net assets without donor restrictions	349,108,999	349,514,561
Total liabilities and net assets	\$ 430,979,010	\$ 431,211,983

See accompanying notes to the consolidated financial statements.

SRC, Inc. and Subsidiaries

Consolidated Statements of Activities and Change in Net Assets

<i>Years Ended September 30,</i>	2019	2018
Operating activities		
Revenue	\$ 380,945,023	\$ 319,979,841
Costs of revenue		
Direct costs	244,167,792	196,805,672
Indirect expenses	83,326,906	69,776,644
Administrative expenses	53,222,499	48,684,854
Total operating expenses	380,717,197	315,267,170
Change in net assets from operations	227,826	4,712,671
Non-operating activities		
Net investment return	4,541,577	14,209,806
Interest expense	(1,302,989)	(657,132)
Other (expense) income, net	(978,550)	261,234
Foreign currency translation adjustment	(345,634)	(340,403)
Postretirement benefits adjustment	(494,285)	(506,452)
Total non-operating activities, net	1,420,119	12,967,053
Change in net assets before (provision for) benefit from income taxes	1,647,945	17,679,724
(Provision for) benefit from income taxes	(2,053,507)	3,451,301
Change in net assets after (provision for) benefit from income taxes	(405,562)	21,131,025
Net assets at the beginning of the year	349,514,561	328,383,536
Net assets at the end of the year	\$ 349,108,999	\$ 349,514,561

See accompanying notes to the consolidated financial statements.

SRC, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

<i>Years Ended September 30,</i>	2019	2018
Cash flows from operating activities:		
Change in net assets	\$ (405,562)	\$ 21,131,025
Adjustments to reconcile change in net assets to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	7,352,513	6,056,968
Change in inventory reserve	(87,224)	39,121
Realized and unrealized loss (gain) on investments	1,405,000	(8,341,000)
Change in deferred income taxes	1,722,547	(4,140,330)
Changes in operating assets and liabilities:		
Accounts receivable	(3,398,571)	13,157,841
Accounts receivable - unbilled	(7,677,759)	(3,287,037)
Inventory	(1,495,557)	(43,697,796)
Deferred contract costs	4,416,885	(2,571,749)
Prepaid expenses and other assets	(3,043,575)	(2,154,769)
Accounts payable, accrued expenses, and other liabilities	5,831,365	4,098,256
Billings in excess of revenue recognized	1,459,377	187,456
Net cash and cash equivalents provided by (used in) operating activities	6,079,439	(19,522,014)
Cash flows from investing activities:		
Cash paid for acquisition	(4,241,905)	-
Purchases of investments	(22,981,029)	(61,968,092)
Sales of investments	35,254,267	37,012,610
Expenditures for property, buildings, and equipment	(16,551,705)	(9,699,343)
Net cash and cash equivalents used in investing activities	(8,520,372)	(34,654,825)
Cash flows from financing activities:		
Net (repayments) borrowings under bank lines-of-credit	(6,013,653)	10,559,705
Repayments made under long-term debt	(1,132,500)	(1,082,500)
Net cash and cash equivalents (used in) provided by financing activities	(7,146,153)	9,477,205
Decrease in cash and cash equivalents	(9,587,086)	(44,699,634)
Cash and cash equivalents at beginning of year	37,296,553	81,996,187
Cash and cash equivalents at end of year	\$ 27,709,467	\$ 37,296,553
Supplemental disclosure of cash flow information:		
Interest paid	\$ 1,300,882	\$ 654,741
Income taxes paid	\$ -	\$ -

See accompanying notes to the consolidated financial statements.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies

SRC, Inc. (SRC) is a not-for-profit organization that provides services mainly to federal government organizations in a wide array of technology areas, including development and production of sensor systems, signal processing, information science and engineering, cybersecurity, and environmental chemistry and risk assessment.

SRC Ventures, Inc. (Ventures), a for-profit wholly-owned subsidiary pursuant to the laws of the State of New York, conducts activities that are generally not in the furtherance of SRC's exempt purposes as a 501(c)(3) organization under the Internal Revenue Code (the IRC), including, but not limited to, the management and execution of production contracts. Included in Ventures are its wholly owned for-profit subsidiaries: SRCTec, LLC (SRCTec) and SRC Commercial Holdings, Inc. (Commercial Holdings). Included in Commercial Holdings are its wholly-owned for-profit subsidiaries: Acumen Detection, LLC (Acumen); Gryphon Sensors, LLC (Gryphon); FourV Systems, LLC (FourV); and SAZE Technologies, LLC (SAZE). Commercial Holdings was established in September 2017, pursuant to the laws of the State of New York, and conducts activities that are generally not in the furtherance of SRC's exempt purposes as a 501(c)(3) organization under the IRC. Effective March 15, 2018, FourV was sold under an asset purchase agreement. Effective April 25, 2018, the operations and activities of Gryphon ceased and all continued business operations were transferred to and are now performed by SRC. Effective March 15, 2019, Acumen was sold under an asset purchase agreement. Commercial Holdings was dissolved effective April 24, 2019.

SRC International, Inc. (International) is a support organization of SRC, Inc. International has qualified as a tax-exempt not-for-profit corporation under Section 509(a)(2) of the IRC. International currently has three wholly-owned for-profit foreign subsidiaries, SRC AUS Pty Ltd (SRC AUS), SRC CAN Ltd (SRC CAN) and SRC GBR Ltd (SRC UK). These entities were established to provide services mainly to international government organizations in a wide array of technology areas, including information science and engineering.

The significant accounting policies followed by SRC, Ventures and International are described below.

Basis of accounting

The accompanying consolidated financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP).

Principles of consolidation

The consolidated financial statements include the accounts of SRC, Ventures, and International as listed above (collectively referred to as the Company). All intercompany balances and transactions have been eliminated in consolidation.

Foreign currency translation and re-measurement

The functional currency of the Company's foreign subsidiaries (SRC AUS, SRC CAN and SRC UK) is their local currency. Net assets are translated at month-end exchange rates while income and expense items are translated at average exchange rates for the applicable period. Translation adjustments are recorded as other non-operating activities in the accompanying consolidated statements of activities and change in net assets. Gains and losses resulting from foreign currency

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

denominated transactions are included as a component of costs of revenue in the accompanying consolidated statements of activities and change in net assets.

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements. Such estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results may differ from estimates under different assumptions or conditions.

Operating cycle

The Company's operating cycle for long-term contracts may be greater than one year and is measured by the average time intervening between the inception and the completion of those contracts. Contract-related assets and liabilities are classified as current assets and current liabilities.

Revenue recognition

Revenue is recognized when persuasive evidence of an arrangement exists, services have been rendered or goods delivered, the contract price is fixed or determinable, and collectability is reasonably assured. Revenue associated with work performed prior to the completion and signing of contract documents is recognized only when it can be reliably estimated and realization is probable. The Company bases its estimates on previous experiences with the customer, communications with the customer regarding funding status, and its knowledge of available funding for the contract.

Revenue on cost-plus-fee contracts is recognized to the extent of costs incurred plus a proportionate amount of the fee earned. The Company considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs incurred in performance of the contract. The Company considers performance-based fees, including award fees, under any contract type to be earned when it can demonstrate satisfaction of performance goals, based upon historical experience, or when the Company receives contractual notification from the customer that the fee has been earned. Revenue on time-and-materials contracts is recognized based on the hours incurred at the negotiated contract billing rates, plus the cost of any allowable material costs and out-of-pocket expenses. Revenue on fixed-price contracts where the Company performs systems design, development and integration is recognized using the percentage-of-completion method of contract accounting. Unless it is determined as part of the Company's regular contract performance review that overall progress on a contract is not consistent with costs expended to date, the Company determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. Revenue on fixed-price service contracts is generally recognized on a straight-line basis over the contractual service period, unless the revenue is earned, or obligations fulfilled, in a different manner. Revenues on contracts being accounted for under the units of delivery method are generally recognized upon delivery and acceptance or when similar requirements occur.

Contract revenue recognition involves estimation. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance,

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

job conditions, and estimated profitability may result in revisions to costs and revenue, and are recognized in the period in which such revisions are determined.

Multiple agencies of the federal government, directly or indirectly, provided the majority of the Company's contract revenue during the years ended September 30, 2019 and 2018.

Federal government contract costs for 2019, including indirect costs, are subject to audit and adjustment by applicable cognizant audit agencies. Contract revenue has been recorded in amounts that are expected to be realized upon final settlement.

Costs of revenue

Costs of revenue include all direct contract costs, as well as indirect overhead costs and selling, general and administrative expenses that are allowable and allocable to contracts under federal procurement standards. Costs of revenue also include costs and expenses that are unallowable and are not allocable to contracts for billing purposes. Such costs and expenses do not directly generate revenue but are necessary for business operations.

Deferred contract costs represent costs incurred on contracts that have not yet been accepted.

Net assets

The Company classifies its net assets into the two categories: net assets without donor restrictions and net assets with donor restrictions.

Net assets without donor restrictions

Net assets without donor restrictions generally result from net revenues derived from contracts, net investment return and other net inflows of assets whose use by the Company is not limited by donor-imposed restrictions.

Net assets with donor restrictions

Net assets with donor restrictions would include contributions or other inflows of assets whose use by the Company is limited by donor-imposed stipulations. As of September 30, 2019 and 2018, no net assets have been received with donor restrictions.

Cash equivalents

The Company considers all highly-liquid instruments with original maturities of three months or less to be cash equivalents, including money market funds.

Investments

The Company records its investments at fair value with net unrealized gains and losses included in non-operating activities. Investments with maturities in excess of 12 months from September 30, 2019, and investments held under the deferred compensation plan are classified as noncurrent other assets.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Accounts receivable, unbilled receivables and billings in excess of revenue recognized

Accounts receivable are generated from prime and subcontracting arrangements with federal governmental agencies and various commercial entities. Billed amounts represent invoices that have been prepared and sent to the customer. Unbilled amounts represent costs and anticipated profits not yet billed or awaiting milestones to bill. Management determines reserve for uncollectible accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Management has recorded an allowance for contract receivables that are considered to be uncollectible. Uncollectible amounts will be written off when all efforts to collect these receivables have been exhausted or when management receives notification that an amount will not be collected.

Billings in excess of revenue recognized represent interim contract billings in excess of costs and estimated earnings incurred on those contracts.

Inventory

Inventory is stated at the lower of cost or net realizable value with cost being determined using the weighted average method. Inventory consists primarily of components and subassemblies and finished products held for sale. Rapid technological change and new product introductions and enhancements could result in excess or obsolete inventory. To minimize this risk, the Company evaluates inventory levels and expected usage on a periodic basis and records adjustments as required.

Property, buildings and equipment

The Company's policy is to capitalize property, buildings and equipment and software purchases in excess of \$5,000. Property, buildings and equipment and software are stated at cost. Expenditures for major additions and improvements are capitalized and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment are retired, or otherwise disposed of, the cost and accumulated depreciation and amortization is removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period. Depreciation and amortization of property, buildings and equipment is computed using the straight-line method over the estimated useful lives of the assets. Amortization of leasehold improvements is computed using the straight-line method over the remaining lease term. Land is not depreciated or amortized. Estimated useful lives of the assets are as follows:

Buildings and improvements	15-40 years
Machinery, equipment, and durable tools	5-10 years
Office equipment	5-10 years
Computer equipment and software	3-5 years
Motor vehicles	5 years

Goodwill

Goodwill represents the excess of purchase price over the net tangible and identifiable intangible assets as a result of the business combinations identified in Note 2. The Company made an accounting election to amortize goodwill over the lesser of a ten year period or useful life in accordance with Accounting Standards Codification (ASC) 350-20, *Intangibles- Goodwill and Other*. Goodwill is reviewed for impairment whenever events or changes in circumstances indicate a

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

reduction in the fair value. No indicators of impairment were identified as of September 30, 2019 and 2018.

Impairment of long-lived assets

The Company reviews the valuation of its long-lived assets for impairment whenever events or circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of the long-lived asset group is measured by a comparison of the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell. No indicators of impairment were identified as of September 30, 2019 and 2018.

Intangible assets

The Company capitalizes costs of software to be sold, leased, or marketed in accordance with ASC 985, *Software*. Included in other assets is approximately \$1,344,000 and \$1,684,000 of unamortized capitalized software as of September 30, 2019 and 2018, respectively. Amortization expense of approximately \$340,000 and \$345,000 was recorded for the years ended September 30, 2019 and 2018, respectively.

Other intangible assets were acquired by the Company in 2016 and have a finite useful life of 15 years. Included in other assets is approximately \$1,625,000 of other intangible assets relating to a customer list with accumulated amortization of approximately \$379,000 and \$289,000 at September 30, 2019 and 2018, respectively. Amortization expense of approximately \$90,000 and \$103,000 was recorded for the years ended September 30, 2019 and 2018, respectively.

Research and development

Research and development costs are expensed in the year incurred. These costs totaled approximately \$19,787,000 and \$17,671,000 for the years ended September 30, 2019 and 2018, respectively, and are included as a component of indirect expenses in the consolidated statements of activities and change in net assets.

Income taxes

SRC, Inc. has qualified as a tax-exempt not-for-profit corporation under Section 509(a)(2) of the IRC and is exempt from federal income taxation on related income pursuant to Section 501(a) of the IRC. Ventures is a for-profit organization and is subject to federal income tax. The majority of SRC and Ventures' earnings are generated within the United States. International has qualified with the Internal Revenue Service (the IRS) for tax-exempt status as a supporting organization of SRC, Inc. International currently has three wholly-owned for-profit foreign subsidiaries. SRC AUS is an Australian for-profit organization and is subject to Australian income tax. The majority of SRC AUS earnings are generated within Australia. SRC CAN is a Canadian for-profit organization and is subject to Canadian income tax. SRC UK is a United Kingdom for-profit organization and is subject to United Kingdom income tax.

Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax basis of assets and liabilities and their reported amounts in

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

the consolidated financial statements. Deferred tax assets and liabilities are included in the consolidated financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

The provisions of ASC 740, *Income Taxes*, provide recognition criteria and a related measurement model for tax positions taken by the Company. In accordance with ASC 740, a tax position is a position in a previously filed tax return or a position expected to be taken in a future tax filing that is reflected in measuring current or deferred income tax assets and liabilities. Tax positions are recognized only when it is more likely than not (likelihood of greater than 50%), based on technical merits, that the position would be sustained upon examination. Tax positions that meet the more-likely-than-not threshold are measured using a probability-weighted approach as the largest amount of tax benefit that is greater than 50% likely of being realized upon settlement. No liability for uncertain tax positions was recorded by the Company as of September 30, 2019 or 2018. With few exceptions, the Company is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for the years ended September 30, 2016 and prior. The foreign taxing authority rules differ by country. The foreign entities are no longer subject to income tax examinations by their federal or local tax authorities for years ended September 30, 2015 and prior.

Fair value of financial instruments

The fair value of the Company's cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate their carrying amounts due to the relatively short maturity of these items. The fair value of the Company's long-term debt approximates its carrying amount due to the variability of the applicable interest rates.

Fair value measurements

Certain assets are recorded at fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability between market participants in an orderly transaction on the measurement date. The market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity for the asset or liability is known as the principal market. When no principal market exists, the most advantageous market is used. This is the market in which the reporting entity would sell the asset or transfer the liability with the price that maximizes the amount that would be received or minimizes the amount that would be paid. Fair value is based on assumptions market participants would make in pricing the asset or liability. Generally, fair value is based on observable quoted market prices or derived from observable market data when such market prices or data are available. When such prices or inputs are not available, the reporting entity should use valuation models.

The Company's assets recorded at fair value are categorized based on the priority of the inputs used to measure fair value. Fair value measurement standards require an entity to maximize the use of observable inputs (such as quoted prices in active markets) and minimize the use of unobservable inputs (such as appraisals or other valuation techniques) to determine fair value. The inputs used in measuring fair value are categorized into three levels, as follows:

Level 1 - Inputs that are based upon quoted prices for identical instruments traded in active markets.

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Notes to the Consolidated Financial Statements

Level 2 - Inputs that are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar investments in markets that are not active, or models based on valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the investment.

Level 3 - Inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models, and similar techniques.

If a financial instrument valuation uses inputs that fall in different levels of the hierarchy, the instrument will be categorized based upon the lowest level of input that is significant to the fair value calculation. The Company's financial assets measured at fair value on a recurring basis are cash equivalents that include a money market fund and short-term investments. The fair value determinations are based upon the unadjusted quoted prices for identical assets in active markets and inputs observable in the marketplace, techniques classified within Level 1 and Level 2, respectively, of the valuation hierarchy described above.

Assets measured at fair value on a recurring basis are summarized below (rounded to nearest thousand):

<i>Description</i>	As of September 30, 2019			
	Assets Measured At Fair Value	Fair Value Hierarchy Level		
		Level 1	Level 2	Level 3
Investments:				
Money market funds	\$ 18,554,000	\$ 18,554,000	\$ -	\$ -
Commercial paper	333,000	333,000	-	-
Mutual funds	9,829,000	9,829,000	-	-
Fixed income funds	1,099,000	-	1,099,000	-
Equity funds and ETF	171,867,000	171,867,000	-	-
	\$ 201,682,000	\$ 200,583,000	\$ 1,099,000	\$ -

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Description	As of September 30, 2018			
	Assets Measured At Fair Value	Fair Value Hierarchy Level		
		Level 1	Level 2	Level 3
Investments:				
Money market funds	\$ 667,000	\$ 667,000	\$ -	\$ -
Commercial paper	278,000	278,000	-	-
Mutual funds	21,935,000	21,935,000	-	-
Fixed income funds	593,000	-	593,000	-
Equity funds and ETF	173,735,000	173,735,000	-	-
	\$ 197,208,000	\$ 196,615,000	\$ 593,000	\$ -

Of the above total investments for the years ended September 30, 2019 and 2018, approximately \$18,511,000 and \$625,000, respectively, is included in cash and cash equivalents; approximately \$180,625,000 and \$194,303,000, respectively, is classified as investments; and approximately \$2,546,000 and \$2,280,000, respectively, relates to assets held in the 457(b) plan (see Note 9) and is included in other assets in the accompanying consolidated statements of financial position.

In determining the fair value of its assets and liabilities, the Company predominately uses the market approach. Securities included in Level 2 are valued by the Company's custodian, who uses independent trust accounting services. To determine the fair value of the Company's Level 2 investments, a variety of inputs are utilized, including, but not limited to, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. The Company reviews the values generated by the independent pricing service for reasonableness. The Company has not adjusted the prices obtained from the independent pricing service.

Interest and dividend income and net realized and unrealized gains on investments were approximately \$4,542,000 and \$14,210,000, respectively, for the years ended September 30, 2019 and 2018. Of this amount, approximately \$5,947,000 and \$5,869,000, respectively, represents interest and dividend income and approximately \$(1,405,000) and \$8,341,000, respectively, represents realized and unrealized (losses) gains for the years ended September 30, 2019 and 2018.

Postretirement health care benefits

The Company recognizes a liability for their defined benefit postretirement plan's underfunded status in its consolidated statements of financial position. The postretirement plan's assets and obligations that determine its funded status are measured as of the end of the fiscal year. The Company reported the change in the funded status in its consolidated statements of activities and change in net assets.

Shipping and handling

Revenues and costs associated with shipping products to customers are included in revenues and direct costs, respectively, on the consolidated statements of activities and change in net assets.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Concentrations of credit risk

The Company's assets that are exposed to credit risk consist primarily of cash and cash equivalents, investments, and contract receivables. Cash is maintained at financial institutions and, at times, balances may exceed federally insured limits. The Company has historically not experienced any losses related to these balances. Amounts on deposit in excess of federally insured limits at September 30, 2019 approximate \$9,474,000. Investment securities, including money market funds, are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the investment balances and the amounts reported in the consolidated statements of financial position. Contract receivables consist primarily of amounts due from various agencies of the federal government or prime contractors doing business with the federal government. Historically, the Company has not experienced significant losses related to contract receivables and, therefore, believes that the credit risk related to contract receivables is minimal.

Functional allocation of expenses

The costs of providing the programs and other activities have been summarized on a functional basis in the accompanying consolidated statements of activities and change in net assets. Accordingly, certain costs have been allocated among the activities benefited.

Expenses that can be identified with a specific program or support service are charged directly according to their natural expenditure classifications. Indirect costs common to multiple functions have been allocated among the various functions benefited based on the total costs incurred by functional expense category.

Expenses by their functional and natural classification are as follows for the year ended September 30, 2019, with comparative totals for 2018 (rounded to nearest thousand):

<i>Natural classification</i>	Program		Support		Total	2018 Total
	Research and Development	Manufacturing	Administrative			
Salaries and benefits	\$ 110,297,000	\$ 25,703,000	\$ 34,402,000	\$	170,402,000	\$ 144,515,000
Subcontracts	3,074,000	19,946,000	-		23,020,000	22,704,000
Direct materials	6,497,000	96,265,000	-		102,762,000	69,642,000
Facilities and overhead	8,971,000	10,156,000	4,169,000		23,296,000	18,714,000
Research and development	7,620,000	8,626,000	3,541,000		19,787,000	17,670,000
Interest expense	502,000	568,000	233,000		1,303,000	657,000
Other	10,152,000	5,276,000	26,022,000		41,450,000	42,022,000
Total	\$ 147,113,000	\$ 166,540,000	\$ 68,367,000	\$	382,020,000	\$ 315,924,000
2018 Total	\$ 140,924,000	\$ 112,347,000	\$ 62,653,000	\$	315,924,000	

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Notes to the Consolidated Financial Statements

The total functional expenses shown above are a summation of total operating expenses and interest expense from the consolidated statement of activities and change in net assets. Only totals are shown for the year ended September 30, 2018 as permitted under ASU 2016-14 in the year of adoption.

Recently adopted authoritative guidance

In August 2016, the FASB issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958) – Presentation of Financial Statements of Not-for-Profit Entities*, related to financial reporting for nonprofit entities. The ASU amends the current reporting model for nonprofit organizations and enhances their required disclosures. The major changes include: (a) requiring the presentation of only two classes of net assets now entitled “net assets without donor restrictions” and “net assets with donor restrictions,” (b) modifying the presentation of underwater endowment funds and related disclosures, (c) requiring the use of the placed in service approach to recognize the expirations of restrictions on gifts used to acquire or construct long-lived assets absent explicit donor stipulations otherwise, (d) requiring that all nonprofits present an analysis of expenses by function and nature in either the statement of activities, a separate statement, or in the notes and disclose a summary of the allocation methods used to allocate costs, (e) requiring the disclosure of quantitative and qualitative information regarding liquidity and availability of resources, (f) presenting investment return net of external and direct internal investment expenses, and (g) modifying other financial statement reporting requirements and disclosures intended to increase the usefulness of nonprofit financial statements. The provisions of the ASU must be applied on a retrospective basis for all years presented although certain optional practical expedients are available for periods prior to adoption. The Company has adopted the new guidance and has adjusted the presentation of these consolidated financial statements accordingly. The new guidance has been applied retrospectively to all periods presented except management has opted to present the liquidity and availability information and the functional expense allocation for only 2019 as permitted under the new guidance in the year of adoption. There was no effect on the change in net assets reported for the year ended September 30, 2018.

Recent accounting pronouncements not yet adopted

In May 2014, the FASB issued guidance that supersedes previously issued guidance on revenue recognition and will apply to virtually all industries. The core principle of this new guidance is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (i) identify the contract with the customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract, and (v) recognize revenue when (or as) the entity satisfies the performance obligation. The new standard will be effective for the Company on October 1, 2019. The Company is currently evaluating the effect that adoption of this new standard will have on the Company’s financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases*, related to leasing for both lessees and lessors. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the statement of financial position for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the statement of activities. The new standard is effective for the Company on October 1, 2021, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at,

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. The Company is currently evaluating the effect that adoption of this new standard will have on the Company's financial statements.

In March 2017, FASB issued ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. This update applies to any employer that sponsors a defined benefit pension plan, other postretirement benefit plan, or other types of benefits accounted for under Topic 715. The amendments in this ASU require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost, as defined in Topic 715, are required to be presented in the consolidated statements of activities separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the consolidated statements of activities to present the other components of net benefit cost must be disclosed. The amendments in this ASU also allow only the service cost component to be eligible for capitalization when applicable. The guidance is effective for the Company beginning October 1, 2019. Early adoption is permitted. The Company is currently evaluating the effect that adoption of this new standard will have on the Company's financial statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement*. The update modifies certain disclosure requirements in Topic 820, *Fair Value Measurement*. The ASU is effective for the Company beginning October 1, 2020. The Company is currently evaluating the effect that adoption of this new standard will have on the Company's financial statements.

Reclassifications

Certain amounts in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation. There was no effect on beginning or ending net assets for 2018 as a result of the change.

2. Business Combinations

On June 28, 2019, SRC acquired the assets of an engineering services company known as SAZE Technologies, LLC for a total purchase price of approximately \$4,242,000 (see Note 6). The purpose of the acquisition was to obtain the technical expertise and contractual backlog of this company.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

3. Availability and Liquidity

The following represents the Company's financial assets available within one year of the consolidated statements of financial position date that are expected to be used for general expenditures as of September 30 (rounded to nearest thousand):

	2019
Financial assets at year-end:	
Cash and cash equivalents	\$ 27,709,000
Accounts receivable	29,903,000
Accounts receivable - unbilled	33,800,000
Total financial assets	\$ 91,412,000

The Company's budgeting model includes the input from various departments, including individuals from contracts and programs, accounting and finance, and executive management. The budget is approved annually by the Board of Trustees. The normal business operations of the Company provide sufficient cash flows.

4. Inventory

Inventory consists of the following at September 30 (rounded to nearest thousand):

	2019	2018
Work-in-progress and finished goods	\$ 20,943,000	\$ 27,547,000
Purchased parts	50,161,000	41,974,000
	\$ 71,104,000	\$ 69,521,000

As of September 30, 2019 and 2018, the Company recorded reserves for excess or obsolete inventory of approximately \$2,692,000 and \$2,779,000, respectively.

5. Property, Buildings and Equipment

Property, buildings and equipment consists of the following at September 30 (rounded to nearest thousand):

	2019	2018
Land	\$ 883,000	\$ 794,000
Building and building improvements	43,737,000	40,713,000
Equipment	67,477,000	62,114,000
Computer software	9,392,000	8,562,000
Leasehold improvements	15,024,000	13,193,000
	136,513,000	125,376,000
Less: accumulated depreciation and amortization	(79,810,000)	(79,066,000)
	\$ 56,703,000	\$ 46,310,000

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Depreciation and amortization expense on property and equipment approximated \$6,496,000 and \$5,580,000 and includes \$371,000 and \$448,000 related to internal-use capitalized software for the years ended September 30, 2019 and 2018, respectively.

6. Goodwill

The following is a summary of goodwill at September 30 (rounded to nearest thousand):

	2019	2018
Goodwill	\$ 6,680,000	\$ 2,600,000
Less: accumulated amortization	(1,329,000)	(780,000)
	\$ 5,351,000	\$ 1,820,000

Goodwill is amortized using the straight-line method over its useful life. Amortization expense related to goodwill totaled approximately \$549,000 and \$780,000 for the years ended September 30, 2019 and 2018, respectively. Future annual amortization of goodwill is as follows for the years ending September 30 (rounded to nearest thousand):

Years ending September 30,

2020	\$ 1,658,000
2021	1,658,000
2022	1,304,000
2023	244,000
2024	244,000
Thereafter	243,000
	\$ 5,351,000

7. Lines-of-credit and Long-term Debt

Lines-of-credit

SRC has available a \$10,000,000 line-of-credit with a bank. The outstanding amounts under the line-of-credit are unsecured and bear interest at 1.50% above one-month London Interbank Offered Rate (LIBOR), adjusting daily (3.52% at September 30, 2019). No amounts were outstanding under the line as of September 30, 2019 or 2018. The line expires, if not renewed, on December 14, 2020.

Ventures has available a \$50,000,000 line-of-credit with a bank, of which any outstanding amounts under this line-of-credit are unsecured and bear interest at the greater of (a) 2.25% above one-month LIBOR, adjusting daily (4.27% at September 30, 2019) or (b) 3.25% per annum. Amounts outstanding under the line at September 30, 2019 and 2018 total approximately \$5,994,000 and \$12,008,000, respectively. The line expires, if not renewed, on December 14, 2020.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Long-term Debt

Long-term debt consists of the following at September 30 (rounded to nearest thousand):

	2019	2018
1997A Series Onondaga County Industrial Development Agency (IDA) Mars Civic Facility Revenue Bonds. Revenue Bonds, payable quarterly, commencing March 1, 1998 through December 2021, of principal plus interest, at a variable rate determined on a weekly basis using SIFMA index (1.58% at September 30, 2019) plus 0.05%. The obligation is collateralized by a letter of credit in the amount of \$1,530,000.	\$ 1,125,000	\$ 1,578,000
2005 Series Onondaga County Industrial Development Agency Variable Rate Demand Civic Facility Revenue Bonds. Revenue Bonds, payable quarterly, commencing December 1, 2007 through December 2031, of principal plus interest, at a variable rate determined on a weekly basis using SIFMA index (1.58% at September 30, 2019) plus 0.05%. The obligation is collateralized by a letter of credit in the amount of \$10,994,000.	10,860,000	11,540,000
	11,985,000	13,118,000
Less: long-term debt - current portion	(1,183,000)	(1,133,000)
Long-term debt, net of current portion	10,802,000	11,985,000
Less: unamortized debt issuance costs	(263,000)	(292,000)
Long-term debt, net of unamortized debt issuance costs	\$ 10,539,000	\$ 11,693,000

As of September 30, 2019, debt obligation maturities are as follows (rounded to nearest thousand):

Years ending September 30,

2020	\$ 1,183,000
2021	1,233,000
2022	870,000
2023	760,000
2024	785,000
Thereafter	7,154,000
	\$ 11,985,000

The letters of credit collateralizing the 1997A Series IDA bonds and the 2005 Series IDA bonds contain a restrictive financial covenant pertaining to cash-to-debt ratio. The Company was in compliance with this covenant at September 30, 2019 and 2018.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

8. Income Taxes

Significant components of the (provision for) benefit from income taxes are as follows for the years ended September 30 (rounded to nearest thousand):

	2019	2018
Current income tax expense	\$ (331,000)	\$ (689,000)
Deferred income tax (expense) benefit	(1,723,000)	4,140,000
(Provision for) benefit from income taxes	\$ (2,054,000)	\$ 3,451,000

The net deferred taxes are comprised of the following for the years ended September 30 (rounded to nearest thousand):

	2019	2018
U.S. operations		
Deferred tax liability:		
Depreciation	\$ 836,000	\$ 892,000
Total deferred tax liability	836,000	892,000
Deferred tax assets:		
Allowances for inventory	565,000	465,000
Start-up costs	118,000	38,000
Inventory capitalization	378,000	429,000
Net operating loss	1,555,000	3,368,000
Warranty and other reserves	182,000	413,000
Benefits reserve	161,000	275,000
Charitable contributions	183,000	-
Other	78,000	16,000
Total deferred tax asset	3,220,000	5,004,000
Net deferred tax assets	\$ 2,384,000	\$ 4,112,000

	2019	2018
Foreign operations		
Deferred tax assets		
Net operating loss	\$ 147,000	\$ -
Other	126,000	126,000
Valuation allowance	(141,000)	-
Net deferred tax assets	\$ 132,000	\$ 126,000

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

U.S. Operations

The above deferred income tax balances reflect the effects of temporary differences between the carrying amounts of assets and liabilities and their tax bases, as well as from net operating losses. Those balances are stated at the enacted tax rates expected to be in effect when the Company pays or recovers the taxes. Deferred income tax assets represent amounts available to reduce income taxes the Company will pay on taxable income in future years. The Company evaluates the ability to realize these future tax deductions by assessing whether the Company expects to have sufficient future taxable income from all sources, including reversal of taxable temporary differences, forecasted operating earnings and available tax planning strategies to utilize these future deductions and credits. The Company establishes a valuation allowance when they no longer consider it more likely than not that a deferred tax asset will be realized. For the year ended September 30, 2018 the Company released the balance of the valuation allowance, on the basis of management's reassessment of the amount of its deferred tax assets that are more likely than not to be realized. As of each reporting date, the Company's management considers new evidence, both positive and negative, that could impact management's view with regard to future realization of deferred tax assets. As of September 30, 2019, management determined that sufficient positive evidence exists to conclude that it is more likely than not that the deferred tax assets are realizable, and therefore, no valuation allowance is required.

On December 22, 2017, H.R.1, known as the "Tax Cuts and Jobs Act," was signed into law. Among other things, the Tax Cuts and Jobs Act permanently lowers the corporate tax rate to 21% from the previous maximum rate of 35%, effective for tax years including or commencing January 1, 2018. As a result of the reduction of the corporate tax rate to 21%, U.S. GAAP requires companies to re-value their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the reporting period of enactment.

As of September 30, 2017, the Company had U.S. net deferred tax assets of approximately \$14,863,000. The Company recorded a re-valuation of its deferred tax assets and liabilities as of September 30, 2018, at the new rate of 21%, based upon balances in existence at date of enactment. The result of the net deferred tax assets being written down was a reduction in the asset and corresponding increase to tax expense of approximately \$5,920,000.

As of September 30, 2019 and 2018, the Company has net operating loss carryforwards of approximately \$7,308,000 and \$15,862,000, respectively, which will be available to offset future taxable income. The net operating loss carryforwards expire, if not utilized, in fiscal years beginning 2023 and forward.

Foreign Operations

In 2016, an Australian for-profit subsidiary of International was formed, SRC AUS. For the years ended September 30, 2019 and 2018, this foreign subsidiary resulted in taxable income of approximately \$1,202,000 and \$1,589,000, respectively.

In 2016 a Canadian for-profit subsidiary of International was formed, SRC CAN. For the year ended September 30, 2019, this foreign subsidiary resulted in a taxable loss of approximately \$357,000. The loss created a deferred tax asset of approximately \$94,000. The Company has recorded a valuation allowance against this deferred tax asset.

In 2019 a United Kingdom for-profit subsidiary of International was formed, SRC UK. For the year ended September 30, 2019, this foreign subsidiary resulted in a taxable loss of approximately

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

\$308,000. The loss created a deferred tax asset of approximately \$47,000. The Company has recorded a valuation allowance against this deferred tax asset.

9. Benefit Plans

Defined Contribution Retirement Plans

All employees of the Company are covered under the TIAA and CREF plans. Participation in the plans is mandatory on the first day of the month following date of hire for all employees age 21 and older. Participants are required to contribute, at a minimum, 5% of compensation. The Company makes contributions to the plan on a periodic basis equal to 10% of the eligible employees' compensation. During the years ended September 30, 2019 and 2018, the amount contributed by the Company to the defined contribution pension plans was approximately \$13,373,000 and \$10,981,000, respectively.

457(b) Plan

The Company provides an unfunded 457(b) deferred compensation plan (the 457(b) Plan) that allows for participation by board members and senior management. Participants may contribute a portion of their compensation up to the maximum IRS limitations each year. The Company contributed approximately \$239,000 and \$214,000 during the years ended September 30, 2019 and 2018, respectively. Plan contributions are held in investment funds with TIAA and CREF and M&T Investment Group. The plan assets are owned by the Company until the participant has a distributable event. Participant contributions were approximately \$159,000 and \$215,000 in 2019 and 2018, respectively. As of September 30, 2019 and 2018, the 457(b) Plan assets and obligations totaled approximately \$2,546,000 and \$2,280,000, respectively, and are included in noncurrent other assets and other long-term liabilities in the accompanying consolidated statements of financial position.

Postretirement Health Care Benefits Plan

The Company provides the SRC Total Care Plan (the Plan) to provide welfare benefits, including medical, dental, prescription drugs, and life insurance, to substantially all currently active employees as well as life insurance benefits to retired employees. On February 12, 2018, the Company adopted a plan amendment to the postretirement life insurance plan that revised the eligibility criteria of the retiree group health benefits program from age 62 with at least 10 years of service after age 52 to the Rule of 72 (the sum of age and years of service must be at least 72), with a minimum age of 55 and minimum of 10 years of service on or after age 62 with at least ten years of continuous service as a full-time employee.

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

The following table presents the change in the postretirement and health care benefit obligation in the consolidated statements of financial position for the years ended September 30 (rounded to nearest thousand):

	2019	2018
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 1,166,000	\$ 762,000
Service cost	66,000	69,000
Interest cost	48,000	39,000
Amendments	-	409,000
Actuarial loss (gain)	324,000	(103,000)
Benefits paid	(10,000)	(10,000)
Benefit obligation at end of year	\$ 1,594,000	\$ 1,166,000

The underfunded status is recorded in other long-term liabilities in the accompanying consolidated statements of financial position as follows as of September 30 (rounded to nearest thousand):

	2019	2018
Change in plan assets		
Fair value of plan assets at beginning of year	\$ -	\$ -
Actual return on plan assets	-	-
Distributions to the employer	10,000	10,000
Benefits paid	(10,000)	(10,000)
Fair value of plan assets at end of year	-	-
Underfunded status	\$ (1,594,000)	\$ (1,166,000)

As of September 30, 2019 and 2018, the Plan had unamortized actuarial net losses of approximately \$560,000 and \$246,000, respectively, and unamortized prior service credit of \$296,000 and \$476,000, respectively.

Weighted average assumptions used to calculate the benefit obligation are as follows as of September 30:

	2019	2018
Expected return on plan assets	0.00%	0.00%
Discount rate	3.17%	4.20%

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

Weighted average assumptions used to calculate the net periodic benefit (income) cost are as follows for the years ended September 30:

	2019	2018
Expected return on plan assets	0.00%	0.00%
Discount rate	4.20%	3.81%

Components of net periodic benefit (income) cost are as follows for the years ended September 30 (rounded to nearest thousand):

	2019	2018
Components of net periodic benefit (income) cost		
Service cost	\$ 66,000	\$ 69,000
Interest cost	48,000	39,000
Amortization of prior service credit	(180,000)	(225,000)
Amortization of net loss	9,000	24,000
	\$ (57,000)	\$ (93,000)

Components of net periodic benefit cost recognized in non-operating activities in the accompanying consolidated statements of activities and change in net assets for the years ended September 30 are as follows (rounded to nearest thousand):

	2019	2018
Prior service cost (credit)	\$ -	\$ 409,000
Actuarial loss (gain)	323,000	(103,000)
Amortization of prior service cost	180,000	224,000
Amortization of actuarial gain	(9,000)	(24,000)
	\$ 494,000	\$ 506,000

Expected benefit payments reflect expected future services. Shown below are the expected gross benefit payments (including prescription drug benefits) for the following fiscal years (rounded to nearest thousand). The Company does not expect to receive any subsidy payments during the next ten fiscal years.

	Net Payments
2020	19,000
2021	21,000
2022	23,000
2023	25,000
Years 2024-2029	218,000

SRC, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

10. Major Customers

For the years ended September 30, 2019 and 2018, customers within the U.S. Federal Government (principally Army, Air Force, and Department of Defense organizations within the intelligence community and Environmental Protection Agency), accounted for 96.7% and 96.1%, respectively, of the Company's revenue. As of September 30, 2019 and 2018, the U.S. Federal Government represents 89.0% and 92.8%, respectively, of the total contract receivables balance.

11. Commitments and Contingencies

Commitments

The Company leases office space and certain equipment under the terms of noncancelable operating leases that expire at various dates through 2029. The Company is also responsible for certain operating expenses. The following is a schedule by year of the future minimum lease payments required under these leases which have initial or remaining terms in excess of one year as of September 30, 2019 (rounded to nearest thousand):

<i>Years ending September 30,</i>	<i>Operating Leases</i>
2020	\$ 4,909,000
2021	4,690,000
2022	4,161,000
2023	3,772,000
2024	3,944,000
Thereafter	7,543,000
Total minimum payments	\$ 28,019,000

The Company recognizes the total cost of its office leases ratably over the respective lease periods. The difference between rent paid and rent expense is included in other long-term liabilities in the accompanying consolidated statements of financial position. Rent expense aggregated approximately \$4,114,000 and \$3,674,000 for the years ended September 30, 2019 and 2018, respectively, which is included as a component of indirect expenses in the accompanying consolidated statements of activities and change in unrestricted net assets.

Contingencies

In 2015, the Company undertook a product recalibration for a customer. As of September 30, 2015, the cost of the recalibration was estimated at \$3,100,000 of which approximately \$356,000 and \$905,000 remains in accrued expenses in the consolidated statements of financial position as of September 30, 2019 and 2018, respectively.

12. Subsequent Events

The Company has evaluated its September 30, 2019 consolidated financial statements for subsequent events through December 13, 2019, the date the consolidated financial statements were available to be issued. The Company is not aware of any subsequent events which would require recognition or disclosure in the consolidated financial statements.

Section

2

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards
and Reports Required by *Government
Auditing Standards* and the Uniform
Guidance

Year Ended September 30, 2019

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards and Reports Required by
Government Auditing Standards and the Uniform Guidance
Year Ended September 30, 2019

SRC, Inc. and Subsidiaries

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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Consolidated Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
SRC, Inc. and Subsidiaries
Syracuse, New York

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of SRC, Inc. and Subsidiaries (the Company) which comprise the consolidated statements of financial position as of September 30, 2019, and the related consolidated statements of activities and change in net assets and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated December 13, 2019.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered the Company's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BDO USA, LLP

McLean, Virginia
December 13, 2019



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8401 Greensboro Drive
Suite 800
McLean, VA 22102

Independent Auditor's Report on Compliance for the Major Federal Program and Report on Internal Control over Compliance Required by the Uniform Guidance

Board of Directors
SRC, Inc. and Subsidiaries
Syracuse, New York

Report on Compliance for the Major Federal Program

In connection with the coordinated audit of SRC, Inc. and Subsidiaries (the Company) as provided for in U.S. Office of Management and Budget (OMB) *Compliance Supplement*, the U.S. Defense Contract Audit Agency (DCAA) and BDO USA, LLP (BDO) each performed certain tasks. Responsibilities under the coordinated audit approach were assigned as follows:

1. BDO performed specific audit procedures over all federal awards of the research and development cluster major federal program for the cash management compliance as described in the *OMB Compliance Supplement*.
2. BDO performed specific audit procedures over non-classified federal awards of the research and development cluster major federal program for all federal agencies for the following compliance requirements as described in the *OMB Compliance Supplement*:
 - Equipment and Real Property Management
 - Matching, Level of Effort and Earmarking
 - Procurement, Suspension and Debarment
 - Program Income
 - Reporting
 - Subrecipient Monitoring
 - Special Tests and Provisions
3. BDO performed specific audit procedures over the direct costs of federal awards from the U.S. Environmental Protection Agency (EPA) for the following compliance requirements as described in the *OMB Compliance Supplement*:
 - Activities Allowed or Unallowed
 - Allowable Cost/Cost Principles
 - Period of Availability of Federal Funds/Period of Performance
4. BDO tested the internal control over compliance with respect to the above listed compliance requirements described as BDO's responsibility as they related to the federal awards of the research and development cluster major federal program.

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5. DCAA performed all audit procedures over the classified federal awards from all agencies of the research and development cluster major federal program for the following compliance requirements as described in the *OMB Compliance Supplement*:
 - Equipment and Real Property Management
 - Matching, Level of Effort and Earmarking
 - Procurement, Suspension and Debarment
 - Program Income
 - Reporting
 - Subrecipient Monitoring
 - Special Test and Provisions
6. DCAA performed all audit procedures over all federal awards (indirect and direct costs) from all federal agencies, except for direct costs with EPA, for the following compliance requirements in the *OMB Compliance Supplement* as they related to the research and development cluster major federal program:
 - Activities Allowed or Unallowed
 - Allowable Cost/Cost Principles
 - Period of Availability of Federal Funds/Period of Performance
7. DCAA tested the internal control over compliance with respect to the above listed compliance requirements described as DCAA's responsibility as they related to the federal awards of the research and development cluster major federal program.

For the BDO responsibilities described above, we have audited the Company's compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on the Company's major federal program for the year ended September 30, 2019. The Company's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Company's major federal program based on our audit of the types of compliance requirements referred to above as BDO's responsibility. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that were the responsibility of BDO, that could have a direct and material effect on a major federal program occurred. An audit includes examining,



on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major federal program with the compliance requirements which were the responsibility of BDO. However, our audit does not provide a legal determination of the Company's compliance.

Opinion on the Major Federal Program

In our opinion, the Company complied, in all material respects, with the types of compliance requirements which were the responsibility of BDO, referred to above that could have a direct and material effect on the major federal program for the year ended September 30, 2019.

Report on Internal Control Over Compliance

Management of the Company is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above under BDO's responsibility. In planning and performing our audit of compliance, we considered the Company's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance with the compliance requirements, which were the responsibility of BDO, for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the consolidated financial statements of the Company as of and for the year ended September 30, 2019, and have issued our report thereon dated December 13, 2019, which contained an unmodified opinion on those consolidated financial statements. Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

BDO USA, LLP

McLean, Virginia
June 24, 2020

Schedule of Expenditures of Federal Awards

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
Research and Development Cluster:				
U.S. Department of Defense				
Direct Programs Department of the Air Force	12.RD		\$ 54,864,229	\$ -
Pass Through Programs From:				
ALION SCIENCE AND TECHNOLOGY	12.RD	SUB1143302	330,344	-
BATELLE MEMORIAL	12.RD	US001-0000703738	1,189	-
BCF SOLUTIONS	12.RD	DIV5-CUAS4-SRC	10,321	-
BLACK RIVER SYSTEMS	12.RD	1725-S01-BRSC	151,363	-
BOOZ-ALLEN	12.RD	S901411BAH	50,618	-
BOOZ-ALLEN	12.RD	107234SB31	47,532	-
BOOZ-ALLEN	12.RD	S900334BAH	35,866	-
CAS, INC.	12.RD	CAS SC 686-18	3,146,700	-
DEFENSE RESEARCH ASSOCIATES	12.RD	SRC-1797B	215,539	-
DILIGENT CONSULTING, INC.	12.RD	2000-M50	187,881	-
LEIDOS, INC.	12.RD	P010191561	515,248	-
MATRIX RESEARCH, INC.	12.RD	CRFR-017	262,155	-
NORTHROP GRUMMAN	12.RD	7500151950	122,856	-
NORTHROP GRUMMAN	12.RD	7500156052	3,425,763	-
NORTHROP GRUMMAN	12.RD	7500164124	242,554	-
ROCKWELL COLLINS	12.RD	CW2248651	53,242	-
SAZE TECHNOLOGIES, LLC	12.RD	I100544	19,403	-
SIERRA NEVADA CORP	12.RD	S17TNH076	5,116	-
SMARTRONIX, INC	12.RD	15R09S	169,771	-
SRCTEC, LLC	12.RD	I100429	30,241	-
ZEL TECHNOLOGIES	12.RD	SRC-18-14	41,394	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
Total Department of the Air Force			63,929,325	-
Direct Programs Department of the Army	12.RD		59,652,793	-
Pass Through Programs From:				
ATI	12.RD	2017-324	2,538,294	-
ATI	12.RD	2017-351 #1	1,522,970	-
ATI	12.RD	2018-359	537,050	-
BATELLE MEMORIAL	12.RD	725981	186,150	-
BLACK RIVER SYSTEMS	12.RD	1840-S01-BRSC	1,592	-
BOOZ-ALLEN	12.RD	107204SB60	5,651,629	-
BOOZ-ALLEN	12.RD	98596XSB0P	763,845	-
CACI TECH	12.RD	P000007826	139,030	-
CACI TECH	12.RD	P000065256	226,905	-
CACI TECH	12.RD	P000074370	3,073	-
DHPC TECHNOLOGIES	12.RD	SD01506	1,357,490	-
DYNETICS	12.RD	DI-SC-19-18	77,295	-
ENGILITY CORP	12.RD	2015-S-EGL-0122	562,404	-
EOIR TECHNOLOGIES, INC	12.RD	S16-10017	1,573,144	-
KORD TECHNOLOGIES, INC.	12.RD	OTA KSC-18-014	68,238	-
LEIDOS, INC	12.RD	PO10226853	333,606	-
LOCKHEED MARTIN	12.RD	4104154202	21,228	-
LOCKHEED MARTIN	12.RD	4104201649	353	-
LOCKHEED MARTIN	12.RD	4103583566	5,662	-
LOCKHEED MARTIN	12.RD	4103677531	5,434	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
NORTHROP GRUMMAN	12.RD	8200217311	26,687	-
RADIANCE TECHNOLOGIES	12.RD	18S-0249	433	-
SAIC	12.RD	B00132	374	-
SAIC	12.RD	P010204667	1,325	-
SAVIT CORP	12.RD	7D03-N-3590	2,366	-
SAZE TECHNOLOGIES, LLC	12.RD	I100546	31,998	-
SIERRA NEVADA CORP	12.RD	S17TNH112	279,051	-
SIERRA NEVADA CORP	12.RD	S19TNH084	76,591	-
SPECTRAL SCIENCES, INC.	12.RD	#3517-001-47	13,607	-
SPECTRAL SCIENCES, INC.	12.RD	11451	13,624	-
SRCTEC, LLC	12.RD	I100305	2,382	-
SRCTEC, LLC	12.RD	I100307	1,601,321	-
SRCTEC, LLC	12.RD	I100346	8,286	-
SRCTEC, LLC	12.RD	I100353	2,013	-
SRCTEC, LLC	12.RD	I100369	3,391,465	-
SRCTEC, LLC	12.RD	I100387	6,494	-
SRCTEC, LLC	12.RD	I100389	68,855	-
SRCTEC, LLC	12.RD	I100423	2,100	-
SRCTEC, LLC	12.RD	I100435	32,421	-
SRCTEC, LLC	12.RD	I100445	1,260,267	-
SRCTEC, LLC	12.RD	I100449	115,362	-
SRCTEC, LLC	12.RD	I100451	123,530	-
SRCTEC, LLC	12.RD	I100468	20,707	-
SRCTEC, LLC	12.RD	I100476A	147,396	-
SRCTEC, LLC	12.RD	I100479	59,362	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
SRCTEC, LLC	12.RD	I100488	18,079	-
SRCTEC, LLC	12.RD	I100490	133,926	-
SRCTEC, LLC	12.RD	I100533	15,662	-
SRCTEC, LLC	12.RD	PO I100130	101,969	-
SRCTEC, LLC	12.RD	PO I100163	14,327	-
SRCTEC, LLC	12.RD	PO I100226	53,049	-
Total Department of the Army			82,853,214	-
Direct Programs Department of the Navy	12.RD		4,126,029	-
Pass Through Programs From:				
AMEWAS, INC	12.RD	2016-SR0013	44,949	-
AMEWAS, INC	12.RD	2019-SRCI0054	658,281	-
J.F.TAYLOR, INC	12.RD	JFT-0016-21	1,310,041	-
LEIDOS, INC	12.RD	4103000004	316,019	-
NORTHROP GRUMMAN	12.RD	4700001709	63,028	-
SAZE TECHNOLOGIES, LLC	12.RD	I100541	191,514	-
SAZE TECHNOLOGIES, LLC	12.RD	I100542	1,952	-
SAZE TECHNOLOGIES, LLC	12.RD	I100543	234,003	-
Total Department of the Navy			6,945,816	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
Research and Development Cluster:				
Direct Programs Department of the Marines	12.RD		594,270	-
Pass Through Programs From:				
NORTHROP GRUMMAN	12.RD	8200218558	26,910	-
SRCTEC, LLC	12.RD	I100311	12,705	-
SRCTEC, LLC	12.RD	I100432	35,848	-
Total Department of the Marines			669,733	-
National Security Agency				
Pass Through Programs From:				
EXCEPTIONAL SW STRATEGIES	12.RD	H98230-14-D-0154-SC-20	197,591	-
Total National Security Agency			197,591	-
Direct Programs National Reconnaissance Organization	12.RD		966,310	-
Pass Through Programs From:				
PARSONS	12.RD	Undisclosed	756,189	-
VENCORE, INC.	12.RD	Undisclosed	656,596	-
Total National Reconnaissance Organization			2,379,095	-
Defense Intelligence Agency				
Pass Through Programs From:				
COLSA CORPORATION	12.RD	HS-161113	82,942	-
Total Defense Intelligence Agency			82,942	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
Research and Development Cluster:				
Direct Programs Defense Advanced Research Projects Agency	12.RD		8,872,834	-
Total Defense Advanced Research Projects Agency			8,872,834	-
Direct Programs Defense Threat Reduction Agency	12.RD		904,101	-
Pass Through Programs From:				
CACI, INC.-FEDERAL	12.RD	P000030899	4,627,799	-
SRCTEC, LLC	12.RD	I100499	84,899	-
URS CORP.	12.RD	URSFS48542	1,926	-
URS CORP.	12.RD	URSFS54188	31,837	-
Total Defense Threat Reduction Agency			5,650,562	-
Defense Logistics Agency				
Pass Through Programs From:				
SRCTEC, LLC	12.RD	I100424	1,206	-
SRCTEC, LLC	12.RD	I100466	5,811	-
Total Defense Logistics Agency	12.RD		7,017	-
Office of the Secretary of Defense				
Pass Through Programs From:				
PRKK, LLC	12.RD	SRC-GF-001	155,912	-
Total Defense Logistics Agency	12.RD		155,912	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
Research and Development Cluster:				
Intelligence Advanced Research Projects Agency				
Pass Through Programs From: SYRACUSE UNIVERSITY	12.RD	29165-04567-S03	141,279	-
Total Intelligence Advanced Research Projects Agency			141,279	-
Other Contracts	12.RD	Undisclosed	2,508,796	-
Total U.S. Department of Defense			174,394,116	-
Environmental Protection Agency				
Direct Programs Environmental Protection Agency	66.RD		6,303,944	-
Pass Through Programs From:				
LOCKHEED MARTIN	66.RD	46033416	1,264,270	-
SUMMITEC CORPORATION	66.RD	16-10-011	64,417	-
VERSAR, INC.	66.RD	MSA2017-02	7,560	-
Total Environmental Protection Agency			7,640,191	-
U.S. Department of Health and Human Services				
Direct Programs Center for Disease Control and Prevention	93.RD		975,662	-
Direct Programs National Library of Medicine	93.RD		346,903	-
Total U.S. Department of Health and Human Services			1,322,565	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
<i>U.S. Department of Homeland Security</i>				
Direct Programs Department of Homeland Security	97.RD		17,879	-
Pass Through Programs From: BATELLE MEMORIAL	97.RD	US001-0000574611	76,263	-
Total U.S. Department of Homeland Security			94,142	-
<i>U.S. Department of State</i>				
Pass Through Programs From: SRCTEC, LLC	19.RD	I100254	231,700	-
Total U.S. Department of State			231,700	-
<i>U.S. Department of Transportation</i>				
Federal Aviation Administration				
Pass Through Programs From: THE OHIO STATE UNIVERSITY	20.RD	60067188	391,131	-
Total Federal Aviation Administration			391,131	-
Total U.S. Department of Transportation			391,131	-

SRC, Inc. and Subsidiaries

Schedule of Expenditures of Federal Awards

Year Ended September 30, 2019

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2019 Federal Expenditures	Amounts Provided to Subrecipients
Research and Development Cluster:				
U.S. Department of Energy				
Pass Through Programs From: BATELLE MEMORIAL	81.RD	413738	8,168	-
Total U.S. Department of Energy			8,168	-
National Aeronautics and Space Administration				
Direct Programs National Aeronautics and Space Administration	43.RD		26,864	-
Pass Through Programs From: LJT & ASSOCIATES, INC	43.RD	6210-SRC-001	7,274	-
Total National Aeronautics and Space Administration			34,138	-
Total Research and Development Cluster Expenditures of Federal Awards			\$ 184,116,151	\$ -

The accompanying notes are an integral part of the schedule.

SRC, Inc. and Subsidiaries

Notes to the Schedule of Expenditures of Federal Awards

1. Summary of Significant Accounting Policies

Expenditures reported on the Schedule of Expenditures of Federal Awards (the Schedule) are reported on the accrual basis of accounting. Such expenditures are recognized following, as applicable, either the cost principles in Office of Management and Budget (OMB) Circular A-122, *Cost Principles for Non-Profit Organizations*, or the cost principles contained in Title 2 U.S. CFR Part 200, *Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards* (Uniform Guidance), wherein certain types of expenditures are not allowable or are limited as to reimbursement.

2. Indirect Cost Rate

Direct and indirect costs are charged to awards in accordance with cost principles contained in the Federal Acquisition Regulation (FAR) Part 31 and the Cost Accounting Standards.

The Company recovers indirect costs under contracts and grants at provisional rates negotiated between itself and the cognizant agency (U.S. Department of Defense). Separate indirect cost rates are negotiated for fringe benefits, management overhead, facilities overhead, bid and proposal/independent research and development costs, general and administrative costs, material handling, and subcontracting costs. Final indirect costs for each fiscal year are determined by the Defense Contract Audit Agency (DCAA) upon subsequent annual audits at which point cost reimbursement contracts are settled at actual rates. A detailed schedule of indirect cost rates is included in the DCAA annual incurred costs report for the year ended September 30, 2019.

The Company has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

3. Basis of Presentation

The accompanying Schedule includes the federal award activity of SRC, Inc. and Subsidiaries (SRC or the Company) under programs of the federal government for the year ended September 30, 2019. The information in this Schedule is presented in accordance with the requirements of the Uniform Guidance. Because the Schedule presents only a selected portion of the operations of the Company, it is not intended to and does not present the financial position, changes in net assets or cash flows of the Company.

All of the Company's federal awards were in the form of cash assistance for the year ended September 30, 2019. The Company had no federally funded insurance programs or loan guarantees during the year ended September 30, 2019.

4. Other Contracts

Other contracts, referred to in the Schedule, primarily consist of federal contracts the Company has entered into that are of a sensitive nature which were subject to audit by a branch of the DCAA that monitors classified contracts.

SRC, Inc. and Subsidiaries

Schedule of Findings and Questioned Costs Year Ended September 30, 2019

Section I - Summary of Auditor's Results

Consolidated Financial Statements

Type of auditor's report issued on whether the consolidated financial statements audited were prepared in accordance with U.S. GAAP:

Unmodified

Internal control over financial reporting:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported
- Noncompliance material to consolidated financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over the major federal program:

- Material weakness(es) identified? ☐ Yes ☒ No
- Significant deficiency(ies) identified? ☐ Yes ☒ None reported

Type of auditor's report issued on compliance for the major federal program:

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?

☐ Yes ☒ No

Identification of the major federal program:

CFDA/Number	Name of Federal Program or Cluster
Various	Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs:

\$3,000,000

Auditee qualified as low-risk auditee?

☒ Yes ☐ No

SRC, Inc. and Subsidiaries

Schedule of Findings and Questioned Costs Year Ended September 30, 2019

Section II - Financial Statement Findings

There were no findings related to the consolidated financial statements which are required to be reported in accordance with generally accepted government auditing standards (GAGAS) identified during the 2019 audit.

Section III - Federal Award Findings and Questioned Costs

There were no findings or questioned costs for federal awards (as defined in Section 2 CFR 200.516(a) of the Uniform Guidance) that are required to be reported.

SRC, Inc.
Uniform Guidance Audit Report: Summary Schedule of Prior Audit Findings
Year Ending September 30, 2018

Finding 2018-006**Summary of Prior Audit Finding:**
Reporting**Recommendation:**

BDO recommended that SRC improve their controls over the preparation and delivery of financial reports. Required reports should be prepared and delivered to each grantor within the contractual time frame unless exempted by a contract clause. Additionally, they recommended that a supervisor review all reports for accuracy prior to submission, for which the review should be documented, as well as maintain evidence of when all reports were submitted. This evidence should be part of a monthly close process, where several individuals can access the documentation and records.

Status of Finding:

SRC agreed that the report in question was submitted late. As stated by BDO in their report, this late submittal was a result of one manager on extended leave. SRC discussed with the applicable manager to ensure they properly delegate report submittals if out of the office in the future. SRC believes this to be an isolated issue as over the last several years SRC has reviewed our processes and procedures, made updates when needed, and has educated employees to ensure adequate procedures are in place that would require compliance with the financial reporting requirements. SRC also believes that evidence is already available to show when reports are submitted and did provide that evidence during the audit. As corrective action, SRC has continued to educate applicable employees on the requirements as well as continued to attempt the negotiation of additional time for financial reporting in its contracts.

Section

3



DEFENSE CONTRACT AUDIT AGENCY

Audit Report No. 03441-2019S10110001

Upstate New York Branch Office

375 Saratoga Road, Suite 1

Glenville, NY 12302

June 17, 2020

Independent Audit Report on SRC, Inc.'s Compliance with Requirements Applicable to its Major Program and on Internal Control Over Compliance in Accordance with the Uniform Guidance at 2 CFR Part 200 for Fiscal Year Ended September 30, 2019

SPECIAL WARNING: The contents of this audit report must not be released or disclosed, other than to those persons whose official duties require access in accordance with Department of Defense (DoD) regulations. This document may contain information exempt from mandatory disclosure under the Freedom of Information Act. Unauthorized disclosure of proprietary, contractor bid or proposal or source selection information may violate Title 18 United States Code (U.S.C.) § 1905 and/or Title 41 U.S.C. § 2102. Please see the Audit Report Distribution and Restrictions section of this report for further restrictions.

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EXECUTIVE SUMMARY

ABOUT SRC, INC. (SRC)

SRC (CAGE Code 28541) is a not-for-profit research and development firm chartered by the State of New York. SRC specializes in Research and Development for the Federal Government. SRC is headquartered at 7502 Round Pond Road in Syracuse, NY. SRC also has sites in Arlington, VA; Chantilly, VA; Charlottesville, VA; Dayton, OH; Rome, NY; San Antonio, TX; and several support locations throughout the country. SRC had sales of \$280 million for Fiscal Year Ended (FYE) September 30, 2019. SRC's Fiscal Year (FY) 2019 sales are 98 percent related to Federal Government, and the Government sales are predominately flexibly priced. SRC has approximately 1,375 employees (SRC 1,121 and SRC Home Office 254). In FY 2019, the primary customers consisted of the US Air Force and US Army, which represented approximately 57 percent of the total claimed costs.

SRC's Federal Awards fall under the designation of a Research and Development (R&D) Cluster. Federal Programs with different Catalog of Federal Domestic Assistance (CFDA) numbers that are closely related programs that share common compliance requirements are defined as a cluster of programs. Since all of SRC's Federal awards fall under the R&D cluster, SRC is considered to only have one major Federal program (R&D).

ABOUT THIS AUDIT

In accordance with Code of Federal Regulations, Title 2, Part 200 (2 CFR 200), the Defense Contract Audit Agency (DCAA) and BDO USA LLP (BDO) performed a coordinated audit of the SRC's R&D Cluster. DCAA's audit responsibility included testing SRC's compliance with the following compliance requirements from the Office of Management and Budget (OMB) 2019 Compliance Supplement: activities allowed or unallowed; allowable cost/cost principles; and period of performance. The Other Government, National Security Agency (NSA), and National Reconnaissance Organization (NRO) awards were audited for compliance with the following additional requirements: procurement and suspension and debarment; subrecipient monitoring and special tests and provisions. Our work included auditing SRC's proposed direct and indirect amounts for reimbursement on Federal Awards contained in its FY 2019 Final Indirect Rate proposal, certified by SRC, Inc. on February 28, 2020.



In addition, we tested SRC's internal control structure with respect to the six compliance requirements listed above as they related to SRC's R&D Cluster. Our audit of the R&D cluster did not include Environmental Protection Agency (EPA) awards included in the Schedule of Expenditures of Federal Awards as the Independent Public Accountant (IPA) is responsible for these awards (see Appendix 4, page 25).

WHAT WE FOUND

Our examination of the auditee's internal controls and claimed costs for FYE September 30, 2019, disclosed the following questioned indirect costs and issues with internal control over compliance:

A. Indirect Costs:

1. We questioned \$55,000 of indirect labor and \$27,197 of directly associated fringe in the Radar and Sensors (R&S) Management Overhead Pool as bonuses claimed were outside the established practice.
2. We questioned \$34,895 of indirect dues and subscription costs in the G&A pool and (\$41,298) in the EW Laboratory intermediate expense pool as costs were recorded in error to the incorrect account.
3. We questioned \$66,241 of the fringe allocation in the EW Laboratory intermediate pool which is directly associated with labor costs for a capital project, which was removed from this pool.

B. Internal Control Over Compliance:

1. We identified an internal control noncompliance as it relates to the lack of authority letter and written policy for the use of facsimile as signatures on payments.
2. We identified an internal control noncompliance as obligations are not liquidated within 90 calendar days after the end of the period of performance.

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM

We have audited SRC's compliance with the compliance requirements described in the 2 CFR 200, Appendix XI, 2019 Compliance Supplement (OMB *Compliance Supplement*) that could have a direct and material effect on each of SRC's major Federal Programs for the year ended September 30, 2019. SRC's major Federal Programs are identified in the summary of auditor's results section of the Schedule of Findings and Questioned Costs (Exhibit, page 11).

We have audited SRC's compliance with three of the compliance requirements described in the OMB *Compliance Supplement* that could have a direct and material effect on SRC's R&D program for the year ended September 30, 2019. The compliance requirements audited by DCAA are as follows, excluding EPA:

- Part A. Activities Allowed or Unallowed;
- Part B. Allowable Cost/Cost Principles; and
- Part H. Period of Performance.

In addition, the Other Government, NSA, and NRO awards were audited for compliance with the requirements of:

- Part I. Procurement, Suspension, and Debarment;
- Part M. Subrecipient Monitoring; and
- Part N. Special Tests and Provisions.

SRC's independent public accounting firm of BDO is responsible for reviewing compliance with Part C. Cash Management for all federal awards and with the following compliance requirements for the R&D Cluster excluding Other Government, NSA and NRO awards:

- Part F. Equipment and Real Property Management;
- Part G. Matching, Level of Effort, Earmarking;
- Part I. Procurement and Suspension and Debarment;
- Part L. Reporting;
- Part M. Subrecipient Monitoring; and
- Part N. Special Tests and Provisions.

In addition, the IPA is responsible for reviewing SRC's compliance with Part A. Activities Allowed or Unallowable; Part B. Allowable Cost/Cost Principle; and Part H. Period of Performance for EPA awards.

The following compliance requirements were determined not applicable to SRC:

- Part E. Eligibility; and
- Part J. Program Income.

In addition, the following compliance requirements were determined not applicable to Other Government, NSA and NRO Awards for the year ended September 30, 2019:

- Part F. Equipment and Real Property Management;
- Part G. Matching, Level of Effort, Earmarking; and
- Part L. Reporting.

We also audited SRC's direct and indirect amounts for contract reimbursement on unsettled flexibly priced contracts contained in its FY 2019 Final Indirect Rate proposal, submitted on February 28, 2020, to determine if the proposed amounts comply with the terms of Federal Awards pertaining to accumulating and billing incurred amounts. The proposed Final Rates apply to the Federal Awards listed in Attachment 3. A copy of SRC's Certificate of Final Indirect Costs, dated February 28, 2020, is included as Appendix 1 to the report.

Management's Responsibility

SRC's management is responsible for compliance with Federal statutes, regulations, and the terms and conditions of its Federal Awards applicable to its Federal Programs, including the design, implementation, maintenance of internal control to prevent or detect and correct noncompliance due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of SRC's major Federal Programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* (GAGAS), issued by the Comptroller General of the United States, and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal Program occurred. An audit includes examining, on a test basis, evidence about SRC's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. The nature, timing, extent of the procedures selected depend on our professional judgment, including an assessment of risks of material noncompliance, whether due to fraud or error, and involve examining evidence about the proposed amounts.

We believe that the evidence we obtained is sufficient and appropriate to ensure that our audit provides a reasonable basis for our audit opinion on compliance for the major Federal Program. However, our audit does not provide a legal determination on SRC's compliance.

Unmodified Opinion on SRC's Compliance with the R&D Cluster

In our opinion, SRC complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal Programs for the year ended September 30, 2019. SRC's proposed amounts on unsettled flexibly priced contracts comply, in all material respects, with contract terms pertaining to accumulating and billing incurred amounts.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned costs as items: 2019-001, 2019-002 and 2019-003 (Exhibit). Our opinion on each major Federal Program is not modified with respect to these matters.

SRC's response to the noncompliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs (Exhibit) as well as SRC's Corrective Action Plan for the Current Year, Appendix 3. SRC's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The Summary Schedule of Claimed Expenditures by Federal Sponsor is found in Appendix 4.

The audit results and recommendations related to the indirect rates are summarized in Attachment 1 and presented in detail in the accompanying Schedule of Findings and Questioned Costs (Exhibit). The detailed final audit determined indirect rates, allocation bases and applicable government participation in these bases are included as Attachment 2 of this report. These Indirect Rates were agreed to in the Indirect Cost Rate Agreement signed June 12, 2020 and documents the auditee's concurrence with our findings and recommendation.

REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Management of SRC is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered SRC's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal Program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal Program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of SRC's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal Program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we did identify certain deficiencies in internal control over compliance, described in the accompanying Schedule of Findings and Questioned Costs (Exhibit) as items 2019-004, and 2019-005, that we consider to be significant deficiencies.

SRC's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs (Exhibit) as well as SRC's Corrective Action Plan for the Current Year (Appendix 3). SRC's response was not subjected to auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

AUDITOR'S COMMENTS ON SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

As part of our audit, we included procedures to assess the reasonableness of SRC, Inc.'s Summary Schedule of Prior Audit Findings, included as Appendix 2. Our audit disclosed that SRC's corrective action was taken regarding audit finding numbers 2018-001, 2018-002, 2018-004, and 2018-005. We followed up on SRC's corrective action in these areas and did not identify any exceptions. Therefore, audit finding numbers 2018-001, 2018-002, 2018-004, and 2018-005 are no longer open.

Our evaluation of the corrective action related to finding 2018-003 determined it was not adequate; therefore, further corrective action is required related to period of performance. We have incorporated this finding in number 2019-004 in the Schedule of Findings and Questioned Costs (Exhibit).

Our prior audit disclosed that SRC's corrective action taken regarding audit finding number 2017-007 included updating its current process to ensure delegation of authority is clearly defined by revising language in the buyer's checklist. During the prior audit, we followed up on the corrective action as part of the direct material and subcontracts testing and took no exception. However, we also performed testing related to Inter-Organizational Transfers (IOT), which do not require buyer's checklists. As a result, proper documentation of delegation of authority was not obtained and the corrective action did not adequately correct the finding. Our current year audit disclosed that SRC's corrective action regarding the IOT portion of finding 2017-007 included enhancing its current process to ensure delegation of authority is clearly defined by revising the language included on the Internal Purchase Order (IPO) approval form. However, this corrective action was not implemented until August 2019; therefore, we were unable to follow-up on the corrective action in this area. As a result, audit finding number 2017-007 remains open.

Our audit disclosed that SRC's corrective action taken regarding audit finding number 2017-008 included updated applicable policies and procedures to document the process for monitoring the timely submission of vouchers by subcontractors and to contact the subcontractors during the first quarter of the FY to ensure adjustment vouchers were submitted on a timely basis. SRC did not make this change until April 2019; therefore, we could not follow up on the corrective action in this area as part of this audit. As a result, audit finding number 2017-008 remains open.

EXIT CONFERENCE

We provided a draft copy of the report and discussed the results of our examination with Ms. Danielle Chabot, Director of Compliance, in an exit conference held on June 2, 2020. SRC concurred with finding numbers 2019-001, 2019-002, 2019-003, and 2019-005 and did not concur with finding number 2019-004. The complete text of the contractor's response appears as Appendix 3. SRC's response and corrective action plan were not subjected to the auditing procedures applied in the audit of compliance, and accordingly, we express no opinion on the response of the corrective action plan.

We are available to discuss the results of audit and participate in negotiations at your convenience.

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General information on audit matters is available at <http://www.dcaa.mil/>.

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RESTRICTONS

1. The For Official Use Only (FOUO) marking placed on this audit report is not a security marking. It is a marking required by DoD Freedom of Information Act (FOIA) regulations. The marking provides notice that the report might contain information that is subject to withholding under the FOIA. The FOUO marking is a notice limited to Department of Defense employees.
2. The Defense Contract Audit Agency has no objection to the auditee releasing this report, at their discretion for public inspection. DCAA also has no objection to the auditee excluding Attachments of this report from the filing with the Federal Clearinghouse due to the proprietary nature of the information included in the Attachments.
3. This report is intended solely for the information and use by Federal Awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS**SRC, Inc.****Fiscal Year Ended September 30, 2019****SECTION I: SUMMARY OF AUDITOR'S RESULTS:****1. Financial Statements:**

Information pertaining to the financial statements and the report on the Schedule of Expenditures of Federal Awards required by the Uniform Guidance are included in the independent public accountant's audit report.

2. Federal Awards:

Type of auditor's report issued on compliance for major programs:

Type of Audit Opinion	Research & Development Cluster
Unmodified	X
Qualified	
Adverse	
Disclaimer	

Internal control over major programs:

	Yes	None Reported
Material weaknesses were identified.		X
Significant deficiencies identified not considered to be material weaknesses.	X	

Audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a):

Yes	X
No	

Identification of Major Programs:

CFDA Number	Federal Program
N/A	Research & Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs:

\$3,000,000

Auditee classified as a low-risk under 2 CFR 200 Subpart F:

Yes	X
No	

SCHEDULE OF FINDINGS AND QUESTIONED COSTS**SRC, Inc.****Fiscal Year Ended September 30, 2019****SECTION II: FINDINGS RELATED TO FINANCIAL STATEMENTS:**

Information pertaining to the financial statements can be found in the independent public accountant's audit report.

SECTION III: FINDINGS RELATED TO FEDERAL AWARDS:

Summary of findings related to Federal Awards:

Finding Number	Major Federal Program	CFDA	Finding
2019-001	R&D Cluster	N/A	Compliance Requirement A and B; FAR 31.201-3
2019-002	R&D Cluster	N/A	Compliance Requirement A and B; FAR 31.201-3
2019-003	R&D Cluster	N/A	Compliance Requirement A and B; FAR 31.201-6(a)
2019-004	R&D Cluster	N/A	Compliance Requirements A, B and H; FAR 31.201-2(d); 2 CFR 200.309; 2 CFR 200.343(b); 2 CFR 200.71; FAR 52.216-7(e)
2019-005	R&D Cluster	N/A	Compliance Requirements A and B

1. INDIRECT COSTS**Radar and Sensors (R&S) Management Overhead (MOH)**

Account	Claimed	Questioned Costs		Note
		Total	Concurred	
Salaries	\$4,815,190	\$55,000	\$55,000	2019-001
Fringe	\$2,379,760	\$27,197	\$27,197	
All Other Costs	\$2,800,662			
Total R&S MOH Pool	\$9,995,612	\$82,197	\$82,197	

Radar and Sensors (R&S) Facilities Overhead (FOH)

Account	Claimed	Questioned Costs		Notes
		Total	Concurred	
Laboratory Overhead	\$2,712,043	\$14,157	\$14,157	2019-002; 2019-003
All Other Costs	\$3,974,534			
Total R&S FOH Pool	\$6,686,577	\$14,157	\$14,157	

Electronic Warfare (EW) Communication Systems (CS) FOH

Account	Claimed	Questioned Costs		Notes
		Total	Concurred	
Laboratory Overhead	\$2,066,429	\$10,787	\$10,787	2019-002; 2019-003
All Other Costs	\$2,465,319			
Total EW CS FOH Pool	\$4,531,748	\$10,787	\$10,787	

General & Administrative (G&A)

Account	Claimed	Questioned Costs		Note
		Total	Concurred	
Home Office -				
G&A Headcount Allocation	\$8,352,565	\$34,895	\$34,895	2019-002
All Other Costs	\$16,381,942			
Total G&A Pool	\$24,734,507	\$34,895	\$34,895	

2019-001 Sign-On Bonuses**a. Condition:**

Our review of compliance and internal control testing in accordance with OMB 2019 Compliance Supplement for Part A. Activities Allowed or Unallowed and Part B. Allowable Cost/Cost Principles questioned \$55,000 of indirect labor signing bonuses claimed in the R&S MOH. In addition, we questioned \$27,197 of the directly associated fringe for total questioned costs of \$82,197. Costs are questioned in accordance with FAR 31.201-3, Determining Reasonableness.

SRC has instituted the practice of awarding sign-on bonuses for applicable new hires which includes a retention stipulation that would require the employee to reimburse SRC for the amount of the signing bonus in the event the employee voluntarily terminates employment within one year of the start date. Our review of SRC's incurred cost submission identified signing bonuses paid to employees outside of the established practice. The applicable offer letters did not include a retention stipulation, and upon further evaluation, these employees were not traditional "new hires." Each of these employees were transitioned to be an SRC employee as part of the recent FY 2019 acquisition. The questioned costs represent indirect costs that pertain to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

We evaluated the claimed costs with the criteria of FAR 31.201-3, Determining Reasonableness, which states, in part:

(a) "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business...." (b) "What is reasonable depends upon a variety of considerations and circumstances, including-- (1) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance; (2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations; (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and (4) Any significant deviations from the contractor's established practices."

We do not consider the \$82,197 questioned amount to be subject to penalty stated at FAR 42.709.

c. Recommendation:

The auditee should adjust the incurred cost submission to exclude as unallowable \$55,000 of signing bonuses and \$27,197 of directly associated fringe from the R&S MOH pool as the costs are not reasonable.

d. SRC's Reaction:

SRC concurs to our findings. SRC's complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.

2019-002 Dues & Subscriptions

a. Condition:

Our review of compliance and internal control testing in accordance with OMB 2019 Compliance Supplement for Part A. Activities Allowed or Unallowed and Part B. Allowable Cost/Cost Principles questioned \$34,895 of indirect dues & subscription costs in the G&A pool and (\$41,298) to the EW laboratory intermediate expense pool. Costs are questioned in accordance with FAR 31.201-3, Determining Reasonableness.

Review of SRC's incurred cost submission identified invoiced dues & subscription costs which were allocated between the EW laboratory intermediate expense pool and a home office expense account. Upon further inquiry and evaluation, we identified that all of the costs for this particular invoice should have been recorded consistently to the EW laboratory intermediate expense pool only. Invoiced costs of \$41,298 were allocated to the home office account which resulted in \$34,895 of home office costs reallocated back to the G&A pool; therefore, we are questioning \$34,895 in the G&A pool and questioning as an upward adjustment the \$41,298 of costs back to the EW laboratory intermediate expense pool. The EW Laboratory intermediate pool allocates costs to the R&S FOH and EW CS FOH pools. Dues & subscription costs were questioned in the amount of (\$23,439) in the R&S FOH and (\$17,859) in the EW CS FOH. The questioned costs represent indirect costs that pertain to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

We evaluated the claimed costs with the criteria of FAR 31.201-3, Determining Reasonableness, which states, in part:

(b) "What is reasonable depends upon a variety of considerations and circumstances, including -- (2) Generally accepted sound business practices, arm's-length bargaining, and Federal and State laws and regulations; (3) The contractor's responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and (4) Any significant deviations from the contractor's established practices."

We do not consider the \$34,895 questioned amount to be subject to penalty stated at FAR 42.709.

c. Recommendation:

The auditee should adjust the incurred cost submission to exclude \$34,895 of home office allocations within the G&A pool and adjust the EW Laboratory intermediate expense pool and the allocations to the R&S FOH and EW CS FOH expense pool in accordance with FAR 31.201-3.

d. SRC's Reaction:

SRC concurs to our findings. SRC's complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.

2019-003 Directly Associated Fringe Costs

a. Condition:

Our review of compliance and internal control testing in accordance with OMB 2019 Compliance Supplement for Part A. Activities Allowed or Unallowed and Part B. Allowable Cost/Cost Principles questioned \$66,241 of fringe costs directly associated with the labor costs for a capital project that were removed from the EW Laboratory intermediate expense pool. Costs are questioned in accordance with FAR 31.201-4, Determining Allocability, and FAR 31.201-6(a), Accounting for Unallowable Costs.

Review of SRC's incurred cost submission identified that labor costs were removed from the salaries account claimed in the EW Laboratory intermediate pool for an employee's labor related to the ARAS capital project. There was no adjustment made to the fringe account in the same pool for these labor costs. As a result, these costs are considered directly associated costs, thus unallocable to the intermediate expense pool. The EW Laboratory intermediate pool allocates costs to the R&S FOH and EW CS FOH pools. Directly associated fringe costs were questioned in the amount of \$37,596 in the R&S FOH and \$28,646 in the EW CS FOH. The questioned costs represent indirect costs that pertain to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

We evaluated the claimed costs with the criteria of FAR 31.201-4, which states the following, in part:

“A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship.”

In addition, FAR 31.201-6(a), states in part:

“Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost that is generated solely as a result of incurring another cost, and that would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.”

We do not consider the \$66,241 questioned amount to be subject to penalty stated at FAR 42.709.

c. Recommendation:

We recommend SRC remove the directly associated fringe costs related to labor costs incurred from the ARAS capital project from the EW Laboratory intermediate expense pool and the allocations to the R&S FOH and EW CS FOH expense pool in accordance with FAR 31.201-4 and FAR 31.201-6(a).

d. SRC's Reaction:

SRC concurs to our findings. SRC's complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.

2. INTERNAL CONTROL OVER COMPLIANCE**2019-004 Internal Control Noncompliance Related to Period of Performance**

a. Condition:

Our review of compliance and internal control testing in accordance with OMB 2019 Compliance Supplement for Part A. Activities Allowed or Unallowed; Part B. Allowable Cost/Cost Principles; and Part H. Period of Performance noted noncompliance with the liquidation of payments.

We identified Federal Awards with performance periods ending during FY 2019, and we tested a sample of transactions recorded during the latter part and after the period of performance to determine if costs were incurred within the period of performance and the liquidation occurred within the allowed time period. We noted the liquidation did not occur within the allowed time period for the following projects:

- US011.01.07: We noted the period of performance ended January 31, 2019, and by the period of performance compliance requirement, the liquidation of payments must occur within 90 days or May 1, 2019. SRC received IOT invoices dated May 3, June 5, July 2, and October 3, 2019. Since all invoices are dated after the required liquidation date, it is not possible for the payment for IOT costs to be completed in the liquidation period outlined in the period of performance compliance requirement. We noted the May, June, and October invoices are for subcontract costs for a billing period of August 3, 2018 through January 31, 2019, and the July invoice is for a FY 2019 rate adjustment for a billing period of October 1, 2018 through January 31, 2019.
- US013.03: We noted the period of performance ended June 30, 2019, and by the compliance requirement the liquidation period ends September 28, 2019, prior to the end of the contractor's FY. The subcontractor submitted an invoice dated July 29, 2019, which was paid with a check dated October 4, 2019. In addition, SRC had to accrue additional subcontract costs for this subcontractor at the FY end as the next invoice received was dated January 28, 2020, or seven months after the end of the period of performance.

Per the OMB 2019 Compliance Supplement, the liquidation must occur no later than 90 days after the end of the period of performance. SRC should be requesting and processing IOT and subcontractor invoices in a timelier manner. We noted SRC's written policy states, "A contract which is cost type or fixed-priced incentive, and requires a settlement of indirect cost rates should be closed within thirty-six (36) months after receiving evidence of physical completion or within a reasonable times after final audit." The thirty-six months is in excess of the period of performance compliance requirement. The procedure causes the contractor to be in noncompliance with the period of performance as the liquidation payment is required within 90 days of the end of the period of performance. The failure to adequately monitor its intercompany and subcontract costs has resulted in a period of performance noncompliance.

In addition, during our reconciliations of the auditee's incurred cost submission, we noted projects which were marked as physically complete in FY 2018 however there were costs in FY 2019. These projects had a period of performance end date of August 30, 2018, and in accordance with the period of performance compliance requirement, the liquidation of payments must occur within 90 days or November 28, 2018. We were informed that the costs were to the IOT accounts for intercompany subcontracts related to FY 2018 for both US009.01.01AA and US009.01.01AB. Our review of the respective invoices noted the majority of the costs for US009.01.01AA are related to FY 2018 rate adjustments. According to SRC, these adjustment vouchers could not be completed until the related entity had audited rates. The related company

has a FY which ends September 30, and the billing rates should have been revised to the final rates in accordance with FAR 52.216-7(e). Therefore, the related company's billing rates should have been revised upon the completion of FY 2018, September 30, 2018, to prevent this underpayment. We note the costs are within the period of performance; however, the liquidation of the payment did not occur within the required 90 day period. In addition, our review of the respective invoices noted the costs for US009.01.01AB are for FY 2018 rate adjustments and lagging subcontract costs. We find the five invoices are dated from February 2019 through October 2019. It appears unreasonable that the intercompany costs are being billed a year after the period of performance had ended. Again, we note costs appear to be within the period of performance; however, the liquidation of the payment did not occur within the required 90 day period. Therefore, the failure to monitor its intercompany costs has led to a period of performance noncompliance. This noncompliance pertains to all Federal Contracts under SRC's R&D cluster. This finding is a repeat finding from the prior period audit. Prior audit finding number is 2018-003.

b. Criteria:

2 CFR Part 200, Part 3.2 Compliance Supplement dated August 2019 for Part H. Period of Performance, which states the following compliance requirements:

“A non-Federal entity may charge to the Federal award only allowable costs incurred during the period of performance and any costs incurred before the Federal awarding agency or pass-through entity made the Federal award that were authorized by the Federal awarding agency or pass-through entity (2 CFR section 200.309).”

“Unless the Federal awarding agency or pass-through entity authorizes an extension, a non-Federal entities must liquidate all obligations incurred under the Federal award not later than 90 calendar days after the end of the date of the period of performance as specified in the terms and conditions of the Federal award (2 CFR section 200.343(b). When used in connection with a non-Federal entity’s utilization of funds under a Federal award, “obligations” means orders placed for property and services, contracts and subawards made, and similar transactions during a given period that require payment by the non-Federal entity during the same or a future period (2 CFR section 200.71).”

2 CFR Part 200, Appendix XI Compliance Supplement dated August 2019 for the requirements of Part A. Activities Allowed or Unallowed; Part B. Allowable Costs/Cost Principles; and Part H. Period of Performance requires us to plan and perform tests of internal control including: information and communication which requires the organization to provide accurate and complete information to appropriate individuals on a timely basis; and monitoring to assess the quality of performance over time and promptly resolve findings. We performed testing to determine if:

Reconciliations and reviews ensure accuracy of reports.

There are established channels of communication between the pass-through entity and sub recipients.

Actions are taken as a result of communications received.

Ongoing monitoring is build-in through independent reconciliations, staff meetings, feedback, rotating staff, supervisory review and management review of reports.

In addition, we evaluated the claimed costs with the criteria of FAR 31.201-2(d), which 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.”

We examined FAR 52.216-7(e), which states in part:

“...Until final annual indirect cost rates are established for any period, the Government shall reimburse the Contractor at billing rates established by the Contracting Officer or by an authorized representative (the cognizant auditor), subject to adjustment when final rates are established. These billing rates –

- (1) Shall be the anticipated final rates; and*
- (2) May be prospectively or retroactively revised by mutual agreement, at either party's request, to prevent substantial overpayment or underpayment.”*

c. Recommendation:

The auditee should strengthen its internal controls to ensure contract costs are liquidated within 90 days after the period of performance or funding period. The auditee should evaluate its process for monitoring subcontractors and IOTs to ensure related invoices are processed for payment in a timely manner and within the required liquidation period. The auditee should evaluate its process for monitoring IOTs to ensure that billing rates are adjusted during and at end of the FY to ensure payment is within the required liquidation period. The auditee should revise its written procedures to ensure the time period for its closing process is in compliance with the period of performance compliance requirement.

d. SRC's Reaction:

SRC agrees in part to this noncompliance. SRC agrees that there were several invoices not paid within the 90 days and will work to strengthen their internal controls to ensure contract costs are liquidated within 90 days of the period of performance. SRC has provided necessary training to all applicable employees and will evaluate their procedures for any necessary changes as it related to the closing process. However, SRC disagrees with recommendation related to the monitoring IOTs to ensure billing rates are adjusted during and at the end of the FY to ensure payment is within the required liquidation period. SRC is in the process of working with the ACO on a resolution and therefore, no further corrective action will be taken related to the indirect rate adjustments pending ACO determination. SRC's complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.

e. Auditor's Response:

SRC states that billing rate adjustments are not included in the definition of obligations. We find that obligations includes orders placed for services and contracts, which would include direct and indirect costs and the adjustment for the rates are therefore also included as they are for the costs incurred during the performance. In addition we note FAR 52.216-7(e) states billing rates are to reflect the anticipated final indirect rates to avoid significant overpayment or underpayment and therefore should be adjusted as required during the year. We note the period of performance compliance requirements states *"Unless the Federal awarding agency or pass-through entity authorizes an extension, a non-Federal entities must liquidate all obligations..."* which indicates that if SRC if unable to liquidate their obligations within the 90 day requirement an extension would be required.

2019-005 Internal Control Noncompliance Related to Facsimile Used on Payments

a. Condition:

Our review of compliance and internal control testing in accordance with OMB Compliance Supplement for Part A. Activities Allowed or Unallowed and Part B. Allowable Costs/Cost Principle noted an internal control deficiency related to use of facsimile for signature approvals.

We performed testing to payments as part of our evaluation of educational benefits claimed in the fringe pool and rent-building, claimed in the Syracuse Building EW Divisional Management intermediate expense pools. We judgmentally selected eight educational benefits invoices and five rent-building invoices for testing. As part of our testing, we examined the payments to determine whether the appropriate approvals were obtained per the contractor's policy. We also identified whether facsimiles were used for approval of the payments. As a result, we identified six educational benefits invoices and two rent-building invoices in which facsimiles were utilized in lieu of the CFO's actual signature for payment approval. The auditee could not produce authorization letters for the use of the facsimile.

Per the contractor's CORP-D-100, Signature Authority Matrix, check signing and EFT/ACH/Wire Funds Transfers may use facsimile for the required signatures. However, the contractor has no written policy or procedure to address the following: who has a facsimile; how many facsimiles are there per person; who is authorized to utilize the facsimile; where the facsimiles are stored; or when it is appropriate to utilize the facsimile. In addition, no authority letters are given to personnel to outline the use of the facsimile. The lack of controls in place for utilizing the facsimile could result in the payments of unauthorized transactions. This noncompliance pertains to all Federal Contracts under SRC's R&D cluster. This noncompliance pertains to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

2 CFR Part 200 – Appendix XI: Uniform Guidance Compliance Supplement dated August 2019 for the requirements of Part A. Activities Allowed or Unallowed and Part B. Allowable Costs/Cost Principles requires us to plan and perform tests of internal control including control environment activities which requires the organization to establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives. We performed testing to determine if:

Policies and procedures are in place to ensure compliance responsibilities are assigned to particular positions.

c. Recommendation:

The auditee should strengthen its internal controls regarding the use of facsimile for signature approvals. The auditee should establish written policies and procedures for the use of facsimile to ensure that only the authorized individuals have access and can utilize the facsimile when given the appropriate approvals.

d. SRC's Reaction:

SRC concurs to our findings. SRC's complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.


SRC, INC.
CERTIFICATE OF FINAL INDIRECT RATES

SRC, Inc.
Schedule N
Certificate of Final Indirect Costs
Fiscal Year Ended September 30, 2019

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 dated February 28, 2020 to establish final indirect cost rates for Fiscal Year October 1, 2018 through September 30, 2019 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: SRC Inc

Signature: 

Name of Certifying Official Philip Fazio

Title Executive Vice President, Finance & CFO

Date of Execution February 28, 2020

**SRC, INC.
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FISCAL YEAR ENDED SEPTEMBER 30, 2019**

(4 Pages)

SRC, Inc.
Uniform Guidance Audit Report: Summary Schedule of Prior Audit Findings
Year Ending September 30, 2018

Finding 2018-001

Summary of Prior Audit Finding:

Home Office Allocation

Recommendation:

The auditee should adjust the incurred cost submission to exclude the \$163,130 from the G&A pool and the \$138,868 from the Material Handling/ Subcontracting pool in accordance with 48 CFR 9904.403, FAR 31.201-2(a)(2), and FAR 31.201-2(a)(3).

Status of Finding:

SRC made the adjustment as recommended by DCAA in our FY18 incurred cost submission.

Finding 2018-002

Summary of Prior Audit Finding:

Internal Control and Compliance Finding Related to CAS 409 Noncompliance

Recommendation:

SRC should review its policies and procedures related to capital assets, dispositioning of assets, and record retention of those assets. We also recommend the auditee establish procedures to ensure that the useful life is periodically evaluated and update the useful lives, if necessary, to be in compliance with CAS 409. Furthermore, we recommend that the auditee train appropriate employees on the updated policies and procedures to ensure compliance with its updated policies and procedures.

Status of Finding:

SRC agrees with the non-compliance and is reviewing current policies and procedures to ensure adequate records as required by 48 CFR 9904.409.50(e)(1) and -50(e)(2) exist to support the Company's estimated useful lives for tangible asset categories, as represented by the useful lives matrix. As part of this review, the Company is verifying the existence of fully depreciated tangible assets that have not been withdrawn from use or disposed of in the accounting system and review useful lives of select assets actively being depreciated. Once complete, SRC will update its policies and procedures to incorporate the periodic analysis and review of our useful lives matrix to analyze if any adjustments are required. Additionally, SRC will educate relevant employees on the proper custody and record keeping of capital assets to ensure practice aligns with current policies and procedures in order to support the average age of retirement, or withdrawal from active use (and retention for standby or incidental use) for each asset class.

Finding 2018-003**Summary of Prior Audit Finding:**

Internal Control and Compliance Finding Related to Period of Performance

Recommendation:

The auditee should strengthen its internal controls to ensure contract costs are liquidated within 90 days after the period of performance. The auditee should evaluate, and revise as necessary, its process for monitoring purchase orders to ensure related invoices are processed for payment in a timely manner and within the required liquidation period. The auditee should evaluate, and revise as necessary, its process for monitoring IOTs to ensure that billing rates are adjusted at the end of the fiscal year to ensure payment is within the required liquidation period.

Status of Finding:

SRC partially agreed with the non-compliance as noted by DCAA. We agreed that the one subcontract invoice in question was not paid within 90 days. As it relates to this portion of the finding, SRC will evaluate our processes and ensure applicable employees are educated by the end of the fiscal year.

However, we disagree with DCAA's interpretation of this period of performance compliance requirement as it relates to indirect billing rates. Per the compliance requirement, the auditee is required to liquidate all obligations incurred not later than 90 days after the period of performance end date. SRC does not believe that billing rate adjustments meet the definition of an "obligation" as defined in 2 FR section 200.71. "Obligation" means "orders placed for property and services, contracts and subawards made, and similar transactions." This definition does not include indirect cost rate adjustments. In addition, even if billing rates were adjusted at the end of the fiscal year as DCAA suggests, this would not ensure that payment was within the required liquidation period as not all contracts have a period of performance end date that coincides with our fiscal year end. Furthermore, billing rates adjusted at the end of the fiscal year are not final audited rates. SRC must wait for those to be audited before final indirect rate adjustments could be made which would mean that for many contracts, final indirect rate adjustments would be made well after the period of performance end date. Under DCAA's interpretation of the term "obligation," SRC would never be in compliance with this requirement.

Finding 2018-004**Summary of Prior Audit Finding:**

Internal Control and Compliance Finding Related to Documentation of Price Analyses

Recommendation:

The auditee should comply with its policy and procedures as indicated in SPP8.1 to ensure adequate price analyses and commercial item determination are in accordance with FAR 2.101 and supports the costs are fair and reasonable per FAR 31. The auditee should document and demonstrate noncompetitive suppliers for subcontract services. Noncompetitive evaluations should explain unique factors of supplier, such as determinations that the item or service is only available from one source.

Status of Finding:

SRC agrees that it should follow its policies and procedures related to price analysis and noncompetitive justifications and that it can enhance its current practices by including more information in its price analysis and noncompetitive justification documentation. Management conducted training with its procurement staff on both of these topics on June 27, 2019. SRC disagreed with DCAA's interpretation of FAR 15.403-1 related to commercial item determinations. This has been reviewed by our ACO who has agreed that SRC is responsible for making the commercial determination for subcontracts, therefore no further corrective action is warranted for this item.

Finding 2018-005**Summary of Prior Audit Finding:**

Internal Control and Compliance Finding Related to Incentive Compensation

Recommendation:

The auditee should evaluate its allocation of incentive compensation costs to ensure costs are allocated based on the relative benefit received and in compliance with the auditee's policies and procedures.

Status of Finding:

SRC reviewed the allocation of incentive compensation to ensure all applicable entities are appropriately sharing in the costs. In addition, SRC has updated its disclosure statement (revision 19 submitted 8/9/19) to move incentive compensation costs from fringe into the overhead of each participating employee. This will ensure that incentive compensation for home office employee is adequately shared across all applicable companies.

SRC, Inc.
Uniform Guidance Audit Report: Summary Schedule of Prior Audit Findings
Year Ending September 30, 2017

Finding 2017-007

Summary of Prior Audit Finding:

Internal Control and Compliance Findings Related to Proper Execution of Purchase Orders

Recommendation:

The auditee should comply with its policies and procedures with regard to ensuring only approved employees (or those with appropriate delegations) execute approved purchase orders.

Status of Finding:

SRC enhanced its current process to ensure delegation of authority is clearly defined by revising the language included on the buyer's checklist and the IPO approval form. This update allows the subcontracts manager to delegate authority upon completing his review of a PO file.

Finding 2017-008

Summary of Prior Audit Finding:

Internal Control and Compliance Findings Related to Timely Submission of Subcontract Vouchers

Recommendation:

The auditee should develop adequate policies and procedures to document the process to be used to monitor the timely submission of adjustment vouchers by subcontracts to ensure that only allowable costs are included in billings and proposals to the auditee. Furthermore, the auditee should identify all open cost-type subcontracts and immediately contact those subcontractors to determine all necessary adjustments and make those adjustments.

Status of Finding:

SRC reviewed our policies and procedures and as a result made changes (SPP 5.1) to document the process for monitoring the timely submission of vouchers by subcontractors. This new process was effective January 2019.

**SRC, INC.
CORRECTIVE ACTION PLAN FOR THE CURRENT YEAR**

(2 Pages)

SRC Inc.
Management's Views and Corrective Action Plan Regarding Uniform Guidance Audit
Findings for the
Year Ending September 30, 2019

Finding 2019-001

SRC has made the adjustment as recommended by DCAA in our FY19 incurred cost submission.

Contact Person Responsible for Corrective Action: Danielle Chabot, Director, Compliance
Completion Date: The adjustment to the incurred cost submission has been completed.

Finding 2019-002

SRC has made the adjustment as recommended by DCAA in our FY19 incurred cost submission.

Contact Person Responsible for Corrective Action: Danielle Chabot, Director, Compliance
Completion Date: The adjustment to the incurred cost submission has been completed.

Finding 2019-003

SRC has made the adjustment as recommended by DCAA in our FY19 incurred cost submission.

Contact Person Responsible for Corrective Action: Danielle Chabot, Director, Compliance
Completion Date: The adjustment to the incurred cost submission has been completed.

Finding 2019-004

SRC partially agrees with the non-compliance as noted by DCAA. We agree that there were several invoices which were not paid within 90 days and that we can work to strengthen our internal controls to ensure contract costs are liquidated within 90 days of the period of performance. As it relates to this portion of the finding, SRC has provided necessary training to all applicable employees and will evaluate our procedures for any necessary changes as it relates to the closing process.

However, we respectfully disagree with DCAA's recommendation that we evaluate our process for monitoring IOTs to ensure that billing rates are adjusted during and at the end of the fiscal year to ensure payment is within the required liquidation period. While we are not disputing the need to submit adjustment vouchers in a timely manner, it is the statement "within the required liquidation period" that we take exception to as we do not agree with their interpretation of this period of performance compliance requirement as it relates to indirect billing rates. Per the compliance requirement, the auditee is required to liquidate all obligations incurred not later than 90 days after the period of performance end date. SRC

does not believe that billing rate adjustments meet the definition of an “obligation” as defined in 2 FR section 200.71. “Obligation” means “orders placed for property and services, contracts and subawards made, and similar transactions.” This definition does not appear to include indirect rate adjustments which we believe would not become an “obligation” until they were finalized. Requiring a contractor to include rate adjustment invoices in this definition will create a constant finding which can never be remedied. For example, in DCAA’s first example, project number US011.01.07 had a period of performance end date of January 31, 2019. SRC and its subsidiaries have a fiscal year end date of September 30, 2019. The earliest that rate adjustments could be available for billing would be November 2019, however this is nine months after the period of performance end date which is clearly outside of the 90-day window. This would be the case for many of our subcontractors working on our programs as well. By interpreting this regulation to include rate adjustments, DCAA creates a situation where there is no possible way to ever put corrective action in place that would satisfy their expectation and interpretation. In addition, in the specific example provided by DCAA in their finding, the July invoice (for US011.01.07) was for a FY2019 rate adjustment for the billing period of October 1, 2018 through January 31, 2019 and was completed as a result of DCAA issuing revised billing rates for SRCTec on June 11, 2019. Note that this adjustment was completed immediately after the receipt of the revised rates, however this date is outside of the 90-day period (which per DCAA’s report would have expired on May 1, 2019). We had no ability to bill for that adjustment prior to July further emphasizing our point that by including rate adjustments in the interpretation of this regulation, DCAA is expecting us to be in continual non-compliance.

SRC does recognize that we do not always submit rate adjustment invoices immediately at the end of a fiscal year, however per conversation with our ACO, this process is acceptable as we submit and are audited on our final rates only a few months later. Even if we were to agree to complete rate adjustments at the close of each fiscal year, we would need to adjust again when the rates were considered audited and final, which would always be outside of the 90-day window. Again, as a result of DCAA’s interpretation of the term “obligation,” SRC could never be in compliance. SRC is in the process of working with our ACO on a resolution; therefore, no further action will be taken relative to indirect rate adjustments pending ACO determination.

Contact Person Responsible for Corrective Action: Danielle Chabot, Director, Compliance
Completion Date: SRC educated all applicable employees in May 2020 related to this 90-day liquidation requirement and we will evaluate our procedures as they relate to the closing process by September 30, 2020. As it relates to the indirect rate adjustments, no further action will be taken pending ACO determination.

Finding 2019-005

SRC will review internal controls surrounding signature approvals for cash disbursements and use of facsimile and make any necessary updates to our policies and procedures.

Contact Person Responsible for Corrective Action: Lisa Kennedy, Senior Manager, Corporate Controller
Completion Date: SRC will complete their review of internal controls and any related policy or procedure update by June 30, 2020.

SRC, Inc.
North Syracuse, NY

Summary Schedule of Claimed Expenditures by Federal Sponsor
For Fiscal Year Ended September 30, 2019

Major Program-R&D Cluster	Federal	Expenditures		
	CFDA Numbers	Direct *	Pass-Through	Total
Department of Defense:				
Department of the Air Force	12	\$54,864,229	\$9,065,096	\$63,929,325
Department of the Army	12	59,652,793	23,200,419	82,853,213
Department of the Navy	12	4,126,029	2,819,786	6,945,815
Department of the Marines	12	594,270	75,463	669,732
National Security Agency	12		197,591	197,591
Defense Intelligence Agency	12		82,942	82,942
Defense Advanced Research Projects Agency	12	8,872,834		8,872,834
Defense Threat Reduction Agency	12	904,101	4,746,460	5,650,561
National Reconnaissance Organization	12	966,310	1,412,786	2,379,095
Defense Logistics Agency	12		7,017	7,017
Office of the Secretary of Defense	12		155,912	155,912
Other Contracts	12	2,508,796		2,508,796
Total Department of Defense		\$132,489,361	\$41,763,472	\$174,252,833
Other Federal Agencies				
Environmental Protection Agency	66	\$6,303,944	\$1,336,247	\$7,640,191
Department of Health and Human Services	93	1,322,566		1,322,566
Department of Homeland Security	97	17,879	76,263	94,142
Department of State	19		231,700	231,700
Department of Transportation	20		391,131	391,131
Department of Energy	81		8,168	8,168
National Aeronautics and Space Administration	43	26,864	7,274	34,138
Office of the Director of National Intelligence	12		141,279	141,279
Total Other Federal Agencies		\$7,671,253	\$2,192,061	\$9,863,314
Total Federal Awards		\$140,160,614	\$43,955,533	\$184,116,147

**Minor differences due to rounding*