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AGENCY FOR INTERNATIONAL DEVELOPMENT

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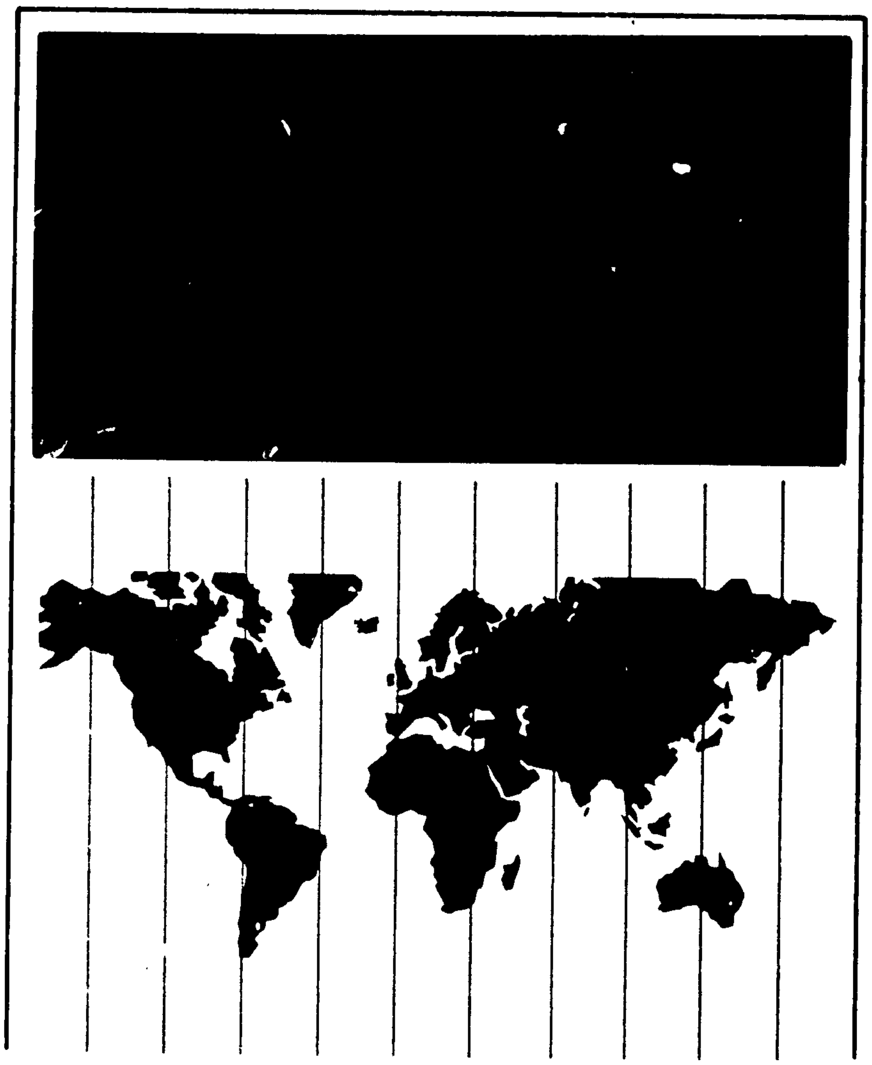

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The Indonesian Agricultural Development Planning and Administration Project Requires Management Attention

USAID/Indonesia
Memorandum Audit Report No. 2-497-84-01
October 28, 1983

This $10.9 million project, approved September 1977, is generally meeting its objectives. However, there are other matters that require USAID/Indonesia attention.

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Memorandum

TO : Mr. William Fuller
Director, USAID/Indonesia

October 28, 1983

FROM : Russel E. Kulik
RIG/A/Manila

SUBJECT: Memorandum Audit Report 2-497-84-01
"The Indonesian Agricultural Development Planning and Administration Project Requires AID's Management Attention"

SUMMARY

This $10.9 million project, approved September 1977, is generally meeting its objectives. A computer center has been established and it is being heavily used. Many persons have been, and are receiving training at U.S., Indonesia and third country universities. While there have been project accomplishments, there are a number of other matters that require the attention of AID Mission management.

-- The project should be deobligated by about $765,000. These funds are not presently programmed (earmarked) for project activities. The project can probably reach its objectives within existing earmarked funds.

-- The supplier of computer equipment did not meet the source and origin requirements of U.S. law and AID regulations. Consequently, about $344,000 in payments were made by AID for ineligible equipment, shipping, and insurance costs. The Mission should take recovery action or obtain a waiver that would retroactively allow procurement of the computer equipment.

-- The contractor selected for maintaining the computer system was not eligible to receive the award. The maintenance contractor also performed poorly. More importantly, AID lost its leverage to control the contractor when the Mission advanced the contractor funds to cover three years of maintenance cost. The Mission should take all steps necessary to ensure the computer system is adequately maintained in the future.

INTRODUCTION

The Agricultural Development Planning and Administration (ADPA) project (497-0265) was approved September 23, 1977. The purpose is to upgrade the planning and programming capability of the Indonesia Ministry of Agriculture (MOA). This is to be done by helping to institutionalize within the MOA the ability to carry out effective agricultural policy analysis and the capacity to design and evaluate appropriate developmental program and project alternatives.

By its projected April 12, 1984 completion date the project is expected to substantially improve the capability of the MOA key planning and policy guidance units to (a) relate agricultural programs to the needs and problems of the rural poor, (b) prepare long and short range agricultural strategies and plans, (c) efficiently process agricultural data, (d) perform necessary micro and macro analysis of that data, and (e) communicate and interact more effectively with BAPPENAS -- The National Development Planning Bureau.

AID funding for the ADPA project totals $6.8 million. Grant Agreement 77-15, signed on September 26, 1977, provides $1.3 million for technical assistance. The Iowa State University, under a contract with the GOI, is to provide the technical assistance. Grant Amendment number seven, dated January 13, 1983, provides an additional $500,000 to finance a one-year extension of the technical assistance. An AID loan (497-T-051) amounting to $5 million, signed on April 12, 1978, finances the commodity and training segments of the project. The Government of Indonesia (GOI) is required to provide $4.1 million in counterpart funds to finance local currency requirements.

PURPOSE AND SCOPE

In performing the audit, we reviewed applicable documentation and financial records which are maintained by USAID/Indonesia. We also interviewed appropriate personnel of USAID/Indonesia, the MOA and the Iowa State technical assistance team. The audit covered the project from its inception through June 1983.

PROJECT LOAN FUNDS SHOULD BE DEOBLIGATED

In our view, the USAID/Indonesia should deobligate about $785,000 in project loan funds. Presently, neither the Mission nor the GOI have specific plans to use these funds. The project probably can be successfully carried out with funds that have already been programmed (earmarked) for specific project activities.

AID Handbook 19 provides guidance on the review of unliquidated balances of obligations. At the middle of each fiscal year and again at the fiscal year end, intensive reviews of obligations are required by AID Missions. The latter review provides the basis for the Mission's certification of the validity of obligations at fiscal year end required by Section 1311 of the Supplemental Appropriation Act, 1955. Agency guidance also states,

> "Amounts obligated which are not needed to pay for goods and services delivered by the PACD 1/ as amended are considered invalid and are subject to deobligation."

The ADPA project had $5 million obligated under Loan Agreement 497-T-051. As of June 16, 1983 only $4.2 million of the loan funds have been identified for

1/ Project Activity Completion Date.

specific project activities. Below shows the earmarks and planned earmarks against the loan obligation.

Loan 051 Obligation		$5,000,000
Earmarked through March 31, 1983	$3,154,178	
Project Implementation Letter (PIL) 19, April 18, 1983	660,135	
Plans per Mission Project Officer, June 16, 1983	400,000	4,214,313
Amount that could be deobligated		$ 785,687

USAID/Indonesia did not agree that the loan funds should be deobligated at this time. On July 7, 1983, the USAID/Indonesia responded to the audit finding stating that "The Mission has the responsibility to determine that the objectives of the project have been met in order to draw the project to a close. A PACD extension is under consideration in order to ensure the objectives are met. As soon as it becomes clear the extent to which funds are available for deobligation, the Mission will take the necessary action."

In our opinion, the major elements of the ADPA project have already been financed with existing programmed loan funds. During the audit, we were informed by the Mission that the PACD might be extended, but only to allow completion of long-term training in the United States. Funds for this training are already earmarked by a contract between the GOI and Iowa State University. Another significant project activity which is loan funded is in-country training. PIL-19 finances this project activity through the end of the project period. Moreover, the funds required for additional in-country training are included in the $400,000 the Mission Project Officer estimated is needed to carry out remaining project activities. The Project Officer also planned a computer upgrade which would use the balance of the $400,000.

Conclusion

In summary, all of the major elements of the project have been financed through earmarks or planned earmarks. Therefore, USAID/Indonesia should make a final review of project activities which may require some additional financing; make an estimate of the funds necessary to adequately complete project activities; and deobligate unneeded funds.

Recommendation No. 1

USAID/Indonesia review the obligation for Loan 497-051, estimate the amount which will not be needed for the project, negotiate the necessary amendment to the Loan Agreement, and deobligate unneeded loan funds.

Mission Comments

The Mission has agreed to carry out the intent of this recommendation.

SOURCE AND ORIGIN REQUIREMENTS OF U.S. CODE NOT MET

The GOI used $344,484 of AID loan funds for purchases, shipping and insurance of commodities -- a computer system. The contract required that all equipment supplied would be of U.S. Code 941 source and origin. While most of the computer equipment was manufactured in the United States, it was shipped to France for assembly and testing. Once the equipment entered the French economy, it took on the source of that country, and therefore became ineligible for AID financing under U.S. Code 941. Under the code, France is not an eligible source country.

Description of Source and Origin Requirements

Source and origin requirements are described in AID Handbook 15 as follows:

> "(1) 'Source' means the country from which a commodity is shipped to the cooperating country, or the cooperating country itself if the commodity is located there when it is purchased. To be eligible for AID financing a commodity must be of a source designated as eligible in the loan or grant agreement and implementing documents, and it must also have been mined, grown, or through manufacturing, processing, or assembly been produced in an eligible source country...."

Code 941 countries were identified in Section 201.11 of AID Regulation 1 as follows:

> "Code 941 - 'Selected Free World': The United States and any independent country in the Free World, except the cooperating country itself and the following...France...."

Description of Contract Terms

One of the principal goals of the ADPA project was the establishment of a computer center in the Ministry of Agriculture. The ADPA loan agreement provides for procurement of computer equipment, related training, and maintenance.

On July 12, 1980, a GOI selection committee recommended that the bid to supply a Honeywell Level 6 Model 53 computer system be accepted. On October 3, 1980, the GOI awarded a contract amounting to $466,369 for the Honeywell computer system. The supplier that received the award was the agent of Cii Honeywell Bull -- a firm located in France. The Loan Agreement stipulates in Section 7.1:

"Foreign Exchange Costs. Disbursements pursuant to Section 8.1 will be used exclusively to finance the costs of goods and services required for the Project having their source and origin in countries included in Code 941 of the A.I.D. Geographic Code Book as in effect at the time orders are placed or contracts are entered into for such goods and services ("Foreign Exchange Costs"), except as A.I.D. may otherwise agree in writing, and except as provided in the Project Loan Standard Provisions Annex, Section C.1 (b) with respect to marine insurance."

Computer Equipment and Related Cost Not Eligible for AID Financing

While proper AID requirements and clauses were included in the various documents related to this procurement, the supplier did not, and in fact, could not comply with these requirements. Although mostly manufactured in the United States, the Honeywell computer equipment costing $318,991 was shipped from the United States to France to be "burned in" -- a process by which the components are assembled and tested, before being shipped to the buyer.

Under the definitions of source requirements, these goods became a French source when the equipment entered France for assembly and testing. In as much as France is not an eligible U.S. Code 941 country, the equipment became ineligible for AID financing.

If commodities are ineligible for AID financing, then all related costs also become ineligible for AID financing. Therefore, the related shipping costs of $19,724 for the computer equipment are ineligible for AID financing. Moreover, the contract specified a price of FOB U.S.A. However, the supplier billed, and was paid, for shipment from France. The shipment was routed through th U.S. to Jakarta, Indonesia. USAID/Indonesia explained that the commodities were routed from France to Jakarta via the U.S. to utilize an American carrier.

The shipment of this computer equipment was insured from France to Singapore (transhipment point) and Singapore to Jakarta. The total cost of the insurance was $5,769. While the AID Handbook on AID-financed commodities does not specifically address insurance on air shipments, it does provide guidance on allowable marine insurance. The Handbook requires that for insurance to be financed, the commodity to be insured must be eligible for AID financing. As we have discussed above, these commodities are ineligible for AID financing and so, therefore, is the insurance.

Conclusion

The computer equipment, shipping and insurance costs are not eligible for AID financing. Granted, most of the equipment was manufactured in the United States. However, the supplier is technically in violation of the source and origin rules followed by AID. Therefore, we have no alternative but to recommend recovery action by the Mission. Should the Mission obtain a waiver or AID/W General Counsel legal opinion that refutes our judgment in this matter, we will, of course, withdraw our recommendation for recovery action.

Recommendation No. 2

USAID/Indonesia take action to recover $344,484 from the GOI loan funds expended for commodities which were of ineligible source ($318,991), shipping of ineligible commodities ($19,724), and insurance placed on ineligible commodities ($5,769).

Mission Comments

USAID/Indonesia requested that we withdraw our recommendation based on an opinion obtained from its legal adviser. The USAID/Indonesia legal adviser noted:

"First, the audit recommendation has acknowledged the U.S. manufacture of the 98 per cent of the total value of the system. But questions the source, since the goods were shipped from France. The shipping and insurance costs are questioned based on the ineligible source claim. The supplier informed us that the goods were shipped from the United States to France to be "burned in", a process by which the components are assembled and tested, before being shipped to the buyer. Such services are incidental to the procurement of commodities and AID's nationality rules do not apply to such services. The project was not charged for the costs of the shipment from the United States to France.

"After the "burning in", the equipment was then shipped to Jakarta via the United States. The supplier ascertains that he shipped via the United States because the only U.S. carrier which would take the large cargo, Flying Tiger Airlines, flew the western route. Passenger airlines at that time did not ship large computer units. Agency regulations require shipment by U.S. carriers if available regardless of a difference in price. Therefore, we believe that the supplier adhered to the terms of the contract by using an American carrier, even though the carrier took a longer route than would be necessary if he had used a foreign carrier.

Finally, the auditor questions the insurance costs. The insurance was placed with an insurance company in Singapore, which is affiliated with an English insurance company. To the best of our knowledge, the company is legally incorporated in Singapore, and meets the AID requirements concerning nationality. At the time the insurance was placed, Singapore was an eligible country under AID geographic code 941..."

We are in agreement with the USAID/Indonesia legal adviser's factual presentation. However, we remain of the opinion that the computer equipment and related costs do not meet the source requirement of U.S. Code 941. In our view, the Mission's comments on "incidental services" are not germane in this case. AID Regulation 1, Section 201.01 (U) describes incidental services as

"...the installation or erection of A.I.D.-financed equipment, or the training of personnel in the maintenance, operation, and use of such equipment.." AID Regulation 1, Section 201.12 states "Incidental services may be financed under the same implement document (loan agreement) which makes funds available for the procurement of equipment if *** (b) Such services are specified in the purchase contract relating to the equipment."

In this instance, the contract called for shipment of the equipment FOB U.S.A. Further, the contract did not provide for any incidental services to be performed in France.

The background of this matter was discussed with AID's Regional Legal Advisor who is attached to USAID/Phillipines. It is the RAL's opinion that the computer equipment should be considered of French source and therefore not eligible for AID financing under the U.S. Code. The RLA atso felt that a waiver of the source requirement should be requested by USAID/Indonesia.

COMPUTER EQUIPMENT NOT MAINTAINED PROPERLY

The same supplier -- the Agent of Cii Honeywell Bull -- also was awarded a contract to maintain the computer equipment.

USAID/Indonesia and the GOI generally agree the supplier has performed poorly in maintaining the computer equipment. The Mission made considerable efforts in the first half of 1982 to get the GOI to terminate the maintenance segment of the contract. These efforts were unsuccessful because, in accordance with the contract, the full cost of the 3-year maintenance contract was advanced at the time the contract came into force. Consequently, the Mission and the GOI had little, if any, leverage to influence the performance of the supplier short of contract termination.

Included in the contract, dated October 3, 1980, for the purchase of the Honeywell computer system was provision for 3 years of hardware and software maintenance beginning after the 1-year warranty period ended. Section 3.2.3 of the host country contract provides the following: "Payment of U.S. $105,162 for the three (3) years maintenance indicated in Annex X, Maintenance Agreement, will be paid immediately upon invoice, following this contract's coming into force." Payment was made in accordance with this provision.

An earlier IG memorandum audit report (RIG/A/East Asia No. 2-497-81-14, May 28, 1981) discussed the inappropriate nature of this advance. We recommended at that time that the advance be recovered and paid at a more appropriate time. USAID/Indonesia replied that the supplier would never agree to the necessary contract amendment to allow recovery of the advance. In January 1982, we agreed that recovery was probably not possible and, in fact, not even beneficial, if the supplier were performing the maintenance work adequately. The recommendation was closed in July 1982, based on the Mission's description of procedures to preclude such advances in the future.

Several months prior to closing the audit report recommendation, the Mission and GOI knew of the serious problems involved with the maintenance portion of the contract. For instance, a May 13, 1982 letter from the USAID Project

Officer to the Indonesian Ministry of Agriculture noted: "And finally, there are sufficient grounds for legal action against the company based on non-performance, misrepresentation and the impossibility of (their) providing U.S. manufactured spare parts and equipment under the maintenance contract." We found no evidence that the GOI responded to the letter.

In June 1983, we apprised the Mission of our concerns about the continuation of the maintenance portion of the computer equipment contract. We suggested that the maintenance segment should be terminated because Honeywell Information System -- The U.S. manufacturer of most of the equipment -- had an authorized representative in Indonesia. This representative has been in Indonesia since December 1981. Further, we suggested that the Mission should seek a refund from the GOI in the amount of the advance paid the supplier to protect the interest of the U.S. Government. The USAID/Indonesia response of July 7, 1983 included the following:

> "As the funds have already been disbursed, the funds cannot be 'withdrawn'.. Termination of the contract and refund from the contractor is one option. However, this is not an option available to the Mission, since the contract is a Host-Country Contract.***The Department, particularly the New Secretary General, has recently indicated a renewed interest in terminating the contract now that Honeywell USA has set up operations in Indonesia. Because of the poor performance of the Honeywell Bull Representative, the Department of Agriculture has expressed an interest in picking up a contract with Honeywell USA either when the contract with Honeywell Bull's representative has been terminated or when it expires.
>
> "USAID believes no further action is necessary with regard to the maintenance contract. We believe the GOI is taking all necessary steps, within the constraints of Indonesian law and practice, to terminate the contract. In passing, we would like to point out that the performance of the contractor has improved considerably under GOI pressure, although we and the GOI realize the performance is not fully satisfactory.
>
> "Further, we believe there are no grounds on which we can demand a refund from the GOI directly. Neither the GOI nor USAID had any evidence to suspect that the contractor was not an authorized representative of a U.S. manufacturer. The situation could have been corrected if the advance had not been made, when Honeywell USA established a representative, but the advance was made on the advice of the USAID representative that it was normal practice in the computer industry and that considerable cost saving could be realized.***Since the GOI neither insisted on the advance payment nor on awarding the contract, and since both actions were taken in good faith based on USAID approval, we do not believe we have any recourse against the GOI, unless they can recover the funds from the contractor. As we pointed out above, the GOI is acting responsibly in this regard. <u>Therefore we believe no further action by USAID. is warranted</u>". (Underlined for emphasis)

We believe that the Mission's knowledge of the supplier's poor performance should have caused it to take recovery action with regard to AID loan funds. However, USAID/Indonesia's position is that since AID is not a party to the contract, AID cannot recovers the funds from the supplier. Nevertheless, recent guidance from AID/W describes how the U.S. Government's interest can be protected under a host country contract. A cable (STATE 191622) dated July 9, 1983, on the subject of Host Country Contracts describes how AID's interests can be protected when the host country is unwilling or unable to act. The cable states, in part:

> "Since A.I.D. is not party to the contract, it obtains its legal recourse either through the cooperation of the host Country Contracting Agency or under the Contractor's or Supplier's Certificate and Agreement with A.I.D. This form (A.I.D. 1440-3 or 1450-4), properly executed by an authorized representative of the contactor, is required to be submitted by the contractor with each request for payment under a Host Country Contract. It gives A.I.D. the right to obtain a refund from the contractor in the event of nonperformance or breach of contract."

Conclusion

In our draft report, we concluded that there was a need for the USAID/Indonesia to protect the interest of the U.S. Goverment. We noted that by using rights conferred by the contractor's certification (AID 1440-3), the Mission could obtain a refund of the monies paid for the computer maintenance services. Consequently, we recommended that USAID/Indonesia take all actions (legal and otherwise) necessary to recover the $105,162 based on non-conformance by the contractor.

The Mission responded that this could not be done because neither form 1440-3 or 1450-4 had been executed at the time the contract was finalized. Rather, the Mission noted that the GOI has indicated interest in picking up a contract with Honeywell USA when the contract with Honeywell Bull's representative expires. Therefore, the Mission concluded no further action was warranted by AID officials.

In our opinion, USAID/Indonesia should stay involved to ensure the computer equipment is adequately maintained in the future. Unless the supplier has fully demonstrated the ability to adequately maintain the equipment it should be excluded from competition on future maintenance contracts.

Recommendation No. 3

USAID/Indonesia before approving a follow-on contract require that the contractor selected is fully qualified to adequately maintain the AID-financed computer system.

REPORT RECIPIENTS

USAID/Indonesia	
Director	5
AID/W	
Bureau for Asia:	
Assistant Administrator	1
Deputy Assistant Administrator (Audit Liaison Officer)	2
Office of Indonesia and South Pacific/ ASEAN Affairs (ASIA/ISPA)	1
Bureau for Science & Technology:	
Office of Development Information & Utilization (S&T/DIU)	4
Bureau for Management:	
Assistant to the Administrator for Management	1
Accounting System Division (M/FM/ASD)	2
Directorate for Program & Management Services: Office of Contract Management (M/SER/CM)	3
Office of the Inspector General:	
Inspector General (IG)	1
Executive Management Staff (IG/EMS)	12
Policy, Plans & Programs (IG/PPP)	1
Office of Legislative Affairs (LEG)	1
Office of the General Counsel (GC)	1
Office of Public Affairs (OPA)	2
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RIG/A/Latin America	1
RIG/II/Manila	1
AAP/New Delhi	1