IAN. 34611 PDAAP 222
4980251
001781

CLUSA PROJECT IN INDONESIA EXPERIENCING MAJOR DIFFICULTIES

Audit Report No. 2-497-84-06
April 21, 1984

The PL 480, Title II grant project in Indonesia, sponsored by the Cooperative League of the U.S.A. (CLUSA), has a record of inadequate planning, management, and monitorship. There also has been a general disregard of AID operating procedures. This report calls for a number of financial and managerial changes in this project, including a review of the rationale for the continuance of the project.

CLUSA PROJECT IN INDONESIA
XPERIENCING MAJOR DIFFICULTIES

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	1
BACKGROUND	1
OBJECTIVES, SCOPE AND METHODOLOGY	2
AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS	3
Overall Planning and Monitoring Deficient	3
CLUSA's Capabilities Not Evaluated Prior To Commodity Grant	3
Project Objectives Vague And Not Measurable	4
Project Budget Not Firm Or Realistic	5
Monitoring Responsibility Not Assigned	5
Project Needs To Be Restructured If It Is To Succeed	6
PUSPETA Klaten Operating At A Loss	6
Project Funds Depleted By Unusually High Subsidies	7
Accounts Receivables Delinquent	7
Dairy Feed Operations Not Profitable	8
Coordination, Planning and Evaluation Committee Not Established	9
Majority Of Reported Project Costs Not Accepted	10
Accounting Records Inconsistent and Unreconciled	12
AID Regulations On Participant Training Not Observed	14
Equipment Procured From Ineligible Sources	16
Equipment Procured Unsuitable	16
Inventory Controls Lacking	17
Standard Grant Provisions And Procedures Should Apply For Title II Grants Awarded To Private Voluntary Organizations (PVOs	17
Cost Overrun Under CLUSA Grant (AS1A-G-1180) Should Be Recovered	18
EXHIBITS	
A. List Of Report Recommendations	19
B. List Of Report Recipients	20

EXECUTIVE SUMMARY

INTRODUCTION

AID is financing an agricultural cooperative service center project in Klaten a district in Central Java, Indonesia. The project is sponsored by a Private Voluntary Organization (PVO) called the Cooperative League of the U.S.A. (CLUSA). By June 30, 1984, CLUSA expected the project to be able to function as a self-sustaining enterprise. The goal is to improve rural food systems and increase farmers' income.

On July 21, 1981, AID signed a Transfer Authorization which provided CLUSA with 5,700 metric tons of PL 480, Title II wheat. CLUSA then sold the wheat to the Government of Indonesia (GOI) for about $1.3 million to finance the Indonesia project. The Transfer Authorization also permitted CLUSA to earn interest on the $1.3 million it received from the sale of Title II commodities, and to use the interest for project purposes. Proceeds from the wheat sales were transferred to a U.S. dollar account in Washington D.C.. Surplus funds from that account will earn an estimated $146,000 in interest during the life of the project. In August 1982, USAID/Indonesia also provide CLUSA $109,926 to support the project under an Operating Program Grant.

AUDIT SCOPE AND PURPOSE

The audit covered project activities from its beginning on July 1, 1981 through July 30, 1983. The audit included selected tests of financial transactions, but focused mainly on project accomplishments in relation to stated objectives. Our purpose was to determine whether PL 480, Title II proceeds and AID grant funds were being prudently managed and monitored in accordance with the covering agreements, applicable U.S. law, and AID regulations.

SUMMARY OF AUDIT FINDINGS

The Title II grant was awarded without an evaluation of CLUSA's performance under this previous grant. Had this occurred, the project may not have been approved, given CLUSA's past performance in Indonesia. For instance, most of the project objectives in a prior $816,000 AID/Indonesia grant to CLUSA were not achieved. Only $46,000 out of the prior grant was used for direct projec activities in Indonesia. The remaining $770,000 went to cover CLUSA technica assistance support and operating costs. (See p. 3.)

A major goal of the project is to establish a profitable, self-sustaining cooperative service center in Klaten by June 30, 1984. The cooperative service center was to serve as a model for replication throughout Indonesia. The center has been losing money steadily since inception and the project, if not restructured, could fail. The losses were the result of disinterested management, unusually high salaries, delinquent accounts receivables, and unprofitable dairy feed mill operations. (See p. 6.)

After the Title II Transfer Authorization was signed in July 1981, there was little to no monitoring of the project. Until April 1983, neither the USAID nor AID/Washington were actively monitoring the CLUSA/Indonesia project because each thought the other had monitoring responsibility. (See p. 5.)

Through December 31, 1982 CLUSA reported total costs of $647,728 expended for project activities. However, a total of $504,948 in costs were either not supportable or were questioned. Because of accounting deficiencies, there were substantial unreconciled differences in CLUSA/Indonesia and CLUSA/Washington accounting records. As a result, we could not accept $479,452 in project costs. Other costs questioned included $23,140 for a trip misclassified as participant training and $2,356 paid for ineligible commodities under AID source/origin requirements. (See p. 10.)

Although AID standard grant provisions were incorporated by reference into the Transfer Authorization, the AID Food for Peace Office was treating the Klaten Project as a commodity transfer. In addition, CLUSA was not following grant procedures. Present AID regulations contain insufficient guidance for the administration of PVO-sponsored projects that are financed through the sales of Title II commodities . AID regulations mainly deal with control over the receipt and distribution of Title II commodities. We believe that the lack of specific guidelines and regulations, as well as general noncompliance with standard grant provisions, contributed to the project deficiencies addressed throughout this report. If similar Title II commodity grants are awarded in the future, they should be treated like other AID grants awarded to PVOs and subject to standard grant procedures and provisions. (See p. 17.)

CONCLUSIONS AND RECOMMENDATIONS

The PL 480 Title II sales program in Indonesia, sponsored by the CLUSA has serious implementation problems which, if not corrected, could lead to the failure of the project. Since this Title II funding mechanism is so new, the project was developed and implemented without sufficient guidance from Agency regulations. As a result, we found numerous financial and managerial problems spanning from the award, through project implementation.

This report calls for a number of financial and managerial changes in this project, including a review of the rationale for the continuance of the project. (See pp. 10, 12, 14, 17, and 18.)

MANAGEMENT COMMENTS

With respect to project performance, USAID/Indonesia comments were generally in agreement with the audit report findings, conclusions and recommendations. The Mission noted that the CLUSA project is now under new management which is working effectively on all of the problems which have "plagued" the project. The Mission went on to say that:

-- There has been an improvement in management of the project and curtailment of questionable activities.

-- There is clearer and more detailed reporting by CLUSA's new management.

-- The accountability problems have been or will be addressed.

Given the dramatic turn-around in this project since our audit, the Mission has requested that the final report be modified to reflect its favorable assessment of the future of the project. This has been done.

BACKGROUND

The PUSPETA Klaten is an agricultural cooperative service center in Klaten, a district in Central Java, Indonesia. The PUSPETA Klaten project is a special pilot project which was conceived and planned in 1977 by the Cooperative League of the U.S.A. (CLUSA) and the Government of Indonesia's (GOI's) Directorate General of Cooperatives. The project, as stated under the PL 480, Title II funding documents was to strengthen, reorganize and revitalize existing village agricultural cooperatives by use of a cooperative federation in the Klaten district. The goal is to improve rural food systems and increase farmers' income. CLUSA was to focus on three critical areas: membership education, management training, and capital formation. At the end of three years CLUSA expected the PUSPETA Klaten cooperative service center to be able to function as a self-sustaining cooperative service enterprise.

On July 21, 1981, the AID Bureau for Food for Peace and Voluntary Assistance, Office of Food for Peace (FVA/FFP) signed a Transfer Authorization (TA No. 497-XXX-000-612) for delivery of 5,700 metric tons of wheat to CLUSA for the PUSPETA Klaten Project. The Transfer Authorization stated that the commodities were to be transferred to this Private Voluntary Organization (PVO) in accordance with the provisions of Title II, PL 480 (as amended), Section 1-201 of Executive Order 12220 and International Development Cooperation Agency Delegation of Authority No. 5, effective June 27, 1980.

On November 16, 1981, approximately 5,700 metric tons of wheat were offloaded at the Indonesian port of Ujung Pandang. The total cost to the U.S. Government was $1,563,331, of which $999,391 applied to the wheat, and $563,940 to freight charges from the U.S. carrier. However, the GOI paid CLUSA only $1,312,506, which was the base cost of the wheat, plus freight computed at a lower, foreign-carrier rate. The difference between the cost to the U.S. Government and to the GOI was $247,370 -- the differential paid for shipping the commodities via a U.S. carrier.

The proceeds from the sale of Title II commodities, along with interest earnings, were to partially fund the project for three years, from July 1, 1981 through June 30, 1984. The total cost of the project as envisioned by the project paper was $6 million. Financial requirements for the project were to be met by proceeds from the sale of Title II commodities and funds from other undetermined sources. If all other sources combined were found to be insufficient for this purpose, the GOI guaranteed that sufficient funds would be provided to the project for its successful completion.

On August 31,1982, USAID/Indonesia provided CLUSA additional funds of $109,926 under an Operating Program Grant (OPG) (No. 82-3) for support of CLUSA's efforts at Klaten. This grant was to pay the bulk of the salary and administrative costs for CLUSA personnel assigned to the project.

OBJECTIVES, SCOPE AND METHODOLOGY

This audit covered program activities funded by the PL 480, Title II grant and the USAID/Indonesia Grant Number 82-3. Our review included selected tests of financial transactions, but focused mainly on project accomplishments in relation to stated objectives. Our purpose was to determine whether PL 480, Title II proceeds and AID grant funds were being prudently managed and monitored in accordance with the covering agreements, applicable U.S. laws, and AID regulations.

We reviewed project documents at USAID/Indonesia, FVA/FFP, CLUSA offices in Washington D.C. and Jakarta, and at the project site in Klaten. We discussed project progress and problems with officials at these offices and at the Indonesian Ministry of Cooperatives. The results of our audit were discussed with USAID/Indonesia officials, and the draft report was submitted to USAID/Indonesia and FVA/FFP for review and comment.

The audit covered project activities from its beginning, on July 1, 1981, through July 30, 1983 and project expenditures through December 31, 1982.

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

OVERALL PLANNING AND MONITORING DEFICIENT

The planning and monitoring for this Title II grant project was unusually poor:

-- The grant was made without any prior evaluation of CLUSA's capabilities;

-- Project impact could not be determined due to lack of clear-cut, measurable objectives;

-- The project budget was unrealistic. The source of funding, other than AID's contribution, was not specified; and,

-- Project monitorship responsibility was not clearly assigned.

CLUSA's Capabilities Not Evaluated Prior To Commodity Grant

This grant was made without any prior evaluation of CLUSA's capabilities. If there had been an objective evaluation of CLUSA's past performance in Indonesia, it is questionable whether this project would have been approved.

The Title II grant project is a follow-on to an earlier project financed by AID under grant ASIA-G-1180. In the earlier grant to CLUSA, very few of the project objectives were achieved. The project had a record of many delays and few tangible accomplishments. Further, almost 95 percent ($770,083) of the grant ($816,234) was expended for CLUSA technical assistance support and operating costs. Only $46,151 found its way directly to the project in Indonesia. According to CLUSA records, the status of the previous grant funds was as follows:

Cost Element	Total As Of June 30, 1982
Direct Salaries and Fringe Benefits	$ 441,026
Travel and Allowances	130,294
Other Direct Costs	27,592
Overhead	173,235
Klaten Project Costs	46,151
Total Costs Incurred	$ 818,298
Authorized by Grant	816,234
Cost Overrun	$ 2,064

The evaluation of CLUSA's performance under the previous grant was not completed until May 27, 1982, ten months after the Title II commodity grant

was awarded to CLUSA. The evaluation concluded that very little was accomplished with AID's contribution of $816,234, and CLUSA's performance hardly justified prolonging the project. Specifically, the evaluators concluded that "...most of the project outputs expressed in the original grant agreement and appended log-frame were not achieved either in terms of quality or quantity..." and "...The major reasons underlying these findings, in the view of the evaluation team, appear to be poor project design (excessively ambitious project goals), an apparent lack of communication between the grantee and the USAID Mission, and inadequate management on the part of the grantee and the USAID Mission." The evaluation report also pointed out that the GOI had reservations concerning the viability and replicability of the sole remaining CLUSA subproject in Indonesia--the PUSPETA Klaten project which is financed by the Title II grant.

Before approval of the Title II grant, a number of questions were also raised about the follow-on PUSPETA Klaten project's feasibility. In one review of the project paper, concern was expressed over the quality of cost and revenue data and the analytical procedures used in evaluating the economic feasibility of the feed mill component. The reviewer noted that CLUSA should go slowly on the feed mill component until it had attained some technical, administrative and business experience in feed mill operations. The reviews also questioned CLUSA's optimistic assumption that cooperative participation would spread rapidly once the Title II funded project got underway. For instance, CLUSA had not demonstrated under the earlier project that (1) additional farm and non-farm employment had been generated, (2) agricultural productivity had increased and, (3) income of cooperative members had become significantly higher than the non-members as a result of cooperative membership. Because none of these issues had been addressed in the follow-on Title II grant project paper, the reviewer suggested that a complete evaluation of CLUSA's track record in Indonesia would be in order. However, no evaluation was undertaken prior to FVA/FFP's approval of the Title II grant project

Project Objectives Vague And Not Measurable

Project results cannot be measured because neither the Transfer Authorization nor the project paper established clear-cut, measurable goals and objectives.

The Transfer Authorization included such general goals as:

* strengthen, reorganize and revitalize existing village agricultural cooperatives by use of a cooperative federation in Klaten;

* improve rural food systems; and

* process and market rural produce.

There were no specific steps listed for achieving these goals, nor were any priorities established.

Similar shortcomings are contained in the project paper. For example, the section on first year activities listed vague objectives such as "Produce feasibility studies", "Begin new economic activity", and "Initiate post-harvest services."

Without specific, quantifiable objectives and work steps, it is not possible to accurately measure project progress.

Project Budget Not Firm Or Realistic

The project paper budget calls for total project funding of $6 million, of which $1.4 million was to be funded from the sale of Title II commodities. The balance of $4.6 million was to be funded from other sources, undetermined at the time, but presumed to be the GOI since the GOI guaranteed that sufficient funds would be provided to complete the project. As of December 31, 1982, only $1.08 million of the "guaranteed" $4.6 million funding shortfall had actually been provided by the GOI. Neither CLUSA nor USAID/Indonesia could explain why the GOI had not honored its financial commitment.

As it now stands, the project, as specified in the project paper, is underfunded. A determination should be made if there are sufficient funds available to carry out planned activities, and to assure project success.

Monitoring Responsibility Not Assigned

The problems that we found in project implementation indicates AID's monitorship needs to be strengthened. The first step would be to clearly assign responsibility. From July 1981 until April 1983, neither the USAID nor AID/Washington was actively monitoring the CLUSA/Indonesia project because each thought the other was responsible.

The Transfer Authorization did not specify which office had monitoring responsibility. The Transfer Authorization mentions the Mission as being responsible for certain duties prior to commodity procurement, and also notes the Mission as being the recipient of CLUSA quarterly reports. The FVA/FFP office in Washington thought that the Transfer Authorization was quite clear in placing monitoring responsibility with the Mission. However, the Mission officials told us that monitoring responsibilities rested in Washington because FVA/FFP had signed the Transfer Authorization.

Subsequent to our audit, the Chief of the Title II Office, FVA/FFP visited Indonesia and signed a draft statement clearly giving the monitoring responsibility for the CLUSA project to the Mission. This statement, also signed by the Mission Director, was countersigned in Washington by relevant CLUSA officials. However, the authority for amending the Transfer Authorization remains with FVA/FFP in Washington.

Conclusions

The CLUSA Indonesia project has a history of inadequate planning and ineffective monitorship. We believe these planning and monitorship deficiencies are the major reasons why the project was experencing significant implementation problems. The following sections discuss in detail the nature of these problems.

PROJECT NEEDS TO BE RESTRUCTURED IF IT IS TO SUCCEED

A major goal of the project was to establish a profitable, self-sustaining cooperative service center in Klaten by June 30, 1984. PUSPETA Klaten was to serve as a model for replication throughout Indonesia. However, the project has lost money steadily since inception and, if not re-structured, will continue to do so.

PUSPETA Klaten Operating At A Loss

Our analysis of the earnings statements obtained from CLUSA showed that the PUSPETA Klaten was operating at a loss.

	1981	1982 (Last 3 Quarters)
Revenues	$748,482	$881,150
Expenses	782,348	884,455
Profit (Loss)	$(33,866)	$(3,305)

Note: All dollar figures in this section of the report were converted at the rate of Rp 655 = US$ 1.00.

Our analysis of the backup to these statements and other data shows that the PUSPETA Klaten has and may produce even more losses within the foreseeable future. For instance, the above expense figures do not include depreciation charges for capital equipment and bad debt expenses relating to accounts receivable.

In mid-1984, PUSPETA Klaten must also begin repaying principal and interest incurred on a $1 million loan from the GOI Department of Finance. Moreover, at that time, AID and GOI funding for PUSPETA Klaten salary subsidies is to end. Both PUSPETA Klaten and CLUSA anticipated continuing payment of these salary subsidies from PUSPETA Klaten profits. Consequently, by July 1984, PUSPETA Klaten must generate about $160,308 annually in additional funds to meet its loan repayment schedule, plus at least $40,390 annually to meet salary subsidy payments.

Neither CLUSA nor PUSPETA Klaten was able to demonstrate with documented projections which of the PUSPETA's income producing operations would generate the necessary funds to cover all of its future financial obligations. Should PUSPETA Klaten fail to meet its financial obligations, CLUSA's long term objective of convincing the GOI to restructure the Indonesian cooperative movement would be jeopardized.

Project Funds Depleted By Unusually High Subsidies

CLUSA had been paying both salary and housing subsidies to PUSPETA Klaten personnel from project funds. These subsidies resulted in salaries to Klaten personnel which were four to five times higher than for comparable positions in GOI cooperative service centers.

Local national personnel at all of the cooperative service centers, including the one at PUSPETA Klaten, were receiving salary subsidies. Salary subsidies valued at $43,000 were paid to 25 PUSPETA personnel through December 31, 1982. The amount of subsidy varied depending on the position of the employee in the organization. For instance, monthly salary subsidies for PUSPETA Klaten personnel paid for with project funds ranged from $38 to $496. The manager of PUSPETA Klaten received a salary subsidy of $496 monthly from project funds, for a total salary of $611 per month. This was more than the salary of higher level officials within the GOI Ministry of Cooperatives.

GOI officials told us that these high salaries created serious problems for the cooperative movement. They believe that PUSPETA Klaten personnel staff should be properly paid, but at a lower level, with a bonus system based on profits. For example, there are some managers of other GOI cooperatives who earned up to $381 per month over their base salary, but the additional payments came from profit bonuses -- not salary subsidies.

CLUSA was also paying housing subsidies with project funds. PUSPETA Klaten requested and received $3,740 in housing allowances for four management level employees for the period July 1981 through December 1982.

We question whether any of these salary and housing subsidies, which depleted project funds, had any beneficial effect on project implementation.

Accounts Receivables Delinquent

PUSPETA records showed that a large amount of credit extended to farmers and businesses was not being repaid on schedule. In addition, no provisions had been made to write-off any bad debts. As of December 31, 1982, the PUSPETA Klaten balance sheet showed receivables valued at $225,000. Of this amount PUSPETA Klaten records listed $78,700 (35 percent) as being more than 90 days past due. After we reported our audit findings to the Mission, the GOI Department of Finance undertook a detailed audit of PUSPETA Klaten records. Their findings were that as of December 31, 1982, PUSPETA Klaten total receivables were $176,000, not the $225,000 shown on the PUSPETA Klaten balance sheet. These differences resulted because the PUSPETA Klaten had

several weaknesses in its administration of accounts receivables. Debt cards were not being kept up to date and debt write-off procedures were not satisfactory. PUSPETA Klaten has begun to resolve these accounting deficiencies, and bad debt write-offs are supposed to start in the first quarter of 1984.

Dairy Feed Operations Not Profitable

The dairy feed operation at PUSPETA Klaten cannot generate a profit for the cooperative or its members. Moreover, farmers in only one of four KUDs 1/ were participating, and only 71 of 1,000 dairy cows provided by the National Dairy Cooperative were involved in the program. This was hardly the ideal model for replication envisioned by project planners.

CLUSA's original plans were to produce corn silage to feed beef cattle. But, with the introduction of dairy cows into the area in early 1982, CLUSA decided to initiate dairy feed operations. By mid-March 1982 the National Dairy Cooperative provided about 1,000 dairy cows to be sold to farmers in the Klaten district. The PUSPETA Klaten, however, was not able to effectively manage these cows because of delays in acquiring feed and equipment; and the long lead time required to build silos, grow corn, and construct the silage. Furthermore, the quality of the cows provided was very poor. The majority of the cows were in weak condition. Most were estimated to be grossly undersized and underaged for the price charged to the farmers.

CLUSA predicted that the poor condition of the heifers would cause hardships for the farmers in the "growing-out", breeding and lactation process. However, CLUSA also believed that supplemental feeding would enable the heifers to reach full production capacity; but additional financing was needed to do this. CLUSA attempts to obtain this financing from the GOI were unsuccessful. As a result, many of the cows will never reach their full milk producing potential.

Our profit/loss calculations, drawn from CLUSA's quarterly reports and discussions with CLUSA personnel, indicate that farmers participating in the PUSPETA Klaten dairy project were losing at least 70 cents per cow each day. Since each cow required about 20 kilograms of feed at 11 cents/kilo per day, the farmer had to pay about $2.20 per day for maintenance. Even with a high milk production level of 8 liters a day per cow (the cows at the demonstration site were producing 6 liters), the farmer could not pay the full cost of the feed. After returning the 3 liters of milk required to liquidate his loan for the cow, the farmer's daily loss per cow was 77 cents, computed as follows:

1/Koperasi Unit Desa or village cooperative unit.

Daily Income - 8 liters at 28.6 cents	$ 2.29
less - Cow Loan Repayment - 3 liters	.86
Balance	$ 1.43
Less - Cost of Feed - 20 kg @ 11 cents	2.20
Net Loss	$(.77)

The few farmers remaining in the project apparently participated because PUSPETA Klaten was selling the feed on credit, and by not paying their feed bills, the farmers could actually have a daily cash surplus of $1.43.

Not following the implementation plan as it pertained to silos added to the problem. The project paper called for two small silos that were to cost a total of $4,580. However, CLUSA and PUSPETA Klaten management decided to build two large silos for silage and a smaller one for molasses. CLUSA reports showed the cost these three silos totaled $20,610. In addition to costing 450 percent more than planned, these silos had the capacity to support about 200 dairy cows, almost three times the number in the program as of December 1982.

Coordination, Planning And Evaluation Committee Not Established

The July 1981 Transfer Authorization (Appendix E, Section 9) called for the GOI to assist PUSPETA Klaten in its development efforts by establishing a Committee for Coordination, Planning and Evaluation within the Directorate of Cooperatives. This committee would help the PUSPETA Klaten set up meetings with GOI agencies, review and evaluate PUSPETA Klaten activities on a quarterly basis, and meet with the PUSPETA Klaten Board of Directors once a year. As of March 25, 1983, the Committee had not yet been established. Although Section 9(a) of Appendix E states the Committee will be selected at a later date, the project now has less than a year to go, and the value of such a committee diminishes as the project completion date approaches.

The evaluation requirements set forth in the Transfer Authorization also had not been met. Section 7.0 specified that "A special joint CLUSA-GOI-AID evaluation of the PUSPETA Project...will be undertaken at the end of the first year of project implementation. This evaluation will determine if the project is on track in meeting objectives..." The project paper called for the evaluations to include such topics as:

* operating profits of the PUSPETA Klaten and each of the KUDs;

* a summary of supervised member projects with estimates of aggregate increases in incomes in the community;

* summary estimates of total direct and indirect income generation in the Klaten district resulting from integrated PUSPETA and KUD activities; and

* an evaluation of progress made in achieving the objectives of the program.

As of February 1984, the evaluation had not been made.

Conclusions and Recommendations

CLUSA was not able to demonstrate with projections which of the operations would generate the funds necessary to cover the operating expenses and future financial obligations of PUSPETA Klaten. A decision needs to be made by the Mission whether or not AID should continue financing the CLUSA project. Unless CLUSA can clearly show the PUSPETA Klaten can become a financially viable organization, the Mission has little choice but to cut off all AID support for the project.

Recommendation No. 1

USAID/Indonesia, together with CLUSA and the GOI, promptly undertake an evaluation of the PL 480, Title II commodity grant project. The evaluation should determine whether the PUSPETA Klaten operations can be restructured to generate the funds necessary to meet all of its future financial obligations and, thus, become self-sustaining. Particular attention should be given to payment of subsidies, credit and collection procedures, and dairy feed activities. If such restructuring is not feasible, USAID/Indonesia should terminate all AID funding for the project.

Mission Comments

USAID/Indonesia is also concerned about the financial viability of the project, and stated that this question would have been answered some time ago but for the weak management of the project. In response to our draft report, the Mission noted that the project is under new management. Further, the Mission believes the new CLUSA management is working effectively to resolve the problems which have "plagued" the project. The USAID commented that improvements in management systems were being made; the economic viability of the project looks more encouraging; an agreement for phasing out the salary subsidies has been reached between CLUSA and PUSPETA Klaten; and the dairy feed program has been reduced in half to minimize its adverse effect on project income. The Mission further noted that a full evaluation of the project will be undertaken when the new CLUSA management is firmly in place. The Mission concluded that prudent restructuring of the project and slower drawdown of funds may lead to an extended and more successful project.

MAJORITY OF REPORTED PROJECT COSTS NOT ACCEPTED

Through December 31, 1982, CLUSA reported total costs of $647,728 expended under the Title II grant, as shown in the summary below. Only $142,780 of these costs were audit acceptable. The difference, $504,948, is comprised of costs questioned or suspended, as of December 31, 1982.

	Budgeted	Expended	Questioned	Suspended	Accepted
Salaries	$ 29,460	$ 21,556			$ 21,556
Consultants	103,500	400			400
Fringe Benefits	10,260	2,818			2,818
Travel & Transportation	60,300	24,486			24,486
Allowances	82,860	39,506			39,506
Other Direct Costs	26,520	13,144			13,144
Participant Training	50,000	23,140	$ 23,140 a/		0
Overhead	87,100	40,870			40,870
Subordinate Agreement with PUSPETA Klaten	950,000	481,808	2,356 b/	154,351 c/ 325,101 d/	0
	$1,400,000	$647,728	$ 25,496	$479,452	$142,780

Notes: a/ Participant training questioned for propriety under AID regulations. (p. 14)

b/ Commodity costs questioned because of ineligible source/origin. (p. 16)

c/ Amount booked as "Working Capital" which is not allowable as an expense until properly identified and accounted for.

d/ Balance of subordinate agreement costs suspended for lack of substantiation. Costs reported by CLUSA/Washington were inconsistent and not reconciled with CLUSA/Indonesia records. (p. 12)

Through the same period, CLUSA reported total costs of $62,069 expended under the support grant (82-3). These costs included wages and benefits for two CLUSA staff members who were providing technical assistance to the project in Klaten ($46,320), plus overhead at 34 percent ($15,749). All costs were properly substantiated and accepted.

It is our view that the costs questioned are unallowable for AID financing and should be refunded to the project account. Suspended costs may be allowable, but are not audit acceptable until CLUSA clearly identifies and substantiates the charges as being proper and chargeable to the grant, and in accordance with U.S. Government regulations. Suspended costs should be negotiated between USAID/Indonesia and CLUSA. We have provided additional information on specific costs questioned and suspended in the following section.

Recommendation No. 2

USAID/Indonesia: (a) require CLUSA to refund $25,496 of costs questioned to the project account; and, (b) negotiate with CLUSA to settle suspended costs of $497,452 under Title II.

Accounting Records Inconsistent And Unreconciled

There were substantial unreconciled differences between the accounting records maintained under CLUSA/Indonesia supervision at PUSPETA Klaten and the expenditure reports submitted to AID by CLUSA's Washington office. For example, CLUSA/Indonesia records of the PUSPETA Klaten project show expenditures of $230,802 under the "subordinate agreement" through December 31, 1982, while total expenditures reported by CLUSA's Washington office under this classification for the same period were $481,808. A large part of this difference could be attributed to late recording of project commodities in PUSPETA Klaten books. It was not until March 10, 1983, that the CLUSA Representative provided PUSPETA Klaten with the journal entries to be posted for equipment, some of which was received one year earlier. However, there were significant discrepancies in other expense items that could not be explained. The task of reconciling was made more difficult by CLUSA's lack of standardization in classifying expenses. Discrepancies and lack of standardization are evident in the following comparison of CLUSA documents:

	Costs Expended Under Subordinate Agreement With PUSPETA Klaten		
	CLUSA/Washington Reports	CLUSA/Indonesia Records	Difference
Salary Subsidies	$ 34,861	$ -	$ 34,861
Salary Subsidy and Housing	-	$ 38,630	(38,630)
Travel and Allowance	3,769	-	3,769
Training Programs & Misc. Expenses	9,423	-	9,423
Clearing Documents, etc. Charges	-	13,175	(13,175)
Equipment	-	14,813	(14,813)
Equipment & Vehicles	19,705	-	19,705
PUSPETA Vehicle	-	9,654	(9,654)
Fixed Assets & Equipment	259,699	-	259,699
Bank Charges	-	179	(179)
Working Capital	154,351	154,351	-
Total	$481,808	$230,802	$251,006

Further discrepancies appeared in a comparison of CLUSA documents pertaining to silo construction. Three silos were built at KUD Karangnonko for the dairy feed operation. CLUSA/Washington reported the total cost to be $20,738, while the records at PUSPETA Klaten showed the total to be only $9,713.

The purchase of an extruder with accessories further exemplified differences in recorded costs and expense classification:

Item	CLUSA/W Records	PUSPETA Records	Differences
Extruder	$ 21,120	$ 24,750	$(3,630)
Volumetric Feeder	2,295	2,700	(405)
3 HP Cutter	2,903	3,400	(497)
Water Injection System	893	1,040	(147)
Exhausted Conditioner	1,271	1,488	(217)
Spare Parts Package	2,000	2,340	(340)
Moisture Testers (2)	640	658	(18)
Crating	400	400	-
Inland Freight	1,722	-	1,722
Handling Charges	216	-	216
Inland Freight & Clearance	-	1,714	(1,714)
Ocean Freight	5,745	-	5,745
Insurance	813	-	813
Freight & Insurance	-	3,122	(3,122)
Total	$ 40,018	$ 41,612	$(1,594)

Most of the differences in costs involved equipment. CLUSA could not explain the differences, but promised to provide us with explanations and a reconciliation. However, we have not yet received the reconciliation as promised by CLUSA.

Conclusions and Recommendation

Reconciliation of the discrepant charges is necessary to assure the integrity of the accounting records. In the absence of this assurance, the charges are not substantiated. Accordingly, we have either questioned or suspended all costs classified under the subordinate agreement with PUSPETA Klaten. (See p. 12.)

To facilitate the settlement of subordinate agreement costs and provide better control of future costs, CLUSA should standardize its accounting procedures and account classifications. Standardized procedures and account classifications should be used in all CLUSA offices.

Recommendation No. 3

USAID/Indonesia require CLUSA to standardize its accounting procedures and account classifications for better control of project costs.

Mission Comments

The Mission basically agrees with our findings contained in this section. In this respect, the USAID is requesting from CLUSA/Washington (1) clarification on certain aspects of the project's working capital account, (2) substantiation of the sub-grant costs for PUSPETA Klaten, (3) evidence that a standard cost coding system is in place, and (4) reconciliation of CLUSA/Washington and PUSPETA Klaten costs records.

AID Regulations On Participant Training Not Observed

The CLUSA Representative and the Project Coordinator at Klaten took five Indonesian officials on a "Participant Training and Observation Trip" to the United States from August 20 through September 13, 1981. The total cost ($23,140) of this trip was paid from Title II grant funds. We are questioning the propriety of this trip since it was taken without considering AID regulation requirements. According to AID Handbook 10, participants are subject to AID participant training policies, regulations, and reporting procedures. The Handbook requires that consideration be given to the following factors in developing a training request:

-- Joint development by the host country and the technical offices of the Mission of the scope and objectives of the training;

-- The functions of the job for which the Participant is being trained and the minimum requirements of skill, knowledge, and understanding the participant must acquire to perform these functions; and,

-- The qualifications of available candidates.

None of these factors were considered by either the Mission or CLUSA prior to the trip. The extent of planning the participant training component of the project consisted of a single line item in the budget for the Transfer Authorization. Participant training is not even mentioned in the project paper.

The travel party included the following individuals:

Indonesian Officials

Director of Cooperative Business Affairs,
Directorate General of Cooperatives

Head of the Economic Division,
Regional Office, Kabupatan Klaten

Head of Cooperative Office, Kabupatan Klaten

PUSPETA Klaten General Manager

Counterpart of CLUSA Resident Representative

CLUSA Personnel

CLUSA/Indonesia Resident Representative

CLUSA Advisor for PUSPETA Klaten

Administrative Assistant/Secretary,
CLUSA/Indonesia

The purpose of the trip was for an observation and buying tour. In its September 30, 1981 Quarterly Report, CLUSA stated that the three week trip included visits to dairy, beef and swine farms, primary and secondary cooperatives, small agribusiness machinery manufacturing plants, feed mills, and small meat-processing plant, all in the midwestern area of the United States.

We do not believe this trip qualifies as "participant training." The travel to the U.S. was neither justified nor approved by the Mission beforehand. We have recommended that the Mission recover the $23,140 expended from CLUSA for this trip. (See p. 12.)

Mission Comments

The USAID agrees that the travel, in substance as well as in form, was not participant training. However, the USAID is considering accepting the cost as "Invitational Travel." Such travel is authorized for U.S. and foreign citizens when it is determined that the functions to be performed are essential to the interest of the Agency. In this respect, the Mission is requesting a written justification from CLUSA which would support the cost of the trip as "Invitational Travel." The justification would serve as a basis for acceptance of the travel cost which was classified by CLUSA as participant training.

We do not believe that the Mission should go out of its way to help CLUSA reclassify this questioned cost. Moreover, if the USAID determines that the questioned travel can be construed as "Invitational Travel," it will be put in a position of retroactively approving an expense which was not included in the project budget.

Equipment Procured From Ineligible Sources

CLUSA disregarded AID source/origin requirements in the procurement of some project commodities. Total cost of the ineligible items, paid from PL 480, Title II funds, was $12,063.

CLUSA purchased an extrusion cooker from a U.S. company for the production of enhanced feed. The total cost of the extruder was $35,718, which included the cost of a large electric motor. When this same motor was found not to be compatible with PUSPETA Klaten generators, CLUSA authorized the purchase of a second motor ($2,356) which would work with the generators. The second motor was manufactured in the People's Republic of China, an ineligible source for AID financed commodities. CLUSA had also expended project funds to purchase a Toyota Hi-Ace diesel van ($9,707), without prior approval from AID.

According to Handbook 13, Appendix 4C, none of these items were eligible for AID financing because there were no documented justifications, source/origin waivers, or prior written authorizations from AID. We recommended that USAID/Indonesia recover the cost expended by CLUSA for these ineligible commodities. The USAID responded that a retroactive waiver had been issued approving the purchase of the Toyota van. In addition, the cost of the electric motor has been refunded by PUSPETA Klaten. We have, therefore, changed the recommendation to recover from CLUSA only the cost ($2,356) of the ineligible electric motor. (See p. 12.)

Equipment Procured Unsuitable

Project funds were used to purchase equipment which could not be used as planned or was not being used at all. CLUSA purchased a forage harvester valued at approximately $13,000 (including spare parts and freight), with the intention of using it to harvest corn for silage in the fields around Klaten. However, the machine was too large for use in the small, furrowed fields in the area.

CLUSA also constructed a silo for the collection of molasses at its dairy demonstration center. The molasses would be used to enhance the nutritional value of silage processed at the center for cattle feed. The estimated cost of this silo was $5,000. The silo was standing idle because CLUSA and PUSPETA Klaten had not found an efficient way of filling it with molasses. CLUSA officials told us they were considering the purchase of a pump to put the silo into operation.

CLUSA purchased an extrusion cooker with a 220/440 volt motor for its feed mill operations. The electric motor was not compatible with PUSPETA generators producing 380 volts. Therefore, an additional $6,057 in project funds was paid for a substitute motor, additional parts, and labor necessary to adapt the extrusion cooker to PUSPETA Klaten generators. The 220/440 volt motor was sitting idle in the PUSPETA Klaten storage room at the time of our audit.

These examples demonstrate further waste of project funds and indicate that CLUSA needs closer supervision in the procurement of capital equipment.

Mission Comments

In our draft report, we recommended that USAID/Indonesia establish procedures for the review and approval of proposed capital equipment purchases for the PUSPETA Klaten project. The Mission concurred with this recommendation and has advised CLUSA/Indonesia that all capital items costing over $5,000 require prior Mission clearance before they can be purchased. Because of this action, we have deleted the recommendation in the final report.

Inventory Controls Lacking

The management at PUSPETA Klaten had not been performing any physical inventory counts of project equipment and material. Although our inspection of a small sample of the equipment revealed no discrepancies or missing items, prudent management would require that the physical inventory be controlled by verification on a regular and continuing basis.

Recommendation No. 4

USAID/Indonesia require the PUSPETA/Klaten to establish a procedure for taking regularly scheduled project commodity inventories.

Mission Comments

The Mission stated the intention of working closely with CLUSA on developing inventory control procedures.

STANDARD GRANT PROVISIONS AND PROCEDURES SHOULD APPLY FOR TITLE II GRANTS AWARDED TO PRIVATE VOLUNTARY ORGANIZATIONS (PVOs)

AID standard grant provisions were incorporated by reference into the PL 480 Title II Commodity Transfer Authorization (Appendix F, Item 2). However, the AID Food for Peace Office did not require CLUSA to follow these grant provisions. Rather, FVA/FFP treated the grant to CLUSA like it would a Title II commodity transfer. In addition, present AID regulations contain insufficient guidance for the administration of Title II commodity grants which are used to finance PVO-sponsored development projects. We believe that if similar Title II grants are awarded in the future, they should be administered by AID the same way as other PVO development grants. These Title II grants also should be subject to AID standard grant provisions and procedures.

Title II regulations published in AID Handbook 9, do not provide guidance for projects like the one sponsored by CLUSA in Indonesia. Handbook 9 deals primarily with the receipt and distribution of commodities. It contains little guidance on the functions of project management. Regulation 11 (also incorporated in Handbook 9) is the governing document on Title II transfers,

but it deals only with the transfer of agricultural commodities to foreign governments, U.S. voluntary agencies, or intergovernmental organizations. It does not provide guidance on project management, administration, or funds control.

The Transfer Authorization for the CLUSA Title II grant also contained provisions which would normally not be permitted in most grant agreements or PL 480 local currency agreements. For example, CLUSA was authorized unrestricted changes in budget line items, AID had no prior approval over funds usage; AID did not receive vouchers accounting for funds spent; and AID had little leverage over the implementing organization because CLUSA had complete control over the grant funds.

Conclusions and Recommendation

The method of financing the CLUSA/Indonesia Title II project is new. Title II commodities are usually donated to developing countries and distributed to needy recipients. However, in this case, the commodities were sold and the proceeds applied to a development project sponsored by a private voluntary organization. AID regulations provide little guidance on how the proceeds from the sale of Title II commodities for PVO sponsored development projects should be administered. We believe that the lack of specific guidelines and regulations, as well as general noncompliance with standard grant provisions, contributed to the project and financial control problems discussed in this report. Accordingly, we recommend that:

Recommendation No. 5

FVA/FFP develop guidelines for the management and control over PVO-sponsored development projects that are financed through Title II commodity grants, should such grants be awarded in the future.

COST OVERRUN UNDER GRANT (ASIA-G-1180) SHOULD BE RECOVERED

On March 21, 1983, CLUSA reported that a cost overrun under grant ASIA-G-1180 was expected to reach $21,000 and requested that these costs be absorbed by the PL 480, Title II grant. Both the Mission and FVA/FFP concurred with this request. As of July 21, 1983, $9,848 in cost overruns had been reimbursed from Title II funds. This reimbursement is in conflict with Federal Procurement Regulations, Subpart 1-15.603-2,21, which states: "Any excess of costs over income on any award is unallowable as a cost of any other award."

Recommendation No. 6

USAID/Indonesia: (a) inform CLUSA that the cost overrun under grant ASIA-G-1180 cannot be charged to any other U.S. Government grant or contract, (b) recover from CLUSA all cost overruns reimbursed to date, and (c) establish procedures to ensure future compliance with the Federal Procurement Regulations.

EXHIBIT A

LIST OF REPORT RECOMMENDATIONS

Recommendation No. 1

USAID/Indonesia, together with CLUSA and the GOI, promptly undertake an evaluation of the PL 480, Title II commodity grant project. The evaluation should determine whether the PUSPETA Klaten operations can be restructured to generate the funds necessary to meet all of its future financial obligations and, thus, become self-sustaining. Particular attention should be given to payment of subsidies, credit and collection procedures, and dairy feed activities. If such restructuring is not feasible, USAID/Indonesia should terminate all AID funding for the project. (See p. 6.)

Recommendation No. 2

USAID/Indonesia: (a) require CLUSA to refund $25,496 of costs questioned to the project account; and, (b) negotiate with CLUSA to settle suspended costs of $497,452 under Title II. (See p. 10.)

Recommendation No. 3

USAID/Indonesia require CLUSA to standardize its accounting procedures and account classifications for better control of project costs. (See p. 12.)

Recommendation No. 4

USAID/Indonesia require the PUSPETA/Klaten to establish a procedure for taking regularly scheduled project commodity inventories. (See page 17.)

Recommendation No. 5

FVA/FFP develop guidelines for the management and control over PVO-sponsored development projects that are financed through Title II commodity grants, should such grants be awarded in the future. (See p. 18.)

Recommendation No. 6

USAID/Indonesia: (a) inform CLUSA that the cost overrun under grant ASIA-G-1180 cannot be charged to any other U.S. Government grant or contract, (b) recover from CLUSA all cost overruns reimbursed to date, and (c) establish procedures to ensure future compliance with the Federal Procurement Regulations. (See p. 18.)

EXHIBIT B

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 Food for Peace and Voluntary Assistance	
Assistant Administrator	2
Bureau for Science & Technology:	
Office of Development Information & Utilization (S&T/DIU)	2
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

OTHERS

Regional Inspector Generals:

RIG/A/Washington	1
RIG/A/Nairobi (Africa East)	1
RIG/A/Dakar (West Africa)	1
RIG/A/Cairo (Egypt)	1
RIG/A Karachi (Near East)	1
RIG/A/Latin America	1
RIG/II/Manila	1
AAP/New Delhi	1