

SIGAR

**Special Inspector General for
Afghanistan Reconstruction**

SIGAR 15-43 Financial Audit

Department of the Army's Legacy East Project: Jorge Scientific Corporation's Lack of Supporting Documentation Results in about \$135 Million in Questionable Project Costs

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



APRIL
2015

SIGAR

Special Inspector General for Afghanistan Reconstruction

WHAT THE AUDIT REVIEWED

On October 21, 2011, the Army Contracting Command awarded a \$50 million contract to Jorge Scientific Corporation (Jorge Scientific)—now reorganized and rebranded under Imperatis Corporation—to implement the Legacy East project. The purpose of the project was to provide highly specialized counterinsurgency intelligence experts to mentor and train Afghan National Security Forces. The project also provided for hiring bilingual cultural advisors and developing Afghanistan-specific instruction in counterinsurgency operations to strengthen Afghanistan's capacity to combat terrorist and insurgent networks. After subsequent modifications, the total estimated cost of the contract was increased to \$191,135,945, though the actual contract expenditures were approximately \$15 million less than that estimated cost.

SIGAR's financial audit, performed by Crowe Horwath LLP (Crowe Horwath) reviewed \$175,873,361 in expenditures charged to the contract from October 21, 2011, through March 15, 2014. The objectives of the audit were to (1) identify and report on significant deficiencies or material weaknesses in Jorge Scientific's internal controls related to the contract; (2) identify and report on instances of material noncompliance with the terms of the contract and applicable laws and regulations, including any potential fraud or abuse; (3) determine and report on whether Jorge Scientific has taken corrective action on prior findings and recommendations; and (4) express an opinion on the fair presentation of Jorge Scientific's Special Purpose Financial Statement. See Crowe Horwath's report for the precise audit objectives.

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

April 2015

Department of the Army's Legacy East Project: Jorge Scientific Corporation's Lack of Supporting Documentation Results in about \$135 Million in Questionable Project Costs

SIGAR 15-43-FA

WHAT THE AUDIT FOUND

Crowe Horwath LLP (Crowe Horwath) identified two material weaknesses, one significant deficiency, and three instances of noncompliance with the terms and conditions of the contract. Jorge Scientific Corporation (Jorge Scientific) did not retain sufficient supporting documentation for a subcontractor's costs; as a result, the auditors were not able to determine if the costs claimed were incurred, allocable, and complied with the appropriate cost principles. Jorge Scientific also did not comply with federal procurement policies. Specifically, Jorge Scientific did not provide support for a competitive procurement process for three subcontracts totaling almost \$5 million. As a result, Jorge Scientific could not demonstrate that these costs were reasonable, and the U.S. government may not have obtained the best value for goods and services procured. Additionally, Jorge Scientific improperly billed the U.S. government for fixed fees beyond the amount authorized by the contract. Although Jorge Scientific returned the excess fees it collected, the U.S. government lost \$36,634 in interest.

As a result of these internal control deficiencies and instances of noncompliance, Crowe Horwath identified \$134,552,665 in total questioned costs, all of it consisting of unsupported costs—costs not supported with adequate documentation or that did not have required prior approval. Crowe Horwath did not identify any ineligible costs—costs prohibited by the contract, applicable laws, or regulations. The auditors also determined that the U.S. government lost \$36,634 in interest because Jorge Scientific billed for more funds than required.

Category	Ineligible	Unsupported	Total Questioned Costs
Subcontractors	\$0	\$129,707,328	\$129,707,328
Other Direct Costs	\$0	\$4,845,337	\$4,845,337
Totals	\$0	\$134,552,665	\$134,552,665

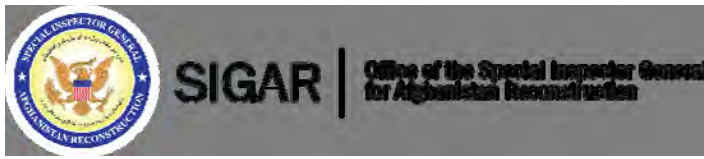
Crowe Horwath did not identify any prior reviews or assessments that could have a material effect on the Special Purpose Financial Statement.

Crowe Horwath issued a disclaimer of opinion on Jorge Scientific's Special Purpose Financial Statement because Jorge Scientific could not provide sufficient documentation supporting a subcontractor's incurred costs.

WHAT SIGAR RECOMMENDS

For the entire scope of this audit, Jorge Scientific was the contractor. In 2013, Jorge Scientific was reorganized and rebranded under Imperatis Corporation (Imperatis). As a result, our recommendations refer to Imperatis, which is now responsible and accountable for addressing any findings related to Jorge Scientific's work. Based on the results of the audit, SIGAR recommends that the Army Contracting Command:

1. Determine the allowability of and recover, as appropriate, \$134,552,665 in questioned costs identified in the report.
2. Collect \$36,634 in unremitted interest from Imperatis.
3. Advise Imperatis to address the report's three internal control findings.
4. Advise Imperatis to address the report's three noncompliance findings.



April 21, 2015

Department of Defense Commands

We contracted with Crowe Horwath LLP (Crowe Horwath) to audit the costs incurred by Jorge Scientific Corporation (Jorge Scientific) under an Army Contracting Command contract to implement the Legacy East project.¹ Crowe Horwath's audit covered \$175,873,361 in expenditures charged to the contract from October 21, 2011, through March 15, 2014. Our contract required that the audit be performed in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States.

For the entire scope of this audit scope, Jorge Scientific was the contractor. In 2013, Jorge Scientific was reorganized and rebranded under Imperatis Corporation (Imperatis). As a result, our recommendations refer to Imperatis, which is now responsible and accountable for addressing any findings related to Jorge Scientific's work. Based on the results of the audit, SIGAR recommends that the Army Contracting Command:

- 1. Determine the allowability of and recover, as appropriate, \$134,552,665 in questioned costs identified in the report.**
- 2. Collect \$36,634 in unremitted interest from Imperatis.**
- 3. Advise Imperatis to address the report's three internal control findings.**
- 4. Advise Imperatis to address the report's three noncompliance findings.**

The results of Crowe Horwath's audit are further detailed in the attached report.² We reviewed Crowe Horwath's report and related documentation. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on Jorge Scientific's Special Purpose Financial Statement. We also express no opinion on the effectiveness of Jorge Scientific's internal control or compliance with the contract, laws, and regulations. Crowe Horwath is responsible for the attached auditor's report and the conclusions expressed in the report. However, our review disclosed no instances where Crowe Horwath did not comply, in all material respects, with generally accepted government auditing standards issued by the Comptroller General of the United States.

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

A handwritten signature in black ink, appearing to read "John F. Sopko".

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

(F-039)

¹ The Army Contracting Command awarded contract number W911QX-12-C-0011 to Jorge Scientific Corporation to implement the Legacy East project, which sought to provide highly specialized counterinsurgency intelligence experts to mentor and train the Afghan National Security Forces.

² Crowe Horwath's audit report refers solely to Imperatis, which was the responsible entity on March 15, 2014, the end of the review period.

DEPARTMENT OF DEFENSE COMMANDS

The Honorable Ashton B. Carter
Secretary of Defense

General Lloyd J. Austin III
Commander, U.S. Central Command

General John F. Campbell
Commander, U.S. Forces–Afghanistan and
Commander, Resolute Support

General Dennis L. Via
Commanding General, U.S. Army Materiel Command

Major General Theodore C. Harrison
Commanding General, U.S. Army Contracting Command



Imperatis Corporation
Special Purpose Financial Statement
Legacy East Program
For the Period October 21, 2011 through March 15, 2014
(With Independent Auditor's Report Thereon)

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Transmittal Letter

March 10, 2015

To Joe Kuhlman, Senior Vice President & Chief Financial Officer
Imperatis Corporation
2331 Crystal Drive, Suite 1114
Arlington, VA 22202

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

We appreciate the opportunity to provide to you our draft report regarding the procedures that we have conducted during the course of our audit of Imperatis Corporation ("Imperatis") contract with the United States Department of Defense ("DOD") funding the contract W911QX-12-C-0011 ("Legacy East Project").

Within the pages that follow, we have provided a brief summary of the work performed. Following the summary, we have incorporated our report on the Special Purpose Financial Statement, report on internal control, and report on compliance. Accordingly, we do not express an opinion on the summary and any information preceding our reports.

When preparing our report, we considered comments, feedback, and interpretations provided by Imperatis, the Office of the Special Inspector General for Afghanistan Reconstruction, and DOD both in writing and orally throughout the audit planning, fieldwork, and reporting phases. Management's final written response to audit findings will be incorporated into the final report as **Appendix A**.

Thank you for providing us the opportunity to work with you and to conduct the financial audit of Imperatis' Legacy East project.

Sincerely,

A handwritten signature in black ink, appearing to read "Bert Nuehring".

Bert Nuehring, CPA, Partner
Crowe Horwath LLP



www.crowehorwath.com

Summary

Background

The Imperatis Corporation entered into a contract with the United States Department of Defense (“DOD”). Under the Legacy East Project (“Legacy E”), Imperatis provided highly specialized counterinsurgency intelligence experts to mentor and train Afghan security forces, allowing them to conduct successful human intelligence operations against terrorist and insurgent networks in support of United States Forces – Afghanistan. This included the development of unique source handling doctrine and Programs of Instruction adapted to the Afghanistan environment, as well as the fielding of bilingual Accredited Cultural Advisors.

The contract– W911QX-12-C-0011 – incorporated an initial ceiling price of \$49,979,715 and a period of performance beginning October 21, 2011. Through subsequent modifications to the contract, the final completion date was established as March 15, 2014, with an obligated amount of \$191,135,945. Total costs incurred under the program amounted to \$175,873,361.

Throughout the period of performance work was conducted in various regions of Afghanistan. Imperatis worked with DOD and various contractors to deliver the requested project scope.

Work Performed

Crowe Horwath LLP (“Crowe”) was engaged by the Office of the Special Inspector General for Afghanistan Reconstruction (“SIGAR”) to conduct a financial audit of Imperatis’ Legacy East Special Purpose Financial Statement (“SPFS”) for the period October 21, 2011 through March 15, 2014.

Objectives Defined by SIGAR

The following audit objectives were defined by the Special Inspector General for Afghanistan Reconstruction and incorporated within the *Performance Work Statement for Financial Audits of Costs Incurred by Organizations Contracted by the U.S. Government for Reconstruction Activities in Afghanistan*:

Audit Objective 1 – Special Purpose Financial Statement

Express an opinion on whether the contractor’s Special Purpose Financial Statement for the contract presents fairly, in all material respects, revenues received, costs incurred, items directly procured by the U.S. Government and balance for the period audited in conformity with the terms of the contract and generally accepted accounting principles or other comprehensive basis of accounting.

Audit Objective 2 – Internal Controls

Evaluate and obtain a sufficient understanding of Contractor’s internal control related to the contract; assess control risk; and identify and report on significant deficiencies including material internal control weaknesses.

Audit Objective 3 – Compliance

Perform tests to determine whether the Contractor complied, in all material respects, with the contract requirements and applicable laws and regulations; and identify and report on instances of material noncompliance with the terms of the contract 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 the Contractor has taken adequate corrective action to address findings and recommendations from previous engagements that could have a material effect on the Special Purpose Financial Statement (SPFS).

Scope

The scope of the audit included the period October 21, 2011 through March 15, 2014, for the Legacy East project. The audit was limited to those matters and procedures pertinent to the contract that could have a direct and material effect on the SPFS and evaluation of the presentation, content, and underlying records of the SPFS. The audit included reviewing the financial records that support the SPFS to determine if there were material misstatements and if the SPFS was presented in the format required by SIGAR. In addition, the following areas were determined to be direct and material and, as a result, were included within the audit program for detailed evaluation:

- Allowable Activities;
- Allowable Costs;
- Cash Management;
- Equipment and Real Property Management;
- Period of Availability of Federal Funds;
- Procurement;
- Reporting.

Methodology

To meet the aforementioned objectives, Crowe completed a series of tests and procedures to audit the SPFS, tested compliance and considered the auditee's internal controls over compliance and financial reporting, and determined if adequate corrective action was taken in response to prior audit findings.

With regard to Audit Objective 1 pertaining to the SPFS, transactions were selected from the financial records underlying the SPFS and the transactions were tested to determine if the transactions were recorded in accordance with the basis of accounting identified by Imperatis; were incurred within the period covered by the SPFS and in alignment with specified cutoff dates; were charged to the appropriate accounts; and were adequately supported.

For purposes of meeting Audit Objective 2 regarding internal control, Crowe requested that the auditee provide copies of policies and procedures and verbally communicate those procedures that do not exist in written format to provide Crowe with an understanding of the system of internal control established by Imperatis. The system of internal control is intended to provide reasonable assurance of achieving reliable financial and performance reporting and compliance with applicable laws and regulations. Crowe corroborated internal controls identified by the auditee and conducted testing of select key controls to understand if they were implemented as designed.

Audit Objective 3 requires that tests be performed to obtain an understanding of the auditee's compliance with requirements applicable to the contract. Crowe identified – through review and evaluation of the contract executed by and between Imperatis and DOD, the Federal Acquisition Regulations (“FAR”), and applicable circulars issued by the United States Office of Management and Budget (“OMB”) – the criteria against which to test the SPFS and supporting financial records and documentation to determine compliance and to assess the allowability of costs. Using sampling techniques, Crowe reviewed expenditures, vouchers submitted to DOD, procurements, cash disbursements, and project reports for audit. Supporting documentation was requested from the auditee to access compliance. Testing indirect costs was limited to determining whether indirect costs were calculated and charged to the U.S. Government in accordance with the interim indirect cost rate associated restrictions and limitations, and whether costs were treated consistently as direct or indirect charges.

To determine whether there was audit, monitoring, assessment, or other reports completed and that required corrective action as per Audit Objective 4, Crowe inquired of both Imperatis and DOD regarding the existence of such reports. No reports were identified and, therefore, no follow-up was necessary.

Summary of Results

Crowe issued a disclaimer of opinion on the SPFS because we were unable to obtain sufficient documentation supporting subcontractor costs incurred. The basis for Crowe's disclaimer of opinion appears within the *Independent Auditor's Report on the Special Purpose Financial Statement*.

Upon completion of Crowe's procedures, Crowe identified three findings because they met one or more of the following criteria: (1) significant deficiency in internal control, (2) material weakness in internal control, (3) deficiency that resulted in questioned costs, and/or (4) noncompliance with rules, laws, regulations, or the terms and conditions of the contract.

Crowe also reported on both Imperatis' compliance with the applicable laws, rules, regulations, and the terms and conditions of the contract and the internal controls over compliance. Three deficiencies in internal control and three instances of noncompliance were reported. Where internal control and compliance findings pertained to the same matter, they were consolidated within a single finding. A total of \$134,552,665 in costs was questioned as presented in **TABLE A**. In addition to the questioned costs noted in TABLE A, there is \$36,634 in imputed interest due to the federal government.

Crowe conducted searches of publicly available information to locate prior audits, reviews, and evaluations pertinent to Imperatis financial performance under the contract. In addition, Crowe inquired of both DOD and Imperatis regarding whether or not such work had been performed. Based on the results of Crowe's searches and, per communications with Imperatis and Army Contracting Command there were no audits or other reviews or assessments conducted in relation to the Legacy East program.

This summary is intended to present an overview of the results of procedures completed for the purposes described herein and is not intended to be a representation of the audit's results in their entirety.

TABLE A: Summary of Findings and Questioned Costs

Finding Number	Matter	Questioned Costs	Cumulative Questioned Costs
2014-01	Unallowable Costs: Inadequate Supporting Documentation	\$129,707,328	\$129,707,328
2014-02	Lack of competitive procurement.	\$4,845,337	\$134,552,665
2014-03	Imputed Interest due the Federal Government for excess cash	\$0	\$134,552,665
Total Unique Questioned Costs			\$134,552,665

Summary of Management Comments

Imperatis disagrees with the findings noted in this report. Imperatis disagrees with finding 2014-01 asserting that the time to respond with supporting documentation was not adequate. For finding 2014-02, Imperatis disagrees with the finding on the basis that Imperatis acted in accordance with guidelines provided by the contracting officer when selecting vendors under this contract. Imperatis does not agree with finding 2014-03 stating that the contract was never overspent and the amount over drawn was returned to the federal government.

Crowe has responded to Imperatis' management comments and that response is included at **Appendix B**.

References to the Appendix

Appendix A contains the Views of Responsible Officials, which are management's responses to the findings presented within the report.

Appendix B contains Crowes response to the Management Comments in regard to the findings noted in the report.

INDEPENDENT AUDITOR'S REPORT ON THE SPECIAL PURPOSE FINANCIAL STATEMENT

To Joe Kuhlman, Senior Vice President & Chief Financial Officer
Imperatis Corporation
2331 Crystal Drive, Suite 1114
Arlington, VA 22202

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

Report on the Special Purpose Financial Statement

We were engaged to audit the Special Purpose Financial Statement ("the Financial Statement") of Imperatis Corporation, ("Imperatis"), and related notes to the Statement, for the period October 21, 2011 through March 15, 2014, with respect to the Legacy East Program funded by contract W911QX-12-C-0011.

Management's Responsibility for the Special Purpose Financial Statement

Management is responsible for the preparation and fair presentation of the Financial Statement in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction ("SIGAR") in Appendix V of Solicitation 14-233-SOL-00148 ("the Contract"). Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of a Financial Statement that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the Special Purpose Financial Statement based on conducting the audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

We were unable to obtain sufficient appropriate audit evidence to determine if costs incurred were adequately supported and thus allowable to the project. Specifically, we were unable to obtain sufficient documentation supporting subcontractor costs incurred and billed to Imperatis. Therefore, we could not determine if the costs presented on the Statement were used to meet the project objectives, if the contract requirements were met, and the full extent of any associated errors. As a result, we could not form an opinion on the Special Purpose Financial Statement.

In addition, we were unable to obtain sufficient appropriate audit evidence to determine the reasonableness of procurements made under the contract. Accordingly, a qualified opinion on the Statement would have been issued based on this item if sufficient appropriate evidence relative to subcontractor costs incurred and billed to Imperatis had been received.

Disclaimer of Opinion on the Special Purpose Financial Statement

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

Basis of Presentation

We draw attention to Note 1 to the Statement, which describes the basis of presentation. The Financial Statement was prepared by Imperatis, in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction in Appendix V of the Contract and presents those expenditures as permitted under the terms of contract number W911QX-12-C-0011, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to comply with the financial reporting provisions of the Contract referred to above.

Restriction on Use

This report is intended for the information of Imperatis, the United States Department of Defense, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.

Report on Other Legal and Regulatory Requirements

In accordance with *Government Auditing Standards*, we have also issued reports dated November 5, 2014, on our consideration of Imperatis' internal controls over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Imperatis internal control over financial reporting and compliance.



Crowe Horwath LLP

November 5, 2014
Washington, D.C.

Imperatis Corporation
Special Purpose Financial Statement
W911QX-12-C-0011
For the Period October 21, 2011 through March 15, 2014

	Actual	Questioned Costs		Notes
		Ineligible	Unsupported	
Revenues				
W911QX-12-C-0011	\$ 175,873,361			
Total Revenue	\$ 175,873,361			
Costs Incurred				
Off-Site Dir Labor (Company Site)	\$ 159,480			
On-Site Dir Labor (Customer Site)	\$ 25,585			
Company Site Direct Labor	\$ 1,343,671			
Govt Site Direct Labor	\$ 4,435,989			
Subcontractors	\$ 129,805,008		\$ 129,707,328	A
Travel	\$ 653,716			
ODC (including consultants & training)	\$ 19,530,130		\$4,845,337	B
Total Direct Cost	\$ 155,953,579			
Fringe Benefits	\$			
Off-Site Overhead (Company Site)	\$			
On-Site Overhead (Customer Site)	\$			
Company Site Overhead	\$			
Govt Site Overhead	\$			
Materials & Handling	\$			
General & Administrative Cost	\$			
Total Indirect Cost	\$ 10,654,682			
Total Costs Incurred	\$ 166,608,261			
Fixed Fee	\$ 9,265,100			
Total	\$ 175,873,361		\$ 134,552,665	

The accompanying notes to the Special Purpose Financial Statement are an integral part of this Statement.

Imperatis Corporation¹
Notes to the Special Purpose Financial Statement
For the Period October 21, 2011 through March 15, 2014

Note 1. Basis of Presentation

The accompanying Special Purpose Financial Statement (the "Statement") includes costs incurred under Contract Number W911QX-12-C-0011 for the Legacy East Contract for the period October 21, 2011 through March 15, 2014. Because the Statement presents only a selected portion of the operations of Imperatis Corporation, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Imperatis Corporation. The information in this Statement is presented in accordance with the requirements specified by the Office of the Special Inspector General for Afghanistan Reconstruction ("SIGAR") and is specific to the aforementioned Federal contract. Therefore, some amounts presented in this Statement may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Note 2. Basis of Accounting

Expenditures reported on the Statement are reported in accordance with Generally Accepted Accounting Principles (GAAP) and, therefore, are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in FAR Part 31, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

Note 3. Revenues

Revenues on the Statement represent the amount of funds to which Imperatis Corporation was entitled to receive from the U.S. Government for allowable, eligible costs incurred under the contract during the period of performance.

Note 4. Costs Incurred - Budget

The total contract amount for the Legacy East program was \$191,135,945. The contract amount exceeded actual costs by \$15,262,584.

Note 5. Costs Incurred - Actual

The actual categories presented and associated amounts reflect the cost line items recorded, billed to, and paid by the U.S. Government.

Note 6. Currency

All amounts presented are shown in U.S. dollars. Amounts invoiced in British Pounds were converted to dollars utilizing the Wall Street Journal, New York Closing, for the business day immediately preceding the date the invoice was received by Imperatis.

Note 7. Subsequent Events

Management has performed an analysis of the activities and transactions subsequent to the October 21, 2011 through March 15, 2014, period of performance. Management has performed their analysis through November 5, 2014.

¹ Notes to the Special Purpose Financial Statement were prepared by Imperatis on behalf of Imperatis Corporation.

Notes to the Questioned Costs Presented on the Special Purpose Financial Statement²**Note A. Allowable Costs: Inadequate Supporting Documentation**

Finding 2014-01 identified \$129,707,328 in questioned costs that resulted from a lack of supporting documentation for invoices submitted by a subcontractor, New Century Consulting, on the Legacy East project.

Note B. Lack of competitive procurement

Finding 2014-02 identified \$4,845,337 in questioned costs that resulted from a lack of supporting documentation for competitive bidding.

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

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To Joe Kuhlman, Senior Vice President & Chief Financial Officer
Imperatis Corporation
2331 Crystal Drive, Suite 1114
Arlington, VA 22202

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

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Special Purpose Financial Statement of Imperatis Corporation ("Imperatis"), and related notes to the Statement, for the period October 21, 2011 through March 15, 2014, with respect to the "Legacy – East" ("Legacy E") funded by contract W911QX-12-C-0011, and have issued our report thereon dated November 5, 2014, within which we disclaimed an opinion.

Internal Control over Financial Reporting

Imperatis management is responsible for establishing and maintaining effective internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that the assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and in accordance with the terms of the; and transactions are recorded properly to permit the preparation of the Special Purpose Financial Statement in conformity with the basis of presentation described in Note 1 to the Special Purpose Financial Statement. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the Special Purpose Financial Statement for the period October 21, 2011 through March 15, 2014, we considered Imperatis' internal controls to determine audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the Special Purpose Financial Statement, but not for the purpose of expressing an opinion on the effectiveness of Imperatis' internal control. Accordingly, we do not express an opinion on the effectiveness of Imperatis internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

(Continued)

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Special Purpose Financial Statement will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies noted in Findings 2014-01 and 2014-02 in the accompanying Schedule of Findings and Questioned Costs to be material weaknesses.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies noted in finding 2014-03 in the accompanying Schedule of Findings and Questioned Costs to be a significant deficiency.

Imperatis Response to Findings

Imperatis' response to the findings was not subject to the auditing procedures applied in the audit of the special purpose financial statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

Restriction on Use

This report is intended for the information of Imperatis, the United States Department of Defense, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.



Crowe Horwath LLP

November 5, 2014
Washington, D.C.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE

To Joe Kuhlmann, Senior Vice President & Chief Financial Officer
Imperatis Corporation
2331 Crystal Drive, Suite 1114
Arlington, VA 22202

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

We were engaged to audit, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Special Purpose Financial Statement of Imperatis, ("Imperatis"), and related notes to the Statement, for the period October 21, 2011 through March 15, 2014, with respect to the "Legacy – East" ("Legacy E") funded by contract W911QX-12-C-0011. We have issued our report thereon dated November 5, 2014, within which we disclaimed an opinion.

Management's Responsibility for Compliance

Compliance with Federal rules, laws, regulations, and the terms and conditions applicable to the contract is the responsibility of the management of Imperatis.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Statement is free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, and contracts, 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. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in Findings 2014-01, 2014-02, and 2014-03 in the accompanying Schedule of Findings and Questioned Costs.

Imperatis' Response to Findings

Imperatis' response to the findings was not subjected to the auditing procedures applied in the audit of the special purpose financial statement and, accordingly, we express no opinion on it.

Purpose of this Report

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

(Continued)

Restriction on Use

This report is intended for the information of Imperatis, the United States Department of Defense, and the Office of the Special Inspector General for Afghanistan Reconstruction. Financial information in this report may be privileged. The restrictions of 18 U.S.C. 1905 should be considered before any information is released to the public.

Crowe Horwath LLP

Crowe Horwath LLP

November 5, 2014
Washington, D.C.

SECTION I: SCHEDULE OF FINDINGS AND QUESTIONED COSTS**Finding 2014-01: Unallowable Costs: Inadequate Supporting Documentation**

Material Weakness and Non-Compliance

Criteria: FAR 31.201-2, states (d) A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

Condition: Imperatis contracted with New Century Consulting (NCC) to implement the task under the DOD contract. Upon review of supporting documentation retained by Imperatis supporting the NCC costs, we were not able to determine if the costs claimed were incurred, allocable and complied with the appropriate cost principles. The documentation was not sufficient to substantiate the allowability of the invoiced costs or to determine if the approval of the invoices was inappropriately or prematurely provided. NCC submitted and was paid for \$129,707,328 in invoiced costs over the term of the contract.

Questioned costs: \$129,707,328.

Effect: The Government may have been charged for costs that were unallowable to the Legacy East project.

Cause: Imperatis did not retain supporting documentation for subcontractor costs.

Recommendation: We recommend that Imperatis provide DOD with sufficient supporting documentation to demonstrate that the costs invoiced and paid were allowable to the Legacy East project or otherwise refund the Government \$129,707,328.

Finding 2014-02: Procurement

Material Weakness and Non-Compliance

Criteria: FAR 52.244-5 – Competition in Subcontracting states in part “(a) The Contractor shall select subcontractors (including suppliers) on a competitive basis to the maximum practical extent consistent with the objectives and requirements of the contract.”

48 CFR Subpart 31.2, states a cost is allowable only when the cost complies with all of the following requirements: (1) Reasonableness; (2) Allocability; (3) Standards promulgated by the [Cost Accounting Standards] board, if applicable, otherwise, generally accepted accounting principles and practices appropriate to the circumstances; (4) Terms of the contract; and (5) Any limitations set forth in this subpart.

48 CFR Subpart 31.201-3(a), *Determining Reasonableness*, "A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer's representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable."

FAR 52.209-6 States “(a) The Government suspends or debar Contractors to protect the Government's interests. The Contractor shall not enter into any subcontract in excess of \$30,000 with a Contractor that is debarred, suspended, or proposed for debarment unless there is a compelling reason to do so”.

FAR 52.209-6, further states "(b) the Contractor shall require each proposed subcontractor whose subcontract will exceed \$30,000, other than a subcontractor providing a commercially off-the-shelf item, to disclose to the Contractor, in writing, whether as of the time of award of subcontract, the subcontractor, or its principals, is or is not debarred, suspended, or proposed for debarment by the Federal Government."

Condition: During our testing of procurement activity we noted several instances of non-compliance:

- Support for a competitive procurement process was not provided for three contracts totaling \$4,845,337. As Imperatis could not demonstrate the reasonableness of these costs via a competitive process the entire amount is questioned. These contracts included contracts for vehicle rentals and construction.
- No documentation was provided showing that searches of the Excluded Parties List System (EPLS) were performed prior to an agreement being executed for eight of the procurements sampled.
- Certifications signed by vendors with procurements which exceeded the \$30,000 threshold, providing assurance the subcontractor or its principals was not suspended, debarred, or proposed for debarment by the Federal Government at the time of the award was not provided for eight vendors.

Questioned costs: \$4,845,337

Effect: In the absence of competition, the Federal government may not have obtained the best value for goods and services procured. Without EPLS searches and vendor certifications, performed at the time of contract award, the risk that Federal funds could have been provided to suspended, debarred, or otherwise excluded parties is increased.

Cause: Imperatis did not have a documented policy or lacked procedures requiring compliance with the above noted FAR clauses.

Recommendation: We recommend that Imperatis establish and document policies to promote competition and protect the federal government's interests and to comply with FAR 52.244-5 and 52.209-6. We further recommend that Imperatis establish the reasonableness of the non-competitively incurred costs or remit \$4,845,337 to the Federal Government.

Finding 2014-03: Cash Management: Excess Fixed Fee Charges

Significant Deficiency and Non-Compliance

Criteria: Imperatis entered into a cost plus fixed fee contract with the Department of Defense. Imperatis was to recognize and bill the fixed fees on a pro-rata basis throughout the contract based on five percent (5%) of other direct costs and eight percent (8%) of labor charges incurred during the life of the contract. The initial contract included costs and fixed fees at \$47,524,514.63 and \$2,455,201.25 respectively. Modification #5 dated August 6, 2012, increased fixed fees to \$5,189,319.60.

Condition: For the period January 10, 2013 through April 5, 2013, for seven invoices Imperatis invoiced the federal government for fixed fees in excess of the allowed fixed fee cap in Modification #5. The excess ranged from \$35,094 in January 2013 to a cumulative amount of \$1,015,396 in excess fee collections in April 2013. On April 5, 2013, Imperatis returned the amount collected over the cap to the federal government and thus no costs are questioned, only the amount of interest lost by the Federal Government during the time excess fees were held.

Cause: Imperatis, in the course of invoicing for the project, did not have a policy or written procedures in place to review cumulative fixed fee amounts invoiced to the government against the fixed fee amount authorized in the contract prior to submitting the invoice.

Effect: Imperatis charged the government for fees beyond that which was authorized and thus the government lost \$36,634 in interest.

Questioned costs: None - \$36,634 lost interest owed to the Federal Government.

Recommendation: We recommend that Imperatis remit the imputed interest amount of \$36,634 to the Federal Government. We further recommend that Imperatis develop a policy to review cumulative fixed fee amounts invoiced against amounts authorized in contracts prior to invoicing the Federal Government.

APPENDIX A – Views of Responsible Parties.



February 17, 2015

Bert Nuehring
Crowe Horwath LLP
1325 G Street NW, Suite 500
Washington, DC 20005

RE: Imperatis Corp. Management Response

The purpose of this letter is to provide a management response by Imperatis Corp. ("Imperatis") to the findings in the draft audit report on the Legacy East Contract No. W911QX-12-C-0011 ("Legacy contract") issued by Crowe Horwath LLP ("Crowe") on behalf of the Special Inspector General of Afghanistan Reconstruction ("SIGAR").

Below we have provided a response to each of the three findings listed in the audit report.

Finding 2014-01: Unallowable Costs: Inadequate Supporting Documentation

Imperatis disagrees with this finding and, based on the details below, respectfully requests SIGAR to reconsider their position.

Prior to fieldwork beginning, Crowe asked us to pull support for 21 invoices from New Century Consulting ("NCC"), a subcontractor to Imperatis who performed more than 80% of the work on the Legacy contract. The total dollar amount of NCC invoices selected was \$118.9M out of \$129.8M in total costs incurred by NCC on the contract. We provided all original invoices to the auditors. It was Crowe's opinion, however, that source documentation from NCC's records was necessary to substantiate the expenditures. We attempted to coordinate the auditor's review of NCC records, which are located on the island of Guernsey in the United Kingdom. The volume of NCC records for \$118.9M was quite extensive, so there was a lot of back and forth discussion on how to proceed with the audit.

On August 22, 2014, we were asked to provide a smaller sample in an effort to "...determine what supporting documentation NCC retains and assist in developing an approach to testing NCC activities." On September 2, 2014, NCC provided supporting documentation for all the sample selections made by the auditors. On September 4, 2014, we were informed by Crowe that the support provided by NCC was "...adequate to perform a subsample of the individual transactions that make up the entire amount billed to the project by NCC."

On September 11, 2014, we were told by the auditors that, based on a conversation with SIGAR, they would be disclaiming an opinion on the audit because SIGAR was not willing to extend the time or provide the funding required for Crowe to audit all the NCC records.

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We respectfully request that SIGAR either provide the time and funding to complete the audit or remove this finding of inadequate supporting documentation. Anything less is misleading to the readers of this audit, defames Imperatis, and threatens to undermine the value and purpose of SIGAR.

Finding 2014-02: Procurement

Imperatis disagrees with this finding and, based on the details below, respectfully requests SIGAR to reconsider their position.

Although our support for the procurements may not have been ideal, the circumstances in Afghanistan often made it impractical to select vendors on a pure competitive "three quote" basis. When practical Imperatis sought to compete vendors, but often the government presented us with lists of pre-approved vendors and directed we use one on the list. We relied on the Government's recommendations and our past history with particular vendors to make vendor selections that were in the best interest of the Government. It was a team effort with the government, and the Contracting Officer was made fully aware and was in support of all procurements prior to execution.

On October 23, 2014, based on the exit conference earlier that day, the auditors asked if we could provide additional information on the procurement findings. In all cases related to this finding, we were able to show evidence there was an effort made to ensure the vendor was not suspended or debarred, the cost to the Government was reasonable, and the Contracting Officer approved the expenditure. On December 2, 2014, we were informed by Crowe that all procurement findings were being dropped based on the information we provided. On January 27, 2015, Crowe informed us that "...through many back and forth with SIGAR and our partners I had to add the procurement finding back into the report."

Clearly there was some indecision on the reported findings and we respectfully request that SIGAR review the documentation provided again before reporting this finding. We believe that we acted with integrity and within the guidelines provided by the contracting officer. As such, we do not believe the finding has merit.

Finding 2014-03: Cash Management: Excess Fixed Fee Contracts

Imperatis disagrees with this finding and, based on the details below, respectfully requests SIGAR to reconsider their position.

On March 1, 2013, the company hired a new President and CEO and new CFO. New management made increased emphasis on integrity and transparency. In early April 2013 management discovered that the fee line on the current contract modification was less than had been historically the authorized. On April 5, 2013, motivated by integrity and in an attempt to ensure transparency, Imperatis volunteered to return fee previously billed but that had not been adequately funded against the fee line on the contract. Although this portion of the contract was "undefinitized" at the time, the Government had not properly allocated sufficient funding to the fee line in the contract. On May 2, 2013, Imperatis received

Modification Number P00014 that "definitized" the contract and added the proper amount to the fee line; thus resolving the issue.


Imperatis never billed more than the total funded on the contract, never billed more than 85% of our proposed fee while the contract was "undefinitized", and never billed more than the fee percentages stipulated in the contract. Imperatis does not believe the Government was harmed financially; in fact Imperatis acted in the government's best interest by returning the fee until the corrections could be effected. If anything, Imperatis was financially harmed due to the inability to adequately bill entitled fee for that period of time.

We respectfully request that SIGAR remove this finding, as we do not believe it has merit.

In conclusion we believe all three findings are without merit and, furthermore, defamatory to Imperatis. We have serious doubts this audit was performed up to professional standards. We encourage SIGAR to reconsider their position on all these findings before issuing a final report.

If you have any questions or need any additional support for these responses, please let me know.

Sincerely,


Joseph Köhlmann
Sr. Vice President and CFO

APPENDIX B – Crowe Response

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

March 10, 2015

Crowe Horwath LLP, in consideration of the views presented by the management of Imperatis International presents the following rebuttal to the Imperatis Corp. (Imperatis) Management Response (Response) found in Appendix A.

Finding 2014-01

Imperatis disagreed with the finding, however, the response does not address a key point of the finding as explained in the condition that documentation was not maintained by Imperatis to demonstrate compliance with FAR 31.201-2. Supporting documentation for invoiced costs could not be provided by Imperatis as the invoice detail support was with NCC, the subcontractor. FAR 31.201-2 requires the contractor, Imperatis, to maintain the documentation which they did not. Furthermore, Imperatis' response does not appropriately address the recommendation to provide further information to demonstrate the costs were adequately supported and allowable.

Finding 2012-02

Imperatis response does not address the recommendation in the finding as they admit that "...the support for the procurements may not have been ideal...". However, policies related to the procurement function have not been provided and the support for the reasonableness of costs for the non-competitively bid procurements have not been provided as called for in the Finding's Recommendation. Crowe reviewed the documentation provided after the exit conference, as referenced in the Imperatis' Response, which included email correspondence, modifications, and proposals. These documents did not provide proof of the contracting officer approval, therefore, the finding remained.

Finding 2012-03

While Imperatis' response supports the dates, as shown in the finding condition, the response does not address the recommendation of the finding. The imputed interest in the recommendation is based on the timing of the fixed fee billing and the date of repayment by Imperatis. As the finding and the Response both indicate, the initial overcharge by Imperatis has been resolved as funds were returned to the federal government but the matter of the interest owed has not been addressed by Imperatis. The interest is owed because Imperatis received and held excess funds for a period of time before they were returned even though they did not exceed the contract maximum.

Summary

Contrary to Imperatis' conclusion that the findings are without merit, as indicated in the Response, insufficient and inadequate support for activities performed for the Legacy Contract is the basis for the findings. Imperatis' failure to provide sufficient documentation to support compliance with the Legacy Contract has been noted by Crowe Horwath and the conditions found have been included as findings in the report in accordance with the requirements of Generally Accepted Auditing Standards and Generally Accepted Government Auditing Standards. The findings, as presented, have been developed in accordance with those Standards.

SIGAR's Mission

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

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

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