

SIGAR

Special Inspector General for
Afghanistan Reconstruction

SIGAR 18-06 Financial Audit

U.S. Air Force Support for Pilatus PC-12 Knight Ryder Aircraft in Afghanistan: Audit of Costs Incurred by Sierra Nevada Corp.

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



OCTOBER
2017

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On May 17, 2014, the Air Force Life Cycle Management Center (AFLCMC) awarded a \$34,425,000 contract to Sierra Nevada Corp. (SNC) to support a fleet of up to 13 modified Pilatus PC-12 Knight Ryder aircraft and three aircrew and four spare parts trainers for the North Atlantic Treaty Organization Special Operations Component Command and the Afghan Special Mission Wing, based at Kabul International Airport and Kandahar Airfield. The initial period of performance was May 17, 2014, through December 16, 2014. After 13 modifications, the contract amount increased to \$39,154,162, and the period of performance was extended to March 16, 2015.

SIGAR's financial audit, performed by Mayer Hoffman McCann (MHM), reviewed \$29,540,958 in expenditures charged to the contract from May 17, 2014, through March 16, 2015. The objectives of the audit were to (1) identify and report on significant deficiencies or material weaknesses in SNC'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 SNC has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of SNC'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.

October 2017

U.S. Air Force Support for Pilatus PC-12 Knight Ryder Aircraft in Afghanistan Audit of Costs Incurred by Sierra Nevada Corp.

SIGAR 18-06-FA

WHAT THE AUDIT FOUND

MHM identified one significant deficiency in SNC's internal controls. MHM found that employees' overtime hours did not have prior approval from a supervisor or manager as required in SNC's timesheet and labor charging policy. However, MHM determined, based on the documentation provided, that the employees worked the overtime hours charged. MHM did not identify any instances of noncompliance with the terms of the contract and applicable laws and regulations.

MHM did not identify any questioned costs, which could have consisted of unsupported costs—costs not supported with adequate documentation or that did not have required prior approval—and ineligible costs—costs prohibited by the contract, applicable laws, or regulations.

| Category | Ineligible | Unsupported | Total Questioned Costs |
|---------------|------------|-------------|------------------------|
| Cost Incurred | \$0 | \$0 | \$0 |
| Totals | \$0 | \$0 | \$0 |

MHM identified one finding and one recommendation from a prior audit that could have a material effect on SNC's SPFS, and determined that SNC had taken adequate corrective actions to address them.

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

WHAT SIGAR RECOMMENDS

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

1. Advise SNC to address the report's one internal control finding.



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

October 20, 2017

The Honorable Jim 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, Jr.
Commander, U.S. Forces–Afghanistan and
Commander, Resolute Support

We contracted with Mayer Hoffman McCann (MHM) to audit the costs incurred by Sierra Nevada Corp. (SNC) under the Air Force Life Cycle Management Center (AFLCMC) contract to support a fleet of up to 13 modified Pilatus PC-12 Knight Ryder aircraft and three aircrew and four spare parts trainers for the North Atlantic Treaty Organization Special Operations Component Command and the Afghan Special Mission Wing.¹ MHM's audit reviewed \$29,540,958 in expenditures charged to the contract from May 17, 2014, through March 16, 2015. 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 the audit, SIGAR recommends that the responsible contracting officer at AFLCMC:

1. Advise SNC to address the report's one internal control finding.

The results of MHM's audit are 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 SNC's Special Purpose Financial Statement. We also express no opinion on the effectiveness of SNC's internal controls 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 U.S. generally accepted government auditing standards issued by the Comptroller General of the United States.

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

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction
(F-102)

¹ AFLCMC awarded contract no. FA8620-14-C-3027 to SNC.

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Air Force Life Cycle Management Center
Contract No. FA8620-14-C-3027
Contractor Logistic Support For

Afghan National Army Special Operations Forces
PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

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Mayer Hoffman McCann P.C.
An Independent CPA Firm

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October 12, 2017

Enclosed is the final report on the financial audit of costs incurred under Contract Number FA8620-14-C-3027, awarded by Air Force Life Cycle Management Center (AFLCMC) for Contractor Logistic Support of the Afghan National Army Special Operations Forces' (ANASOF) PC-12 Fixed-Wing Aircraft. The audit covers the period May 17, 2014 through March 16, 2015.

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, based on an audit of the Special Purpose Financial Statement performed in accordance with *Government Auditing Standards*. 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 SNC, the Special Inspector General for Afghanistan Reconstruction (SIGAR) and the AFLCMC. Management of SNC 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

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

Background

On May 17, 2014, the Air Force Life-Cycle Management Center ("AFLCMC") entered into Contract Number FA8620-14-C-3027 with Sierra Nevada Corporation ("SNC") in the original amount of \$34,425,000, of which \$12,825,231 was obligated, with an initial period of performance from May 17, 2014 through December 16, 2014. The AFLCMC utilized Big Safari to assist in the procurement of this contract. Big Safari is a United States Air Force program that began in 1952, which provides management, direction, and control of the acquisition, modification, and logistics support for special purpose weapons systems derived from exiting aircraft and systems. To that end, Big Safari assisted with this procurement by applying standardized procedures to procure the service/supply by establishing the contractual instrument ensuring the contractor performed and abided by the terms of the contract. The contract was modified 13 times for such items as increasing the contract amount to \$39,154,162 and extending the period of performance through March 16, 2015. 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> |
|-------------------------|-----------------------|--|
| P00004 | 9/15/14 | Increased the obligated amount of the contract by \$21,599,769 to \$34,425,000. |
| P00007 | 11/24/14 | Exercised Option 1, which added CLINs 0005, 0006, 0007 and 0008 to the contract and extended the period of performance to March 16, 2015. The total contract amount increased by \$15,800,000 to \$50,225,000, and the obligated amount increased by \$11,850,000 to \$46,275,000. |
| PZ0005 | 1/20/15 | Definitized the ANASOF CLS requirement and decreased the total contract amount by \$11,170,838 to \$39,054,162, and decreased the obligated amount by \$7,220,838 to \$39,054,162. |
| P00009 | 2/26/15 | Increased CLIN 0008 which increased the total contract amount by \$100,000 to \$39,154,162. |

The purpose of the contract was to provide Contractor Logistics Support (CLS) and additional site stand-up for the PC-12 Knight Ryder aircraft for a period of seven months. SNC was to support operations for a fleet of up to 13 modified Pilatus PC-12, three pilot desk trainers and four part task trainers for use by the North Atlantic Treaty Organization (NATO) Special Operations Component Command and the Afghan Special Mission Wing projected to be based at Kabul International Airport (KAIA) and in Kandahar Airfield (KAF). Operations at KAIA included aircrew training and operational mission support, while operations at KAF were limited to operation mission support only. The first option of the contract provided for an additional three months of support. The contract involved foreign military sales.

SIERRA NEVADA CORPORATION

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For the Period May 17, 2014 through March 16, 2015

Founded in 1963, SNC is a privately held advanced technology company that provides solutions in the areas of aerospace, aviation, electronics, and systems integration. Within its six business areas, SNC technologies are used in relation to telemedicine, navigation and guidance systems, threat detection and security, commercial aviation, scientific research, and infrastructure protection. SNC has a workforce of nearly 3,000 personnel working multiple subsidiaries and affiliates, and operates 34 locations in 19 U.S. states, England, Germany and Turkey providing global support to customers.

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 SNC's Special Purpose Financial Statement ("SPFS") for costs incurred under contract number FA8620-14-C-3027 for the period May 17, 2014 through March 16, 2015. We reviewed \$29,540,958 in expenditures charged to the contract from May 17, 2014 through March 16, 2015.

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 SNC'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 SNC'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 SNC 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 SNC 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.

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

Scope

The scope of this audit included the cost reimbursement component of the contract in the amount of \$39,154,162, and excluded the firm fixed price component of the contract. This amount is the budgeted ceiling for cost reimbursement, not the actual amount incurred and reimbursed. Our testing of the overhead, general and administrative ("G&A"), integration, and fringe rates were limited to determining that the rates were calculated using rates no greater than the proposed overhead, G&A, integration and fringe rates as approved 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, SNC, SIGAR, the AFLCMC and Big Safari.

Planning

During our planning phase, we performed the following:

- Obtained an understanding of SNC, 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, medium or low risk for inclusion in our test of transactions. None of the 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:

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

- 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 will test 100% of the transactions.
- For high risk cost categories, we sampled individual transactions greater than \$146,900, not to exceed 50% of the total amount expended for each cost category.
- For medium risk cost categories, we sampled individual transactions greater than \$293,800, not to exceed 20% of the total amount expended for each cost category.
- For low risk cost categories, we sampled individual transactions greater than \$293,800, 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 SNC'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 SNC and conducted testing of select key controls to understand if they were implemented as designed and operating effectively.

Compliance with Agreement 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;
- 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

SIERRA NEVADA CORPORATION

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Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

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 June 22, 2017 via conference call. Participants included MHM, SNC, SIGAR, the AFLCMC and Big Safari. 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 SNC under the contract with the AFLCMC identified the following audit results. One internal control finding was noted.

Auditor's Opinion on SPFS

We issued a qualified opinion on the fairness of the presentation of the SPFS. This opinion was a result of SNC not providing required management representations indicating that it has provided us with all relevant information, among other matters, upon which we would base our opinion. In the absence of such representations, the scope of our work was limited to enable us to express an unmodified opinion on the Special Purpose Financial Statement. 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 | Clarification needed for SNC written overtime policy | \$0 | \$0 |

Internal Control Findings

Our audit discovered one internal control finding, which was classified as a significant deficiency. See Independent Auditor's Report on Internal Control on page 14. The complete management response from SNC to the internal control finding can be found in Appendix A to this report.

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

For the Period May 17, 2014 through March 16, 2015

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 the SPFS. The results of our tests disclosed no instances of noncompliance related to this audit. See Independent Auditor's Report on Compliance on page 16.

Review of Prior Findings and Recommendations

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

Summary of SNC's Responses to Findings

For Finding 2017, SNC agreed with the nature of the finding, but disagreed with the characterization of the finding as a significant deficiency in internal control. 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
Sierra Nevada Corporation
444 Solomon Circle
Sparks, Nevada 89434

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 Sierra Nevada Corporation ("SNC") under Contract No FA8620-14-C-3027, with the Air Force Life Cycle Management Center ("AFLCMC") to provide the Afghan National Army Special Operations Forces ("ANASOF") with Contractor Logistics Support ("CLS") for the PC-12 fixed-wing aircraft for the period May 17, 2014 through March 16, 2015, 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

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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 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 qualified audit opinion.

Basis for Qualified Opinion

Management of SNC refused to provide us with certain representations that we requested to represent that it has responsibility for the presentation of the Special Purpose Financial Statement and that it has provided us with all relevant information, among other matters, upon which we would base our opinion.

Opinion

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion paragraph, the Special Purpose Financial Statement referred to above presents fairly, in all material respects, the respective revenue received and costs incurred by SNC under the contract for the period May 17, 2014 through March 16, 2015 in accordance with the basis of accounting described in Note 2.

Restriction on Use

This report is intended for the information of Sierra Nevada Corporation, 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 October 12, 2017 on our consideration of SNC'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

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reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering SNC's internal control over financial reporting and compliance.

A handwritten signature in blue ink, appearing to read "Mayer Hoffmann".

Irvine, California
October 12, 2017

SIERRA NEVADA CORPORATION
Contract No. FA8620-14-C-3027
ANASOF CLS for PC-12 Fixed-Wing Aircraft

Special Purpose Financial Statement

May 17, 2014 through March 16, 2015

| | Budget | Actual | Questioned Costs | | Total | Notes |
|------------------------------|-------------------|----------------------|------------------|-------------|-------------|-------|
| | | | Ineligible | Unsupported | | |
| Revenues: | | | | | | |
| FA8620-14-C-3027 | <u>39,154,162</u> | <u>\$ [REDACTED]</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | (3) |
| Total revenues | <u>39,154,162</u> | <u>29,540,958</u> | <u>-</u> | <u>-</u> | <u>-</u> | |
| Expenditures: | | | | | | |
| CLS labor and materials | 25,771,249 | [REDACTED] | - | - | - | (4) |
| Travel | 381,156 | [REDACTED] | - | - | - | (4) |
| Emergency support | 15,213 | [REDACTED] | - | - | - | (4) |
| CLS labor (Option 1) | 10,348,793 | [REDACTED] | - | - | - | (4) |
| Travel (Option 1) | 77,977 | [REDACTED] | - | - | - | (4) |
| Emergency support (Option 1) | 147,903 | [REDACTED] | - | - | - | (4) |
| Fixed fee | <u>2,411,871</u> | <u>[REDACTED]</u> | <u>-</u> | <u>-</u> | <u>-</u> | (5) |
| Total costs incurred | <u>39,154,162</u> | <u>29,540,958</u> | <u>-</u> | <u>-</u> | <u>-</u> | (6) |
| Outstanding fund balance | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | |

See Notes to Special Purpose Financial Statement

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Notes to Special Purpose Financial Statement¹

For the Period May 17, 2014 through March 16, 2015

(1) **Background**

On May 17, 2014, the Air Force Life-Cycle Management Center ("AFLCMC") entered into Contract Number FA8620-14-C-3027 with Sierra Nevada Corporation ("SNC") to provide the Afghan National Army Special Operations Forces ("ANASOF") with Contractor Logistics Support ("CLS") for the PC-12 fixed-wing aircraft. In addition, they were to provide sustainment services necessary to perform the maintenance operations for aircraft operability. SNC was required to perform work at Kabul International Airport and in Kandahar. The contract is on a cost plus fixed fee basis, and was awarded in the original amount of \$34,425,000, of which \$12,825,231 was obligated through December 16, 2014. The contract was modified 13 times for such items as increasing the contract amount to \$39,154,162 and extending the end date through March 16, 2015. The AFLCMC utilized Big Safari to assist in the procurement of this contract. Big Safari is a United States Air Force program that began in 1952, which provides management, direction, and control of the acquisition, modification, and logistics support for special purpose weapons systems derived from exiting existing aircraft and systems. To that end, Big Safari assisted with this procurement by applying standardized procedures to procure the service/supply by establishing the contractual instrument ensuring the contractor performed and abided by the terms of the contract.

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

Basis of Presentation

The accompanying Special Purpose Financial Statement ("SPFS") includes costs incurred to provide the ANASOF with CLS for the PC-12 fixed-wing aircraft, as well as to provide sustainment services necessary to perform the maintenance operations for aircraft operability, at both the Kabul International Airport and in Kandahar for the period May 17, 2014 through March 16, 2015. Because the SPFS presents only a selected portion of the operations of SNC, it is not intended to and does not present the financial position, changes in financial position, or cash flows of SNC. 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*.

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

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Notes to Special Purpose Financial Statement

(Continued)

(2) Summary of Significant Accounting Policies (Continued)

Currency

All amounts presented are shown in U.S. dollars, the reporting currency of SNC. SNC did not pay any amounts under the contract in a foreign currency. Accordingly, no foreign conversion was required.

(3) Revenue

As of March 16, 2015, SNC has reported \$29,371,973 in revenue. This revenue equals the expenditures invoiced to the AFLCMC for the period May 17, 2014 through March 26, 2015.

(4) Indirect Cost

SNC's indirect cost rates for calendar years 2014 and 2015 were reviewed by the Defense Contract Audit Agency ("DCAA") on February 11, 2015. The DCAA-approved indirect cost rates are as follows:

| <u>Indirect Cost</u> | <u>Provisional Rates</u> | |
|----------------------|--------------------------|------|
| | 2014 | 2015 |
| Overhead – Eng/Ops | | |
| Overhead – TS | | |
| Overhead – FS | | |
| G&A | | |
| Integration Rate | | |
| Fringe | | |

Indirect costs are not a separate cost category on the SPFS, but are included within each of the cost categories. Additionally, SNC charged the 2014 provisional rates to the contract for the entire period.

(5) Fixed Fee

The contract contains a fixed fee of [REDACTED] that is to be paid to SNC as it accrues, in regular installments based upon the percentage of completion of work, or the expiration of the contract.

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Notes to Special Purpose Financial Statement

(Continued)

(6) Outstanding Fund Balance

As of March 16, 2015, there was no outstanding fund balance under the contract as the SPFS is prepared under the accrual basis of accounting described in Note 2.



**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
Sierra Nevada Corporation
444 Solomon Circle
Sparks, Nevada 89434

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 Sierra Nevada Corporation ("SNC") representing revenues received and costs incurred under Contract No. FA8620-14-C-3027, with the Air Force Life Cycle Management Center ("AFLCMC") to provide the Afghan National Army Special Operations Forces ("ANASOF") with Contractor Logistics Support ("CLS") for the PC-12 fixed-wing aircraft for the period May 17, 2014 through March 16, 2015, and the related Notes to the Special Purpose Financial Statement, and have issued our report thereon dated October 12, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the Special Purpose Financial Statement, we considered SNC'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 SNC's internal control. Accordingly, we do not express an opinion on the effectiveness of SNC'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 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 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 one deficiency in internal control, described in the accompanying Detailed Audit Findings as Finding 2017-1, which we consider to be a significant deficiency.

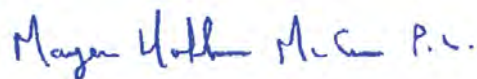
SNC's Response to Findings

SNC's response to the finding identified in our audit is included verbatim in Appendix A. SNC'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 SNC'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 Sierra Nevada Corporation, 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
October 12, 2017



Mayer Hoffman McCann P.C.
An Independent CPA Firm

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**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
Sierra Nevada Corporation
444 Solomon Circle
Sparks, Nevada 89434

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 Sierra Nevada Corporation ("SNC") representing revenues received and costs incurred under Contract No. FA8620-14-C-3027, with the Air Force Life Cycle Management Center ("AFLCMC") to provide the Afghan National Army Special Operations Forces ("ANASOF") with Contractor Logistics Support ("CLS") for the PC-12 fixed-wing aircraft for the period May 17, 2014 through March 16, 2015, and the related Notes to the Special Purpose Financial Statement, and have issued our report thereon dated October 12, 2017.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SNC'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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

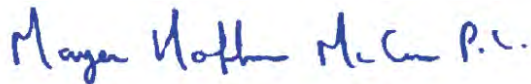
Board of Directors
Sierra Nevada Corporation
444 Solomon Circle
Sparks, Nevada 89434

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 Sierra Nevada Corporation, 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 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 "Mayer Hoffman McCon P.C.".

Irvine, California
October 12, 2017

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Status of Prior Findings

For the Period May 17, 2014 through March 16, 2015

We requested copies of prior engagements including audits, reviews and evaluations pertinent to SNC'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 one finding and recommendation that was included in the scope of our audit as it could have a potential material effect on the SPFS. Based on our review, adequate corrective action was implemented on this prior finding.

[REDACTED]

[REDACTED]

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Detailed Audit Findings

For the Period May 17, 2014 through March 16, 2015

Finding Number 2017-1: Clarification Needed for SNC Written Overtime Policy

Nature of Finding:

Internal control – significant deficiency

Condition:

SNC included \$440,000 of overtime costs as part of its labor costs included on the SPFS. In all 84 individual overtime transactions tested, the overtime was approved and documented through the timesheet approval process, which is an after the fact approval.

Criteria:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Cause:

SNC indicated that overtime is allowed per the contract and that prior approval was implied when the Supervisor/Manager approves the timesheet.

Effect:

Lack of following established procedures for prior approval of overtime could result in excess or unauthorized overtime charged to the contract.

Questioned Costs:

There are no questioned costs related to this finding as all time was actually incurred.

Recommendation:

We recommend that SNC either revise its policies requiring prior approval of overtime, or implement the established policy and obtain and document the prior approval for all overtime worked.

September 14, 2017

Erick Martin, CPA | Manager
Davis Farr LLP
2301 Dupont Drive, Suite 200
Irvine, CA 92612

Hi Erick

Here is SNC's response to the Draft SIGAR Audit Report

[REDACTED]

Regards,

[REDACTED]

Sierra Nevada Corporation
Corporate Director Government Compliance

SIERRA NEVADA CORPORATION

Financial Audit of Costs Incurred Under
Contract No. FA8620-14-C-3027
CLS for ANASOF PC-12 Fixed-Wing Aircraft

Auditor's Rebuttal to SNC's Response to Findings

For the Period May 17, 2014 through March 16, 2016

Finding Number 2017-1: Clarification Needed for SNC Written Overtime Policy

SNC agreed with the finding. However, SNC disagreed that the issue gives rise to a significant deficiency in internal control. We based the 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 overtime policy requires prior approval for overtime and SNC approved overtime after the fact, we believe that it is important enough to merit the attention of those charged with governance. 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.

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- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
- U.S. fax: +1-703-601-4065

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