

SIGAR

Special Inspector General for
Afghanistan Reconstruction

SIGAR 20-40 Financial Audit

USAID's Afghanistan Health Sector Resiliency Project: Audit of Costs Incurred by Palladium International LLC

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



SIGAR 20-40-FA/USAID's HSR

JUNE
2020

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On September 25, 2015, the U.S. Agency for International Development (USAID) awarded a cost-plus-fixed-fee contract for \$37,936,471 to Futures Group International LLC to support the Afghanistan Health Sector Resiliency Project; a later modification to the contract recognized that Futures Group International changed its name to Palladium International LLC. The objective of the project was to help the Afghan government strengthen and reform the Afghan health system to become self-reliant. After 11 modifications, the contract's total funding decreased to \$27,634,654, and end of the period of performance changed from September 30, 2019, to September 27, 2020.

SIGAR's financial audit, performed by Davis Farr LLP (Davis Farr), reviewed \$8,987,950 in costs charged to the contract from January 1, 2018, through September 30, 2019. The objectives of the audit were to (1) identify and report on material weaknesses or significant deficiencies in Palladium'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 Palladium has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of Palladium's Special Purpose Financial Statement (SPFS). See Davis Farr's report for the precise audit objectives.

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

June 2020

USAID's Afghanistan Health Sector Resiliency Project: Audit of Costs Incurred by Palladium International LLC

SIGAR 20-40-FA

WHAT SIGAR FOUND

Davis Farr identified four significant deficiencies in Palladium's internal controls and four instances of noncompliance with the terms of the contract. The auditors determined that Palladium presented and reported transactions on the SPFS that occurred before and after the period of performance. This resulted in \$113,690 in ineligible costs charged to USAID. Davis Farr tested transactions related to travel and transportation and found (1) Palladium paid twice for the same lodging expenses, which resulted in \$6,247 in ineligible costs charged to USAID, and (2) six instances where Palladium did not comply with the terms of the contract related to international travel that required three weeks' advanced requests for approval. In addition, Davis Farr determined that Palladium misclassified fringe benefits and consultant expenses that could have led to unallowable costs billed to the government. There were no questioned costs because Palladium reclassified these expenses on the SPFS to align with the budget.

Because of these internal control deficiencies and instances of noncompliance, Davis Farr identified \$119,937 in total questioned costs. The questioned costs consisted entirely of ineligible costs—costs prohibited by the contract, applicable laws, or regulations. Davis Farr 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
Direct Costs	\$101,724	\$0	\$101,724
Indirect Costs	\$18,213	\$0	\$18,213
Total Costs	\$119,937	\$0	\$119,937

Davis Farr identified two prior audit reports that were relevant to Palladium's activities under the contract. The reports had 18 findings, 14 of which could have a material effect on the SPFS and other financial data significant to this audit's objectives. Davis Farr conducted follow-up procedures and concluded that Palladium had taken adequate corrective action on 17 of the 18 findings. The one remaining finding related to misclassified expenses; it was repeated under this audit and is reported in Finding Number 2020-04.

Davis Farr issued an unmodified opinion on Palladium's SPFS, noting that it presents fairly, in all material respects, revenues received, and costs incurred for the period indicated.

WHAT SIGAR RECOMMENDS

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

1. Determine the allowability of and recover, as appropriate, \$119,937 in questioned costs identified in the report.
2. Advise Palladium to address the report's four internal control findings.
3. Advise Palladium address the report's four noncompliance findings.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

June 19, 2020

Mr. John Barsa
Acting Administrator, U.S. Agency for International Development

Mr. Peter Natiello
USAID Mission Director for Afghanistan

SIGAR contracted with Davis Farr LLP (Davis Farr) to audit costs incurred by Palladium International LLC under a contract from the U.S. Agency for International Development (USAID) to support to the Afghanistan Health Sector Resiliency project.¹ The project's objective was to help the Afghan government strengthen and reform the Afghan health system to become self-reliant, thereby decreasing the need for donor support. Davis Farr reviewed \$8,987,950 in costs charged to the contract from January 1, 2018, through September 30, 2019. Our contract with Davis Farr 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 the audit, SIGAR recommends that the responsible contracting officer at USAID:

- 1. Determine the allowability of and recover, as appropriate, \$119,937 in questioned costs identified in the report.**
- 2. Advise Palladium to address the report's four internal control findings.**
- 3. Advise Palladium to address the report's four noncompliance findings.**

The results of Davis Farr's audit are discussed in detail in the attached report. We reviewed Davis Farr'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 Palladium's Special Purpose Financial Statement. We also express no opinion on the effectiveness of Palladium's internal control or compliance with the contract, laws, and regulations. Davis Farr is responsible for the attached auditor's report and the conclusions expressed in it. However, our review disclosed no instances in which Davis Farr did not comply, in all material respects, with generally accepted government auditing standards issued by the Comptroller General of the United States.

We are requesting documentation of the corrective actions taken and/or target dates for completion of the recommendations. Please provide this information to sigar.pentagon.audits.mbx.recommendation-follow-up@mail.mil within 60 days from the issue date of this report.

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

(F-173)

¹ The contract number is AID-306-C-15-00009.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

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May 22, 2020

Enclosed is the final report on the financial audit of costs incurred by Palladium International LLC (Palladium) under Contract No. AID-306-C-15-00009 for the Afghanistan Health Sector Resiliency (HSR) Project. The audit covers the period January 1, 2018 through September 30, 2019.

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 Palladium, the Special Inspector General for Afghanistan Reconstruction and the United States Agency for International Development. Management of Palladium 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,

DAVIS FARR LLP



Marcus D. Davis, CPA
Partner

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

Background

On September 25, 2015, the United States Agency for International Development (USAID) awarded Contract No. AID-306-C-15-00009 (Contract) to Futures Group International, LLC to support the Afghanistan Health Sector Resiliency (HSR) Project. The Contract is a cost-plus-fixed-fee (CPFF) completion type contract. Modification No. 5 to the Contract authorized the change in name for Futures Group International, LLC to Palladium International LLC (Palladium). The objective of the project was to support the Government of the Islamic Republic of Afghanistan (GIROA), to foster a strengthened, reformed and increasingly self-reliant Afghan health system prepared for the decreased donor support anticipated over the coming decade. The HSR Project will act as a resource and a catalyst to the Afghan Ministry of Public Health (MoPH) and other GIROA entities as it considers and implements critical sector-wide reforms that will be required to make the system more resilient and sustainable and be reliant on domestic resources. As government reform must be an internally-led process, the MoPH will take the lead in all project activities, while the Project serves as a key technical advisor and resource to the MoPH to address the need for increased efficiencies, sustainability, and continued gains in health for all Afghans.

The Contract was awarded in the original amount of \$37,936,471, consisting of [REDACTED] in cost reimbursement and [REDACTED] in fixed fee for the period of performance from September 25, 2015, through September 27, 2020. After 11 modifications, the contract total cost reimbursement amount decreased to \$27,634,654, and the period of performance was shortened to September 30, 2019 from September 27, 2020.

Our audit procedures reviewed \$8,987,950 of costs plus fixed fee incurred for the period January 1, 2018 through September 30, 2019.

Work Performed

Davis Farr LLP (Davis Farr) was engaged by the Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) to conduct a financial audit of Palladium's Special Purpose Financial Statement (SPFS) for the period January 1, 2018 through September 30, 2019. Total costs plus fixed fee reported by Palladium during this period were \$8,987,950.

Objectives, Scope, and Methodology

Objectives Defined by SIGAR

The objectives of the audit include the following:

- *Special Purpose Financial Statement (SPFS)* – Express an opinion as to whether Palladium'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.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

- *Internal Controls* – Evaluate and obtain a sufficient understanding of Palladium’s **internal** control 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 Palladium 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.
- *Corrective Action on Prior Findings and Recommendations* – Determine and report on whether Palladium 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

Total costs plus fixed fee incurred for the period January 1, 2018 through September 30, 2019 were \$8,987,050, consisting of [REDACTED] in cost reimbursement and [REDACTED] in fixed fee. The scope of this audit included the total costs plus fixed fee of \$8,987,050. The period of performance of the Contract is not yet complete. Our testing of the indirect cost rates was limited to verifying that the rates were calculated using the rates identified in the Negotiated Indirect Cost Rate Agreement (NICRA) approved by USAID.

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 October 9, 2019. Participants included representatives of Davis Farr, Palladium, SIGAR and the USAID.

Planning

During our planning phase, we performed the following:

- Obtained an understanding of Palladium;
- Reviewed the Contract and all modifications to date;
- Reviewed sections of the Federal Acquisition Regulation (FAR) Part 31 and the USAID Acquisition Regulation (AIDAR), as applicable to the Contract;
- Performed a financial reconciliation; and

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

- 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, moderate or low risk for inclusion in our test of transactions. All samples were selected on a judgmental basis. Our sampling methodology was as follows:
 - For accounts that appear to contain unallowable and restricted items according to the terms of the Contract, FAR, AIDAR and any other applicable regulations, we sampled 100% of the transactions.
 - For high risk cost categories, we sampled transactions greater than \$42,000, and additional transactions below \$42,000 to ensure that at least 50% of the total amount expended for each cost category was sampled.
 - For moderate risk categories, we sampled transactions that are greater than \$84,000, and additional transactions below \$84,000 to ensure at least 20% of the total amount expended for each cost category was sampled.
 - For low risk categories, we sampled transactions to ensure at least 10% of the costs for each low risk cost category was sampled. No sample was selected as we tested the proper application of the indirect cost rates. This included reviewing the NICRA to ensure that Palladium's indirect costs did not exceed the approved rates.

Internal Control Related to the SPFS

We reviewed Palladium's internal control 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 control identified by Palladium 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 reached out to SIGAR, Palladium and USAID and 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

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

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;
- 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 Partner 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 February 19, 2020 via conference call. Participants included representatives from Davis Farr, Palladium, SIGAR and USAID. 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 Palladium under the Contract with USAID identified the following matters. Findings are classified as either 1) internal control, 2) noncompliance, or 3) a combination of internal control and noncompliance.

Auditor's Opinion on SPFS

We issued an unmodified opinion on the fairness of the presentation of the SPFS. We also identified \$119,937 of questioned costs under the Contract. A summary of findings and questioned costs is described in the next section.

Summary of Findings and Questioned Costs

Finding Number	Nature of Finding	Matter	Questioned Costs	Total Cumulative Questioned Costs
2020-01	Internal control – significant deficiency Noncompliance	Costs incurred outside of SPFS period	\$113,690	\$113,690

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

Finding Number	Nature of Finding	Matter	Questioned Costs	Total Cumulative Questioned Costs
2020-02	Internal control – significant deficiency Noncompliance	Duplicate expenses charged to the Contract	\$6,247	\$119,937
2020-03	Internal control – significant deficiency Noncompliance	Approval for international travel not requested in a timely manner	\$0	\$119,937
2020-04	Internal control – significant deficiency Noncompliance	Misclassification of expenses	\$0	\$119,937

Internal Control Findings

As part of obtaining reasonable assurance about whether the SPFS is free from material misstatement, we considered Palladium’s internal control over financial reporting and performed tests of those controls. The results of our tests disclosed four internal control weaknesses required to be reported under *Government Auditing Standards*. See Independent Auditor’s Report on Internal Control on page 16.

Compliance Findings

As part of obtaining reasonable assurance about 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 the SPFS. The results of our tests disclosed four instances of noncompliance related to this audit. See Independent Auditor’s Report on Compliance on page 18.

In performing our testing, we considered whether the information obtained during our testing resulted in either detected or suspected material fraud, waste, or abuse, which would be subject to reporting under *Government Auditing Standards*. Evidence of such items was not identified by our testing.

Review of Prior Findings and Recommendations

We requested from Palladium, SIGAR and USAID copies of any prior engagements including audits, reviews, attestation engagements and other studies that relate to Palladium’s activities under this Contract. We identified one audit report, Financial Audit of Costs Incurred Under Contract No. AID-306-C-15-00009 for the HSR Project for the period September 28, 2015 through December 31, 2017, which was conducted by CohnReznick on behalf of USAID and issued on January 29, 2019, that

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
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Afghanistan Health Sector Resiliency (HSR)

For the Period January 1, 2018 through September 30, 2019

contained three findings that could have a potential material effect on the SPFS or other financial data significant to the audit objectives. We also identified one internal audit report, Internal Review Report for the period July 1, 2017 through December 31, 2017, which was performed by Afghanistan Holding Group, that contained 15 findings, 11 of which could have a potential material effect on the SPFS or other financial data significant to the audit objectives.

We performed follow-up procedures, tested transactions and reviewed documentation to determine if these issues occurred under our audit. Accordingly, we have concluded that Palladium has taken adequate corrective action on 17 of the 18 findings. The remaining one finding relates to misclassified expenses. This same issue was noted in our audit and reported in Finding Number 2020-04. See the Status of Prior Findings on page 20 for a detailed description of the prior findings and recommendations.

Summary of Palladium's Responses

The following represents a summary of the responses provided by Palladium to the findings identified in this report. The complete responses received can be found in Appendix A to this report.

- Finding Number 2020-01: Palladium disagreed with this finding indicating that the costs incurred outside of the SPFS period were not accrued previously and thus were not double billed. Palladium also indicated that the SPFS period is different than its fiscal year and the costs in question were immaterial and thus not subject to accrual.
- Finding Number 2020-02: While Palladium acknowledged that the costs incurred were duplicate expenses, it disagreed with the finding indicating that it has received a refund of these costs from the vendor and reflected the refund on subsequent billings under the Contract.
- Finding Number 2020-03: While Palladium acknowledged that some requests for international travel were submitted to the COR less than three weeks prior to travel, it disagreed with the characterization of the finding as a significant deficiency.
- Finding Number 2020-04: Palladium disagreed with this finding indicating that any misclassification of expenses is not an internal control weakness since the classification of costs on the SPFS is not part of its internal control system.

References to Appendices

The auditor's reports are supplemented by two appendices, Appendix A, which contains management's responses to the audit findings and Appendix B, which contains the auditor's rebuttal to management's comments.

INDEPENDENT AUDITOR'S REPORT
ON SPECIAL PURPOSE FINANCIAL STATEMENT

Palladium International LLC
1331 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004

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 Palladium International LLC (Palladium) under Contract No. AID-306-C-15-00009 (Contract) with the United States Agency for International Development (USAID) to support the Afghanistan Health Sector Resiliency (HSR) Project for the period January 1, 2018 through September 30, 2019, 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 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

Palladium International LLC
1331 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004

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

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 Palladium under the Contract for the period January 1, 2018 through September 30, 2019 in accordance with the basis of accounting described in Note 2.

Restriction on Use

This report is intended for the information of Palladium, USAID, 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 May 22, 2020 on our consideration of Palladium'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 Palladium's internal control over financial reporting and compliance.



Irvine, California
May 22, 2020

PALLADIUM INTERNATIONAL LLC
Contract No. AID-036-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Special Purpose Financial Statement

For the Period January 1, 2018 through September 30, 2019

	Budget	Actual	Questioned Costs			Notes
			Ineligible	Unsupported	Total	
Revenues:						
AID-036-C-15-00009	██████████	██████████	\$ -	\$ -	\$ -	(3)
Total revenues	<u>27,634,654</u>	<u>8,987,950</u>	<u>-</u>	<u>-</u>	<u>-</u>	
Costs incurred:						
Labor	7,866,436	2,655,151	-	-	-	
Fringe benefits	2,988,667	660,481	-	-	-	(A)
Consultants	387,367	151,794	-	-	-	(B)
Travel and transportation	1,032,040	468,138	13,520	-	13,520	(C)
Allowances	1,248,904	690,613	19,527	-	19,527	(D)
Other direct costs	1,449,581	777,248	-	-	-	
Equipment and supplies	299,454	52,725	-	-	-	
Communication	262,697	90,241	-	-	-	
Direct facilities costs	1,521,592	292,090	-	-	-	
Subcontracts	2,812,091	490,490	68,677	-	68,677	(E)
Security	<u>1,901,749</u>	<u>46,638</u>	<u>-</u>	<u>-</u>	<u>-</u>	
Total direct costs incurred	██████████	██████████	██████████	-	██████████	
Indirect costs	██████████	██████████	██████████	-	██████████	(4),(F)
Total costs incurred	██████████	██████████	██████████	-	██████████	
Fixed fee	██████████	██████████	-	-	-	(5)
Total costs plus fixed fee	<u>27,634,654</u>	<u>8,987,950</u>	<u>119,937</u>	<u>-</u>	<u>119,937</u>	(6)
Outstanding fund balance	\$ -	\$ -	\$ (119,937)	\$ -	\$ (119,937)	(7),(G)

See Notes to Special Purpose Financial Statement
and Notes to Questioned Costs Presented on the Special Purpose Financial Statement

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Notes to Special Purpose Financial Statement¹

For the Period January 1, 2018 through September 30, 2019

(1) Background

On September 25, 2015, the United States Agency for International Development (USAID) awarded Contract No. AID-306-C-15-00009 (Contract) to Futures Group International, LLC to support the Afghanistan Health Sector Resiliency (HSR) Project. The Contract is a cost-plus-fixed-fee (CPFF) completion type contract. Modification No. 5 to the Contract authorized the change in name for Futures Group International, LLC to Palladium International LLC (Palladium). The HSR Project was a resource and a catalyst to the Ministry of Public Health (MoPH) to implement critical sector-wide reforms that were required to increase the resiliency and self-sufficiency of the health sector and move towards sustainability. The reform was an internally-led process where the MoPH led all project activities while Palladium served as a key technical advisor and resource to the MoPH, other Government of the Islamic Republic of Afghanistan (GIROA) entities and the private sector to address the need for increased efficiencies, sustainability, and continued gains in health for all Afghans. It is anticipated that as the sector matures and the donor landscape shifts, the needs and circumstances of the MoPH will change, and the HSR Project must be responsive, innovative and flexible to adapt to this fluctuating environment.

The HSR Project primarily focuses on the governance, finance and human resources and engages both the public and private components of the health sector. The Project supports the MoPH to strengthen and reform its systems at both central and subnational levels by applying and adapting relevant best practices to support the MoPH to successfully navigate the transition period. The HSR Project also includes a learning agenda to guide project implementation and determine the impact of systems strengthening and reform activities and their impact on health status.

The Contract was awarded in the original amount of \$37,936,471, consisting of [REDACTED] in cost reimbursement and [REDACTED] in fixed fee. The period of performance was from September 25, 2015 through September 27, 2020. The Contract was modified 11 times through September 30, 2019 for reasons related to the modification of the project scope and contract clauses, **and change in the entity's name**. Modification 8, dated February 18, 2018, was the only modification with significance. It descoped the HSR Project by reducing the cost reimbursement amount by [REDACTED] and reducing the fixed fee amount by [REDACTED], for a total reduction in the ceiling amount of [REDACTED]. Modification 8 also realigned the budget.

¹ The Notes to the Special Purpose Financial Statement with a numeric identifier are the responsibility of Palladium.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Notes to Special Purpose Financial Statement

(Continued)

(2) Summary of Significant Accounting Policies

Basis of Presentation

The accompanying Special Purpose Financial Statement (SPFS) includes costs incurred for the HSR Project for the period January 1, 2018 through September 30, 2019. Because the SPFS presents only a selected portion of the operations of Palladium, it is not intended to and does not present the financial position, changes in financial position, or cash flows of Palladium. 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 Grant.

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 48 CFR Part 31.

Currency

All amounts presented are shown in U.S. dollars, the reporting currency of Palladium. Palladium incurred costs during the period January 1, 2018 through September 30, 2019, which were paid in the Afghan afghanis, for costs incurred in Afghanistan. Palladium converts any expenses that were paid in Afghan afghanis into U.S. dollars by using the spot exchange rate provided by the local bank during currency conversion as the rate used for transactions that were paid for using the local currency and applies the weighted average monthly rate based on the rates used during the month.

(3) Revenue

As of September 30, 2019, Palladium has reported \$8,987,950 in revenue, which is inclusive of the fixed fee of [REDACTED]. This revenue equals the [REDACTED] by Palladium under the Contract for the period January 1, 2018 through September 30, 2019.

(4) Indirect Costs

Palladium's indirect costs were reviewed and approved by USAID in a Negotiated Indirect Cost Rate Agreement (NICRA) dated March 20, 2019. The following provisional indirect cost rates were applicable to the Contract:

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Notes to Questioned Costs Presented on the Special Purpose Financial Statement²

For the Period January 1, 2018 through September 30, 2019

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

(A) Fringe Benefits

Palladium reported fringe benefits in the amount of [REDACTED] for the period January 1, 2018 through September 30, 2019. During our audit of these costs, as described in Note D, Palladium misclassified [REDACTED] of fringe benefits as allowances. As such, [REDACTED] was reclassified from allowances to fringe benefits on the SPFS.

(B) Consultants

Palladium reported consultants costs in the amount of \$0 for the period January 1, 2018 through September 30, 2019. During our audit of these costs, as described in Note E, Palladium misclassified \$151,794 of consultants costs as subcontracts. As such, \$151,794 was reclassified from subcontracts to consultants on the SPFS.

(C) Travel and Transportation

Palladium reported travel and transportation costs in the amount of \$468,138 for the period January 1, 2018 through September 30, 2019. During our audit of these costs, we noted the following. See Finding Numbers 2020-01 and 2020-02.

<u>Finding Number</u>	<u>Observation</u>	<u>Questioned Costs (Ineligible)</u>
2020-01	Costs incurred outside of SPFS period	\$8,216
2020-02	Duplicate lodging expenses	<u>5,304</u>
Total questioned costs		<u>\$13,520</u>

(D) Allowances

Palladium reported allowances in the amount of \$1,021,530 for the period January 1, 2018 through September 30, 2019. During our audit of these costs, we identified \$19,527 of costs that were incurred outside of the SPFS period. See Finding Number 2020-01.

² The Notes to Questioned Costs presented on the Special Purpose Financial Statement with an alphabetical identifier were prepared by Davis Farr LLP for information purposes only and as such are not a part of the audited Special Purpose Financial Statement.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Notes to Questioned Costs Presented on the Special Purpose Financial Statement

(Continued)

(D) Allowances (Continued)

Additionally, we identified \$330,737 of fringe benefits that were misclassified as allowances. These costs were reclassified on the SPFS. See Finding Number 2020-04.

(E) Subcontracts

Palladium reported subcontracts costs in the amount of \$642,284 for the period January 1, 2018 through September 30, 2019. During our audit of these costs, we identified \$151,794 of consultants costs that were misclassified as subcontracts. These costs were reclassified on the SPFS. See Finding Number 2020-04. Additionally, we noted that \$68,677 of subcontracts costs were incurred outside of the SPFS period. See Finding Numbers 2020-01.

(F) Indirect Costs

Palladium reported indirect costs in the amount of [REDACTED] for the period January 1, 2018 through September 30, 2019. [REDACTED]
[REDACTED], which resulted in questioned (ineligible) indirect costs of \$18,213.

(G) Outstanding Fund Balance

The total outstanding fund balance as of September 30, 2019 in the amount of \$(119,937) represents the total questioned ineligible costs of \$119,937.

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

Palladium International LLC
1331 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004

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

We have audited the accompanying Special Purpose Financial Statement of Palladium International LLC (Palladium) under Contract No. AID-306-C-15-00009 (Contract) with the United States Agency for International Development (USAID) to support the Afghanistan Health Sector Resiliency (HSR) Project for the period January 1, 2018 through September 30, 2019, and the related notes to the Special Purpose Financial Statement, and have issued our report thereon dated May 22, 2020.

Internal Control over Financial Reporting

In planning and performing our audit of the Special Purpose Financial Statement, we considered Palladium'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 Palladium's internal control. **Accordingly, we do not express an opinion on the effectiveness of Palladium'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 combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these

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2530 Crystal Drive
Arlington, Virginia 22202

limitations, during our audit, we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify four deficiencies in internal control, described in the accompanying Detailed Audit Findings as Finding Numbers 2020-01, 2020-02, 2020-03 and 2020-04 that we consider to be significant deficiencies.

Palladium's Response to Findings

Palladium's response to the finding identified in our audit is included verbatim in Appendix A. Palladium'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 the entity's internal control. This report is an integral part of an audit performed in accordance with *Government Auditing Standards in considering the entity's internal control*. Accordingly, this communication is not suitable for any other purpose.

This report is intended for the information of Palladium, USAID, 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.

A handwritten signature in blue ink that reads "Dawn Fan" followed by a stylized initial "WF".

Irvine, California
May 22, 2020

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

Palladium International LLC
1331 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004

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

We have audited the accompanying Special Purpose Financial Statement of Palladium International LLC (Palladium) under Contract No. AID-306-C-15-00009 (Contract) with the United States Agency for International Development (USAID) to support the Afghanistan Health Sector Resiliency (HSR) Project for the period January 1, 2018 through September 30, 2019, and the related notes to the Special Purpose Financial Statement, and have issued our report thereon dated May 22, 2020.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Palladium's **Special Purpose** Financial Statement is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts 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. The results of our tests disclosed four 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 and Finding Numbers 2020-01, 2020-02, 2020-03 and 2020-04.

Palladium's Response to Findings

Palladium's response to the findings identified in our audit is included verbatim in Appendix A. Palladium'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.

Palladium International LLC
1331 Pennsylvania Avenue NW, Suite 600
Washington, DC 20004

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

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 Palladium, USAID, 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.

A handwritten signature in blue ink that reads "Danie Fan" followed by a stylized flourish.

Irvine, California
May 22, 2020

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
 Contract No. AID-306-C-15-00009
 Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

For the Period January 1, 2018 through September 30, 2019

Finding 2020-01: Costs Incurred Outside of SPFS Period

Nature of Finding:
 Internal control – significant deficiency
 Noncompliance

Condition:

Palladium has prepared its SPFS on the accrual basis of accounting. Palladium included transactions totaling \$81,928 prior to January 1, 2018, and transactions totaling \$14,492 subsequent to September 30, 2019 on its SPFS. Total costs incurred outside of the SPFS period were Specifically, we noted the following:

<u>Cost Category</u>	<u>Transactions Sampled</u>		<u>Prior to January 1, 2018</u>		<u>Subsequent to September 30, 2019</u>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Travel and transportation	59	\$ 208,282	2	\$ 8,216	0	\$ 0
Allowances	77	538,943	1	5,035	2	14,492
Subcontracts	15	327,609	4	68,677	0	0
Totals	151	<u>\$1,074,834</u>	7	<u>\$81,928</u>	2	<u>\$14,492</u>

Cause:

Palladium inadvertently reported the transactions on the SPFS on the cash basis of accounting outside the period of performance.

Criteria:

48 CFR §52.230-3, *Disclosure and Consistency of Cost Accounting Practices*, states, in part:

“(a) The Contractor, in connection with this contract, shall...

(3)(i) Follow consistently the Contractor’s cost accounting practices...”

Palladium’s cost accounting practices are to use the accrual basis of accounting in accordance with generally accepted accounting principles. The SPFS is prepared on the accrual basis of accounting. Under the accrual basis of accounting, expenses are reported when they are incurred. In other words, the expenses are recognized regardless of when the payment is actually made.

Effect:

Reporting expenses on a basis of accounting different than the basis of accounting with which the SPFS was prepared, resulted in an overstatement of costs for the period January 1, 2018 through September 30, 2019.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
 Contract No. AID-306-C-15-00009
 Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Questioned Costs:

Total ineligible costs resulting from reporting expenses outside of the SPFS period were \$113,690 , including associated indirect costs of [REDACTED] as follows:

<u>Cost Category</u>	<u>Questioned Costs</u>	<u>Associated Questioned Indirect Costs</u>	<u>Total Questioned Ineligible Costs</u>
Travel and transportation	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Allowances	[REDACTED]	[REDACTED]	[REDACTED]
Subcontracts	[REDACTED]	[REDACTED]	[REDACTED]
Totals	\$ [REDACTED]	\$ [REDACTED]	\$ <u>113,690</u>

Recommendation:

- (1) We recommend that Palladium either provide evidence that the costs incurred outside of the audit period were not previously billed to USAID, or return \$113,690 to the U.S. Government.
- (2) We recommend that Palladium establish procedures to review future special purpose financial statements prior to submission to ensure that costs are reported on the accrual basis of accounting, and to provide training to appropriate individuals to ensure procedures are implemented correctly.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Finding 2020-02: Duplicate Expenses Charged to Contract

Nature of Finding:
Internal control – significant deficiency
Noncompliance

Condition:

During our testing of 59 travel and transportation transactions totaling \$208,282, we noted one transaction in the amount of \$[REDACTED] that was a duplicate expense. Palladium paid twice for the same lodging costs for one individual.

Cause:

Palladium processed the same invoice in two separate months due to clerical error.

Criteria:

48 CFR §31.201-2, *Determining allowability*, states, in part:

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

48 CFR Subchapter B, *Procurement Practices and Cost Accounting Standards*, Part 9904, *Cost Accounting Standards*, §402-20, *Purpose*, states, in part:

“The purpose of this standard is to require that each type of cost is allocated only once and on only one basis to any contract or other cost objective...”

Effect:

Claiming duplicate costs against the Contract resulted in the U.S. Government paying for unallowable costs. Claiming duplicate costs against the Contract raises doubts about the propriety of other costs claimed against the Contract.

Questioned Costs:

Total ineligible costs resulting from duplicate travel and transportation costs were \$6,247 in ineligible costs including associated indirect costs of [REDACTED] as follows:

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

<u>Cost Category</u>	<u>Questioned Costs</u>	<u>Associated Questioned Indirect Costs</u>	<u>Total Questioned Ineligible Costs</u>
Travel and transportation	██████	██████	\$6,247

Recommendation:

- (1) We recommend that Palladium either provide evidence that the lodging cost incurred was not a duplicate cost, or return \$6,247 to the U.S. Government.
- (2) We recommend that Palladium establish procedures to ensure that invoices are carefully reviewed prior to processing for payment to ensure that the invoices do not represent duplicate transactions and provide training to appropriate individuals to ensure the procedures are implemented correctly.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Finding 2020-03: Approval for International Travel not Requested in a Timely Manner

Nature of Finding:

Internal control – significant deficiency
Noncompliance

Condition:

During our testing of 64 travel and transportation transactions in the total amount of \$235,674, we noted 6 transactions totaling \$17,009 that represented international travel for which prior approval from the USAID Contracting Officer Representative (COR) was not requested at least three weeks prior to travel. In all 6 transactions for which prior approval was not requested from the COR at least three weeks prior to travel, the COR did approve the request for international travel after the request was submitted.

Cause:

Palladium indicated that it was under the impression that only two weeks advance notice was required. Additionally, according to Palladium, there were unusual circumstances that caused Palladium to request approval for international travel on short notice.

Criteria:

Contract No. AID-306-C-15-0009, Section H.23, *International Travel Approval*, states, in part:

“...The Contractor will therefore present to the cognizant COR an itinerary for each planned international trip, showing the name of the traveler, purpose of the trip, origin/destination (and intervening stops), and dates of travel, as far in advance of the proposed travel as possible, but in no event less than three weeks before travel is planned to commence...”

48 CFR §31.201-2, *Determining allowability*, states, in part:

“(a) A cost is allowable only when the cost complies with all of the following requirements:...

(4) Terms of the contract...”

Effect:

Failure to provide the COR with the required advance notice of international travel can result in costs being incurred for which the COR did not approve the request.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Questioned Costs:

Even though Palladium submitted the request for international travel less than three weeks prior to the date of travel, there are no questioned costs associated with this finding as the COR did approve the international travel after the request was submitted and before the travel occurred.

Recommendation:

We recommend that Palladium modify its policies and procedures to ensure that requests for international travel are submitted to the COR for approval at least three weeks in advance of travel, and to provide training to appropriate individuals to ensure the procedures are implemented correctly.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Finding 2020-04: Misclassification of Expenses

Nature of Finding:
Internal control – significant deficiency
Noncompliance

Condition:

Of the 72 allowance transactions tested in the total amount of \$510,943, we noted 49 transactions totaling ██████████ that should have been reported as fringe benefits. Based upon the large number of misclassified expenses identified, we reviewed all transactions reported as allowances and noted that ██████████ should have been reported as fringe benefits.

Additionally, of the 15 subcontracts transactions tested in the total amount of \$327,609, we noted 10 transactions totaling ██████████ that should have been reported as consultants. Based upon the large number of misclassified expenses identified, we reviewed all transactions reported as subcontracts and noted that ██████████ should have been reported as consultants.

Cause:

Palladium’s account structure identifies the transactions in question as allowances, thus Palladium reported the amount per its general ledger as allowances instead of translating the accounts to align with the approved budget per the Contract.

Criteria:

48 CFR §31.201-2, *Determining allowability*, states, in part:

“(a) A cost is allowable only when the cost complies with all of the following requirements:...

(2) Allocability.

(4) Terms of the **contract...**”

48 CFR §31.201-4, *Determining allocability*, states, in part:

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

Contract No. AID-306-C-15-00009, Modification No. 8 realigned the budget for the HSR Project. The budget went from a Contract Line Item Number (CLIN) budget structure, to a cost category budget structure as presented in the SPFS.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Detailed Audit Findings

(Continued)

Effect:

Misclassification of costs on the SPFS could result in unallowable or unallocable costs billed under the Contract. In addition, misclassifications could result in amounts billed in excess of Contract line items.

Questioned Costs:

There are no questioned costs associated with this finding as the costs have been reclassified on the SPFS. After reclassification, the dollar amount of the individual line items are within the budget.

Recommendation:

We recommend that Palladium implement procedures to ensure that the account groupings and classifications on future special purpose financial statements are in accordance with the account groupings and classifications per the Contract, and to provide training to appropriate individuals to ensure that the procedures are implemented correctly.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Status of Prior Audit Findings

For the Period January 1, 2018 through September 30, 2019

We requested from Palladium, SIGAR and USAID copies of any prior engagements including audits, reviews, attestation engagements and other studies that relate to Palladium's activities under the Contract. We identified one audit report that contained three findings that could have a potential material effect on the SPFS or other financial data significant to the audit objectives. We also identified one internal audit report that contained 15 findings, 11 of which could have a potential material effect on the SPFS or other financial data significant to the audit objectives. We have performed follow up procedures including discussion with management, reviewed the revised policies and procedures and conducted testing of similar areas surrounding these issues during our current audit. Accordingly, we have concluded that Palladium had taken adequate corrective actions on 17 of the 18 of the findings. The remaining one finding related to misclassified expenses was noted in our current audit and reported as Finding Number 2020-04. The summary of prior audit findings that could have a potential material effect on the SPFS are listed below:

Financial Audit of Costs Incurred Under Contract No. AID-306-C-15-00009 for the HSR Project for the period September 28, 2015 through December 31, 2017, which was conducted by CohnReznick on behalf of USAID

- Finding 1 (Misclassified Costs): The audit firm identified subcontract costs that were misclassified as consultant costs.

Status: During our testing of costs included on the SPFS, we identified \$743,769 of misclassified costs, which has been reported as Finding No. 2020-04. As such, the corrective action has not been adequately implemented.

- Finding 2 (Labor Timesheets): The audit firm identified Cooperating Country National (CCN) timesheets for the second half of the month were submitted prior to the end of the month.

Status: During our testing of labor transactions, we noted no instances where timesheets were submitted in advance of the period end. As such, the corrective action has been adequately implemented.

- Finding 3 (Reporting Compliance): The audit firm noted that two quarterly reports were submitted after the required due date.

Status: During our testing of reporting compliance, we noted that all reports tested were submitted within the required timeframes. As such, the corrective action has been adequately implemented.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Status of Prior Audit Findings

(Continued)

Internal Review Report for the period July 1, 2017 through December 31, 2017, which was performed by Afghanistan Holding Group

- Finding 1 (Compliance with Standard Operating Procedures(SOPs)): The audit firm noted that Palladium did not consistently comply with its procedures as outlined in its SOPs.

Status: During our testing of transactions, we noted no instances in which Palladium did not comply with its SOPs. As such, the corrective action has been adequately implemented.

- Finding 2 (Financial and Accounting Policies): **The audit firm noted that Palladium's** policies did not include policies related to the recording of assets, liabilities, capital, income and expenses.

Status: We reviewed the policies and procedures of Palladium as they pertain to the procurement of goods and services, which is material to the SPFS, and noted that adequate procurement policies exist. As such, the corrective action has been adequately implemented.

- Finding 3 (Iranian Sanction Act of 1996): The audit firm noted that Palladium had purchased Iranian products.

Status: During our testing of costs charged to the Contract, none of the transactions tested were for goods or services purchased from Iran. As such, the corrective action has been adequately implemented.

- Finding 4 (Auditor's Report 2016): The audit firm noted that the reporting framework was inconsistent in the 2016 audited financial statements. The financial statements were prepared in accordance with a basis of accounting that was a compliance framework instead of based upon the International Financial Reporting Standards (IFRS). Additionally, an outdated report format was used.

Status: Palladium prepared its SPFS on the accrual basis of accounting under accounting practices generally accepted in the United States of America, which is an allowable basis of accounting under the Contract. As such, the corrective action has been adequately implemented.

- Finding 5 (National Technical Assistance (NTA) Salary Scale): The audit firm noted that some salaries were not paid in accordance with the NTA salary scale.

Status: During our testing of labor costs, we noted that Palladium's **pay structure is in** accordance with the NTA salary scale. As such, the corrective action has been adequately implemented.

- Finding 6 (Red Flags): The audit firm noted that some contracts have been awarded to the same suppliers for a long period of time.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Status of Prior Audit Findings

(Continued)

Status: During our procurement testing, we noted that the procurement files adequately document the procurement process and selection of vendors. As such, the corrective action has been adequately implemented.

- Finding 7 (Purchase Requisitions): The audit firm noted that for some transactions tested, a purchase requisition was either not prepared or not properly completed.

Status: During our procurement testing, we noted that the procurement files adequately document the procurement process, including the use of purchase requisitions. As such, the corrective action has been adequately implemented.

- Finding 8 (Request for Quotation): The audit firm noted that for some transactions tested, a request for quotation was not used.

Status: During our procurement testing, we noted that the procurement files adequately document the procurement process, including the use of requests for quotations. As such, the corrective action has been adequately implemented.

- Finding 9 (Service Received Note (SRN)): The audit firm noted that the SRNs were not consistently completed.

Status: During our procurement testing, we noted that the procurement files adequately document the procurement process, including the completion of SRNs. As such, the corrective action has been adequately implemented.

- Finding 10 (Discrepancies and Supporting Documents): The audit firm noted that there were various discrepancies and missing information on supporting documents provided for review.

Status: During our testing of costs charged to the Contract, all documentation provided for our review was complete and no documentation was missing. As such, the corrective action has been adequately implemented.

- Finding 11 (Office Rent): The audit firm noted that there was no market study performed prior to extending rental of the office in Afghanistan.

Status: During our testing of costs charged to the Contract, the costs charged to office rent were determined to be reasonable. As such, the corrective action has been adequately implemented.

April 17th, 2020

Dear Sirs

Please find the following responses to the recent financial audit report from Davis Farr and upon further review, Palladium offers the following additional information in support of the questioned costs incurred under Contract No. AID-306-C-15-15-0009 ("the Contract").

Re Finding # 2020-01:

Palladium confirms that the questioned costs were not accrued previously when incurred and therefore no double billing occurred.

Additionally, the audit implies that Palladium operates on a calendar-year fiscal year. It does not; Palladium's fiscal year runs from July 1 to June 30. Accordingly, all of the questioned consultant costs were incurred, invoiced, paid, and billed to the government in the same fiscal year. This accords with FAR 52.216-7.

Moreover, those questioned costs that do not fall within a single fiscal year need not be accrued. Generally accepted accounting principles do not require accrual of immaterial amounts. A total of \$100,000 on a \$27,634,654 contract is considerably less than 0.5% and is immaterial. Accordingly, Palladium was not required to accrue these costs when they were incurred.

Finally, the contract period of performance is still open. FAR 52.216-7(g) permits adjustments for underpayments "at any time" before final payment.

Given this analysis, Palladium respectfully requests removal of this finding as unsupported.

Re Finding # 2020-02:

Palladium confirms that a vendor double charged their expense in the sum of [REDACTED] which amounted to a burdened cost of \$ 6,247. It is noted that a refund has been provided by the vendor and is booked in a subsequent period to that under audit. Given this occurrence, Palladium respectfully requests removal of this finding as having been rectified.

Re Finding # 2020-03:

Palladium acknowledges that some requests for approval for international travel were sent less than three weeks before the travel dates as required in the contract but there were appropriate reasons for each case.

On one occasion the request itself from the mission did not afford the three week notice period, on another there were challenges securing an appropriate resource due to security concerns and in other cases there were delays caused by the Synchronized Pre-deployment and Operational Tracker (SPOT) which is required

for approval of international consultants to alert the US Embassy to the presence of an additional expatriates in country for security reasons.

The mission is well aware of all these issues and, as noted in the audit report, have never failed to approve the travel, albeit after the deadline.

In no case was there reason to believe that Palladium was failing in its diligent efforts, but only that circumstances prevented the full notice period, and Palladium gave as much notice as possible in those circumstances.

We therefore respectfully disagree that there was a significant control deficiency but agree that steps have been taken to ensure that the three-week notice period is applied, and all exceptions are fully documented and supported including the specific reasons for reduced notice times.

Re Finding # 2020-04:

Palladium disagrees that the classification of expenses issue as described in this finding forms any sort of internal control weakness. This is because the classification of expenses on the Special Purpose Financial Statements (SPFS) is not inherently part of any control system, there being alternate regularly performed financial reporting and management controls in place and functioning as designed. The SPFS were specifically created to meet the needs of the audit based on a definition provided to Palladium and the classification of expenses was performed for this sole purpose. Given the difference in understanding of the purpose of the SPFS, Palladium respectfully requests removal of this finding as unsupported.

Please contact the undersigned in case you have any further questions on the content of this response.

Yours sincerely

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PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Auditor's Rebuttal to Palladium's Response to Findings

For the Period January 1, 2018 through September 30, 2019

Palladium disagreed with all four findings. **We have reviewed management's response for its disagreements and provide the following rebuttals.**

Finding 2020-01: Costs Incurred Outside of SPFS Period

Palladium disagreed with this finding indicating that the costs incurred outside of the SPFS period were not accrued previously and thus were not double billed. Palladium also indicates that the SPFS period is different than its fiscal year and the costs in question were immaterial and thus not subject to accrual. Palladium further indicates that all costs were incurred, invoiced, paid and billed to the U.S. Government within its fiscal year in accordance with FAR 52.216-7. The SPFS was prepared and presented on the accrual basis of accounting. Of the questioned costs, \$81,928 was incurred prior to the beginning of the SPFS period and \$14,492 was incurred subsequent to the period of the SPFS. Under the accrual basis of account, which is the basis of accounting of the SPFS, these costs should have been excluded from the SPFS. The costs should have been reported in the period in which they were incurred. **We agree with Palladium's statement that the costs were incurred, invoiced, paid and billed to the U.S. Government.** However, that is not the issue of this finding. This finding focuses on the fact that the costs as reported on the SPFS are not reported in accordance with the accrual basis of accounting, which is the basis of accounting in which the SPFS was prepared and presented. As such, our finding remains unchanged.

Finding 2020-02: Duplicate Expenses Charged to Contract

While Palladium acknowledged that the costs incurred were duplicate expenses, it disagreed with the finding indicating that it has received a refund of these costs from the vendor and reflected the refund on subsequent billings under the Contract. However, the costs were duplicated in the SPFS and this costs on the SPFS were overstated. As such, our finding remains unchanged.

Finding 2020-03: Approval for International Travel not Requested in a Timely Manner

While Palladium acknowledged that some requests for international travel were submitted to the COR less than three weeks prior to travel, it disagreed with the characterization of the finding as a significant deficiency. According to the terms of the Contract, requests for all international travel must be made to the COR at least three weeks in advance of the dates of travel. Additionally, the individual travel requests in question represented six different instances for six different travelers throughout the audit period, thus the issue is not an isolated instance, but rather this matter occurred repeatedly. A significant deficiency is defined as 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. In our professional judgment, this issue is important enough to merit attention. As such, our finding remains unchanged.

PALLADIUM INTERNATIONAL LLC

Financial Audit of Costs Incurred Under
Contract No. AID-306-C-15-00009
Afghanistan Health Sector Resiliency (HSR)

Auditor's Rebuttal to Palladium's Response to Findings

(Continued)

Finding 2020-04: Misclassification of Expenses

Palladium disagreed with this finding indicating that any misclassification of expenses is not an internal control weakness since the classification of costs on the SPFS is not part of its internal control system. However, the scope of the audit encompasses internal control over financial reporting on the SPFS. Since Palladium reported costs in incorrect cost categories there was clearly a weakness in internal controls over financial reporting. As such, our finding remains unchanged.

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