I SN 69256
PD ABC 105

AUDIT OF SELECTED USAID/ECUADOR ACTIVITIES

Audit Report No. 1-518-87-32
July 27, 1987

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AGENCY FOR INTERNATIONAL DEVELOPMENT

OFFICE OF THE REGIONAL INSPECTOR GENERAL
AMERICAN EMBASSY
TEGUCIGALPA - HONDURAS

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July 27, 1987

MEMORANDUM

TO : USAID/Ecuador Director, Frank Almaguer

FROM : RIG/A/T, Coinage N. Gothard

Coinage N. Gothard

SUBJECT: Audit of Selected USAID/Ecuador Activities

The Office of the Regional Inspector General for Audit/Tegucigalpa conducted a financial and compliance audit of selected USAID/Ecuador activities. The audit covered the Mission's management of local currency trust funds, monitoring of host country contracts under the Macroeconomic Analysis project, and certain transactions and activities which have become the subject of an investigation. Discussion of those activities has been deleted from this audit report in order to avoid prejudicing the outcome of the investigation. The audit objective was to determine whether selected activities supported by USAID/Ecuador were in compliance with applicable laws and regulations.

The audit showed that USAID/Ecuador had not complied with AID Handbook 19 requirements for establishing and managing local currency trust fund accounts. Also, in some instances, the Mission had not complied with guidance on monitoring performance under host country contracts found in Handbook 19 and elsewhere.

The first report finding discusses non-compliance with requirements for establishing and managing trust fund accounts. The Mission had established two accounts in the name of the Mission Controller (rather than in the name of the U.S. Disbursing Officer) and used trust funds to purchase certificates of deposit in the Controller's name. In addition, the Mission did not maintain accounting records to keep track of transactions involving the certificates, and did not adequately safeguard the certificates of deposit. The second finding concerns weak monitoring of performance under host country contracts. The Mission relied on the implementing agency's certification of performance when authorizing payments to host country contractors, rather than personally verifying performance. Later, after a change in project officers, the Mission more closely monitored performance under host country contracts, but approved payments to one contractor who did not fulfill all of the terms of his contract.

The first recommendation is that USAID/Ecuador account for trust funds under its guardianship, and establish procedures for managing trust funds in accordance with Handbook 19. The second recommendation is that the Mission provide its project officers guidelines for monitoring performance under host country contracts.

USAID/Ecuador generally agreed with the findings and recommendations, but proposed a number of changes to improve the report's completeness and accuracy. Where appropriate, we have incorporated these changes. The Mission's detailed comments and our response are presented in Appendix 1.

Please advise this office within 30 days of the actions planned or taken to implement the report recommendations.

EXECUTIVE SUMMARY

This report discusses three programs managed by USAID/Ecuador. The first is a $24.2 million Economic Support Fund grant, signed on September 29, 1985. The second is a PL 480 Title I loan agreement, signed on May 17, 1985, which provided for the sale of $15 million in agricultural commodities. The third is the Macroeconomic Policy Analysis project, signed on September 28, 1984, which provided $1.3 million in Development Assistance funds.

The Office of the Regional Inspector General for Audit/Tegucigalpa conducted a financial and compliance audit of selected USAID/Ecuador activities. The audit encompassed certain transactions and activities which have become the subject of an investigation. The discussion of these activities has been deleted from this audit report in order to avoid prejudicing the outcome of the investigation. The audit objective was to determine whether selected activities supported by USAID/Ecuador were in compliance with applicable laws and regulations.

The audit showed that USAID/Ecuador had not complied with AID Handbook 19 requirements for establishing and managing local currency trust fund accounts. Also, in some instances, the Mission had not complied with guidance on monitoring performance under host country contracts found in Handbook 19 and elsewhere.

Current Mission management had, however, taken several corrective actions before the audit began. For example, it had closed two trust fund accounts which were improperly established. It had also instructed the Government of Ecuador that certificates of deposit purchased with PL 480 Title I funds should be purchased in the name of the PL 480 Title I program rather than in the name of the Mission Controller.

The first report finding discusses non-compliance with requirements for establishing and managing trust fund accounts. The Mission had established two accounts in the name of the Mission Controller (rather than in the name of the U.S. Disbursing Officer) and used trust funds to purchase certificates of deposit in the Controller's name. In addition, the Mission did not maintain accounting records to keep track of transactions involving the certificates, and did not adequately safeguard the certificates of deposit. The second finding concerns weak monitoring of performance under host country contracts. The Mission relied on the implementing agency's certification of performance when authorizing payments to host country contractors, rather than personally verifying performance. Later, after a change in project officers, the Mission more closely monitored performance under host country contracts, but approved payments to one contractor who did not fulfill all of the terms of his contract.

According to AID Handbook 19, the U.S. Disbursing Officer is to make deposits to and payments from AID trust fund accounts, and AID is to account for and report on the trust fund operations to the host government and AID/Washington. Contrary to these requirements,

USAID/Ecuador opened two trust fund accounts at a local bank ("La Previsora") in the name of the Mission Controller to manage local currency generated under the PL 480 Title I and Economic Support Fund programs. Also, the Controller did not maintain required accounting records to keep track of the resources under his control. The exact reason why the two accounts were established at La Previsora is not clear. Mission officials offered several possible explanations: that the Controller thought he was the U.S. Disbursing Officer and his actions were in compliance with AID regulations; that the Controller was asked by his superiors to establish the accounts at La Previsora; or that the Government of Ecuador wanted the accounts opened at La Previsora to bolster the bank's financial position. Since required internal control procedures were not followed in establishing and managing the trust fund accounts, approximately $17.1 million in local currency could have easily been misappropriated from the accounts. The report recommends that USAID/Ecuador prepare an accounting for trust funds under its control, and establish procedures to ensure that trust funds are managed in accordance with AID/Handbook 19. Mission officials generally agreed with this finding and recommendation.

AID's management system places project monitoring responsibility on its project officers who administratively approve payments under host country contracts after ensuring that services have been properly rendered. The Mission approved payment under three host country contracts based solely upon the contracting agency's certification. Later, the Mission approved payment under a host country contract even though the contractor had not complied with all of the contract terms. USAID/Ecuador had not developed guidelines or procedures to assist its project officers in establishing systems to monitor performance under host country contracts. As a result, over $196,000 in U.S. grant funds was paid to host country contractors who had not provided all of the products and services stipulated in their contracts. However, according to Mission officials, $150,000 of this amount was paid to a contractor who at least complied with the intent of his contract. The report recommends that USAID/Ecuador issue guidance on monitoring performance under host country contracts. The Mission generally agreed with this finding and recommendation.

Office of the Inspector General

AUDIT OF SELECTED
USAID/ECUADOR ACTIVITIES

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USAID/ECUADOR ACTIVITIES

PART I - INTRODUCTION

A. Background

Three programs are discussed in this report: an Economic Support Fund (ESF) grant, a PL 480 Title I sales program, and the Development Assistance-funded Macroeconomic Policy Analysis project.

The ESF grant agreement was signed on September 29, 1985. The basic agreement and its four amendments obligated $24.2 million for balance-of-payments support. At the time of the audit, this entire amount had been disbursed, and S/. 2,311,536,000 (Ecuadorian sucres) 1/ had been generated under the agreement. This local currency was to be used for purposes agreed to by USAID/Ecuador and the Government of Ecuador.

The PL 480 Title I loan agreement, signed on May 17, 1985, provided for the sale of $15 million in U.S. agricultural commodities. The sale of these commodities generated S/. 1,414,046,488 to be used for purposes agreed to by USAID/Ecuador and the Government of Ecuador.

The agreement for the Macroeconomic Policy Analysis project was signed on September 28, 1984; the project assistance completion date was September 30, 1987. The project agreement obligated $1.3 million in Development Assistance funds and required counterpart contributions equivalent to $435,000. As of March 31, 1987, $1.1 million in AID funds had been disbursed.

B. Audit Objectives and Scope

The Office of the Regional Inspector General for Audit/Tegucigalpa conducted a financial and compliance audit of selected USAID/Ecuador activities. The audit covered the Mission's management of local currency trust funds, monitoring of host country contracts under the Macroeconomic Analysis project, and certain transactions and activities which have become the subject of an investigation. Discussion of those activities has been deleted from this audit report in order to avoid prejudicing the outcome of the investigation.

The audit objective was to determine whether selected activities supported by USAID/Ecuador were in compliance with applicable laws and regulations. The audit work consisted of: reviewing relevant laws and regulations; reviewing Mission documents such as agreements, correspondence, reports, and accounting records; and interviewing

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1/ Local currency was generated using the exchange rate of S/. 95 to $1. The same exchange rate is used throughout this report.

USAID/Ecuador and host government officials. The review of compliance and internal controls was limited to the findings in this report. The audit work was performed from January through April 1987, and covered the period from May 1985 through March 1987. The audit covered AID disbursements of $1.1 million and local currency generations equivalent to $39.2 million. The audit was made in accordance with generally accepted government auditing standards.

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PART II - RESULTS OF AUDIT

The audit showed that USAID/Ecuador had not complied with AID Handbook 19 requirements for establishing and managing local currency trust fund accounts. Also, in some instances, the Mission had not complied with guidance on monitoring performance under host country contracts found in Handbook 19 and elsewhere.

However, USAID/Ecuador had taken several corrective actions before the audit began. For example, it had closed two trust fund accounts which were improperly established. It had also notified the Government of Ecuador that certificates of deposit purchased with PL 480 Title I funds should be purchased in the name of the PL 480 Title I program rather than in the name of the Mission Controller.

The first report finding discusses non-compliance with requirements for establishing and managing trust fund accounts. The Mission had established two accounts in the name of the Mission Controller (rather than in the name of the U.S. Disbursing Officer) and used trust funds to purchase certificates of deposit in the Controller's name. In addition, the Mission did not maintain accounting records to keep track of transactions involving the certificates, and did not adequately safeguard the certificates of deposit. The second finding concerns weak monitoring of performance under host country contracts. The Mission relied on the implementing agency's certification of performance when authorizing payments to host country contractors, rather than personally verifying performance. Later, after a change in project officers, the Mission more closely monitored performance under host country contracts, but approved payments to one contractor who did not fulfill all of the terms of his contract.

The first recommendation is that USAID/Ecuador account for trust funds under its guardianship, and establish procedures for managing trust funds in accordance with Handbook 19. The second recommendation is that the Mission provide its project officers guidelines for monitoring performance under host country contracts.

A. Findings and Recommendations

1. Two Trust Fund Accounts Were Improperly Established and Carelessly Managed

According to AID Handbook 19, the U.S. Disbursing Officer is to make deposits to and payments from AID trust fund accounts, and AID is to account for and report on the trust fund operations to the host government and AID/Washington. Contrary to these requirements, USAID/Ecuador opened two trust fund accounts at a local bank ("La Previsora") in the name of the Mission Controller to manage local currency generated under the PL 480 Title I and Economic Support Fund (ESF) programs. Also, the Controller did not maintain required accounting records to keep track of the resources under his control. The exact reason why the two accounts were established at La Previsora is not clear. Mission officials offered several possible explanations: that the Controller thought he was the U.S. Disbursing Officer and his actions were in compliance with AID regulations; that the Controller was asked by his superiors to establish the accounts at La Previsora; or that the Government of Ecuador wanted the accounts opened at La Previsora to bolster the bank's financial position. Since required internal control procedures were not followed in establishing and managing the trust fund accounts, approximately $17.1 million in local currency could have easily been misappropriated from the accounts.

Recommendation No. 1

We recommend that USAID/Ecuador:

a) prepare a full accounting for the use of the Economic Support Fund and PL 480 Title I local currency funds deposited into and disbursed from the two trust fund accounts at La Previsora bank, and

b) establish procedures to ensure that AID trust funds are established and managed in accordance with AID Handbook 19.

Discussion

AID Handbook 19 reflects U.S. Treasury regulations in specifying the procedures to be followed in establishing and managing trust fund accounts. The cooperating country makes local currency available for deposit in a U.S. trust account pursuant to negotiations and a definitive agreement with AID. Title for foreign currency trust funds resides with the cooperating country, and the Mission acts as trustee for the country and reports thereon to the country and to AID/Washington. Deposits to and payments from the trust account are effected by the U.S. Disbursing Officer in accordance with standard collection, certification, and accounting procedures. (The U.S. Disbursing Officer for Ecuador is located in Mexico City, Mexico.) The AID Mission is required to maintain accounting records and prepare reports on trust fund operations.

Contrary to the requirements of Handbook 19, USAID/Ecuador opened two trust fund accounts in the name of the Mission Controller at La Previsora bank to manage $17.1 million in local currency generated under the PL 480 Title I program and the ESF program. The Mission Controller and the Deputy Mission Director were authorized to sign checks drawn on these accounts, but all checks drawn on the accounts (between December 1985 and August 1986) were in fact signed by the Controller.

The account for PL 480 Title I local currency was opened on December 4, 1985 pursuant to a Trust Fund Agreement with the Government of Ecuador dated October 21, 1985. A total of $12.8 million in local currency generated plus interest earned were deposited into the account. USAID/Costa Rica's Deputy Controller, who was asked by USAID/Ecuador to provide technical assistance on managing local currency, questioned the legality of this account in a report dated February 7, 1986. On July 10, 1986 (five months later) the Mission closed the account and transferred the balance ($6.4 million) to a PL 480 Title I account at the National Development Bank controlled by the Ministry of Agriculture (see Exhibit 1). Another account, used only to pay the costs of the PL 480 Title I Implementation Secretariat, was opened in the name of the U.S. Disbursing Officer on November 24, 1986.

The account for the ESF program was opened on January 24, 1986 pursuant to a trust fund agreement with the Government of Ecuador dated January 23, 1986. A total of $4.3 million in local currency generated and interest earned was deposited into this account at La Previsora bank. A February 7, 1986 report prepared by USAID/Costa Rica's Deputy Controller who had travelled to Quito at the request and expense of USAID/Ecuador in order to help the Mission establish accounting and control systems over the ESF local currency generations also questioned the legality of this account. The trust fund agreement was amended on May 29, 1986 (four months later) to put the trust account in the name of the U.S. Disbursing Officer. However, USAID/Ecuador's Controller continued to disburse funds from the Previsora account until a new account in the U.S. Disbursing Officer's name was opened on August 22, 1986. On December 30, 1986 the old Previsora account was finally closed and the balance ($3.9 million) transferred to a Central Bank account at La Previsora bank (see Exhibit 2).

The Controller did not maintain accounting records (required by Handbook 19) to keep track of the trust funds. Instead, he relied on bank statements and notations in the check books to account for uses of trust funds.

The Controller invested some of the funds from the two trust fund accounts in certificates of deposit at the National Development Bank. Most of the certificates paid 22 percent interest and had short-term maturities. The certificates were purchased in the name of the Controller rather than the name of the PL 480 Title I or ESF program. A total of 23 certificates of deposit were purchased (18 with PL 480 Title I funds and five with ESF funds). About $9.5 million ($6.3 million in PL 480 Title I funds and $3.2 million ESF funds) was invested in certificates of deposit. (These figures do not include interest earned on the certificates.)

The Mission's careless management of trust funds is illustrated by its failure to properly protect the $6.3 million in PL 480 Title I funds invested in certificates. Eleven of the certificates were redeemed at the National Development Bank by the Executive Secretary of the program, even though the certificates were in the name of the Mission Controller. The Executive Secretary was a foreign service national employee working under a personal services contract with the Mission's Agriculture and Rural Development Office. The other seven certificates were kept by the Mission Controller in his Cashier's safe. Prior to his departure from Ecuador in September 1986, the Controller gave the seven unredeemed certificates to the Executive Secretary who kept them in his office. When the current Controller was instructed in December 1986 to secure all Mission files relating to our audit, the Executive Secretary delivered two sealed envelopes to the Controller for safe-keeping. According to the current Controller, the two sealed envelopes were placed in a safe that he had obtained for the purpose of controlling sensitive information. Upon cataloguing the information the following day, the Controller found that the two sealed envelopes contained the seven unredeemed certificates of deposit.

In addition, the Controller did not maintain any accounting records to track investments of PL 480 Title I and ESF funds in certificates of deposit. Although the National Development Bank provided monthly statements to USAID/Ecuador, the Mission had no accounting records to verify the information contained in the bank's statements. Given the absence of controls over the certificates of deposit, it would have been quite possible for the Executive Secretary to misappropriate the equivalent of millions of dollars in trust funds.

To correct this situation, the Controller turned the seven unredeemed certificates over to the Ministry of Agriculture for safe-keeping on January 8, 1987. At that time, Implementation Letter No. 65 was issued, mandating that the name on the certificates be changed from the Mission Controller to the PL 480 Title I Program and that the certificates be held by appropriate Government of Ecuador officials. The Implementation Letter also suggested that the certificates be kept in the custody of the National Development Bank and that authority to transfer funds between certificates of deposit and the PL 480 Title I Program account be exercised by the Minister of Agriculture or his representative who served as the Chairman of the PL 480 Advisory Council.

The exact reason why the two trust fund accounts were established at La Previsora bank is not clear. Some possible explanations given by USAID officials were that the Mission Controller was asked to do so by his superiors; or that the Government of Ecuador wanted the account opened at La Previsora bank to bolster its financial position. Also, we were told that the draft of the first trust fund agreement for the PL 480 Title I program (which was approved by AID/Washington) stated that the trust account should be in the name of the U.S. Disbursing Officer. However, this draft agreement was reportedly changed during Mission clearance because the Controller reportedly advised Mission officials that he was the U.S. Disbursing Officer.

Although we accounted for all funds deposited into and disbursed from the two trust fund accounts at La Previsora bank, we did not verify that all of the funds disbursed from the accounts were used for intended purposes. In separate audit reports on the ESF and PL 480 Title I local currency programs, we recommend that uses of the funds disbursed under these programs be promptly reviewed by local auditing firms.

The establishment of the two trust fund accounts in the name of the Mission Controller and the failure to account for the transactions was a serious internal control deficiency. The equivalent of $17.1 million in local currency could have easily been diverted to unauthorized uses since either the Controller or the Deputy Mission Director could have written checks on these accounts without any vouchers to authorize the transactions or could have supported the transactions with falsified vouchers.

Management Comments

USAID/Ecuador questioned whether it would have actually been possible for the Executive Secretary to misappropriate trust funds invested in certificates of deposit. It also stated that one possible reason trust funds were deposited in La Previsora bank was so that the funds would earn interest. With its response to the draft report, the Mission provided copy of a Mission Order dated June 19, 1987, which established policies for managing trust funds in accordance with AID and U.S. Treasury regulations.

Office of Inspector General Comments

We continue to believe that trust funds could have easily been misappropriated. The Controller could have written checks based on falsified or non-existent supporting documentation, and the Executive Secretary could have redeemed certificates of deposit without authorization. The validity of the suggestion that trust funds may have been deposited in La Previsora to earn interest is doubtful since (1) the accounts did not earn interest and (2) interest could have been earned at any bank other than the Central Bank of Ecuador. The Mission Order issued in June 1987 implements part "b" of recommendation number 1 which is closed upon issuance of this report. Part "a" is resolved, and will be closed when the required action is completed.

2. Host Country Contract Monitoring Needed Improvement

AID's management system places project monitoring responsibility on its project officers who administratively approve payments under host country contracts after ensuring that services have been properly rendered. The Mission approved payment under three host country contracts based solely upon the contracting agency's certification. Later, the Mission approved payment under a host country contract even though the contractor had not complied with all of the contract terms. USAID/Ecuador had not developed guidelines or procedures to assist its project officers in establishing systems to monitor performance under host country contracts. As a result, over $196,000 in U.S. grant funds was paid to host country contractors who had not provided all of the products and services stipulated in their contracts. However, according to Mission officials, $150,000 of this amount was paid to a contractor who at least complied with the intent of his contract.

Recommendation No. 2

We recommend that USAID/Ecuador issue a Mission Order on monitoring host country contracts which complies with Agency guidance.

Discussion

AID regulations found in Handbook 19, Chapter 3 provide that project officers assigned to oversee project implementation are to administratively approve all vouchers submitted under host country contracts (with certain exceptions not relevant here). The project officer's approval:

> ...signifies that the [project officer], who is in a position to know or find out if services have been performed pursuant to the terms of the contract, is satisfied that the services set forth in the document attached to the claim or bill have in fact been performed and that the [project officer] assures to the best of his/her knowledge that such services are in accordance with the contract involved.

While AID Handbook 19, Chapter 3, Section H places primary importance upon the certificate of performance executed by the contracting agency, it does not relieve the project officer of responsibility for independently verifying contract performance. AID Handbook 19, Appendix 3A provides criteria for the project officer's administrative approval of all vouchers. It stipulates that, under contracts providing for payment at fixed intervals (as was the case under the contracts in question) the project officer is expected "...to know whether the work has been completed" before approving payment.

In addition, Section 101 of the Foreign Assistance Act of 1961, as amended stipulates that "... United States development resources be effectively and efficiently utilized." Sound management procedure would dictate that AID not delegate this monitoring responsibility to a host country contracting agency, as would be the case if the project officer relied solely upon contracting agency certifications to ensure compliance with contract terms.

Finally, AID Handbook 3, Chapter 11 provides that Bureaus and Missions must establish systems to adequately monitor projects in their portfolios.

USAID/Ecuador's Macroeconomic Policy Analysis Project (No.518-0050) funded host country technical services contracts with three Ecuadorian nationals. The scopes of work of these contracts were vague, but it was intended that the contractors would provide advisory services, reports and analyses to the Ministry of Finance in whatever manner the Minister of Finance deemed appropriate. Two of the contracts also required the contractors to evaluate reports which were not scheduled for completion and delivery until the host country contracts were approaching termination. Therefore, the project in essence funded Ministry of Finance staff positions, relieving the Ministry of Finance of the salary burden of three staff advisors. The contractors were, however, to provide detailed work plans to the Mission and/or the Ministry of Finance within 30 days of the contracts' effective dates. The contractors were also to provide periodic progress reports, work plans and final reports. The progress reports would summarize their work performance, problems encountered and how they were solved, conclusions, and recommendations. The final reports would provide a compilation of achievements, problems and recommendations. These reports were to be submitted to the Ministry of Finance. The first contract became effective in November 1984 and terminated in February 1987. The remaining two contracts became effective in September 1985 and were terminated for convenience by the Ministry of Finance in June 1986.

Under the terms of the contracts, USAID/Ecuador made monthly payments directly to the contractors for "services rendered." The contractors submitted "Public Vouchers for Purchases and Services Other Than Personal" (SF-1034), together with Ministry of Finance certifications of performance, to the Mission each month. Two project officers were assigned to monitor the contracts at different times.

The Mission administratively approved payments based solely on the Ministry's certification of performance. Notwithstanding the Ministry's certification, two of the contractors did not perform satisfactorily, and their contracts were terminated for convenience in June 1986. The third contractor performed more satisfactorily, but still did not provide the work plan, progress reports, and final report required by his contract.

In May 1986, after a change in project officers, the Mission discovered that two of the contractors were not performing as required and immediately took steps to terminate their contracts. The Mission, however, continued to administratively approve payments for the third contractor, even though the contractor had not provided the required work plan, progress reports, and final report.

USAID/Ecuador had not established a system or specific guidelines for its project officers to use in monitoring activity under host country contracts, so as to enable them to make informed payment authorizations. Without positive guidance, the project officers assigned to monitor the Macroeconomic Policy Analysis Project expressed the belief that they need not or could not actively monitor activities under these host country contracts. In August 1986, the Mission issued a Staff Notice requiring each project officer to submit a completed monitoring checklist to the Mission Controller's Office with each reimbursement voucher submitted for payment, including payments under host country contracts. This checklist mentioned meeting with counterparts to discuss contractor performance as one basis for approving payment vouchers. This is a necessary step in establishing an adequate payment authorization and certification system. It does not, however, directly address the needs of the project officers monitoring host country contracts. These include the need to physically inspect work products, guidelines for refusing to authorize payment in the absence of specific performance, and a description of project officers' duties and responsibilities as a representative of a non-signatory participant under the contract.

In the absence of such guidance, project officers were left to independently determine the scope of their monitoring responsibilities. In this instance, the lack of guidance resulted in disbursement of almost $200,000 to contractors who failed to abide by the terms of their agreements. Despite a lack of physical evidence of contract compliance, AID had disbursed, through March 1987, $196,632 (partly in local currency) to the three contractors for "services rendered." According to Mission officials, $150,000 of this amount was paid to a contractor who at least complied with the intent of his contract, although he did not produce exactly what was called for in the contract.

Management Comments

USAID/Ecuador generally agreed with this finding and recommendation, but suggested certain changes to the text to improve the completeness and accuracy of the finding and recommendation. According to the Mission, the Regional Legal Advisor and the Regional Contracting Officer were reviewing a draft Mission Order which provided guidelines on monitoring host country contracts.

Office of Inspector General Comments

We consider recommendation number 2 resolved. It may be closed when the Mission Order on monitoring host country contracts is issued in final form.

B. Compliance and Internal Control

1. Compliance

The audit disclosed compliance problems in two areas. First, USAID/Ecuador had not complied with Handbook 19 requirements for establishing and managing trust fund accounts. The Mission established two trust fund accounts in the name of the Mission Controller rather than in the name of the U.S. Disbursing Officer in Mexico as required by AID and U.S. Treasury Regulations. The Mission also used trust funds to purchase certificates of deposit in the Controller's name. The Mission did not maintain accounting records to control the certificates, and did not properly safeguard the certificates themselves. The second area of non-compliance concerned monitoring performance under host country contracts. The Mission relied on the implementing agency's certification of performance when administratively approving vouchers for payment, rather than personally verifying performance. Later, after a change in project officers, the Mission more closely monitored contractors' performance, but approved payments to one contractor who had not provided all of the products called for in his contract. The review of compliance was limited to the two areas discussed above.

2. Internal Control

The internal control weaknesses revealed during the audit concerned the same areas discussed above. First, the failure to establish sound internal controls over trust funds introduced an unacceptable risk that these funds could be misappropriated or wasted. Second, due to the lack of Mission procedures for monitoring host country contracts, about $200,000 was disbursed to contractors who had not entirely fulfilled the terms of their contracts. The review of internal controls was limited to the matters discussed above.

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USAID/ECUADOR ACTIVITIES

PART III - EXHIBITS AND APPENDICES

Exhibit 1

ANALYSIS OF DEPOSITS AND DISBURSEMENTS
LA PREVISORA TRUST FUND ACCOUNT - PL 480 TITLE I PROGRAM
DECEMBER 9, 1985 TO JULY 14, 1986

Deposits

- PL 480 Title I Sales Proceeds	$14,884,700
- Loan from Ministry of Agriculture	105,263
- Redemption of Certificates of Deposit	1,101,246
Total Deposits	$16,091,209

Disbursements

- Repayment of Loan	$ 105,263
- Purchase of Certificates of Deposit	6,315,790
- Program Expenses	3,255,795
- Transferred to National Development Bank	6,414,362
Total Disbursements	$16,091,209

<u>Exhibit 2</u>

ANALYSIS OF DEPOSITS AND DISBURSEMENTS
LA PREVISORA TRUST FUND ACCOUNT - ESF PROGRAM
JANUARY 24 TO DECEMBER 30, 1986

<u>Deposits</u>

- ESF Special Account at Central Bank	$4,000,000
- Redemption of Certificates of Deposit	3,491,431
Total Deposits	$7,491,431

<u>Disbursements</u>

- Purchase of Certificates of Deposit	$3,157,895
- Program Costs	388,731
- Transferred to Central Bank Special Account at La Previsora	3,944,805
Total Disbursements	$7,491,431

UNITED STATES GOVERNMENT

memorandum

DATE: July 14, 1987

Frank Almaguer

REPLY TO ATTN OF: Frank Almaguer, Director
USAID/Ecuador

O/CONT-87-318

SUBJECT: Draft Audit Report of Selected USAID/Ecuador Activities

TO: Mr. Coinage Gothard, LAC/RIG/A

The Mission has reviewed the subject draft audit report and has the following comments, observations and recommendations/requests for changes:

1. Page i (first paragraph)

   The last sentence in this paragraph states that the Macroeconomic Policy Analysis project was signed on September 28, 1985. The correct signing date is September 28, 1984.

2. Page i (last paragraph)

   Mission requests that the first sentence be changed to read: "Current Mission management had taken many corrective actions...".

3. Page ii (middle paragraph, last two sentences)

   Mission requests that the last two sentences be changed to read: "The Mission relied on the implementing agency's certification of performance when authorizing payments to certain host country contractors under one project." We also request that the next sentence be changed to read: "Later, after a change in project officers, the Mission more closely monitored the project performance under the host country contracts, but approved payments to one contractor who did not fulfill all of the terms of his contract."

4. Page iii (first paragraph) and Page 10 (second sentence)

   We know of no factual evidence to support the statement that the Government of Ecuador "...wanted the accounts opened at La Previsora to bolster the bank's position." Unless there are documented statements made by GOE officials to support this claim, then we believe the statement should be deleted from the report. If speculative statements are to be included in the report, then other possible reasons include a desire to earn

OPTIONAL FORM NO. 10
(REV. 1-80)
GSA FPMR (41 CFR) 101-11.6
5010-114
☆ U.S. GPO 1986-491-2??/4??

interest on the L/C and presumed greater accessability under the trust arrangement of the Mission.

Also, we question the statement that "...approximately $17.1 million in local currency could have easily been embezzled from the accounts." Admittedly, internal controls were weak, but that does not necessarily mean that monies could have been embezzled easily. If this statement is to remain, it should be explained in the report, in precise language, just how easily the money could have been embezzled. In the absence of this language, we believe the statement should be changed to read: "...in local currency was succeptable to misuse."

Because of the several changes requested to this finding, we request that the last sentence in this paragraph be deleted.

5. Page iii (last paragraph second sentence)

The Mission requests that the sentence be changed to read "The Mission approved..." We also request that the next sentence be changed to real: "Later, the Mission approved payment..."

6. Page iv (last sentence)

Because of the changes requested in items No. 4 and 5 above, the Mission believes that the last sentence on this page is unnecessary and should be deleted.

7. Page 5 (sentence which begins on line 11)

We request that the sentence be changed to read "Current Mission officials offered several possible explanations: that the accounts would earn interest, that the controller..."

8. Page 5 (last sentence)

Please refer to our comments related to the ease with which money could have been embezzled. Again, we question the validity of this statement in the report unless it is substantiated. We suggest that the sentence be changed to refer to poor internal controls which left the resources vulnerable.

9. Page 6 (recommendation a and b)

We request that the recommendation be rewritten as follows:

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interest on the L/C and presumed greater accessability under the trust arrangement of the Mission.

Also, we question the statement that "...approximately $17.1 million in local currency could have easily been embezzled from the accounts." Admittedly, internal controls were weak, but that does not necessarily mean that monies could have been embezzled easily. If this statement is to remain, it should be explained in the report, in precise language, just how easily the money could have been embezzled. In the absence of this language, we believe the statement should be changed to read: "...in local currenc was succeptable to misuse.".

Because of the several changes requested to this finding, we request that the last sentence in this paragraph be deleted.

5. Page iii (last paragraph second sentence)

The Mission requests that the sentence be changed to read "The Mission approved..." We also request that the next sentence be changed to read: "Later, the Mission approved payment..."

6. Page iv (last sentence)

Because of the changes requested in items No. 4 and 5 above, the Mission believes that the last sentence on this page is unnecessary and should be deleted.

7. Page 5 (sentence which begins on line 11)

We request that the sentence be changed to read "Current Mission officials offered several possible explanations: that the accounts would earn interest, that the controller..."

8. Page 5 (Last sentence)

Please refer to our comments related to the ease with which money could have been embezzled. Again, we question the validity of this statement in the report unless it is substantiated. We suggest that the sentence be changed to refer to poor internal controls which left the resources vulnerable.

9. Page 6 (recommendation a and b)

We request that the recommendation be rewritten as follows:

a. "Prepare a full report which will include a complete accounting for the use of ESF and PL 480 Title I local currency funds deposited into and disbursed from the two trust fund accounts at La Previsora bank, and..."

We believe the recommendation as presently written implies that the Mission should reconstruct accounting reports to AID/W that would have been prepared if the trust accounts had been established properly. If this is the intent of the recommendation, we do not believe it would serve any purpose to do so, and there would be no way the accounting reports to AID/W could be processed retroactively.

b. This section of Recommendation No. 1 can be deleted because the Mission has taken the recommended action. Mission Order No. 236 was issued on June 19, 1987. We are providing a copy of the order to RIG/A and this should be reflected in the final report.

10. Page 7 (third line)

There is a footnote 1/ but there is no explanation of the footnote.

11. Page 9 and 10 (reference to misappropriation of funds)

Again, there were internal control weaknesses present but we do not know whether it would have been possible for the Executive Secretary to actually embezzle trust funds. He did not have check signing authority over any funds, but did have certificates of deposits in his possession, although they were not in his name. Whether the bank would have allowed him to cash them and receive currency is highly unlikely and raises doubt about the broad statement in the draft audit report regarding the ease with which he could have accessed the funds. The Mission believes that the statements on the subject should be deleted or altered to reflect the fact that weaknesses in internal controls left the Mission vulnerable.

12. Page 11 (last paragraph)

The Mission Order has been drafted and is being reviewed by the RLA and RCO. We believe this should be reflected in the final report.

13 Page iii, Page 12, and Pages 17 and 18

On these four pages the draft report refers to $196,000 which was paid to host country contractors who had not "...provided all of the products and services in their contracts." This amount includes $150,000 paid to one contractor who we believe more than met the conditions of his contract and provided reports and other documents to justify the contract payments made to him. The deliverables produced may not have been precisely what were called for in the contract, but it would be misleading to claim that the entire $196,000 had been paid out to contractors who had not produced anything during the terms of their contracts. We believe the statements in the draft report should be changed to reflect the views of the Mission on this matter.

14. Page 12 (Recommendation No. 2)

We request that the second sentence be deleted. We are in the process of issuing an order which conforms to Agency guidance for the monitoring of host country contracts. Personal knowledge of acceptable work performed is only one of several acceptable monitoring techniques available to project officers to ensure performance by host country contractors. Perhaps the recommendation could be rewritten to require the Mission to provide guidance to project officers on monitoring techniques which conform to Agency standards.

15. Page 15 (second paragraph, last sentence)

Mission requests that this sentence be deleted. It implies that there were two officers assigned to monitor the same contracts which was not the case.

16. Page 15 (third paragraph)

We request that the first sentence be changed to read: "The Mission administratively approved payments..."

17. Page 15 (last paragraph)

Mission requests that the first sentence be changed to read: "In May 1986, the Missicn discovered that..." Also, please change the last sentence of the paragraph to read: "The Mission, however, continued to..."

18. Page 17 (first paragraph, last sentence)

This sentence should read: "An additional...was paid on..."

19. Page 17 (second paragraph, first sentence) and Page 18 (Compliance)

Because of the language changes previously requested relating to the two project officers, it is not now necessary to differentiate between the two project officers, and these sentences should be deleted.

20. Page 17 (last sentence)

This sentence should read: "The RLA and RCO are presently reviewing a draft Mission Order which provides guidelines for monitoring host country contracts."

21. Page 18 (Compliance)

The wording in the second sentence in this paragaph implies that the local bank account should have been opened in the name of the USDO, and, of course, this would not have been acceptable. We suggest the last part of the sentence be rewritten to read: "...in the name of the Mission Controller rather than opening a trust account with the USDO in Mexico as required by AID and US Treasury regulations.

Att.: a/s

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OFFICE OF INSPECTOR GENERAL RESPONSE TO MANAGEMENT COMMENTS

Note: The paragraph numbers below correspond to those used in USAID/Ecuador's comments.

1. We have made the correction suggested by the Mission.

2. We have made the change requested by the Mission.

3. We have made the change requested by the Mission.

4. The suggestion that the Government of Ecuador wanted trust funds deposited in La Previsora bank in order to bolster the bank's financial position is supported by a December 9, 1986 letter from the USAID/Ecuador Director to the Assistant Administrator for Latin America and the Caribbean. We doubt that the desire to earn interest was a motivating factor, since (1) the accounts did not earn interest and (2) interest could have been earned by depositing the funds in any bank other than the Central Bank of Ecuador.

   We continue to believe that the trust funds could have easily been misappropriated. The Controller could have written checks based on falsified or non-existent supporting documentation, and the Executive Secretary could have redeemed certificates of deposit without authorization.

5. We have made the change requested by the Mission.

6. We have made the change requested by the Mission.

7. The validity of the Mission's suggestion that trust funds may have been deposited in La Previsora because of a desire to earn interest is questionable for the reasons discussed above in response number 4.

8. See response number 4.

9. We have made a change in the recommendation similar to that suggested by the Mission.

10. We have deleted the footnote.

11. See response number 4.

12. The fact that the Mission order has been drafted has been included in the report.

13. The Mission's views on this matter have been incorporated in the report.

14. We have re-written the recommendation as the Mission suggested.

15. We have changed the report to make clear that the two project officers assigned to monitor these contracts were assigned at different times.

16. We have made the change requested by the Mission.

17. We have made the change requested by the Mission.

18. The sentence the Mission refers to has been deleted.

19. We have made the change requested by the Mission.

20. We have made the change requested by the Mission.

21. We have made the change requested by the Mission.

Appendix 2

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