

SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR 17-63 Financial Audit

U.S. Air Force Logistical Support to the Afghan Air Force: Audit of Costs Incurred by AAR Supply Chain Inc.

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



AUGUST
2017

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On July 30, 2015, the U.S. Air Force Life Cycle Management Center (AFLCMC) awarded a 1-year, \$72.1 million contract to AAR Supply Chain Inc. (AAR) to provide logistical support to the Afghan Air Force (AAF). The objectives of the contract were to support and sustain up to four C-130H aircraft, provide on-call support, and interface with contractors tasked with training AAF maintenance personnel. The contract has been modified 11 times, increasing the value to \$75.4 million, and extending the period of performance to July 30, 2018. Three of the modifications, including one to exercise the second option year, were outside the scope of this audit.

SIGAR's financial audit, performed by Mayer Hoffman McCann (MHM), reviewed ██████████ in reimbursable costs incurred on the contract between July 30, 2015, and July 30, 2016. The objectives of the audit were to (1) identify and report on significant deficiencies and material weaknesses in AAR's internal controls related to the contract; (2) identify and report on instances of material noncompliance with the terms of the contract and applicable laws and regulations, including any potential fraud or abuse; (3) determine and report on whether AAR has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of AAR's Special Purpose Financial Statement (SPFS). See MHM's report for the precise audit objectives.

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

August 2017

U.S. Air Force Logistical Support to the Afghan Air Force: Audit of Costs Incurred by AAR Supply Chain Inc.

SIGAR 17-63-FA

WHAT THE AUDIT FOUND

MHM identified three significant deficiencies in AAR's internal controls and three instances of noncompliance with the terms and conditions of the contract. All dealt with ineligible travel costs charged to the contract. Specifically, AAR charged airfare and lodging in excess of the amounts allowed by federal travel regulations, and claimed dental expenses as travel costs.

As a result of these internal control deficiencies and instances of noncompliance, MHM identified \$1,215 in total questioned costs, consisting entirely of ineligible costs—costs prohibited by the contract, applicable laws, or regulations. MHM did not identify any unsupported costs—costs not supported with adequate documentation or that did not have required prior approval.

Category	Ineligible	Unsupported	Total Questioned Costs
Travel Costs	\$1,215	\$0	\$1,215
Totals	\$1,215	\$0	\$1,215

MHM reviewed prior audit reports applicable to the C-130H logistical support contract and identified one finding that could have had a material effect on the SPFS. Based on the results of its testing, MHM determined that AAR has taken adequate corrective action to address the prior finding.

MHM issued an unmodified opinion on AAR's SPFS, noting that it presents fairly, in all material respects, revenues received and costs incurred for the period audited.

WHAT SIGAR RECOMMENDS

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

- 1. Determine the allowability of and recover, as appropriate, \$1,215 in questioned costs identified in the report.**
- 2. Advise AAR to address the report's three internal control findings.**
- 3. Advise AAR to address the report's three noncompliance findings.**



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

August 22, 2017

The Honorable James Mattis
Secretary of Defense

The Honorable Heather A. Wilson
Secretary of the Air Force

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

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

We contracted with Mayer Hoffman McCann (MHM) to audit the costs incurred by AAR Supply Chain Inc. (AAR) under a U.S. Air Force Life Cycle Management Center (AFLCMC) contract to provide logistical support to the Afghan Air Force.¹ MHM's audit covered [REDACTED] in expenditures charged to the contract between July 30, 2015, and July 30, 2016. Our contract with MHM required that the audit be performed in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

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

- 1. Determine the allowability of and recover, as appropriate, \$1,215 in total questioned costs identified in the report.**
- 2. Advise AAR to address the report's three internal control findings.**
- 3. Advise AAR to address the report's three noncompliance findings.**

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

¹ AFLCMC awarded contract number FA8553-15-D-0001 to AAR to support and sustain up to four C-130H aircraft, provide on-call support, and interface with contractors tasked with training Afghan Air Force maintenance personnel.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

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

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

(F-103)

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

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Mayer Hoffman McCann P.C.
An Independent CPA Firm

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July 26, 2017

Enclosed is the final report on the financial audit of costs incurred by AAR Supply Chain, Inc. ("AAR") under Contract Number FA8553-15-D0001 for services under C-130H Contractor Logistic Support for the Afghan Air Force. The audit covers the period July 30, 2015 through July 30, 2016.

Included within the final report is a summary of the work performed, our report on the Special Purpose Financial Statement, report on internal control and report on compliance. We do not express an opinion on the summary or any information preceding our reports.

When preparing our report, we considered comments, feedback and interpretations from AAR, the Special Inspector General for Afghanistan Reconstruction and the Air Force Life-Cycle Management Center. Management of AAR has prepared responses to the findings identified during our audit and those responses are included as part of this report. The responses have not been audited and we express no opinion on them.

Sincerely,

Mayer Hoffman McCann P.C.

A handwritten signature in blue ink, appearing to read 'Marcus D. Davis', is written over a horizontal line.

Marcus D. Davis, CPA
Shareholder

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

Background

On July 30, 2015, the Air Force Life-Cycle Management Center (“AFLCMC”) entered into Contract Number FA8553-15-D-0001 (“the Contract”) with AAR Parts Trading, Inc. (which later changed its name to AAR Supply Chain, Inc. (“AAR”). The Contract is an indefinite-delivery/indefinite-quantity (“IDIQ”) contract to provide contractor logistics support to the Afghan Air Force (“AAF”). The objectives of the Contract are to support and sustain up to four C-130H aircraft, provide on-call support, and to interface with contractors tasked with training AAF maintenance personnel. Specific contracted services include technical support for all logistics functions (supply, spares and parts replenishment, warehousing, packaging, and shipment of parts), maintenance (on- and off-aircraft, engine, and propellers), and operations (plans and scheduling, debriefing, and aircrew life support). The work under the Contract was performed primarily at the Main Operating Base in Kabul, Afghanistan and, as needed, at forward operating locations.

The Contract was awarded in the original amount of \$72,138,794, of which \$20,295,113 was obligated, [REDACTED]. The Contract had a basic ordering period from July 30, 2015 through July 30, 2016, plus four option ordering periods of 12 months each. The first option ordering period was exercised, which extended the end date to July 30, 2017. There are three remaining option ordering periods. The end date of the contract will be July 30, 2020, if all remaining option years are exercised. The Contract was modified 8 times, increasing the total amount to \$75,425,595, of which \$21,795,113 had been obligated as of August 20, 2015, [REDACTED]. Some of the more significant modifications that had an impact on the original Contract are described below:

<u>Modification No.</u>	<u>Effective Date</u>	<u>Significance</u>
1	8/20/15	Increased the obligated amounts by \$1,500,000 to \$21,795,113, [REDACTED]. The total amount of the Contract remained unchanged.
AZ	3/12/16	Changed the name of the Company from AAR Parts Trading, Inc. to AAR Supply Chain, Inc.
2	4/15/16	Realigned funds [REDACTED]. The total Contract amount remained unchanged.
P00002	4/15/16	Increased the total Contract amount by \$3,286,801 to \$75,425,595. The obligated amount remained unchanged.
3	5/5/16	Realigned funds [REDACTED]; the

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For the Afghan Air Force (AAF)

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<u>Modification No.</u>	<u>Effective Date</u>	<u>Significance</u>
		total Contract remained unchanged.
P00003	7/30/16	Exercised the first option ordering period. The total Contract amount and all other terms and conditions remained unchanged.

AAR provides aviation services to the worldwide commercial aerospace and the government and defense industries. AAR services include, but are not limited to, logistics, distribution, component repair, inventory management, and airlift operations. According to its website, AAR is the largest provider of airlift services in Afghanistan, assisting the U.S. Department of Defense in the transport of equipment, supplies, and mail. AAR also performs airlift operations in Africa and the Western Pacific regions.

Work Performed

Mayer Hoffman McCann P.C. ("MHM") was engaged by the Office of the Special Inspector General for Afghanistan Reconstruction ("SIGAR") to conduct a financial audit of AAR's Special Purpose Financial Statement ("SPFS") for costs incurred under Contract Number FA8553-15-D-0001 the period July 30, 2015 through July 30, 2016.

Objectives, Scope, and Methodology

Objectives Defined by SIGAR

The objectives of the audit include the following:

- *Special Purpose Financial Statement (SPFS)* – Express an opinion on whether AAR's SPFS for the Contract presents fairly, in all material respects, revenues received, costs incurred, items directly procured by the U.S. Government, and balance for the period audited in conformity with the terms of the Contract and generally accepted accounting principles or other comprehensive basis of accounting.
- *Internal Controls* – Evaluate and obtain a sufficient understanding of AAR's internal controls related to the Contract; assess control risk; and identify and report on significant deficiencies including material internal control weaknesses.
- *Compliance* – Perform tests to determine whether AAR complied, in all material respects, with the Contract 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.

AAR SUPPLY CHAIN, INC.

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For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

- *Corrective Action on Prior Findings and Recommendations* – Determine and report on whether AAR has taken adequate corrective action to address findings and recommendations from previous engagements that could have a material effect on the SPFS or other financial data significant to the audit objectives.

Scope

[REDACTED]. Our testing of the general and administrative (“G&A”) rate and material handling rate was limited to determining that the G&A and material handling rates were calculated using no greater than the proposed G&A and material handling rates as audited by the Defense Contract Audit Agency (“DCAA”).

Methodology

In order to accomplish the objectives of this audit, we designed our audit procedures to include the following:

Entrance Conference

An entrance conference was held via conference call on March 1, 2017. Participants included MHM, AAR, SIGAR and the AFLCMC.

Planning

During our planning phase, we performed the following:

- Obtained an understanding of AAR, its environment and assessed the risks of material misstatement;
- Reviewed the Contract and all modifications;
- Reviewed sections of the Federal Acquisition Regulation (“FAR”) and the Defense Acquisition Regulation System (“DFARS”) as applicable to the Contract;
- Performed a financial reconciliation; and
- Selected samples based on our approved sampling techniques. According to the approved Audit Plan, we used the detailed accounting records that were reconciled to the financial reports, and based upon the risk assessment and materiality included as part of the approved Audit Plan, we performed data mining to assess individual expenditure accounts and transactions that were considered to be high or medium to low risk for inclusion in our test of transactions. None of the

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

populations were homogeneous in nature, thus statistical sampling was not used. All samples were selected on a judgmental basis. Our sampling methodology for judgmental samples was as follows:

- For accounts that appeared to contain unallowable and restricted items according to the terms of the Contract, FAR Part 31 and any other applicable regulations, we sampled 100% of the transactions.
- For high risk cost categories, we sampled individual transactions greater than \$33,600, not to exceed 50% of the total amount expended for each cost category.
- For medium risk cost categories, we sampled individual transactions greater than \$67,200, not to exceed 20% of the total amount expended for each cost category.
- For low risk cost categories, we individual sampled transactions greater than \$67,200, not to exceed 10% of the total amount expended for each cost category, not to exceed 50 transactions in total for all accounts comprising low risk categories.

Internal Control Related to the SPFS

We reviewed AAR's internal controls related to the SPFS. The system of internal control is intended to provide reasonable assurance of achieving reliable financial reporting and compliance with applicable laws and regulations. We corroborated internal controls identified by AAR and conducted testing of select key controls to understand if they were implemented as designed and operating effectively.

Compliance with Contract Requirements and Applicable Laws and Regulations

We reviewed the Contract and modifications and documented all compliance requirements that could have a direct and material effect on the SPFS. We assessed inherent and control risk as to whether material noncompliance could occur. Based upon our risk assessment, we designed procedures to test a sample of transactions to ensure compliance with the Contract requirements and laws and regulations.

Corrective Action on Prior Findings and Recommendations

We requested all reports from previous engagements, as well as searched publicly available information for other reports, in order to evaluate the adequacy of corrective actions taken on findings and recommendations that could have a material effect on the SPFS. See the Review of Prior Findings and Recommendations subsection of this Summary for this analysis.

Special Purpose Financial Statements

In reviewing the SPFS, we performed the following:

- Reconciled the costs on the SPFS to the Contract, modifications and general ledger;

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

- Traced receipt of funds to the accounting records; and
- Sampled and tested the costs incurred to ensure the costs were allowable, allocable to the Contract and reasonable. If the results of a judgmental sample indicated a material error rate, our audit team consulted with our Audit Manager and Project Director as to whether the sample size should be expanded. If it appeared that based upon the results of the judgmental sample, an entire account was deemed not allowable, we did not expand our testing, but instead questioned the entire account.

Exit Conference

An exit conference was held on May 19, 2017 via conference call. Participants included MHM, AAR, SIGAR and the AFLFMC. During the exit conference, we discussed the preliminary results of the audit and established a timeline for providing any final documentation for consideration and reporting.

Summary of Results

Our audit of the costs incurred by AAR under the Contract with the AFLCMC identified the following audit results. Findings are classified as either internal control, compliance, or a combination of internal control and compliance.

Auditor's Opinion on SPFS

We issued an unmodified opinion on the fairness of the presentation of the SPFS. We also identified \$1,215 of questioned costs under the Contract. A summary of findings and questioned costs is as follows:

Summary of Findings and Questioned Costs

Finding Number	Nature of Finding	Matter	Questioned Costs	Total Cumulative Questioned Cost
2017-1	Internal control – significant deficiency Compliance	Airfare in excess of allowable amount per Federal Travel Regulation (FTR)	\$432	\$432
2017-2	Internal control – significant deficiency Compliance	Lodging in excess of allowable amount per FTR	\$624	\$1,056

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

For the Period July 30, 2015 through July 30, 2016

Finding Number	Nature of Finding	Matter	Questioned Costs	Total Cumulative Questioned Cost
2017-3	Internal control – significant deficiency Compliance	Dental expenses claimed as travel costs	\$159	\$1,215

Internal Control Findings

Our audit discovered three internal control findings, all of which are classified as significant deficiencies. See Independent Auditor's Report on Internal Control on page 14. The complete management responses from AAR to each of the internal control findings can be found in Appendix A to this report.

Compliance Findings

As part of obtaining reasonable assurance as to whether the SPFS is free from material misstatement, we performed tests of its compliance with certain provisions of the Contract and other laws and regulations, noncompliance with which could have a direct and material effect on the determination of amounts in the SPFS. The results of our tests disclosed three instances of noncompliance related to this audit. See Independent Auditor's Report on Compliance on page 16. The complete management responses from AAR to each of the compliance findings can be found in Appendix A to this report.

Review of Prior Findings and Recommendations

We requested copies of prior engagements including audits, reviews and evaluations pertinent to AAR's activities under the Contract. We identified one finding from a prior engagement that could have a material effect on the SPFS. We tested transactions and determined that AAR has taken adequate corrective action to address the finding. See the Status of Prior Findings on page 18 for a detailed description of the prior findings and recommendations.

Summary of AAR's Responses to Findings

For all three findings, 2017-1 through 2017-3, AAR agreed with the questioned costs identified in each finding, but disagreed with the characterization of each finding as a significant deficiency in internal control. Additionally, AAR believes the "cause" included for each finding is not substantiated by sufficient appropriate evidence. The complete responses received can be found in Appendix A to this report.



INDEPENDENT AUDITOR'S REPORT ON SPECIAL PURPOSE FINANCIAL STATEMENT

Board of Directors
AAR Supply Chain, Inc.
1100 North Wood Dale Road
Wood Dale, Illinois 60191

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

Report on the Special Purpose Financial Statement

We have audited the accompanying Special Purpose Financial Statement of AAR Supply Chain, Inc. ("AAR") under Contract No FA8553-15-D-0001 ("Contract"), with the Air Force Life Cycle Management Center ("AFLCMC") for the implementation of services under C-130H Contractor Logistic Support for the Afghan Air Force ("AAF") for the period July 30, 2015 and July 30, 2016, and the related notes to the Special Purpose Financial Statement.

Management's Responsibility for the Special Purpose Financial Statement

Management is responsible for the preparation and fair presentation of the Special Purpose Financial Statement in accordance with the methods of preparation described in Note 2; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements (including the Special Purpose Financial Statement) that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Special Purpose Financial Statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Special Purpose Financial Statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Special Purpose Financial Statement in order to design audit procedures that are appropriate

Board of Directors
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Arlington, Virginia 22202

in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Special Purpose Financial Statement.

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

Opinion

In our opinion, the Special Purpose Financial Statement referred to above presents fairly, in all material respects, the respective revenue received and costs incurred by AAR under the Contract for the period July 30, 2015 through July 30, 2016 in accordance with the basis of accounting described in Note 2.

Restriction on Use

This report is intended for the information of AAR Supply Chain, Inc., the United States Air Force, and the Special Inspector General for Afghanistan Reconstruction ("SIGAR"), and is not intended to be and should not be used by anyone other than these specified parties. Financial information in this report may be privileged. The restrictions of 18 USC 1905 should be considered before any information is released to the public. However, subject to applicable laws, this report may be released to Congress and to the public by SIGAR in order to provide information about programs and operations funded with amounts appropriated or otherwise made available for the reconstruction of Afghanistan.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our reports dated July 26, 2017 on our consideration of AAR's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering AAR's internal control over financial reporting and compliance.



Irvine, California
July 26, 2017

AAR SUPPLY CHAIN, INC.
 Contract No. FA-8553-15-D-0001
 Services under C-130H Contractor Logistic Support
 For the Afghan Air Force (AAF)

Special Purpose Financial Statement

July 30, 2015 through July 30, 2016

	Budget	Actual	Questioned Costs		Total	Notes
			Ineligible	Unsupported		
Revenues:						
FA8553-15-D-0001	██████████	\$ 6,774,733	\$ -	\$ -	\$ -	(3)
Total revenues	██████████	6,774,733	-	-	-	
Expenditures:						
Materials	██████████	██████████	-	-	-	
Travel	██████████	██████████	1,215	-	1,215	(A)
Total costs incurred	██████████	6,715,474	1,215	-	1,215	
Outstanding fund balance	\$ -	\$ 59,259	\$ (1,215)	\$ -	\$ (1,215)	(5),(B)

See Notes to Special Purpose Financial Statement
 and Notes to Questions Costs Presented on Special Purpose Financial Statement

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Notes to Special Purpose Financial Statement¹

For the Period July 30, 2015 through July 30, 2016

(1) **Background**

On July 30, 2015, the Air Force Life Cycle Management Center (“AFLCMC”) entered into Contract Number FA8553-15-D-0001 (“Contract”) with AAR Supply Chain, Inc. (“AAR”). At the time of the original award, AAR was called AAR Parts Trading, Inc., and did business as AAR Defense Systems & Logistics. The Contract is an indefinite-delivery/indefinite-quantity (“IDIQ”) contract to provide contractor logistics support to the Afghan Air Force (“AAF”).

The Contract was awarded in the original amount of \$72,138,794, of which \$20,295,113 was obligated, [REDACTED]

[REDACTED] The Contract had a basic ordering period from July 30, 2015 through July 30, 2016, plus four option ordering periods of 12 months each if exercised. The first option ordering period was exercised, which extended the end date to July 30, 2017. There are three remaining option ordering periods. The end date of the contract would be July 30, 2020 if all remaining option years are exercised. The Contract was modified 8 times increasing the total amount to \$75,425,595, of which \$21,795,113 was obligated, [REDACTED], and extending the period of performance through July 30, 2017.

(2) **Summary of Significant Accounting Policies**

Basis of Presentation

The accompanying Special Purpose Financial Statement (“SPFS”) includes costs incurred for services under C-130H Contractor Logistic Support for the AAF for the period July 30, 2015 through July 30, 2016. Because the SPFS presents only a selected portion of the operations of AAR, it is not intended to and does not present the financial position, changes in financial position, or cash flows of AAR. The information in the SPFS is presented in accordance with the requirements specified by the Special Inspector General for Afghanistan Reconstruction (“SIGAR”), accounting principles generally accepted in the United States of America, and is specific to the aforementioned Contract.

Basis of Accounting

Expenditures reported on the SPFS 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 Federal Acquisition Regulation (“FAR”) Part 31 – *Contracts with Commercial Organizations*.

¹ The Notes to Special Purpose Financial Statement are the responsibility of AAR.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Notes to Special Purpose Financial Statement

(Continued)

(5) Outstanding Fund Balance

As of July 30, 2016, there was an outstanding fund balance of \$59,259. This outstanding fund balance represents the difference between the provisional indirect cost rates as billed by AAR to the AFLCMC, and the actual final indirect cost rates as calculated by AAR and submitted to DCAA for review. The provisional indirect cost rates were greater than the actual final indirect cost rates calculated by AAR and submitted to DCAA for review. Should DCAA approve AAR's calculated indirect cost rates, then future billings to the AFLCMC will be reduced until the outstanding fund balance has been eliminated.

(6) Subsequent Events

AAR has evaluated subsequent events through July 26, 2017, which is the date the SPFS was available to be issued. There were no subsequent events identified that would impact the SPFS as of this date.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Notes to Questioned Costs Presented on Special Purpose Financial Statement²

For the Period July 30, 2015 through July 30, 2016

There are two categories of questioned costs, ineligible and unsupported. Ineligible costs/amounts that are explicitly questioned because they are unreasonable; prohibited by the audited contract or applicable laws and regulations; or not award related. Unsupported costs are not supported with adequate documentation or did not have required prior approvals or authorizations.

(A) Travel

AAR reported travel costs in the amount of \$208,364 for the period July 30, 2015 through July 30, 2016. During our audit of these costs, we noted the following, which resulted in ineligible costs.

<u>Finding Number</u>	<u>Observation</u>	<u>Ineligible Costs</u>
2017-1	Airfare in excess of allowable amount per Federal Travel Regulation (FTR)	\$ 432
2017-2	Lodging in excess of allowable amount per FTR	624
2017-3	Dental expenses claimed as travel costs	<u>159</u>
Total ineligible costs		<u>\$1,215</u>

(B) Outstanding Fund Balance

The total outstanding fund balance as of July 30, 2016 in the amount of \$(1,215) represents the total questioned costs, all of which were deemed to be ineligible costs. These questioned costs, when applied to the outstanding fund balance reported by AAR, results in a net outstanding fund balance of \$60,474 as follows:

Outstanding fund balance as reported	\$59,259
Total questioned costs resulting in additional fund balance	<u>1,215</u>
Outstanding fund balance per audit	<u>\$60,474</u>

² The Notes to Questioned Costs presented on the Special Purpose Financial Statement were prepared by the auditor for information purposes only and as such are not part of the audited Special Purpose Financial Statement.



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF THE SPECIAL PURPOSE FINANCIAL STATEMENT
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITOR'S REPORT

Board of Directors
AAR Supply Chain, Inc.
1100 North Wood Dale Road
Wood Dale, Illinois 60191

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Special Purpose Financial Statement of AAR Supply Chain, Inc. ("AAR") representing revenues received and costs incurred under Contract No. FA8553-15-D-0001 ("Contract"), with the Air Force Life Cycle Management Center ("AFLCMC") for C-130H Contractor Logistic Support for the Afghan Air Force ("AAF") for the period July 30, 2015 through July 30, 2016, and the related Notes to the Special Purpose Financial Statement, and have issued our report thereon dated July 26, 2017.

Internal Control over Financial Reporting

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

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

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combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying Detailed Audit Findings as Findings 2017-1, 2017-2 and 2017-3 that we consider to be significant deficiencies.

AAR's Response to Findings

AAR's response to the findings identified in our audit is included verbatim in Appendix A. AAR's response was not subjected to the auditing procedures applied in the audit of the Special Purpose Financial Statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

This report is intended for the information of AAR Supply Chain, Inc., the Air Force Life Cycle Management Center, and the Special Inspector General for Afghanistan Reconstruction ("SIGAR"), and is not intended to be and should not be used by anyone other than these specified parties. 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. However, subject to applicable laws, this report may be released to Congress and to the public by SIGAR in order to provide information about programs and operations funded with amounts appropriated or otherwise made available for the reconstruction of Afghanistan.



Irvine, California
July 26, 2017



**REPORT ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF THE SPECIAL PURPOSE FINANCIAL STATEMENT
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

INDEPENDENT AUDITOR'S REPORT

Board of Directors
AAR Supply Chain, Inc.
1100 North Wood Dale Road
Wood Dale, Illinois 60191

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Special Purpose Financial Statement of AAR Supply Chain, Inc. ("AAR"), representing revenues received and costs incurred under Contract No. FA8553-15-D-0001 ("Contract"), with the Air Force Life Cycle Management Center ("AFLCMC") for C-130H Contractor Logistic Support for the Afghan Air Force ("AAF") for the period July 30, 2015 through July 30, 2016, and the related Notes to the Special Purpose Financial Statement, and have issued our report thereon dated July 26, 2017.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether AAR's Special Purpose Financial Statement is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and the aforementioned Contract, noncompliance with which could have a direct and material effect on the determination of Special Purpose Financial Statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. As we performed our testing, we considered whether the information obtained during our testing indicated the possibility of fraud or abuse. The results of our tests disclosed three instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Detailed Audit Findings as Findings 2017-1, 2017-2 and 2017-3.

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AAR's Response to Findings

AAR's response to the findings identified in our audit is included verbatim in Appendix A. AAR's response was not subjected to the auditing procedures applied in the audit of the Special Purpose Financial Statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

This report is intended for the information of AAR Supply Chain, Inc., the Air Force Life Cycle Management Center, and the Special Inspector General for Afghanistan Reconstruction, and is not intended to be and should not be used by anyone other than these specified parties. 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. However, subject to applicable laws, this report may be released to Congress and to the public by SIGAR in order to provide information about programs and operations funded with amounts appropriated or otherwise made available for the reconstruction of Afghanistan.



Irvine, California
July 26, 2017

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Status of Prior Findings

For the Period July 30, 2015 through July 30, 2016

We requested copies of prior engagements including audits, reviews and evaluations pertinent to AAR's activities under the Contract. We reviewed the corrective actions taken to address findings and recommendations from prior engagements that could have a material effect on the SPFS. There was one prior engagement with findings and recommendations that were included in the scope of our audit. This engagement identified three findings, one of which has a potential material effect on the SPFS. Based on our review, adequate corrective action was implemented on this prior finding.

Year End Assessment of Trading, Programs, Distribution and Shared Services (TPDS) for Fiscal Year 2016

AAR's Internal Audit Department performed an assessment of internal controls surrounding AAR's TPDS in accordance with Section 404 of the Sarbanes-Oxley (SOX) Act. The Internal Auditors noted that three purchases were not properly approved according to the AAR Chart of Authority Matrix. During our testing of procurement over materials, all repair orders or costs related to repairing aircraft were approved in accordance with the Chart of Authority Matrix. As such, the corrective action has been adequately implemented.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

For the Period July 30, 2015 through July 30, 2016

Finding Number 2017-1: Airfare in Excess of Allowable Amount per Federal Travel Regulation

Nature of Finding:

Internal control – significant deficiency
Compliance

Condition:

Twenty-three airfare transactions, totaling \$45,935, were tested. AAR invoiced AFLCMC for one of the twenty-three airfares in excess of the amount allowable under the Federal Travel Regulation (FTR). One business class ticket in the amount of \$1,107 was purchased without justification for a round trip from Kabul, Afghanistan to Dubai, United Arab Emirates for travel in June 2016. A coach class ticket in June 2016, based upon an average of prices quoted by Emirates Airlines (the air carrier for the original trip),

Criteria:

48 CFR 31.205-46, *Travel costs*, states, in part:

“...(b) Airfare costs in excess of the lowest priced airfare available to the contractor during normal business hours are unallowable except when such accommodations require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, are not reasonably adequate for the physical or medical needs of the traveler, or are not reasonably available to meet mission requirements. However, in order for airfare costs in excess of the above airfare to be allowable, the applicable condition(s) set forth above must be documented and justified.

Cause:

AAR's corporate travel policies allow for reimbursement in amounts that could be greater than as allowed by the FTR. The travel policies are silent as to the application of the limitations of the FTR when billing the government. Upon preparing billings to the AFLCMC under the Contract, AAR did not reduce the excess travel costs to allowable amounts due to a lack of familiarity with the FTR.

Effect:

Weaknesses in internal controls over the accuracy of billing could permit additional errors to go unnoticed and the government to be overcharged.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

(Continued)

Questioned Costs:

Total questioned travel costs, including the associated G&A fee, are as follows:

	<u>Questioned Costs</u>
	
Total Questioned Costs	<u>\$432</u>

Recommendation:

- (1) We recommend that AAR return \$432 to the AFLCMC for airfare costs in excess allowable amounts per the FTR.
- (2) We recommend that AAR modify its policies to ensure that travel costs are not claimed in excess of allowable amounts per the FTR.
- (3) We recommend that AAR provide training to employees responsible for preparation of invoices to ensure that travel costs in excess of allowable amounts per the FTR are not claimed.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

(Continued)

Finding Number 2017-2: Lodging in Excess of Allowable Amount per FTR

Nature of Finding:

Internal control – significant deficiency
Compliance

Condition:

Seventeen lodging transactions, totaling \$19,707, were tested. AAR invoiced AFLCMC for two of the seventeen in excess of the amount allowable under the FTR. AAR's records contained no justification for the excess charges. The excess charges are detailed as follows:

<u>Location</u>	<u>Amount Charged</u>	<u>Allowable Amount</u>	<u>Excess Lodging</u>
Itasca, Illinois	[REDACTED]	[REDACTED]	[REDACTED]
Warner Robins, Georgia	[REDACTED]	[REDACTED]	[REDACTED]
Totals	<u>\$2,175</u>	<u>\$1,587</u>	<u>\$588</u>

Criteria:

48 CFR 31.205-46(a), *Costs for transportation, lodging, meals, and incidental expenses*, states, in part:

“(1) Costs incurred by contractor personnel on official company business are allowable, subject to the limitations contained in this subsection...”

(2) Except as provided in paragraph (a)(3) of this section, costs incurred for lodging, meals, and incidental expenses (as defined in the regulations cited in (a)(2) (i) through (iii) of this paragraph) shall be considered to be reasonable and allowable only to the extent that they do not exceed on a daily basis the maximum per diem rates in effect at the time of travel as set forth in the— (i) Federal Travel Regulation, prescribed by the General Services Administration, for travel in the contiguous United States...”

Cause:

AAR's corporate travel policies allow for reimbursement in amounts that could be greater than as allowed by the FTR. The travel policies are silent as to the application of the limitations of the FTR when billing the government. Upon preparing billings to the AFLCMC under the Contract, AAR did not reduce the excess travel costs to allowable amounts due to a lack of familiarity with the FTR.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

(Continued)

Effect:

Weaknesses in internal controls over the accuracy of billing could allow additional errors to go unnoticed and the government to be overcharged.

Questioned Costs:

Total questioned travel costs, including the associated G&A fee, are as follows:

	<u>Questioned Costs</u>
Travel [REDACTED]	[REDACTED]
Total Questioned Costs	<u>\$624</u>

Recommendation:

- (1) We recommend that AAR return \$624 to the AFLCMC for lodging in excess of the FTR.
- (2) We recommend that AAR modify its policies to ensure that travel costs are not claimed in excess of allowable amounts per the FTR.
- (3) We recommend that AAR provide training to employees responsible for preparation of invoices to ensure that travel costs in excess of allowable amounts per the FTR are not claimed.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

(Continued)

Finding Number 2017-3: Dental Expenses Claimed as Travel Costs

Nature of Finding:

Internal control – significant deficiency
Compliance

Condition:

Seventeen miscellaneous travel transactions, totaling \$20,763, were tested. One of the seventeen miscellaneous travel transactions included reimbursement of dental expenses in the amount of [REDACTED], which is not related to the Contract. The cost categories included in the SPFS consist of travel and materials only. No other costs are allocable to the contract.

Criteria:

48 CFR 31.201-4, *Determining allocability*, states:

“A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

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

Cause:

Management did not closely review the nature of the expenses claimed on the employee's expense report.

Effect:

Weaknesses in internal controls over the accuracy of billing could permit additional errors to go unnoticed and the government to be overcharged.

Questioned Costs:

Total questioned travel costs, including the associated G&A fee, are as follows:

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Detailed Audit Findings

(Continued)

	<u>Questioned Costs</u>
Travel [REDACTED]	[REDACTED]
Total Questioned Costs	<u>\$159</u>

Recommendation:

- (1) We recommend that AAR return \$159 to the AFLCMC for unallocable dental expenses charged to the Contract.
- (2) We recommend that AAR provide training to employees responsible for reviewing travel expense reports to ensure that the review includes identifying any costs claimed which are not travel related and excluding those costs from the amounts charged to the Contract.



July 13, 2017

Marcus D. Davis, CPA
Mayer Hoffman McCann P.C.
2301 Dupont Drive
Suite 200
Irvine, California 92612

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

Dear Mr. Davis:

cc: Office of the Special Inspector General for Afghanistan Reconstruction:

Introduction

AAR Supply Chain Inc. (“AAR”, “us”, “we”) would like to express our gratitude to the Office of the Special Inspector General for Afghanistan Reconstruction (“SIGAR”), and Mayer Hoffman McCann P.C. (“Auditor(s)”) for the professionalism of both parties throughout the course of the audit. AAR is honored to perform on the C-130H Contractor Logistic Support Contract for the Afghan Air Force. As an organization, continuous improvement to operational performance and financial compliance is a cornerstone of AAR’s mission of “Doing It Right”. AAR looks forward to continue doing all we can to support the noble and admirable mission of SIGAR to promote efficiency and effectiveness of Afghan reconstruction, and detect and prevent waste, fraud, and abuse.

AAR is a leading provider of aviation services to the worldwide commercial aerospace and government / defense industries. At AAR, we constantly search for the right thing to do for our customers, for our employees, for partners and for society. We wake up in the morning knowing we have to deliver, and at the end of the day believe we did our best, and are encouraged to return the next day, and do even better. We do not rest on our earlier accomplishments.

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AAR Response to Draft Audit Findings**(A) Independent Auditor's Report on Special Purpose Financial Statement****AAR Response:**

As the Auditor's Report included no findings, no response has been requested for this report. AAR is simply acknowledging the report for purposes of completeness of our response.

(B) Report on Internal Control Over Financial Reporting Based on an Audit of the Special Purpose Financial Statement Performed in Accordance with Government Auditing Standards**AAR Response:**

AAR respectfully disagrees with the Auditor's opinion that the three isolated instances of questioned costs identified in Detailed Audit Findings 2017-1, 2017-2, and 2017-3 are due to a significant deficiency in internal controls. The Auditor's Report questions only \$1,215 of costs, out of total incurred costs of \$6,715,474 (0.018% of audited costs). Rather, AAR views the immateriality of these isolated findings as clear evidence of the adequacy and effectiveness of AAR's internal control structure. The Auditor's opinion infers any instance, regardless of materiality, of questioned costs is a significant deficiency in internal controls. Thus, implying upon a contractor, a standard of absolute perfection in every transaction, with any instance of questioned costs resulting in a significant deficiency.

Furthermore, as described in the subsequent rebuttals to the individual findings, AAR believes the "Cause" included within the Auditor's Report for each finding is not substantiated by sufficient appropriate evidence, as described in Generally Accepted Government Auditing Standard ("GAGAS") Chapter 4.20.

It is AAR's view that the Auditor's Report lacks clarity as to the guidance, or metrics applied to lead to the determination that each finding qualifies as a significant deficiency, rather than a deficiency, in internal controls. As noted above, the questioned costs as a percentage of absolute dollars are certainly not material, nor do they demonstrate a lack of systemic controls. Thus, we believe the Auditor reached the conclusions based on ambiguous judgement, which AAR believes to be overly conservative and not reflective of the comprehensive results of the audit.

(C) Report on Compliance and Other Matters Based on an Audit of the Special Purpose Financial Statement Performed in Accordance with Government Auditing Standards



Finding Number 2017-1: Airfare in Excess of Allowable Amount per Federal Travel Regulation

AAR Response:

AAR respectfully disagrees with the basis of the Auditor's assertion that the questioned direct costs of [REDACTED] are a result of an internal control significant deficiency associated with AAR travel policies, and a lack of familiarity with the Federal Travel Regulations. The Auditor's opinion that AAR's corporate travel policy is the cause that led to the questioned costs is not substantiated by the evidence. The Auditor's Report included the following:

- (1) *"AAR's corporate travel policies allow for reimbursement in amounts that could be greater than as allowed by the FTR."*
- (2) *"The travel policies are silent as to the application of the limitations of the FTR when billing the government."*
- (3) *"Upon preparing billings to the AFLCMC under the Contract, AAR did not reduce the excess travel costs to allowable amounts due to a lack of familiarity with the FTR."*

The first "Cause" noted in the Auditor's Report is misguided, and we request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. Non-Government entities have no obligation to follow the Federal Travel Regulations ("FTR") in determining the extent to which certain travel expenses are reimbursable to their employees, nor are companies prohibited by any regulation from reimbursing their employees for costs incurred in excess of per diem.

The second "Cause" noted in the Auditor's Report is not supported by sufficient appropriate evidence of a control deficiency in the actual processes followed by AAR. We request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. It is of utmost importance to note, the Auditors did not find that a review for unallowable costs was not performed as part of the billing process. Instead, the Auditor assumes the travel policy is somehow related to the accounting and billing processes AAR has in place to properly account for and to exclude unallowable costs from billings. Travel reimbursement policies are and should be separate from billing policies.

The third "Cause" noted in the Auditor's Report is based on conjecture, and is not substantiated by sufficient appropriate evidence. We request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. The Auditor's opinion insinuates a systemic control deficiency, which is not supported by fact. AAR performs annual transactional testing in accordance with FAR -- Part 31 Contract Cost Principles and Procedures, with specific emphasis on FAR – Part 31.205-46 Travel Costs.

AAR does not dispute the costs in question. AAR takes any instance of potential non-compliance very seriously, and will give thoughtful consideration to the Auditor's recommendations, but as noted in our response, we believe the Auditor's finding on internal controls to be unfounded and should be excluded from the final report.



Finding Number 2017-2: Lodging in Excess of Allowable Amount per FTR

AAR Response:

AAR respectfully disagrees with the basis of the Auditor's assertion that the questioned direct costs of █████ are a result of an internal control significant deficiency associated with AAR travel policies, and a lack of familiarity with the Federal Travel Regulations. The Auditor's opinion that AAR's corporate travel policy is the cause that led to the questioned costs is not substantiated by the evidence. The Auditor's Report included the following:

- (1) *"AAR's corporate travel policies allow for reimbursement in amounts that could be greater than as allowed by the FTR."*
- (2) *"The travel policies are silent as to the application of the limitations of the FTR when billing the government."*
- (3) *"Upon preparing billings to the AFLCMC under the Contract, AAR did not reduce the excess travel costs to allowable amounts due to a lack of familiarity with the FTR."*

The first "Cause" noted in the Auditor's Report is misguided, and we request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. Non-Government entities have no obligation to follow the Federal Travel Regulations ("FTR") in determining the extent to which certain travel expenses are reimbursable to their employees, nor are companies prohibited by any regulation from reimbursing their employees for costs incurred in excess of per diem.

The second "Cause" noted in the Auditor's Report is not supported by sufficient appropriate evidence of a control deficiency in the actual processes followed by AAR. We request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. It is of utmost importance to note, the Auditors did not find that a review for unallowable costs was not performed as part of the billing process. Instead, the Auditor assumes the travel policy is somehow related to the accounting and billing processes AAR has in place to properly account for and to exclude unallowable costs from billings. Travel reimbursement policies are and should be separate from billing policies.

The third "Cause" noted in the Auditor's Report is based on conjecture, and is not substantiated by sufficient appropriate evidence. We request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. The Auditor's opinion insinuates a systemic control deficiency, which is not supported by fact. AAR performs annual transactional testing in accordance with FAR -- Part 31 Contract Cost Principles and Procedures, with specific emphasis on FAR – Part 31.205-46 Travel Costs.

AAR does not dispute the costs in question, but does take exception with the determination that these costs are categorized as ineligible. The FTR does not preclude reimbursement of lodging expenses in excess of per diem. §301-11.30 of the FTR states, "(a) You may request reimbursement on an actual expense basis, not to exceed 300 percent of the maximum per diem allowance, (b) Approval of actual expenses is usually in advance of travel and at the discretion of your agency." AAR believes these costs to be unsupported, as the travel was pre-approved, but the travel request authorization did not include context to justify the hotel costs in excess of the FTR per diem allowance. AAR takes any instance of potential non-compliance very seriously, and will give thoughtful consideration to the Auditor's recommendations, but as noted in our response, believe the Auditor's finding on internal controls to be unfounded and should be excluded from the final report.

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Finding Number 2017-3: Dental Expenses Claimed as Travel Costs

AAR Response:

AAR respectfully disagrees with the basis for Auditor's assertion that the questioned direct costs of [REDACTED] are a result of an internal control significant deficiency. The Auditor's Report included the following:

- (1) *Management did not closely review the nature of the expenses claimed on the employee's expense report."*

The "Cause" noted in the Auditor's Report is based on conjecture, and is not substantiated by sufficient appropriate evidence. We request the Auditor to reassess the determination of a significant deficiency, and the finding to be excluded from the final report. The Auditor speculates to reach the opinion, and does not identify a deficiency in control design. Instead, the Auditor implies that this singular instance of non-compliance merits an opinion of an internal control significant deficiency.

AAR does not dispute the costs in question, AAR takes any instance of potential non-compliance very seriously, and will give thoughtful consideration to the Auditor's recommendations, but as noted in our response, believe the Auditor's finding on internal controls to be unfounded and should be excluded from the final report.

Sincerely,

A handwritten signature in black ink, appearing to read 'L. Gaydon', written over a horizontal line.

Lewis Gaydon
Director of Government Compliance
AAR CORP.

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Auditor's Rebuttal to AAR's Response to Findings

For the Period July 30, 2015 through July 30, 2016

AAR agreed with the questioned costs included in all 3 findings, but disagreed with other aspects of the findings. We have reviewed management's responses and provide the following rebuttals.

Finding Number 2017-1: Airfare in Excess of Allowable Amount per Federal Travel Regulation

AAR agreed with the questioned costs of [REDACTED]. However, AAR disagreed that the questioned costs give rise to a significant deficiency in internal control. Furthermore, AAR disagreed with the causes of this finding. Specifically, AAR stated that the it can have travel policies that are not in accordance with the FTR and that the causes are not supported by sufficient appropriate evidence. We agree that AAR can have its own travel policies and procedures which do not have to follow the FTR. However, no documentation was provided to us for review to indicate that AAR has a process in place to ensure that when it contracts with the federal government, that any travel costs that were incurred in accordance with its travel policy is further reviewed to ensure that the costs are reduced, where necessary, for billing purposes to ensure travel costs do not exceed allowable amounts per the FTR. As to our determination of the finding as being a significant deficiency, we based that determination on AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, which defines a significant deficiency as "A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance." *Government Auditing Standards* follows this definition. In our professional judgment, because the airfare was not reduced to an amount that was in accordance with the FTR, the condition gave rise to it being considered a significant deficiency, regardless of the dollar amount involved. As such, our finding and recommendation remains unchanged.

Finding Number 2017-2: Lodging in Excess of Allowable Amount per FTR

AAR agreed with the questioned costs of [REDACTED]. However, AAR disagreed that the questioned costs give rise to a significant deficiency in internal control. Furthermore, AAR disagreed with the causes of this finding. Specifically, AAR stated that the it can have travel policies that are not in accordance with the FTR and that the causes are not supported by sufficient appropriate evidence. We agree that AAR can have its own travel policies and procedures which do not have to follow the FTR. However, no documentation was provided to us for review to indicate that AAR has a process in place to ensure that when it contracts with the federal government, that any travel costs that were incurred in accordance with its travel policy is further reviewed to ensure that the costs are reduced, where necessary, for billing purposes to ensure travel costs do not exceed allowable amounts per the FTR. As to our determination of the finding as being a significant deficiency, we based that determination on AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, which defines a significant deficiency as "A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged

AAR SUPPLY CHAIN, INC.

Contract No. FA8553-15-D-0001
Services under C-130H Contractor Logistic Support
For the Afghan Air Force (AAF)

Auditor's Rebuttal to AAR's Response to Findings

(Continued)

with governance." *Government Auditing Standards* follows this definition. In our professional judgment, because the lodging expenses were not reduced to an amount that was in accordance with the FTR, the condition gave rise to it being considered a significant deficiency, regardless of the dollar amount involved. As such, our finding and recommendation remains unchanged.

Finding Number 2017-3: Dental Expenses Claimed as Travel Costs

AAR agreed with the questioned costs of [REDACTED]. However, AAR disagreed that the questioned costs give rise to a significant deficiency in internal control and that the cause is based upon conjecture which is not substantiated with sufficient appropriate evidence. We based our determination of whether an internal control matter is classified as a significant deficiency on AU-C Section 265, *Communicating Internal Control Related Matters Identified in an Audit*, which defines a significant deficiency as "A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those charged with governance." *Government Auditing Standards* follows this definition. The cause of the finding is accurate. Had management closely reviewed the expense reports, it would have identified dental expenses as not travel related and not chargeable to the Contract. As such, our finding and recommendation remains unchanged.

SIGAR's Mission

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

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

Obtaining Copies of SIGAR Reports and Testimonies

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

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

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

- Web: www.sigar.mil/fraud
- Email: sigar.pentagon.inv.mbx.hotline@mail.mil
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