SIGAR

Special Inspector General for Afghanistan Reconstruction

SIGAR 20-55 Financial Audit

Department of State's Introducing New Vocational Education and Skills Training in Kandahar Program: Audit of Costs Incurred by Mercy Corps

SEPTEMBER 2020

SIGAR 20-55-FA/INVEST

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On September 1, 2014, the Department of State's Bureau of Population, Refugees, and Migration (State) commenced the first of four consecutive cooperative agreements to Mercy Corps totaling $5,616,210 in support of the Introducing New Vocational Education and Skills Training in Kandahar program. The objectives of the program were to reintegrate internally displaced people into their communities and expand economic opportunities. State modified the agreements six times, which decreased the total funding to $5,437,739 but did not change the end date of June 30, 2018.

SIGAR's financial audit, performed by Williams, Adley & Company-DC LLP (Williams Adley), reviewed $5,412,478 in costs charged to the agreements from September 1, 2014, through June 30, 2018. The objectives of the audit were to (1) identify and report on material weaknesses or significant deficiencies in Mercy Corps' internal controls related to the agreements; (2) identify and report on instances of material noncompliance with the terms of the agreements and applicable laws and regulations, including any potential fraud or abuse; (3) determine and report on whether Mercy Corps has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of Mercy Corps' Special Purpose Financial Statement (SPFS). See Williams Adley'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 wherein Williams Adley did not comply, in all material respects, with U.S. generally accepted government auditing standards.

September 2020

Department of State's Introducing New Vocational Education and Skills Training in Kandahar Program: Audit of Costs Incurred by Mercy Corps

SIGAR 20-55-FA

WHAT SIGAR FOUND

Williams Adley identified one material weakness and two deficiencies in Mercy Corps' internal controls and four instances of noncompliance with the terms of the agreements. For example, Mercy Corps charged State for equipment and construction costs that were not authorized under the agreements. In another example, Mercy Corps could not prove that guesthouse usage and vehicle maintenance and repair charges benefited the program.

Because of the internal control issues and instances of noncompliance, Williams Adley identified $29,590 in total questioned costs, consisting of $4,891 unsupported costs—costs not supported with adequate documentation or that do not have required prior approval—and $24,699 ineligible costs—costs prohibited by the agreements and applicable laws and regulations.

Category	Ineligible	Unsupported	Total Questioned Costs
Fringe Benefits	$116	$0	$116
Equipment	$1,529	$0	$1,529
Contractual	$1,326	$0	$1,326
Construction	$17,552	$0	$17,552
Other	$0	$4,285	$4,285
Indirect Charges	$4,176	$606	$4,782
Total Costs	**$24,699**	**$4,891**	**$29,590**

Williams Adley identified one prior audit that was relevant to Mercy Corps' agreements. It had nine findings that could have a material effect on the SPFS and other financial data that are significant to this audit's objectives. Williams Adley conducted follow-up procedures and concluded that Mercy Corps took adequate corrective action on eight of the findings, but had not adequately addressed the ninth.

Williams Adley issued a qualified opinion on Mercy Corps' SPFS because the $29,590 in questioned costs are material to the statement.

WHAT SIGAR RECOMMENDS

Based on the results of the audit, SIGAR recommends that the responsible agreement officer at State:

1. **Determine the allowability of and recover, as appropriate, $29,590 in questioned costs identified in the report.**
2. **Advise Mercy Corps to address the report's three internal control findings.**
3. **Advise Mercy Corps to address the report's four noncompliance findings.**

September 25, 2020

The Honorable Michael R. Pompeo
Secretary of State

Ms. Carol Thompson O'Connell
Acting Assistant Secretary for Population, Refugees, and Migration

Ambassador Ross Wilson
U.S. Chargé d'Affaires for Afghanistan

We contracted with Williams, Adley & Company-DC LLC (Williams Adley) to audit the costs incurred by Mercy Corps under four cooperative agreements from the Department of State in support of the Introducing New Vocational Education and Skills Training in Kandahar program.[1] The objectives of the program were to reintegrate internally displaced people into their communities and expand economic opportunities. Williams Adley reviewed $5,412,478 in costs charged to the agreements from September 1, 2014, through June 30, 2018. Our contract with Williams Adley 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 agreement officer at State:

1. **Determine the allowability of and recover, as appropriate, $29,590 in questioned costs identified in the report.**
2. **Advise Mercy Corps to address the report's three internal control findings.**
3. **Advise Mercy Corps to address the report's four noncompliance findings.**

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

Please provide documentation related to corrective actions taken and/or target dates for completion for 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-166)

[1] The agreements are S-PRMCO-14-CA-1122, S-PRMCO-15-CA-1263, S-PRMCO-16-CA-1179, and S-PRMCO-17-CA-2019.

OFFICE OF THE
SPECIAL INSPECTOR GENERAL FOR
AFGHANISTAN RECONSTRUCTION

Audit F-166

Financial Audit of Costs Incurred Under Cooperative Agreement Numbers:

SPRMCO14CA1122, SPRMCO15CA1263,
SPRMCO16CA1179 and SPRMCO17CA2019

by

Mercy Corps

For the Period

September 1, 2014 – June 30, 2018

Submitted by

WILLIAMS ADLEY

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WILLIAMS ADLEY

Transmittal Letter

July 31, 2020

Jennifer Cooperman, Interim Chief Financial Officer
Amy Mulkerin, Senior Director of International Finance
Jamey Pietzold, International Finance Manager
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Portland, OR 97204

The Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR)
2530 Crystal Drive
Arlington, VA 22202

We hereby provide to you our final report, which reflects results from the procedures we completed during our audit of Mercy Corps cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 with the U.S. Department of State (State), Bureau of Population, Refugees, and Migration (hereinafter referred to as "State PRM") to conduct the "Introducing New Vocational Educational Skills Training in Kandahar" (INVEST-in-Kandahar) program.

Within the pages that follow, we provide a summary of the work performed. Following the summary, we provide our Report on the Special Purpose Financial Statement (SPFS), Report on Internal Control, and Report on Compliance. We do not express an opinion on the summary, Report on Internal Control or Report on Compliance.

When preparing our reports, we considered comments, feedback and interpretations provided by Mercy Corps and SIGAR, in writing and orally, throughout the audit. Mercy Corps' responses to the audit reports and our corresponding auditor analysis are incorporated herein.

Thank you for providing us the opportunity to work with you and to conduct the audit of Mercy Corps' Cooperative Agreements.

Sincerely,

Jocelyn Hill

Jocelyn Hill, CPA
Partner

Summary

Background

Beginning on August 27, 2014, the Department of State's Bureau of Population, Refugees, and Migration awarded four consecutive cooperative agreements to Mercy Corps totaling $5,616,210 in support of the Invest-in-Kandahar program. The agreements' objectives were to reintegrate internally displaced returnees into their communities of origin, and to expand livelihood opportunities through enhanced vocational and life skills. After six modifications, the agreements' total funding decreased to $5,437,739 with no change to the period of performance, which ran from September 1, 2014 through June 30, 2018 (see tables below).

Mercy Corps, a 501 (c)(3) nonprofit organization incorporated in the State of Washington, is a leading global non-governmental, humanitarian aid organization operating in areas that have undergone various forms of economic, environmental, social and political instabilities. The organization has assisted more than 220 million people survive humanitarian conflicts, seek improvements to their livelihoods, and deliver durable development to their communities. Currently Mercy Corps operates within 40 countries, including Afghanistan, Central African Republic, Myanmar, and Somalia, with programs focused in several humanitarian sectors such as conflict management, children and youth, and agriculture and food security.

Table 1: SPRMCO14CA1122 Cooperative Agreement and Modifications

Period of Performance: September 1, 2014 through August 31, 2015			
	Issue Date	Amount Funded (Obligated)	Purpose
Base Year	8/27/2014	$ 1,470,608	Cooperative Agreement Initial Obligation
Mod 1	4/20/2015	-	Modification Request for Location Change
Mod 2	5/5/2016	(167,372)	Budget Amendment
Mod 3	3/30/2018	(11,099)	De-obligation of Remaining Funds to Close Cooperative Agreement
	Total	$ 1,292,137	

Table 2: SPRMCO15CA1263 Cooperative Agreement and Modification

Period of Performance: September 1, 2015 through August 31, 2016			
	Issue Date	Amount Funded (Obligated)	Purpose
Base Year	8/31/2015	$ 1,390,122	Cooperative Agreement Initial Obligation
Mod 1	3/23/2016	-	Incorporate Requested Revisions to Objectives and Indicators
	Total	$ 1,390,122	

Table 3: SPRMCO16CA1179 Cooperative Agreement and Modification

Period of Performance: September 1, 2016 through August 31, 2017			
	Issue Date	Amount Funded (Obligated)	Purpose
Base Year	8/31/2016	$ 1,255,480	Cooperative Agreement Initial Obligation
Mod 1	12/8/2016	-	Amend Purpose/Scope of Cooperative Agreement
	Total	$ 1,255,480	

Table 4: SPRMCO17CA2019 Cooperative Agreement and Modification

Period of Performance: July 24, 2017 through June 30, 2018			
	Issue Date	Amount Funded (Obligated)	Purpose
Base Year	7/24/2017	$ 1,500,000	Cooperative Agreement Initial Obligation
Mod 1	4/24/2018	-	Authorize Mercy Corps' Request for Change to Indicator Targets
	Total	$ 1,500,000	

Work Performed

The Office of the Special Inspector General for Afghanistan Reconstruction (SIGAR) contracted with Williams, Adley & Company-DC, LLP (Williams Adley) to conduct a financial audit and close-out of costs incurred by Mercy Corps under cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 and associated modifications as indicated in the tables above. Our audit procedures covered $5,412,478 in total costs incurred for the period September 1, 2014 through June 30, 2018.

Objectives

The objectives of the audit were to:

Audit Objective 1 - Special Purpose Financial Statement

Express an opinion on whether Mercy Corps' Special Purpose Financial Statement (SPFS) for the agreements 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 agreements and generally accepted accounting principles or other comprehensive basis of accounting.

Audit Objective 2 - Internal Controls

Evaluate and obtain a sufficient understanding of Mercy Corps' internal controls related to the agreements; assess control risk; and identify and report on significant deficiencies including material internal control weaknesses.

Audit Objective 3 – Compliance

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

Audit Objective 4 - Corrective Action on Prior Findings and Recommendations
Determine and report on whether Mercy Corps 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

The audit included State cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 and related modifications executed for revenues applied to and costs incurred during the period September 1, 2014 through June 30, 2018, as reported on the SPFS. Over the course of the INVEST-in-Kandahar program, Mercy Corps incurred $5,383,732 in program costs and earned program income of $28,746 related to fees collected from program participants bringing total program costs to $5,412,478. This was a close-out audit and therefore subject to additional audit procedures. The audit was limited to those matters pertinent to the cooperative agreements that have a direct and material effect on the SPFS and included an evaluation of the presentation, content and records supporting the SPFS. The following areas were included within the audit program for evaluation:

i. Administrative Procedures and Fraud Risk Assessment
ii. Budget Management
iii. Cash Management
iv. Disbursements and Financial Reporting
v. Procurement and Inventory Management
vi. Close-out Procedures
vii. Quality Assurance Review and Audit Close-out

Our audit was conducted to form an opinion on the SPFS in accordance with the SPFS presentation requirements in Note 2. Therefore:

- The Transmittal Letter to SIGAR and the information presented in the Table of Contents and Summary are presented for informational and organizational content purposes and are not required parts of the SPFS. Such information has not been subject to the auditing procedures applied in the audit of the SPFS, and accordingly, we do not express an opinion or provide any assurance on it.

- The scope of our audit does not include procedures to verify the efficacy of the State funded program, and accordingly, we do not express an opinion or provide any assurance on it.

Methodology

We conducted our audit in accordance with generally accepted auditing standards (GAAS), and generally accepted government auditing standards (GAGAS) as published in the Government Accountability Office's *Government Auditing Standards*. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the SPFS of the costs incurred under the agreements is free of material misstatement. An audit includes:

- Obtaining an understanding of Mercy Corps' internal controls related to the agreements, assessing control risk, and determining the extent of audit testing needed based on the control risk assessment.

- Examining, on a test basis, evidence supporting the amounts and disclosures presented in the SPFS.

To meet the audit objectives, we prepared an audit plan for the engagement.

For audit objective 1, we reviewed transactions for the period September 1, 2014 through June 30, 2018, subsequent events, and information that may have a significant impact on the SPFS for the audit period. We used both statistical and non-statistical sampling techniques to select personnel, fringe benefits, travel, equipment, supplies, construction, contractual (program), and other direct cost samples to test for allowability of incurred costs. We also reviewed procurement records to determine cost reasonableness and tested the allowability and allocability of the program income included in the SPFS. The scope of our audit reflects our assessment of control risk and includes tests of incurred costs to provide a reasonable basis for our opinion.

For audit objective 2, we reviewed applicable background materials, including cooperative agreements, auditee financial and progress reports, State regulations, SIGAR's Afghanistan alert letters, audit reports and special program reports, and auditee single audits, performance audits and/or financial statement audits as made available and provided. To gain an understanding of the control environment, we interviewed management and reviewed business processes to determine if critical internal controls were in place that mirrored best practices such as sufficient management oversight of business processes, proper segregation of duties, documented policies and procedures, robust financial management systems, and sufficient monitoring of controls to ensure effective implementation thereof. We assessed the control risk for sampling and testing purposes.

For audit objective 3, we performed compliance testing including, but not limited to: determination of allowable costs under the applicable cost principles and federal regulations; validation of indirect cost calculations pursuant to a provisional or final negotiated indirect cost rate agreement; verification of incurred cost eligibility; confirmation of equipment and real property management and disposal in accordance with an approved disposition plan; determination as to whether expenditures complied with the period of availability of the federal funds; verification that procurement activities complied with full and open competition standards or justification for noncompetitive bids was documented when applicable, and suspension and debarment of the subcontractor or subrecipient was considered in the cooperative agreement decision; and determination that financial reporting was accurate, timely and complete. In addition, we performed testing to assess and determine any potential fraud, abuse and illegal acts. We performed close-out procedures to ensure that: unobligated funds and unliquidated advances in excess of cash were returned to the U.S. Government; final program and financial reports were signed and submitted to the funding agency; and the auditee obtained an approved disposition plan.

For audit objective 4, we requested prior audit reports, reviews and assessments pertinent to Mercy Corps' activities under the agreements. We also performed independent research of publicly available information to identify prior audit and review reports. If prior audits indicated a need for corrective action to be taken by Mercy Corps, we determined through inquiry, observation and testing whether the necessary steps were taken to adequately address those findings and recommendations.

Summary of Results

We issued a qualified opinion on Mercy Corps' Special Purpose Financial Statement due to $29,590 in questioned costs, including related indirect costs of $4,782, of which $20,523 plus indirect costs of $4,176 were deemed ineligible and $4,285 plus indirect costs of $606 were unsupported. Ineligible costs are unreasonable, prohibited by the cooperative agreement or applicable laws and regulations, or not related to the cooperative agreement. Unsupported costs are costs not supported with adequate documentation or that do not have prior approval or authorization.

As a result of our audit procedures we identified one material weakness, two internal control deficiencies, and four instances of noncompliance with the terms and conditions of the cooperative agreements that are required to be reported under *Government Auditing Standards*.

Summary of Findings and Questioned Costs

Questioned Costs Classification

Finding No.	Description	Material Weakness	Significant Deficiency	Internal Control Deficiency	Non-Compliance	Ineligible Costs	Unsupported Costs	Total Questioned Costs
2019-01	Ineligible Construction and Equipment Costs	√			√	$ 19,081		$ 19,081
2019-02	Ineligible Entertainment Cost				√	$ 116		$ 116
2019-03	Unsupported Allocated Costs			√	√		$ 4,285	$ 4,285
2019-04	Failure to Withhold Supplier Taxes			√	√	$ 1,326		$ 1,326
					Total Direct Costs	$ 20,523	$ 4,285	$ 24,808
					Total Indirect Costs	$ 4,176	$ 606	$ 4,782
					Total Questioned Costs	$ 24,699	$ 4,891	$ 29,590

We also considered whether the information obtained during our audit 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.

Status of Prior Audit Findings

We identified one prior audit report, SIGAR 14-19-FA, that was assessed for purposes of determining if there were findings and corrective actions requiring follow-up. The report contained nine findings that could have a material effect on the SPFS. We performed testing of similar matters during our current audit and determined that Mercy Corps had either not repeated or taken corrective action on eight of the findings. The remaining finding that could have a material effect on the SPFS or other financial data significant to our audit objectives, however, was not adequately addressed. For this one finding we found similar issues during our audit. Please see Status of Prior Audit Findings and Recommendations section for a detailed description.

Summary of Management's Comments

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

Mercy Corps disagrees with Findings 2019-01, 2019-02, and 2019-03 and stated that they will coordinate with the awarding donor DOS BPRM (State PRM) to address the allowability of the costs in question. Mercy Corps partially agrees with Finding 2019-04 and requested a correction to the total questioned cost amount. In addition to providing responses to the findings identified in this report, Mercy Corps requested five corrections to the report.

Our rebuttal to management comments is detailed in Appendix B of this report.

Attachments
The auditor's reports are supplemented by two attachments:

- Appendix A - Management's Response to the Findings and Recommendations
- Appendix B - Auditor's Response to Management Comments

WILLIAMS ADLEY

Independent Auditor's Report on the Special Purpose Financial Statement

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Amy Mulkerin, Senior Director of International Finance
Jamey Pietzold, International Finance Manager
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We have audited the Special Purpose Financial Statement (SPFS) of Mercy Corps' cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 and the related notes for the period September 1, 2014 through June 30, 2018.

Management's Responsibility for the Special Purpose Financial Statement

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

Auditor's Responsibility

Our responsibility is to express an opinion on this SPFS based on conducting the audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the SPFS is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the SPFS. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the SPFS, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to Mercy Corps' preparation and fair presentation of the SPFS 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 Mercy Corps' 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 SPFS.

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

Basis for Qualified Opinion

Mercy Corps incurred and billed ineligible costs of $20,523, plus $4,176 of related indirect costs, and unsupported costs of $4,285, plus $606 of related indirect costs, that were not in accordance with the requirements of the Code of Federal Regulations. The total questioned cost amount of $29,590 is considered material to the Special Purpose Financial Statement.

Qualified Opinion

In our opinion, except for the effects of the $29,590 in questioned costs described in the Basis for Qualified Opinion paragraph, the SPFS referred to above presents fairly, in all material respects, the respective costs incurred, items procured by the U.S. Government and balance for the period September 1, 2014 through June 30, 2018 in accordance with the terms of the agreement and in conformity with the basis of accounting described in Note 2 of the SPFS.

Basis of Accounting

We draw your attention to Note 2 of the SPFS, which describes the basis of accounting. As described in Note 2 of the SPFS, the SPFS has been prepared using the accrual method of accounting. Under the accrual basis of accounting revenues are recognized when earned.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards,* we have also issued our reports, dated February 28, 2020, on our consideration of Mercy Corps' internal control over financial reporting and our tests of its compliance with certain provisions of laws and regulations. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this Independent Auditor's Report in considering the results of our audit.

Restriction on Use

Our report is intended solely for the information and use of Mercy Corps, State, and 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.

Williams, Adley & Company-DC, LLP

Washington, D.C.
February 28, 2020

Mercy Corps
Special Purpose Financial Statement
September 1, 2014 through June 30, 2018

Description	Budget	Actual	Questioned Costs		Notes[1]
			Ineligible	Unsupported	
Revenues					3
Receipts from Donor	$5,437,739	$ 5,383,732			
Program Income		28,746			
Total Revenue	**$ 5,437,739**	**$ 5,412,478**			
Costs Incurred					4
Personnel	$ 1,903,473	$ 1,959,902			
Fringe Benefits	502,026	546,792	116		B
Travel	84,037	66,301			
Equipment	-	1,578	1,529		A
Supplies	64,222	60,597			
Contractual	1,807,315	1,675,290	1,326		
Construction	**-**	17,552	17,552		A
Other	336,455	318,957		4,285	C, D
Total Direct Charges	**$4,697,528**	**$4,646,969**	**20,523**	**4,285**	
Indirect Charges	740,211	765,509	4,176	606	A, B, C, and D
Total Costs Incurred	**$5,437,739**	**$ 5,412,478**	**$ 24,699**	**$ 4,891**	
Outstanding Balance	**$ -**	**$ -**			5

[1] The Notes to the Special Purpose Financial Statement are an integral part of the Statement.

Mercy Corps
Notes to the Special Purpose Financial Statement[2]
For the Period of September 1, 2014 to June 30, 2018

Note 1. Background and Presentation

The accompanying Special Purpose Financial Statement (SPFS) includes costs incurred under four Cooperative Agreements with U.S. Department of State, Bureau of Population Refugees and Migration. SPRMCO14CA1122 had a program period of 9/01/14-8/31/15, SPRMCO15CA1263 had a program period of 9/1/15-8/31/16, SPRMCO161179 had a program period of 9/1/16-8/31/17, and SPRMCO17CA2019 a program period from 7/24/2017-6/30/2018.

The Introducing New Vocational Educational Skill Training (INVEST) program facilitates the successful reintegration of Afghan returnees and other vulnerable populations into their communities by expanding livelihood opportunities through enhanced vocational and life skills.

The information in the SPFS is presented in accordance with the audit requirements of the Special Inspector General for Afghanistan Reconstruction (SIGAR) and the specific agreements referenced above. The SPFS presents only a selected portion of the operations of Mercy Corps. Therefore, some amounts presented in this SPFS may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Note 2. Summary of Significant Accounting Policies

a. Basis of Accounting
The SPFS has been prepared from Mercy Corps' financial system and follows the accrual basis of accounting. The final rates for FY 2017 and FY 2018 as established in the Negotiated Indirect Cost Rate Agreement dated August 21, 2019 have been included in the SPFS.

b. Foreign Currency conversion method
For purposes of preparing the SPFS, conversions form local currency to United State dollars were not required. Transactions are recorded in Mercy Corps' financial system in the original transaction currency and USD at the time of recording the transaction.

[2] The Notes to the Special Purpose Financial Statement are the responsibility of Mercy Corps management.

Note 3. Revenues

The total budget funds approved as per cooperative agreements and the total revenues received by State Bureau and program income are detailed as follows:

Cooperative Agreement No.	Approved Budget	Revenues	
		Program Income	DOS/BPRM
SPRMCO14CA1122	$ 1,292,137	$ 1,584	$ 1,290,553
SPRMCO15CA1263	1,390,122	12,871	1,373,839
SPRMCO16CA1179	1,255,480	6,934	1,248,546
SPRMCO17CA2019	1,500,000	7,357	1,470,794
Totals	**$ 5,437,739**	**$ 28,746**	**$ 5,383,732**

Note 4. Cost Categories

The budget categories presented, and associate amounts reflect the budgets presented within the final approved Cooperative Agreements.

Note 5. Outstanding Balance

Final settlement with State Bureau has been completed as part of administrative close-out of these cooperative agreements.

Mercy Corps
Notes to the Questioned Costs Presented on the Special Purpose Financial Statement [3]

Note A: Ineligible Construction and Equipment Costs – (Finding 2019-01)

Condition: Mercy Corps incurred $19,081 in ineligible construction and equipment costs and $3,888 in associated indirect costs totaling $22,969.

Note B: Ineligible Entertainment Cost – (Finding 2019-02)

Condition: Mercy Corps incurred $116 in ineligible entertainment costs and $17 in associated indirect costs, totaling $133, for an employee appreciation party charged to cooperative agreement SPRMCO15CA1263.

Note C: Unsupported Allocated Costs – (Finding 2019-03)

Condition: Mercy Corps allocated costs for guest house usage and vehicle maintenance and repair without documentation to demonstrate the proportional benefit of the costs allocated to the cooperative agreements. Unsupported allocated costs were $4,285, plus the associated indirect costs of $606, for a total questioned cost of $4,891.

Note D: Failure to Withhold Supplier Taxes (Finding 2019-04)

Condition: Mercy Corps failed to withhold sales taxes when paying suppliers, resulting in the government being charged for $1,326 in ineligible taxes and $271 in associated indirect costs totaling $1,597.

[3] Alphabetic notes to the questioned costs presented on the Special Purpose Financial Statement were developed by and are the responsibility of the auditor.

WILLIAMS ADLEY

Independent Auditor's Report on Internal Control

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We have audited the Special Purpose Financial Statement (SPFS) and related notes to the SPFS, 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, of Mercy Corps' cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 for the period September 1, 2014 to June 30, 2018. We have issued our report thereon dated February 28, 2020 with a qualified opinion.

Internal Control Over Financial Reporting

In planning and performing our audit of the SPFS, we considered Mercy Corps' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the SPFS, but not for the purpose of expressing an opinion on the effectiveness of Mercy Corps' internal control. Accordingly, we do not express an opinion on the effectiveness of Mercy Corps' internal control.

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 Mercy Corps' SPFS 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. 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.

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. Given these limitations, material weaknesses may exist that have not been identified. We did note one material weakness as defined and described in Finding 2019-01, and two internal control deficiencies as defined and described in Findings 2019-03 and 2019-04 in the attached Schedule of Findings and Questioned Costs.

Mercy Corps' Response to the Findings

Mercy Corps' response to the findings identified in our audit is included verbatim in Appendix A. Mercy Corps' response was not subjected to the auditing procedures applied in the audit of the SPFS, and accordingly, we express no opinion on it.

Purpose of this Report

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

Restriction on Use

This report is intended for the information of Mercy Corps, State, and SIGAR. 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.

Williams, Adley & Company-DC, LLP

Washington, D.C.
February 28, 2020

WILLIAMS ADLEY

Independent Auditor's Report on Compliance

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We have audited the Special Purpose Financial Statement (SPFS) and related notes to the SPFS, 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, of Mercy Corps' cooperative agreement numbers SPRMCO14CA1122, SPRMCO15CA1263, SPRMCO16CA1179 and SPRMCO17CA2019 for the period September 1, 2014 to June 30, 2018. We have issued our report thereon dated February 28, 2020 with a qualified opinion.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mercy Corps' SPFS is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and cooperative agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. During testing we considered whether potential fraud or abuse[4] has occurred or is likely to have occurred and based on documentation obtained we did not find evidence of fraud or abuse that is required to be reported to SIGAR. However, the results of our tests disclosed four instances of noncompliance as noted in Findings 2019-01, 2019-02, 2019-03, and 2019-04 in the

[4] Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse.

Schedule of Findings and Questioned Costs, which are required to be reported under *Government Auditing Standards.*

Mercy Corps' Response to the Findings

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

Purpose of this Report

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

Restriction on Use

This report is intended for the information of Mercy Corps, State, and SIGAR. 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.

Williams, Adley & Company-DC, LLP

Washington, D.C.
February 28, 2020

Schedule of Findings and Questioned Costs

Finding 2019-01: Ineligible Construction and Equipment Costs

Nature of Finding: Material Weakness in Internal Control and Non-Compliance

Condition: Mercy Corps charged ineligible construction and equipment costs totaling $19,081 to two of the agreements. Equipment and construction costs were not specified as items of expenditure in the authorized direct cost budgets for these agreements. Additionally, there was no evidence documenting that a budget revision, which would allow for this type of expenditure, was requested or approved. The tables below show the amounts that were charged to each cooperative agreement and the related indirect costs.

Construction

Agreement No.	Questioned Cost	Applicable Indirect Cost Rate	Indirect Cost Amount	Total Questioned Costs
SPRMCO14CA2019	$ 17,259	20.47%	$ 3,533	$ 20,792
SPRMCO15CA1263	293	14.50%	42	335
Totals	$ 17,552		$ 3,575	$ 21,127

Equipment

Agreement No.	Questioned Cost	Applicable Indirect Cost Rate	Indirect Cost Amount	Total Questioned Costs
SPRMCO14CA2019	$ 1,529	20.47%	$ 313	$ 1,842
Grand Total	**$19,081**		**$ 3,888**	**$ 22,969**

Criteria:

2 CFR § 200.48, *General purpose equipment* is defined as follows: "General purpose equipment means equipment which is not limited to research, medical, scientific or other technical activities. Examples include office equipment and furnishings, modular offices, telephone networks, information technology equipment and systems, air conditioning equipment, reproduction and printing equipment, and motor vehicles. See also Equipment and Special Purpose Equipment."

2 CFR § 200.308(c)(1), *Revision of budget and program plans*:

"For non-construction Federal awards, recipients must request prior approval from Federal awarding agencies… (iv) The inclusion, unless waived by the Federal awarding agency, of costs that require prior approval in accordance with Subpart E—Cost Principles…"

2 CFR 200.439(b), *Equipment and other capital expenditures,* states that the following rules of allowability must apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and land are unallowable as direct charges, except with the prior written approval of the Federal awarding agency or pass-through entity...”

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior written approval of the Federal awarding agency, or pass-through entity. See § 200.436 Depreciation, for rules on the allowability of depreciation on buildings, capital improvements, and equipment.

The U.S. Department of State; Standards Terms and Conditions XIII. Prior Approval Requirements - For non-construction Federal awards, non-Federal entities must request prior approvals from Federal awarding agencies for (b) The inclusion, unless waived by the Federal awarding agency, of costs that require prior approval.

Cause: Mercy Corps claims it was not required to seek written approvals for budget changes, including equipment and construction costs, so long as they did not exceed 10% of the total budget. Mercy Corps incorrectly uses the Section 15(b)[5] under cooperative agreements Nos SPRMCO15CA1263 and SPRMCO17CA2019 to justify these changes without written approval. However, equipment and construction costs were not included as items of expenditure in the direct cost budget. Consequently, Mercy Corps cannot use Section 15(b) to justify expenditures for equipment and construction. In accordance with CFR 2 CFR § 200.308 (c)(1)(iv), Mercy Corps needed prior written approval for these expenditures, which it did not request or receive.

Effect: Incurring costs under unauthorized budget categories increases the risk that funds are expended in ways that are not related or do not contribute to the award’s purpose.

Questioned Cost: $22,969 comprised of $19,081 in ineligible construction and equipment costs, plus $3,888 in related indirect costs.

Recommendation: We recommend that Mercy Corps:

1. Provide training on allowable budget revisions as appropriate to include controls that will ensure compliance with 2 CFR 200.

2. Provide evidence of approval, or a waiver from State PRM, to support the allowability of the construction and equipment costs billed to State or return $22,969 to State for ineligible construction and equipment costs.

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[5] Cooperative Agreements Section 15(b).”… The transfer of funds among direct cost categories or programs, functions and activities for which the cumulative amount of such transfers exceeds or is expected to exceed 10 percent of the total approved budget (see 2 CFR 200.308(e)) requires prior approval by the grant officer by way of amendment.”

Finding 2019-02: Ineligible Entertainment Cost

Nature of Finding: Non-Compliance

Condition: We tested a sample of 157 non-payroll disbursements, valued at $670,354, from a population of 12,080 disbursements, totaling $2,965,959, and noted one instance where Mercy Corps allocated $116 to cooperative agreement SPRMCO15CA1263 for an Iftar[6] employee appreciation party. Mercy Corps did not provide evidence that the entertainment costs supported programmatic purposes, were authorized in the budget, or were approved in writing in accordance with 2 CFR § 200.438. We question $116 for the ineligible cost plus $17 in related indirect costs.

Criteria:
2 CFR § 200.438, *Entertainment costs*, states: "Costs of entertainment, including amusement, diversion, and social activities and any associated costs are unallowable, except where specific costs that might otherwise be considered entertainment have a programmatic purpose and are authorized either in the approved budget for the Federal award or with prior written approval of the Federal awarding agency."

Cause: Mercy Corps management considers the Iftar party an allowable cost pursuant to 2 CFR 200.437[7] – Employee Health and Welfare Costs. Mercy Corps stated that team member policies are structured to highlight the importance of improving working conditions, employer-employee relations, team member health and well-being, and performance and that this specific cost is related to improving employer-employee relations and team member health (morale and well-being). While we agree that the Iftar party may have contributed to employee morale, we do not agree that 2 CFR 200.437 can be used to justify the allowability of these charges as language specific or related to employee morale is not included in this CFR. Accordingly, the charges for this dinner must be considered solely as entertainment and are subject to 2 CFR 200.438, which requires evidence that the entertainment costs supported programmatic purposes, were authorized in the budget or were approved in writing.

Effect: The government was charged $133 for unallowable entertainment expenses. Additionally, the classification of entertainment expenses as employee health and welfare costs increases the risk that ineligible costs will go undetected and will be billed to State.

Questioned Cost: $133 comprised of $116 in ineligible entertainment cost plus $17 in related indirect costs.

[6] Iftar is the name for the event in which Muslims break their fast after a day of fasting from dawn to dusk. During Ramadan people organize parties where other people are invited to do iftar with them. These are called iftar parties.

[7] 2 CFR §200.437 Employee health and welfare costs. "(a) Costs incurred in accordance with the non-Federal entity's documented policies for the improvement of working conditions, employer-employee relations, employee health, and employee performance are allowable..."

Recommendation: We recommend that Mercy Corps:

1. Develop policies to distinguish cost classification of employee health and welfare and entertainment costs according to 2 CFR 200.437 and 2 CFR 200.438, respectively, to ensure that Iftar employee appreciation parties are properly classified as entertainment costs and therefore not charged to cooperative agreements unless they meet the criteria of 2 CFR §200.438.

2. Provide support and an explanation to State as to why the entertainment cost should be allowable or return $133 to State for the ineligible cost.

Finding 2019-03: Unsupported Allocated Costs

Nature of Finding: Internal Control Deficiency and Non-Compliance

Condition: We reviewed 157 non-payroll disbursement samples valued at $670,354, from a population of 12,080 disbursements representing $2,965,959 in costs. We identified 5 items, related to guest house usage and vehicle maintenance and repair, totaling $4,285, that were allocated to cooperative agreements SPRMCO14CA1122, SPRMCO15CA1263, and SPRMCO16CA1179. These items lacked documentation supporting the proportional benefit of the allocated costs charged to the agreements. The tables below show the allocated costs plus the associated indirect costs of $606 totaling $4,891 in questioned costs.

Guest House Costs

Transaction Date	Allocated Cost	Rate	Indirect Cost Amount	Total Questioned Costs
2/28/15	$ 1,327	13.75%	$ 182	$ 1,509
4/30/15	2,094	13.75%	288	2,382
Subtotal	**$ 3,421**		**$ 470**	**$ 3,891**

Vehicle Maintenance and Repair Costs

Transaction Date	Allocated Cost	Rate	Indirect Cost Amount	Total Questioned Costs
2/28/15	$ 405	13.75%	$ 56	$ 461
1/31/16	241	14.50%	35	276
7/31/17	218	20.47%	45	263
Subtotal	**$ 864**		**$ 136**	**$ 1,000**
Total Questioned Cost	**$ 4,285**		**$ 606**	**$ 4,891**

Criteria:

OMB Circular A-110 Uniform Administrative Requirements for Grants and Agreements With Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations

Subpart C – Post Award Requirements: Financial and Program Management

.21 Standards for Financial Management System.

"…(b) Recipients' financial management system shall provide the following.

…(2) Records that identify adequately the source and application of funds for federally sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, income and interest."

OMB Circular A-122 Cost Principles for Non-Profit Organizations

General Principles

A. Basic Considerations.

"…4 *Allocable costs.*

(a)"A cost is allocable to a particular cost objective, such as a grant, contract, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Federal award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received…"

B. *Direct costs*.

"1. Direct costs are those that can be identified specifically with a particular final cost objective, i.e., a particular award, project, service, or other direct activity of an organization…"

Cause: According to Mercy Corps management, their cost allocation methodology is used because of its relative simplicity and to reduce the risk associated with employing a more complex cost allocation approach. Mercy Corps' cost allocation method does not require maintenance of documentation which would demonstrate costs are allocated based on the proportional benefit to the cooperative agreements.

Effect: Because Mercy Corps did not provide adequate documentation that clearly and directly associated the questioned costs with cooperative agreements SPRMCO14CA1122, SPRMCO15CA1263, and SPRMCO16CA1179 it cannot be determined if the agreements were properly charged. Insufficient documentation of allocated costs diminishes the federal government's ability to rely on Mercy Corps' allocation methodology for proper assignment of costs to federal awards.

Questioned Cost: $4,891 comprised of $4,285 of unsupported cost allocation and $606 in related indirect costs.

Recommendation: We recommend that Mercy Corps:

1. Develop procedures to comply with OMB Circular A-110.21, related to financial management systems, to ensure that allocated costs are supported by adequate documentation that supports the tracing of funds to a level of expenditures

adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the cooperative agreement.

2. Provide supporting documentation that identifies the allocated costs to the charged cooperative agreement, or refund State $4,891 which includes $606 in related indirect costs.

Finding 2019-04: Failure to Withhold Supplier Taxes and Ineligible Payment

Nature of Finding: Internal Control Deficiency and Non-Compliance

Condition: We reviewed 157 non-payroll disbursement samples valued at $670,354, from a population of 12,080 disbursements representing $2,965,959 in costs. We identified two disbursements, related to agreement SPRMCO16CA1179, where Mercy Corps did not withhold the required amount of tax from suppliers to remit to the Afghan Ministry of Finance (MoF) as required by the Afghanistan Tax law. Mercy Corps paid suppliers and charged the agreement for the full amount of invoiced costs, including the amounts that should have withheld and remitted to the MoF. Subsequently, Mercy Corps paid the tax to the MoF (which should have been withheld and remitted to the MoF) and charged the cooperative agreement for the amount paid even though Mercy Corps previously charged the government for these costs. Consequently, Mercy Corps charged an ineligible payment to the government of $1,326, plus $271 in associated indirect costs for a total of $1,597.

Criteria:

2 CFR § 200.62(a)(3), *Internal control over compliance requirements for Federal awards*, requires the awardee to "[d]emonstrate compliance with Federal statutes, regulations, and the terms and conditions of the Federal award."

2 CFR § 200.303, *Internal controls*, states:
"The non-Federal entity must: (a) Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award…"

2 CFR § 200.53, *Improper Payment:*

"(a) Improper payment means any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements; and

(b) Improper payment includes any payment to an ineligible party, any payment for an ineligible good or service, any duplicate payment, any payment for a good or service not received (except for such payments where authorized by law), any payment that does not account for credit for applicable discounts, and any payment where insufficient or lack of documentation prevents a reviewer from discerning whether a payment was proper."

Afghanistan Tax Law 2009 (Dated 18th March 2009 as amended)

Article 72. Withholding tax on contractors. " (1) Persons who, without a business license or contrary to approved by-law,[8] provide supplies, materials, construction and services under contract to government agencies, municipalities, state entities, private entities and other persons shall be subject to 7 percent fixed tax in lieu of income tax. This tax is withheld from the gross amount payable to the contractor.

(2) Persons who have a business license and provide supplies, materials, construction and services and other activities mentioned in paragraph (1) of this Article to the specified entities shall be subject to 2 percent contractor tax…"

The tax mentioned above shall be withheld by the payer from payment and shall be transferred to the relevant account within ten days. Contractors subject to this Article shall be required to, upon signing the contract, send a copy thereof to the relevant tax administration.

Afghanistan Tax Administration Law (November 2015 (27 Aqrab 1394)

Article 36: Additional tax for failure to withhold or pay withholding tax -

(1) Where a person fails to withhold or pay tax from payments subject to withholding tax, they shall be liable to pay additional tax equal to 10% of the amount of tax deducted from the payment.
(2) The liability for the amount under subsection (1) of this Article shall be borne by the person who failed to withhold or pay the tax.

Article 45: Tax offences (2) A person who, without reasonable excuse, fails to withhold or pay withholding tax as required by the tax laws shall as per the circumstances be liable upon conviction by an authorized court to a monetary penalty equal to 10% of the withholding tax collectible or to imprisonment for a term not exceeding six months, or both.

Mercy Corps' Cooperative Agreements 8 Responsibilities of the Recipient, 8.C.1 General - The Recipient shall perform its responsibilities under this agreement in coordination with the State Bureau and in a manner consistent with United States law and policy, as well as applicable laws of the countries where activities are performed.

[8] In December of 2016 Article 72 (1) was revised. The revision changed the wording in the first sentence from "Persons who, without a business license, or contrary to approved by law…" to "Persons who, without a business license, …"

Cause: Mercy Corps improperly charged cooperative agreement SPRMCO16CA1179 because it did not have sufficient internal controls in place to ensure compliance with Afghan tax law related to withholding tax. For example, Mercy Corps' policies and procedures did not include specific guidance for supervisory review to determine compliance with Afghan tax law related to withholding taxes.

Effect: The government was charged $1,326 in ineligible charges to the agreement. Mercy Corps did not comply with the terms and conditions of the cooperative agreement and did not have proper internal controls as required by 2 CFR 200.303 to provide reasonable assurance that it handled supplier withholding taxes properly. Also, there is an increased risk that Mercy Corps may be subject to payment of monetary penalties to the Afghanistan government for failure to properly withhold supplier taxes for which it may improperly charge the cooperative agreement.

Questioned Cost: $1,597 comprised of $1,326 in ineligible tax payments and $271 in associated indirect costs.

Recommendation: We recommend that Mercy Corps:

1. Revise its policies and procedures to include guidance related to applicable local tax laws, which should define all invoice costs that require Afghan tax withholding and provide for supervisory review and certification of compliance with Afghan tax withholding requirements.

2. Provide documentation to State supporting the eligibility for the supplier tax payment to the Ministry of Finance, or reimburse State $1,597 in ineligible taxes, including $271 in associated indirect costs.

Status of Prior Audit Findings and Recommendations

We reviewed one prior audit report pertaining to Mercy Corps activities in Afghanistan. The report contained nine findings and recommendations that could have a direct and material impact on the Special Purpose Financial Statement or other financial information significant to the audit objectives. We conducted follow-up procedures including discussions with management and performed testing of similar matters during our audit.

Report: SIGAR 14-19 Financial Audit, USAID's Community Development Program: Audit of Costs Incurred by Mercy Corps, issued January 13, 2014.

The report addresses expenditures charged to USAID Cooperative Agreement 306-A-00-09-00512-00 between March 10, 2009 and December 31, 2011. During our testing, we reviewed the nine findings and recommendations identified in this prior audit report and determined that one of the nine findings was repeated, and corrective action was taken for the remaining eight.

See below summary of prior audit findings, corrective action taken and the current status:

Finding Number 1 – 2013-1: Lack of Complete Documentation to Support Cash-for-Work Programs

Issue: Within the CFW Program, a total of 113 transactions, consisting of 59 program transactions totaling $59,347 and 54 subgrant transactions totaling $312,670, were statistically selected for testing. A summary of the observations noted is as follows.

<u>Observations:</u>

Contractual (program): Results of CFW transaction testing noted numerous errors including: incomplete project reports; missing or illegible CFW fingerprints or signatures, or the same individual's fingerprint was on different documents; Participant/Tools and Equipment Distribution List (PEDL) was missing or not approved; a photograph of the workgroup was not taken at the beginning of the project; incorrect wage rate was paid to CFW laborers; and no approvals of timesheets for CFW laborers.
Total Number of Transactions with Errors: 42
Amount: $11,511

Contractual (subgrant): Results of CFW transaction testing noted numerous errors including: missing project reports; missing or illegible CFW fingerprints or signatures, or the Payment Summary Report was missing or lacked approvals; Material/Refuse Tracking Form was missing; the village or location was not identified in the supporting documentation; and a photograph of the workgroup was not taken at the beginning and/or at the completion of the project.

Total Number of Transactions with Errors: 54
Amount: $312,266

Status: The results of testing during this audit did not identify any instances where Mercy Corps did not provide documentation to support Cash-for-Work Programs. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-2: Personnel Costs Claimed for Non-Program Personnel and Missing Documentation

Issue: Mercy Corps claimed personnel costs for employees that either did not work in the CDP Program, or worked partially in the CDP Program. Additionally, various records requested to support personnel and personnel-related costs were either not provided, illegible or those records that were provided did not completely support the costs claimed. In addition, Mercy Corps employees are paid based upon a pay scale and grade matrix. The exact pay grade for each employee was not reflected on any of the payroll records or in the personnel files. As such, we were unable to determine whether the rates actually paid were in accordance with the pay grade assigned. No costs were questioned as compensating controls existed in the form of management review and approval of payroll registers.

Status: The results of testing during this audit did not identify any instances where Mercy Corps claimed personnel costs for non-program personnel or personnel documentation was not provided. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-3: Missing or Insufficient Source Documentation to Support Expenses

Issue: Mercy Corps was unable to provide records, or provided insufficient records, to support transactions selected for testing within the Travel, Contractual (Subgrant) and Other Direct Costs cost categories.

Status: During our testing we found instances of insufficient support related to allocated costs for a guest house and vehicle maintenance and repair. See Finding 2019-03. As a result, we have determined that this finding will remain open.

Finding number 2013-4 – Lack of Adherence to Procurement Procedures

Issue: Mercy Corps was unable to provide records, or provided insufficient records, to support the procurement efforts as follows:

Cost Category	Observation	Number of Transactions with Errors	Amount
Contractual (program)	Missing approval on bid analysis	1	$2,314

Contractual (subgrant)	Missing quotation and/or bid analysis	6	1,425
Other direct costs	Missing procurement documentation	2	2,320
Total costs for which procurement procedures were not followed		**9**	**$6,059**

Status: The results of testing during this audit did not identify any instances of missing approvals, missing quotations, or missing procurement documentation. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-5: Need to Review the Excluded Parties List

Issue: No documentation was provided to support that Mercy Corps and SCF conducted reviews of 16 and 99 vendors, respectively, in the Excluded Parties List System (EPLS) prior to entering into vendor contracts to verify that the vendors were not suspended, debarred or otherwise excluded from receiving Federal funds.

Status: The results of testing during this audit did not identify any instances where Mercy Corps did not perform a review of the vendors in the EPLS. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-6: Lack of Segregation of Duties within Cash Disbursement Process

Issue: There is a lack of segregation of duties within the cash disbursement process. The same individual prepared, reviewed and entered the following Sub-journal Vouchers into the Sub-journal. Additionally, no documentation was provided to support that an independent review was performed on the Sub-journal.

Status: The results of testing during this audit did not identify any instances where the same individual prepared, reviewed and entered Sub-journal Vouchers into the Sub-journal. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-7: Misclassified Expenses

Issue: Mercy Corps miscoded supplies in the amount of $18,391 as contractual (program) costs, and fringe benefits in the amount of $380 as travel costs.

Status: The results of testing during this audit did not identify any instances of misclassification. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-8: Foreign Tax Reports Missing

Issue: Mercy Corps was not able to provide copies of foreign tax reports submitted for the periods October 1, 2008 to September 30, 2009 and October 1, 2010 to September 30, 2011.

Status: The results of testing during this audit did not identify any instances where Mercy Corps did not provide copies of foreign tax reports. As a result, we determined that Mercy Corps took corrective action.

Finding number 2013-9: Property Management System Lacked Approval

Issue: The property management system used by Mercy Corps for the receipt, use, maintenance, protection, custody and care of equipment, materials and supplies for which it has custodial responsibility, was not approved by either the USAID Agreement Officer or Agreement Officer's Representative.

Status: The results of testing during this audit did not identify any instances where Mercy Corps used systems without approval. As a result, we determined that Mercy Corps took corrective action.

Summary of Finding Status:

Prior Audit Finding	Comment
2013-1 Lack of Complete Documentation to Support Cash-for-Work Programs	We noted no instances during our audit
2013-2 Personnel Costs Claimed for Non-Program Personnel and Missing Documentation	We noted no instances during our audit
2013-3 Missing or Insufficient Source Documentation to Support Expenses	See Finding 2019-03
2013-4 Lack of Adherence to Procurement Procedures	We noted no instances during our audit
2013-5 Need to Review the Excluded Parties List	We noted no instances during our audit
2013-6 Lack of Segregation of Duties within Cash Disbursement Process	We noted no instances during our audit
2013-7 Misclassified Expenses	We noted no instances during our audit
2013-8 Foreign Tax Reports Missing	We noted no instances during our audit
2013-9 Property Management System Lacked Approval	We noted no instances during our audit

Appendix A – Management's Response to the Findings and Recommendations

MERCY CORPS

Thank you for the opportunity to review the draft report and provide management comments to the findings. In review of the report, multiple errors and/or updates were noticed and we ask that the report be corrected prior to the report being issued.

A. Corrections
   1. Transmittal Letter reference to Cooperative Agreement SPRMCO15CA1263 includes a typographical error. Mercy Corps has bolded and underlined the incident for Williams Adley's ease of reference and correction to remove the additional "S", SPRMCO**S**15CA1263.
   2. Special Purpose Financial Statement (page 10) presentation of ineligible questioned costs presents $1,353 of questioned costs under the Personnel Object Class Category when the finding 2019-04 relates to supplier tax withholding and should be presented under the Contractual Object Class Category.
   3. Finding 2019-01. During the second Exit Conference with Williams Adley, this finding was referenced as "Internal Control" and "Non-Compliance" with no questioned cost. Please update the reference in the Questioned Cost Classification Table and the questioned costs section of the Special Purpose Financial Statements.
   4. Finding 2019-03. The Condition section references SPRMCO14CA1122 however should also reference SPRMCO15CA1263 and SPRMCO16CA1179.
   5. Status of Prior Audit Findings and Recommendations, Summary of Finding Status table applies the language "Prior Year Finding". Please update to "Prior Audit Finding".

B. Management Comments

Finding 2019-01: Ineligible Construction and Equipment Costs

Management Response:

Mercy Corps disagrees with this finding as these costs are associated with the activities included in our programmatic description and additional approvals were not required. We note that the "Concern" section states "Equipment and construction costs were not specified as items of expenditure in the authorized direct cost budgets for these agreements" and "...there was no evidence documenting that a budget revision, which would allow for this type of expenditure, was requested or approved". We understand the intent of these sentences to mean that these expenditures were not in compliance with the budget flexibility restrictions applicable to each award. However, the "Criteria" section does not reference the budget flexibility restrictions, but instead lists requirements to obtain prior approval to incur specific types of expense. We also note that the "Cause" section incorrectly states "Mercy Corps claims it was not required to seek written approvals for budget changes, including equipment and construction costs, so long as they did not exceed 10% of the total budget." This claim was made in relation

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to initial concern raised by Williams Adley that these expenditures were not in compliance with the budget flexibility restrictions for the applicable award. Mercy Corps is well aware that purchases of equipment and capital expenditures require individual prior approval under 2 CFR 200.439. Please see our response below on why we believe 2 CFR 200.439 does not apply to these expenditures.

Applicability of 2 CFR 200.439 to Construction Expenditures. Mercy Corps does not agree that 2 CFR 200.439 is applicable to the $17,552 in construction expenditures. The $17,552 represents construction costs related to improvements to multiple community vocational facilities and construction of community athletic fields/playgrounds as incorporated in the programmatic description components of the respective cooperative agreements. These facilities are owned by the relevant community/vocational training center/education ministry. Mercy Corps disagrees that these expenditures represent "capital expenditures" under 2 CFR 200.439 because Mercy Corps did not purchase or hold title to the facilities. 2 CFR 200.13 defines capital expenditures as "expenditures to **acquire** capital assets" (emphasis added). It also states capital expenditures also include improvements to existing capital assets that "materially increase their value or useful life". We understand this to mean improvements to existing capital assets that the recipient owns, and does not refer to improvements to capital assets owned directly or indirectly by the intended program beneficiaries. Even if the definition of capital expenditures is extended to capital assets that are not owned by the recipient, Mercy Corps does not believe that these construction costs meet the definition of material, as construction expenditures for each individual facility does not exceed $5,000. Mercy Corps believes that $5,000 represents a reasonable amount for considering a capital asset to be "material" in this context based on the USG's use of $5,000 unit cost to define equipment in 2 CFR 200.33, and both equipment and capital expenditures being addressed in 2 CFR 200.439.

Applicability of 2 CFR 200.439 to Vehicle Depreciation Costs and Vehicle Rental Costs. Mercy Corps does not agree that 2 CFR 200.439 is applicable to the $1,578 in expenditures under SPRMCO14CA2019. This amount represents $1,528 of vehicle depreciation expense, related to a vehicle purchased with Mercy Corps' private funds but which was used on this program. The applicable select item of cost for depreciation expense is 2 CFR 200.436 Depreciation. In addition, this amount includes $49 in taxi fees. While we acknowledge that this expense should have been classified as Travel, classifying these expenditures under the object class category "Equipment" does not mean the actual expense represents the purchase of equipment and is subject to the prior approval requirement in 200.439. Please note, the expenditure class categories used in the Special Purpose Financial Statements come from SF 424A and do not correlate to the "Selected Items of Cost" in 2 CFR 200 Subpart E.

Application of Award Section 15(b) per the "Cause" Section of this Finding. Williams Adley originally stated to Mercy Corps that they believe these costs to be unallowable because Mercy Corps did not budget for the construction under the "Construction" cost category in budget for the applicable award. Mercy Corps was referencing Section 15(b) in the context of allowable budget flexibility. Specifically we were referring to "The transfer of funds among direct cost categories or programs, functions and activities for which the cumulative amount of such transfers exceeds or is expected to exceed 10 percent of the total approved budget (see 2 CFR 200.308(e)) requires prior approval by the GO by way of amendment." Mercy Corps was within the allowed budget flexibility when it transferred these amounts to the "Construction" direct cost category. Please note, the prior approval requirement for equipment or capital assets in 2 CFR 200.439 (and as reiterated in 200.308(c)(1)(iv)) means that prior approval is required to purchase equipment or incur capital expenditures. It is separate and excluded from overall budget flexibility, which is addressed in 200.308(e).

To provide additional context regarding construction activities and prior approval requirements. Awards SPRMCO15CA1263 and SPRMCO17CA2019 do not include a specific requirement that construction activities must be approved (although, like any other cost, they must be for activities that are within the scope of the program). In addition, the awards do not include a requirement for approval to transfer funds to/from the construction budget category. As there is not a specific requirement to approve transfers to/from the construction budget line, the standard budget flexibility restriction (that transfers between direct cost categories require approval if they exceed 10% of the total budget amount) would apply to this transfer.

As recommended, Mercy Corps will coordinate with the awarding donor DOS BPRM to address the allowability of these costs.

Finding 2019-02: Ineligible Entertainment Cost

Management Response:

Mercy Corps disagrees with this finding and understands the cost in question is allowable as provisioned and defined under 2 CFR 200.437 and further supported by Mercy Corps team member policy resources (team member handbooks, code of conduct, anti-harassment policy, continued professional development, etc.). Specifically, Mercy Corps views this cost as directly related to the improvement of employer-employee relations and team member health (morale and well-being). To address the reference to Iftar, Mercy Corps selected this time to engage as a team which is usual and customary in Afghanistan prior to the end of Ramadan and the upcoming Eid al-Fitr break.

Pursuant to 2 CFR 200.437 (bold added for emphasis).

200.437 Employee health and welfare costs.

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(a) Costs incurred in accordance with the non-Federal entity's documented policies for the improvement of working conditions, employer-employee relations, employee health, and employee performance are allowable.

(b) Such costs will be equitably apportioned to all activities of the non-Federal entity. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably sent to employee welfare organizations.

(c) Losses resulting from operating food services are allowable only if the non-Federal entity's objective is to operate such services on a break-even basis. Losses sustained because of operating objectives other than the above are allowable only:

(1) Where the non-Federal entity can demonstrate unusual circumstances; and

(2) With the approval of the cognizant agency for indirect costs.

As recommended, Mercy Corps will coordinate with the awarding donor DOS BPRM to address the allowability of this cost.

Finding 2019-03: Unsupported Allocated Costs

Management Response:

Mercy Corps disagrees with this finding as described in detail below. For each transaction selection, Mercy Corps is able to provide the original transaction, the basis of allocation, and the supporting documentation for the basis of allocation per our Cost Allocation Framework.

Cause. Mercy Corps disagrees with the assertion "Mercy Corps' cost allocation method does not require maintenance of documentation which would demonstrate costs are allocated based on the proportional benefit to the cooperative agreements". Mercy Corps' cost allocation methodology distributes costs that benefit more than one program "... in reasonable proportion to the benefits received…" as was required by A-122, Attachment A. The basis for determining the allocation in reasonable proportion to the benefits received is documented for the costs in question, and maintenance of this documentation is required under our cost allocation policy. Please note, while OMB Circular A-122 was the applicable set of cost principles for the cooperative agreement SPRMCO14CA1122 and 2 CFR 200 Subpart E for Cooperative Agreements SPRMCO15CA1263 and SPRMCO16CA1179, 2 CFR 200 Subpart E subsequently clarified in 200.405(d) that "If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then, notwithstanding paragraph (c) of this section, **the costs may be allocated or transferred to benefitted projects on any reasonable documented basis"** (emphasis added). Additionally, each transaction is supported by the original payment transaction, the basis of allocation and the supporting documentation for the basis of allocation.

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Effect. Mercy Corps disagrees with the assertion "Insufficient documentation of allocated costs diminishes the federal government's ability to rely on Mercy Corps' allocation methodology for proper assignment of costs to federal awards." We assume the basis for this assertion is OMB Circular A-122, as cited in the Criteria section. Circular A-122 (codified as 2 CFR 230) was superseded in 2014 by 2 CFR 200, Subpart E. As cited above, 200.405(d) clarified that costs benefiting two or more programs can be allocated on "any reasonable documented basis". Mercy Corps' Cost Allocation methodology provides reasonable bases for the allocation of costs and the applicable basis of allocation for a particular cost is documented.

As recommended, Mercy Corps will address the allowability of costs by providing supporting documentation for the basis of allocation to the awarding donor DOS BPRM.

Finding 2019-04: Failure to Withhold Supplier Taxes and Ineligible Payment

Management Response

Mercy Corps partially agrees with this finding. Mercy Corps accepts and agrees that quotation presentation provided by the supplier led to the incorrect amount being included in the contract. The supplier had presented the 2% tax withholding as an additional line item on the quoted amount of $66,317 rather than a deduction, for a total quote of $67,643. As detailed below, this presentation led to a price difference of $1,326.

Quote	**USD**
Price	66,317
2% tax	1,326
Total	67,643
Contract Amount	
Price	67,643
2% tax withholding	(1,353)
Variance in Price	**1,326**

Mercy Corps withheld and remitted the appropriate tax to the proper authorities per the terms of the contract. Mercy Corps identified this error as an outlier and believes our policies and procedures adequately capture the internal control process for approval and financial review as well as compliance with withholding and remittances to local tax authorities.

Mercy Corps asks that this finding be updated to reflect $1,326 as the questioned costs as it is the amount that has been mischarged to the award. The amount of $1,353 represents that amount withheld and should evidence that Mercy Corps has withheld supplier taxes per the terms of the contract. As recommended, Mercy Corps will reimburse DOS BPRM direct costs of $1,326 plus associated indirect costs.

Finding number 2013-3: Missing or Insufficient Source Documentation to Support Expenses (Prior Audit)

Management Response:

Mercy Corps disagrees with this finding. Please refer to our Management Response under Finding 2019-03.

Appendix B – Auditor's Response to Management Comments

Williams, Adley & Company-DC, LLP (Williams Adley or auditor) has reviewed the letter submitted June 28, 2020, containing Mercy Corps' (or auditee) responses to the draft audit report. In consideration of those views, we have included below our rebuttal to certain matters presented by the auditee regarding Findings 2019-01, 2019-02, 2019-03, and 2019-04. Based on review of Mercy Corps' comments, Williams Adley made the following revisions to the report:

- Finding 2019-01 - Added 2 CFR § 200.439 (b)(3) to the "Criteria" section.
- Finding 2019-04 - Deleted the questioned cost amount related to taxi fees, $49 plus $10 in related indirect costs, for a total of $59.

Williams Adley also made the following corrections to the report as requested by Mercy Corps:

- **General** - corrected cooperative agreement number SPRMCOS15CA1263 to read SPRMCO15CA1263 throughout the report.
- **Special Purpose Financial Statement** - revised presentation of ineligible questioned costs by moving $1,353 from Personnel Object Class Category to Contractual Object Class Category based on questioned cost related to Finding 2019-4.
- **Finding 2019-03** - revised language to add references to cooperative agreement numbers SPRMCO15CA1263 and SPRMCO16CA1179.
- **Finding 2019-04** - revised the questioned cost amount from $1,353 to $1,326 and the related indirect cost amount from $277 to $271, which resulted in a reduction of the total questioned cost from $1,630 to $1,597.
- **Status of Prior Audit Findings and Recommendations** – corrected column heading "Prior Year Finding" in Summary of Finding Status table to read "Prior Audit Finding".

Williams Adley did not make corrections to the report as anticipated by Mercy Corps for Finding 2019-01. The unapproved construction costs discussed in Finding 2019-01 were initially the subject of more than one preliminary finding. When drafting the report, we determined it was appropriate to question the costs associated with the construction charges.

Finding 2019-01

Mercy Corps disagrees with this finding and argues that 2 CFR 200.439 does not apply to the expenditures in question. Mercy Corps states, "The $17,552 represents construction costs related to improvements to multiple community vocational facilities and construction of community athletic fields/playgrounds…" and points out that the facilities were owned by the community and education ministry, not Mercy Corps. Further, the auditee states that "…these costs are associated with the activities included in our programmatic description and additional approvals were not required".

Williams Adley refutes Mercy Corps' interpretation that 2 CFR 200.439 only applies to "…improvements to existing capital assets that the recipient owns and does not refer to improvements to capital assets owned directly or indirectly by the intended program beneficiaries." Williams Adley argues that the auditee does not have a clear understanding of the key terms and requirements in the regulation and cites the following definitions from 2 CFR 200 as support:

(1) Capital Expenditures – definition

> *2 CFR 200.13 says capital expenditures are "expenditures[9] to acquire capital assets or expenditures[9] to make additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations, or alterations to capital assets that materially increase their value or useful life."*
>
> By Mercy Corps' own words, the $17,552 cost was for "construction costs related to improvements" and the definition of capital expenditures clearly includes charges made by a non-federal entity for a project or program related to improvements to capital assets.
>
> *2 CFR 200.12 says capital assets are "tangible or intangible assets used in operations having a useful life of more than one year which are capitalized in accordance with GAAP. Capital assets include:*
>
> *a) Land, buildings (facilities), equipment, and intellectual property (including software) whether acquired by purchase, construction, manufacture, lease-purchase, exchange, or through capital leases; and*
>
> *b) Additions, improvements, modifications, replacements, rearrangements, reinstallations, renovations or alterations to capital assets that materially increase their value or useful life (not ordinary repairs and maintenance)."*

This definition of capital assets does not specify who must own the capital asset (recipient or beneficiary).

(2) Prior Written Approval - requirement

> *2 CFR 200.439 (b)(3) says "Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior written approval of the Federal awarding agency, or pass-through entity."*

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[9] 2 CFR 200.34, Expenditures: "means charges made by a non-federal entity to a project or program for which a Federal award was received…"

This definition clearly states that capital expenditures for "improvements" require prior written approval.

(3) Material Increase – definition

Mercy Corps stated that "Even if the definition of capital expenditures is extended to capital assets that are not owned by the recipient, Mercy Corps does not believe that these construction costs meet the definition of material, as construction expenditures for each individual facility do not exceed $5,000." Mercy Corps believes that $5,000 should be the threshold for materiality, since it is the unit cost used to define equipment in 2 CFR 200.33, but did not justify this rationalization. There is no actual definition of "material" in 2 CFR 200.

In summary, Mercy Corps did not substantiate its claim that 2 CFR 200.439 does not apply to the construction expenditures, therefore the finding and recommendations related to construction costs remain unchanged.

Mercy Corps stated that they misclassified vehicle depreciation expense as equipment costs. Mercy Corps explained that it did not purchase the vehicle for the program but instead owned the vehicle and used it for programmatic purposes. The $1,529 charge was for depreciation of the vehicle and not for an expenditure to acquire an asset. Williams Adley acknowledges that Mercy Corps was not required to obtain prior written approval to charge depreciation expense to the cooperative agreement. However, Mercy Corps did not provide the auditor with documentation to support the costs charged to vehicle depreciation, as required by 2 CFR 200.436 (e) Depreciation, which states that "charges for depreciation must be supported by adequate property records, and physical inventories must be taken at least once every two years to ensure that the assets exist and are usable, used, and needed. Statistical sampling techniques may be used in taking these inventories. In addition, adequate depreciation records showing the amount of depreciation taken each period must also be maintained." As such, the questioned cost amount of $1,529 plus related indirect costs of $313, for a total of $1,842, remains unchanged.

Williams Adley agrees to remove the questioned cost related to taxi fees, $49 plus indirect costs of $10 for a total of $59, because federal regulations do not require documentation to support costs of $75 or less.

Finding 2019-02
Mercy Corps disagrees with this finding and understands that the cost in question is allowable as provisioned and defined under 2 CFR 200.437 and further supported by Mercy Corps' team member policy resources (team member handbooks, code of conduct, anti-harassment policy, continued professional development, etc.). Mercy Corps views the cost as directly related to the improvement of employer-employee relations and team member health (morale and well-being).

Williams Adley maintains that 2 CFR 200.437 should not be used to justify the allowability of the Iftar party because this CFR does not include specific language related to employee morale. 2 CFR 200.437 – *Employee health and welfare costs*, as quoted by Mercy Corps in its response, relates to the improvement of working conditions, employer-employee relations, employee health, and employee performance. Williams Adley affirms that while the Iftar party may have contributed to employee morale, the event was a dinner party that represents a social activity in accordance with 2 CFR 200.438 - *Entertainment costs*, which are unallowable except where specific costs have a programmatic purpose and are authorized either in the approved budget for the Federal award or with prior written approval of the Federal awarding agency. The auditor was not provided with documentation to support that the Iftar party had a programmatic purpose, and nothing in Mercy Corps' response changes the fact that the auditee's budget did not contain approval for such entertainment and prior written approval was not obtained from State PRM. As such, the finding and recommendations remain unchanged.

Finding 2019-03

Mercy Corps disagrees with this finding and asserts that for each transaction selected for audit Mercy Corps was able to provide the original transaction, the basis of allocation, and the supporting documentation for the basis of allocation per its Cost Allocation Framework. Mercy Corps also disagrees with the auditor's statement that Mercy Corps' cost allocation method does not require maintenance of documentation which would demonstrate that costs are allocated based on the proportional benefit to the cooperative agreements.

While Williams Adley acknowledges the explanations provided in Mercy Corps' response, sufficient audit evidence related to the original transactions was not presented to the auditor to link the allocated costs in question to assets that were used specifically for the award and/or that supported the objectives of the program. As such, the finding and recommendations remain unchanged.

Finding 2019-04

Mercy Corps partially agrees with this finding and accepts that it overcharged cooperative agreement SPRMCO16CA1179 for supplier taxes. Mercy Corps accurately states and supports that the amount of taxes in question was misquoted by the supplier which led to an incorrect amount having been overcharged to the agreement.

Williams Adley revised the questioned cost from $1,353 to $1,326, and the related indirect cost from $277 to $271, which resulted in a $33 reduction in the total questioned cost from $1,630 to $1,597; please refer to corresponding revisions throughout the report. All other portions of the finding and recommendations remain unchanged. Williams Adley acknowledges Mercy Corps' statement that it will reimburse DOS BPRM (State PRM) direct costs of $1,326 plus associated indirect costs.

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