

AGENCY FOR INTERNATIONAL DEVELOPMENT

UNITED STATES A. I. D. MISSION TO BRAZIL

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REPORT ON EXAMINATION
OF
RIO GRANDE DO NORTE EDUCATION
PROJECT AGREEMENT No. 512-11-640.037.3
FOR THE PERIOD
JANUARY 1, 1965 THROUGH JUNE 30, 1968



OFFICE OF THE CONTROLLER



REPORT No. 16/69

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**AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES A.I.D. MISSION TO BRAZIL**

Office of the Controller

November 13, 1968

**TO The Director of Mission
Minister William A. Ellis**

The Office of the Controller, Audit Division, has completed an examination of the grant funded project, Elementary Education and Training and Curriculum Improvement, Rio Grande do Norte. This is the second audit of the project and covered the period from January 1, 1965 to June 30, 1968.

The project agreement was entered into on December 3, 1962 in an effort to reduce the high percentage of illiteracy in the State which was attributed to a shortage of adequately trained teachers, training materials, classrooms, equipment and instructional materials as well as to weaknesses in the organization and administration of the education system. The original ProAg called for contributions of NCr\$1,661,350 from USAID/B, NCr\$100,000 from SUDENE and NCr\$304,000 from the State. It included a number of far reaching objectives which visualized a 3 year improvement program of the entire elementary education program in the State.

In 1965, after the first audit report, which had a cut off date of December 31, 1964, revealed that the project had fallen far short of its objectives, the NEAO determined that additional funds would be required just to complete the construction already initiated under the program. Additional contributions of NCr\$1,250,000 by USAID, NCr\$255,000 by the State and NCr\$72,080 by CONTAP were subsequently committed through 6

amendments to the ProAg. On December 17, 1966, Revision No. 3 completely revised the specific goals of the ProAg to conform with the actual project accomplishments at that date. It also required the completion of 120 schools and the John F. Kennedy Institute in Natal, all of which were completed or nearing completion. Since then, the major activity of the project has been directed toward completion of these schools.

The audit report discloses that all construction with the exception of a 5 room school house and a kindergarten building at the John F. Kennedy Institute has been completed. All funds have been contributed with the exception of NCr\$71,533.89 of USAID/B funds committed for construction expenditures, NCr\$250,000 of USAID/B funds committed for other educational expenditures, NCr\$20,400.64 of State funds committed for construction and NCr\$21,796 of CONTAP funds. However, the project has been subject to frequent delays, resulting from a shortage of State funds, inflationary factors and inadequate contractor capabilities. The State has consistently failed to make its contributions on a timely and regular basis, and has not utilized project funds in accordance with terms of the ProAg as revised. The State used USAID funds for the payment of expenditures properly chargeable to State funds and resorted to a continual shifting of funds from the USAID/B account in order to pay current expenditures and maintain the education program in the face of serious financial difficulties. At the time Revision No. 3 was signed in 1966 there were not enough funds available to complete the construction of the 120 schools called for in that revision. In addition, the examination disclosed that SUDENE had

not effectively and timely fulfilled its responsibility of ensuring the proper use of funds by reviewing documents proving expenditures. Consequently, we are recommending that USAID/B require SUDENE to complete the verification of all expenditures and certify to USAID/B that all prior releases have been used in accordance with terms of the ProAg prior to any further release of USAID funds.

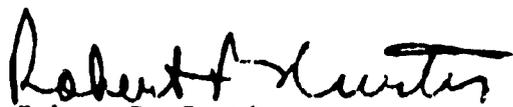
The audit report indicated that in April 1968, 6 of the 120 schools constructed with project funds were not in use. The physics and biology laboratory building on the John F. Kennedy Institute has never been used due to a lack of equipment. Two schools visited in the western part of the State appear to be adequately planned but poorly constructed. Kitchen and toilet facilities have never been properly connected to an adequate source of water.

Under the terms of the ProAg the State agreed to maintain and repair all equipment, schools constructed and other facilities. At the present time there is no adequate maintenance program for State schools because of a lack of funds and organization. The State has drawn up a list of all repairs needed on all schools constructed with project funds and plans for completing these repairs will be put into effect if and when funds become available.

The prior audit report disclosed that the State was maintaining inventory control cards for all non-expendable property purchased with project funds. At that time the State also agreed to establish an equipment ledger which would act as a control account for the property cards.

During the present audit neither the aforementioned control cards nor an inventory ledger could be located. In addition, the State is not presently maintaining adequate inventory records on vehicles purchased with project funds and the audit accounted for only 9 of the 14 vehicles currently remaining on the program. We are recommending that all inventory records be brought up to date.

The audit disclosed that the reporting requirements on the financial progress of the project were completely inadequate. The NEAO/ED files contained only 3 reports prepared by the State for the period under examination. The NEAO/ED records show that these reports were considered inadequate but there was no evidence that follow-up action resulted in improved reporting.


Robert B. Curtis
Controller

AGENCY FOR INTERNATIONAL DEVELOPMENT
UNITED STATES A.I.D. MISSION TO BRAZIL

REPORT ON EXAMINATION
OF
RIO GRANDE DO NORTE EDUCATION

SECTION I - GENERAL

A. SCOPE AND PURPOSE

An examination of the "Elementary Education and Training and Curriculum Improvement, Rio Grande do Norte" project has been made at the request of the USAID/Brazil Northeast Area Office (NEAO). This is the second audit of this Project Agreement, which was originally signed on December 2, 1962, and covered the period from January 1, 1965 to June 30, 1968. A review of the first audit report, No. 12/65, indicated that all recommendations contained therein had been closed.

The principal objective of this examination was to review and evaluate the effectiveness of program implementation as compared with objectives outlined in the Project Agreement (ProAg) as revised, and to determine the extent of compliance with its terms. Other purposes were to verify the adequate utilization of project funds and to determine the quality and effectiveness of the financial and administrative management.

The examination was made in accordance with generally accepted auditing standards, applicable manual orders and such other audit steps as were considered necessary under the circumstances. It included the examination of the accounting records and related files of the USAID/B Controller's Office in Rio and the USAID/B/NEAO offices of the Assistant Controller, the Education Division and the Engineering Division, in Recife. Meetings and discussions were

held with responsible NEAO officials. A field trip was made to Natal and to the interior of the State of Rio Grande do Norte for the purpose of reviewing the accounting records and files of the Serviço Cooperativa de Educação do Rio Grande do Norte (SECERN). Discussions were also held with the State Secretary of Education. Heavy seasonal rains and flooded rivers limited end-use observation to the physical facilities of the John F. Kennedy Institute in Natal and several schools in the Municipality of Patú, all constructed with ProAg funds.

The audit was conducted jointly with SUDENE auditors who are issuing their own separate report. Before issuance, our report was reviewed by appropriate USAID/B/NEAO officials and their comments have been given due consideration.

B. BACKGROUND AND PROJECT REVISIONS

In the State of Rio Grande do Norte, as of 1962, it was estimated that 46 per cent of the State's children between seven and fourteen years of age were attending school and that more than two thirds of the adult population were illiterate. It was concluded that the high rate of illiteracy was mainly due to a shortage of adequately trained teachers, training materials, classrooms and equipment, furniture and instructional materials, as well as weaknesses in the organization and administration of the education system.

As a consequence, a project agreement was entered into on December 3, 1962 between USAID/B, the Superintendencia do Desenvolvimento do Nordeste (SUDENE), the State of Rio Grande do Norte (State), and the Brazil Ministry of Education and Culture (MEC) for the purpose of improving and expanding the educational system in Rio Grande do Norte and to reduce the high rate of illiteracy. The project agreement as originally drafted called for contributions of NCr\$1,661,350 from USAID/B, P.L. 480 Title I, Section 104 (c) grants, NCr\$100,000 from SUDENE and NCr\$304,000 from the State. (See table of financing on page 10).

The original project agreement included a number of far reaching objectives and visualized a 3 year improvement program of the entire elementary education program of the State, from restoring and equipping old schools to building and equipping new schools, creating new education centers, training new teachers, retraining old teachers and reducing adult illiteracy.

The first audit report on the project, Report No. 12/65, which had a cut-off date of December 31, 1964, revealed that the project really did not get underway until April-May 1963 and that it had fallen far short of its objectives. The report indicated that major deficiencies were due to such factors as inadequate and inefficient management and delays of State contributions to the project as well as delays of USAID contributions which were caused by slow SUDENE voucher verification procedures. However, the major obstacle to the satisfactory progress of the program during 1963 and 1964 was the acute inflation throughout Brazil which cut deeply into the project funds and resulted in a far higher cost than originally estimated. SECERN therefore decided to postpone certain of the planned objectives listed in the project agreement and concentrate its efforts on items of highest priority.

The items postponed were mainly in the construction field and included expansion of training centers at Cangaretama and Pau dos Ferros Agricultural Schools, building and equipping 3 training centers with dormitories, building physical plants for 8 normal schools, expanding and equipping Institute of Education in Caicó and Mossoró and building and equipping visual Education Centers and Educational Material Production Centers.

The balance of the building program which included construction of 1,000 new classrooms, 10 industrial arts workshops for elementary age youths and the John F. Kennedy Institute of Education in Natal, was initiated but on a greatly reduced scale. The prior report disclosed that a total of 232 classrooms in 149 schools had been started by 5 separate contractors at a total bid price of NCr\$539,195.38. Construction of the John F. Kennedy Institute was

also commenced with a contract for 5 buildings being let at a total cost of NCr\$229,067.85. In addition, 5 industrial arts workshops had been completed as of December 31, 1964.

In 1965, the entire elementary education project threatened to collapse due to the run-away inflation which was coupled with inadequate contractor capability for timely construction completion, the inadequacy of SECERN in administering a project of this size and the delay of the State in providing its financial contributions.

After a study of the project by the USAID/B/NEAO, it was determined that an additional NCr\$1,000,000 would be required just to complete the 150 schools currently under construction as well as the uncompleted portion of the John F. Kennedy Institute. Consequently, on August 4, 1965 Revision No. 1 was signed providing an additional NCr\$1,000,000 contribution by USAID again from P.L. 480 Title I, Section 104 (e) grant funds for the specific purpose of assisting in the financing of the construction of the uncompleted elementary schools and the kindergarten building on the John F. Kennedy Institute. The State agreed to increase its contribution by NCr\$15,000 and to establish a system of priorities for construction remaining under the project so as to assure the rapid completion of the maximum number of schools.

In August 1966, the final report prepared by Norman M. Giller and Associates, the architectural and engineering consultants to the project, disclosed that the construction had again come to a standstill due to a shortage of funds. The contractors refused to proceed until payment requisitions were honored by SECERN.

On December 7, 1966, Revision No. 3 was signed for the specific purpose of completely revising the goals of the project agreement to conform with actual project accomplishment and to complete the construction of 120 schools with 197 classrooms and the John F. Kennedy Institute. At that time, construction of 115 schools had been completed leaving 5 large schools and the kindergarten building of the John F. Kennedy Institute unfinished. The Revision estimated the completion of those schools would cost a total of NCr\$536,283. In

order to make up this balance, the State agreed to increase its contribution by NCr\$240,000.

In addition to completing construction of these schools, Revision No. 3 also amended the project agreement so that it embraced only those objectives which had been accomplished at that date. This included the following:

1. Renovation of 246 classrooms and facilities for approximately 19,000 students.
2. Renovation of a normal school at Natal.
3. Training of 4 teaching supervisors in Belo Horizonte and training 36 supervisors in special subject areas.
4. Training 2,000 non-certified teachers during summer vacations.
5. Training 300 adult education instructors in short period courses.
6. Literacy training for approximately 6,000 adults and adolescents.
7. Assistance in the organization and financing of SECERN to implement the project.
8. Equip approximately 1,000 classrooms, 2 normal schools, 5 supervisory centers and 5 industrial arts shops.
9. Purchase of teaching material for training of non-certified teachers.
10. Purchase of vehicle to assist in the project activities during the execution phase and in the supervision of education activities under the project.

With the development of the works of the program, the need arose for a new source of funds to provide equipment for the supervisory centers of Mossoró, Santa Cruz, Angicos, Nova Cruz, and Pau dos Ferros and for the supervisory and curricular office; for teaching materials for teachers and supervisors; and for curricular printing costs of the curriculum and supervisory agency. A request for additional funds was made to the Technical Cooperation Council for the Alliance for Progress (CONTAP) and, on March 27, 1967, Revision No. 4 was signed linking funds from CONTAP in the amount of NCr\$.. 72,080 to the RGN Education Program for these purposes.

On October 1, 1967, Revision No. 6 was signed for the purpose of carrying out a program which would bring an increase in educational opportunities as well as improved instruction for the school-age population in Rio Grande do Norte. This revision made available to the State a grant of NCr\$250,000 from the line of credit made by USAID/B to SUDENE under the "Umbrella Loan Agreement" No. 512-G-012 whose source was P.L. 480, Title I, Section 104 (g) funds dated May 3, 1963. Prior to any release of funds under the revision, the State is required to prepare an overall plan for the utilization of those funds and submit this plan to SUDENE and USAID/B for approval.

SECTION II - FINDINGS AND RECOMMENDATIONS

A. FUNDING OF THE PROJECT

1. General

A summary of commitments and releases of funds to the project as of April 30, 1968 is as follows:

	<u>COMMITTED</u>		<u>RELEASED</u>	<u>BALANCE</u>
	<u>NCr\$</u>	<u>NCr\$</u>	<u>NCr\$</u>	<u>NCr\$</u>
<u>USAID/B</u>				
ProAg 12/3/62	1,661,350	1/		
Rev. 1 8/4/65	1,000,000	1/		
Rev. 6 10/1/67	<u>250,000</u>	2/	2,589,816.11	321,533.89
<u>RGN STATE</u>				
ProAg 12/3/62	304,000			
Rev. 1 8/4/65	15,000			
Rev. 3 12/7/66	<u>240,000</u>	559,000	538,599.36	20,400.64
<u>SUDENE</u>				
ProAg 12/3/62		100,000	100,000.00	-0-
<u>CONTAP</u>				
Rev. 4 3/27/67		72,080	50,284.00	21,796.00
TOTALS		<u>3,642,430</u>	<u>3,278,699.47</u>	<u>363,730.53</u>

See Exhibit A for a schedule of the source and application of all project funds.

1/ P.L. 480, Title I, Section 104 (o) grant funds.
 2/ P.L. 480, Title I, Section 104 (g) loan funds.

2. USAID/B Contribution

In accordance with the original project agreement, USAID/B agreed to contribute NCr\$1,661,350 to the project from funds generated by the Second Sales Agreement - P.L. 480, Title I, Section 104 (e) cruzeiro Grant Funds. Under Revision No. 1 dated August 4, 1965, USAID/B increased the pledged contributions by NCr\$1,000,000 from funds produced by the Fifth Sales Agreement - P.L. 480, Title I, Section (o). The first audit of the project disclosed that a total of NCr\$1,011,629.79 had been released prior to November 30, 1964. Total releases on the project to April 30, 1968 are as follows:

<u>DATE</u>	<u>AMOUNT</u>
Prior to 11/30/64	NCr\$1,011,629.79
12/ 9/64	240,060.49
4/17/65	281,255.68
9/ 9/65	900,000.00
1/15/67	155,000.00
Interest Earned	<u>1,870.15</u>
Total Contribution	NCr\$2,589,816.11

The earned interest of NCr\$1,870.15 is included as part of the USAID contribution in accordance with the project agreement.

The ProAg required USAID/B contributions to be deposited in a separate account with the Banco de Nordeste de Brasil. An analysis of SECERN Bank statements disclosed that the USAID releases had been deposited to both the Banco de Nordeste and the Banco de Estado de Rio Grande do Norte in violation of the ProAg. SECERN continually deposited large amounts of USAID releases in the Banco de Estado de Rio Grande do Norte. The NEHR/Ed office was aware of this practice and took action to remedy the situation through a number of letters to responsible State officials, beginning in January 1964. Although State officials gave assurance of compliance with this requirement, subsequent USAID releases continued to be deposited in the Banco de Estado de Rio Grande do Norte. WFAO has informed us that at present only NCr\$6.02 remain in the Banco de Estado de Rio Grande do Norte.

Revision No. 6, which was signed on October 1, 1967, provided for an additional USAID contribution in the amount of NCr\$250,000. The source of the contribution was the unexpended funds from USAID Loan No. 512-G-012, P.L. 480, Title I, Section 104 (g) loan funds, for the improvement of Elementary and Basic Education in the Northeast. Our review of that loan agreement indicated that Section 1.01 limited the use of such funds to the States of the Northeast which had not previously received funds for their state education programs. Since Rio Grande do Norte had already received other funds at the date the loan agreement was signed, the use of these loan funds appeared to be in violation of the loan agreement. We brought this violation to the attention of NEAO/PO which subsequently prepared Amendment No. 4 to Loan Agreement No. 512-G-012 deleting the limitation provided in Section 1.01.

3. State of Rio Grande do Norte Contribution

In the original project agreement, the State agreed to contribute NCr\$304,000 by the end of 1965 on the basis of NCr\$.. 16,000 for the last 2 months of 1962 plus NCr\$96,000 per year during 1963, 1964, and 1965. The first audit of the project indicated that as of December 31, 1964, the required contributions had been made by the State but on an untimely and irregular basis. Our current examination disclosed that as of December 31, 1965, the State was short in its contributions by NCr\$56,000. Revision No. 1 signed in September 1965 called for an added State contribution of NCr\$15,000 which was to be made in January, 1966. However, the State contributions continued on an untimely and irregular basis and as of November 30, 1966, a total State contribution of NCr\$284,000 rather than the required NCr\$319,000 left an unpaid balance of NCr\$35,000.

Revision No. 3 which was signed in December 1966 and completely revised the project, required an additional contribution of NCr\$... 240,000 bringing the total State contribution to NCr\$550,000. This revision took into account the shortage of NCr\$35,000 and specified that the State make a NCr\$120,000 contribution not later than January 31, 1967 with the remaining \$155,000 to be paid in 11 monthly installments during 1967. The State financial difficulties continued during

1967 and no contributions were made until July, when NCr\$106,599.36 from Federal Education Funds was made available for the construction of schools under the project agreement. An additional contribution of NCr\$148,000 was made in October, 1967 leaving an outstanding balance of NCr\$20,400.64 to be contributed by the State. NEAO/Ed officials have informed us that this situation has been discussed informally with the State Secretary of Education and an official letter indicating this position will be forwarded to the State.

4. SUDENE Contribution

SUDENE pledged a contribution of NCr\$100,000 to the project to be used primarily for the training of personnel and investments in physical facilities. SUDENE fulfilled its commitment by releasing NCr\$83,333.33 on December 31, 1964 and NCr\$16,666.67 on December 20, 1965. These funds were properly deposited in a separate account with Banco do Nordeste do Brasil in Natal. As of April 30, 1968, the entire contribution of NCr\$100,000 plus interest earned on deposits of NCr\$70.17 had been used for the purposes stated in the ProAg.

5. CONTAP Contribution

Revision No. 4 to the project agreement which was signed on March 27, 1967 provided for a NCr\$72,080 contribution by CONTAP to purchase additional equipment and teaching materials. On December 27, 1967 the sum of NCr\$50,284 was received from CONTAP and deposited in a special account in the Banco do Estado do Rio Grande do Norte. As of April 30, 1968, none of these funds have been expended although bids for the purchase of the equipment have been obtained and are awaiting approval.

6. Utilization of Funds

Our examination disclosed that through April 30, 1968, SECERN had expended a total of NCr\$3,269,736.49 in the project as shown in the Schedule of Source and Application of Funds which is included as Exhibit A of this report. This schedule is a consolidation of a monthly "Statement of Accounts" prepared by SECERN which is a breakdown of all expenses charged against project funds by accounting classification of source. We made no attempt to verify the accuracy

or the propriety of such expenditures since the condition of the basic documents did not make such a determination feasible. In addition this is a function of the SUDENE Audit staff.

Our examination did disclose, however, that project funds were not utilized in accordance with terms of the ProAg as revised. With the signing of Revision No. 1 on August 4, 1965, USAID agreed to contribute an additional NCr\$1,000,000 from P.L. 480, Title I, Section 104 (e) grant funds for financing the construction of elementary schools and the John F. Kennedy Institute in Natal. On September 9, 1965, USAID released NCr\$900,000 of this added contribution. We found that no more than NCr\$589,725 of this release had been used for the construction of schools. An amount of NCr\$196,763 was used to liquidate accounts payable, none of which had previously been charged to school construction expenditures. An additional sum of NCr\$110,175 was applied to SECERN administrative expenditures and posted as a State expenditure.

An analysis of Exhibit A of this report also reveals several problems concerning the utilization of project funds. First, it should be noted that there are total State expenditures of NCr\$.. 710,802 posted against total State contributions of NCr\$538,850. This indicates that State expenditures exceeded State contributions by NCr\$171,952. We found that these excess State expenditures were made possible through the improper use of USAID releases, State advances, contractors deposits and employees tax withholding funds. As of April 30, 1968 the status of USAID releases and expenditures was as follows:

Releases	NCr\$2,589,816
Expenditures	<u>2,458,963</u>
Balance	130,853
Balance in Bank Account	<u>113</u>
USAID funds charged to State Expenses	NCr\$ 130,740

The necessity for using USAID funds for paying expenditures properly chargeable to State contributions results from the State's failure to release its own contributions on a regular and timely basis.

Consequently, SECERN resorted to a continual shifting and juggling of funds from account to account in order to pay current expenditures and to maintain the education program in the face of serious financial difficulties.

Further analysis of Exhibit A discloses not only that the total disbursements of NCr\$710,802 charged against State funds exceeds the amounts presently released but that they exceed the total required State contribution of NCr\$559,000. The State Secretary of Education now proposes an accounting adjustment by which construction expenditures of NCr\$130,740 presently posted against State contributions would be charged against USAID fund releases in order to properly account for undisbursed USAID funds. If this adjustment is made, a summary of the source and utilization of project funds would be as follows:

<u>Source</u>	<u>USAID/B</u>	<u>State of RGN</u>
Contribution Released	NCr\$2,589,816 =====	NCr\$ 538,850 =====
Application:		
Classroom Construction	1,118,993	94,494
John F. Kennedy Institute	294,509	1,242
Administrative Expenses	215,682	439,938
All Other Expenses	<u>960,519</u>	<u>44,388</u>
TOTAL	NCr\$2,589,703 =====	NCr\$580,062 =====
Balance	NCr\$113 =====	NCr\$41,212 =====

This summary reveals that even if this accounting adjustment is made, the State contributions will not have been utilized in accordance with the ProAg as revised. The State has continually used project funds for the payment of administrative expenses to such an extent that it is impossible to complete construction required under the terms of Revision 3 without the use of additional funds from other sources.

At the time Revision No. 3 was signed on December 7, 1966, it was determined that a total of NCr\$536,284 would be required to complete 5 large schools at the municipalities of Alexander, Antonio Martins, Almino Alfonso, Patú, and Apodí as well as the kindergarten building at the John F. Kennedy Institute. The amounts for the con-

struction were to be derived from the following sources:

Unreleased USAID Contribution	NCr\$228,404
Unreleased State Contribution	285,000
Bank Account Balances	3,378
Special State Commitment	<u>19,502</u>
TOTAL	<u>NCr\$536,284</u>

However, as of December 31, 1966, the SECERN Statement of Accounts disclosed that expenditures of NCr\$422,188 including NCr\$374,170 charged to administrative expenses had already been charged against State contributions. Consequently, there was only a balance of NCr\$136,811 which could be used for construction purposes as shown below:

Total State Contributions Required		NCr\$559,000
Total Expenses charged - 12/31/66:		
Classroom Construction	2,422	
Administrative	374,170	
Other	<u>45,596</u>	<u>422,188</u>
Balance Available for Construction		136,812
Balance Required by Revision No. 3		<u>285,000</u>
Funding Deficiency		<u>NCr\$148,188</u>

While this funding deficiency of NCr\$148,188 had not been released as a State contribution, it had been committed for other expenditures and State contributions had to be used to liquidate accounts payable including the NCr\$130,741 of USAID funds used for State expenditures. NEAO/Ed should have been aware of this problem when the 3rd Revision was written so that realistic plans for financing the remaining construction could have been formulated.

SUDENE's responsibilities as outlined in Section III A of the project agreement include the following: "4) and exercise the following controls: accounting; ensuring the proper use of funds;"

In addition, the procedures for the advance of funds by USAID/B were outlined in Section III D of the agreement and read as follows:

" 2) Further advances, as funds are needed for 3 months operations, based on written requests from the State of Rio Grande do Norte will be submitted to SUDENE for its approval and submission

to USAID/B, for USAID/B consideration and approval. Those requests shall contain: (a) detailed information regarding the use of funds previously made available with the documents needed to prove expenditures, (b) a statement of the extent of progress in completing the project, (c) a description of any changes in the estimated costs, and (d) the projected use of funds for the succeeding 3 months period."

Our examination disclosed that SUDENE has not effectively and timely fulfilled these responsibilities of ensuring the proper use of funds by reviewing the documents proving expenditures and the use of funds previously made available to the project. We were informed by the SUDENE Audit team in our joint audit, that owing to the pressure of workload and the lack of qualified personnel, the SUDENE Audit Division had made no reviews of the project since our prior audit in 1964 and that verification of expenditures by examination of supporting documents for the past 3 years had not been initiated until February 1967 upon USAID/B/CONT notification that the present audit was being initiated. The only action taken has been an occasional analysis of the SECERN Statement of Accounts by the Assistant Manager of the SUDENE Audit staff for purposes of determining remaining balances.

The NEAO informed us that while the SUDENE Audit Division suffers from an obvious shortage of staff, it has developed a great deal in recent years, making significant improvement with regard to standardizing and streamlining its controls, procedures and schedules for verification of the application of funds on the part of the implementing agencies. For example, SUDENE has prepared a consolidated "Manual Order on Accounting Systems and Procedures, Chart of Accounts, and Rendering of Accounts" which was printed in January 1968 and distributed to all agencies implementing project agreements. NEAO feels that this is a very commendable step, indicating SUDENE's serious preoccupation in attempting to perform the controlling functions vested on them by project agreements.

However, it appears that up to the date of our audit, neither SUDENE nor the NEAO Education Division has provided effective financial and verification controls of previous project expenditures and it is our opinion that the question of improper utilization of project funds mentioned above is in part related to SUDENE's failure to execute these responsibilities and to follow prescribed procedures for releases of funds. If SUDENE is incapable of providing the proper controls and expenditure verification, it will be necessary for the NEAO Education Division to implement additional control procedures over USAID funds.

RECOMMENDATION No. 1

The USAID/B NEHR/Education Division prior to further release of USAID funds should (a) discuss with SUDENE officials the lack of accounting controls and expenditure verification in order to determine ways in which this deficiency can be corrected, and (b) require SUDENE to complete the verification of all expenditures and certify to USAID/B that all prior releases have been used in accordance with terms of the Project Agreement as revised.

(The NEHR office in responding to our draft report stated that they were not in agreement with Recommendation No. 1 because they feel that the wording would in effect mean the termination of the Rio Grande do Norte Education Program. The NEHR office stated that it would officially request SUDENE to complete the remaining verification on all project expenditures as this procedure is possible under the ProAg. However, based on their knowledge of SUDENE's operations they feel this request will require an unduly long period of time to complete. Since they feel that the draft audit report disclosed no evidence of wrong doing, other than faulty bookkeeping, they wish to maintain the training element of the program during the completion of the SUDENE verification procedures.)

B. PROJECT PROGRESS

1. School Construction

a. General

The prior audit report disclosed that as of December 31, 1964 construction of 149 schools with 233 classrooms had been initiated and 10 of these schools had been completed. Since then, the major activities of the project have been directed toward the completion of these schools. Revision No. 3 specifically designated 120 schools for completion with project funds. As of our review 119 schools had been completed. We also found that the John F. Kennedy Institute of Education has 4 buildings completed; a senior normal school, an elementary school, an industrial arts shop and a physics and biology laboratory building. The only construction not completed in accordance with Revision No. 3 was a large 6 room school in the municipality of Patú on which only foundation work had been completed and the kindergarten building at the John F. Kennedy Institute on which all work was stopped in 1966 due to lack of funds. The kindergarten building is approximately 40 per cent complete. The remaining 29 schools originally started have nothing more than foundation work completed.

Bids for the construction of the elementary schools were originally let to 5 construction firms and the municipality of Arcaia Branca. Contracts were signed on a unit price basis according to the specifications and location of each school and the total contract price for the 149 schools amounted to NCr\$539,195.38 in 1963. The SECERN Statement of Accounts disclosed that a total of NCr\$1,247,064.08 had been charged against schoolroom construction as of April 30, 1966. This excessive increase is due mainly to inflationary factors aggravated by construction delays since construction contracts allowed for increased cost based on a monthly "construction index" reflecting the added costs due to inflation. However, the failure of the State to provide timely contributions to the project delayed construction and contributed directly to increased construction costs.

Our examination included a review of the SECERN construction files in order to determine how such increased construction costs were computed and to reconcile individual school contract costs with total construction costs reported by SECERN. We found that these files were incomplete and in such a state of confusion that in no event could the total cost of individual contracts be accurately determined. In those construction records which were available, there appeared to be many inconsistencies in the computation of increased costs based on the monthly construction index and no state officials who could explain the method of computing the adjustments were available at the date of our audit. Furthermore, the concept of maintaining adequate construction cost information is lacking in the SECERN administrative operation and raises a question as to the adequacy of controls over construction expenditures as well as to SUDENE voucher verification procedures. We feel that in order to ensure that there were no improprieties in the use of funds for the construction of schools and to provide a final analysis of schools completed and in use, the following recommendation is in order:

RECOMMENDATION No. 2

- (a) The USAID/B NEHR/Education Division should request the RGN State Secretary of Education to prepare and forward to USAID/B a detailed schedule of all new schools constructed with project funds, including the John F. Kennedy Institute, showing name, location, number of classrooms, date completed, contract cost, cost adjustment, total cost and total expenditures to date. Total expenditures to date should be reconciled to school construction expenditures.
- (b) The USAID/B NEAO Engineering, Industrial and Natural Resources Division and Human Resources Division should analyze this schedule to determine the propriety of expenditures of USAID funds. The schedule will also serve

Recommendation No. 2 (Cont'd)

as a guide for follow up action on the correction of construction deficiencies and the future review of school utilization and maintenance.

The State Secretary of Education estimates that completion of the elementary school building at Patu will cost approximately NCr\$79,930.52. No estimates have been made of costs to complete the John F. Kennedy kindergarten building. The State is presently waiting for the final USAID release of construction funds of NCr\$71,533.05 as well as the remaining State contribution of NCr\$20,400.64 in order to initiate final work on the 2 buildings. The balance needed to complete these 2 buildings has been pledged from State and National Education funds. The other 29 schools originally started are expected to be completed as additional State funds become available in the future.

b. Utilization of Schools

With the exception of the John F. Kennedy Institute in Natal all of the schools constructed with project funds are scattered throughout the western part of the State. Our audit plan included on-site observation at a number of these schools for the purpose of checking on construction, utilization, and maintenance. Unfortunately, the roads in this section of the State had been made impassable by seasonal rains and other than the John F. Kennedy Institute, we were able to observe only 2 completed schools which were in the municipality of Patu. One of these schools was operating and the other had been closed since December 1967 when the teacher had left for additional training. No replacement had been nominated at the date of our visit. A report prepared by SUDENE in April 1968 disclosed that 6 of the 121 schools constructed with project funds were not in use.

Both schools visited appeared adequately planned but poorly constructed and maintained. They each consisted of a classroom, a small kitchen and indoor toilet facilities. However, water pumps had never

been connected and the kitchen and toilet facilities were not in use. One school had holes in the roof and was in need of interior painting. Both schools were minimally equipped with desks and a blackboard.

Our visit to the John F. Kennedy Institute disclosed that the Senior Normal School is operating in the mornings and afternoons and has 460 students enrolled. The elementary school also operates in 2 shifts and has 381 students. Elementary students also make use of the facilities of the industrial arts shops. The physics and biology laboratory building has never been used due to a lack of laboratory equipment. As previously stated, the kindergartn building has not been completed. All buildings appear to be adequately constructed and are well located on a campus style site which provides a pleasing appearance.

RECOMMENDATION No. 3

The USAID/B NEHR/Education Division should discuss with the State Secretary of Education the importance of providing equipment for the laboratory building. A commitment of State funds for this purpose should be given top priority.

c. Maintenance

Under the project agreement, the State agreed to maintain and repair all equipment, construction and other facilities. At the present time there is no adequate maintenance program for State schools because of a lack of funds and organization. The State Secretary of Education did inform us, however, that a maintenance program for all State schools, including those built with USAID funds, is being developed to carry out repairs according to a program of priority, taking into consideration the degree and urgency of repair, the location of the school, etc. Funds to defray such costs are expected to be made available by the State.

A list of all repairs needed by the 120 schools built with project funds was drawn up and submitted to NEHR/Wd. Plans for completing these repairs are being formulated and will be put into effect if and when funds become available.

2. Renovation of Classrooms

The prior audit reported a total of 316 schools were to be renovated with project funds. At that time a total of 124 schools with 195 classrooms had been restored at a total cost of NCr\$334,188. Due to a shortage of funds, first priority was given to new classroom construction and the restoration program was gradually terminated. As of April 30, 1968, SECERN records show a total of NCr\$366,179.43 had been expended in the renovation of 246 old classrooms.

3. Training

SECERN records disclosed a total of NCr\$212,829.05 had been expended for training and education purposes as outlined below:

Training	NCr\$210,639.57
Scholarships	12,189.48
TOTAL	<u>NCr\$212,829.05</u>

An important objective of the project was the training of lay-teachers during school vacations. This training covered 3 consecutive vacation periods and SECERN records showed the following number of teachers had completed the total course:

(a) Started in 1963 and completed January 1965	642
(b) Started in January 1964 and completed June 1965	685
(c) Started in June 1964 and completed December 1965	<u>573</u>
TOTAL	<u>1,900</u>

Another 655 teachers had completed the second step of the training course as of July 1966. The 3rd step of this course is expected to be administered when funds become available.

Other training included short courses for 300 adult education instructors, general professional training for 4 teaching supervisors in a special 8 week course in Belo Horizonte and special subject courses for 36 supervisors in other parts of Brazil.

The previous audit reported that the campaign to reduce illiteracy had been terminated due to adverse publicity when the present Federal government took over on April 1, 1964. No further funds have been expended in this program since that time.

In addition, USAID/B defrayed the training expense and international travel costs of 13 participants to the United States and one to Mexico from non-project sources. Of those receiving participant training, 11 are still working in the Department of Education of the State of Rio Grande do Norte.

4. Equipment

The prior audit report disclosed that SECERN maintained perpetual inventory control cards for all non-expendable equipment showing a description of the item, number, date of purchase, cost and location. At that time, SECERN also agreed to establish an equipment ledger which would act as a control account for the property cards. Recommendation No. 5 of that report requested NEHR/Ed to inform SECERN of the necessity of taking at least an annual physical inventory of equipment.

During our audit we were unable to locate any of the aforementioned control records. We were informed that when the SECERN organization was phased out in 1967 the State Secretary of Education authorized the transfer of all equipment to his office and other educational institutes throughout the State. We were supplied with a list of items supposedly transferred in this manner but having no inventory records to which the list could be reconciled it was of little value. In addition, no cost figures were included. We made no further effort to reconcile equipment inventories. Due to this complete lack of control over the purchase and disposition of a substantial amount of equipment, the following recommendation is made:

RECOMMENDATION No. 4

The USAID/B NEHR/Ed should request the State Secretary of Education to instruct his personnel to locate the missing inventory records or reconstruct the inventory from the accounting records. In the event such files are found, all control cards should be brought up to date showing new location and transfer authorization. A detailed list of all equipment should then be prepared with a copy being forwarded to USAID/B/NFAO and SUDENE.

5. Vehicles

The original project agreement authorized the purchase of 20 vehicles from project funds for use in the program. The prior audit report disclosed that SECERN had actually purchased 29 vehicles, the cost of which had all been charged against USAID contributions. SUDENE was supposedly disallowing the costs attributable to the 9 additional vehicles but we were informed that the issue had never been settled and no adjustments had been made to the account. As of April 30, 1968, the SECERN Statement of Accounts showed total vehicle costs of NCr\$59,675.58 had been charged against USAID releases. Our analysis of this account revealed that this total included some operating and maintenance expenses as well as several amounts which should have been charged to other accounts.

We also found that SECERN had sold 10 vehicles in June 1965 and had purchased 2 new vehicles with the proceeds. A second sale of 7 vehicles took place in February 1967 and left a balance of 14 vehicles. All purchase and sales were charged or credited to the vehicle account. Neither sale of vehicles was authorized by SUDENE or USAID.

No adequate inventory records on the vehicles are presently being maintained. A physical inventory taken at the time of our audit accounted for only 9 of the remaining 14 vehicles.

RECOMMENDATION No. 5

The USAID/B NEMR/Ed should (a) request the State Superintendent of Schools to prepare and submit to USAID/B a detailed schedule listing vehicles purchased, vehicles sold, and the location of the remaining 14 vehicles. The schedule should include the date of purchase and sale, make and type, serial number, cost and selling price, (b) supply SUDENE with a copy of this schedule and request SUDENE to analyze all charges to the account and to take action to disallow any expenditures which are not properly chargeable to project funds, and

Recommendation No. 5 (Cont'd)

(c) in the event of non-accountability of the vehicles, institute claim for refund action in accordance with the terms of the ProAg.

C. ARCHITECTURAL AND ENGINEERING CONTRACT SERVICE

In accordance with the project agreement, contract No. AID/1a-159 (Brazil) was signed on January 23, 1964 between USAID and the architectural and engineering firm of Norman M. Giller and Associates. The contractors' responsibilities included inspection and approval of all school building sites, review and approval of all plans and specifications, advice to Brazilian agencies in the selection, negotiation and award of all construction contracts and approval of all contracts and awards. The original contract expired on January 31, 1966 and a second contract, No. AID/1a-379 (Brazil), was signed with the same firm on March 4, 1966 to continue the work on the project. On the expiration of this second contract in September, 1966, it was felt that the contractors' services could no longer be adequately utilized due to the unprogressive state of the construction work. Consequently, the contractors departed Brazil. The engineering responsibilities were assumed by the NEAO Engineer, Industry and Natural Resources Division (NEEIN).

We made no examination of the above listed contracts but did review reports prepared by Giller & Associates. During the time Giller was associated with the project some 14 progress reports were prepared and a final supplementary report consisting of project progress to August 31, 1966 was submitted. We found these reports satisfactory in scope. However, we are of the opinion that the unsatisfactory record of construction completion can be attributed in part to SECERN failure to take advantage of the technical advice and practical experience available from Giller & Associates. At the beginning of the program there were difficulties between SECERN and the contractors due to the fact that the State government had not been consulted prior to the signing of the Giller contract and the services went beyond those envisioned in the project agreement.

Although many of these difficulties were subsequently overcome we found, for example, engineering reports by Giller which indicated that SECERN continued to make final payments to contractors even though work had not been unconditionally accepted by Giller. A closer working relationship would have been advantageous to all parties concerned.

D. REPORTING

We found that reporting on the financial progress of the project was completely inadequate. Although the project agreement did not explicitly describe the type of reports to be submitted by the State, the general procedures outlined for the release of funds by USAID required detailed information regarding the use of funds previously released and a statement on the extent of progress of the project to be submitted quarterly to SUDENE for its approval and submission to USAID/B.

We found that the NEAO Education Division's files contained only 3 reports from SECERN covering the period under examination. These reports were a simple listing of expenses by category and in one case represented estimated costs versus actual expenditures. The NEAO Education Division records show that all of these reports were considered inadequate but we found no evidence that follow-up action resulted in improved reporting by the State. It appears that the NEAO Education Division relied on SUDENE to monitor the financial aspects of the project through its system of expenditure verification required by the project agreement.

In addition to the reports mentioned above, the State submitted a monthly Statement of Accounts which showed total receipts and expenditures to date. However, such statements were not submitted on a regular basis and were generally 3 to 4 months in arrears. If these statements had been properly analyzed by the NEAO Education Division, it would have been noted that the State was deviating in the utilization of USAID/B funds from classroom construction to administrative expenses as discussed in Section A. 6 of this report. We feel that if a proper reporting schedule had been set up and complied

with from the beginning of the program, a more realistic evaluation of program activities would have been achieved.

The NEAO Education Division has recently initiated new procedures for the implementation and control of all reports and plans required to be submitted by all Northeast States currently receiving USAID funds for education projects. Our analysis indicates that if such procedures are properly followed, the project reporting requirements will be properly implemented. Consequently, we are making no recommendations.

E. PUBLICITY AND MARKING

We contacted the United States Information Service (USIS), Recife, for information concerning the publicity given to the project. We found that the project had received press coverage in Natal and Recife, especially when USAID funds were released, and the Alliance for Progress participation was clearly identified.

The prior audit report disclosed that signs showing the Alliance for Progress symbols had not been installed and maintained at school construction sites and recommended compliance with this requirement. During our examination we were informed that 30 signs denoting Alliance for Progress participation had recently been purchased but had not yet been installed at schools constructed. We noted that no signs were displayed at the 2 schools visited in the municipality of Patú.

RECOMMENDATION No. 6

The USAID/B NEHR/Education Division should initiate follow-up action with the State to see that all schools constructed with USAID funds are properly identified with the Alliance for Progress signs.

EXHIBIT A

SOURCE AND APPLICATION OF FUNDS

April 30, 1968

<u>SOURCE</u>	<u>USAID/B</u>	<u>State of RGN</u>	<u>SUDENE</u>	<u>TOTAL</u>
Contributions Received	2,587,945.96	538,599.36	100,000.00	3,226,545.32
Interest Earned	<u>1,870.15</u>	<u>250.63</u>	<u>70.17</u>	<u>2,190.95</u>
Total	<u>2,589,816.11</u>	<u>538,849.99</u>	<u>100,070.17</u>	<u>3,228,736.27</u>

APPLICATION

Classroom Construction	988,252.83	225,233.68	33,597.57	1,247,084.08
J.F.K. Institute Construction	294,508.50	1,241.70	- o -	295,750.20
Primary School Restoration	366,179.43	156.65	3,003.85	369,339.93
Administrative Expenses	215,681.55	439,937.75	6,837.21	662,456.51
Training	153,211.84	3,194.04	54,233.69	210,639.57
Scholarships	6,685.47	3,204.92	2,299.09	12,189.48
Literacy Campaign	42,471.17	2,253.44	- o -	44,724.61
Re-equip CEPE	20,472.76	16,116.91	- o -	36,589.67
Re-equip Primary Schools	67,806.74	369.70	- o -	68,176.44
Classroom Equipment	206,266.24	5,279.59	- o -	211,545.83
Vehicles	59,675.18	- o -	- o -	59,675.18
Regional Normal Schools	12,658.54	320.12	- o -	12,978.66
Miscellaneous & Sundry	<u>25,093.02</u>	<u>13,493.31</u>	<u>- o -</u>	<u>38,586.33</u>
Total	<u>2,458,963.27</u>	<u>710,801.81</u>	<u>99,971.41</u>	<u>3,269,736.49</u>
Balance	130,852.84	(171,951.82)	98.76	(41,000.22)
Balance in Bank Accounts	<u>112.68</u>	<u>19,158.07</u>	<u>- o -</u>	<u>19,270.75</u>
Short (Overexpenditure)	<u>130,740.16</u>	<u>(191,109.89)</u>	<u>98.76</u>	<u>(60,270.97)</u>

SUMMARY OF RECOMMENDATIONS

<u>Number</u>		<u>Page</u>
1	The USAID/B NEHR/Education Division prior to further release of USAID funds should (a) discuss with SUDENE officials the lack of accounting controls and expenditure verification in order to determine ways in which this deficiency can be corrected, and (b) require SUDENE to complete the verification of all expenditures and certify to USAID/B that all prior releases have been used in accordance with terms of the Project Agreement as revised.	18
2	(a) The USAID/B NEHR/Education Division should request the RGN State Secretary of Education to prepare and forward to USAID/B a detailed schedule of all new schools constructed with project funds, including the John F. Kennedy Institute, showing name, location, number of classrooms, date completed, contract cost, cost adjustment, total cost and total expenditures to date. Total expenditures to date should be reconciled to school construction expenditures.	20
	(b) The USAID/B/NEAO Engineering, Industrial and Natural Resources Division and Human Resources Division should analyze this schedule to determine the propriety of expenditures of USAID funds. The schedule will also serve as a guide for follow-up action on the correction of construction deficiencies and the future review of school utilization and maintenance.	20
3	The USAID/B NEHR/Education Division should discuss with the State Secretary of Education the importance of providing equipment for the laboratory building. A commitment of State funds for this purpose should be given top priority.	22
4	The USAID/B NEHR/Education Division should request the State Secretary of Education to instruct his personnel to locate the missing inventory records or reconstruct the inventory from the accounting records. In the event such files are found, all control cards should be brought up to date showing new location and transfer authorization. A detailed list of all equipment should then be prepared with a copy being forwarded to USAID/B/NEAO and SUDENE.	

SUMMARY OF RECOMMENDATIONS

<u>Number</u>		<u>Page</u>
5	The USAID/B NEHR/Education Division should (a) request the State Superintendent of Schools to prepare and submit to USAID/B a detailed schedule listing vehicles purchased, vehicles sold, and the location of the remaining 14 vehicles. The schedule should include the date of purchase and sale, make and type, serial number, cost and selling price, (b) supply SUDENE with a copy of this schedule and request SUDENE to analyze all charges to the account and to take action to disallow any expenditures which are not properly chargeable to project funds, and (c) in the event of non-accountability of the vehicles, institute claim for refund action in accordance with the terms of the ProAg.	25
6	The USAID/B NEHR/Education Division should initiate follow-up action with the State to see that all schools constructed with USAID funds are properly identified with the Alliance for Progress signs.	28

EXHIBIT C**DISTRIBUTION OF
REPORT ON EXAMINATION
No. 16/69**

	<u>COPY No.</u>
Minister William A. Ellis, Director, United States Agency for International Development Mission to Brazil	1
Dr. Herman Kleine, Deputy Mission Director (DDOM) - USAID/B	2
Mr. Shepard J. Hollander, Associate Director (NEAD) - USAID/B/NEAO	3
State Department - The Honorable J.K. Mansfield, Inspector General of Foreign Assistance (IGA)	4
State Department - Mr. Jack B. Kubish, Country Director - Office of Brazil Affairs (ARA/BR)	5
AID/W - Executive Director (ARA-LA/MGT/EX)	6 - 7
AID/W - Office of the Controller, Audit Division (C/AUD)	8
AID/W - Director, Inspections and Investigations Staff (IIS)	9
USAID/B - Evaluations Officer (OPEV)	10
USAID/B - Assistant Director for Program (ADPR)	11
USAID/B - Office of Management (ADMG/MGEX/MGMA)	12
USAID/B - Office of Human Resources (HRO)	13
USAID/B/NEAO - Office of Human Resources, Education Branch (NEHR/ED)	14 - 15
USAID/B/NEAO - Office of Engineering, Industry and Natural Resources (NNEIN)	16
USAID/B/NEAO - Program Staff (NEPS)	17
USAID/B - Director's Special Assistant (DSA)	18
USAID/B - Office of Special Assistant for Information (DSAI)	19
USAID/B - Office of the Controller (CONT)	20
USAID/B/NEAO - Office of the Controller (NECO)	21
USAID/B - Controller's Official File Copy	22
USAID/B - Audit Division (COAD)	23 - 28

NOTE: All audit work papers are attached to Copy No. 23 which is on file
in the Office of the Controller, Audit Division (COAD), USAID/B.

ACTIVITY IDENTIFICATION IN U-425 REPORT

1. Not Identified in U-425 Report - Audit Plan for FY 1968
as audit work substantially completed on June 30, 1968.

2. Dollar Value Audited (in thousands):

P.L. 480 Title I Section 104 (e) Grants NCr\$2.661 (U.S. equivalent
\$832.00 1/)

P.L. 480 Title I Section 104 (g) Loans NCr\$ 250 (U.S. equivalent
\$ 77.00 1/)

3. Man-Months Expended:

U.S. 2.0

Local 1.5

1/ At June 30, 1968 rate of NCr\$3.2 to each \$1.00.