

SIGAR

**Special Inspector General for
Afghanistan Reconstruction**

SIGAR 16-30 Financial Audit

Construction of the Special Forces Kandak in Kandahar: Audit of Costs Incurred by Environmental Chemical Corporation



APRIL
2016

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On February 28, 2011, the 772nd Enterprise Sourcing Squadron, in support of the Air Force Center for Engineering and the Environment—reorganized in 2012 as the Air Force Civil Engineer Center (AFCEC)—awarded a 19-month, \$13.0 million task order to Environmental Chemical Corporation (ECC) to design and construct facilities and infrastructure for the 2nd Special Forces Kandak in Kandahar, Afghanistan. A kandak is a battalion-sized unit consisting of approximately 800 Afghan National Army soldiers. Under the task order, ECC was to construct various buildings and facilities, including barracks, a power plant, and a road system, at the kandak. After seven modifications, the total funding of the task order increased to \$21,647,410, and the period of performance was extended to April 23, 2014.

SIGAR's financial audit, performed by Crowe Horwath LLP (Crowe), reviewed \$21,639,589 in expenditures charged to the task order from February 28, 2011, through April 23, 2014. The objectives of the audit were to (1) identify and report on significant deficiencies or material weaknesses in ECC's internal controls related to the task order; (2) identify and report on instances of material noncompliance with the terms of the task order and applicable laws and regulations, including any potential fraud or abuse; (3) determine and report on whether ECC has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of ECC's Special Purpose Financial Statement. See Crowe's report for the precise audit objectives.

In contracting with an independent audit firm and drawing from the results of the audit, SIGAR is required by auditing standards to review the audit work performed. Accordingly, SIGAR oversaw the audit and reviewed its results. Our review disclosed no instances where Crowe did not comply, in all material respects, with U.S. generally accepted government auditing standards.

April 2016

Construction of the Special Forces Kandak in Kandahar: Audit of Costs Incurred by Environmental Chemical Corporation

SIGAR 16-30-FA

WHAT THE AUDIT FOUND

Crowe identified one material weakness and four significant deficiencies in ECC's internal controls, and five instances of noncompliance with the terms and conditions of the task order. Specifically, ECC was unable to provide supporting documentation for seven petty cash transactions, leading to \$195,499 in unsupported costs. Additionally, Crowe questioned \$18,407 billed to the task order for misallocated vehicle fuel purchases. Crowe also found and questioned \$6,985 of telephone expenses billed for employees who did not work under the task order. Furthermore, ECC did not fully comply with the task order's requirements to perform required annual inventory reconciliations or periodic inventories, and to provide AFCEC with monthly progress reports and biweekly cost schedule status updates. Additionally, ECC was unable to provide support for the approval of certain key personnel changes during the period of performance.

As a result of these internal control weaknesses and instances of noncompliance, Crowe identified \$220,891 in total questioned costs, consisting of \$25,392 in ineligible costs—costs prohibited by the task order, applicable laws, or regulations—and \$195,499 in unsupported costs—costs not supported with adequate documentation or that did not have required prior approvals or authorization.

Category	Ineligible	Unsupported	Total Questioned Costs
General Conditions	\$0	\$190,599	\$190,599
Materials	\$0	\$4,900	\$4,900
Utilities	\$25,392	\$0	\$25,392
Totals	\$25,392	\$195,499	\$220,891

Crowe did not identify any prior audits or assessments that pertained to ECC's design and construction of the 2nd Special Forces Kandak or were material to the Special Purpose Financial Statement.

Crowe issued an unmodified opinion on ECC's Special Purpose Financial Statement, noting that it presents fairly, in all material aspects, revenues received, cost incurred, and the balance for the period audited.

WHAT SIGAR RECOMMENDS

Based on the results of the audit, SIGAR recommends that the responsible contracting officer at AFCEC:

1. **Determine the allowability of and recover, as appropriate, \$220,891 in questioned costs identified in the report.**
2. **Advise ECC to address the report's five internal control findings.**
3. **Advise ECC to address the report's five noncompliance findings.**



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

April 19, 2016

The Honorable Ashton B. Carter
Secretary of Defense

General Joseph L. Votel
Commander, U.S. Central Command

General John W. Nicholson
Commander, U.S. Forces–Afghanistan and
Commander, Resolute Support

General Ellen M. Pawlikowski
Commander, U.S. Air Force Materiel Command

Mr. Randy E. Brown
Director, Air Force Civil Engineer Center

We contracted with Crowe Horwath LLP (Crowe) to audit the costs incurred by Environmental Chemical Corporation (ECC) under a task order awarded by the 772nd Enterprise Sourcing Squadron, in support of the Air Force Center for Engineering and the Environment—reorganized in 2012 as the Air Force Civil Engineer Center (AFCEC)—to design and construct facilities and infrastructure for the 2nd Special Forces Kandak in Kandahar, Afghanistan.¹ Crowe's audit covered \$21,639,589 in expenditures charged to the task order from February 28, 2011, through April 23, 2014. Our contract required that the audit be performed in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

Based on the results of audit, SIGAR recommends that the responsible contracting officer at AFCEC:

- 1. Determine the allowability of and recover, as appropriate, \$220,891 in questioned costs identified in the report.**
- 2. Advise ECC to address the report's five internal control findings.**
- 3. Advise ECC to address the report's five noncompliance findings.**

The results of Crowe's audit are detailed in the attached report. We reviewed Crowe's report and related documentation. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on ECC's Special Purpose Financial Statement. We also express no opinion on the effectiveness of ECC's internal control or compliance with the task order, laws, and regulations. Crowe is responsible for the attached auditor's report and the conclusions expressed in the report. However, our review disclosed no instances where Crowe did not comply, in all material respects, with generally accepted government auditing standards issued by the Comptroller General of the United States.

¹ The 772nd Enterprise Sourcing Squadron, in support of the Air Force Center for Engineering and the Environment awarded contract no. FA8903-06-D-8511, task order 0074 to ECC to design and construct facilities and infrastructure for the 2nd Special Forces Kandak in Kandahar, Afghanistan. A kandak is a battalion-sized unit consisting of approximately 800 Afghan National Army personnel. Under the task order, ECC was to construct various buildings and facilities, including barracks, a power plant, and a road system, at the kandak.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

We will be following up with your agency to obtain information on the corrective actions taken in response to our recommendations.

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

(F-073)



**Environmental Chemical Corporation
Special Purpose Financial Statement
The Design and Construction for the 2nd Special Forces Kandak at
Kandahar, Afghanistan (2nd SF KAF)**

For the Period February 28, 2011 through April 23, 2014

(With Independent Auditor's Report Thereon)

Table of Contents

TRANSMITTAL LETTER.....	1
SUMMARY.....	2
INDEPENDENT AUDITOR'S REPORT ON THE SPECIAL PURPOSE FINANCIAL STATEMENT	6
NOTES TO THE SPECIAL PURPOSE FINANCIAL STATEMENT.....	9
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL.....	12
INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE	14
SECTION 1: SCHEDULE OF FINDINGS AND QUESTIONED COSTS.....	16
SECTION 2: SUMMARY SCHEDULE OF PRIOR AUDIT AND REVIEW FINDINGS.....	24
APPENDIX A: VIEWS OF RESPONSIBLE OFFICIALS	25
APPENDIX B: AUDITOR'S REBUTTAL	31



www.crowehorwath.com

© Copyright 2016 Crowe Horwath LLP

Crowe Horwath LLP is an independent member of Crowe Horwath International, a Swiss verein. Each member firm of Crowe Horwath International is a separate and independent legal entity. Crowe Horwath LLP and its affiliates are not responsible or liable for any acts or omissions of Crowe Horwath International or any other member of Crowe Horwath International and specifically disclaim any and all responsibility or liability for acts or omissions of Crowe Horwath International or any other member of Crowe Horwath International. Crowe Horwath International does not render any professional services and does not have an ownership or partnership interest in Crowe Horwath LLP. Crowe Horwath International and its other member firms are not responsible or liable for any acts or omissions of Crowe Horwath LLP and specifically disclaim any and all responsibility or liability for acts or omissions of Crowe Horwath LLP.

**Crowe Horwath LLP**

Independent Member Crowe Horwath International

1325 G Street NW, Suite 500
Washington D.C. 20005-3136
Tel 202.624.5555
Fax 202.624.8858
www.crowehorwath.com

Transmittal Letter

February 2, 2016

To the Office of the Special Inspector General for Afghanistan Reconstruction
2530 Crystal Drive
Arlington, Virginia 22202

To the Principals of Environmental Chemical Corporation
240 Bayshore Highway
Burlingame, CA 94010

We appreciate the opportunity to provide to you our report regarding the procedures that we have completed during the course of our financial audit of Environmental Chemical Corporation's (ECC) contract with the United States Air Force Civil Engineering Center (AFCEC) funding the Design and Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan (2nd SF KAF).

Within the pages that follow, we have provided a brief summary of the work performed. Following the summary, we have incorporated our report on the Special Purpose Financial Statement, report on internal control, and report on compliance. We do not express an opinion on the summary or any information preceding our reports.

When preparing our report, we considered comments, feedback, and interpretations of Environmental Chemical Corporation, the Office of the Special Inspector General for Afghanistan Reconstruction, and AFCEC provided both in writing and orally throughout the audit planning and fieldwork phases. Management's written responses to the findings are incorporated into the final report and are followed by auditor's responses, if necessary.

Thank you for providing us the opportunity to work with you and to conduct the financial audit of ECC's 2nd SF KAF Project.

Sincerely,

A handwritten signature in black ink, appearing to read "Bert Nuehring".

Bert Nuehring, CPA, Partner
Crowe Horwath LLP



www.crowehorwath.com

Summary

Background

Environmental Chemical Corporation (ECC or the Auditee) entered into a cost plus fixed fee contract task order with the United State Air Force Civil Engineering Center, Air Force 772 Enterprise Sourcing Squadron for heavy engineering repair and construction (HERC) within Afghanistan on February 28, 2011. The contract task order's objectives were to provide design and construct facilities and infrastructure for the 2nd Special Forces Kandak at Kandahar, Afghanistan (2nd SF KAF), and included an option for construction of a physical training area. The 2nd SF KAF Project was funded by contract task order number FA8903-06-D-8511-0074 (Contract), which incorporated an initial ceiling price of \$12,960,623, comprised of \$12,343,450 cost reimbursement and \$617,173 fixed fee. Seven modifications were subsequently issued that extended the period of performance to February 28, 2011 through April 23, 2014 and increased the ceiling amount to \$21,647,410 (\$21,085,915 cost reimbursement and \$561,495 fixed fee).

Throughout the program's period of performance, ECC worked with numerous vendors, subcontractors, construction companies and the Air Force Civil Engineer Center (AFCEC) to execute upon the scope of work identified in the Contract. As reported in ECC's final report on the project, dated April 29, 2014 results (unaudited by Crowe) included, but were not limited to, construction of:

- Security Perimeter Wall, Seven Guard Shacks and Security Fencing
- Underground Utilities, including: Sewer/Drainage, Electrical, Communications, Water and Fuel
- Admin HQ Building
- Officers and NCO Barracks
- Six Team Room Buildings
- Storage Rooms/Buildings (Arms, Propane, POL, DFAC etc.)
- Medical Clinic
- Fitness facilities, including Multi-Purpose Fitness, 12 Station Fitness Field and a Soccer Field
- Warehouse
- Re-fueling Point; Fuel Point Wash Rack; Fuel Tanks
- Power Plant
- Helicopter Landing Zone
- Internal and External Road System
- Storm Drainage System and Underground Sewage System
- Perimeter Lighting

The project was concluded in April of 2014, and had not been formally closed out as of the date of this report.

Work Performed

Crowe Horwath LLP (Crowe) was engaged by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) to conduct a financial audit of costs incurred by ECC under task order FA8903-06-D-8511-0074 and associated modifications as indicated in a Special Purpose Financial Statement of ECCs 2nd SF KAF Project.



Objectives Defined by SIGAR

The following audit objectives were defined within the *Performance Work Statement for Financial Audits of Costs Incurred by Organizations Contracted by the U.S. Government for Reconstruction Activities in Afghanistan*:

Audit Objective 1 – Special Purpose Financial Statement

Express an opinion on whether the Special Purpose Financial Statement (SPFS) for the task order presents fairly, in all material respects, revenues received, costs incurred, items directly procured by the U.S. Government and balance for the period audited in conformity with the terms of the task order and accounting principles generally accepted in the United States of America or other comprehensive basis of accounting.

Audit Objective 2 – Internal Controls

Evaluate and obtain a sufficient understanding of ECC's internal control related to the award; assess control risk; and identify and report on significant deficiencies including material internal control weaknesses.

Audit Objective 3 – Compliance

Perform tests to determine whether ECC complied, in all material respects, with the task order requirements and applicable laws and regulations; and identify and report on instances of material noncompliance with terms of the task order and applicable laws and regulations, including potential fraud or abuse that may have occurred.

Audit Objective 4 – Corrective Action on Prior Findings and Recommendations

Determine and report on whether ECC has taken adequate corrective action to address findings and recommendations from previous engagements that could have a material effect on the special purpose financial statement or other financial data significant to the audit objectives.

Scope

The scope of the audit included the period February 28, 2011, through April 23, 2014, for the 2nd SF KAF Project. The audit was limited to those matters and procedures pertinent to the contract that have a direct and material effect on the SPFS and evaluation of the presentation, content, and underlying records of the SPFS. The audit included reviewing the financial records that support the SPFS to determine if there were material misstatements and if the SPFS was presented in the format required by SIGAR. In addition, the following areas were determined to be direct and material and, as a result, were included within the audit program for detailed evaluation:

- Allowable Costs;
- Allowable Activities;
- Period of Availability;
- Cash Management;
- Equipment and Property Management;
- Procurement;
- Reporting; and
- Special Tests and Provisions

Methodology

To meet the aforementioned objectives, Crowe completed a series of tests and procedures to audit the SPFS, tested compliance and considered ECC's internal controls over compliance and financial reporting,



and determined if adequate corrective action was taken in response to prior audit, assessment, findings and review comments, as applicable.

For purposes of meeting Audit Objective 1 pertaining to the SPFS, transactions were selected from the financial records underlying the SPFS and were tested to determine if the transactions were recorded in accordance with the basis of accounting identified by the ECC; were incurred within the period covered by the SPFS and in alignment with specified cutoff dates; were charged to the appropriate budgetary accounts; and were adequately supported.

With regard to Audit Objective 2 regarding internal control, Crowe requested and the auditee provided copies of policies and procedures and verbally communicated those procedures that do not exist in written format to provide Crowe with an understanding of the system of internal control established by ECC. The system of internal control is intended to provide reasonable assurance of achieving reliable financial and performance reporting and compliance with applicable laws and regulations. Crowe corroborated internal controls identified by the auditee and conducted testing of select key controls to understand if they were implemented as designed.

Audit Objective 3 requires that tests be performed to obtain an understanding of the auditee's compliance with requirements applicable to the contract and task order. Crowe identified the task order requirements and applicable laws and regulations through review of the contract, task order and subsequent modifications and the Code of Federal Regulations (CFR). Using sampling techniques, Crowe selected expenditures, vouchers submitted to AFCEC for payment, procurements, property and equipment dispositions, and project reports for audit. Supporting documentation was provided by the auditee and subsequently evaluated to assess ECC's compliance. Testing of indirect costs was limited to determining whether indirect costs were calculated and charged to the U.S. Government in accordance with approved indirect cost rates, and if adjustments were made, as required and applicable.

Regarding Audit Objective 4, Crowe inquired of both ECC, AFCEC and SIGAR regarding prior audits and reviews to obtain an understanding of the nature of audit reports and other assessments that were completed and the required corrective action. Based upon our review, no follow-up on prior findings/reports was deemed necessary.

Summary of Results

Upon completion of Crowe's procedures, Crowe identified five findings because they met one or more of the following criteria: (1) significant deficiency in internal control, (2) material weakness in internal control, (3) noncompliance with rules, laws, regulations, or the terms and conditions of the contract; and/or (4) questioned costs resulting from identified instances of noncompliance. Other matters that did not meet the aforementioned criteria were communicated verbally to ECC and SIGAR.

Crowe issued an unmodified opinion on the SPFS.

Crowe also reported on both ECC's compliance with the applicable laws, rules, regulations, and the terms and conditions of the contract and internal controls over compliance. One material weakness in internal control, four significant deficiencies in internal control, and five instances of noncompliance were reported. Where internal control and compliance findings pertained to the same matter, they were consolidated within a single finding. A total of \$220,891 in costs were questioned as presented in **TABLE A** contained herein.

Crowe also requested copies of prior audits, reviews, and evaluations pertinent to ECC's financial performance under the contract. Per communications with ECC, SIGAR and AFCEC, there were no reviews or assessments conducted by SIGAR or AFCEC that pertained to ECC's implementation of the project. However, there was one audit issued by DCAA pertaining to indirect costs. We obtained and reviewed the audit report. Based on a review of the audit, we noted one finding related to the cost allocation methodology utilized by ECC. However, this allocation issue stemmed from the 2006 allocation period and



was remediated by ECC in 2009 as indicated in the Contracting Officers Determination Letter to ECC, two years prior to the start of audit period. Based on this review, we did not note any items that might be direct and material to the SPFS. Therefore, there were no prior audit findings on which to follow-up.

This summary is intended to present an overview of the results of procedures completed for the purposes described herein and is not intended to be a representation of the audit's results in their entirety.

TABLE A: Summary of Findings and Questioned Costs

Finding Number	Matter	Questioned Costs
2015-01	Lack of Documentation over Allowable Costs	\$195,499
2015-02	Improper Allocation of Costs	25,392
2015-03	Lack of Documentation and Controls over Equipment Records	0
2015-04	Lack of Documentation and Controls over Required Reports	0
2015-05	Lack of Documentation and Controls over Key Personnel Changes	0
Total Questioned Costs		\$220,891

Summary of Management Comments

Management provided responses to the audit findings in which management disagreed with all five findings. Management disagreed with finding 2015-01 as they felt there was adequate documentation to support the allowabilty of the costs. Management disagreed with finding 2015-02 as they did not agree with the extrapolation method used for the costs questioned as part of the finding. Further, management stated the project management office (PMO) costs were too complex to break out by project. Management disagreed with the classification of finding 2015-03 as a significant deficiency and noncompliance as there were no questioned costs associated with the finding. Management disagreed with the classification of finding 2015-04 as a significant deficiency and noncompliance as there were no questioned costs associated with the finding and, while there was a lack of evidence over the submission of the reports, they stated the reports were submitted. Management disagreed with finding 2015-05 as they did not feel the IDIQ contract level requirements over key personnel changes were applicable or would have an effect on task order 74.

References to Appendices

The auditor's reports are supplemented by two appendices - **Appendix A** containing the Views of Responsible Officials, and Appendix B containing the Auditor's Rebuttal.

INDEPENDENT AUDITOR'S REPORT ON THE SPECIAL PURPOSE FINANCIAL STATEMENT

To the Office of the Special Inspector General for Afghanistan Reconstruction
2530 Crystal Drive
Arlington, Virginia 22202

To the Board of Directors of the Environmental Chemical Corporation
240 Bayshore Highway
Burlingame, CA 94010

Report on the Special Purpose Financial Statement

We have audited the Special Purpose Financial Statement (the Statement) of Environmental Chemical Corporation (ECC), and related notes to the Statement, for the period February 28, 2011 through April 23, 2014, with respect to the Design and Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan funded by task order number FA8903-06-D-8511-0074.

Management's Responsibility for the Special Purpose Financial Statement

Management is responsible for the preparation and fair presentation of the Statement in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) in Appendix IV of Solicitation ID11140014 (the Solicitation). Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a Statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the Special Purpose Financial Statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *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 Statement is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Statement, 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 Statement 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 Statement.

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

Opinion

In our opinion, the Statement referred to above presents fairly, in all material respects, revenues received, costs incurred, and balance for the indicated period in accordance with the requirements established by the Office of the Special Inspector General for Afghanistan Reconstruction in Appendix IV of the Solicitation and on the basis of accounting described in Note 1.

Basis of Presentation

We draw attention to Note 1 to the Statement, which describes the basis of presentation. The Statement was prepared by ECC in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction in Appendix IV of the Solicitation and presents those expenditures as permitted under the terms of task order number FA8903-06-D-8511-0074, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the task order referred to above. Our opinion is not modified with respect to this matter.

Restriction on Use

This report is intended for the information of ECC, the United States Air Force, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued reports dated February 2, 2016, on our consideration of ECC's internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is 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 internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering ECC's internal control over financial reporting and compliance.



Crowe Horwath LLP

February 2, 2016
Washington, D.C.

Environmental Chemical Corporation
Special Purpose Financial Statement
FA8903-06-D-8511, Task Order 74
For the Period February 28, 2011 through April 23, 2014

					Questioned Costs
	<u>Budget</u>	<u>Actual</u>	<u>Ineligible</u>	<u>Unsupported</u>	<u>Notes</u>
Revenues					
FA8903-06-D-8511, Task Order 74	\$ 21,647,410	\$ 21,639,589			4
Total Revenue	<u>21,647,410</u>	<u>21,639,589</u>			
Costs Incurred					
CLIN 1008AA:					5, 10
General Conditions	4,714,099	6,673,272		190,599	A
Materials	4,852,423	6,707,391		4,900	A
General Site Infrastructure	2,585,803	2,211,538			
Troop Housing	4,328,873	2,961,664			
Command and Common Facilities	1,678,128	644,053			
Motor Pool Facilities	539,100	365,100			
Utilities	<u>2,360,551</u>	<u>1,515,076</u>	<u>25,392</u>		B
Total CLIN 1008AA	<u>21,058,977</u>	<u>21,078,094</u>	<u>25,392</u>	<u>195,499</u>	5
CLIN 1008AB:					
Optional Training Facility	<u>26,938</u>	<u>-</u>			
Total CLIN 1008AB	<u>26,938</u>	<u>-</u>			5
Fixed Fee	561,495	561,495	-	-	6
Total Costs Incurred	<u>21,647,410</u>	<u>21,639,589</u>	<u>25,392</u>	<u>195,499</u>	
Balance	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (25,392)</u>	<u>\$ (195,499)</u>	

The accompanying notes to the Special Purpose Financial Statement are an integral part of this Statement.

Environmental Chemical Corporation
Notes to the Special Purpose Financial Statement
For the Period February 28, 2011 through April 23, 2014
Contract Task Order FA8903-06-D-8511-0074

Note 1. Basis of Presentation

The accompanying Special Purpose Financial Statement (the Statement) includes costs incurred under task order 0074, Design and Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan, issued under Contract No FA8903-06-D-8511-0074 for the Air Force Civil Engineering Center (AFCEC) Heavy Engineering Repair and Construction program for the period Feb 28, 2011, through April 23, 2014. Because the Statement presents only a selected portion of the overall operations of Environmental Chemical Corporation (ECC), it is not intended to and does not present the financial position, changes in net assets, or cash flows of ECC as a corporation. The information in this Statement is presented in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) and is specific to the aforementioned federal task order. Therefore, some amounts presented in this Statement may differ from amounts presented in, or used in the preparation of other financial statements. The Statement was prepared at the request of SIGAR for the sole purpose of the subject audit.

Note 2. Basis of Accounting

Expenditures reported on the Statement are reported in accordance with accounting principles generally accepted in the United States of America (GAAP) and, therefore, are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in Title 48, Subpart 31.2 of the United States Code of Federal Regulations, wherein certain types of expenditures are not allowable or are limited as to reimbursement. This Task Order was completed in April 2014 and all expenses have been billed to the government, there are no accrued costs to consider.

Note 3. Foreign Currency Conversion Method

Some purchases made in local Afghanistan markets involved currency conversions from Afghanistan currency, Afghanis (AFN) to United States Dollars (USD). This conversion was done at the time the purchase was made using the spot rate, prior to payment. In addition, there were some invoices involving purchases from Dubai that were presented in United Arab Emirates currency, Arab Emirates Dirham (AED). The conversion from AED to USD was performed using the current conversion rate between the currencies. It should be noted that the AED is pegged to the USD in value so there is minimal fluctuation in the conversion rate.

Note 4. Revenues

Revenues on the Statement represent the amount of funds that ECC is entitled to receive from AFCEC in accordance with the terms and conditions of Contract No FA8903-06-D-8511-0074 during the period of performance. The project was completed and was fully invoiced and paid, except for a small retention held by AFCEC as described above, and no material change in revenue is anticipated. Therefore, revenue is fully recognized.

The Government has paid ECC \$21,629,589. In addition, ECC has \$10,000 in fees held by the Government pending the issuance by Defense Contract Audit Agency (DCAA) of the final indirect rates including fringe, Overhead and G&A for the time period which the project was performed.

Note 5. Costs Incurred by Cost Category

The budgeted amounts reflect those amounts approved as of Modification No. 0007 dated July 2, 2013, which established the final budgetary amounts for the task order. The SPFS presents eight cost categories, reflecting different project functions. However, the task order only contained a single line item valued at \$21,620,472, a fixed fee line item valued at \$561,495 and an optional line item for a Training Facility (Line Item 1008AB) valued at \$26,938. The option was not exercised by the Government.

The variance in cost versus budget was the result of Termination for Default of the principal subcontractor, Prime Group. The termination resulted in project time extension leading to an increase in project management costs. The termination also shifted costs from the subcontractor to ECC as ECC was now purchasing materials versus the subcontractor.

Note 6. Fixed Fee

This is a cost-plus fixed fee contract. The fee information and billing status is presented below.

Delivery or Task Order Number	Authorized Fixed Fee Amount	Amount Earned as of April 23, 2014	Amount Paid as of December 14, 2015	Fee Withheld Pending DCAA Audit
0074	\$561,495.00	\$561,495.00	\$551,495.00	\$10,000.00
TOTALS:	\$561,495.00	\$561,495.00	\$551,495.00	\$10,000.00

Note 7. Currency

All amounts presented are shown in United States Dollars (USD).

Note 8. Program/Project Status

The work under Task Order FA8903-06-D-8511-0074 has been completed. However, the task order has not been closed out pending finalization of indirect cost rates by DCAA, as described in Note 4 above.

Note 9. Subsequent Events

Management has performed an analysis of the activities and transactions subsequent to the February 28, 2011, through April 23, 2014, period covered by the Statement. Management has performed their analysis through February 2, 2016.

Note 10. Unreimbursable Costs (Unaudited)

The format of the SPFS precludes presenting all the costs that were incurred by ECC. ECC incurred additional costs totaling \$253,121, these would have been billed except for funding limitations set by government. All costs incurred by ECC, including the \$253,121 not billed to the Government, are reflected in ECC's accounting records.

Notes to the Questioned Costs Presented on the Special Purpose Financial Statement¹

Note A. Lack of Documentation over Petty Cash Disbursements

Finding 2015-01 identified \$195,499 in questioned costs that resulted from ECC not providing documentation to support petty cash disbursements. \$4,900 of costs were related to a purchase of construction materials, and was included within the CLIN 1008AA, "Materials" category. \$190,599 related to payments to Afghan national laborers, and was included within the CLIN 1008AA, "General Conditions" category.

Note B. Improper Allocation of Costs

Finding 2015-02 identified \$25,392 in questioned costs that resulted from ECC improperly allocating utility related costs to employees not billed to the task order. These costs were included within the CLIN 1008AA, "Utilities" category.

¹ Notes to the Questioned Costs Presented on the Special Purpose Financial Statement were prepared by the auditor for informational purposes only and as such are not part of the audited Statement.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To the Board of Directors of Environmental Chemical Corporation
240 Bayshore Highway
Burlingame, CA 94010

To the Office of the Special Inspector General for Afghanistan Reconstruction
2530 Crystal Drive
Arlington, Virginia 22202

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 Special Purpose Financial Statement ("the Statement") of Environmental Chemical Corporation ("ECC"), and related notes to the Statement, for the period February 28, 2011, through April 23, 2014, with respect to the Design and Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan funded by contract task order number FA8903-06-D-8511-0074. We have issued our report thereon dated February 2, 2016.

Internal Control over Financial Reporting

ECC's management is responsible for establishing and maintaining effective internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and in accordance with the terms of the cooperative agreement; and transactions are recorded properly to permit the preparation of the Statement in conformity with the basis of presentation described in Note 1 to the Statement. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the Statement for the period February 28, 2011, through April 23, 2014, we considered ECC's internal controls to determine audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the Statement, but not for the purpose of expressing an opinion on the effectiveness of ECC's internal control. Accordingly, we do not express an opinion on the effectiveness of ECC's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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 Statement will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency noted in Finding 2015-01 in the accompanying Schedule of Findings and Questioned Costs to be a material weakness.

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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as Findings 2015-02, 2015-03, 2015-04 and 2015-05 to be significant deficiencies.

ECC's Response to Findings

ECC's response to the findings were not subject to the auditing procedures applied in the audit of the special purpose financial statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

Restriction on Use

This report is intended for the information of ECC, the United States Air Force, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.



Crowe Horwath LLP

February 2, 2016
Washington, D.C.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

To the Board of Directors of Environmental Chemical Corporation
240 Bayshore Highway
Burlingame, CA 94010

To the Office of the Special Inspector General for Afghanistan Reconstruction
2530 Crystal Drive
Arlington, Virginia 22202

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 Special Purpose Financial Statement ("the Statement") of Environmental Chemical Corporation ("ECC"), and related notes to the Statement, for the period February 28, 2011, through April 23, 2014, with respect to the Design and Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan funded by contract task order number FA8903-06-D-8511-0074. We have issued our report thereon dated February 2, 2016.

Management's Responsibility for Compliance

Compliance with Federal rules, laws, regulations, and the terms and conditions applicable to the cooperative agreement is the responsibility of the management of ECC.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Statement is free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matter that is required to be reported under *Government Auditing Standards* and which are described in Findings 2015-01, 2015-02, 2015-03, 2015-04 and 2015-05 in the accompanying Schedule of Findings and Questioned Costs.

ECC's Response to Findings

ECC's response to the findings were not subjected to the auditing procedures applied in the audit of the special purpose financial statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

Restriction on Use

This report is intended for the information of ECC, the United States Air Force, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.

A handwritten signature in dark ink that reads "Crowe Horwath LLP". The signature is written in a cursive, flowing style.

Crowe Horwath LLP

February 2, 2016
Washington, D.C.

SECTION 1: SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Finding 2015-01: Lack of Documentation over Allowable Costs

Material Weakness and Noncompliance

Condition: During testing of 67 transactions, 7 petty cash transactions were identified that were lacking supporting documentation to determine that the cost was allowable under the task order. In addition to these 7 transactions, 1 of 67 transactions was not approved in accordance with ECC's written control procedures. These transactions are summarized below:

- Seven (7) transactions tested could not be determined as an allowable cost due to the lack of supporting documentation, as follows:
 - o A petty cash purchase for construction materials (cement) did not include adequate documentation to support allowability of the cost and to determine whether the goods purchased were used for this Task Order. The purchase was made via petty cash, rather than through ECC's standard procurement procedures. Based upon our testing, this was the only cement purchase noted as being paid through petty cash.
 - o Approximately 141 petty cash transactions were made to Afghan national laborers that did not include adequate support to determine the reasonableness, and allowability of the services performed. There was insufficient documentation to support the work completed by the laborers on the Task Order, such as labor agreements and/or work products. ECC did not maintain job descriptions, agreements or other negotiations with Afghan national laborers.
- One transaction tested did not include documentation to support review/approval by ECC prior to payment. The transaction was for contractor travel due to a leave of absence. However, documentation was not provided to support the approval for travel prior to the costs being incurred. Though this transaction did not have support for internal ECC approvals prior to payment, ECC was able to provide documentation to support the allowability of this cost in accordance with the task order. Thus, there are no questioned costs associated with this exception.

See table below for further details on questioned costs related to unsupported transactions as described above:

Transaction Type	# of Exceptions	Unsupported Costs
Petty Cash – Construction Materials	1	\$4,900
Petty Cash – Afghan National Laborer Payments	6	\$190,599
Travel – Lack of Approval	1	\$0
Total Unsupported Costs		\$195,499

Criteria: According to 48 CFR 31.201-2(a), "A cost is allowable only when the cost complies with all of the following requirements:

- (1) Reasonableness.
- (2) Allocability.
- (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
- (4) Terms of the contract.
- (5) Any limitations set forth in this subpart.

In addition, 48 CFR 31.201-2(d) states, "A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs

claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported."

Further, ECC's Accounts Payable Policies, Procedures and Practices, "POLICY EXP001: Authorization to Travel," states "All Domestic and International Travel must be authorized by employee's supervisor or a senior manager."

Questioned costs: \$195,499

Effect: ECC charged the Air Force for \$195,499 of unsupported costs.

Cause: ECC stated the standard company policy over petty cash payments to Afghan national laborers did not require a contract or labor agreement. In addition, turnover in staff occurred since the project had been completed, which caused difficulties in obtaining adequate documentation and support over petty cash activity. ECC also stated approval over the travel cost was provided informally at the project site, due to the nature of the emergency leave travel.

Recommendation: We recommend ECC provide missing supporting documentation or reimburse the Air Force for \$195,499 of unsupported costs. In addition, ECC should develop a process to obtain documentation to support allowability prior to payment and maintain this documentation for the proper retention period.

In addition, for travel related transactions, a travel authorization request, should be completed and approved prior to the cost being incurred. ECC should update their policies to include this requirement for all travel, including emergency leave.

Management Response: See **Appendix A** for management's response and **Appendix B** for auditor's rebuttal.

Finding 2015-02: Improper Allocation of Costs

Significant Deficiency and Noncompliance

Condition: During testing of 67 transactions, we identified 5 transactions that were not deemed as allowable or allocable under the Task Order, as follows:

- o Two of two monthly telephone bills tested included \$342 of charges billed to the task order for four employees who did not bill hours to the Task Order. There were 27 monthly payments to the telephone carrier billed to the task order. Based upon the items noted above identified during testing, the entire amount of monthly telephone costs billed to the task order, \$6,985, is being questioned.
- o Two of two months of fuel payments tested were billed to the task order directly for vehicles used by an employee charging time to the Project Management Office (PMO). PMO costs are for costs incurred covering multiple projects within a geographic location, and allocated monthly based upon a ratio of direct task order costs to total PMO costs. Therefore, only a proportionate share of the fuel costs should have been billed within the monthly PMO allocation. Costs were recalculated using applicable PMO percentages to determine an allocable portion, and an additional \$638 was charged to the TO for these two invoices. There were several additional payments made to this vendor billed to the task order. Based upon the issues noted during testing, all fuel payments paid to this vendor and billed to the task order, \$18,407, were questioned.

See table below for further details on questioned costs related to improper allocation to the task order as described above:

Transaction Type	# of Exceptions	Questioned / Unsupported Amounts
Telephone Bill for ECC Employees and Subcontractors	2	\$6,985
Fuel Purchase for Vehicles	2	\$18,407
Total Questioned Costs		\$25,392

Criteria: According to 48 CFR 31.201-2(a), "A cost is allowable only when the cost complies with all of the following requirements:

- (1) Reasonableness.
- (2) Allocability.
- (3) Standards promulgated by the CAS Board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances.
- (4) Terms of the contract.
- (5) Any limitations set forth in this subpart.

According to 48 CFR 31.201-4, a cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

- (a) Is incurred specifically for the contract;
- (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or
- (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

Questioned costs: \$25,392

Effect: ECC charged the Air Force for \$25,392 of unallowable/unallocable costs that did not benefit the task order.

Cause: ECC stated these types of costs are incurred monthly for all Non U.S. related transactions. An allocation of each monthly telephone bill is performed to determine the portion to bill to each task order, as applicable. ECC stated the management uses their judgment, based upon the individual's duties, as to where to allocate costs. The reasoning behind this judgment wasn't always documented.

Recommendation: We recommend ECC provide documentation that supports the allowability of these costs, or reimburse the Air Force for \$25,392 of costs that could not be determined to be allowable or allocable. In addition, ECC should implement policies that require a review of costs to determine charges billed are for individuals who benefited the project or Task Order. Costs associated with an employee should be allocated only as appropriate.

Management Response: See **Appendix A** for management's response and **Appendix B** for auditor's rebuttal.

Finding 2015-03: Lack of Documentation and Controls over Equipment Records

Significant Deficiency and Noncompliance

Condition: We noted that ECC did not perform annual inventory reconciliations or periodic inventory counts over property purchased through the contract task order.

Criteria: Federal Acquisition regulation (FAR) 52.245-1(f)(1)(iv) states, "Physical Inventory: The Contractor shall periodically perform, record, and disclose physical inventory results."

In addition, ECC's Property Management Plan (PMP) over Contract FA8903-06-D-8511, section 1.4.5, "Physical Inventory" states: "The ECC Property Manager will establish a system for the physical inventory of all property used on the contract. The physical inventory system will ensure all government furnished property is accounted for, properly utilized, and properly disposed of at the end of the property's life cycle. The inventory system will be coordinated through the Project Manager and will comply with guidance outlined in FAR Parts 45 and FAR clause 52.245-1(f)(iv)."

Questioned costs: None.

Effect: A lack of control over inventory and consistent inventory records may signal lost property or thefts that go undetected. Incomplete inventory records and reconciliations throughout the course of this task order also signal greater potential for noncompliance with the contract and federal requirements.

Cause: ECC did not have formal procedures, or follow inventory procedures in place, to perform annual property inventory and reconciliations to the property listing, accounting records and to the actual counts.

Recommendation: We recommend that ECC implement formal procedures to comply with FAR 52.245(f)(1)(iv) related to periodic performance of inventories. ECC should develop processes to perform annual inventory reconciliations and periodic inventory counts, document the reconciliations and counts, and maintain this documentation for the required retention period.

Management Response: See **Appendix A** for management's response and **Appendix B** for auditor's rebuttal.

Finding 2015-04: Lack of Documentation and Controls over Required Reports

Significant Deficiency and Noncompliance

Condition:

ECC did not provide the required reports per the Task Order. Based upon the time frame of the task order, 25 of 39 monthly Contractor's Progress, Status, and Management Report (CPSMR) and 70 of 83 biweekly Cost Schedule Status Report (CSSR) could not be provided. Further, a portion of CSSRs submitted covered an improper reporting period, and were reported on a monthly or bimonthly basis, rather than the required biweekly basis.

In addition to the missing reports, we also noted the available reports did not include documentation of management review. As such, we could not confirm the reports were reviewed prior to submission to determine information was accurate and properly reported. Further, ECC did not maintain written control procedures over the reporting process, so we could not determine ECC's controls over reporting, if any.

Criteria: Task order FA8903-06-D-8511-0074 includes requirements for periodic financial and status reporting, as follows:

Section 4.3.1.1 – Contractor's Progress, Status, and Management Report (CPSMR), states "The Contractor shall prepare and submit a CPSMR. The CPSMR shall be used to review and evaluate the overall progress of the project, along with any existing or potential problem areas. The report shall be prepared in the CO-approved format. The CPSMR shall include a summary of the events that occurred during the reporting period, discussion of performance, identification of problems, proposed solutions, corrective actions taken, and outstanding issues." Exhibit A of the Task Order, "CONTRACT DATA REQUIREMENTS LIST" requires the CPSMR to be submitted on a monthly basis, 15 days after month-end.

Section 4.3.1.2 - Cost/Schedule Status Report (CSSR), states "The Contractor shall prepare CSSRs, which summarize performance information for program management purposes. The CSSR contains contract data, including original and current contract values and management estimate at completion, performance data, and narrative explanations which present information on significant cost, schedule variances, contractual problems, or other areas of interest. The Contractor shall develop Earned Value Charts as part of the Cost/Schedule reporting requirements. In addition, the Contractor shall populate tracking web sites as specified by the COR. Exhibit A of the Task Order, "CONTRACT DATA REQUIREMENTS LIST" requires the CSSR to be submitted on a biweekly basis, on the 3rd and 18th of each month.

In addition, it is a best practice to have controls in place over financial reporting. Internal control procedures dictate a review and approval of the reports prior to submission to the Air Force to ensure accurate and complete information is being reported, and reports are submitted timely.

Questioned costs: None

Effect: Lack of available financial and status reports could indicate lack of monitoring over the progress of the project. In addition, without proper controls and review over the reports, the submitted reports may be inaccurate and incomplete, and financial information may be misstated.

Cause: ECC stated the reports may have been submitted on-site or through another method, other than the project portal, during the time of the task order. However, due to the turnover of personnel, no support could be obtained to confirm this explanation. Furthermore, there were formal procedures to ensure that ECC maintained documentation of reports submitted and the formal approval of reports.

Recommendation: We recommend ECC implement policies and procedures to prompt review of whether or not required reports have been submitted to the Federal Government. This would include implementing a review/approval process to verify reports are accurate and complete prior to submission. In addition, ECC should institute policies which require management to maintain documentation of reviews over the reports as they are performed.

Management Response: See **Appendix A** for management's response and **Appendix B** for auditor's rebuttal.

Finding 2015-05: Lack of Documentation and Controls over Key Personnel Changes

Significant Deficiency and Noncompliance

Condition: Documentation was not provided to support the approval of key personnel changes during the task order period. Five individuals were identified as key personnel in ECC's base contract no. FA8903-06-D-8511 with the Air Force. The base contract included these key personnel to perform various duties under the contract. The contract did not provide specific guidance for key personnel's involvement in any task orders issued under the contract. As of the task order end date, three individuals were still employed in a key position listed in the contract. As such, it was determined at least two key personnel changes had been made. ECC did not provide documentation to support the approvals for the key personnel changes during the Task order period. However, as individuals within key positions were not charged to the task order nor were key personnel requirements included in the task order itself, there are no questioned costs related to this matter.

Criteria: The IDIQ, FA8903-06-D-8511, includes requirements for key personnel changes, as follows:

Section PKV-H015 – Key Personnel – Contract Level:

“The HERC CO and HERC Program Manager/COR shall be notified of any proposed changes at least 10 days in advance. The notification should include an explanation of the circumstances necessitating the substitution, a complete resume of the proposed substitute, and any other information needed by the HERC CO and HERC Program Manager/COR to enable them to determine that the Contractor is maintaining the same quality of personnel as those included at the time of the award.”

Questioned costs: None

Effect: Without notifications and approvals over key personnel changes, AFCEC cannot properly control such changes or determine the key personnel substitutes are individuals who are properly qualified and have the suitable skill-sets necessary to perform key personnel duties.

Cause: ECC did not have procedures in place to maintain such documentation.

Recommendation: We recommend ECC implement policies and procedures to maintain documentation of the approval of key personnel changes, as required by the base contract.

Management Response: See **Appendix A** for management's response and **Appendix B** for auditor's rebuttal.

SECTION 2: Summary Schedule of Prior Audit and Review Findings

Per discussion with ECC and AFCEC, there were no prior audits completed by SIGAR and AFCEC over ECC related to the task order under audit. However, there was one audit issued by DCAA, Audit Report No. 04281–2010E19200005 related to indirect cost allocations. We obtained and reviewed the audit report. Based on a review of the audit, we noted one finding related to the cost allocation methodology utilized by ECC. However, this allocation issue stemmed from the 2006 allocation period and was remediated by ECC in 2009 as indicated in the Contracting Officers Determination Letter to ECC, two years prior to the start of this audit period. Based on this review, we did not note any items that may be direct and material to the SPFS. Therefore, there were no prior audit findings on which to follow-up.

Appendix A: Views of Responsible Officials



Corporate Office

1240 Bayshore Highway
Burlingame, CA 94010

Phone: (650) 347-1555

Fax: (650) 347-8789

www.ecc.net

January 20, 2016
Serial # 2016.COR.003

Mr. Bert Neuhring, CPA, Partner
Crowe Horwath LLP
1325 G Street NW Suite 500
Washington DC 20005-3136

Subject: ECC Response to Crowe Horwath SIGAR Audit Report

Dear Mr. Bert Nuehring,

This is in response to the SIGAR audit findings of the costs billed to the Government for USAF Task Order 74, Construction of the 2nd Special Forces Kandak at Kandahar, Afghanistan.

Thank you for allowing ECC the opportunity to comment on the subject report. Our comments are provided in greater detail in attachment A to this letter. In summary, we do not agree that there were any material weaknesses, points of noncompliance or significant deficiencies in ECC's execution of the project. We acknowledge that certain improvements to some aspects of the project administration are worthy of comment and improvement and we are grateful to have an independent review of the same. However, the points raised in the audit while beneficial to future projects are far from being significant or material in relation to this project.

ECC is open to further discussion with our clients on the points raised. Overall, while we do not agree with all of the points raised, as included in our response herein, we note that the findings account for less than 1% of the contract value. We also note that ECC incurred \$253,121 allowable costs in excess of the funds reimbursed to ECC due to the government funding limitations, and that this amount significantly exceeds even the disputed amounts itemized in the audit report. One can only thus conclude that there is no harm (material or otherwise) to the government demonstrated as a result of this audit process, and that the audit's recommendation to credit funds back to the US Government is an inappropriate and unnecessary recommendation at best.

Again, thank you for your review and comments. It was a pleasure interacting with your staff.

Regards,

 glenn
2016.01.20
14:56:15 -08'00'

Glenn Sweatt
Vice President, Contracts

A. Audit Finding Number 2015-01 Lack of Documentation over Allowable Costs/Material Weakness and Noncompliance

ECC disagrees that there is material weakness and disagrees with the audit report questioning \$195,499 allowable costs based on inadequate audit support.

Cement Purchase using Petty Cash. ECC acknowledges that petty cash (\$4,900) was used to purchase ready-mix concrete for the project. This purchase represents a very minor portion of the total concrete purchased on the project (estimated to be much less than 1% of all the concrete purchased). However, there is proper documentation, which includes a receipt from the vendor which shows the vendor's name and phone number, the quantity of concrete purchased, the date and the total cost. The receipt for this minor purchase does meet all the requirements for allowability and allocability in that:

- 1) The price is reasonable at \$140/cubic meter and the price is consistent with other purchases
- 2) The cost is allocable as concrete was needed to construct this facility
- 3) The use of petty cash is considered appropriate for the circumstances (Afghanistan security conditions and a minor purchase given the overall concrete costs for the project)
- 4) A contract is not relevant or necessary as this was a minor cash purchase for an immediate service

The payment procedure for petty cash disbursement is consistent with ECC's petty cash policies and follows generally accepted cash management practices. As evidenced by the petty cash receipt and the petty cash report which were already provided to the auditor, the purchase was approved by the Project Manager, the cash disbursement was overseen by the Protect Cost Controller and the payment was made by the Project Administrative Assistant. This is recorded as part of the purchase documentation. Further, this process leaves no doubt that the concrete was purchased for this project and the question of whether the concrete was purchased for this task order has no basis.

Cash Payment to Afghan National Laborers. ECC acknowledges that Afghan National laborers were paid in cash. This is a common practice in the local Afghan construction industry. In fact it is the only practical way to pay many laborers in many parts of Afghanistan as the workers simply do not have personal bank accounts.

There should be no questions as to the necessity and allowability of the labor costs on the construction project, which were evidenced and supported by the payment receipt and report. It goes without saying that construction requires labor and the cash payments in question is for the labor. It follows then that the labor costs are necessary and allowable as a project cost under this Task Order.

Contrary to auditor's statement that supporting documentation is missing, the labor costs in question are well documented. The documentation includes 1) a Labor Time Card and 2) a Petty Cash Disbursement Record. The Labor Time Card includes the following information:

- 1) Labor name
- 2) Tazkara Number (this is an Afghan National ID number)
- 3) ECC Employee ID Number
- 4) Position Title

- 5) Monthly Salary
- 6) Days worked (by date)
- 7) Signature of Employee
- 8) Project cost coding (by proper WBS number)

The cash payment to the employee is documented via the Petty Cash Disbursement report which includes the following information:

- 1) Petty cash disbursement request date
- 2) Date of payment
- 3) Amount paid (in US \$)
- 4) WBS cost coding
- 5) Approval of the Project Manager
- 6) Approval of the Project Cost Controller
- 7) Disbursement by the Project Administrator

Based on the above, both the petty cash payment to the cement purchase and to the local Afghanistan laborers are adequately documented and supported. ECC does not agree there is material weakness in the execution of this contract and believes both the concrete cost (\$4,900) and the construction labor (\$190,599) are allowable and allocable to the project as they are necessary elements of the construction project. The costs are supported by sufficient and appropriate documentation which is consistent with standard practices for cash disbursements. Further, the payment of general construction labor costs without formal labor agreements or contracts is the local industry practice and is appropriate and allowable under Afghan law.

B. Audit Finding Number 2015-02 Improper Allocation of Costs/ Significant Deficiency and Noncompliance

ECC disagrees that there is significant deficiency and noncompliance and disagrees with the audit report questioning \$25,392 allowable costs.

First, there is no adequate basis to question the entire telephone and fuel costs allocated to the task order. The audit report stated that "Two of two monthly telephone bills tested included \$342 of charges billed to the task order for four employees who did not bill hours to the Task Order. There were 27 monthly payments to the telephone carrier billed to the task order. Based upon the issues identified during testing, the entire amount of monthly telephone costs billed to the task order, \$6,985, is being questioned." Similarly, the report also stated that "Two of two months of fuel payments tested were billed to the task order directly for vehicles used by an employee charging time to the Project Management Office (PMO)... There were several additional payments made to this vendor billed to the task order. Based upon the issues noted during testing, all fuel payments paid to this vendor and billed to the task order, \$18,407, were questioned."

The audit sample evidence at most revealed two possible but sporadic inconsistencies out of the many different telephone bills and fuel invoices and the audit used the two minor inconsistencies to question the entire telephone and fuel costs allocated to task order 74. This is not consistent with the requirements of the generally accepted government auditing standards that audit conclusion has to be based on adequate audit evidence. The audit conclusion seems to have used the assumption that all other telephone and fuel costs are incorrect because of the

sample line items it identified as inconsistent or inaccurate. It is not appropriate for the audit to use two insignificant line items in its limited sample review and use it as basis to question the entire costs.

Second, the audit did not consider all the complexity of the contract and the difficult environment where the contract was executed. In executing the contract in Afghanistan, there were many personnel and vehicles that were involved in supporting both the task order 74 and/or the overall PMO area which covers the entire Kandahar surroundings. Some personnel and vehicles might be dedicated to one single task order while others are dedicated to the entire portfolio of PMO projects. To maintain cost efficiency, there were frequent employee and vehicle transitions among the projects. In dealing with the complexity of the contract, ECC had onsite cost tracking staff to monitor and record all of these task order and PMO activities and the amount of cost tracking work was tremendous. The cost allocation was performed by the onsite cost trackers in real time and based on their best knowledge as to who and which vehicle was on which task order and/or PMO duty. Due to the volume of the work, there could be a few isolated errors or inconsistencies. But the overwhelming majority of the cost allocations done by the onsite cost trackers are accurate and reliable because the cost trackers were fully trained professionals and they were dedicated full time to the real time cost tracking in Afghanistan.

C. Audit Finding Number 2015-03 Lack of Documentation and Controls over Equipment Records/ Significant Deficiency and Noncompliance

ECC has a Government Property Management Plan as the audit report acknowledged. The plan requires physical inventory and reconciliation for the property's life cycle. ECC has the proper policies and controls in place, consistent with this Plan. The government property in questions was closely controlled as it was in use throughout the project, for example, by the government Title II personnel who were housed in the facilities provided by ECC per the contract.

Arguably the most critical part of the inventory management process, and referenced by Finding 2015-03, is the proper disposal or transfer of the inventory. ECC provided the audit team with appropriate paperwork and communications between ECC and AFCEC that demonstrated compliance with disposition and equipment transfer requirements. Such paperwork included a Government Property Relief letter signed by the AFCEC Contracting Officer which documented that all government equipment purchased for the project was appropriately transferred to government custody at the conclusion of the project. In fact, at no point during the project did any AFCEC or Title II representative raise a compliance concern pertaining to ECC's management of government property on the contract. Furthermore, the audit report does not question any cost in relation to the management of the government property. As a result, there is not adequate basis for this finding to be characterized as a "Significant Deficiency and Noncompliance" for this special purpose audit.

D. Audit Finding Number 2015-04 Lack of Documentation and Controls over Required Reports/ Significant Deficiency and Noncompliance

ECC acknowledges that there are contract requirements for periodic financial and status reporting. Specifically, the contract requires monthly submission of the Contractor's Progress, Status, and Management Report (CPSMR) and biweekly submission of the Cost Schedule Status Report (CSSR). While it was correct that ECC was unable to demonstrate to the audit team that each and every report required by the contract had been uploaded to the project portal (or otherwise provided to the government), concluding that "ECC did not provide the required reports per the Task Order" is overbroad and misleading. Thousands of reports were properly uploaded to the project portal. ECC is confident that many or all of the 'missing' reports were provided to

AFCEC representatives by other means including by email and/or by hand delivery at routine meetings between the on-site personnel of the two organizations. However, due to the employee turnover on both the government and ECC sides in the years since the project was completed and the fact that other media may have been used in lieu of the project portal, such submissions could no longer be verified because they were not available.

Notwithstanding the lack of evidence for the required reports, it is worth noting that the FINAL CCASS review issued by the Air Force for the project deemed ECC's performance with respect to reporting as 'Satisfactory' and included comment that "Contractor completed project in accordance with contract." Lastly, the audit report does not question any cost in relation to this documentation and reporting subject. As a result, there is not adequate basis for this finding to be characterized as a "Significant Deficiency and Noncompliance" for this special purpose audit.

E. Audit Finding Number 2015-05 Lack of Documentation and Controls over Key Personnel Changes/ Significant Deficiency and Noncompliance

This finding pertains to the IDIQ Contract Level Key Personnel clause (and not personnel directly on the project). The audit report asserts that 4 of the 5 Program Level Key Personnel identified in the Base IDIQ contract were no longer employed with ECC at the time Task Order 74 concluded. This is not a correct statement. The following three Key Personnel were existing ECC employees throughout 2013 and directly engaged with the management of ECC's Afghanistan Program.

Program Manager: Brent Nixon

Program QA/QC Manager: Leili Arjomand

Program Construction Manager: Michael Meuleners

While correct that the other two Key Personnel listed in the IDIQ were no longer ECC employees at the conclusion of TO74 in 2013, it is worth noting and the audit report pointed it out too that the IDIQ contract did not provide specific guidance for key personnel's involvement in any task orders issued under the contract. ECC did not and was not required to provide advance documentation for the approvals for the key personnel changes during the task order period. Nevertheless, ECC's execution of the contract conformed to the contract terms and ECC always had key personnel available and on duty for this task order and they ensured the completion of the contract which was inspected and accepted by the government. This provides the evidence that such key personnel change did not have any material or meaningful impact on the subject task order. The fact the audit report did not question any cost associated with this also testifies to the insignificance and immateriality of the matter. Accordingly, ECC's inability to provide the SIGAR audit team with the Key Personnel change request letters for those two IDIQ Programmatic positions does not establish grounds for this finding to be considered a 'Significant Deficiency and Noncompliance' for this special purpose audit on Task Order 74.

Appendix B: Auditor's Rebuttal

Crowe Horwath LLP, in consideration of the views presented by the management of ECC presents the following rebuttal to certain matters presented by the auditee. The responses below are intended to clarify factual errors and provide context, where appropriate, to assist users of the report in their evaluation of the audit report.

Finding 2015-01

The Code of Federal Regulations (CFR), 48 CFR part 31.202-2(d) states:

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

The first section of the response describes ECC's disagreement with the finding and questioned costs related to the lack of supporting documentation for the petty cash purchase of \$4,900 of concrete. ECC purchased concrete through procured vendors throughout the project period, but this purchase was purchased with petty cash. The supporting documentation included a hand-written receipt that did not contain adequate documentation to support the need for the purchase and use of the concrete outside of the normal procurement process utilized for other concrete purchases on this project.

The second section of the response describes ECC's disagreement with the finding and questioned costs related to the lack of supporting documentation over the petty cash payments to Afghan national laborers. While it may be reasonable to utilize Afghan national laborers for work on the project, there was inadequate documentation provided to support the reasonableness of the duties performed or costs paid, such as agreements with Afghan national laborers or documentation of standard Afghan national laborer positions, qualifications and rates. Without adequate documentation to support the use of the laborers for specific functions on the project and the estimate of the rate/cost for those functions, Crowe Horwath LLP could not determine the tie-in between the Afghan national laborer plan for the construction and what actually occurred. The documentation did not clearly state what the Afghan national laborers did or how they fit into the project itself. While it may be common practice within Afghanistan to not require labor agreements for these type of workers, FAR 48 CFR 31.202-2(d) requires the contractor to maintain appropriate documentation to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles.

Outside of the eight items as identified by ECC as included within the support, the documentation provided is still lacking information to support the allowability of the costs, as described above. Further, contrary to ECC's response, the documentation provided did not include all eight items on the time cards as identified by ECC. Five of the six petty cash payments to Afghan national laborers tested were missing at least one item identified as included in the documentation by ECC, as follows:

- Two of the six petty cash payments tested did not include the proper name of the laborer, as only a first name was included on the timesheet.
- Three of the payments tested included only a broad description of the position, such as "laborer" or "kitchen," thus it was not easily identifiable what these individuals were assigned to do.
- One of the petty cash payments did not include a labor time card, therefore, no employee number, monthly salary, days worked or employee signature was provided. Further, the support for work performed for this payment was a handwritten note of the payment due to for work performed on the task order.

In accordance with Government Auditing Standards (Chapter 6, paragraphs 6.39 and 6.56 – 6.72), there was insufficient evidence to support the allowability, allocability and reasonability of the petty cash payments in question. The finding remains as originally stated.

Finding 2015-02

ECC disagreed with the finding and related questioned costs. Generally Accepted Auditing Standards, SAS 117 AU §801.11, discusses the use of extrapolation over questioned costs to determine likely questioned costs, when the total questioned costs are not specifically identifiable. The standard states, “likely questioned costs are developed by extrapolating from audit evidence obtained, for example, by projecting known questioned costs identified in an audit sample to the entire population from which the sample was drawn.” As the known questioned costs for both the telephone bills and fuel bills were not identifiable, we extrapolated the errors to the population, as described below.

We tested two telephone bills within our randomly selected testing sample pool, and 100% of the bills tested had exceptions in which employee who did not charge any time to the task order were charging telephone costs/services to the task order. We extrapolated the impact of the findings to the population based upon the sample, as described by auditing standards above. Therefore, as 100% of the sample tested had errors, we extrapolated to 100% of the telephone bills charge to the task order. Further, ECC did not provide additional documentation to support these instances were isolated occurrences and did not affect other telephone bills charged to the project.

The fuel bills charged to the task order at the full amount of the cost were for individuals who were billed to the project based upon the Project Management Office (PMO) allocation, and not for 100% of salary or time. For costs that are too difficult to determine the amount to directly charge to a specific project, a reasonable allocation methodology should be used. As stated in ECC's response, if the task order was too complex to directly charge PMO related costs, then these costs should have been reasonably allocated through an indirect cost methodology or flowed through the indirect cost rate. All of the fuel costs should have been allocated in a reasonable fashion, rather than billing at 100%. As noted above, extrapolation was also used in determining the total error of the fuel costs. As 100% of fuel costs tested had exceptions, we extrapolated 100% of the fuel costs billed to the task order.

The response provided by ECC did not provide support for allowability or reasonableness of the costs. Therefore, the finding remains as originally stated.

Finding 2015-03

ECC disagreed with the classification of the finding as a significant deficiency in internal control and noncompliance. 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. The classification of the significant deficiency was determined as the control deficiency was deemed severe enough to warrant the attention of the United States Air Force Civil Engineering Center and SIGAR, and not based upon questioned costs. ECC violated FAR) 52.245-1(f)(1), thus, this was considered a noncompliance finding. The classification of this finding will remain as a significant deficiency and noncompliance.

Finding 2015-04

ECC disagreed with the finding over reporting requirements. In accordance with Government Auditing Standards (Chapter 6, paragraphs 6.39 and 6.56 – 6.72), sufficient documentation is required in order to support proper audit evidence. If documentation to support completion of an activity cannot be provided, there is insufficient audit evidence to support compliance. Records for this project are required to be maintained and available for audits for at least three years after the final payment (48 CFR subpart 4.703). Since this documentation could not be provided, we could not determine if compliance was met. If ECC chose to utilize other means to transmit the required reports, such as email or hand delivery, documentation of that transmittal should have been maintained in accordance with 48 CFR 4.7, through the required retention period. The classification of this finding will remain as a significant deficiency and noncompliance.

Finding 2015-05

Based upon ECC's response, the finding was updated to include the correct number of key personnel changes during the audit period.

ECC, however, disagreed with the classification of the finding as a significant deficiency and noncompliance. During testing, ECC had difficulty providing documentation to support the key personnel and their roles within the company during the task order period. As identified within the finding criteria, Section PKV-H015 of the contract (FA8903-06-D-8511) requires notification of key personnel changes. This requirement would apply for all task orders issued directly under this contract. The fact that the contract did not specifically state how the key personnel were to be used on the task order is irrelevant, as key personnel identified on contract are key personnel for all task orders under the aforementioned contract. ECC's point that this requirement is not relevant to task order 0074 is not accurate. Documentation of all approvals, for any task order under the contract, should have been maintained by ECC. Without this documentation, compliance with the contract requirements could not be determined. Further, questioned costs are not required to consider a finding to be a significant deficiency, as described above. Therefore, the finding remains as originally classified.

SIGAR's Mission

The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:

- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
- improve contracting and contract management processes;
- prevent fraud, waste, and abuse; and
- advance U.S. interests in reconstructing Afghanistan.

Obtaining Copies of SIGAR Reports and Testimonies

To obtain copies of SIGAR documents at no cost, go to SIGAR's Web site (www.sigar.mil). SIGAR posts all publically released reports, testimonies, and correspondence on its Web site.

To Report Fraud, Waste, and Abuse in Afghanistan Reconstruction Programs

To help prevent fraud, waste, and abuse by reporting allegations of fraud, waste, abuse, mismanagement, and reprisal, contact SIGAR's hotline:

- Web: www.sigar.mil/fraud
- Email: sigar.pentagon.inv.mbx.hotline@mail.mil
- Phone Afghanistan: +93 (0) 700-10-7300
- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
- U.S. fax: +1-703-601-4065

Public Affairs

Public Affairs Officer

- Phone: 703-545-5974
- Email: sigar.pentagon.ccr.mbx.public-affairs@mail.mil
- Mail: SIGAR Public Affairs
2530 Crystal Drive
Arlington, VA 22202