

AGENCY FOR INTERNATIONAL DEVELOPMENT

UNITED STATES A. I. D. MISSION TO BRAZIL

AUDIT REPORT

OF

ELEMENTARY AND BASIC EDUCATION IN THE BRAZILIAN NORTHEAST

STATE OF SERGIPE

PROJECT AGREEMENT No. 512-N-64-AE

FOR THE PERIOD

JULY 30, 1963 THROUGH MAY 31, 1966

REPORT NO. 10/67

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OFFICE OF THE CONTROLLER

USAID/BRAZIL

DATE: OCTOBER 20, 1966

PD AAR 667 SERGIPE

AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES A.I.D. MISSION TO BRAZIL
Office of the Controller

October 20, 1966

TO The Director of Mission
Minister Stuart H. Van Dyke

The Office of the Controller has completed an examination of the Sergipe Elementary and Basic Education project covering the period from July 30, 1963 through May 31, 1966. Our attached audit report contains 13 recommendations for program improvement which for convenience are listed separately in Exhibit A (pp. 19-20).

Under a loan agreement with SUDENE, USAID obligated Cr\$17.2 billion of Public Law 480 Title I funds for a program of school construction in 8 states of the Northeast. SUDENE in turn grants the funds to individual states pursuant to separate project agreements with each State. The Sergipe agreement provided for a grant of Cr\$1,275 million of AID funds over a three year period ending in July 1966. Additional contributions totaling Cr\$350 million were to be made by SUDENE and the State.

The Sergipe program provided for the construction and reconstruction of 900 classrooms, construction of supervisory centers, 3 teacher training centers, 4 industrial workshops, procurement of school equipment, and teacher training programs. The program is administered by a State organization known as "Comissão Executiva para Programas Cooperativos de Educação no Estado de Sergipe (CEPCES)."

As of May 31, 1966, the three signatories to the project agreement (USAID/B, SUDENE, and the State) had released a total of Cr\$1.5 billion of the Cr\$1.6 billion pledged. Of the funds released, the State had expended Cr\$1,341 million.

Implementation of this project has been highly unsatisfactory. Significant deficiencies found in the program are cited below:

1. Nine hundred classrooms were to be constructed or reconstructed during the 36 month period of this program. However, during the 34 month period covered by our audit, only 164 classrooms were either constructed or reconstructed. Approximately 62 per cent of the project funds budgeted for constructional reconstruction has been expended as compared with 19 per cent of the physical goals attained. It is estimated that Cr\$120 millions will be required to finish construction under way. Since the latter expenditure will exhaust funds presently available, no new construction activity is anticipated under the present program (p. 5).

2. CEPCE's engineering staff lacked the competence and personnel to administer a program of the size undertaken. Architectural plans were usually faulty and incomplete, and costly adjustments had to be made after construction had started (pp. 5-6).

3. Construction contractor capabilities were poor, and buildings were often unsafe for occupancy. A training center at Aracaju collapsed and was subsequently abandoned (p. 6).

4. Construction planning for the program was unsatisfactory. Long delays were encountered until sites were selected and approved, deeds legalized, and SUDENE and NEAO approval obtained (pp. 6-7).

5. Construction/reconstruction work was not subject to the usual public competitive bidding practices proscribed by Brazilian regulations. Contracts were let to the lowest bidders, but subsequent upward adjustments added more than 50 per cent additional to original bid costs. USAID consulting engineers advised that they were not permitted by CEPCE to review contracts or adjustments prior to awards (p. 7).

6. Three contracts were awarded on a cost plus a percentage of cost basis. The AID engineering consultant subsequently warned that such a system lent itself to serious abuses. Costs on those three contracts eventually amounted to 3-1/2 times the original estimates (pp. 8-9).

The John Kennedy school exemplifies the inherent inefficiency of contracts awarded on a "cost plus" basis. Originally budgeted to cost Cr\$38 million, it is currently budgeted at Cr\$160 million. AID's engineering consultants informed us that the actual cost for this school should not have exceeded Cr\$90 million, inflation considered (pp. 9-10).

7. There was a high incidence of school buildings not completed and/or used. Of 33 buildings observed, 8 were found not to be utilized. Six buildings were not being completed because of construction deficiencies; two others which had been completed were not used because of lack of teachers (pp. 10-11).

8. Responsibility for maintenance of buildings was that of the State of Sergipe. However, there was no continuous maintenance program because of a lack of funds and competent engineering staff. Deterioration is already a problem in a few of the schools completed (p. 12).

9. There were no adequate receiving, distribution, or stock records for school equipment purchased. Equipment was generally not well distributed or effectively employed. Warehouse facilities were completely inadequate. Three of 7 vehicles purchased from USAID funds for supervisory centers were requested by the State Governor for uses outside the project (pp. 13-14).

10. CEPCE's accounting procedures were poor, and there are no effective controls to safeguard against fraudulent use of funds. There was no qualified accountant to maintain proper books of account (pp. 16-17).

11. SUDENE did not effectively discharge its responsibilities with regard to auditing, checking execution of plans, and inspection (pp. 17-18).

12. Although inflation was a significant factor contributing to unsatisfactory results, poor planning, execution, and monitoring were

also major underlying factors.

The NEAO seems to be aware of many of the difficulties cited above, and its "Task Force" is working to define problem areas and initiate corrective action.

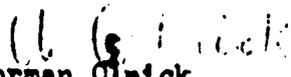

Norman Olmick
Controller

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AGENCY FOR INTERNATIONAL DEVELOPMENT
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AUDIT REPORT
OF
ELEMENTARY AND BASIC EDUCATION IN THE BRAZILIAN NORTHEAST
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SECTION I - INTRODUCTION

A. PURPOSE

The purpose of this examination was to review and evaluate the progress achieved as related to the project agreement, to determine the extent of compliance with its terms, and to verify that funds were properly utilized.

B. SCOPE

This is the initial audit of this project agreement in the State of Sergipe, covering the period from inception on July 30, 1963 through May 31, 1966. During the course of our audit, we examined records and related files in the USAID/B/NEAO offices of the Assistant Controller, the Education Branch, and the Engineering Branch. Meetings and discussions were held with officials of Comissao Executiva para Programas Cooperativos de Educaçao no Estado de Sergipe (CEPCES) and their pertinent records were reviewed. Meetings were also held with the Secretary of Education. Field trips were made to 30 schools and 3 training centers for purposes of physical observation and evaluation. Related discussions were held with principals and teachers of the schools visited.

Our examination was made in accordance with applicable manual orders, other directives, and generally accepted auditing standards considered appropriate in the circumstances. The audit was conducted jointly with SUDENE auditors who are issuing their own, separate report.

We reviewed and discussed the findings in this report with officials from the NEAO Education Branch, and Engineering, Industry and Natural Resources Division, who indicated general agreement with findings and recommendations contained herein.

SECTION II - GENERAL

A. LOAN AGREEMENT

On May 3, 1963, USAID/B extended a Cr\$10,800,000,000 local currency loan (512-G-012) to the Superintendência do Desenvolvimento do Nordeste (SUDENE) for the improvement and expansion of basic education in the Northeast. The amount of this loan was subsequently increased by two separate amendments to Cr\$17,280,592,000.

On July 30, 1963, SUDENE, USAID/B, and the State of Sergipe entered into Project Agreement No. 512-N-64-AE under which SUDENE agreed to make available to the State of Sergipe, as a grant from the Federal Government, the amount of Cr\$1,275,357,000 from the USAID/B loan proceeds. The scope of this project agreement provided broadly for the construction and reconstruction of 900 classrooms, construction of 8 supervisory centers, construction and/or reconstruction of 3 training centers, construction of 4 industrial workshops, equipment, and teacher training programs.

USAID/B loan funds were generated from the Second Salou Agreement under Public Law 480 Title I, Section 104 (g).

SECTION III - FINDINGS AND RECOMMENDATIONS

A. FUNDING

1. General

A total of Cr\$1,625,357,000 was pledged by the signatories to accomplish the objectives of this project. The records disclosed that as of May 31, 1966, (CEPCES), the State organization responsible for co-

ordinating the project, recorded the receipt of Cr\$1,519,801,451, as shown herewith.

| | <u>OBLIGATION</u> | <u>FUNDS PROVIDED</u> |
|------------------|--------------------------|--------------------------|
| USAID/B | Cr\$1,275,357,000 | Cr\$1,225,357,000 |
| SUDENE | 100,000,000 | 100,000,000 |
| State of Sergipe | <u>250,000,000</u> | <u>194,444,451</u> |
| TOTAL | <u>Cr\$1,625,357,000</u> | <u>Cr\$1,519,801,451</u> |

The final contribution date under the project agreement was July 29, 1966. An amendment to the project agreement is in process which will extend that date. The USAID/B released the above funds in 3 tranches which were properly deposited to a separate account opened in the name of the project at the Banco do Nordeste do Brasil, hereinafter referred to as the USAID/B account. As of May 31, 1966, the USAID/B account reflected an unexpended balance of Cr\$139,734,380.

We found that a check for Cr\$50 million, dated September 24, 1965, and payable to the State of Sergipe has not been delivered. NEAO has been withholding delivery of this check, with the approval of SUDENE, pending resolution of difficulties at the Aracaju Training Center which collapsed due to construction difficulties (see page 6). The construction of the Training Center will cost about Cr\$100 million, so that the proceeds being withheld represent only about 50 per cent of total funding required. However, the State has not demonstrated its ability to provide necessary funds once construction has been started.

As of May 31, 1966, interest in the amount of Cr\$7,383,719 had been earned on USAID/B funds, and Cr\$5,044,675 of this sum had been spent on project activities. No prior authorization had been obtained for the expenditure of these funds, as required by the project agreement. Such authorization should be obtained.

Under the project agreement, the State of Sergipe pledged Cr\$250 million toward implementation of the program. The State was to deposit its funds at a minimum rate of Cr\$6,944,444 per month for the 36 month period of the agreement. As of May 31, 1966, the State had provided

only Cr\$194,444,451, representing 28 monthly payments. No State releases have been made since January 1966. As of May 31, 1966, the State should have released Cr\$236,111,111, or the equivalent of 34 months' contribution. The State of Sergipe is therefore Cr\$41,666,660 in arrears, or 6 months behind in its agreed payments. It is our opinion that NEAO should consider withholding further releases of funds until the State fulfills its financial obligations.

Recommendation No. 1

That the NEAO Education Branch initiate appropriate action requiring the State to respect its financial obligations.

B. PROJECT PROGRESS

1. General

Through May 31, 1966, CEPCES had expended Cr\$1,080,079,867 from the USAID/B account for the following activities:

| | |
|---------------------------------|--------------------------|
| Construction and reconstruction | Cr\$ 768,383,160 |
| Equipment | 146,128,958 |
| Training | 13,936,011 |
| Other | <u>151,631,738</u> |
| TOTAL | <u>Cr\$1,080,079,867</u> |

Formal records of the above expenditures were seldom maintained. In those instances where we found records, they were usually unreliable. The above figures were taken from reports which usually could not be cross-referenced to accounting records.

2. Construction and Reconstruction

During the 34-month period elapsed since the signing of the project agreement, less than 19 per cent of the physical objectives had been started or completed. This fact is reflected in the following summary of construction and reconstruction work which accounts for reported expenditures of Cr\$768,383,160 of USAID/B funds.

| <u>Type of Construction</u> | <u>PROGRAM</u> | | <u>ACTUAL</u> | |
|------------------------------|----------------|--------------------------|---------------|------------------------|
| | <u>Number</u> | <u>Cost</u> | <u>Number</u> | <u>Cost</u> |
| Nowly Constructed classrooms | | | 81 | Cr\$416,212,315 |
| Reconstructed | | | 83 | 169,926,793 |
| | | | 164 | Cr\$586,139,108 |
| Total Classrooms planned | 900 | Cr\$ 983,420,000 | | |
| Supervisory Centers | 8 | 71,250,000 | - | 6,400,000 |
| Teacher Training Centers | 3 | 90,000,000 | 3 | 171,683,420 |
| Industrial Workshops | 4 | 77,400,000 | - | - |
| Educational Institute | 1 | 15,000,000 | 1 | 4,160,632 |
| TOTAL | | <u>Cr\$1,237,070,000</u> | | <u>Cr\$768,363,160</u> |

SUDENE and State contributions included.

Additionally CEPCEC records disclosed that Cr\$192,046,533 of SUDENE and State funds were disbursed for the program.

There are currently twenty schools still in varying unfinished stages, included in the figures above. According to CEPCEC's engineering records, approximately Cr\$120,000,000 of additional project funds will be required to complete this construction in progress. As of May 31, 1966, an unexpended balance of Cr\$178,372,129 of USAID/B funds, SUDENE, and State funds could be used for the completion of the construction program.

Inflation was a factor which seriously affected the success of this program. For example, the construction index for the State of Guanabara, which can be used for illustrative purposes, increased from 747 for 1962 to 4,249 for 1965. Coupled with this adverse climate of inflation, we also found many of the same factors cited in our audit reports on the educational projects of Maranhão, Ceará, and Paraíba, i.e., incompetent engineering, inadequate contractor capability and lack of proper planning. These factors, which are discussed below, augmented the already harmful impact of inflation:

CEPCEC engineering staff lacked the competence and personnel to administer a program of this magnitude. The CEPCEC engineering staff consisted of one architect, one engineer, two draftsmen, and three field inspectors. The Leo A. Daly Co., engineering consultant engaged by

AID/W, informed us that the architectural plans were usually faulty and incomplete, resulting in costly corrective changes after construction had started. Subsequent adjustments to the contracts, necessitated by changes in the scope of work, represented about 39 per cent of the total contract value as shown below:

| | |
|--------------------|--------------------------|
| Original contracts | Cr\$ 759,262,062 |
| Adjustments | <u>477,256,578</u> |
| TOTAL | <u>Cr\$1,236,518,640</u> |

According to the Leo A. Daly Co., the CEPCES field inspection group was particularly understaffed and inexperienced. Daly stated that CEPCES's inspection group visited jobs only once every three or four months and then was unable to recognize construction deficiencies and/or provide technical assistance.

Contractor capability was poor. The Leo A. Daly Co. disapproved practically all the construction and reconstruction under this program. In its January 1965 report to the NEMO, Daly emphasized this problem in the following words: "With all the time, effort and money which had been contributed to date, Sorgipe has completed five schools, all of which are unsafe for occupancy because of major construction deficiencies." During our end-use examination, we observed a training center (Aracajá) which had collapsed and was subsequently abandoned. We saw a school (Melhadec) which had been reconstructed but was in such poor condition that the teacher was actually holding classes in her residence.

The construction planning for this program was unsatisfactory. We found no evidence to indicate that adequate advance to control the implementation of the program. Notable among the deficiencies were the following:

- a. Schools were not selected or approved sufficiently in advance. Sites were selected only after funds were advanced for construction plans. Subsequently, long delays were usually encountered until the site was approved, the deed legalized and SUDIEM and NEMO approval

obtained. We found that most construction work was started and completed without SUDENE and NEAO approval.

b. Requests for funds were not prepared sufficiently in advance. We found that CEPCEB usually waited until it expended all funds before submitting an additional request for funds. As a result, construction program was temporarily suspended until additional funds were released.

Due to the limitation of funds under this agreement, no additional construction can be initiated. Consequently, corrective action appears restricted to the completion of construction in progress and correction of construction deficiencies. We therefore feel that NEAO should (1) survey on a school by school basis the funds required to complete or correct deficient construction, (2) use any remaining funds to complete schools on which construction has already begun, and (3) establish reporting requirements to assure that the funds are expended as required.

Recommendation No. 2

That the NEAO Engineering, Industry and Natural Resources Division initiate action to ensure that funds are allocated and controls instituted to complete the unfinished construction and remedy any deficient construction under this program.

a. Contracting Procedures

Construction and reconstruction work was not subject to the usual public competitive bidding practices prescribed by Brazilian federal regulations for governmental agencies. CEPCEB solicited non-public bids only from firms which previously were registered with the State Engineering Department. Fifty contracts amounting to Cr\$759,262,062 were awarded to such contractors. All bids examined by us revealed that the lowest bidder was awarded the contract. These contracts however, were subject to subsequent upward readjustments of Cr\$477,256,576. The Leo A. Daly Co. informed us that its representatives were not allowed by CEPCEB to review the contracts or adjustments before contractor awards were made. It is our opinion that this lack of control permitted serious abuses as reflected in the large number of readjustments subsequently given.

Other major deficiencies noted in the contracting procedures are presented below:

1. CEPCEB collected 3 per cent "fiscalization fees" on the total amount of adjusted contract values, these fees amounting to approximately Cr\$37,000,000. Fees collected on USAID/B funds were about Cr\$23,000,000. The records disclosed that these fees were used for payment of salaries and miscellaneous expenses. However, the project agreement (Section III C 8) specifically states that these expenses should not be defrayed with USAID/B funds.

Recommendation No. 3

That the NEAO Education Branch request the State to re-deposit to the USAID/B account the "fiscalization fees" collected on all USAID/B funds.

2. CEPCEB awarded three contracts on a cost-plus a percentage of cost. These contracts provided for a 10 per cent contractor fee based on total labor and material costs. After these contracts were awarded the Leo A. Daly Co. emphasized in its June 1964 report to NEAO the following:

"It is impossible to control the total cost of the work because: (a) the contractor is not interested in labor efficiency as additional labor costs result in an increased fee to himself, (b) wasted labor and materials result unless full-time supervision is performed, and (c) unless very rigid control is maintained the possibility for gross diversion of materials and padding of payrolls is so great as to be nearly impossible to resist."

The records disclosed that these contracts were originally budgeted at Cr\$79,750,000 but were adjusted considerably above the original estimates as shown below:

| | |
|-------------|------------------------|
| Original | Cr\$ 79,750,000 |
| Adjustments | <u>203,965,050</u> |
| TOTAL | <u>Cr\$283,715,050</u> |

The Leo A. Daly Co. informed us that actual cost would not have exceeded 75 per cent of the total costs reflected above had proper supervision and controls been established.

Our perusal of the contracts disclosed that construction was subject to completion within 120 days after which the contractor was subject to a punitive fine of Cr\$10,000 per day. We found, however, that the actual construction period in two instances was 2-1/2 years while the third school (John Kennedy) requires about 3 years. In no instance did we find that CEPCEs exercised the penalty clauses. We were unable to obtain from CEPCEs an adequate explanation why these contractual clauses were waived.

We found that CEPCEs's chief engineer procured and paid with project funds for all materials used in these schools, the purpose of this system being to cut down costs. The materials were subsequently sold by CEPCEs to the contractors at cost; however, there were no adequate records or controls to account for the materials purchased and/or sold to the contractors. On further examination we found the following deficiencies:

1. There was no evidence that the purchases were subject to competitive bidding. It appeared that all purchases were negotiated directly with the suppliers.
2. The materials purchased were often billed on non-official invoices. We found some instances where scraps of paper served as invoice. There were other examples of receipts prepared by the CEPCEs chief engineer but signed by suppliers.
3. There were no records or controls established which enabled us to ascertain whether the materials purchased were received or delivered to the contractor.
4. The contractor did not establish records or controls for the materials received from CEPCEs.

The John Kennedy schools (Aracajú) typifies the inefficiency and waste of the "cost-plus a percentage of cost contract". In January 1964,

this school was budgeted to cost Cr\$38,000,000; periodic adjustments have increased this figure so that it is currently budgeted at Cr\$... 160,000,000. The Leo A. Daly Co. informed us that the actual cost for this school should not have exceeded Cr\$90,000,000 considering the impact inflation and changes in scope of work. Records disclosed that Cr\$... 126,131,985 have already been expended on this school, as well as an unascertainable amount of the Cr\$106,748,048 of USAID/B funds shown as avances (see also p.15).

The NEAO has recognized the sky-rocketing costs at the John Kennedy school and has set a maximum of Cr\$127,000,000 for the building. However, evidence indicates that additional USAID/B funds are being used and will continue to be used until the school is completed.

Recommendation No. 4

That the NEAO Engineering, Industry and Natural Resources Division request CEPGES to redeposit all USAID/B funds in excess of Cr\$127,000,000 used for construction of the John Kennedy school.

b. Utilization

Construction or reconstruction was initiated for 50 school buildings. We performed an end-use observation of 33 school structures in various stages of completion of which ten were now construction and 23 reconstruction. Our physical observations disclosed the following

| | <u>NEW CONSTRUCTION</u> | <u>RECONSTRUCTION</u> |
|--------------------|-------------------------|-----------------------|
| Operating | 5 | 16 |
| Under Construction | 2 | 2 |
| Unutilized | <u>3</u> | <u>5</u> |
| TOTAL | <u>10</u> | <u>23</u> |

The principal reasons for non-utilization of the 8 unutilized schools shown above were the following:

1. Poor construction plans and specifications; construction work on 4 schools was stopped due to deficient roof designs. We saw one school (Itabaiana) where construction was stopped more than 1-1/2 years ago

because SUDENE did not provide the necessary roof design. We found no apparent evidence to suggest that CEPCEB was going intended to complete the constructions so that the schools could eventually be utilized.

2. Deficient construction; a Training Center (Aracajá), accounting for at least Cr\$6,400,000 of USAID/B funds, collapsed due to major construction deficiencies. The Loo A. Daly Co. informed us that the deficiencies of this building could not be corrected and the building had to be completely razed.

3. Poor site selection; we found a six room school (Suíça-Aracajá), accounting for at least Cr\$1,863,424 of USAID/B funds, which was constructed in a marsh, and abandoned before it was completed. There appears to be no possibility that this unfinished school could be used for alternative purposes.

4. Inadequate number of teachers; we found that two schools were unutilized due to lack of teachers. We were informed by the Secretary of Education that 235 State schools are closed principally due to lack of teachers. It is, therefore, questionable when the necessary teachers can be recruited.

We were unable to identify the amount of USAID/B funds expended on total unutilized construction due to inadequate records. Nevertheless, it is our opinion that the State should refund to the USAID/B account the amount of Cr\$8,263,424 applicable to the unrepairable construction, namely (1) Aracajá Training Center (Cr\$1,863,424) and (2) Suíça-Aracajá school (Cr\$6,400,000). However, we feel that the question of redeposit on the other school buildings should be deferred until the NEAO has thoroughly reviewed the possibilities for completion and utilization. Recommendation No. 2 on page 7 indicated corrective action applicable to uncompleted and deficient construction. In commenting on this report, NEAO stated that it is aware of this difficulty and has been working on a solution for the Suíça school and Aracajá training center.

Recommendation No. 5

That the NEAO Education Branch request the State of Sergipe to redeposit the Cr\$8,263,424 to the USAID/B account in settlement of the unrepairable construction found under this program.

c. Maintenance

Under the project agreement, the State agreed to "maintain and repair all equipment, construction, and other facilities." At present, a continuous maintenance program for State schools does not exist because of: (1) lack of adequate State funds, and (2) an engineering staff organizationally not prepared to administer a program of this magnitude. It is therefore reasonable to expect that the construction initiated under this program will be subject to inadequate care. Deterioration is already a problem in a few of the schools completed.

Recommendation No. 6

That the NEAO Engineering, Industry and Natural Resources Division make reasonable efforts to have CEPCEC effect a maintenance system for all schools either constructed or reconstructed under this program.

3. Equipment

Our examination revealed that CEPCEC expended Cr\$146,128,958 of USAID/B funds on equipment as detailed herewith.

| | |
|---------------------|------------------------|
| Office equipment | Cr\$ 13,006,325 |
| Classroom furniture | 68,671,402 |
| Kitchen equipment | 12,414,820 |
| Dormitory equipment | 39,878,901 |
| Vehicles | <u>12,157,510</u> |
| | <u>Cr\$146,128,958</u> |

a. Procurement

Our review of CEPCEC procurement procedures disclosed that usual Brazilian bidding regulations were not always adhered to. About 50 per cent of the procurement was negotiated directly with suppliers, and CEPCEC officials were usually advanced funds for the payment of all

supplier invoices. Evidence indicated that in most instances such funds were advanced four to five months prior to date of invoice. In several cases the advances were considerably in excess of actual expenses incurred. The advances were later cleared with the presentation of paid invoices to the CEPCEs accounting section; however, the accounting section did not exert control over the advances. In our opinion the practice of advances was abused and resulted in CEPCEs officials benefiting from use of the funds and/or interest earned on these funds.

Recommendation No. 7

That the NEAO Education Branch request CEPCEs to discontinue further advances of funds for procurement of equipment and materials.

b. Receiving and Distribution Records

CEPCEs did not maintain effective receiving and distribution records. Receiving reports were not prepared for equipment purchased, and no stock records were kept for equipment received and/or distributed. Some efforts are currently being made to correct this condition; however, the reliability of figures being compiled is questionable. We performed a selective sampling of classroom furniture figures compiled and found several deficiencies.

Recommendation No. 8

That the NEAO Education Branch request CEPCEs to (1) establish and maintain book inventory records for all equipment purchased with USAID/B funds, (2) reconcile such book inventory with a physical count of equipment, and (3) render a report to NEAO with respect to any missing equipment.

c. Utilization

On a selective basis we performed on-use observations of equipment purchased and found that it was generally not well distributed or effectively employed. Warehouse facilities for undistributed classroom

equipment were completely inadequate. We saw classroom furniture (about 40 per cent of total purchased) which had been damaged by rain and termites. This equipment was so badly damaged that it will have to be repaired before it can be distributed to the schools.

CEPCES purchased seven vehicles with USAID/B funds, three of which were specifically purchased for supervisory centers. We found that these vehicles were requested by the Governor for uses outside of the project.

Recommendation No. 9

That the NEAO Education Branch request the State to (1) provide adequate storage facilities for unused classroom equipment, (2) renovate all damaged equipment now in storage, and (3) effect the proper distribution of vehicles.

4. Training

As of May 31, 1966, CEPCES had expended Cr\$13,936,011 of USAID/B funds on training activities as shown below:

| | <u>PROGRAM</u> | | <u>ACTUAL</u> | |
|----------------------------|----------------|------------------------|---------------|-----------------------|
| | <u>Number</u> | <u>Cost</u> | <u>Number</u> | <u>Cost</u> |
| Lay Teacher Training | 1000 | Cr\$ 26,280,000 | 743 | Cr\$10,750,929 |
| Schools Principals | - | - | 68 | - |
| Scholarships | 30 | 12,530,000 | - | - |
| Supervisory Training | 35 | 4,230,000 | 28 | 780,000 |
| Emergency Teacher Training | 600 | 128,700,000 | - | - |
| Training Materials | - | 26,280,000 | - | 2,405,082 |
| Adult Literacy Program* | 1200 | 59,760,000 | - | - |
| Other | - | 4,816,000 | - | - |
| TOTAL | | <u>Cr\$262,596,000</u> | | <u>Cr\$13,936,011</u> |

* Monitors and instructional materials.

Additionally, Cr\$912,830 of SUDENE and State funds were expended on training activities.

No progress was achieved in Emergency Teacher Training, as reflected in the comparative figures above. This lack of progress was due principally to inadequate teacher training facilities. Inasmuch as two training centers have recently been completed and put into operation, this situation is expected to improve.

The Adult Literacy Program was cancelled by order of the Federal Ministry of Education subsequent to the March 1964 Revolution. The Secretary of Education indicated that the State has no plans to initiate an alternative program.

5. Other

CEPCES's records disclosed that Cr\$151,631,738 of USAID/B funds were expended on salaries, administrative expenses, and advances as shown below:

| | <u>PROGRAM</u> | <u>ACTUAL</u> |
|----------------------|-----------------------|------------------------|
| Technicians salaries | Cr\$35,160,000 | Cr\$ 34,192,660 |
| Miscellaneous | - | 10,691,030 |
| Advances | - | 106,748,048 |
| TOTAL | <u>Cr\$35,160,000</u> | <u>Cr\$151,631,738</u> |

The advances of Cr\$106,748,048 reflected above generally represented funds actually expended. The primary reason for the advances shown above was due to the fact that the accounting section had not cleared the advance account with appropriate documentation which in several instances was presented in 1963 and 1964. It is necessary that these advances be cleared out and charged to the proper accounts for reporting purposes.

Recommendation No. 10

That the HELIO Education Branch request CEPCEB to clear the advance account where the proper accounting documentation has been presented.

C. REPORTING, ACCOUNTING, AND SUBSIDIARY AUDITING PROCEDURES

1. Reporting Procedures

Reporting on the financial progress of this project was inadequate. Our examination revealed that CEPCEB only accounted for the expenditure of USAID/B funds when requests for additional funds were submitted. We found that reports were prepared for two periods; in each case the period was longer than one year. The result was a general lack of budgetary control over this project.

Recommendation No. 11

That the NEAO Education Branch request CEPCEB to report on a quarterly basis for the expenditure of USAID/B funds.

The Leo A. Daly Co. submitted school inspection reports as well as monthly progress reports to NEAO. We reviewed the monthly progress reports and generally found that they contained complete and accurate narrative information. Many findings presented in this report were cited repeatedly in Daly's reports. However, NEAO files indicated that only limited corrective action was taken when deficiencies were reported. We feel that more effective NEAO utilization could have been made of these reports. This deficiency was similarly pointed out in our Maranhão audit report (No. 3/67, Recommendation No. 13). Inasmuch as corrective action has been initiated by NEAO for 4 Northeast states with basic education programs, the recommendation is not being repeated here.

2. Accounting Procedures

We reviewed CEPCEB accounting procedures insofar as they were related to our examination of the project agreement and it was our opinion that books and records were not maintained in accordance with acceptable accounting practices. The following deficiencies illustrate the lack of accounting procedures and controls.

1. We found no effective controls to safeguard against the fraudulent use of funds. The individual responsible for disbursing funds was also responsible for negotiating all procurements and approval of all documentation.

2. USAID/B funds were advanced to CEPCEB officials for school purchases, several of these advances being in excess of Cr\$20 million. As there was no way of controlling effectively the advances, the opportunity existed for personal gain through the use of principal or interest earnings on the advances.

3. CEPCEB did not have a qualified person in charge of its accounting section. The chief accountant worked on a part time basis, leaving the accounting routine to an inexperienced girl.

4. CEPCEB did not maintain ledgers to control expenses. Expenses were simply added up at the end of each month and then combined with the previous month's totals.

5. CEPCEB did not perform a comparison of monthly statements received from the bank with balances shown on CEPCEB books for the USAID/B account. There was thus no procedure to account for the current balance of funds or safeguard against their misuse.

It is our opinion that the present CEPCEB administrative staff is incapable of effecting the corrective action needed. We therefore feel that SUDENE should assume this responsibility.

Recommendation No. 12

That the NEAO Education Branch inform SUDENE of the accounting deficiencies in CEPCEB and request SUDENE to establish effective accounting records, procedures, and controls.

3. SUDENE Auditing Procedures

According to the project agreement, SUDENE was assigned the responsibility for exercising the following controls: "auditing; ensuring the proper use of funds; checking the execution of plans; and inspecting and evaluating results to ensure compliance with proper technical standards."

Our examination revealed that SUDENE did not effectively execute the above responsibilities. We found that this current joint audit was the first field examination that SUDENE had performed of CEPCEB's records and procedures. SUDENE certified expenditures in the amount of Cr\$..... 533,244,111 of USAID/B funds on the basis of "desk audits".

Our examination also revealed that SUDENE approved CEPCEB's requests for construction funds although the SUDENE engineering department did not approve the related architectural specifications. In most cases, schools were completed with the SUDENE architectural department's approval. It is our opinion that the unsatisfactory performance under this entire program is in part related to SUDENE's failure fully to

execute its responsibilities. Again, this SUDENE deficiency was pointed out in our Maranhão audit report (No. 3/67, Recommendation No. 15). Since NEAO is now acting upon this recommendation with respect to all 4 states with basic education programs, we are making no further recommendation.

D. PUBLICITY AND MARKING

We contacted the United States Information Service (USIS), Recife, for information pertinent to any publicity given this project. We found that the project had received limited press coverage in the State of Sergipe, with USAID's participation always identified.

Our end-use observation of 33 schools revealed that 5 of these were not identified with signs or other markings reflecting the participation of the Alliance for Progress.

Recommendation No. 13

That the NEAO Education Branch initiate action to identify properly all buildings constructed or reconstructed with USAID/B funds.

LIST OF RECOMMENDATIONS

| <u>Number</u> | | <u>Page</u> |
|---------------|---|-------------|
| 1 | That the NEAO Education Branch initiate appropriate action requiring the State to respect its financial obligations. | 4 |
| 2 | That the NEAO Engineering, Industry and Natural Resources Division initiate action to ensure that funds are allocated and controls instituted to complete the unfinished construction and remedy any deficient construction under this program. | 7 |
| 3 | That the NEAO Education Branch request the State to redeposit to the USAID/B account the "fiscalization fees" collected on all USAID/B funds. | 8 |
| 4 | That the NEAO Engineering, Industry and Natural Resources Division request CEPCES to redeposit all USAID/B funds in excess of Cr\$127,000,000 used for construction of the John Kennedy school. | 10 |
| 5 | That the NEAO Education Branch request the State of Sergipe to redeposit the Cr\$8,263,424 to the USAID/B account in settlement of the unrepairable construction found under this program. | 12 |
| 6 | That the NEAO Engineering, Industry and Natural Resources Division make reasonable efforts to have CEPCES effect a maintenance system for all schools either constructed or reconstructed under this program. | 12 |
| 7 | That the NEAO Education Branch request CEPCES to discontinue further advances of funds for procurement of equipment and materials. | 13 |
| 8 | That the NEAO Education Branch request CEPCES to (1) establish and maintain book inventory records for all equipment purchased with USAID/B funds, (2) reconcile such book inventory with a physical count of equipment, and (3) render a report to NEAO with respect to any missing equipment. | 13 |
| 9 | That the NEAO Education Branch request the State to (1) provide adequate storage facilities for unused classroom equipment, (2) renovate all damaged equipment now in storage, and (3) effect the proper distribution of vehicles. | 14 |

LIST OF RECOMMENDATIONS (Cont'd)

| <u>Number</u> | | <u>Page</u> |
|---------------|---|-------------|
| 10 | That the NEAO Education Branch request CEPCES to clear the advance account where the proper accounting documentation has been presented. | 15 |
| 11 | That the NEAO Education Branch request CEPCES to report on a quarterly basis for the expenditure of USAID/B funds. | 16 |
| 12 | That the NEAO Education Branch inform SUDENE of the accounting deficiencies in CEPCES and request SUDENE to establish effective accounting records, procedures, and controls. | 17 |
| 13 | That the NEAO Education Branch initiate action to identify properly all buildings constructed or reconstructed with USAID/B funds. | 18 |

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file in the Office of the Controller (NECO), USAID/B/NEAO.

SERGIFE

AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES A.I.D. MISSION TO BRAZIL
Office of the Controller

October 20, 1966

TO The Director of Mission
Minister Stuart H. Van Dyke

The Office of the Controller has completed an examination of the Sergipe Elementary and Basic Education project covering the period from July 30, 1963 through May 31, 1966. Our attached audit report contains 13 recommendations for program improvement which for convenience are listed separately in Exhibit A (pp. 19-20).

Under a loan agreement with SUDENE, USAID obligated Cr\$17.2 billion of Public Law 480 Title I funds for a program of school construction in 8 states of the Northeast. SUDENE in turn grants the funds to individual states pursuant to separate project agreements with each State. The Sergipe agreement provided for a grant of Cr\$1,275 million of AID funds over a three year period ending in July 1966. Additional contributions totaling Cr\$350 million were to be made by SUDENE and the State.

The Sergipe program provided for the construction and reconstruction of 900 classrooms, construction of supervisory centers, 3 teacher training centers, 4 industrial workshops, procurement of school equipment, and teacher training programs. The program is administered by a State organization known as "Comissão Executiva para Programas Cooperativos de Educação no Estado de Sergipe (CEPCES)."

As of May 31, 1966, the three signatories to the project agreement (USAID/B, SUDENE, and the State) had released a total of Cr\$1.5 billion of the Cr\$1.6 billion pledged. Of the funds released, the State had expended Cr\$1,341 million.

Implementation of this project has been highly unsatisfactory. Significant deficiencies found in the program are cited below:

1. Nine hundred classrooms were to be constructed or reconstructed during the 36 month period of this program. However, during the 34 month period covered by our audit, only 164 classrooms were either constructed or reconstructed. Approximately 62 per cent of the project funds budgeted for constructional reconstruction has been expended as compared with 19 per cent of the physical goals attained. It is estimated that Cr\$120 millions will be required to finish construction under way. Since the latter expenditure will exhaust funds presently available, no new construction activity is anticipated under the present program (p. 5).

2. CEPCE's engineering staff lacked the competence and personnel to administer a program of the size undertaken. Architectural plans were usually faulty and incomplete, and costly adjustments had to be made after construction had started (pp. 5-6).

3. Construction contractor capabilities were poor, and buildings were often unsafe for occupancy. A training center at Aracaju collapsed and was subsequently abandoned (p. 6).

4. Construction planning for the program was unsatisfactory. Long delays were encountered until sites were selected and approved, deeds legalized, and SUDENE and NEAO approval obtained (pp. 6-7).

5. Construction/reconstruction work was not subject to the usual public competitive bidding practices prescribed by Brazilian regulations. Contracts were let to the lowest bidders, but subsequent upward adjustments added more than 50 per cent additional to original bid costs. USAID consulting engineers advised that they were not permitted by CEPCE to review contracts or adjustments prior to awards (p. 7).

6. Three contracts were awarded on a cost plus a percentage of cost basis. The AID engineering consultant subsequently warned that such a system lent itself to serious abuses. Costs on those three contracts eventually amounted to 3-1/2 times the original estimates (pp. 8-9).

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The John Kennedy school exemplifies the inherent inefficiency of contracts awarded on a "cost plus" basis. Originally budgeted to cost Cr\$38 million, it is currently budgeted at Cr\$160 million. AID's engineering consultants informed us that the actual cost for this school should not have exceeded Cr\$90 million, inflation considered (pp. 9-10).

7. There was a high incidence of school buildings not completed and/or used. Of 33 buildings observed, 8 were found not to be utilized. Six buildings were not being completed because of construction deficiencies; two others which had been completed were not used because of lack of teachers (pp. 10-11).

8. Responsibility for maintenance of buildings was that of the State of Sergipe. However, there was no continuous maintenance program because of a lack of funds and competent engineering staff. Deterioration is already a problem in a few of the schools completed (p. 12).

9. There were no adequate receiving, distribution, or stock records for school equipment purchased. Equipment was generally not well distributed or effectively employed. Warehouse facilities were completely inadequate. Three of 7 vehicles purchased from USAID funds for supervisory centers were requested by the State Governor for uses outside the project (pp. 13-14).

10. CEPCE's accounting procedures were poor, and there are no effective controls to safeguard against fraudulent use of funds. There was no qualified accountant to maintain proper books of account (pp. 16-17).

11. SUDENE did not effectively discharge its responsibilities with regard to auditing, checking execution of plans, and inspection (pp. 17-18).

12. Although inflation was a significant factor contributing to unsatisfactory results, poor planning, execution, and monitoring were

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- 4 -

also major underlying factors.

The NEAO seems to be aware of many of the difficulties cited above, and its "Task Force" is working to define problem areas and initiate corrective action.

W. G. Olack
Norman Olack
Controller