

SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR Financial Audit 13-1

Audit of Costs Incurred by Chemonics International, Inc. in Support of USAID's Alternative Livelihoods Program– Southern Region

In accordance with legal requirements, SIGAR has redacted certain
information deemed proprietary or otherwise sensitive from this report.



JUNE
2013



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

June 6, 2013

Dr. Rajiv Shah
Administrator
U.S. Agency for International Development

Dr. S. Ken Yamashita
Mission Director for Afghanistan
U.S. Agency for International Development

This letter transmits the results of our audit of costs incurred by Chemonics International, Inc. (Chemonics) under a contract in support of USAID's Alternative Livelihoods Program–Southern Region for the period February 15, 2005, through October 31, 2009.¹ The audit was performed by Crowe Horwath LLP (Crowe) with SIGAR oversight. It covered \$165,261,548 in expenditures.

The goal of the USAID contract was to provide short-term employment and to assist in the development and expansion of a licit agricultural industry providing an alternative to the opium poppy industry in Afghanistan's southern region. Activities focused on physical infrastructure construction, small and medium enterprise development, and agricultural and agribusiness assistance. The project was later renamed the Alternative Development Program–Southern Region, and references to both occur throughout the contract period and are used interchangeably in the financial audit report.

The specific objectives of the audit were to

- render an opinion on the fair presentation of Chemonics' Fund Accountability Statement;²
- determine and report on whether Chemonics has taken corrective action on recommendations from prior audits or assessments;
- identify and report on significant deficiencies, including any material weaknesses, in Chemonics' internal financial controls; and
- identify and report on instances of material noncompliance with terms of the award and applicable laws and regulations.

In contracting with an independent audit firm and drawing from the results of their audit, SIGAR is required by auditing standards to provide oversight of the audit work performed. Accordingly, SIGAR reviewed Crowe's audit results and their supporting audit documentation and found them to be in accordance with generally accepted government auditing standards.

Crowe issued a disclaimer of opinion on the Fund Accountability Statement because (1) Chemonics refused to provide support necessary to demonstrate that the indirect costs charged to the contract were accurate, and (2) Crowe observed instances of noncompliance with the terms and conditions of the contract and applicable regulations that have a direct and material effect on amounts presented on the Fund Accountability Statement.

¹ USAID contract no. 306-M-00-05-00516-00.

² The Fund Accountability Statement is a special purpose financial statement that includes all revenues received, costs incurred, and any remaining balance for a given award during a given period.

Crowe identified three findings from a limited financial review of the program previously issued by USAID. One of the three findings had not been resolved when Crowe completed fieldwork. Related to the unresolved finding, Crowe questioned \$61,320 as ineligible.³

Crowe reported two material weaknesses and six significant deficiencies in internal control over financial reporting and twelve instances of noncompliance, which prompted the auditors to question a total of \$13,555,998 in costs. The \$13,555,998 in questioned costs included \$6,758,678 in ineligible costs and \$6,797,320 in unsupported costs.⁴ See table 1 below.

Table 1 - Summary of Questioned Costs⁵

Category	Questioned Costs Total	Ineligible	Unsupported
Expatriate labor work days ordered	\$726,737	\$708,705	\$18,032
Travel and transportation	\$10,893		\$10,893
Other direct costs	\$61,320	\$61,320	
Equipment, vehicles, and freight	\$48,749	\$48,749	
Security	\$4,480	\$4,480	
Implementation fund	\$6,768,649	\$254	\$6,768,395
General and administrative	\$5,935,170	\$5,935,170	
Totals	\$13,555,998	\$6,758,678	\$6,797,320

Given the results of the audit, SIGAR recommends that the Mission Director of USAID/Afghanistan:

1. **Determine the allowability of and recover, as appropriate, \$13,555,998 in questioned costs identified in the report.**
2. **Advise Chemonics International, Inc. to address the eight internal control findings identified in the report.**
3. **Advise Chemonics International, Inc. to address the twelve compliance findings identified in the report.**

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

³ Ineligible costs are costs that the auditor has determined to be unallowable. These costs are recommended for exclusion from the Fund Accountability Statement and review by USAID to make a final determination regarding allowability.

⁴ Unsupported costs are costs for which adequate or sufficient documentation necessary for the auditor to determine the propriety of costs was not made available.

⁵ Section 1 of the financial audit report contains 13 audit findings explaining why these costs were questioned.



Chemonics International, Inc.

Fund Accountability Statement – Afghanistan Alternative Livelihoods Program

For the Period February 15, 2005, through October 31, 2009

(With Independent Auditor's Report Thereon)

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Transmittal Letter

May 3, 2013

To the Board of Directors and Shareholders' of
Chemonics International, Inc.
1717 H Street NW, #1
Washington, District of Columbia 20006

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

We appreciate the opportunity to provide to you our final report reflecting upon the procedures that we completed during the course of our audit of Chemonics International, Inc.'s ("Chemonics") contract with the United States Agency for International Development ("USAID") funding the Afghanistan Alternative Livelihoods Program – Southern Region (Contract Number 306-M-00-05-00516-00).

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 Fund Accountability Statement, report on internal control, and report on compliance. Accordingly, we do not express an opinion on the summary and any information preceding our reports.

In March 2013, we provided to SIGAR a draft report reflecting upon our audit procedures and results. Chemonics received a copy of the report in April 2013 and provided written responses subsequent thereto. These responses have been considered in the formation of the final report, in addition to both the written and oral feedback provided by Chemonics and SIGAR. Chemonics's responses and our corresponding rebuttal, are incorporated into this report following our audit reports.

Thank you for providing us the opportunity to work with you and to conduct the audit of Chemonics's Afghanistan Alternative Livelihoods Program – Southern Region.

Sincerely,

A handwritten signature in black ink, appearing to read "Bert Nuehring", written in a cursive style.

Bert Nuehring, CPA, Partner
Crowe Horwath LLP

Summary

Background

Chemonics International, Inc. (“Chemonics”) was awarded a contract by the United States Agency for International Development (“USAID”) to provide short-term employment and assist in the development and expansion of a licit agricultural industry providing an alternative to the major poppy industry. The contract - 306-M-00-05-00516-00 – incorporated an initial ceiling price of \$119,899,774 and a period of performance of February 15, 2005, through February 15, 2009. Through subsequent expansions in scope and responsibilities as documented through fifteen contract modifications, the final completion date was established as October 31, 2009, and the ceiling price set at \$166,143,244. Chemonics expended \$165,261,548 throughout the contract period. The project was entitled the Alternative Livelihoods Program/Southern Region (“ALP/S”) and was later re-named the Alternative Development Program/Southern Region (“ADP/S”). As a result, references to both occur throughout the contract period and are used interchangeably.

Throughout the four-and-a-half years that the contract work was performed in the Southern region provinces of Helmand and Kandahar, Chemonics collaborated with citizens of Afghanistan, USAID, the British Foreign and Commonwealth Office, local and international subcontractors, and non-profit entities to deliver the requested project scope. As reported in Chemonics’s final report on the ADP/S project, results (unaudited by Crowe) included:

- Establishment of a poultry industry in Helmand;
- Expansion of the Lashkar Gah electrical capacity;
- Development of an agricultural center adjacent to the rehabilitated Lashkar Gah Bost Airfield;
- Rehabilitation of the irrigation system;
- Building of five new public parks; and
- Distribution of more than 1,875 tons of wheat seed and 5,625 tons of fertilizer to more than 19,000 farmers.

Project work concluded in October 2009. The contract remains open pending approval of a final negotiated indirect cost rate agreement (NICRA).

Work Performed

Crowe Horwath LLP (“Crowe”) was engaged by the Special Inspector General for Afghanistan Reconstruction (“SIGAR”) to conduct a financial audit of Chemonics’s ALP/S 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 – Internal Controls

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

Audit Objective 2 – Compliance

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

Audit Objective 3 – Corrective Action on Prior Audit Recommendations

Determine and report on whether the audited entity has taken adequate corrective action on prior external audit report recommendations or other external assessment recommendations.

Audit Objective 4 – Fund Accountability Statement

Express an opinion on whether the Fund Accountability Statement for the award presents fairly, in all material respects, revenues received, costs incurred, items directly procured by the U.S. Government and fund balance for the period audited in conformity with the terms of the award and generally accepted accounting principles or other comprehensive basis of accounting.

Scope

The scope of the audit included the period from February 15, 2005, to October 31, 2009, and was limited to those matters and procedures pertinent to the contract that have a direct and material effect on the Fund Accountability Statement ("FAS") and evaluation of the presentation, content, and underlying records of the FAS. The audit included reviewing the financial records that support the FAS to determine if there were material misstatements, the FAS was prepared in accordance with accounting principles generally accepted in the United States of America, and the FAS 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;
- Cash Management;
- Procurement;
- Reporting;
- Special Tests and Provisions, including evaluation of Chemonics's Code of Business Ethics for adoption during the contract period, review of the methodology used to determine if a subcontractor was involved in or diverted funds to terrorist activities, conduct of inquiries to determine if known credible dishonest acts, fraud, waste, or abuse were reported to the Office of the Inspector General;
- Equipment and Real Property Management; and
- Eligibility.

Methodology

To meet the aforementioned objectives, Crowe identified – through review and evaluation of the contract agreement executed by and between Chemonics and USAID, the Federal Acquisition Regulation (“FAR”), and the USAID Acquisition Regulation (AIDAR) – the criteria against which to test the Fund Accountability Statement and supporting financial records and documentation. 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 Chemonics to provide reasonable assurance of achieving reliable financial and performance reporting and compliance with applicable laws and regulations.

Using sampling techniques, Crowe selected samples of expenditures, procurements, inventories, assets that were disposed of after the contract performance period, and quarterly financial reports for audit. Supporting documentation was provided by the auditee and subsequently evaluated to assess Chemonics’s compliance. Testing of indirect costs was limited to determining whether indirect costs were calculated and charged to the U.S. Government in compliance with the negotiated indirect cost rate agreements.

Due to the nature of the contracted work, a significant quantity of subcontractors and beneficiaries were and are still located in Afghanistan. As such, certain audit procedures were performed on-site in Afghanistan, as deemed necessary.

Summary of Results

Upon completion of Crowe’s procedures, the auditor identified eighteen exceptions. Of the eighteen exceptions, thirteen resulted in questioned costs and/or were classified as either significant deficiencies or material weaknesses thus elevating them to the level of an audit finding. Accordingly, there are thirteen findings reflected in Crowe’s report. The remaining five exceptions were reported to Chemonics within a management letter dated May 3, 2013.

Crowe disclaimed the opinion on the Fund Accountability Statement. The disclaimer was the result of Chemonics’s:

- Declining to provide support necessary to demonstrate that indirect costs were accurate and compliant with Federal regulations;
- The quantity of material deviations from federal regulations resulting in questioned costs that significantly exceed the threshold for materiality;
- Unwillingness to represent to their responsibility for complying with applicable laws and regulations, including the identification of requirements to which they are responsible for complying as required by the generally accepted government auditing standards; and
- Unwillingness to represent to matters required under auditing standards generally accepted in the United States of America.

Crowe also reported on Chemonics’s internal controls and compliance regarding the Fund Accountability Statement. Two material weaknesses and six significant deficiencies in internal control were reported and twelve findings pertained to matters of noncompliance. Where internal control and compliance findings pertained to the same matter, they were consolidated within a single finding. A total of \$13,555,998 in costs were questioned. The questioned costs are summarized in the following table.

TABLE A: Summary of Findings and Questioned Costs¹

Finding Number	Matter	Questioned Costs	Cumulative Questioned Costs
2012-01	Indirect cost components could not be evaluated	\$5,935,170	\$5,935,170
2012-02	Sole source procurements	\$6,741,513	\$12,676,683
2012-03	Indirect costs allocated to subcontracts	\$5,935,170	\$12,676,683
2012-04	Local procurement	\$708,705	\$13,385,388
2012-05	Small business utilization	\$0	\$13,385,388
2012-06	Vendor payment support	\$53,329	\$13,438,717
2012-07	Inadequate and unproduced expenditure support	\$50,773	\$13,489,490
2012-08	Cash management: Inaccurate application of the indirect cost rate	\$3,504	\$13,489,490
2012-09	Memorandum of Understanding: Vendor selected outside of procurement process	\$4,480	\$13,493,970
2012-10	Exchange rate conversion	\$454	\$13,494,424
2012-11	Reporting: Misstated actual expenditures	\$0	\$13,494,424
2012-12	Cooperating Country National Compensation	\$254	\$13,494,678
2012-13	Reimbursement of Disallowed Fertilizer Costs	\$61,320	\$13,555,998
Total Questioned Costs:			\$13,555,998

Crowe performed procedures to follow-up on findings identified from a previous limited financial review applicable to the ALP/S Project issued by USAID, dated June 14, 2008, that were considered applicable to the scope of the audit. Crowe noted three prior findings and recommendations in the associated report. Chemonics did not take adequate corrective action in response to the findings and recommendations. A summary of those findings and the corresponding results are shown in Section 2 – Summary Schedule of Prior Audit, Review, and Assessment Findings shown after the Independent Auditor’s Report.

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 its entirety.

¹ Note that, due to the same costs being questioned in one or more findings, the costs presented in the “Cumulative Questioned Costs” column will not always increase with each additional finding; the column is intended to show the running balance of unique questioned costs.

Summary of Management Comments

Chemonics's management provided responses to each of the findings identified in Crowe's report in a letter dated April 25, 2013. Within the responses, Chemonics disagreed with each of the auditor's findings and all questioned costs. Management of Chemonics asserted that:

- 1) The application of the indirect cost rate in accordance with the provisions of the negotiated indirect cost rate agreement (NICRA) for purposes of charging project costs to USAID were not within the audit's scope;
- 2) Sole source and local procurements were properly conducted and the resulting costs are allowable due to USAID's approving the subcontracts and purchases having been made within geographic code 935;
- 3) The regulatory requirement to utilize small businesses did not apply;
- 4) Supporting documentation provided subsequent to the audit for payments and expenditures is sufficient to waive the findings;
- 5) Chemonics did not consider the memorandum of understanding with the Afghan National Police to be a contract subject to procurement requirements;
- 6) The variances identified between the actual costs incurred as reported to USAID on the quarterly financial reports are reasonable due to reports being produced prior to the closing Chemonics's accounting records;
- 7) Compensation for cooperating country nationals was appropriate due to Chemonics's decision to utilize its existing recruitment and compensation policies and procedures and the wage rates not having been incorporated into Chemonics's contract; and
- 8) The disallowed fertilizer costs having been approved for payment by USAID.

References to Appendices

The auditor's reports are supplemented by two appendices. **Appendix A** presents the Views of Responsible Officials, which are management's responses to the findings presented within the report. In addition to the narrative response, Chemonics provided documentation that, in the auditee's opinion, supports its position on the various findings. Due to the voluminous nature of the documentation (referenced within the management responses as "annexes"), these items have not been included within our report. The documentation has been provided to SIGAR under separate cover.

Appendix B contains the auditor's rebuttal to management's responses, which is intended to clarify matters of fact or disagreement between management and the auditor as required by *Government Auditing Standards*.

INDEPENDENT AUDITOR'S REPORT ON THE FUND ACCOUNTABILITY STATEMENT

To the Board of Directors and Shareholders of Chemonics International, Inc.
1717 H Street NW, #1
Washington, District of Columbia 20006

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

Report on the Fund Accountability Statement

We were engaged to audit the Fund Accountability Statement (the "Statement") of Chemonics International, Incorporated ("Chemonics" or the "Company") for contract number 306-M-00-05-00516-00 for the period February 15, 2005, through October 31, 2009, and the related Notes to the Fund Accountability Statement.

Management's Responsibility for the Fund Accountability Statement

Management is responsible for the preparation and fair presentation of the Statement 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 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 Fund Accountability Statement based on conducting the 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. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were unable to examine the indirect costs charged to the contract for appropriate application and were unable to satisfy ourselves through other audit procedures. We also observed compliance exceptions during our audit of Chemonics's compliance with the terms and conditions of the Company's contract with the United States Agency for International Development ("USAID") and regulations applicable thereto that have a direct and material effect on amounts presented on the Fund Accountability Statement. We identified \$13,555,998 in costs that are questioned as a result of noncompliance. In addition, management was unwilling to represent to certain matters that are required components of management's responsibilities under *Government Auditing Standards* and the auditing standards generally accepted in the United States of America.

(Continued)

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the Fund Accountability Statement.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued reports dated May 3, 2013, on our consideration of Chemonics's internal controls 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* and should be considered in assessing the results of our audit.

This report is intended for the information of Chemonics International, Inc., the United States Agency for International Development, and 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

April 11, 2013
Washington, D.C.

Chemonics International, Inc.
Fund Accountability Statement
For the Period February 15, 2005 to October 31, 2009

	<u>Budget</u>	<u>Actual</u>	<u>Ineligible</u>	<u>Unsupported</u>	<u>Questioned Costs</u>	<u>Corresponding Note(s)</u>
Revenues						
Total Revenue	\$ -	\$ 165,261,548	\$ -	\$ -	\$ -	4
Costs Incurred by Budget Category						
Time (Labor):						
Expat Labor Work Days Ordered	\$ 36,128,065	\$ 35,756,962	\$ 708,705	\$ 18,032		C, D, E
Local Hire Professionals CCN Labor	\$ 4,886,239	\$ 4,871,464	\$ -	\$ -		
Total Time (Labor):	\$ 41,014,304	\$ 40,628,426	\$ 708,705	\$ 18,032		6
Materials (Other Budgetary Costs):						
Travel and Transportation	\$ 1,506,030	\$ 1,429,529	\$ -	\$ 10,893		D
Allowances	\$ 4,588,519	\$ 4,432,008	\$ -	\$ -		
Other Direct Costs	\$ 9,900,940	\$ 9,452,657	\$ 61,320	\$ -		I
Equipment, Vehicles, Freight	\$ 4,189,303	\$ 4,143,700	\$ 48,749	\$ -		E
Training	\$ 810	\$ 810	\$ -	\$ -		
Security	\$ 19,362,389	\$ 18,262,156	\$ 4,480	\$ -		F
Implementation Fund	\$ 79,622,449	\$ 80,977,091	\$ 254	\$ 6,768,395		B, D, G, H
Total Material (Other Budgetary Costs):	\$ 119,170,440	\$ 118,697,952	\$ 114,803	\$ 6,779,288		
General and Administrative	\$ 5,958,500	\$ 5,935,170	\$ 5,935,170	\$ -		A
Total General and Administrative:	\$ 5,958,500	\$ 5,935,170	\$ 5,935,170	\$ -		
Total Costs Incurred	\$ 166,143,244	\$ 165,261,548	\$ 6,758,678	\$ 6,797,320		
Outstanding Fund Balance	\$ -	\$ 0.03				

The accompanying notes to the Fund Accountability Statement are an integral part of this Statement.

Chemonics International, Inc.²
Notes to the Fund Accountability Statement
For the Period February 15, 2005, through October 31, 2009

Note 1. Basis of Presentation

The accompanying Fund Accountability Statement (the "Statement") includes costs incurred under Contract 306-M-00-05-00516-00 for the Afghanistan Alternative Livelihoods Program - Southern Region for the period February 15, 2005, through October 31, 2009. Because the Statement presents only a selected portion of the operations of Chemonics International ("Chemonics"), it is not intended to and does not present the financial position or cash flows of Chemonics. The information in this Statement is presented in accordance with the requirements specified by the Special Inspector General for Afghanistan Reconstruction ("SIGAR") and is specific to the aforementioned contract. Therefore, some amounts presented in this Statement may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Note 2. Basis of Accounting

Expenditures reported on the Statement are required to be presented in accordance with accounting principles generally accepted in the United States of America 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, and Cost Principles for Commercial Organizations, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note 3. Foreign Currency Conversion Method

For purposes of preparing the Statement, Chemonics applies the Standard Exchange Rate (SER) to foreign currency transactions for all international contracts. The SER is adjusted monthly and ranged from 48.43 Afghanis per U.S. dollar to 52.5.

Note 4. Revenues

Revenues on the Statement represent the amount of funds that may be reimbursed to Chemonics from USAID for allowable, eligible costs incurred under the contract during the period of performance.

Note 5. Questioned Costs

Questioned costs are those costs that are questioned by the auditor because of an audit finding: (1) which resulted from a violation or possible violation of a provision of law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds; (2) where the costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do not reflect the actions a prudent person would take in the circumstances. Questioned costs are presented in the Statement in two categories: unsupported and ineligible costs. Unsupported costs are those costs for which adequate or sufficient documentation necessary for the auditor to determine the allowability and accuracy of costs was not made available. Ineligible costs are those costs that the auditor has determined to be unallowable or inaccurate and recommended for exclusion from the Statement and for a final determination by the USAID Contracting Officer.

² The Notes to the Fund Accountability Statement denoted herein are the responsibility of Chemonics International, Inc.

(Continued)

Questioned costs are detailed within the Schedule of Findings and Questioned Costs that accompanies the Independent Auditor's Report on Compliance. Total questioned costs identified by the auditor are \$13,555,998.

Note 6. Costs Incurred by Budget Category

The budget categories presented and associated amounts reflect the budget line items presented within the final, USAID-approved contract budget adopted as a component of the fourteenth modification to the contract award agreement dated July 16, 2009.

Note 7. Fund Balance

The fund balance presented on the Statement represents the difference between revenues earned and costs incurred such that an amount greater than \$0 would reflect that revenues have been earned that exceed the costs incurred or charged to the contract and an amount less than \$0 would indicate that costs have been incurred, but are pending additional evaluation before a final determination of allowability and amount of revenue earned may be made.

Note 8. Currency

All amounts presented are shown in U.S. dollars - the reporting currency of Chemonics International. Costs incurred in a foreign country and recorded in a foreign currency have been converted to U.S. dollars consistent with Chemonics's foreign currency conversion policy.

Note 9. Status of Invoicing to USAID

The Statement, as presented, reflects all invoices submitted to USAID as of December 1, 2012. The contract has not been closed and a final invoice to USAID has not been rendered pending finalization of Chemonics's negotiated indirect cost rate agreement ("NICRA").

Note 10. Subsequent Events

Management has performed an analysis of the activities and transactions subsequent to the February 15, 2005, through October 31, 2009, period of performance. Management has performed their analysis through April 11, 2013.

(Continued)

Notes to the Questioned Costs Presented on the Fund Accountability Statement³

Note A. Questioned Costs - Indirect Costs

Findings 2012-01 and 2012-03 question the full population of indirect costs (\$5,935,170) due to the general and administrative rate being assessed on subcontracts that bill using fixed daily rates and Chemonics's unwillingness to provide documentation to prove that the rate is being applied appropriately and consistent with the NICRA. In addition, Finding 2012-08 questions \$3,504 of the \$5,935,170 in indirect costs due to the indirect costs having been mathematically miscalculated.

Note B. Questioned Costs - Sole Source Procurements

Finding 2012-02 presents a finding questioning \$6,741,513 in costs due to improper procurement procedures.

Note C. Questioned Costs - Local Procurement

Finding 2012-04 questions \$708,705 in costs due to a local procurement not having been pre-approved by the Contracting Officer as required by regulations governing local procurement.

Note D. Questioned Costs – Incomplete Payment Support

Chemonics did not provide support demonstrating that \$53,329 in costs billed to USAID were paid. These costs include \$10,893 in travel and transportation costs, \$16,008 in expatriate labor work days ordered, and \$26,428 in implementation costs. The costs are questioned in finding 2012-06.

Note E. Questioned Costs – Supporting Documentation for Expenditures

Finding 2012-07 questions \$50,773 due to \$2,024 of expatriate labor and \$48,749 in charges for equipment, vehicles, and freight being associated with goods that were not shipped on a U.S. Flag Vessel.

Note F. Questioned Costs – Memorandum of Understanding

Finding 2012-09 questions \$4,480, the value of a memorandum of understanding funding police and law enforcement services and that was not properly procured.

Note G. Questioned Costs – Foreign Currency Conversion

\$454 is questioned in Finding 2012-10 due to inaccurate foreign currency conversions.

Note H. Questioned Costs – Cooperating Country National Compensation

\$254 is questioned in Finding 2012-12 due to two employees' monthly salaries exceeding the prevailing compensation for the region.

Note I. Questioned Costs – Reimbursement of Disallowed Fertilizer Costs

Finding 2012-13 questions \$61,320 in costs that were disallowed by the USAID Contracting Officer in connection with a limited financial review and that Chemonics has not yet repaid to the Government.

³ Notes to the Questioned Costs Presented on the Fund Accountability Statement were developed by and are the responsibility of the auditor.

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To the Board of Directors and Shareholders' of
Chemonics International, Inc.
1717 H Street NW, #1
Washington, District of Columbia 20006

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

We were engaged to audit the Fund Accountability Statement (the "Statement") of Chemonics International ("Chemonics" or the "Company") for the period February 15, 2005, through October 31, 2009, and have issued our report thereon dated May 3, 2013, within which we disclaimed an opinion. We were engaged to 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 Fund Accountability Statement is free of material misstatement.

Internal Control: Chemonics'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 agreements; and transactions are recorded properly to permit the preparation of the Fund Accountability Statement in conformity with the basis of accounting described in Note 2 to the Fund Accountability 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 of Chemonics for the period February 15, 2005, through October 31, 2009, we obtained an understanding of internal control. With respect to internal control, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the Statement and not to provide an opinion on internal control over financial reporting. Accordingly, we do not express such an opinion on internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses under standards established by the American Institute of Certified Public Accountants ("AICPA") and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

(Continued)

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 statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses: Findings 2102-03 and 2102-08.

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 to be significant deficiencies: Findings 2012-01, 2012-02, 2012-04, 2012-11, 2012-12, and 2012-13.

Chemonics' responses to the findings identified in our audit are attached as Appendix A to this report. We did not audit Chemonics's responses and, accordingly, we express no opinion on them.

We noted certain matters that we reported to Chemonics's management in a separate letter dated May 3, 2013.

This report is intended for the information of Chemonics International, Inc., the United States Agency for International Development, and 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

April 11, 2013
Washington, D.C.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

To the Board of Directors and Shareholders' of
Chemonics International, Inc.
1717 H Street NW, #1
Washington, District of Columbia 20006

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

We were engaged to audit the Fund Accountability Statement (the "Statement") of Chemonics International ("Chemonics" or the "Company") for the period February 15, 2005, through October 31, 2009, and have issued our report on it dated May 3, 2013, within which we disclaimed an opinion.

We were engaged to audit in accordance with *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 Fund Accountability Statement is free of material misstatement resulting from violations of agreement terms and laws and regulations that have a direct and material effect on the determination of the Fund Accountability Statement amounts.

Compliance with agreement terms and laws and regulations applicable to Chemonics is the responsibility of Chemonics's management. As part of our audit engagement, we performed tests of Chemonics's compliance with certain provisions of agreement terms and laws and regulations. However, our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Twelve instances of noncompliance that are required to be reported in accordance with Government Auditing Standards were discovered during our procedures. These instances are described in findings: 2012-01, 2012-02, 2012-03, 2012-04, 2012-05, 2012-06, 2012-07, 2012-08, 2012-09, 2012-10, 2012-12, and 2012-13.

The purpose of this report is solely to describe the scope of our testing of compliance with the terms and laws and regulations that have a direct and material effect on the Statement and the results of that testing, and not to provide a legal determination of compliance with those requirements or an opinion on compliance. Accordingly, this report is not suitable for any other purpose.

This report is intended for the information of Chemonics International, Inc., the United States Agency for International Development, and 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

April 11, 2013
Washington, D.C.

SECTION 1 – SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Finding 2012-01: Allowable Costs – Indirect Cost Rate Components and Application

Significant Deficiency and Non-Compliance

Criteria: Per FAR 52.232-7(b), Chemonics may only seek recovery of allocable indirect costs that are clearly excluded from the hourly rate. In addition, per 48 CFR Subpart 31.202, the contractor may not allocate charges directly to a contract that have been otherwise treated as indirect costs when incurred for the same purpose in like circumstances. The Negotiated Indirect Cost Rate Agreement (NICRA) also prohibits use of the rate when costs treated as indirect costs have been claimed as direct costs. Commercial cost principles also restrict the charges for certain executives' compensation to limits established by the U.S. Office of Management and Budget per 48 CFR Subpart 31.205-6(p).

Condition: Chemonics directly charged a series of home office costs that are frequently observed within the components of indirect cost pools used in calculating the NICRA. The costs we observed included postage, passports and visas, printing, copier charges, and procurement staff activities. In addition, without obtaining the components of the indirect cost rate, we could not determine if executive compensation was being assessed to contracts through the general and administrative cost rate applied to contract charges. In addition, per USAID's approval of Chemonics's invoicing using fully loaded fixed daily rates (FDR) on the project, Chemonics charged the contract using FDRs that incorporate indirect costs. We requested, but were not provided with, a listing of components of the indirect cost rate calculation to determine if the costs direct charged to the contract were also included in the indirect costs incorporated into the fully loaded fixed daily rates thereby resulting in an over-recovery of costs.

Questioned costs: \$5,935,170. In the absence of sufficient evidence to examine compliance with allowable cost requirements, we question all indirect costs charged to the contract as being ineligible for reimbursement.

Effect: Chemonics may have invoiced USAID for costs directly charged to the ADP/S contract that were also included in the indirect cost calculation, costs that were not clearly excluded from the hourly rate, and cost components that are unallowable per the applicable cost principles.

Cause: Chemonics considered matters pertaining to the application and allowability of the indirect cost rate to be out of scope of the audit and, as a result, did not provide documentation necessary for us to adequately evaluate the indirect costs charged to the contract.

Recommendation: We recommend that Chemonics produce a schedule showing the components of the indirect cost pool used in the calculation of the indirect cost rate. The schedule should also clearly display which items flow into the fixed daily rates. The result of the analysis should be presented to USAID.

(Continued)

Finding 2012-02: Procurement and Suspension and Debarment: Sole Source Procurements

Significant Deficiency and Non-Compliance

Criteria: In accordance with the provisions of 48 CFR Subpart 31.201-3, a cost is reasonable if it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. If an initial review of the facts results in a challenge of cost, the burden of proof shall be upon the contractor to establish that such cost is reasonable.

In addition, Chemonics is responsible for promoting competition as per FAR Part 13.104, including the conduct of adequate competitive procedures to ensure that a reasonable cost is obtained for goods and services that exceed the micro-purchase threshold of \$2,500.

Condition: Three vendors - Central Asia Development Group (CADG) (Contract IP-18), the Afghanistan Veterinary Association (Contract IP-12), and MACTEC (Contract IP-160) - were selected using sole source procurements. Included within the justification for sole source procedures were statements pertaining to there being no other vendors available to complete the procedures, possessing the appropriate skillset, or able and willing to work in the region. The contents of the procurement file were insufficient to support the justifications and to demonstrate that the reasonableness threshold was satisfied.

With regard to CADG, Chemonics also noted that the Company had prior experience with the vendor and that the initiation of work was urgent. We reviewed the support from USAID and noted the preference for prompt initiation; however, approval to bypass competitive procurement requirements was not located within the USAID communications. Chemonics did not produce documentation of an analysis to support the aforementioned assertions for CADG and AVA or documentation of USAID's instruction to sole source or waiver of competitive bidding.

With regard to MACTEC, the justification presented pertains to the qualifications of a single vendor over others, but does not reflect the inability or lack of willingness of other vendors within the 935 geographic code to provide the airport runway survey services or the presence of a single capable vendor. AVA's selection was based on the organization's prior experience in the region and infrastructure; documentation was not presented that analyzed or otherwise considered whether or not other entities possessed the same of similar skill sets and could provide the same service at a cost more beneficial to the Government.

Questioned costs: \$6,741,513 in costs is considered to be unsupported by appropriate procurement documentation. We question the portion of each contract's value that exceeds the micro-purchase threshold of \$2,500 due to the improper procurements thereof. The contract values follow: CADG (\$4,876,701), AVA (\$1,790,434), and MACTEC (\$81,878).

Effect: In the absence of documentation showing that the market of providers was evaluated and there were no other vendors willing, able, and capable of providing the goods and services, we could not determine that the costs charged to USAID were reasonable for the services provided and that the procurement did not exclude or otherwise limit competition.

Cause: Chemonics indicated that there was no time to bid due to USAID requesting a contract to be in place within two weeks and CADG's operating in an extremely dangerous environment, having local relationships, and carrying out the same or similar work in other activities. The auditee also indicated, through the sole source justification, that prior experience with other companies was sufficient to determine that the procurement was fair and reasonable.

Recommendation: We recommend that Chemonics produce an analysis showing that costs incurred by these vendors was or was not reasonable and forward the resulting assessment to USAID to review for a final determination regarding allowability.

(Continued)

Finding 2012-03: Allowable Costs: Indirect Costs Allocated for Subcontracts

Material Weakness and Non-Compliance

Criteria: FAR 52.232-7 states that the Contractor may include allocable indirect costs and other direct costs to the extent they are:

- 1) Comprised only of costs that are clearly excluded from the hourly rate;
- 2) Allocated in accordance with the Contractor's written or established accounting practices; and
- 3) Indirect costs are not applied to subcontracts that are paid at the hourly rates.

In addition, per FAR 52.216-7, costs charged to the contract must be allowable as determined by the application of 48 CFR Subpart 31.2.

Condition: During our evaluation of costs charged to USAID, we identified two vendors - Louis Berger Group and Central Asia Development Group (CADG) - that incurred charges under the contract against which general and administrative indirect charges were assessed. Section B.5(a)(1) of CADG's contract requires that the subcontractor cite the fixed daily rates presented therein. Similarly, we noted that the Louis Berger Group invoiced Chemonics using fixed daily rates.

In addition, we noted that CADG and another subcontractor - FAF Development - invoiced Chemonics for overhead costs. We inquired of Chemonics regarding the process used to ensure that both entities' overhead costs charged were allowable and that the fixed daily rates charged by CADG were allowable. Chemonics did not respond to our requests for information pertaining to the indirect cost charges. As a result, we could not determine if all or a subset of subcontracts included fixed daily rate charges or if procedures were conducted to determine if subcontractors' indirect costs were allowable.

Questioned costs: \$5,935,170 in costs is questioned and considered to be ineligible. \$1,095,304 was charged on the May 2007 and July 2007 invoices to USAID for CADG within the Other Direct Costs component of the invoice, which corresponds to \$54,765 in indirect costs charged. On the July 2007 and October 2007 invoices to USAID, Chemonics charged \$25,715 in the Other Direct Costs component of the invoices, which resulted in \$1,288 in indirect costs being charged. Chemonics did not provide the information necessary to calculate the specific amount of indirect costs charged to subcontracts. As a result, we question the full value of indirect costs charged to USAID. These costs are also questioned within finding 2012-01.

Effect: Chemonics obtained an over-reimbursement of indirect costs by assessing the general and administrative rate against subcontract charges determined in whole or in part through the use of fixed daily rates. Also, in the absence of supporting documentation regarding the assessment of subcontractors' overhead costs, we could not determine if the overhead charges were exclusive of costs included within the fixed daily rates or if they were duplicative of costs included in the FDRs. Using the data made available to us, we could not identify the specific amount of duplicate reimbursement. As a result, we question the full amount of indirect costs charged to the contract.

Cause: Chemonics considered matters pertaining to the application of the indirect cost rate and the allowability thereof to be outside of the scope of the audit. Inquiries requesting Chemonics' position on the allowability of the indirect costs and the reason that the indirect cost rate was assessed on subcontractors invoicing using fixed daily rates were unaddressed.

Recommendation: We recommend the following: 1) Chemonics should conduct an evaluation of all contracts that include one or more employees charging labor based on fixed daily or hourly rates and determine if the general and administrative rate was assessed against all or a part of the contract costs;

2) Chemonics should deliver the result of the analysis to USAID so that USAID may determine the specific amount of disallowed costs; and

3) Chemonics should establish a process to exclude subcontractors that invoice using fixed daily rates from the assessment of the indirect cost rate.

(Continued)

Finding 2012-04: Procurement and Suspension and Debarment: Local Procurement

Significant Deficiency and Non-Compliance

Criteria: Per 22 CFR Part 228.40 as referenced in AIDAR 752.225-71 and Section A.19 of Chemonics's contract, local procurements are eligible for USAID financing for professional services that do not exceed \$250,000 and local procurements conducted in geographic code 935 that do not exceed \$5,000 unless otherwise specified in the implementing document or a waiver is granted by USAID.

Condition: One vendor - Ubique Group, Inc. (Contract IP-44) - was awarded a contract in the amount of \$958,705 for demolition and structure clearing services. Per review of the procurement file, other vendors' proposals, and the contract, the procurement was a solicitation conducted locally and that Crowe determined to be a local procurement. The contract specifies geographic code 935, which permits procurement from Afghanistan. Documentation of the contracting officer's pre-approval to procure the services locally was not provided by Chemonics.

Questioned costs: \$708,705 in costs are ineligible, represents the value of the contract that exceeds the threshold requiring the Contracting Officer's prior approval (\$250,000).

Effect: The protections designed for the United States Government as implemented through the local procurement thresholds were not afforded and upheld due to Chemonics's noncompliance with the procurement requirements.

Cause: Chemonics considers USAID's identification of the geographic code 935 in the contract to be a waiver of the applicability of the local procurement threshold requirements and approval to contract locally without limitations.

Recommendation: We recommend that Chemonics obtain written approval from the Contracting Officer for waivers and written clarification from the Contracting Officer in instances where there is a real, apparent, or perceived inconsistency between the terms and conditions of the Federal contract and Federal regulations.

(Continued)

Finding 2012-05: Procurement: Small Business Utilization

Non-Compliance

Criteria: Per AIDAR 752.219-8, as referenced in Section A.19 of Chemonics's contract, Chemonics is required to provide notice to OSDBU at least 45 days prior to placing an order that exceeds the small purchase threshold. In addition, FAR 19.708(a)(2) denotes that the provision applies on contracts except where the work is performed entirely in the cooperating country.

Condition: Chemonics did not provide a description and quantity of services and commodities to be procured, the closing date for receiving quotations or bids, or the address where invitations or specifications could be obtained for any orders in excess of the simplified acquisition threshold (\$100,000) to the Office of Small and Disadvantaged Business Utilization (OSDBU) during the contract's period of performance. Work under the contract was performed both domestically within the United States and abroad. Chemonics represented that the Company produced and utilized a small business plan within the performance of the project.

Questioned costs: None

Effect: Small business entities that were potentially capable of providing goods and services under the contract may not have been afforded the opportunity to evaluate and participate in the procurement process.

Cause: Chemonics indicated that the company did not consider the requirement to apply due to the majority of the work being performed in Afghanistan. This interpretation is inconsistent with the regulation, which presents an exception for contracts where "the work is performed entirely in the cooperating country".

Recommendation: We recommend that Chemonics identify the population of vendors paid under the contract with costs exceeding \$100,000 and provide the listing to USAID for review and a determination regarding additional penalties or sanctions.

(Continued)

Finding 2012-06: Cash Management: Inadequate and Unproduced Vendor Payment Support

Non- Compliance

Criteria: Per FAR 52.232-7(b), USAID will reimburse Chemonics for payments made for materials in accordance with the terms and conditions of the agreement or invoice. The regulation also permits USAID to reimburse Chemonics if the contractor ordinarily makes payments within 30 days of submission of the payment request to USAID and the payment is in accordance with the agreement or invoice's requirements.

Condition: Chemonics was unable to provide documentation for three of twenty-five sample selections, and the documentation provided did not show evidence of payment for one selection. For one transaction - a \$39,135 charge for ground transportation - the supporting documentation provided did not agree to the amount charged per the invoice; the difference of \$10,100 was unsupported.

The specific transactions with the issues summarized above are presented below.

Transaction	Invoice Date	Invoiced Amount	Amount Questioned
Employee BD	3/30/2007	\$ 16,008.00	\$ 16,008.00
AICB!Inv#5/EvenReport/Oct-D	10/31/2007	\$ 26,341.00	\$ 26,341.00
ALP3/Ground Transport-D	10/31/2007	\$ 39,135.00	\$ 10,100.00
██████████/Lodging/23-27 Aug/DX-D	10/31/2008	\$ 793.00	\$ 793.00
SGUILU-:N/AGENCY FEE/OCT	10/20/2008	\$ 87.00	\$ 87.00

Questioned costs: \$53,329 in costs is unsupported.

Effect: Chemonics invoiced USAID for costs that the contractor could not provide sufficient documentation showing the costs were paid as required by Federal regulations.

Cause: Chemonics was unable to produce payment documentation for all components of the sample selection.

Recommendation: We recommend that Chemonics repay the \$53,329 in charges for which payment support was not provided.

(Continued)

Finding 2012-07: Allowable Costs: Inadequate and Unproduced Supporting Documentation

Non-Compliance

Criteria: In accordance with 48 CFR Subpart 31.201-2(d), the contractor is responsible for maintaining supporting documentation adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles. Per FAR 52.232-7, the contractor's vouchers for payment under the contract must be supported by individual daily job timekeeping records. Further, regarding the international ocean transportation/shipping of things, U.S. flag vessels are required by AIDAR 752.7002(p)(i) to be used unless a release is obtained from the Transportation Division of the Office of Acquisition and Assistance of USAID.

Condition: Chemonics did not produce adequate supporting documentation for three of the expenditures that we selected. One \$2,024 personnel cost transaction for an engineer was unsupported by time records for the period in which costs were incurred.

In addition, Bokkers Trading B.V. (IP 143) provided cooling and ventilation systems for the contract that were, per inquiry with the auditee, manufactured in India and shipped to Lashkar Gah by sea then land. The goods were shipped on the Deja Bhum, which was not shown in listings of U.S. Flag Vessels. Chemonics also did not produce documentation showing that the vessels used to transport the cooling and ventilation systems were U.S. Flag Vessels or that a waiver of the requirement was obtained.

Questioned costs: \$50,773, including \$2,024 in unsupported costs and \$48,749 in ineligible costs.

Effect: Chemonics invoiced USAID for costs that may be unallowable or inappropriately allocated to the contract.

Cause: Chemonics could not locate the supporting documentation required to support the amounts invoiced and to show that the ship carrying the goods was a U.S. Flag Vessel.

Recommendation: We recommend that Chemonics locate the supporting documentation and provide the information to USAID to aid in USAID's rendering of a final allowability determination.

(Continued)

Finding 2012-08: Cash Management: Inaccurate Application of the Indirect Cost Rate

Material Weakness and Non-Compliance

Criteria: FAR 52.232-7(b) denotes that indirect costs may be charged to a contract when consistent with the contractor's written or established accounting practices, and the NICRA presents the maximum rate to be applied subject to certain limitations. In addition, for costs to be allowable per 48 CFR Subpart 31.2, only the total costs incurred may be charged to the contract.

Condition: Chemonics invoiced USAID using a constant general and administrative (G&A) rate of [REDACTED] assessed against materials costs incurred to recover indirect costs. This approach is consistent with the Negotiated Indirect Cost Rate Agreement (NICRA) in effect at the time of Chemonics' submission of the contract bid. During the evaluation of twenty-six invoices submitted to USAID during the course of the contract's period of performance, twenty-two instances were identified in which the rate, when recalculated by multiplying the materials amount shown on invoices to USAID by the [REDACTED] G&A rate, did not agree to the amount presented on each invoice. The total difference between the recalculated amount and the amounts invoiced to USAID was \$3,504. Chemonics's Deputy Controller reported that there were no indirect cost adjustments and the Director - Afghanistan/Pakistan Region confirmed that the rate was used throughout the contract period consistent with the application.

Questioned costs: \$3,504 in ineligible costs is questioned. This amount is also included within the amounts questioned in findings 2012-01 and 2012-03.

Effect: Chemonics overcharged USAID in the amount of \$3,504 for indirect costs.

Cause: Chemonics's review process did not identify the mathematical miscalculations.

Recommendation: We recommend that Chemonics conduct a review of the invoicing process to determine why the variances were not identified during the regular review and approval process.

(Continued)

Finding 2012-09: Memorandum of Understanding: Vendor Classification and Competitive Procedures

Non-Compliance

Criteria: Per FAR 13.104, the contractor is responsible for promoting competition, including the conduct of adequate competitive procedures to ensure that a reasonable cost is obtained for goods and services exceeding the micro-purchase threshold of \$2,500 pursuant to FAR Part 13 and the \$500 field office competitive threshold per Chemonics' *Procurement Guidelines for the Afghanistan Alternative Livelihoods Program (ALP) Order No. 306-M-00-05-00516-00*.

In addition, AIDAR 752.225-70(b)(3) prohibits the procurement of commodities and services for support of police and other law enforcement activities.

Condition: During our evaluation of procurement files, we reviewed memoranda of understanding executed by and between Chemonics and individuals and companies in the region. The Director - Caucasus and Central Asia reported that MOUs are included in the subcontractor population because they are agreements with another party and are cost share agreements for which no money was received by the MOU holder. Our review of procurement files identified one MOU executed with the Department of the Afghan National Police (Contract MOU-036) for police security services in which the MOU references Chemonics's paying allowances to the Police officers while providing security services. Specifically, the MOU identifies ADP/S' responsibilities as the drafting of a security plan, payment of mobilization and transport allowances of \$5.00 per ANP officer per day, payment of food and beverage allowance of \$3.00 per ANP officer per day, and allowances for the maximum of twenty officers assigned payable every week. The ANP was responsible for acting in accordance with the security plan provided and providing 20 ANP officers daily. The MOU was valued at approximately \$4,480 based on work days authorized in the MOU and the amount of allowances. These items were not procured through Chemonics's usual and customary procurement processes.

Questioned costs: \$4,480 in ineligible costs.

Effect: Chemonics entered into a contract with the ANP without executing the procurement process to help ensure that a reasonable cost was obtained in exchange for the services provided per the MOU.

Cause: Chemonics did not consider the agreement with ANP to be indicative of a vendor contractual relationship and, therefore, did not consider the procurement requirements to be applicable. Chemonics asserted that the payment was not a payment for services, but rather Chemonics's effort to support the Afghan National Police's participation.

Recommendation: We recommend that Chemonics conduct an evaluation of the MOU to determine why the contract was not subject to the procurement procedures and forward the results of the assessment to USAID.

(Continued)

Finding 2012-10: Allowable Costs: Exchange Rate Conversion

Non-Compliance

Criteria: Federal cost principles require that costs incurred be reasonable in order to be considered allowable charges to a contract. In addition, costs must be incurred and treated consistently with internal policies and procedures.

Condition: The methodology used by Chemonics for foreign currency exchange conversions is inconsistent. Chemonics reported that, during preparation of the Fund Accountability Statement, costs are converted from foreign currency to U.S. dollars using standard exchange rates. In evaluating the conversions, we identified three transactions that were incorrectly converted and resulted in a \$454 overcharge to the contract. The transactions are summarized below:

Sample #	Batch #	Period Post	Amount Charged Per Expenditure Detail	SER for the Applicable Period	Expected Charge	Variance
Compliance - 34	20069	200505	\$687.50	49.00	\$673.47	\$14
Compliance - 8	29614	200705	\$449.00	50.09	\$434.25	\$15
FAS - 52	37643	200903	\$89,203.35	52.50	\$88,778.57	\$425
Total Variance:						\$454

Chemonics subsequently reported that costs originating in the field are converted at the bank's exchange rate. Chemonics did not provide supporting documentation for the exchange rates used or a policy reflecting the change in methodology. As a result, the exchange rate conversion method communicated by Chemonics could not be corroborated.

Questioned costs: \$454 in unsupported costs.

Effect: Due to the inconsistent approaches to converting foreign currency to the United States dollar, invoices to USAID have been inaccurately calculated.

Cause: Chemonics's representatives presented two approaches to the conversions from Afghanis to U.S. dollars. Chemonics failed to identify that multiple approaches to converting foreign currency transactions to U.S. dollars were being utilized. In the absence of a policy or procedure on the matter, a uniform approach to conversions was not applied.

Recommendation: We recommend that Chemonics execute the following steps: 1) calculate the total costs incurred that were not converted using the standard exchange rates; 2) document a policy on the conversion of the foreign currency to U.S. dollars for purposes of recording charges originating in foreign countries in the financial system of record maintained in the United States; and 3) upon approval, distribute the policy to all individuals involved in financial reporting and management.

(Continued)

Finding 2012-11: Reporting: Misstated Actual Expenditures

Significant Deficiency

Criteria: Recipients of Federal funds are responsible for establishing a system of internal control that is sufficient to detect and correct misstatements and matters of noncompliance.

Condition: During the review of eight quarterly financial reports (QFRs), the amounts reported as actuals on the QFRs did not agree or reconcile to the expenditures reflected in the expenditure detail report produced from Chemonics's financial system. The variances ranged from an understatement of \$17,305,321 for the quarter ended December 31, 2008, to an overstatement of \$24,532 for the period ended December 31, 2005. The table below presents the amounts reported, actuals per the expenditure detail, and the differences between the two for reports in our sample.

Reporting Period End	Cumulative Expenditures Per QFRs	Cumulative Expenditures Per Expenditure Detail	Difference
June 2005	\$ 2,865,927.00	\$ 3,439,143.00	\$ (573,216.00)
December 2005	\$ 3,825,530.00	\$ 3,800,998.00	\$ 24,532.00
March 2006	\$ 5,732,674.00	\$ 12,638,675.00	\$ (6,906,001.00)
September 2006	\$ 7,903,547.00	\$ 12,400,171.00	\$ (4,496,624.00)
March 2007	\$ 10,678,517.00	\$ 15,354,363.00	\$ (4,675,846.00)
September 2007	\$ 16,242,347.00	\$ 24,128,502.00	\$ (7,886,155.00)
June 2008	\$ 9,040,906.00	\$ 11,330,465.00	\$ (2,289,559.00)
December 2008	\$ 11,871,421.00	\$ 29,176,742.00	\$ (17,305,321.00)

Questioned costs: None

Effect: Quarterly Financial Reports are not supported by the financial records and thus are not reliable for presentation of the contract's financial position.

Cause: Chemonics develops and submits the report prior to the completion of quarter-end financial closing procedures. As a result, the auditee estimates expenditures for the final month of each quarter. The financial report indicates that Chemonics produces the "Estimated Cumulative Expenditures" by summing actual expenditures during the quarter and cumulative expenditures prior to the quarter; there were no line items specifying that a component of the actuals was an estimate in five of the eight reports evaluated. Chemonics indicated that issues receiving invoices timely from vendors contributes to the level of variance between actual costs incurred and the estimates presented in the QFRs. Chemonics reported that the format and labels presented on the QFR are determined by USAID.

Recommendation: Chemonics should revise the procedure used for financial reporting to accurately report actual costs to USAID. Alternatively, if Chemonics is unable to modify the format required for reporting, then we recommend that Chemonics obtain approval to report estimates.

(Continued)

Finding 2012-12: Allowable Costs: CCN Compensation

Significant Deficiency and Non-Compliance

Criteria: In accordance with Section A. 14(b) of the contract with USAID, Chemonics may not, without prior approval of the Mission Director or Assistant Administrator having program responsibility for the project, pay third country or cooperating country nationals a level of compensation that exceeds the prevailing compensation paid to personnel performing comparable work in Afghanistan as determined by the USAID Mission.

Condition: Chemonics did not provide an analysis of prevailing wages or other documentation used to ensure that prevailing compensation levels were not exceeded. Chemonics provided a copy of an Action Memorandum dated November 15, 2003, permitting the payment of Third Country Nationals' (TCN) compensation in U.S. dollars and extending payment of allowances and benefits to TCNs. Cooperating country nationals (CCNs) were not addressed within the memorandum. Documentation was not provided that addressed the comparability of compensation, including promotions and merit increases, to the prevailing levels in the region. Cooperating country nationals were utilized on the project and related charges invoiced to USAID based on actual salaries.

Chemonics reported that the Company followed its recruiting policies and assessed the fair market rate for the location of the field office during the course of the project. Rates were used based on Chemonics's experience in the region rather than the USAID Afghanistan FSN schedule due to Chemonics's understanding that the USAID rates would be too high and may have an adverse impact on the local employment scenario by paying greater than the market rate for applicable laborer groups.

For purposes of evaluation, Chemonics provided a copy of the document entitled *FY07 Local Compensation Plan – Embassy Kabul – 48 Hour Workweek*, which contained eight employee grades and salaries for twelve steps. Chemonics also provided a document for use in classifying employees; the document was entitled *General Grade Levels Guide*. These documents were not utilized by the contractor in the setting of salaries and wages. Using the aforementioned documents, fifteen local support employees' monthly salaries in 2007 were assessed. Two were identified as having salaries that exceeded the 2007 prevailing wages.

Document Title	Employee Job Function	Payment Amount	Rate Class Used (Rate)	Overage
CVL-2886	Chief Cook	\$437	Grade 1 – Step 1 (\$403)	\$34
CVL-2839	Admin Officer	\$910	Grade 5 – Step 1 (\$690)	\$220
Totals:				\$254

Questioned costs: \$254 in costs is ineligible.

Effect: Chemonics paid a minimum of two CCNs wages that exceed the prevailing wage rates for the geographic region and may have paid additional cooperating country nationals salaries and wages that exceed the level permitted by the contract. Reimbursement from USAID may have been obtained for the difference between actual compensation and the prevailing compensation amounts. As a result, USAID may have been overcharged for local salaries and wages.

(Continued)

Cause: Chemonics does not consider the requirement identified in the contract to be applicable due to the use of fixed daily rates for the charging of employee labor costs. In addition, Chemonics interprets the language presented within the Action Memorandum permitting TCNs and CCNs to be treated as employees to be a waiver of the requirement to pay prevailing salaries and an approval to pay TCNs and CCNs consistent with Chemonics's employee compensation levels without regard for the geographic location. Further, with regard to CCN labor charges invoiced to USAID at actual cost, Chemonics believes the approach taken to be sufficient and noted that USAID does not always provide the labor rates for the region to contractors.

Recommendation: We recommend that Chemonics: 1) obtain from USAID the historical compensation levels for labor positions filled by CCNs and conduct an assessment to determine if the compensation paid exceeded prevailing compensation levels in the cooperating country; 2) calculate the difference between the salary amount charged (prorated as necessary) and the prevailing salary for the region; and 3) refund USAID for any overpayment thereof.

(Continued)

Finding 2012-13: Allowable Costs: Reimbursement for Disallowed Fertilizer Costs

Significant Deficiency and Non-Compliance

Criteria: Pursuant to AIDAR 752.225-70(c), Chemonics may not procure restricted goods without the prior written approval of the Contracting Officer. Fertilizer is included within the "restricted goods" classification.

Condition: Chemonics purchased fertilizer for the ALP/S project without obtaining the prior written approval of the Contracting Officer. The associated cost of \$72,000 was questioned during a limited financial review conducted by USAID in June 2008. On October 8, 2008, the USAID Contracting Officer sustained the questioned costs in part and disallowed \$61,320. Chemonics submitted a request to be reimbursed for the allowable component in 2009; however, the invoice amount was submitted for the full value of the charge (\$72,000) rather than the allowable component (\$10,680). Chemonics received the \$72,000 payment on October 21, 2009.

Questioned costs: \$61,320 in costs is considered to be ineligible.

Effect: USAID was overcharged by \$61,320.

Cause: Chemonics made an administrative error when submitting the reclaim voucher and included the full amount of the transaction rather than the allowable component only.

Recommendation: We recommend that Chemonics remit the full value of the unallowable charges (\$61,320) to USAID.

SECTION 2 – Summary Schedule of Prior Audit, Review, and Assessment Findings

Findings from a previous limited financial review applicable to the Afghanistan Alternative Livelihoods Program issued by the United States Agency for International Development's ("USAID") Office of Financial Management, dated June 14, 2008, were considered applicable to the scope of our audit. An evaluation of corrective action resulting from those findings was included in our audit procedures. Chemonics did not resolve each of the prior findings presented in the limited financial review.

Findings from USAID identified during the aforementioned limited financial review:

Finding Objective No. 1(b) – Fertilizer costs in the amount of \$72,000 under Invoice #048190 were incurred without prior approval of the Contracting Officer.

Status – The matter has not been resolved and is repeated as finding 2012-13 in this report. The USAID Contracting Officer disallowed \$61,320 of the \$72,000 transaction. Chemonics submitted a voucher to recover the allowable component of the cost; on the voucher, the full value of the transaction was submitted rather than the allowable component only. The \$61,320 is questioned.

To determine if the underlying cause of the disallowance continued, we tested a sample of expenditures, including restricted goods, and obtained documentation of the Contracting Officer's prior written approvals. We noted no exceptions during our procedures with regard to this matter.

Finding Objective No. 1(c) – The CTO suspended Chemonics's claim for severance payments totaling \$275,940 for three expatriate staff whose contracts were terminated early. It was unclear if severance pay is permitted or saved the government funds. \$254,459.12 was questioned.

Status – The USAID Contracting Officer disallowed \$256,437. Because the amounts were suspended, Chemonics was not paid for the amounts in question. The severance payments based on fixed daily rates were not re-submitted for reimbursement. This finding is not repeated.

To determine if the underlying cause of the disallowance continued, we tested severance payments charged to the contract during the period under audit and noted no exceptions. Severance payments are allowable as per 48 CFR Subpart 31.2. During our procedures, we did not identify any instances in which Chemonics charged severance payments at the fixed daily rates rather than at the actual amount paid to the employee. This finding is not repeated.

Finding Objective No. 1(d) – R&R costs for a Third Country National (TCN) employee amounting to \$6,117.20 under Invoice #048686 were questioned.

Status – The USAID Contracting Officer disallowed \$1,977 of the charge. Due to the full value of the transaction having been suspended, Chemonics was not paid for the amount in question. The allowable component of the charge as determined by the Contracting Officer was subsequently re-submitted for reimbursement.

To determine if the underlying cause of the disallowance continued, we tested a sample of expenditures, including TCN-related transactions and travel costs incurred under the contract, and noted no exceptions. This finding is not repeated.

APPENDIX A - Views of Responsible Officials



Eric Russell
Crowe Horwath LLP
1325 G Street NW, Suite 500
Washington D.C. 20005-3136

April 25, 2013

Dear Mr. Russell,

Please find below, and attached in numbered annexes, the response of Chemonics International Inc. to each of the findings and questioned costs in the draft audit report which we received on April 4, 2013 related to the SIGAR audit of Contract No. 306-M-00-05-00516-00.

FINDING 2012- 01

Indirect cost components could not be evaluated
\$5,935,170

The audit finding asserts that Chemonics has been “unwilling to provide documentation to prove that the [G&A] rate is being applied appropriately and consistent with the NICRA.” Chemonics disagrees with this statement, and all the costs questioned under this finding. By way of background, the ADP/S award is an order placed under Chemonics’ General Services Administration (“GSA”) Schedule contract for Mission Oriented Business Integrated Services (“MOBIS”). MOBIS is a time-and-materials type contract with established Fixed Daily Rates (“FDRs”) for various categories of labor. Thus, under ADP/S, Chemonics billed for labor based on the FDRs accepted by the government. Chemonics invoiced the cost of materials (without any fee), and applied its accepted [REDACTED] G&A rate to materials costs in accordance with its USAID-issued Negotiated Indirect Cost Rate Agreement (NICRA) and within the ceiling rate specifically negotiated for ADP/S. During the audit, Chemonics made available all invoices related to ADP/S, our USAID-issued Negotiated Indirect Cost Rate Agreement (NICRA), and the relevant terms of the ADP/S contract. This is sufficient documentation for the auditors to confirm that Chemonics’ G&A rate was properly applied and invoiced — consistent with footnote (e) of the NICRA — at the lesser of the then-current provisional rate or up to the ceiling rate negotiated for the ADP/S contract.

During the audit, Chemonics received a few requests for documents relevant to the above finding that we did not understand and questioned. For example, the auditors sought to examine the

composition of the NICRA-established G&A rate *and* the elements of the fixed labor rates contained in the MOBIS contract. The following is an example of such a request: “Could you please forward me the schedule showing the calculation of the [REDACTED] [G&A] figure and the components thereof? Could you also provide a schedule or policy/procedure showing the components that flow into the hourly rate calculations used to invoice USAID?” E-mail, E. Russell (Crowe Horwath) to Chemonics, 2/12/2013.

These requests presented significant conceptual and practical problems. First, under a time and materials contract, the individual elements composing the fixed labor are generally not subject to audit. See “Payment for Time-and-Materials and Labor-Hour Contracts,” Federal Acquisition Regulation (FAR) 52.232-7(a) (payment for labor based on rates prescribed in the Schedule multiplied by hours performed). The request for a schedule for the composition of the fixed rates was confusing, since there is no "schedule" of sub-components that are used to invoice the FDRs, which, by their nature, are fixed at the time of negotiation. The GSA "Schedules" are FDRs. Second, the MOBIS FDRs were first established and accepted by the government in 1997 and updated in 2003 – long before the ADP/S contract was ever considered. The rates used on ADP/S from the Financial and Business Solutions (FABS) and Environmental Services Schedule (ESS) contracts that Chemonics holds with GSA likewise predated the ADP/S contract and had been accepted by the government.

Regarding the approach taken at the time these FDRs were proposed and accepted by the government, we followed the FAR and solicitation requirements for these types of GSA Schedules. The basic methodology for developing the rates was described in Chemonics’ proposals to GSA at the time. It essentially involved determining an estimated base average salary over time per labor category, applying the then-current NICRA to recover indirect costs associated with labor (but not those associated with materials), and pricing an estimated fee rate for each labor category to arrive at each FDR. We provide here relevant pages from our proposals to GSA that indicate this (see Annex 1.1 through 1.3). Thus, there was no *schedule* of individual cost components for the FDRs that could have been provided.

Similarly, Chemonics could not provide a “schedule showing the calculation of the [REDACTED] [G&A rate applied to materials] figure and the components thereof.” The [REDACTED] charge was based on Chemonics’ NICRA – not a build-up of discrete costs comprising a G&A pool for the specific ADP/S task order. NICRAs are negotiated with the USAID contracting officer responsible for established final indirect cost rates, per FAR 42.704(a), and are based on consideration of prior DCAA-determined indirect rates and high-level roll-ups of cost experience in recent financial reporting periods, and on cost accounting standards conforming to and accepted by USAID. The auditors’ requests were therefore confusing and thus, Chemonics was unable to reach an accord with respect to these requests in the timeframe covered by the audit.

The draft audit and comments at the exit briefing added better context to the purpose of the requests. The auditors questioned the entirety of indirect costs charged under the award for the following reasons: (1) “Chemonics directly charged a series of home-office costs that are frequently observed within the components of indirect cost pools used in calculating the NICRA. The costs we observed included postage, passports and visas, printing, copier charges, and procurement staff activities;” (2) “In addition, without obtaining the components of the indirect cost rate, we could not determine if executive compensation was being assessed to contracts

through the general and administrative cost rate applied to contract charges; and (3) “. . . per USAID's approval of Chemonics' invoicing using fully loaded fixed daily rates (FDR) on the project, Chemonics charged the contract using FDRs that incorporate indirect costs. We requested, but were not provided with, a listing of components of the indirect cost rate calculation to determine if the costs direct charged to the contract were also included in the indirect costs incorporated into the fully loaded fixed daily rates thereby resulting in an over-recovery of costs.” Chemonics complies fully with appropriate cost accounting standards, cost allocation and invoicing standards, and our NICRA, and there is no basis for questioning such costs. We address each in turn below.

A. “Home-office” costs charged as direct.

While it is not entirely clear what charges the auditors are addressing, Chemonics frequently assigns home office staff to work directly on projects. Costs associated with such direct work are directly charged to the project in accordance with FAR 31.201-4 and our cost accounting standards. Moreover, other direct costs (ODCs) directly associated with such project operations are also a direct charge. The categories of costs cited in the draft audit (postage, passports and visas, printing, copier charges, and procurement staff activities) all were clearly budgeted in Chemonics’ cost proposal for the ADP/S award. Similarly, our proposed G&A ceiling rate, applicable to materials, was also proposed according to our NICRA and cost accounting standards, and was accepted at the proposed ceiling rate. We do not recall that our cost proposal was requested by the auditors, but it would have been provided had it been requested, and it remains available for inspection.

Direct charging of such expenses, when incurred in direct support of a project, is entirely consistent with Chemonics’ Cost Accounting Disclosure Statement and with the practices that Chemonics has consistently followed for many years. At no time did the auditors identify any invoice or any specific element of expense for which they sought clarification regarding allocation. Had they done so, Chemonics could have addressed this issue decisively. There is no factual basis for the auditors’ classification of any indirect costs, much less the entire universe of indirect costs, as questionable based on this rationale.

B. Executive compensation assessed to contracts through G&A

Chemonics has no record of being asked during the audit about its policies regarding executive compensation or how such expense is recorded in its books and records. There is, of course, nothing improper about charging executive compensation to G&A or another appropriate indirect pool. Chemonics understands and abides by the regulations regarding limits on the amount of expense that can be reimbursed through indirect accounts. Chemonics’ accounting system clearly reflects the proper allocation for the allowable amounts of executive compensation included to its indirect pools, and of any amounts treated as unallowable for each of its executive officers. There are no grounds for questioning such indirect costs on this basis.

C. Fixed Daily Rates include costs charged as direct under ADP/S

The supposition that Chemonics may have included cost elements in the build-up of its fixed labor rates that were also billed as direct costs under the ADP/S task order is confusing. As noted above, the FDRs used under MOBIS were established *years* before the ADP/S task was even conceived, and were developed in the context of a GSA schedule contract designed to service myriad different requirements. There could not have been any correlation between development of the rates and anticipated ADP/S direct costs.

More importantly, under the MOBIS contract, what the fixed daily rate covers is strictly defined. The FDR “means the rate(s) prescribed in the contract for payment for labor that meets the labor category requirements of a labor category specified in the contract,” per FAR 52.232-7(a)(1). The promise to pay a fixed amount in return for the prescribed unit of labor is an essential element of a time-and-materials contract. The auditors’ apparent premise – that the fixed labor rates might also cover some unidentified materials costs – is fundamentally inconsistent with the terms of the contract. There is no factual or legal basis for questioning costs based on this theory.

D. Conclusion

We understand that SIGAR has an important mandate for auditing expenditure of Afghanistan reconstruction funds. Chemonics is respectful of SIGAR’s oversight responsibilities and our policy is to facilitate the conduct of audits. While Chemonics had no issue with assisting the audit team in addressing discrete questions concerning any element of cost charged under the ADP/S award, we did develop concerns that the audit scope of examining costs incurred under the ADP/S contract was moving into a wholesale examination of indirect cost rates, NICRAs, and compliance with cost accounting standards.

FAR 42.703-1(a) establishes that a single agency shall be responsible for auditing contractor indirect rates, and FAR 42.002(a) requires that agencies “avoid duplicate audits, reviews, inspections, and examinations of subcontractors, by more than one audit agency, through the use of interagency agreements.” The Defense Contracts Audit Agency (DCAA) is the cognizant auditor for Chemonics’ indirect rates and compliance with CAS regulations. Additionally, USAID’s internal procedures state the following:

Normally, per FAR 42.101, the Defense Contract Audit Agency (DCAA) is the Government audit agency for contractors other than educational institutions and nonprofit organizations. Accordingly, the Memorandum of Understanding between the OIG and the DCAA states that DCAA will audit U.S. for-profit firms for which USAID is cognizant. When DCAA cannot be responsive to USAID’s needs for an audit, *M/OAA/CAS will contract* with a non-Federal public accountant to perform the audit. – ADS 591.3.1.2 (emphasis added).

Comprehensive indirect rate and CAS audits are complex and time-consuming, require significant experience with government cost accounting principles, and are binding on all agencies. During the audit, some requests and positions expressed caused us concern regarding

interagency coordination and established industry practices. In retrospect, we believe that communications regarding these issues were not resolved as effectively as they could have been. Should SIGAR, Crowe Horwath, or the contracting officer believe that follow-up on particular issues might be helpful, please feel free to contact us.

All of the questioned costs are properly allocated, reasonable, and fully consistent with the terms of our contract, we see no basis for the questioning of these costs and request that the \$5,935,170 in questioned costs be removed from the findings.

FINDING 2012 – 02

Sole Source Procurements

\$6,741,513

In this finding, the auditors are questioning costs associated with sole source procurements with three vendors: the Central Asia Development Group (IP-18), the Afghanistan Veterinary Association (IP-12) and MACTEC (IP-160). Chemonics asserts that all three subcontracts were properly entered into, and that the absence of competition was justified within the parameters of our prime contract and properly documented at the time that we entered into these agreements. Chemonics promotes competition in procurements to the maximum extent practicable. However, there will naturally be occasions, particularly in a rapidly changing and conflict-affected environment such as southern Afghanistan, when urgent needs or unique capabilities of an offeror make competition impracticable. All three subcontracts in question have detailed and contemporaneous negotiation memoranda, which we submitted to the auditors, that fully explain the reasons why the procurements were not competed. The auditors assert that the justifications in these negotiation memoranda are insufficient. However, they offer no substantive basis for rejecting the justifications.

Moreover, the proposed CADG and AVA subcontracts, along with the sole source justifications, were submitted to USAID for contracting officer consent before Chemonics entered into them. Part of the contracting officer's consideration for granting consent, pursuant to FAR 44.202-2(a)(5), was to evaluate whether "adequate price competition was obtained *or its absence properly justified*" (emphasis added). The auditors ignore the fact that contracting officer consent was granted and provide no explanation why their subjective assessment should be substituted. They also do not explain why Chemonics should not have been able to rely on the contracting officer's consent to the sole source awards.

Although the total of the MACTEC fixed price subcontract was under the simplified acquisition threshold and so did not require contracting officer consent to subcontract under FAR 52.244-2, a memorandum justifying the absence of competition was included in the files and submitted to the auditors. Again, the auditors offer no basis for concluding the justification was inadequate or that the price paid was unreasonable.

Finally, the auditors' reliance on FAR 13.104 for the proposition that Chemonics is obligated to conduct competitive procurements when awarding subcontract is misplaced. This provision provides instruction applicable to U.S. government contracting officers conducting direct procurements below the simplified acquisition threshold — i.e., those with a value of less than \$150,000. We find nothing in our contract that incorporates the requirements of this FAR clause or makes compliance with FAR 13.104 a precondition for allowability of a cost. When questioned about the applicability of this FAR clause at the exit conference, the auditors stated

only that our contract was “governed by the FAR.” The auditors’ apparent belief that the FAR, in its entirety, governs the award of subcontracts is a misconception.

All of the questioned procurements are properly supported by the procurement documentation and fully consistent with the terms of our contract. We see no basis for the questioning of these costs and request that the \$6,741,513 in questioned costs be removed from the findings.

FINDING 2012 – 03

Indirect costs allocable to subcontracts
\$5,935,170

Chemonics disagrees with all questioned costs for substantially the same reasons as outlined in our response to Finding 2012-01, which questions the same costs. Our response to the auditors’ characterization of FAR 52.232-7 is also contained within the response to Finding 2012-01. We note a few additional points below for clarity or reemphasis:

As noted above, our G&A rate on materials was clearly excluded from our FDRs in both our proposal to GSA for each of the federal supply schedules used on ADP/S and in our proposal for the ADP/S contract itself. Excluding indirect costs applicable to materials from burdened daily or hourly labor rates is consistent with FAR 52.232-7(b)(1)(ii)(D), which includes “applicable indirect costs” as part of the definition of what constitutes reimbursable “materials” under a time-and-materials contract.

In compliance with FAR 52.232-7(b)(5)(iii), we did not invoice G&A on the fixed hourly or daily rates of subcontractors. We only invoiced G&A on subcontractors’ materials costs, which, as noted above, is consistent with our NICRA and our organizational Cost Accounting Standards, our proposal submitted to USAID for the ADP/S contract, and our proposals submitted to GSA for each of the Federal Supply Schedule contracts from which labor rates were used on ADP/S. We note that pursuant to USAID’s agency policies at ADS 302.3.6.8 and the CIB 92-17 incorporated therein, only Mr. Jim Davis, our cognizant ACO for indirect rates at M/OAA/CAS, can approve a contract-specific base of application for our G&A rates that differs from our NICRA. As no such approval has been communicated to Chemonics, we calculated and invoiced G&A on materials in a manner consistent with our government-wide NICRA.

Our subcontractors had substantially the same contract terms and conditions, and priced their labor rates and materials budget using the same rationale that we have presented above for Chemonics.

All of the questioned costs are properly supported by the contract terms and applicable regulations. We see no basis for the questioning of these costs and request that the \$5,935,170 in questioned costs be removed from the findings.

FINDING 2012 – 04

Local Procurement
\$708,705

The auditors erroneously assert that Chemonics did not comply with 22 CFR 228.40 (Local Procurement) by entering into a subcontract with Ubique (a local Afghan firm) that exceeded the

\$250,000 threshold without receiving a prior waiver for the procurement. This finding is based on an apparent misunderstanding of USAID's rules regarding the nationality of suppliers. Pursuant to 22 CFR 228.30(a)(2), USAID will only finance awards to suppliers that are organized within the "authorized geographic zone." For example, in many cases, USAID contracts specify Geographic Code 000, which makes only suppliers from U.S. based companies eligible for USAID financing. See 22 CFR 228.03. However, USAID's rules provide for an important exception to this Geographic Code limitation that applies to purchases from local suppliers at 22 CFR 228.40. This provision states, "[u]nless otherwise specified in an implementing document, or a waiver is approved by USAID in accordance with subpart F of this part, local procurement is eligible for USAID financing . . ."

As was explained to the auditors, Chemonics' contract, at the time the Ubique subcontract was awarded, specified a geographic code of 935. This allowed Chemonics to enter into contracts with suppliers located in "[a]ny area or country including the cooperating country, but excluding the foreign policy restricted countries" per 22 CFR 228.03. Thus, Chemonics could properly award to an Afghanistan-based company without resorting to the local procurement procedures reflected in 22 CFR 228.40.

Additionally and pursuant to ADS 302.3.2.3, a mission wide waiver was in effect under the authorization of 22 CFR 228, subpart F. Specifically, AAPD 03-06, incorporated into ADS 302 and labeled "expedited acquisition procedures," provided a broad "source, origin and nationality waiver for goods and services" (page 11 of AAPD 03-06). The source, origin and nationality waiver included in AAPD 03-06 invoked the waiver criteria listed in 22 CFR 228.51(a)(3), subpart F, stating: "It is necessary to promote efficiency in the use of United States foreign assistance resources, including to avoid impairment of foreign assistance objectives."

The auditors' suggestion that Geographic Code 935 designation and the blanket waiver of nationality somehow did not apply to Afghanistan-based companies is not a valid reading of the regulations. Chemonics therefore requests that this finding be removed from the draft audit report.

FINDING 2012 – 05

Small Business utilization

\$0

As the auditors have stipulated, the language of the clause at AIDAR 752.219-8 is linked to, and its applicability is contingent upon, the conditions of the prescribing language at FAR 19.708(a). As the auditors have further stipulated, AIDAR 752.219-8 does not apply to contracts performed outside the United States, consistent with FAR 19.708(a)(2). The ADP/S contract was solicited, awarded, and obligated by a USAID field mission in Afghanistan, and was performed in Afghanistan. The clause at AIDAR 752.219-8 is self-deleting in this context and does not apply to the work performed under this contract. This is consistent with FAR 19.000(b), which states that the entirety of FAR Part 19 (except 19.6, which is not germane to this discussion) "applies only in the United States or its outlying areas." Thus, FAR 19.708, and with it AIDAR 752.219-8, is non-applicable outside the United States. Applying these provisions to contract performance in Afghanistan would require a deviation from FAR 19.000(b), which per AIDAR 701.470(a) would need to be approved by the Head of the Contracting Activity after obtaining written comments from M/OAA/P and coordinating with the Office of the General Counsel. To the best of our knowledge, no such deviation was proposed or approved for the ADP/S contract.

Our recent discussions with representatives from USAID/Washington's OAA and General Counsel's offices confirmed the agency shares our view that FAR Part 19, and clauses deriving therefrom (which includes the AIDAR clause in question), are not applicable to work tendered by field missions and performed overseas. This also appears to be the view of the Small Business Administration, which counts only funds obligated in the United States toward its small business utilization scorecard and does not allow funds spent overseas to be counted toward small business goals, as reported by OIG in a September 2012 audit of USAID's small business utilization practices. Given that SBA is charged with ensuring that small business utilization is accurately reported according to FAR Part 19, the only plausible explanation for the exclusion of overseas dollars is SBA's concurrence with our interpretation regarding the applicability of Part 19-linked contract clauses to work performed overseas.

Notwithstanding the lack of contractual obligation, Chemonics' strong corporate commitment to small business utilization is reflected in our performance of the ADP/S contract. Small businesses received nearly 60 percent of U.S. subcontracting dollars expended during the life of the program.

Had the AIDAR clause applied to the work of ADP/S, it would have required 45-day advance notification of OSDDBU "to the maximum extent possible" before placing subcontracts for "equipment supplies and services." This project operated in an active conflict environment where operating conditions and implementation needs changed by the day and sometimes even by the hour. Observing such a lengthy notification timeframe when procuring equipment supplies or services for ADP/S would not have been possible without compromising either the safety and security of our personnel or the objectives of USAID's program.

Chemonics therefore requests that this finding be removed from the draft audit report.

FINDING 2012-06

Vendor Payment Support

\$57,900

The auditors have selected six transactions for which they assert that no payment support was provided. We provided some of these supporting documents to the auditors during the audit field work, and we are resending these here. We have since located additional documentation which we are now providing. Each of the six selections is addressed below:

1. [REDACTED]

We provided proof of payment for this item to the auditors on February 22, 2013, and are hereby re-submitting the information in Annex 2.1. As explained to the auditors, [REDACTED] was employed by one of our subcontractors, CADG. As such we are once again providing a copy of CADG's invoice for the period in which [REDACTED] time was billed, along with a check stub and proof of deposit into CADG's Wachovia Bank account. This documentation represents proof of payment for [REDACTED] services, and we therefore request that the \$16,008 be removed from the list of questioned costs.

2. [REDACTED]

In response to the auditors' request to see proof of payment for ADP/S employee [REDACTED]'s Danger pay adjustments billed to USAID on 7/18/08, Annex 2.2 contains a copy of [REDACTED]'s Earnings Statement as well as a copy of the invoice pages in which the Danger Pay adjustment was billed to USAID. The Earnings Statement shows payment in the amount of \$6,496.20, which is the sum of two adjustment entries on the invoice, one in the amount of \$4,571.40 and one in the amount of \$1,924.80. This documentation represents proof of payment for [REDACTED]'s Danger Pay adjustment, and we request that the \$4,571.40 be removed from the list of questioned costs.

3. AICB

Per the auditors' request to see proof of payment for cost associated with AICB, please see in Annex 2.3 the Kabul Bank Statement for the project's account, showing a transfer of \$26,341.00 to the Afghan Innovative Consulting Bureau (AICB) on October 10, 2007. This documentation represents proof of payment to AICB, and we request that the \$26,341.00 be removed from the list of questioned costs.

4. ALP 3/Ground Transport

Upon review of the previous correspondence between the auditors and Chemonics, there appears to have been a miscommunication as to the specific number of selections that the auditors wanted to see as part of the \$39,135 expenditure (as this amount is made up several dozen individual expenditures which were rolled up into one line item on Chemonics' invoice to USAID). Through subsequent correspondence with the auditors, we have been able to understand that they wanted to see the entirety of the selections that made up the total, not just what we had initially interpreted as selected transactions. We are pleased to provide this documentation contemporaneously with this response. Chemonics asserts that this documentation adequately supports the full \$39,135 amount, and we therefore request that the \$10,100 be removed from the list of questioned costs. As the size of the requested documentation is 28MB, we have uploaded as Annex 2.4 the entire proof of payment documentation for the \$39,135.00 billing to the Crowe Horwath CIRT system, in the section labeled Pro-2-IR-Vendor Records, rather than attaching it to the same email as this response.

5. [REDACTED]

In August 2008, ADP/S Agricultural Specialist [REDACTED] took a delegation of nine Afghan and Indian exporters and buyers to Dubai for a series of business-to-business meetings with Reliance (a large supermarket chain) with the objective of developing market linkages for Kandahar-grown goods such as pomegranates, cumin, chilies, paprika and peanuts. As the delegation lead, [REDACTED] incurred allowable and allocable costs on behalf of the delegation, including \$793.00 in lodging expenses on behalf of one of the delegates, [REDACTED]. [REDACTED] was reimbursed for these expenses through an expense report, which he submitted in October, 2010. We are hereby attaching a copy of this expense report in Annex 2.5, as well as a "Coding Sheet" with [REDACTED]'s signature certifying that he was paid for his expenses. This documentation represents proof of payment for [REDACTED] expenses on behalf of [REDACTED], and the \$793.00 should be removed from the list of questioned costs.

6. SGUILU

Per the auditors' request to see proof of payment for costs associated with the travel agency fee a trip taken by [REDACTED] in June 2008, please see in Annex 2.6 a statement for Chemonics' PNC Bank corporate credit card account for October 2008, showing a transfer of \$87.00 to reference number (703) 591-3544 (United Fairfax Travel's phone number). This documentation represents proof of payment to United Fairfax Travel, and the \$87.00 should be removed from the list of questioned costs.

FINDING 2012 – 07

Inadequate and unproduced expenditure support
\$51,123

The auditors have selected three transactions for which they assert that Chemonics did not provide adequate supporting documentation. We provided some of these supporting documents to the auditors during the audit field work, and we are resending them here. We have since found additional documentation which we are now providing. Each of the three selections is addressed below:

Engineer

A review of our records indicate that, due to an internal miscommunication, we identified the requested timesheets for the engineer in our records but did not send them to the auditors. We regret this oversight. Please find in Annex 3.1 the requested timesheets corresponding to the ADP/S subcontract engineer's billings. As we are now providing the documentation necessary to support the costs, we request that the \$2,204 be removed from the list of questioned costs.

Personnel Costs

Documentation for the questioned "HSK" personnel cost of \$350.24 was provided to the auditors on February 18, 2013. We hereby resubmit that documentation with this response in Annex 3.2, which consists of a timesheet for HSK showing that he worked 11 days, as well as his paystub showing payment for 11 days totaling AFA 17,512AFA (\$350.24). Chemonics asserts that this documentation is sufficient to establish that the cost is reimbursable under our contract terms and conditions, and we request that the \$350.24 be removed from the list of questioned costs.

Bokkers subcontract (IP 143)

The auditors are questioning the entirety of the Bokkers IP 143 subcontract based on their interpretation of AIDAR 752.7002(p)(i) which requires shipping of goods on U.S. flag vessels unless a waiver is released. Had we been informed of this finding earlier, which was not included in the preliminary findings presented in the February 22, 2013 meeting, we would have been able to provide the auditors with adequate documentation at an earlier date. Attached in Annex 3.3 is a written memorandum received via fax from the USAID/M/OAA/T (USAID Transportation Division) on January 29, 2008, which included the following guidance (emphasis added): "USAID will finance ocean transportation costs on vessels *whose flag of registry is in a country included in the authorized geographic code for source/origin.*" Since Code 935 was the

authorized geographic code of the prime contract, the ocean transportation was eligible on any Code 935 (rather than U.S.) flag registry. No further approval from the USAID Transportation Division was needed.

We also wish to note that shipping costs were only a portion of the overall \$48,749 paid to Bokkers under this subcontract, and no basis has been presented to question other costs incurred under this subcontract. For these reasons, we request that the \$48,749 in questioned costs be removed from the draft report.

FINDING 2012 – 08

Cash management: inaccurate application of the indirect cost rate
\$3,504

Our G&A rate was not miscalculated. Our invoicing system is automated and designed to correctly apply G&A to the base of applicable costs at the lesser of the current provisional rate or the contract ceiling. The invoices for ADP/S had a manual cover page that displayed some materials costs as part of the Workdays Ordered line item rather than the Materials line item due to an internal error. The auditors attempted to calculate G&A by applying our [REDACTED] rate to the Materials total on the manual cover page, but in fact this would undercalculate the G&A because the Materials total was incorrect. As we explained to the auditors during their field work and again at the exit conference, the G&A rate can be verified as correct by simply taking the total Materials costs on the detailed invoice pages (which are automated, unlike the manual cover page) and multiplying them by the [REDACTED] rate. We therefore request that this finding be removed from the draft report.

FINDING 2012 – 09

MOU: vendor selected outside of procurement process
\$4,480

The auditors incorrectly state that Chemonics entered into a contract with the Afghanistan National Police without adhering to a proper procurement process. The agreement was properly formalized through the signing of Memorandum of Understanding 036 with the ANP.

In May and June of 2008, ADP/S initiated a peanut seed and fertilizer distribution program that aimed to reach 5,000 farmers in the rural areas of Helmand Province. Although the seed distribution program was entirely carried out by ADP/S staff and security personnel, the entry of the staff into certain villages could not be guaranteed as they would be entering some of the most dangerous areas in Afghanistan. In order to facilitate entry, ADP/S entered into an MOU with the ANP so that they could accompany our technical and security staff on the seed distribution events. While the ANP agreed to provide 20 policemen for the duration of the distribution program and pay the policemen's salaries, they did not have the funds to cover the transportation costs or the meals of the men, as they had to self-transport to the distribution sites and remain there until the distribution was finished. The ANP requested, and Chemonics agreed, to cover a daily \$5 transportation and a \$3 daily food stipend. These stipends were considered to be fair and reasonable, especially since the ANP agreed to provide the men and pay their salaries, and since the success of the seed distribution program would have been compromised without the accompaniment of the ANP.

Chemonics asserts that we have provided sufficient documentation to demonstrate that the MOU did not constitute a payment for police or law enforcement services and was properly entered into by all parties. Therefore, we request that the \$4,480 of questioned costs associated with MOU 36 be removed from the draft audit report. As for the erroneous reference to FAR 13.104, please see our response to this in Finding 2012-02 above.

FINDING 2012 – 10

Exchange Rate Conversion

\$454

The auditors have questioned three transactions related to Chemonics' application of foreign currency conversion, and have asked for clarification on the way that Chemonics applies its Standard Exchange Rate (SER).

Our explanation of procedures, which is consistent with information previously provided to the auditors, is as follows: Chemonics uses the SER when converting costs paid in local currency to US dollars on the invoice to USAID. It is Chemonics' policy to use the SER by establishing a monthly standardized rate for our field office operations and to maintain consistency in calculating currency exchange reconciliations (i.e., gain and losses on amounts wired to our field offices). The SER is an estimated exchange rate established at the beginning of each month and applied throughout the monthly billing period to currency exchange transactions to simplify accounting procedures and ensure that costs are charged at the appropriate exchange rate. Our procedures on SER and Exchange Rate Gain/Loss (ERGL) are applied consistently on all contracts worldwide and have been audited and passed acceptance tests by DCAA and our corporate auditors at PricewaterhouseCoopers.

Each of the three selections is addressed below:

Compliance 34

Upon review of this selection, we agree with the auditors that we used an erroneous SER in calculating the referenced expense and that there is a \$14 variance. We are taking immediate steps to make the necessary corrections, and will be making the appropriate adjustments in an invoice to USAID. We appreciate the auditors' assistance in locating this inadvertent error.

Compliance 8

Upon review of this selection, we agree with the auditors that we used an erroneous SER in calculating the referenced expense and that there is a \$15 variance. We are taking immediate steps to make the necessary corrections, and will be making the appropriate adjustments in an invoice to USAID. We appreciate the auditors' assistance in locating this inadvertent error.

FAS 52

The auditors appear to be using an exchange rate of 52.50, which is incorrect. The SER in effect for March 2009 was 52.25, as shown by the attached backup of Chemonics' SER and ABACUS coding sheet for this charge in Annex 4.1. This SER was used in all of Chemonics' Afghanistan projects in March 2009. We maintain that we have used the correct SER and charged USAID the correct amount and we request that this portion of Finding 2012-10 be removed from the list of questioned costs.

FINDING 2012 – 11

Reporting; misstated actual expenditures
\$0

The auditors erroneously state that the financial information reported in the ADP/S Quarterly Reports (QR) are not supported by the financial records and thus are not a reliable presentation of the contract's financial position. Their reasoning is that the financial estimates presented in the Quarterly Reports do not match the quarterly financial data when compared with the project's actual Expenditure Detail. What we attempted to explain to the auditors is that the information is not intended to match; the information in the QRs is a best estimate of what Chemonics thinks it will bill by the end of the quarter, while the information pulled from the Expenditure Details is an actual representation of what was billed to USAID during the quarter. We explain why this procedure is used below.

As we are required to submit our QRs before the end of the billing quarter, often over one month before the actual expenditures for that quarter are finalized, our estimated quarterly expenditures are based on the best available projected information at the time that the QRs are submitted. There are many reasons why an estimate of costs to be billed will not match the actuals billed one month or more later, particularly in a dynamic environment such as southern Afghanistan. It is also important to note that USAID is entirely cognizant that the financial information that we provide in the QRs is based on projections, and that this is not the official mechanism by which we report our actual financial situation to USAID. This is done through a detailed monthly invoice that clearly states the total contract budget, the amount of that month's billing, the total invoiced amount, and the total funds remaining.

We therefore request that this finding be removed from the draft report.

FINDING 2012-12

Cooperating Country National Compensation
\$254

The auditors question two Cooperating Country National (CCN) wages that they assert exceeded the prevailing wage rates for the geographic region, and point to the Afghanistan FSN scale as the Mission's interpretation of what prevailing wages in the region were in the region at the time. As we relayed to the auditors, the FSN scale was not incorporated into our contract. In determining CCN compensation, Chemonics adhered to its established policies and procedures, and relied on contemporaneous data to determine prevailing wages.

Chemonics follows recruitment policies to ensure that qualified candidates are chosen, and that the salaries are supported by either a formal salary history, and/or prevailing market value for the position and the part of the country where the job will be performed. In the case of the two positions selected by the auditors, Chief Cook and Administrative Officer, the proposed salaries were determined by considering the employee's prior salary history. In addition, we ensured that the salaries were fair, reasonable, and consistent with comparable projects under a similar on-going Chemonics project in Southern Afghanistan (RAMP), thereby establishing prevailing compensation amounts for similar positions.

It is also worth noting that, had we utilized the Mission's FSN scale, both of the selected salaries would have been well within the Mission's 2007 FSN scale in the grades that the auditors believed would most appropriately correspond to their qualifications and job duties. The Chief Cook was paid \$437 per month during the 2007 period in question, and the FSN Grade 01 salary

range in 2007 was between US \$403 and \$548 per month (equivalent). The Administrative Officer was paid \$910 per month during the period in question, and the FSN Grade 05 salary range in 2007 was between US \$690 and \$938 per month (equivalent). As both of these salaries were consistent with prevailing compensation for similar work and were set in accordance with Chemonics' established policies and procedures, we believe there is no basis for questioning the costs and we request that this finding be removed from the draft audit report.

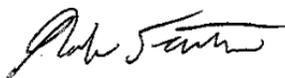
FINDING 2012 - 13

Reimbursement of Disallowed Fertilizer Costs
\$61,320

As the auditors note, \$72,000 for the purchase of fertilizer was initially questioned during the limited financial review conducted by USAID in June 2008, and later disallowed on October 8, 2008. USAID also corrected the amount of the disallowance from \$72,000 to \$61,320, as they had included an erroneous amount. However, the decision to treat the fertilizer as unallowable was subsequently overturned by Contracting Officer Yves B. Kore, on April 16, 2009. A copy of this approval is attached in Annex 5.1. Mr. Kore's letter was not previously provided to the auditors due to an internal miscommunication on our part, which we regret. However we are providing the letter in this response. As a result of this documented decision by the contracting officer, Chemonics does not need to reimburse USAID for the referenced \$61,320, and we request that this finding be removed from the draft audit report.

Thank you for considering the above comments. Please do not hesitate to contact me at (202) 955-3451 or rteitelbaum@chemonics.com should you have any questions or concerns.

Best regards,



Rob Teitelbaum
Controller

APPENDIX B - Auditor's Rebuttal

(Continued)

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

May 3, 2013

Crowe Horwath LLP, in consideration of the views presented by the management of Chemonics International, Inc. ("Chemonics" or the "auditee"), 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 findings and recommendations included in this report. In those instances where management's response did not provide new information and support to modify the facts and circumstances that resulted in the initial finding, we have not provided a response.

Finding 2012-01

Crowe Horwath disagrees with the auditee's assertions within the management responses. The application of the indirect cost (G&A) rate appearing in the negotiated indirect cost rate agreement (NICRA) and the rate utilized for the calculation of amounts billed to USAID are within the scope of the audit. The Fund Accountability Statement includes indirect costs, Chemonics submitted indirect costs to USAID, and were reimbursed for said costs. Chemonics inquired regarding the requests for information during the course of the audit and was provided with both verbal and written explanations via email on February 15, 2013, regarding the applicability of the matter, why the costs were in scope, and the specific items requested. We also noted that Chemonics communicated verbally that it was unwilling to provide the requested documentation during both the audit status meeting held on February 15, 2013, and the audit exit meeting on February 22, 2013.

In addition, the NICRA identifies an application basis and sets forth limitations on the use and application of the rate. Specifically, note limitations specified in "Section II: General" of the NICRA, which states that "...the rate(s) contained in this Agreement is subject to all statutory or administrative limitations and is applicable to a given grant, contract or other agreement only to the extent that funds are available." The NICRA continues to specify conditions applicable to the application of the rate.

The regulatory provisions referenced within the *criteria* of Finding 2012-01 were utilized as the foundation for testing the application of the NICRA. The auditor was not engaged to and did not attempt to audit the indirect cost rate agreed to by USAID and Chemonics. The application of that rate and compliance with the provisions of the NICRA as pertaining to the contract were within the scope of the audit.

Accordingly, the finding and the corresponding questioned costs will not be modified.

Finding 2012-02

Crowe Horwath disagrees with management's responses. As noted within the audit finding, the procurement documentation provided was inadequate and did not support the assertions made by the auditee within its procurement justification documentation and failed to demonstrate that the associated costs were reasonable. As referenced within the applicable Federal cost principles at 48 CFR Subpart 31.201-3(a) addressing the determination of reasonableness, "the burden of proof shall be upon the contractor to establish that such cost is reasonable." The reasonableness determination is further dependent upon "any significant deviations from the contractor's established practices". Reasonableness is a fundamental requirement for costs to be allowable under the provisions of 48 CFR Subpart 31.201-2(a). Chemonics did not provide adequate documentation to support the reasonableness of costs.

(Continued)

The auditor disagrees with the auditee's assumption that Crowe considers the entirety of the Federal Acquisition Regulation (FAR) to be applicable to Chemonics. The auditor did not apply the FAR in its entirety to Chemonics's contract. We note, however, that Chemonics' asserts the applicability of the FAR to its project-specific procurement procedures. We are in agreement with Chemonics's Director of Procurement Contract's statement made during the exit conference on February 22, 2013, that Chemonics is required to demonstrate "adequate" competition and noted that Chemonics's *Procurement Guidelines for the Afghanistan Alternative Livelihoods Program (ALP) Order No. 306-M-00-05-00516-00* makes reference to the ADS 302.5.1 (Applicability of FAR and AIDAR)'s statement that "It is USAID policy to conduct all direct procurement in accordance with FAR and AIDAR." Further, we note that Chemonics's procurement policy states the following:

"Note: The official FAR threshold for purchasing without competitive quotations is up to \$2,500. The \$500 limit is the official threshold set by Chemonics policy for field office purchases." - *Procurement Guidelines for the Afghanistan Alternative Livelihoods Program (ALP) Order No. 306-M-00-05-00516-00*.

In consideration of the above, the finding and the corresponding questioned costs will not be removed as Chemonics has failed to meet the requirement for reasonableness of costs. Ergo, the costs incurred are unallowable.

Finding 2012-03

Crowe disagrees with management's response. Management reported that "[Chemonics] did not invoice G&A on the fixed hourly or daily rates of subcontractors." As noted within Finding 2012-03, the regulation permits the inclusion of indirect costs to the extent that they are not applied to subcontracts that are paid at the hourly rates. The regulation does not provide an exception or otherwise distinguish between the components of a subcontract. Management's response indicates that Chemonics agrees that the G&A rate was applied to subcontracts that are paid at the hourly rates. Due to the fixed rates being represented within the subcontractors' costs as noted by management, the costs should not have been included within the base for application. Per the NICRA, the base of application includes "[REDACTED]".

In consideration of the above and management's responses, the finding and associated questioned costs remain unchanged.

Finding 2012-04

Crowe disagrees with management's response. Chemonics failed to provide documentation indicating that the local procurement requirements referenced in the contract – which incorporate, by reference, restrictions on purchases within geographic code 935 – were considered null, void, or otherwise waived. The regulation provides clear and concise instruction regarding the circumstances when prior approval is required. Such approval was not gained for the local procurements.

The finding and associated questioned costs remain unchanged.

Finding 2012-05

Crowe disagrees with management's assertions. Chemonics charged USAID for work performed by both home office personnel and personnel located in Afghanistan. Ergo, the work was not performed "entirely outside of the United States and its outlying areas." Accordingly, the exception does not apply and the finding stands.

Finding 2012-06

Please note the following responses regarding proof of payment:

1. The support provided for [REDACTED], similar to the support previously provided, does not reflect the amounts charged to USAID. As such, this documentation is inadequate to support the invoiced amounts. The questioned costs remain.
2. We have reviewed the documentation provided for [REDACTED] and consider the support to be sufficient. The questioned costs associated with [REDACTED] have been withdrawn.
3. The bank statement provided does not provide sufficient detail for the auditor to conclude that the transfer was for the charge in question.
4. We have reviewed the documentation provided by Chemonics. The documentation includes Abacus coding sheets, purchase requests, and invoices. Such documentation is not evidence of payment. Thus, we cannot accept this information as evidence that Chemonics paid the vendors. The questioned costs remain subject to a final review and determination by USAID.
5. We have reviewed the documentation provided and do not consider the expense report and employee signature to be adequate support for a cash outlay. The questioned costs remain.
6. We have reviewed the documentation provided and cannot determine, from the redacted statement, that the payment referenced is for the specific transaction in question. The questioned costs remain.

Per the above comments, the questioned costs originally presented in Finding 2012-06 have been reduced to \$53,329.

Finding 2012-07

Please note the following responses:

1. We have reviewed the documentation provided. The selection in the sample provided to Chemonics on January 5, 2013, pertained to \$2,204 in charges for the engineer with a transaction date of January 14, 2008, and a note referencing November 2007 charges. The supporting documentation pertains to work performed in September and October 2007. As such, we cannot accept this information as support for the charges in question. The questioned costs remain.
2. The documentation initially provided in support of the expenditure was an Abacus coding sheet, which is inadequate to support the expenditure. We have reviewed the documentation provided with the management response and agreed the support to the expenditure selected as part of our sample. We found the support to be adequate and cleared the questioned costs associated with this employee.
3. Crowe requested documentation regarding the shipping lines applicable to the transaction as well as documentation showing that the vessel referenced in the shipping document were on the list of U.S. Flag Vessels. See the email to Chemonics dated February 20, 2013. Chemonics chose not to respond to the auditor's inquiry.

Upon review of the documentation provided with management's responses, we noted that general guidance was provided and information was requested that would enable the processing of a waiver. The waiver is not included and also does not reference the transaction in question for the project. The questioned costs remain subject to additional review by USAID.

(Continued)

Finding 2012-08

Crowe disagrees with management's response. The components of the summary mathematically add to the amounts within the invoice detail, and sum of the components agrees to the amounts invoiced. Chemonics did not respond to Crowe's requests on February 16, 2013, or on February 17, 2013. During the audit exit meeting, Chemonics communicated verbally that a recalculation on the part of the auditee had resulted in an expected undercharge. Due to the inconsistencies and calculations shown on the invoices to USAID, the questioned costs remain.

We did not conduct an audit of Chemonics' financial management system. Accordingly, we express no opinion on the reliability, adequacy, or capabilities of the system and the controls therein.

Finding 2012-10

Crowe disagrees with Chemonics' management response. Two distinct exchange rate procedures were communicated to the auditor on January 19, 2013, and February 15, 2013. Crowe requested a written policy to resolve the discrepancy; a policy was not provided. See email communications to Chemonics dated February 22, 2013.

Chemonics's comments indicated that two other sets of auditors review their procedures. Crowe did not review or otherwise assess the work of other auditors. Accordingly, we express no opinion on the results of their procedures for this matter.

Finding 2012-13.

As Chemonics referenced, complete documentation was not provided during the course of the audit. Due to the evolving nature of the matter, the finding will remain subject to review by USAID and confirmation that there were no subsequent communications, modifications, or decisions regarding the disallowance.

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- Phone International: +1-866-329-8893
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