



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, 2020

**SRC, Inc.**

**Report on Federal Awards in Accordance with the Uniform Guidance**

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## SRC, Inc. and Subsidiaries

Consolidated Financial Statements,  
Independent Auditor's Report and Reports  
Required by *Government Auditing Standards*  
and the Uniform Guidance  
Years Ended September 30, 2020 and 2019

## **SRC, Inc. and Subsidiaries**

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Consolidated Financial Statements, Independent Auditor's Report and  
Reports Required by *Government Auditing Standards* and the  
Uniform Guidance  
Years Ended September 30, 2020 and 2019

# SRC, Inc. and Subsidiaries

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## **Independent Auditor's Report**

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

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of SRC, Inc. and Subsidiaries (SRC or the Company), which comprise the consolidated statement of financial position as of September 30, 2020, 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.

#### ***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 audit. We conducted our audit in accordance with 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. 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.

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### ***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, 2020, and the changes in their net assets and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Other Matters***

#### ***Supplemental information***

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, as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis 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 the 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 information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 15, 2020, on our consideration of the Company's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Company's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

*BDO USA, LLP*

McLean, Virginia

December 15, 2020, except for the schedule of expenditures  
of federal awards and Notes 7, 10 and 13, for which the date is June 25, 2021



## **Consolidated Financial Statements**

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# SRC, Inc. and Subsidiaries

## Consolidated Statements of Financial Position

<i>September 30,</i>	2020	2019
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 18,822,524	\$ 27,709,467
Investments	176,574,188	180,624,594
Accounts receivable, net of reserve for uncollectible accounts of \$171,297 and \$201,381 for 2020 and 2019, respectively	52,133,805	29,902,847
Contract assets	31,141,309	33,800,453
Inventory, net	78,396,410	71,103,751
Deferred contract costs	8,308,407	6,208,268
Prepaid expenses and other assets	9,138,235	11,339,252
<b>Total current assets</b>	<b>374,514,878</b>	<b>360,688,632</b>
Property, buildings and equipment, net	70,194,017	56,703,293
Other assets	5,884,400	5,720,485
Goodwill, net	3,759,389	5,351,070
Deferred income taxes	1,792,338	2,515,530
<b>Total assets</b>	<b>\$ 456,145,022</b>	<b>\$ 430,979,010</b>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities</b>		
Lines-of-credit	\$ 25,980,827	\$ 5,994,052
Accounts payable	10,935,871	17,377,195
Accrued expenses	27,109,556	27,421,688
Contract liabilities	10,580,070	10,116,164
Long-term debt - current portion	1,232,500	1,182,500
<b>Total current liabilities</b>	<b>75,838,824</b>	<b>62,091,599</b>
Long-term debt, net of current portion and unamortized debt issuance costs	9,332,000	10,538,500
Other long-term liabilities	15,960,259	9,239,912
<b>Total liabilities</b>	<b>101,131,083</b>	<b>81,870,011</b>
<b>Net assets without donor restrictions</b>	<b>355,013,939</b>	<b>349,108,999</b>
<b>Total liabilities and net assets</b>	<b>\$ 456,145,022</b>	<b>\$ 430,979,010</b>

*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>	2020	2019
<b>Operating activities</b>		
Revenue	\$ 374,681,238	\$ 380,945,023
<b>Costs of revenue</b>		
Direct costs	223,730,674	244,167,792
Indirect expenses	94,812,903	83,326,906
Administrative expenses	58,496,121	53,222,499
<b>Total operating expenses</b>	<b>377,039,698</b>	<b>380,717,197</b>
<b>Change in net assets from operations</b>	<b>(2,358,460)</b>	<b>227,826</b>
<b>Non-operating activities</b>		
Net investment return	9,449,249	4,541,577
Interest expense	(1,115,249)	(1,302,989)
Other income (expense), net	302,378	(978,550)
Foreign currency translation adjustment	304,957	(345,634)
Postretirement benefits adjustment	(420,896)	(494,285)
<b>Total non-operating activities, net</b>	<b>8,520,439</b>	<b>1,420,119</b>
<b>Change in net assets before provision for income taxes</b>	<b>6,161,979</b>	<b>1,647,945</b>
Provision for income taxes	(1,154,155)	(2,053,507)
<b>Change in net assets after provision for income taxes</b>	<b>5,007,824</b>	<b>(405,562)</b>
<b>Net assets at the beginning of the year</b>	<b>349,108,999</b>	<b>349,514,561</b>
Cumulative effect of accounting policy change	897,116	-
<b>Net assets at the end of the year</b>	<b>\$ 355,013,939</b>	<b>\$ 349,108,999</b>

*See accompanying notes to the consolidated financial statements.*

# SRC, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

Years Ended September 30,	2020	2019
<b>Cash flows from operating activities:</b>		
Change in net assets	\$ 5,007,824	\$ (405,562)
Adjustments to reconcile change in net assets to net cash and cash equivalents (used in) provided by operating activities:		
Depreciation and amortization	9,499,303	7,352,513
Change in inventory reserve	1,702,428	(87,224)
Realized and unrealized (gain) loss on investments	(4,929,000)	1,405,000
Change in deferred income taxes	723,192	1,722,547
Changes in operating assets and liabilities:		
Accounts receivable	(22,230,958)	(3,398,571)
Contract assets	5,752,389	(7,677,759)
Inventory	(8,995,087)	(1,495,557)
Deferred contract costs	(7,519,457)	4,416,885
Prepaid expenses and other assets	1,482,372	(3,043,575)
Accounts payable, accrued expenses, and other liabilities	(33,109)	5,831,365
Contract liabilities	3,687,095	1,459,377
<b>Net cash and cash equivalents (used in) provided by operating activities</b>	<b>(15,853,008)</b>	<b>6,079,439</b>
<b>Cash flows from investing activities:</b>		
Cash paid for acquisition	-	(4,241,905)
Purchases of investments	(39,986,407)	(22,981,029)
Sales of investments	48,965,813	35,254,267
Proceeds from sale of property, buildings, and equipment	1,129,980	-
Expenditures for property, buildings, and equipment	(21,973,596)	(16,551,705)
<b>Net cash and cash equivalents used in investing activities</b>	<b>(11,864,210)</b>	<b>(8,520,372)</b>
<b>Cash flows from financing activities:</b>		
Net borrowings (repayments) under bank lines-of-credit	19,986,775	(6,013,653)
Repayments made under long-term debt	(1,156,500)	(1,132,500)
<b>Net cash and cash equivalents provided by (used in) financing activities</b>	<b>18,830,275</b>	<b>(7,146,153)</b>
Decrease in cash and cash equivalents	(8,886,943)	(9,587,086)
Cash and cash equivalents at beginning of year	27,709,467	37,296,553
<b>Cash and cash equivalents at end of year</b>	<b>\$ 18,822,524</b>	<b>\$ 27,709,467</b>
<b>Supplemental disclosure of cash flow information:</b>		
Interest paid	\$ 1,116,043	\$ 1,300,882
Income taxes paid	\$ 680,255	\$ 586,573

*See accompanying notes to the consolidated financial statements.*

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### 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. As of September 30, 2020, included in Ventures are its wholly owned for-profit subsidiaries: SRCTec, LLC (SRCTec) and SAZE Technologies, LLC (SAZE). As of September 30, 2019, included in Ventures were its wholly owned for-profit subsidiaries: SRCTec, LLC (SRCTec), SAZE Technologies, LLC (SAZE), and SRC Commercial Holdings, Inc. (Commercial Holdings). Included in Commercial Holdings was its wholly-owned for-profit subsidiary: Acumen Detection, LLC (Acumen). 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 UK 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 denominated transactions are included as a component of costs of revenue in the accompanying consolidated statements of activities and change in net assets.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### *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*

On October 1, 2019, the Company adopted Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, using the modified retrospective method applied to those contracts that were not substantially complete as of October 1, 2019. ASC 606 outlines a five-step model whereby revenue is recognized as performance obligations within the contract are satisfied. The Company's performance obligations are satisfied over time as work progresses or at a point in time. ASC 606 also requires new, expanded disclosures regarding revenue recognition. The Company recognized the cumulative effect of adopting ASC 606 as an increase to the 2019 opening balance of net assets in the amount of approximately \$897,000, with the impact primarily related to fixed-price contracts. Results for reporting periods beginning after October 1, 2019 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in accordance with ASC 605, *Revenue Recognition*. The impact of applying this guidance for the year ended September 30, 2019 primarily resulted in an increase in revenue of approximately \$6,316,000. See the Recently Adopted Authoritative Guidance section for further details.

The Company's revenues from contracts with customers are derived from offerings that include sales of products, engineering and research and development services substantially with the U.S. government and its agencies, and to a lesser extent, subcontractors. Generally, the Company provides services and products under various contract types which are determined by or negotiated with the U.S. government and may depend on certain factors, including the type and complexity of the work to be performed, degree and timing of the responsibility to be assumed by the contractor for the costs of performance and the extent of price competition and the amount. The Company generates revenues under several types of contracts, including the following:

- **Cost-Reimbursable Contracts:** Cost-reimbursable contracts provide for the payment of allowable costs incurred during performance of the contract, up to a ceiling based on the amount that has been funded, plus a fixed or award fee.
- **Time-and-Materials (T&M) Contracts:** Under T&M contracts, the Company charges a fixed hourly rate for each direct labor hour expended and is reimbursed for billable materials costs and billable out-of-pocket expenses, inclusive of allocable indirect costs. The Company assumes the financial risk on T&M contracts as costs of performance may exceed negotiated hourly rates.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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- **Fixed-Price-Level-of-Effort (FP-LOE) Contracts:** Substantially similar to T&M contracts except such contracts require a specified level of effort over a stated period of time. This type of contract is generally used when the contractor is required to perform an investigation or study in a specific research and development area and to provide a report demonstrating the results achieved based on the level of effort. Payment is based on the effort expended rather than the results achieved.
- **Firm-Fixed-Price (FFP) Contracts:** Provide for a fixed price for specified products, systems and/or services. This type of contract is generally used when the government acquires products and services on the basis of reasonably definitive specifications and which have a determinable fair and reasonable price. These contracts offer potential increased profits if the Company can complete the work at lower costs than planned. While FFP contracts allow a benefit from cost savings, these contracts may also increase the Company's exposure to the risk of cost overruns.

The Company's earnings and profitability may vary materially depending on changes in the proportionate amount of revenues derived from each type of contract and the nature of services or products provided is finally determined.

The Company recognizes revenue over time when there is a continuous transfer of control to the customer and, when applicable, no alternative use of the units in production. For U.S. government contracts, this continuous transfer of control to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay for costs incurred plus a reasonable profit and take control of any work in process. When control is transferred over time, revenue is recognized based on the extent of progress towards completion of the performance obligation. Based on the nature of the products and services provided in the contract, the Company uses judgment to determine if an input measure or output measure best depicts the transfer of control over time. For service contracts, the Company typically satisfies performance obligations as services are rendered. The Company typically uses a cost-based input method to measure progress. Revenue is recognized proportionally as contract costs are incurred plus estimated fees. For T&M contracts, the Company bills the customer per labor hour and per material, and revenue is recognized in the amount invoiced as the amount corresponds directly to the value of performance to date. For certain fixed-price service contracts, a time-elapsed output method is used to measure progress, and revenue is recognized straight-line over the term of the contract.

If a contract does not meet the criteria for recognizing revenue over time, revenue is recognized at a point in time. Revenue is recognized at the point in time when control of the good or service is transferred to the customer. The Company considers control to be transferred when it has a present right to payment and the customer has legal title.

Contract modifications are routine in the performance of contracts. Contracts are often modified to account for changes in contract specifications or requirements. In most instances, contract modifications are for goods or services that are not distinct and, therefore, are accounted for as part of the existing contract.

Accounting for long-term contracts involves the use of various techniques to estimate total contract revenue and costs. Contract estimates are based on various assumptions to project the outcome of future events that often span several years. These assumptions include labor productivity and availability, the complexity of the work to be performed, the cost and availability of material, the performance of subcontractors and the availability and timing of funding from the customer. When

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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estimates of total costs to be incurred on a contract exceed total estimates of the transaction price, a provision for the entire loss is determined at the performance obligation level and is recorded in the period in which the loss is determined.

### *Performance obligations*

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation within that contract and recognized as revenue when, or as, the performance obligation is satisfied. The majority of the Company's contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and is, therefore, not distinct. Some contracts have multiple performance obligations, most commonly due to the contract covering multiple phases of the product lifecycle (development, production, maintenance and support). For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation using management's best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which the Company forecasts expected costs of satisfying a performance obligation and then adding an appropriate margin for that distinct good or service.

For arrangements with the U.S. Government, work on contracts generally does not begin until funding is appropriated by the customer. Billing timetables and payment terms on contracts vary based on a number of factors, including the contract type. Typical payment terms under fixed-price contracts with the U.S. Government provide that the customer pays when ownership transfers. The Company recognizes a liability for payments in excess of revenue recognized, which is presented as a contract liability on the accompanying consolidated statements of financial position. The portion of payments retained by the customer until final contract settlement is not considered a significant financing component because the intent is to protect the customer from the Company's failure to adequately complete some or all of the obligations under the contract. Payments received from customers in advance of revenue recognition are not considered to be significant financing components because they are used to meet working capital demands that can be higher in the early stages of a contract.

### *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 recognize revenue at a point in time due to the Company having an alternative use for the units in production and for which the units have not 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.



# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### *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. The Company does not have any net assets with donor restrictions as of September 30, 2020 and 2019.

### *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, 2020, and investments held under the deferred compensation plan are classified as noncurrent other assets.

### *Accounts receivable, contract assets and contract liabilities*

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. 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 accounts 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.

Contract assets represent costs and anticipated profits not yet billed or awaiting milestones to bill.

Contract liabilities 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.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### *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, buildings 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

### *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 reduction in the fair value. No indicators of impairment were identified as of September 30, 2020 and 2019.

### *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, 2020 and 2019.

### *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 \$964,000 and \$1,344,000 of unamortized capitalized software as of September 30, 2020 and 2019, respectively. Amortization expense of approximately \$380,000 and \$340,000 was recorded for the years ended September 30, 2020 and 2019, 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 \$1,719,000 of other intangible assets relating to a

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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customer list with accumulated amortization of approximately \$516,000 and \$379,000 at September 30, 2020 and 2019, respectively. Amortization expense of approximately \$137,000 and \$90,000 was recorded for the years ended September 30, 2020 and 2019, respectively.

### *Research and development*

Research and development costs are expensed in the year incurred. These costs totaled approximately \$15,791,000 and \$19,787,000 for the years ended September 30, 2020 and 2019, 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 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, 2020 or 2019. 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, 2017 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, 2016 and prior.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### *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.

**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.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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

<i>Description</i>	As of September 30, 2020			
	Assets Measured At Fair Value	Fair Value Hierarchy Level		
		Level 1	Level 2	Level 3
<b>Investments:</b>				
Money market funds	\$ 3,408,000	\$ 3,408,000	\$ -	\$ -
Commercial paper	440,000	440,000	-	-
Mutual funds	117,379,000	117,379,000	-	-
Fixed income funds	1,045,000	-	1,045,000	-
Equity funds and ETF	60,470,000	60,470,000	-	-
	\$ 182,742,000	\$ 181,697,000	\$ 1,045,000	\$ -

<i>Description</i>	As of September 30, 2019			
	Assets Measured At Fair Value	Fair Value Hierarchy Level		
		Level 1	Level 2	Level 3
<b>Investments:</b>				
Money market funds	\$ 18,554,000	\$ 18,554,000	\$ -	\$ -
Commercial paper	333,000	333,000	-	-
Mutual funds	133,545,000	133,545,000	-	-
Fixed income funds	1,099,000	-	1,099,000	-
Equity funds and ETF	48,151,000	48,151,000	-	-
	\$ 201,682,000	\$ 200,583,000	\$ 1,099,000	\$ -

Of the above total investments for the years ended September 30, 2020 and 2019, approximately \$3,324,000 and \$18,511,000, respectively, is included in cash and cash equivalents; approximately \$176,574,000 and \$180,625,000, respectively, is classified as investments; and approximately \$2,844,000 and \$2,546,000, respectively, relates to assets held in the 457(b) Plan, 457(f) Plan and Deferred Compensation Plan (see Note 10) 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.

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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Interest and dividend income and net realized and unrealized gains on investments were approximately \$9,449,000 and \$4,542,000, respectively, for the years ended September 30, 2020 and 2019. Of this amount, approximately \$4,520,000 and \$5,947,000, respectively, represents interest and dividend income and approximately \$4,929,000 and \$(1,405,000), respectively, represents realized and unrealized gains (losses) for the years ended September 30, 2020 and 2019.

### ***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.

### ***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, 2020 approximate \$15,612,000. 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.

## SRC, Inc. and Subsidiaries

### Notes to the Consolidated Financial Statements

Expenses by their functional and natural classification are as follows for the year ended September 30, 2020 (rounded to nearest thousand):

<i>Natural classification</i>	Program		Support	Total
	Research and Development	Manufacturing	Administrative	
Salaries and benefits	\$ 115,816,000	\$ 27,921,000	\$ 44,485,000	\$ 188,222,000
Subcontracts	8,412,000	18,293,000	-	26,705,000
Direct materials	10,255,000	74,936,000	-	85,191,000
Facilities and overhead	3,034,000	2,863,000	1,542,000	7,439,000
Research and development	6,441,000	6,077,000	3,273,000	15,791,000
Interest expense	455,000	429,000	231,000	1,115,000
Other	9,832,000	15,013,000	28,847,000	53,692,000
<b>Total</b>	<b>\$ 154,245,000</b>	<b>\$ 145,532,000</b>	<b>\$ 78,378,000</b>	<b>\$ 378,155,000</b>

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

<i>Natural classification</i>	Program		Support	Total
	Research and Development	Manufacturing	Administrative	
Salaries and benefits	\$ 110,297,000	\$ 25,703,000	\$ 34,402,000	\$ 170,402,000
Subcontracts	3,074,000	19,946,000	-	23,020,000
Direct materials	6,497,000	96,265,000	-	102,762,000
Facilities and overhead	8,971,000	10,156,000	4,169,000	23,296,000
Research and development	7,620,000	8,626,000	3,541,000	19,787,000
Interest expense	502,000	568,000	233,000	1,303,000
Other	10,152,000	5,276,000	26,022,000	41,450,000
<b>Total</b>	<b>\$ 147,113,000</b>	<b>\$ 166,540,000</b>	<b>\$ 68,367,000</b>	<b>\$ 382,020,000</b>

The total functional expenses shown above are a summation of total operating expenses and interest expense from the consolidated statements of activities and change in net assets.

#### ***Recently adopted authoritative guidance***

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 (ASC 606) and related amendments, which superseded all prior revenue recognition methods and industry-specific guidance. The core principle of ASC 606 is an entity should recognize revenue to depict the transfer of control for promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying the revenue principles, an entity is required to identify the contract(s) with a customer, identify the performance obligations, determine the transaction price, allocate the transaction price to the performance obligations and recognize revenue when the performance

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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obligation is satisfied (i.e., either over time or point in time). ASC 606 further requires that companies disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

ASC 606 provided companies an option of two transition methods: the full retrospective method, in which case the standard would be applied to each prior reporting period presented and the cumulative effect of applying the standard would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The ASU was effective for annual reporting periods beginning after December 15, 2018. In June 2020, the effective date of the ASU was extended an additional twelve months, though the Company elected to adopt in fiscal year 2020.

In adopting ASC 606, the Company elected to use certain practical expedients permitted by the standard including using the portfolio approach where contracts with similar characteristics were assessed collectively to evaluate risk over the impact of ASC 606. The Company also elected to adopt the right-to-invoice practical expedient on certain cost-reimbursable contracts where the Company recognizes revenues as it is contractually able to invoice the customer based on the control transferred to the customer.

The following table summarizes the results the adoption of the ASU had on the consolidated statements of financial position as of October 1, 2019 (rounded to the nearest thousand):

	As previously reported	Impact of ASC 606	As adjusted
Contract assets	\$ 33,800,000	\$ 3,093,000	\$ 36,893,000
Deferred contract costs	6,208,000	(5,419,000)	789,000
<b>Total assets</b>	<b>\$ 430,979,000</b>	<b>\$ (2,326,000)</b>	<b>\$ 428,653,000</b>
Contract liabilities (billings in excess of revenue recognized)	\$ 10,116,000	\$ (3,223,000)	\$ 6,893,000
Total liabilities	81,870,000	(3,223,000)	78,647,000
Net assets without donor restrictions	349,109,000	897,000	350,006,000
<b>Total liabilities and net assets</b>	<b>\$ 430,979,000</b>	<b>\$ (2,326,000)</b>	<b>\$ 428,653,000</b>

The adjustment primarily relates to the change in recognition of certain fixed-price contracts from a point-in-time method under the previous guidance to an over-time method under the new guidance.

In June 2018, the FASB issued ASU 2018-08, *Not-for-Profit Entities (Topic 958), Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made*. This ASU was issued to standardize how grants and other contracts received and made are classified across the sector, as either an exchange transaction or a contribution. The standard provides guidance to assist in the determination of whether a transaction is a contribution or an exchange transaction. If the transaction is deemed to be a contribution, the guidance provides factors to consider with regard to whether the contribution is conditional or unconditional. For contributions received, if



# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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determined to be an unconditional contribution, the determination will then need to be made as to whether the contribution is restricted. The ASU assists in the determination of the nature of the transaction which will then govern the revenue and expense recognition methodology and timing of the transaction. The ASU is effective for transactions in which the Company serves as the resource recipient beginning on October 1, 2019. The effect of ASU 2018-08 was examined in conjunction with ASC 606, and the adoption of ASU 2018-08 did not have an effect on the Company's consolidated financial statements as it was determined that substantially all active contracts held by the Company qualified as exchange transactions and therefore follow ASC 606.

The Company adopted ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 is intended to reduce diversity in practice in how certain cash receipts and cash payments are presented and classified in the consolidated statement of cash flows by providing guidance on eight specific cash flow issues. The ASU became effective for private companies for annual periods beginning after December 31, 2018, and for interim periods beginning after December 31, 2019, with early adoption permitted. The adoption of the ASU did not have a material effect on the Company's statements of cash flows in 2020.

### ***Recent accounting pronouncements not yet adopted***

In February 2016, the FASB issued ASU 2016-02, *Leases*, amending the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. The new leases standard was subsequently updated by ASUs 2018-01, 2018-10, 2018-11, 2018-20, 2019-01, 2019-10 and 2020-05. The new lease standard provides lessors with a practical expedient, by class of underlying asset, to elect not to separate nonlease components from the associated lease component and, instead, to account for those components as a single component if the nonlease components otherwise would be accounted for under the new revenue guidance (ASC 606) and both the timing and pattern of transfer of the nonlease component(s) and associated lease component are the same, and the lease component, if accounted for separately, would be classified as an operating lease. If the nonlease component or components associated with the lease component are the predominant component of the combined component, an entity is required to account for the combined component in accordance with ASC 606. Otherwise, the entity must account for the combined component as an operating lease in accordance with ASC 842. On November 15, 2019, the FASB issued an ASU to extend the effective date for calendar-year private companies to annual periods beginning after December 15, 2020. On June 3, 2020, the FASB voted unanimously to further defer the effective date for implementation of this standard for an additional twelve months. The revised effective date for private companies is for annual periods beginning after December 15, 2021. Earlier application is permitted for all entities. The Company will evaluate the effect that adoption of this new standard will have on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, which eliminates the requirement that a credit loss on a financial instrument be "probable" prior to recognition. Instead, a valuation allowance will be recorded to reflect an entity's current estimate of all expected credit losses, based on both historical and forecasted information related to an instrument. The update is effective for private business entities for annual and interim reporting periods beginning after December 15, 2022, and should be adopted using a modified retrospective approach, which applies a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. A prospective approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date and loans and debt securities acquired

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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with deteriorated credit quality. Early adoption is permitted. The Company will evaluate the effect that adoption of this new standard will have on the Company's consolidated 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.

The Company has assessed other accounting pronouncements issued or effective during the years ended September 30, 2020 and 2019 and deemed they were not applicable to the Company or are not anticipated to have a material effect on the consolidated financial statements.

### 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.

### 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):

	2020	2019
Financial assets at year-end:		
Cash and cash equivalents	\$ 18,823,000	\$ 27,709,000
Accounts receivable	52,134,000	29,903,000
Contract assets	31,141,000	33,800,000
Total financial assets	\$ 102,098,000	\$ 91,412,000

The Company's budgeting model includes the input from various departments, including 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):

	2020	2019
Work-in-progress and finished goods	\$ 33,750,000	\$ 20,943,000
Purchased parts	44,646,000	50,161,000
	\$ 78,396,000	\$ 71,104,000

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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As of September 30, 2020 and 2019, the Company recorded reserves for excess or obsolete inventory of approximately \$4,394,000 and \$2,692,000, respectively, which is included with purchased parts in the table above.

### 5. Property, Buildings and Equipment

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

	2020	2019
Land	\$ 883,000	\$ 883,000
Building and building improvements	49,913,000	43,737,000
Equipment	73,504,000	67,477,000
Computer software	9,925,000	9,392,000
Leasehold improvements	15,703,000	15,024,000
	149,928,000	136,513,000
Less: accumulated depreciation and amortization	(79,734,000)	(79,810,000)
	\$ 70,194,000	\$ 56,703,000

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Depreciation and amortization expense on property and equipment approximated \$7,705,000 and \$6,496,000 and includes \$380,000 and \$371,000 related to internal-use capitalized software for the years ended September 30, 2020 and 2019, respectively.

### 6. Goodwill

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

	2020	2019
Goodwill	\$ 6,812,000	\$ 6,680,000
Less: accumulated amortization	(3,053,000)	(1,329,000)
	\$ 3,759,000	\$ 5,351,000

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# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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Goodwill is amortized using the straight-line method over its useful life. Amortization expense related to goodwill totaled approximately \$1,724,000 and \$549,000 for the years ended September 30, 2020 and 2019, respectively. Future annual amortization of goodwill is as follows for the years ending September 30 (rounded to nearest thousand):

*Years ending September 30,*

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2021	\$	1,667,000
2022		1,318,000
2023		258,000
2024		258,000
2025		258,000
	\$	3,759,000

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### 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 (1.65% at September 30, 2020). No amounts were outstanding under the line as of September 30, 2020 or 2019. There is no stated expiration date on the line-of-credit.

Ventures has available a \$70,000,000 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 2.50% above the greater of (a) one month-LIBOR, adjusting daily or (b) 1.00% (3.50% at September 30, 2020). Amounts outstanding under the line at September 30, 2020 and 2019 total approximately \$25,981,000 and \$5,994,000, respectively. There is no stated expiration date on the line-of-credit.

#### *Margin Loan*

In January 2021, the Company entered into a margin loan agreement with the investment custodian. The margin loan allows the Company to draw funds against the assets within the investment portfolio not to exceed the maintenance margin requirement. There are no specified repayment terms, and interest accrues at the federal funds rate plus a spread between 0.60% and 1.60% depending on the balance of the margin loan. There is no outstanding margin loan balance as of the date the consolidated financial statements were available to be issued.

# 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):

	2020	2019
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 (0.11% at September 30, 2020) plus 0.05%. The obligation is collateralized by a letter of credit in the amount of \$1,052,000. The letter of credit expires, if not renewed, on December 14, 2021.	\$ 643,000	\$ 1,125,000
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 (0.11% at September 30, 2020) plus 0.05%. The obligation is collateralized by a letter of credit in the amount of \$10,285,000. The letter of credit expires, if not renewed, on December 14, 2021.	10,160,000	10,860,000
Less: long-term debt - current portion	10,803,000 (1,233,000)	11,985,000 (1,183,000)
Long-term debt, net of current portion	9,570,000	10,802,000
Less: unamortized debt issuance costs	(238,000)	(263,000)
Long-term debt, net of unamortized debt issuance costs	\$ 9,332,000	\$ 10,539,000

As of September 30, 2020, debt obligation maturities are as follows (rounded to nearest thousand):

Years ending September 30,

2021		\$ 1,233,000
2022		870,000
2023		760,000
2024		785,000
2025		805,000
Thereafter		6,350,000
		\$ 10,803,000

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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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, 2020 and 2019.

### 8. Disaggregation of Revenue

The Company disaggregates revenue from contracts with customers by contract type, customer, as well as whether the Company acts as prime contractor or sub-contractor, as the Company believes these categories best depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

Performance obligations related to the Company's contracts are satisfied over time as work progresses or at a point in time. Revenue from products and services transferred to customers over time totaled approximately \$224,221,000 and \$267,359,000 for the years ended September 30, 2020 and 2019, respectively. Revenue from services transferred to customers at a point in time totaled approximately \$150,460,000 and \$119,902,000 for the years ended September 30, 2020 and 2019, respectively. The amount of revenue recorded over time from fiscal year 2019 includes \$6,316,000 as described in Note 1. Incurred costs represent work performed, which corresponds with, and thereby best depicts, the transfer of control to the customer.

### *Performance Obligations*

Remaining performance obligations represent the transaction price of exercised contracts for which work has not yet been performed, irrespective of whether funding has or has not been authorized and appropriated as of the date of exercise. Remaining performance obligations do not include negotiated but unexercised options or the unfunded value of expired contracts.

### 9. Income Taxes

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

	2020	2019
Current income tax (expense)	\$ (421,000)	\$ (331,000)
Deferred income tax (expense)	(733,000)	(1,723,000)
Provision for income taxes	\$ (1,154,000)	\$ (2,054,000)

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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

	2020	2019
<b>U.S. operations</b>		
Deferred tax liability:		
Depreciation and amortization	\$ (1,481,000)	\$ (836,000)
Total deferred tax liability	(1,481,000)	(836,000)
Deferred tax assets:		
Allowances for inventory	923,000	565,000
Start-up costs	340,000	118,000
Inventory capitalization	646,000	378,000
Net operating loss	490,000	1,555,000
Warranty and other reserves	223,000	182,000
Benefits reserve	202,000	161,000
Charitable contributions	145,000	183,000
Other	123,000	78,000
Total deferred tax asset	3,092,000	3,220,000
Net deferred tax assets	\$ 1,611,000	\$ 2,384,000

	2020	2019
<b>Foreign operations</b>		
Deferred tax assets		
Net operating loss	\$ 128,000	\$ 147,000
Other	170,000	126,000
Valuation allowance	(117,000)	(141,000)
Net deferred tax assets	\$ 181,000	\$ 132,000

### ***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. As of each reporting date,

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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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, 2020, 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.

As of September 30, 2020 and 2019, the Company has net operating loss carryforwards of approximately \$2,201,000 and \$7,308,000, respectively, which will be available to offset future taxable income. The net operating loss carryforwards expire, if not utilized, in fiscal years beginning 2037 and forward.

On March 27, 2020, the CARES Act was signed into law in response to the coronavirus disease 2019 (COVID-19) pandemic. The CARES Act includes several significant income tax relief provisions. The income tax benefits include a favorable increase in the interest expense limitation under section 163(j), allowing for the current refund of AMT credit carryforward, allowing a five-year NOL carryback provision for certain NOLs, and increasing the amount of NOL corporations may use to offset income. The Company evaluated the income tax impacts of the CARES Act and included the benefit of the AMT credit refund and elected to defer the deposit and payment of the employer's share of Social Security taxes in the provision for income taxes for the year ended September 30, 2020.

### ***Foreign Operations***

In 2016, an Australian for-profit subsidiary of International was formed, SRC AUS. For the years ended September 30, 2020 and 2019, this foreign subsidiary resulted in taxable income of approximately \$1,503,000 and \$1,202,000, respectively.

In 2016 a Canadian for-profit subsidiary of International was formed, SRC CAN. For the year ended September 30, 2020, this foreign subsidiary resulted in a taxable loss of approximately \$4,000. As of September 30, 2020 and 2019, The Company has net operating loss carryforwards of approximately \$357,000, which will be available to offset future taxable income. 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, 2020, this foreign subsidiary resulted in taxable income of approximately \$280,000, which is offset by the net operating loss carryforward from prior year. The Company has deferred tax assets, which include net operating loss carryforwards of approximately \$23,000 and \$47,000 respectively. The Company has recorded a valuation allowance against the deferred tax assets.

## **10. 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 date of hire for all employees age 18 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, 2020 and 2019, the amount contributed by the Company to the defined contribution retirement plans was approximately \$14,992,000 and \$13,373,000, respectively.



# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### ***457(b) Plan***

The Company provides an unfunded 457(b) deferred compensation plan (the 457(b) Plan) that allows for participation by board approved senior management. Participants may contribute a portion of their compensation up to the maximum IRS limitations each year. Plan contributions are held in investment funds with TIAA CREF. The plan assets are owned by the Company until the participant has a distributable event. Participant contributions were approximately \$176,000 and \$159,000 in 2020 and 2019, respectively. As of September 30, 2020 and 2019, the 457(b) Plan assets and obligations totaled approximately \$1,086,000 and \$932,000 respectively, and are included in long-term other assets and other long-term liabilities in the accompanying consolidated statements of financial position.

### ***457(f) Plan***

The Company provides a funded 457(f) nonqualified restoration plan (the 457(f) Plan) that allows for participation by board approved senior management. The Company contributes 10% of annual compensation above the IRS compensation limits each year. The Company contributed approximately \$381,000 and \$239,000 during the years ended September 30, 2020 and 2019, respectively. Plan contributions are held in investment funds with TIAA CREF. The 457(f) Plan assets are owned by the Company until the participant has reached the selected vesting date. As of September 30, 2020 and 2019, the 457(f) Plan assets and obligations totaled approximately \$587,000 and \$477,000 respectively, and are included in long-term other assets and other long-term liabilities in the accompanying consolidated statements of financial position.

### ***Deferred Compensation Plan***

The Company provides a deferred compensation plan to certain employees. To be eligible, an employee must be a Vice President or President. The Company contributes 10% of annual compensation above the IRS compensation limits each year. The Company contributed approximately \$29,000 and \$15,000 during the years ended September 30, 2020 and 2019, respectively. Participants may contribute a portion of their compensation up to the maximum IRS limitations each year. Plan contributions are held in investment funds with M&T Bank. The Plan assets are owned by the Company until the participant has reached the elected distribution date. As of September 30, 2020 and 2019, the Plan assets and obligations totaled approximately \$1,171,000 and \$1,137,000, respectively, and are included in long-term 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. The postretirement life insurance plan eligibility criteria is 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):

	2020	2019
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	\$ 1,594,000	\$ 1,166,000
Service cost	109,000	66,000
Interest cost	52,000	48,000
Actuarial loss	273,000	324,000
Benefits paid	(20,000)	(10,000)
<b>Benefit obligation at end of year</b>	<b>\$ 2,008,000</b>	<b>\$ 1,594,000</b>

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):

	2020	2019
<b>Change in plan assets</b>		
Fair value of plan assets at beginning of year	\$ -	\$ -
Actual return on plan assets	-	-
Distributions to the employer	20,000	10,000
Benefits paid	(20,000)	(10,000)
<b>Fair value of plan assets at end of year</b>	<b>-</b>	<b>-</b>
<b>Underfunded status</b>	<b>\$ (2,008,000)</b>	<b>\$ (1,594,000)</b>

As of September 30, 2020 and 2019, the Plan had unamortized actuarial net losses of approximately \$802,000 and \$560,000, respectively, and unamortized prior service credit of \$116,000 and \$296,000, respectively.

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

	2020	2019
Expected return on plan assets	0.00%	0.00%
Discount rate	2.69%	3.17%

# 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:

	2020	2019
Expected return on plan assets	0.00%	0.00%
Discount rate	3.17%	4.20%

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

	2020	2019
Components of net periodic benefit (income) cost		
Service cost	\$ 109,000	\$ 66,000
Interest cost	52,000	48,000
Amortization of prior service credit	(180,000)	(180,000)
Amortization of net loss	32,000	9,000
	\$ 13,000	\$ (57,000)

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):

	2020	2019
Actuarial loss	\$ 273,000	\$ 323,000
Amortization of prior service cost	180,000	180,000
Amortization of actuarial gain	(32,000)	(9,000)
	\$ 421,000	\$ 494,000

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	
2021	\$	23,000
2022		26,000
2023		28,000
2024		31,000
2025		34,000
Years 2026-2030		235,000

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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### *Voluntary Separation Program*

On September 15, 2020, the Company announced a voluntary separation program (VSP). The VSP is an opportunity for employees to voluntarily separate from the Company while receiving certain severance and other benefits to which they may not have otherwise been entitled. The goal of the VSP is to reduce indirect expenses. Employees were required to apply to participate in the VSP by October 16, 2020 and were notified of acceptance or denial of participation in the VSP by October 30, 2020. Most accepted applicants' employment ended on December 31, 2020 with payouts of severance benefits 60 days after employment has ended. The Company estimates payouts of severance benefits to total \$15,527,000, of which approximately \$12,976,000 has been paid through the date the consolidated financial statements were available to be issued. In accordance with ASC 712, *Compensation - Nonretirement Postemployment Benefits*, the Company did not recognize a liability for severance benefits until fiscal year 2021, despite the VSP being created and announced during fiscal year 2020, as the acceptance of the termination benefits by both the employee and the Company did not occur until October 2020 as previously described.

### 11. Major Customers

For the years ended September 30, 2020 and 2019, 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 93.2% and 96.7%, respectively, of the Company's revenue. As of September 30, 2020 and 2019, the U.S. Federal Government represents 91.2% and 89.0%, respectively, of the total accounts receivables balance.

### 12. 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 2032. 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, 2020 (rounded to nearest thousand):

<i>Years ending September 30,</i>	Operating Leases
2021	\$ 6,216,000
2022	6,105,000
2023	5,742,000
2024	4,958,000
2025	4,183,000
Thereafter	24,186,000
<b>Total minimum payments</b>	<b>\$ 51,390,000</b>

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 \$5,906,000 and \$4,114,000 for the years ended September 30, 2020 and 2019,

# SRC, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements

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respectively, which is included as a component of indirect expenses in the accompanying consolidated statements of activities and change in unrestricted net assets.

### ***Risks and uncertainties***

On January 30, 2020, the World Health Organization (WHO) announced a global health emergency because of a new strain of coronavirus originating in Wuhan, China (the “COVID-19 outbreak”) and the risks to the international community as the virus spreads globally beyond its point of origin. In March 2020, the WHO classified the COVID-19 outbreak as a pandemic, based on the rapid increase in exposure globally. The Company faces various risks related to the global outbreak of COVID-19. The Company is dependent on its workforce to deliver its services primarily to the U.S. Government and its agencies. If a significant portion of the Company’s workforce are unable to work effectively, or if U.S. Government and its agencies and/or other customers’ operations are curtailed due to illness, quarantines, government actions, facility closures, or other restrictions in connection with the COVID-19 pandemic, the Company’s operations will likely be impacted. The Company may be unable to perform fully on its contracts and costs may increase as a result of the COVID-19 outbreak. These cost increases may not be fully recoverable or adequately covered by insurance.

At this time, the Company’s management cannot predict the full impact of the COVID-19 pandemic, but management continues to monitor the situation, to assess further possible implications to operations, the supply chain, and customers, and to take actions in an effort to mitigate adverse consequences.

On March 27, 2020, President Trump signed into law the CARES Act. The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations, increased limitations on qualified charitable contributions, and technical corrections to tax depreciation methods for qualified improvement property. The CARES Act also appropriated funds for the SBA Paycheck Protection Program loans that are forgivable in certain situations to promote continued employment, as well as Economic Injury Disaster Loans to provide liquidity to small businesses harmed by COVID-19.

Through September 30, 2020, the Company has utilized certain provisions of the CARES Act, including deferral of employer social security tax payments totaling approximately \$4,715,000, which is included in other long-term liabilities in the accompanying consolidated statements of financial position, as well as certain provisions during the preparation of the provision for income taxes (see Note 9). Management continues to examine the future impact that the CARES Act may have on the Company’s financial condition, results of operations, and liquidity.

### **13. Subsequent Events**

The Company has evaluated its September 30, 2020 consolidated financial statements for subsequent events through June 25, 2021, 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, except as described in Note 7 as it relates to the margin loan and Note 10 as it relates to the VSP.

## Schedule of Expenditures of Federal Awards

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## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

Year Ended September 30, 2020

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b>Research and Development Cluster:</b>				
<b>U.S. Department of Defense</b>				
Direct Programs Department of the Air Force	12.RD		\$ 53,419,942	\$ 134,749
Pass Through Programs From:				
ASSURED INFO SECURITY, INC	12.RD	1115	436,356	-
BALL AEROSPACE	12.RD	P000024474	21,804	-
BLACK RIVER SYSTEMS	12.RD	1725-S01-BRSC	203,925	-
CACI TECH	12.RD	P000078597	2,345,447	-
CAS, INC.	12.RD	CAS SC 686-18	629,465	-
DYNETICS	12.RD	DI-SC-20-73	807	-
LEIDOS, INC	12.RD	P010191561	425,959	-
MATRIX RESEARCH, INC.	12.RD	CRFR-017	29,314	-
Millennium Engineering	12.RD	22020-8009	51,196	-
NORTHROP GRUMMAN	12.RD	7500156052	944,985	-
NORTHROP GRUMMAN	12.RD	7500164124	315,762	-
SAIC	12.RD	PO10248427	209,450	-
SRCTec, LLC	12.RD	I100429	18,459	-
SRCTec, LLC	12.RD	I100583	11,548	-
SRCTec, LLC	12.RD	I100623	1,069	-
SRCTec, LLC	12.RD	I100609	4,446	-
Total Department of the Air Force			59,069,934	134,749

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

Year Ended September 30, 2020

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b>Research and Development Cluster:</b>				
Direct Programs Department of the Army	12.RD		40,978,634	-
Pass Through Programs From:				
AGILE DEFENSE, INC.	12.RD	SRC-02005	1,272,071	-
ATI	12.RD	2017-324	843,481	-
ATI	12.RD	2017-351	11,733	-
ATI	12.RD	2018-359	3,482,710	-
BATELLE MEMORIAL	12.RD	US001-0000760991	181,680	-
BOOZ-ALLEN	12.RD	107204SB60	4,535,901	-
BOOZ-ALLEN	12.RD	98596XSB0P	61,187	-
BOOZ-ALLEN	12.RD	S905030BAH	125,939	-
CACI TECH	12.RD	P000065256	671,739	-
CACI TECH	12.RD	P000074370	125,108	-
CACI TECH	12.RD	P000083973	27,337	-
DHPC TECHNOLOGIES	12.RD	SD01506	6,315,416	-
DHPC TECHNOLOGIES	12.RD	SD01921	1,257,972	-
DYNETICS	12.RD	DI-SC-19-18	51,134	-
ENGILITY CORP	12.RD	2015-S-EGL-0122	3,862	-
EOIR TECHNOLOGIES, INC	12.RD	S16-10017	1,882,396	-
LEIDOS, INC	12.RD	PO10226853	839,958	-
LEIDOS, INC	12.RD	P010233069	780,091	-
LOCKHEED MARTIN	12.RD	4104154202	2,277	-
LOCKHEED MARTIN	12.RD	4104201649	2,059	-
LOCKHEED MARTIN	12.RD	4104577226	921,360	-
PARSONS	12.RD	PO-0009581	31,164	-
SAIC	12.RD	B00132	191	-



## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

*Year Ended September 30, 2020*

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
SAIC	12.RD	P010244305	362,061	-
SAVIT CORP	12.RD	9D03-N-4513	109,668	-
SAVIT CORP	12.RD	DOTC-19-01-INIT0203	566,075	-
SAZE TECHNOLOGIES, LLC	12.RD	I100546	399,253	-
SIERRA NEVADA CORP	12.RD	S19TNH084	206,716	-
SPECTRAL SCIENCES, INC.	12.RD	11451	47,474	-
SRCTec, LLC	12.RD	I100590	1,973	-
SRCTec, LLC	12.RD	I100625	61,548	-
SRCTec, LLC	12.RD	I100130	17,852	-
SRCTec, LLC	12.RD	I100305	28,395	-
SRCTec, LLC	12.RD	I100307	1,261,434	-
SRCTec, LLC	12.RD	I100369	593,846	-
SRCTec, LLC	12.RD	I100389	6,901	-
SRCTec, LLC	12.RD	I100423	33,546	-
SRCTec, LLC	12.RD	I100435	47,153	-
SRCTec, LLC	12.RD	I100445	304,052	-
SRCTec, LLC	12.RD	I100449	227,595	-
SRCTec, LLC	12.RD	I100451	2,413	-
SRCTec, LLC	12.RD	I100468	10,000	-
SRCTec, LLC	12.RD	I100476A	170,825	-
SRCTec, LLC	12.RD	I100479	35,705	-
SRCTec, LLC	12.RD	I100488	3,934	-
SRCTec, LLC	12.RD	I100490	72,361	-
SRCTec, LLC	12.RD	I100521	2,091	-
SRCTec, LLC	12.RD	I100533	1,524,632	-
SRCTec, LLC	12.RD	I100588	21,257	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

*Year Ended September 30, 2020*

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
SRCTec, LLC	12.RD	I100591	2,672	-
SRCTec, LLC	12.RD	I100594	761,277	-
SRCTec, LLC	12.RD	I100595	2,444	-
SRCTec, LLC	12.RD	I100606	16,107	-
SRCTec, LLC	12.RD	I100611	1,458	-
SRCTec, LLC	12.RD	I100624	683	-
STARA Technologies, Inc.	12.RD	PO-3464	14,111	-
TECHNOLOGY SERV CORP	12.RD	TSC-1226-60265	805	-
Total Department of the Army			71,323,717	-
Direct Programs Department of the Navy		12.RD	8,979,190	-
Pass Through Programs From:				
AMEWAS, INC	12.RD	2016-SR0013	1,001,268	-
AMEWAS, INC	12.RD	2019-SRCI0054	1,348,666	-
R-DEX SYSTEMS, INC	12.RD	20200505	88,521	-
SAZE TECHNOLOGIES, LLC	12.RD	I100541	74,729	-
SAZE TECHNOLOGIES, LLC	12.RD	I100543	700,454	-
Total Department of the Navy			12,192,828	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

*Year Ended September 30, 2020*

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b><i>Research and Development Cluster:</i></b>				
Direct Programs Department of the Marines	12.RD		804,827	-
Pass Through Programs From:				
NORTHROP GRUMMAN	12.RD	8200218558	19,289	-
SRCTEC, LLC	12.RD	I100402	8,006	-
SRCTEC, LLC	12.RD	I100432	4,321	-
SRCTEC, LLC	12.RD	I100630	1,936	-
Total Department of the Marines			838,379	-
National Security Agency				
Pass Through Programs From:				
EXCEPTIONAL SW STRATEGIES	12.RD	H98230-14-D-0154-SC-20	186,050	-
Total National Security Agency			186,050	
Direct Programs National Reconnaissance Organization				
Pass Through Programs From:				
PARSONS	12.RD	Undisclosed	463,066	-
PARSONS	12.RD	PO-0009856	24,646	-
Vencore, Inc.	12.RD	Undisclosed	647,291	-
Total National Reconnaissance Organization			1,961,796	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

Year Ended September 30, 2020

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
Defense Intelligence Agency				
Pass Through Programs From: COLSA CORPORATION	12.RD	HS-161113	288,315	-
Total Defense Intelligence Agency			288,315	-
Direct Programs Defense Advanced Research Projects Agency				
	12.RD		62,163	-
Total Defense Advanced Research Projects Agency			62,163	-
Direct Programs Defense Threat Reduction Agency				
Pass Through Programs From: CACI, INC.-FEDERAL	12.RD	P000030899	4,343,664	-
URS Corp.	12.RD	AM00000315	378	-
URS Corp.	12.RD	URSFS62047	12,804	-
Total Defense Threat Reduction Agency			4,890,423	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

Year Ended September 30, 2020

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<i>Research and Development Cluster:</i>				
Defense Logistics Agency				
Pass Through Programs From:				
ADS, INC.	12.RD	1072897	90,568	-
SRCTec, LLC	12.RD	I100590	197	-
SRCTec, LLC	12.RD	I100424	15,786	-
SRCTec, LLC	12.RD	I100629	6,918	-
Total Defense Logistics Agency			113,469	-
Office of the Secretary of Defense				
Pass Through Programs From:				
IS4S	12.RD	103054	167,871	-
PRKK, LLC	12.RD	SRC-GF-001	196,812	-
PRKK, LLC	12.RD	SRC-GFII-001	67,300	-
Total Office of the Secretary of Defense			431,983	-
Defense Technical Information Center				
Pass Through Programs From:				
Alion Science & Technology	12.RD	SUB1159003	263,170	-
Total Defense Technical Information Center			263,170	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

Year Ended September 30, 2020

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b><i>Research and Development Cluster:</i></b>				
Other Contracts	12.RD	Undisclosed	6,842,457	-
Total U.S. Department of Defense			158,464,684	134,749
<b><i>Environmental Protection Agency</i></b>				
Direct Programs Environmental Protection Agency	66.RD		6,433,994	-
Pass Through Programs From:				
ICF, INC.	66.RD	19CBSK0004	2,168	-
LOCKHEED MARTIN	66.RD	46033416	595,716	-
SUMMITEC CORPORATION	66.RD	16-10-011	63,378	-
Total Environmental Protection Agency			7,095,256	-
<b><i>U.S. Department of Health and Human Services</i></b>				
Direct Programs Center for Disease Control and Prevention	93.RD		444,443	-
Direct Programs National Library of Medicine	93.RD		179,404	-
Total U.S. Department of Homeland Security			623,847	-
<b><i>U.S. Department of Homeland Security</i></b>				
Direct Programs Department of Homeland Security	97.RD		12,976	-
Pass Through Programs From:				

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

*Year Ended September 30, 2020*

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b><i>Research and Development Cluster:</i></b>				
BATELLE MEMORIAL	97.RD	US001-0000574611	106,318	-
Total U.S. Department of Health and Human Services			119,294	-
<b><i>U.S. Department of State</i></b>				
Pass Through Programs From:				
General Dynamics	19.RD	7SK0020SL	633,115	-
SRCTec, LLC	19.RD	I100590	1,523	-
Total U.S. Department of State			634,638	-
<b><i>U.S. Department of Transportation</i></b>				
Pass Through Programs From:				
THE OHIO STATE UNIVERSITY	20.RD	60067188	433,004	-
Total U.S. Department of Transportation			433,004	-
<b><i>National Aeronautics and Space Administration</i></b>				
Pass Through Programs From:				
LJT & ASSOCIATES, INC	43.RD	6210-SRC-001	3,398	-
Total National Aeronautics and Space Administration			3,398	-

## SRC, Inc. and Subsidiaries

### Schedule of Expenditures of Federal Awards

*Year Ended September 30, 2020*

Federal Grantor / Pass-through Grantor / Program or Cluster Title	Federal CFDA Number	Contract Number / Pass-Through Entity	2020 Federal Expenditures	Amounts Provided to Subrecipients
<b><i>Research and Development Cluster:</i></b>				
<b><i>U.S. Department of Agriculture</i></b>				
Pass Through Programs From: TELLEVATE, LLC	10.RD	SC-SRC2019-1	3,535	-
Total U.S. Department of Agriculture			3,535	-
<b><i>Total Research and Development Cluster Expenditures of Federal Awards</i></b>			<b>\$ 167,377,656</b>	<b>\$ 134,749</b>

*The accompanying notes are an integral part of the schedule.*



# SRC, Inc. and Subsidiaries

## Notes to the Schedule of Expenditures of Federal Awards

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### 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, and general and administrative 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, 2020.

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, 2020. 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, 2020. The Company had no federally funded insurance programs or loan guarantees during the year ended September 30, 2020.

### 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.

**Independent Auditor's Reports Required by *Government Auditing Standards* and the Uniform Guidance**

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8401 Greensboro Drive  
Suite 800  
McLean, VA 22102

## **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 statement of financial position as of September 30, 2020, and the related consolidated statement 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 15, 2020.

### **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) as a basis for designing 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 consolidated financial statements. 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 15, 2020



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Fax: 703-893-2766  
www.bdo.com

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.

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.



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 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 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, 2020. 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, 2020.

### **Other Matters**

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2020-004. Our opinion on the major federal program is not modified with respect to this matter.

The Company's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Company's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

### **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 the 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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we did identify a certain deficiency in internal control over compliance, described in the accompanying schedule of findings and questioned costs as item 2020-004, that we consider to be a significant deficiency.

The Company's response to the internal control over compliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Company'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 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.

*BDO USA, LLP*

McLean, Virginia  
June 25, 2021



# SRC, Inc. and Subsidiaries

## Schedule of Findings and Questioned Costs Year Ended September 30, 2020

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### 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      X   No
- Significant deficiency(ies) identified? \_\_\_\_\_ Yes      X   None reported
- Noncompliance material to consolidated financial statements noted? \_\_\_\_\_ Yes      X   No

#### *Federal Awards*

Internal control over the major program:

- Material weakness(es) identified? \_\_\_\_\_ Yes      X   No
- Significant deficiency(ies) identified?   X   Yes    \_\_\_\_\_ None reported

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

Unmodified

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

  X   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?

  X   Yes    \_\_\_\_\_ No

# SRC, Inc. and Subsidiaries

## Schedule of Findings and Questioned Costs Year Ended September 30, 2020

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### 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 2020 audit.

### Section III - Federal Award Findings and Questioned Costs

#### 2020-004 - Internal Control Over Compliance - Subrecipient and Contractor Determinations

##### Information on Federal Program:

Research and Development Cluster  
U.S. Department of Defense  
Direct program with the Department of the Air Force  
CFDA Number: 12.RD  
Award Number: 47QFLA19A0021

##### Criteria:

2 CFR § 200.331 *Subrecipient and contractor determinations*

The non-Federal entity may concurrently receive Federal awards as a recipient, a subrecipient, and a contractor, depending on the substance of its agreements with Federal awarding agencies and pass-through entities. Therefore, a pass-through entity must make case-by-case determinations whether each agreement it makes for the disbursement of Federal program funds casts the party receiving the funds in the role of a subrecipient or a contractor. The Federal awarding agency may supply and require recipients to comply with additional guidance to support these determinations provided such guidance does not conflict with this section.

Condition: While BDO was gaining an understanding of internal controls over subrecipient versus contractor determinations for all non-classified federal awards of the research and development cluster major federal program, BDO noted that SRC did not have a control in place during fiscal year 2020 to categorize and document the Company's assessment of whether a new supplier of goods and/or services constitutes a contractor relationship or a subrecipient relationship.

Cause: There was not a control in place to document SRC's assessment of subrecipient versus contractor determinations.

Effect: Failure to properly identify a subrecipient relationship resulted in the initial schedule of expenditures of federal awards to understate subrecipient expenditures, and could result in failure to perform proper monitoring controls of subrecipients. This could ultimately lead to noncompliance with the terms of the federal award.

Questioned Costs: None.

Context: This is a condition identified during BDO's gaining an understanding of internal controls over subrecipient versus contractor determinations for all non-classified federal awards of the research and development cluster major federal program. The subrecipient expenditures identified

## SRC, Inc. and Subsidiaries

### Schedule of Findings and Questioned Costs Year Ended September 30, 2020

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in the course of the audit procedures related entirely to classified federal awards of the research and development cluster major federal program and therefore outside the scope of BDO's testing.

Repeat finding: This is not a repeat finding.

Recommendation: We recommend that SRC implement and enhance their controls over the determination and identification of subrecipients versus contractors. We recommend that each new supplier utilized on federal awards be analyzed for indicators of a subrecipient versus contractor relationship in accordance with 2 CFR 200.331. Additionally, we recommend that a supervisor review these conclusions prior to determining appropriate monitoring procedures to be performed on subrecipients.

Views of Responsible Officials: SRC agrees with the finding. While SRC does evaluate each agreement and ensures the proper monitoring procedures are performed, we agree we do not have adequate procedures in place to document and communicate the final determination. SRC will evaluate and update its procedures, as applicable, to ensure that information is shared with the appropriate individuals.

## Management Prepared Document

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SRC Inc.  
Management's Views and Corrective Action Plan Regarding Uniform Guidance Audit  
Findings for the  
Year Ending September 30, 2020

Finding 2020-004

SRC agrees with the finding. While SRC does evaluate each agreement and ensures the proper monitoring procedures are performed, we agree we do not have adequate procedures in place to document and communicate the final determination. SRC will evaluate and update its procedures, as applicable, to ensure that information is shared with the appropriate individuals.

Contact Person Responsible for Corrective Action: Tasha Haynes, Senior Manager, Compliance, (315) 412-8132, and Ben Bergan, Manager, Subcontracts, (315) 452-8072  
Completion Date: Corrective action will be completed by September 30, 2021.

# Section

# 2



**DCAA**

DEFENSE CONTRACT AUDIT AGENCY

# **Audit Report No. 03441-2020S10110001**

Upstate New York Branch Office

90 Curtwright Drive, Suite 1

Williamsville, NY 14221

**June 21, 2021**

## **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, 2020**

**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

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### 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 (R&D) 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 \$311 million for fiscal year ended (FYE) September 30, 2020. SRC's Fiscal Year (FY) 2020 sales are 95 percent related to Federal Government, and the government sales are predominately flexibly priced. SRC has approximately 1,412 employees (SRC 1,098 and SRC Home Office 314). In FY 2020, the primary customers consisted of the US Air Force and US Army, which represented approximately 46 percent of the total claimed costs.

SRC's Federal Awards fall under the designation of a 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.

### 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 SRC's R&D Cluster. DCAA's audit responsibility included testing SRC's compliance with three compliance requirements included in the OMB 2020 Compliance Supplement. These parts were: (A) activities allowed or unallowed; (B) allowable cost/cost principles; and (H) 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 in parts: (I) procurement and suspension and debarment; (M) subrecipient monitoring; and (N) special tests and provisions. Our work included auditing SRC's proposed direct and indirect amounts for reimbursement on Federal awards contained in its FY 2020 final indirect cost proposal, revised on April 29, 2021. In addition, we tested SRC's internal control



structure with respect to the six compliance requirements listed above as they related to the 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 BDO is responsible for these awards. In addition, our audit of the R&D Cluster did not include specific Federal awards within the “Other Contract Costs” section of the Schedule of Expenditures of Federal Awards because we do not have audit cognizance over those Federal Awards (see Appendix 4).

### WHAT WE FOUND

Our examination of SRC’s internal controls and claimed costs for FYE September 30, 2020, disclosed findings related to internal control over compliance. We identified three internal control noncompliances related to the allocation of home office costs; lack of proper authority for approving and executing purchase orders issued for inter-organizational transfer (IOT) costs; and obligations were 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 type of compliance requirements described in the 2020 2 CFR 200, Appendix XI, 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, 2020. SRC's major Federal programs are identified in the Schedule of Findings and Questioned Costs summary of auditor's results section (Exhibit).

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 FYE September 30, 2020. The compliance requirements audited by DCAA, excluding EPA, are as follows:

- 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 (as determined applicable):

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

SRC's independent public accounting firm, BDO, was responsible for reviewing compliance with Part C. Cash Management for all Federal awards and with the following 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, Suspension, and Debarment;
- Part J. Program Income;
- Part L. Reporting;
- Part M. Subrecipient Monitoring; and
- Part N. Special Tests and Provisions.

In addition, BDO was 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.

Part E. Eligibility compliance requirement was determined not applicable to SRC for FYE September 30, 2020.

In addition, the following compliance requirements were determined not applicable to Other Government, NSA and NRO Awards for the FYE September 30, 2020:

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

Our audit of Federal R&D cluster did not include specific Federal awards with the "Other Contracts" section of the Schedule of Expenditures of Federal Awards due to externally imposed security restrictions. SRC was informed in a letter dated March 26, 2021 of this restriction and their responsibility to ensure that these contracts were audited. Therefore, we excluded \$2,587,923 of costs related to these Federal awards from our audit. See Appendix 4, under "Other Contracts" costs excluded from the audit, for more details.

We also audited SRC's direct and indirect amounts for contract reimbursement on unsettled flexibly priced contracts contained in its FY 2020 final indirect rate proposal, revised April 29, 2021, 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 April 29, 2021, 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 our audit and the evidence obtained is sufficient and appropriate to ensure that our audit provides a reasonable basis for our audit opinion on compliance for each major Federal program. However, our audit does not provide a legal determination on SRC's compliance.

### **Unmodified Opinion on SRC's Compliance with 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, 2020. 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 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 15, 2021 and documents the auditee's concurrence with our findings and recommendations.

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

### **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 2020-001, 2020-002, and 2020-003 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 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'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 2019-001, 2019-002, 2019-003, 2019-005, and 2017-008. We followed up on SRC's corrective action in these areas and did not identify any exceptions. Therefore, audit finding numbers 2019-001, 2019-002, 2019-003, 2019-005, and 2017-008 are no longer open.

Our evaluation of the corrective action related to finding 2017-007 determined it was not adequate; therefore, further corrective action is required related to the proper execution of purchase orders. We have incorporated this finding in number 2020-002 in the Schedule of Findings and Questioned Costs. In addition, our evaluation of the corrective action related to findings 2019-004 determined it was not adequate; therefore, further corrective action is required related to the period of performance. We incorporated this finding in number 2020-003 in the Schedule of Findings and Questioned Costs (Exhibit).

#### EXIT CONFERENCE

We provided a draft copy of the report and discussed the results of our examination with Ms. Danielle Chabot, SRC, Assistant Vice President Contracts, Compliance and Internal Audit, and Ms. Tasha Haynes, SRC, Senior Manager Compliance, in an exit conference held on June 10, 2021. SRC concurred with finding numbers 2020-002 and 2020-003 and did not concur with finding number 2020-001 in part. 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.

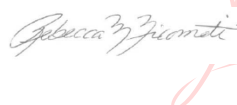
We are available to discuss the results of audit and participate in negotiations at your convenience.

**DCAA PERSONNEL**

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

**AUDIT REPORT AUTHORIZED BY:**

 Digitally signed by  
NICOMETI.REBECCA.M.1  
460895053  
Date: 2021.06.21  
14:55:39 -04'00'

Rebecca M. Nicometi  
Branch Manager  
DCAA Upstate New York Branch Office



**AUDIT REPORT DISTRIBUTION**

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DCAA New Jersey Branch Office Cherry Tree Corporate Center 535 Route 38 East, Suite 422 Cherry Hill, NJ 08002 Prime Contractor: DHPC Technologies, Inc. Prime Contract: W56KGU-15-D-0006	dcaa-fao1341@dcaa.mil

## Restrictions

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. The contents of this audit report are intended for persons whose official duties require access in accordance with Department of Defense (DoD) Manual 5200.01, Volume 4 - DoD Information Security Program, February 2012, Enclosure 3, paragraph 2.d. The audit report and supporting documentation may contain information exempt from mandatory disclosure under the Freedom of Information Act. Exemption 4, of the Freedom of Information Act, which addresses proprietary information, may apply.

It is not practical to identify, during the conduct of the audit, all elements of the data that are proprietary. Proprietary determinations should be made considering the access to Uniform Guidance Audit Reports granted to the public. Unauthorized disclosure of proprietary information violates Title 18 United States Code (U.S.C.) 93 §1905. Any person who unlawfully discloses such information is subject to penalties such as fines, imprisonment, and/or removal from office or employment.

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 an 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, 2020**

**SECTION I: -- SUMMARY OF AUDITOR’S RESULTS:**

A. 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.

B. 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
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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, 2020**

**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
2020-001	R&D Cluster	N/A	Compliance Requirements A, B and H; 48 CFR 9904.403-40(a)(1); 48 CFR 9904.403-50(a)(2)
2020-002	R&D Cluster	N/A	Compliance Requirements A, B and H
2020-003	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

**A. INTERNAL CONTROL OVER COMPLIANCE**

2020-001 Internal Control and Compliance Finding Related to CAS 403 Noncompliance

a. Condition:

Our review of compliance and internal control testing in accordance with OMB *Compliance Supplement* for Part A. Activities Allowed or Unallowed; Part B. Allowable Cost/Cost Principles; and Part H. Period of Performance, identified a noncompliance related to allocation of SRC Home Office costs, as reported in DCAA Audit Report Nos. 03441-2021S19200001, dated March 2, 2021, and 03441-2021S19200002, dated May 20, 2021.

SRC claimed home office costs that are not allocable to them. Our review of the home office pool costs and allocation bases identified the following noncompliances with specific requirements of 48 CFR 9904.403, *Allocation of Home Office Expense to Segments*:

- Home Office Computer Center labor support for home office employees is accumulated and allocated directly to SRC, which is in noncompliance with 48 CFR 9904.403-40(a)(1), as reported in DCAA Audit Report No. 3441-2021S19200002.

- The allocation base of certain home office organizations includes values (square footage, payroll, net book value) for both SRC and home office and identified as the total for SRC. Also identified that a related entity home office payroll is excluded from three factor formula allocation values. We consider this to be in noncompliance with 48 CFR 9904.403-40(a)(1) and 50(a)(2), as reported in DCAA Audit Report No. 3441-2021S19200002.
- Certain expenses which originate in the home office are allocated to SRC, and SRC allocates some of those expenses back to the home office, which are ultimately shared with other related entities in addition to SRC. We consider this to be in noncompliance with 48 CFR 9904.403-40(a)(1), as reported in DCAA Audit Report No. 3441-2021S19200002.
- SRC Board of Trustee fees and consultant compensation review services related to the review of trustee fees are not accumulated and allocated in compliance with 48 CFR 9904-403-40(a)(1), as reported in DCAA Audit Report No. 3441-2021S19200001.

Therefore, SRC does not separately identify home office and SRC employees or organizations and instead combines both to make up SRC. Due to the lack of separation of SRC and Home Office employees, costs are charged direct to SRC based on their disclosed practices. As a result, home office costs are over allocated to SRC, which results in SRC incurring additional costs on its contracts. The resolution of the CAS noncompliances will be handled through the resolution process specified in FAR 30.605, *Processing Noncompliances*. Therefore, we have not questioned any indirect costs. This noncompliance pertains to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

We examined 48 CFR 9904.403-40(a)(1), which states:

*“Home office expenses shall be allocated on the basis of the beneficial or causal relationship between supporting and receiving activities. Such expenses shall be allocated directly to segments to the maximum extent practical. Expenses not directly allocated, if significant in amount and in relation to total home office expenses, shall be grouped in logical and homogeneous expense pools and allocated pursuant to paragraph (b) of this subsection. Such allocations shall minimize to the extent practical the amount of expenses which may be categorized as residual (those of managing the organization as a whole). These residual expenses shall be allocated pursuant to paragraph (c) of this subsection.”*

In addition, we examined 48 CFR 9904.403-50(a)(2) which states:

*“Where the expense of a given function is to be allocated by means of a particular allocation base, all segments shall be included in the base unless:*

*(i) Any excluded segment did not receive significant benefits from, or contribute significantly to the cause of the expense to be allocated and,*

*(ii) Any included segment did receive significant benefits from or contribute significantly to the cause of the expense in question.”*

c. Recommendation:

SRC’s pool costs and allocation bases for its home office organizations should be compliant with 48 CFR 9904.403. SRC should develop and implement appropriate monitoring and reviewing of home office expenses and allocation bases to ensure compliance with 48 CFR 9904.403. SRC should revise its disclosed practices accordingly.

d. Contractor Response:

SRC partially agrees with DCAA’s finding related to home office allocations and will evaluate options to update the allocation of costs. However, SRC does not agree the trustee fees or the consultant costs for compensation review service for trustees should be shared with the related entities. SRC’s complete response is included in the Corrective Action Plan for the Current Year in Appendix 3.

e. Auditor’s Response:

The SRC Board of Trustee is responsible for SRC which includes both SRC and SRC home office. We note a number of items addressed at various board of trustee meeting which impact at a minimum, both SRC and the SRC home office and /or potentially, related entities. In addition, four of the five executive management team members are included in the home office. Therefore, costs associated with these individuals are included in the home office and can be directly charged to the respective entity, if specifically identified, or are included in the residual costs which are allocated to SRC and related entities. We affirm the Board of Trustee’s responsibilities encompass the home office, which benefit both SRC and the related entities. We also find the level of the SRC Board of Trustee’s decision making and oversight over the SRC home office and related entities constitute costs which should not be borne solely by SRC. We continue to recommend that home office expenses are allocated on the basis of the beneficial or causal relationship between supporting and receiving activities and are not directly allocated to a single segment. The contractor should develop and implement appropriate monitoring and reviewing of home office expenses to ensure costs are accumulated and allocated in compliance with 48 CFR 9904.403.

2020-002 Internal Control and Compliance Finding Related to Proper Execution of Inter-Organizational Purchase Orders

## a. Condition:

Our review of compliance and internal control testing in accordance with OMB *Compliance Supplement* for Part A. Activities Allowed or Unallowed; Part B. Allowable Cost/Cost Principles; and Part H. Period of Performance identified a noncompliance related to the control activities for approving and executing purchase orders issued for inter-organizational transfer (IOT) costs.

Inter-organizational transfer costs are recorded to account number 5-4-080 – IOT from Limited Liability Corporations (LLC's) and 5-4-086 – IOT Time and Material (T&M.) We performed transaction testing for claimed IOT costs under auditable contracts. We judgmentally selected eight transactions totaling \$6,532,971 or 32 percent of the auditable IOT universe. These eight transactions were associated with three inter-company purchase orders (IPOs).

During our examination of the selected costs, we requested and received IPOs and related Buyer's Signatory Delegation Letters executed within this FY for all of the selected transactions. We compared the delegation amounts to the IPOs and/or the applicable change order identified. We concluded that out of eight IPOs tested, seven were approved and executed by a buyer without the proper authority for the initial purchase or a subsequent change order. In each instance, we reviewed the Buyer's Delegation of Signature Authority noting the IPOs were executed in excess of the buyer's threshold for signatory authority delegation.

This is a continued noncompliance as reported previously in the FY 2017 Uniform Guidance Audit under audit finding 2017-007 in DCAA Audit Report No. 3441-2017M10110001, dated June 22, 2018. The original noncompliance was related to direct material, subcontract, and IOT purchase orders. In the subsequent FY 2018 audit, we verified corrective action was taken related to the material and subcontract purchase orders by enhanced processes to ensure delegation of authority is clearly defined by revised language included in the Buyer's Checklist; however, the portion of the corrective action related to IPOs was not implemented. Based on our evaluation in the FY 2019 audit issued under DCAA Audit Report No. 3441-2019S10110001, dated June 17, 2020, we identified that the corrective action related to IOTs was not implemented until August 13, 2019; therefore, we were unable to verify the corrective action was properly implemented during our prior year audit.

Based on the contractor's corrective action, the IPO Approval Form, SPP 10.1B, was amended to include a statement indicating the subcontract manager's intent to delegate signature authority to the buyer. As part of our evaluation of internal controls, we evaluated the SPP 10.1B for each applicable contract action taken in FY 2020 related to the selected IPOs and noted that the form was amended as described in the corrective action; however, we identified that there is no indication on the form to whom the delegation is to be made. While we were able to verify the contractor's attempt to correct the prior finding, the corrective action was only

partially implemented, and we note this as a noncompliance with SRC's CORP-P-100, *Approval and Signature Authority*, and CORP-D-100, *Signature Authority Matrix*.

Inter-Organizational Transfers testing included three different IPOs: I100340 (valued at \$2,714,871), I100481 (valued at \$83,310,922), and I100562.01 (valued at \$16,364,850) with initial orders and change orders that were executed by buyers with delegations limited to \$250,000.

SRC has indicated that the approval and delegation on the form SPP 10.1B by the subcontracts manager asserts that the buyer can execute the purchase order. However, the form does not indicate the buyer to whom the delegation is to be made. When signing a purchase order in excess of delegated amount, there is the risk to potentially make the contractor liable for excess costs on a given contract which could also impact performance on Government contracts. 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 2020 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.*

We examined SRC's CORP-P-100 policy, dated April 27, 2012, and CORP-D-100, with effective dates of November 15, 2019, and June 20, 2020, which state and include in part:

*“The procedure defines signature authority as identified in our Signature Authority Matrix. A sound internal control environment requires that only officers of the Company and their designees approve financial and contractual transactions for the company.”*

The Signatory Authority Matrix included in CORP-D-100 for Purchasing and Subcontracts provides for the following:



<b>Signature Authority Matrix - Purchasing &amp; Subcontracts</b>		
	<b>Signature Thresholds</b>	<b>Responsible Signatory</b>
<b>Subcontracts, Purchase Orders and Associated Modifications</b>		
	Any Value - Per Delegation Letters	Contracts/ Subcontracts/ AVP Contracts
		Company Officers (General Counsel, CFO, COO, EVPs)
		President & CEO
<p>Note: The signature authority for purchasing and subcontracts will be delegated by the applicable Director or AVP.</p> <p>Note1: Where appropriate, individuals may designate an approver provided the designee is at an equivalent, higher or (with proper delegation) one level lower approval level.</p>		

c. Recommendation:

SRC should comply with its policies and procedures with regard to ensuring only approved employees (or those with appropriate delegations) execute approved IPOs.

d. Contractor Response:

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

2020-003 Internal Control and Compliance Finding Related to Period of Performance

a. Condition:

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

We judgmentally selected 21 federal awards for period of performance testing. We identified those federal awards with performance periods ending during FY 2020. As a result, we tested 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:

- For US028.CP.1019AA, the period of performance ended January 30, 2020, and by the period of performance compliance requirement, the liquidation of payments must occur within 90 days or by April 29, 2020. SRC received an IOT invoice dated September 2, 2020. Since the invoice is 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. The IOT costs were billed after the liquidation period due to SRC not providing funding to the related entity in a timely manner.
- For US028.CP.2016AB, the period of performance ended July 27, 2020, and by the period of performance compliance requirement, the liquidation of payments must occur within 90 days or by October 25, 2020. SRC received an IOT invoice dated December 2, 2020. Since the invoice is 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. The delay in submitting the invoice was a result of lagging subcontract invoices.

This is a continued noncompliance as reported previously in the FY 2019 Uniform Guidance Audit under audit finding 2019-004 in DCAA Audit Report No. 3441-2019S10110001, dated June 17, 2020. As a result of the prior audit finding, SRC requested an extension to the 90 day liquidation requirement as it relates to indirect rate adjustments from the Administrative Contracting Officer (ACO). On October 14, 2020, the ACO granted an extension to the 90 day liquidation period as it relates to indirect rates only. The liquidation of payments explained above did not relate to indirect rates and therefore are not covered by the extension granted. Therefore, per the OMB *Compliance Supplement*, the liquidation for these two projects must occur no later than 90 days after the end of the period of performance. We consider this to be inadequate monitoring of its IOT costs which led to a period of performance noncompliance.

In addition, during our reconciliation of the SRC's incurred costs submission, we identified projects which were marked as ready to close in FY 2019, however, there were credit amounts claimed in FY 2020. As a result, we reviewed the credit amount for project US011.01.07AA, whose period of performance ended January 31, 2019. Our review noted four IOT invoices dated January, July, and October 2020. One invoice was for a FY 2019 rate adjustment and the other three were for lagging subcontract costs. We noted the liquidation of payment did not occur within the required 90 day period for three invoices with lagging subcontract costs. SRC stated that the subcontracts department sent a letter on October 28, 2019 to its subcontractor; however, the related entity did not receive the subcontract invoices until April and September 2020. It is unreasonable that the IOT costs are being billed a year after the end of the period of performance. We also noted other direct costs for rental of equipment was charged to the project outside the period of performance. SRC did not record a journal entry to reclassify the costs to unallowable until 14 months after the period of performance end date,

when the charge was identified as incorrect. SRC has procedures in which costs are reviewed on a regular basis, by the program managers and financial analysts, and monthly by management at various levels. Therefore, the inadequate monitoring of its IOT and other direct costs has led to a period of performance noncompliance. This noncompliance pertains to all Federal Contracts under SRC's R&D cluster.

b. Criteria:

2 CFR Part 200, Part 3 Compliance Supplement dated August 2020 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 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 2020 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."*

c. Recommendation:

SRC should strengthen its internal controls to ensure contract costs are liquidated within 90 days after the period of performance for other than indirect rates. SRC should evaluate its process for monitoring IOTs to ensure related invoices are processed for payment in a timely manner and within the required liquidation period.

d. Contractor Response:

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**

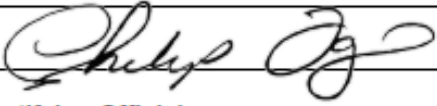
**SRC, Inc.  
Schedule N  
Certificate of Final Indirect Costs  
Fiscal Year Ended September 30, 2020**

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 April 29, 2021 to establish final indirect cost rates for Fiscal Year October 1, 2019 through September 30, 2020 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.**

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Signature: 

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Name of Certifying Official **Philip Fazio**

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Title **Executive Vice President, Finance & CFO**

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Date of Execution **Thursday, April 29, 2021**

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**SRC, INC.  
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS  
FISCAL YEAR ENDED SEPTEMBER 30, 2020**

(4 pages)



**SRC, Inc.**  
**Uniform Guidance Audit Report: Summary Schedule of Prior Audit Findings**  
**Year Ending September 30, 2019**

***Finding 2019-001***

**Summary of Prior Audit Finding:**  
Sign-On Bonuses

**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.

**Status of Finding:**

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

***Finding 2019-002***

**Summary of Prior Audit Finding:**  
Dues & Subscriptions

**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.

**Status of Finding:**

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

***Finding 2019-003***

**Summary of Prior Audit Finding:**  
Directly Associated Fringe Costs

**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).

**Status of Finding:**

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

**Finding 2019-004****Summary of Prior Audit Finding:**

Internal Control Noncompliance 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 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.

**Status of Finding:**

SRC partially agreed with the non-compliance as noted by DCAA. We agreed 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.

However, we respectfully disagreed 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 were 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 was deemed 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. As part of our initial response, we requested a final determination from our Administrative Contracting Officer (ACO) who granted SRC, Inc. an extension to the 90-day liquidation requirement as it relates to indirect rate adjustments. SRC will issue indirect rate adjustments in accordance with ACO guidance.

***Finding 2019-005***

**Summary of Prior Audit Finding:**

Internal Control Noncompliance Related to Facsimile Used on Payments

**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.

**Status of Finding:**

SRC reviewed its internal controls surrounding signature approvals for cash disbursements and use of facsimile. As a result, in June of 2020, SRC updated the signature authority matrix and related policies and procedures to only require one signature on checks. This eliminated the need for the facsimile and therefore there is no need for authorization letters. This change was also vetted with our external auditors who agreed this approach was appropriate.



**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 CURRENT YEAR FINDINGS**



SRC Inc.  
Management's Views and Corrective Action Plan Regarding Uniform Guidance Audit  
Findings for the  
Year Ending September 30, 2020

Finding 2020-001

SRC understands DCAA's assessment of our treatment of costs as it relates to the Cost Accounting Standards. SRC does believe it properly tracks costs associated with our Home Office. While we understand DCAA does not like the method in which we have accumulated and allocated those costs, SRC's intention was to ensure costs were properly allocated to the appropriate final cost objective. To ensure compliance with the Cost Accounting Standards, SRC will evaluate options to update our process of allocating costs. We will also update the FY22 disclosure statement to reflect any changes made.

As it relates to the SRC board of Trustee Fees and consultant compensation review services, SRC disagrees with DCAA's findings as previously communicated to DCAA and are awaiting ACO resolution.

Contact Person Responsible for Corrective Action: Tasha Haynes, Senior Manager, Compliance

Completion Date: Corrective action will be completed by September 30, 2021, except for the item related to Board of Trustee Fees and consultant compensation review services. Timing of corrective action for this item, if necessary, is dependent on ACO resolution.

Finding 2020-002

SRC has revised the Intercompany Purchase Order Approval form so that the buyer is identified. This change will clearly identify who has the delegated authority to execute the approved purchase order.

Contact Person Responsible for Corrective Action: Ben Bergan, Manager, Subcontracts  
Completion Date: The revision has been completed.

Finding 2020-003

SRC will review its processes and make updates as needed to ensure costs are liquidated within 90 days as required. Where applicable, this process will include formal requests of the ACO for extensions to the 90-day period when SRC is awaiting the submittal of final invoices from our subcontractors. In addition, we believe one instance (US028.CP.1019AA) was an isolated incident and in this instance, the employees who coordinated this transaction will be re-educated on procedures as well as the 90-day requirement.

Contact Person Responsible for Corrective Action: Ben Bergan, Manager, Subcontracts  
Completion Date: All corrective action will be implemented by September 30, 2021.

**SRC, INC.  
NORTH SYRACUSE, NY**

**SUMMARY SCHEDULE OF CLAIMED EXPENDITURES BY FEDERAL SPONSOR  
FOR FISCAL YEAR ENDED SEPTEMBER 30, 2020**

Major Program-R&D Cluster	Federal CFDA Numbers	Expenditures		
		Direct	Pass-Through	Total *
Department of Defense:				
Department of the Air Force	12	\$ 53,419,942	\$ 5,649,985	\$ 59,069,927
Department of the Army	12	40,978,634	30,345,080	71,323,714
Department of the Navy	12	8,979,190	3,213,638	12,192,828
Department of the Marines	12	804,827	33,552	838,379
National Security Agency	12		186,050	186,050
National Reconnaissance Organization	12	826,793	1,135,003	1,961,796
Defense Intelligence Agency	12		288,315	288,315
Defense Advanced Research Projects Agency	12		62,163	62,163
Defense Threat Reduction Agency	12	533,577	4,356,831	4,890,409
Defense Logistics Agency	12		113,469	113,469
Office of the Secretary of Defense	12		431,983	431,983
Defense Technical Information Center	12		263,170	263,170
Other Contracts	12	4,254,534		4,254,534
"Other Contracts" costs excluded from our audit	12	2,587,923		2,587,923
Total Department of Defense *		\$ 112,385,420	\$ 46,079,239	\$ 158,464,659
Other Federal Agencies				
Environmental Protection Agency	66	\$ 6,433,994	\$ 661,262	\$ 7,095,256
Department of Health and Human Services	93	623,847		623,847
Department of Homeland Security	97	12,976	106,318	119,295
Department of State	19		634,638	634,638
Department of Transportation	20		433,004	433,004
National Aeronautics and Space Administration	43	3,398	(5)	3,394
Department of Agriculture			3,535	3,535
Total Other Federal Agencies *		\$ 7,074,217	\$ 1,838,752	\$ 8,912,969
Total Federal Awards *		\$ 119,459,636	\$ 47,917,991	\$ 167,377,627

\*Minor differences due to rounding.