

PD-ABC-392

ISN 70127

**Audit of Costs Incurred under
the University of Illinois Subcontract
with Institut Merieux under
A.I.D. Contract No. DPE-0453-C-00-3059**

Audit Report No. 7-138-91-05
January 25, 1991

AGENCY FOR INTERNATIONAL DEVELOPMENT
Office of the Regional Inspector General for West Africa

January 25, 1991

MEMORANDUM

TO: Mr. Terrence J. McMahon, Director, Office of
Procurement

FROM: 
Paul E. Armstrong, RIG/A/Dakar

SUBJECT: Audit of Costs Incurred under the University of Illinois
Subcontract with Institut Merieux under A.I.D. Contract
No. DPE-0453-C-00-3059
Audit Report No. 7-138-91-05

Enclosed are five copies of the subject report. In preparing this report, we reviewed your comments and those of Institut Merieux officials which are included in Appendix II and III, respectively. Please respond to this report within thirty days, indicating any actions planned or already taken to implement the recommendations.

I appreciate the cooperation and courtesies extend to my staff by Institut Merieux during the audit.

Background

Malaria, one of the world's leading health problems, afflicts up to 200 million people annually and causes as many as two million deaths each year. When it was evident that international efforts to control the disease through insecticides and drugs were not effective, A.I.D. authorized the Malaria Immunology and Vaccine Research (MIVR) project to develop a malaria vaccine. Initiated in 1966, MIVR channels funds to 12 institutions implementing a total of 15 subprojects. The project has funded \$91 million of research since inception.

The University of Illinois (UI), a recipient of A.I.D. funding since inception of the MIVR project, signed a \$4.2 million six-year contract with A.I.D. in 1983 (Contract No. DPE-0453-C-00-3059) to develop a vaccine based on soluble antigens released by the parasite during infection. To assist these efforts, UI planned to execute a subcontract with Institut Merieux (IM), a pharmaceutical company in Lyon, France, with which it had collaborated on malaria research since 1981. However, legal questions about patent rights delayed awarding of the subcontract.

In April 1986, after the patent issue was finally resolved, UI requested IM to submit a research proposal so they could proceed with the subcontract. IM responded by submitting a description of malaria research work already performed in collaboration with UI and requested reimbursement of \$418,000. After further negotiations IM agreed to reduce its claim to \$200,000 and signed a cost-reimbursement contract with UI in 1988.

This unusual agreement, signed with A.I.D.'s knowledge and consent, required UI to reimburse IM for research costs incurred while informally collaborating on the MIVR project from 1983 to 1987. IM then submitted a statement of expenditures totaling \$194,672 to UI, which UI sought to reimburse with A.I.D. funds allocated to its contract No. DPE-0453-C-00-3059. However, neither UI nor IM were able to provide A.I.D. with adequate documentary support for these costs, and a recent UI internal audit alleged financial improprieties on the part of a researcher assigned to the MIVR project. In light of these developments, the Office of the Inspector General audited costs incurred under the subcontract.

Audit Objectives

The Office of the Regional Inspector General for Audit, Dakar, audited costs billed by Institut Merieux to the University of Illinois for services rendered under the subcontract from October 1, 1983 to April 30, 1987 to determine whether such costs were reasonable, allocable and allowable under the terms and conditions of the subcontract.

In accomplishing these audit objectives, we tested whether Institut Merieux (i) followed applicable internal control procedures and (ii) complied with terms and conditions of the subcontract and certain provisions of laws and regulations. Our tests were sufficient to provide reasonable, but not absolute, assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. When we found problem areas, we performed additional work to:

- conclusively determine whether Institut Merieux was following a procedure or complying with a legal requirement;
- identify the cause and effect of the problem; and
- make recommendations for A.I.D. action.

Appendix I describes in detail the audit scope and methodology.

Audit Findings

For the period October 1, 1983 to April 30, 1987, IM reported costs totalling \$194,672 incurred under the subcontract with UI. The subcontract scope of work consisted of three components: mass producing, detecting and partially purifying malaria exoantigens. Our review of IM research reports and laboratory notes showed evidence of work in these areas; and interviews with IM researchers and review of their correspondence files and travel records demonstrated collaboration on malaria vaccine research between UI and IM. However, our audit showed the entire cost of \$194,672 to be either unsupported or questionable, as shown below:

	<u>Costs Claimed</u>	<u>Unsupported Costs</u>	<u>Questioned Costs</u>
Salaries	\$114,679	\$114,679	
Materials & Supplies	60,845	60,845	
Travel	16,291	1,669	\$14,622
Equipment	<u>2,857</u>	<u> </u>	<u>2,857</u>
Total	<u>\$194,672</u>	<u>\$177,193</u>	<u>\$17,479</u>

We were unable to determine the allocability and allowability of material and supply costs and salaries charged to the subcontract because IM did not maintain books and records, nor establish accounting procedures and practices, sufficient to support those costs. IM was responsible for maintaining such support as evidence of costs incurred under this cost-reimbursement agreement. We questioned travel and equipment costs because IM failed to comply with relevant terms and conditions of the subcontract.

We presented Institut Merieux officials with the above findings upon conclusion of our audit. While they took no exception to our audit findings, they stated that the Institut performed the subcontract work in good faith and prefinanced the research costs fully expecting to be reimbursed. They attributed the accounting deficiencies and instances of non-compliance noted during our audit to their inexperience with U.S. Government grants.

A series of deficiencies resulted in the above unsupported and questionable costs. IM incurred research costs without the benefit of a contract and in ignorance of fiscal recordkeeping requirements for U.S. Government contracts. UI awarded the subcontract--with A.I.D. consent--for work already completed, and IM agreed to terms and conditions with which it had not complied. To make matters worse, IM research personnel, with no accounting expertise and no knowledge of details of the subcontract, prepared the statement of costs submitted to A.I.D. Detailed discussions of these costs and our recommendations follow.

Salaries - Salary costs of \$114,679 claimed for reimbursement under the subcontract represent a portion of the salaries of two laboratory technicians in IM's Department of Human Parasitology Research & Development. Laboratory records showed that, besides the UI collaboration, this department was also conducting research on three other malaria projects and in at least two non-malaria fields during the subcontract period. However, we found the department had no system or controls in place for allocating salary costs among its various research activities during the subcontract period, and no records allowing a reliable retroactive allocation of such costs.

In June 1987, years after most of the work was performed, the IM department manager allocated salary costs to the subcontract based on her recollection of department activities during the period. She informed us that she had no knowledge of the subcontract provisions when she made this allocation, which is not surprising since the agreement was not signed until 1988. We discussed with the department manager--as well as with IM accounting, legal and research personnel--the basis for determining the allocation factors, reviewed available accounting and activity reports, and found the allocations to be arbitrary and unsupported by competent, reliable evidence. This problem was compounded by the fact that IM never prepared quarterly progress reports required under the subcontract. Such reports could have assisted, for example, in determining the level of effort employees applied to the project. We then examined the salaries of the two technicians, the costs against which the allocation factors were applied. This examination showed that IM's claim included salary costs totalling \$10,447 incurred prior to the subcontract period, notwithstanding subcontract provisions specifically disallowing such costs, and that the allocation was applied to budgeted rather than actual expenditures. Based on the above, we concluded that salary costs claimed for reimbursement under the subcontract were unsupported, inaccurate and, given the lack of reliable accounting procedures and activity records, impossible to accurately calculate.

Recommendation No. 1: We recommend that the Director, Office of Procurement, disallow the \$114,679 of unsupported salary costs billed by Institut Merieux to the University of Illinois under the subcontract.

Materials and Supplies - Material and supply costs allocated to the subcontract, totaling \$60,845, consisted of a portion of laboratory supplies, reagent material and culture media -used by IM's Department of Human Parasitology Research & Development. The audit showed that although this department was simultaneously engaged in other research projects while collaborating with UI under the subcontract, there were no system, procedures or controls in place to allocate material and supply costs among the various activities. The allocation was again based on the recollection of the department manager, and again we found it to be arbitrary and unsupported by reliable, competent evidence. Nevertheless, we proceeded to test a judgmental sample of 22 material and supply expenditures included in the cost pool allocated to the

subcontract. IM was unable to provide source documents supporting 45 percent of the sampled transactions because its record-retention policy allowed disposal of the documents after two years, despite subcontract provisions requiring record retention for a significantly longer period. Furthermore, our audit showed that:

- contrary to terms of the subcontract, IM charged UI approximately \$9,000 of material and supply costs incurred by the department during the four months prior to commencement of the subcontract;
- IM made a \$1,195 arithmetic error in its favor in calculating material and supply costs allocated to the project; and
- IM claimed duplicate reimbursement for one item costing \$224 by reporting it as both a material and supply expense and an equipment expense.

Based on the above, we concluded that IM's claim for material and supply costs was unsupported, inaccurate and, given the inadequate accounting controls, procedures and practices, impossible to accurately calculate.

Recommendation No. 2: We recommend that the Director, Office of Procurement, disallow the \$60,845 of unsupported material and supply costs billed by Institut Merieux to the University of Illinois under the subcontract.

Travel - IM claimed reimbursement for travel costs totalling \$16,291. The subcontract required that all international travel be approved by the cognizant technical office of A.I.D. and that travellers use U.S. flag air carriers whenever available. IM officials informed us they were not aware of these requirements. We found that, though the entire \$16,291 of travel costs resulted from international travel, IM never obtained A.I.D. clearance to undertake such travel. As a result, all travel costs are questioned. Furthermore, this amount included (i) \$5,413 for air travel on foreign airlines, without required certification that U.S. carriers were not available, (ii) \$1,880 for transatlantic air travel on an unidentified airline, (iii) \$1,669 of unsupported travel costs, and (iv) \$1,188 of travel undertaken prior to commencement of the subcontract period. These costs are itemized in Exhibit I. However, for the supported travel costs, air travel was coach class, hotel and meals were moderately priced.

Recommendation No. 3: We recommend that the Director, Office of Procurement:

- 3.1 instruct the cognizant technical office of A.I.D. to review the purpose of each trip shown in Exhibit I and determine its allocability to the subcontract;**

- 3.2 based on that review, make a determination of the allowability of those allocable costs that are supported and comply with the Fly America Act; and
- 3.3 disallow unsupported travel costs of \$1,669, travel costs incurred prior to the subcontract period totaling \$1,188 and cost of flights on foreign and unidentified air carriers amounting to \$7,293.

Equipment - IM requested reimbursement for equipment costs totaling \$2,857, as shown below:

<u>Item</u>	<u>Acquisition Date</u>	<u>Cost</u>
Cell Culture	12-83	\$496
Distribution System	1-84	454
Cell Culture	1-84	224
Chromatograph	10-84	<u>1,683</u>
Total		<u>\$2,857</u>

IM accounting records showed this equipment to have a useful life of five years. We reviewed procurement documentation, interviewed research personnel and concluded that costs were adequately supported, reasonable and that the equipment was procured for and used to perform subcontract work. However, we questioned those costs due to IM's non-compliance with subcontract provisions. The subcontract required IM to periodically report to A.I.D. equipment purchased under the project and required a final property report upon completion of the subcontract. IM never notified A.I.D. of equipment purchases and, at completion of the subcontract, stated no property was on hand. However, at the time of our audit, the equipment was still being used in IM laboratories almost three years after expiration of the subcontract. A lack of communication between IM's legal department and its researchers managing the project caused the incorrect statement issued by IM, resulting in IM's retention of project equipment potentially useful in other MIVR activities.

Recommendation No. 4: We recommend that the Director, Office of Procurement, determine the allowability of equipment costs, totaling \$2,857, questioned by the audit.

Conclusion

Because the subcontract was awarded by the University of Illinois long after Institut Merieux ended its collaboration on the project, some of its provisions made little sense when applied retroactively. For example, the agreement required Institut Merieux to obtain A.I.D.'s prior approval for all international travel charged to the project and report quarterly on the progress of its work. Yet it should have been evident to both parties that IM had not complied with these provisions and could not do so retroactively.

While primary responsibility for the deficiencies noted in this report rests with the University of Illinois and Institut Merieux, we feel that a comment regarding A.I.D.'s contracting review process is warranted. While after-the-fact approval of contracts covering work already performed is permissible under A.I.D. regulations, this audit amply demonstrates the hazards of such extraordinary and unusual arrangements. We consider it an anomaly that an A.I.D. contracting officer on August 20, 1987 signed a contract amendment which formally incorporated a subcontracting agreement that had not yet been signed and also had the additional disadvantage of being for work long since completed or presumed completed by the subcontractor. In a recent RIG/A/Dakar audit report (No. 7-631-90-04), the auditors noted that a contracting officer signed two amendments retroactively providing funds to cover a large cost overrun of a cooperative agreement's spending limits. In that case we were advised by the IG Legal Counsel that the contracting officer's action "ratified" the grantee's actions. While reportedly legal, neither of these actions inspire great confidence in the Agency's contractual procedures. While it is beyond the scope of our cost audit, we strongly suggest that the A.I.D. contracting office review its practices in this regard.

Agency Comments And IG Response

The A.I.D. Office of Procurement (MS/OP) provided a response to our draft report (Appendix II). While agreeing that the report's findings on the costs were reasonable, MS/OP pointed out that A.I.D. contracting officials had merely provided "consent," not "approval," to the subcontract. In MS/OP's opinion, it was the responsibility of the prime contractor, University of Illinois, to ensure that its subcontractor, Institut Merieux, complied with applicable regulations. The University therefore had to assume any risks of noncompliance by the subcontractor, including disallowance of costs incurred under the subcontract.

An opinion provided to us by the IG Legal Counsel (Appendix IV) stated that there was no approved subcontract between Institut Merieux and the University of Illinois under the requirements of the A.I.D. prime contract with the University. IG Legal Counsel further believes that it is A.I.D.'s responsibility to assert a claim against the University of Illinois to resolve this \$194,672 unauthorized commitment made by the University. The recommendations made in this report will remain open until implemented or otherwise satisfactorily resolved by A.I.D.

TRAVEL COSTS CLAIMED FOR REIMBURSEMENT
BY INSTITUT MERIEUX

	<u>NAME OF TRAVELLER</u>	<u>DATE OF TRIP</u>	<u>DESTINATION</u>	<u>PURPOSE OF TRIP</u>	<u>FOREIGN AND UNKNOWN AIRLINES</u>	<u>UNSUPPORTED COSTS</u>	<u>OTHER SUPPORTED COSTS</u>	<u>TOTAL</u>
1.	Dr. Maryvonne Cagnard	2/2/84-3/4/84	Lyon-Champaign, IL-Lyon	UI Collaboration (Prof Ristic)	\$1,880	\$ 290	\$1,026	\$3,196
2.	Dr. Maryvonne Cagnard	11/7/85-11/15/85	Lyon-Champaign, IL-Lyon	UI Collaboration (Prof Ristic)			613	613
3.	Dr. Maryvonne Cagnard	2/23/86-3/8/86	Lyon-Champaign, IL- Mexico-Lyon	UI Collaboration (Prof Ristic) Purpose of Mexico visit unknown	1,690		1,198*	2,888
4.	Dr. Maryvonne Cagnard	9/15/84-9/30/84	Lyon-Calgary, Canada-Lyon	To Attend Congress on Tropical Medicine	1,407	296	723	2,426
5.	Dr. Yves Moreau	6/21/85-6/28/85	Lyon-Nairobi-Lyon	To Attend Int'l Congress on Protozoology		529	737	1,266
6.	Dr. Maryvonne Cagnard	11/2/85-11/11/85	Miami-Lyon	To Attend Meeting of American Society of Tropical Medicine & Hygiene			934	934
7.	Dr. Maryvonne Cagnard	8/21/86-8/31/86	Lyon-Brisbane, Australia-Lyon	To Attend Int'l Congress on Parasitology	2,315	91	233	2,639
8.	Dr. Maryvonne Cagnard	April, 1985	7 Trips Lyon-Marcy, France-Lyon	Road Travel between IM Laboratories			79	79
9.	Mr. Colombey	April-May, 1985	11 Trips Lyon-Marcy-Lyon	"			124	124
10.	Dr. Maryvonne Cagnard	January, 1986	2 Trips Lyon-Marcy-Lyon 1 Trip Lyon-Grenoble- Lyon	"			187	187
11.	Dr. Maryvonne Cagnard	August 21, 1986	Lyon-Paris-Lyon	Unknown			200	200
12.	Mr. Autheman	June 6, 1985	Lyon-Paris-Lyon	Unknown			86	86
	UNIDENTIFIED TRAVEL						463	463
SUB-TOTAL					\$7,292	\$1,669	\$6,142	\$15,103
TRAVEL UNDERTAKEN PRIOR TO COMMENCEMENT OF THE SUBCONTRACT PERIOD								1,188
TOTAL TRAVEL COSTS CLAIMED FOR REIMBURSEMENT								\$16,291

Note: All travellers are professional employees of Institut Merieux's Parasitology Department. IM did not provide us with requested evidence relating trips 4 through 12 to the subcontract scope of work. However, trips 1,2 and the \$1,198 portion of trip 3 appeared to be related to performance of the subcontract.

* All costs claimed were in relation to UI trip.

SCOPE AND METHODOLOGY

Scope

We audited costs billed by Institut Merieux under its subcontract with the University of Illinois in accordance with generally accepted government auditing standards. The contract totaled \$194,672 for services rendered from October 1, 1983 through April 30, 1987 under a subcontract which was signed in 1988. We conducted our field work in the offices of Institut Merieux in Lyon and Marcy L'Etoile, France from August 27, 1990 through September 6, 1990. Accordingly, our audit was limited to work performed at the Institut Merieux and did not review and assess the University of Illinois' procedures for negotiating, awarding and administering the subcontract.

Methodology

To accomplish the audit objectives, we tested Institut Merieux's financial reports and records related to costs claimed by the Institut for reimbursement under its subcontract with the University of Illinois to determine the allocability and allowability of those costs. We also assessed the reasonableness, as defined by contract provisions, of equipment and travel costs. Because material and supply costs and salaries were unsupported, we did not assess the reasonableness of those costs. Audit methodology included:

- analyzing controlling documents and regulations, such as contractual agreements and relevant Federal and A.I.D. Acquisition Regulations;
- examining procurement and payroll records;

- assessing related internal controls;
 - determining compliance with relevant regulations and agreements;
 - reviewing evidence of work performed; and
 - interviewing cognizant Institut Merieux administrative and research officials.
-

ACTION: RIG INFO: 'AMB DCM

APPENDIX II

VZCZCDK0303
 OO RUEHDK
 DE RUEHC #9290 3550229
 ZNR UUUU ZZH
 O 210229Z DEC 90
 FM SECSTATE WASHDC
 TO AMEMBASSY DAKAR IMMEDIATE 6637
 BT
 UNCLAS STATE 429290

LOC: 010 61
 21 DEC 90 0756
 CN: 28146
 CHRG: RIG
 DIST: RIG

AIDAC ATTN: RIG/A/DAKAR PAUL F. ARMSTRONG

E.O. 12356: N/A

TAGS:

SUBJECT: DRAFT AUDIT REPORT OF COSTS INCURRED UNDER THE UNIVERSITY OF ILLINOIS SUBCONTRACT WITH INSTITUT MERIEUX

REFERENCES: (1) CONTRACT NO. DPL-0453-C-00-3059-00,
 (2) RIG/A/DAKAR MEMORANDUM DATED 10/22/90, SAME
 SUBJECT, (3) DAKAR 13550

1. PLEASE ACCEPT APOLOGY FOR DELAY IN RESPONDING TO REF
 (2). SUBSTANCE OF AUDIT AS RELATES TO COSTS INCURRED
 UNDER THE SUBCONTRACT WITH INSTITUT MERIEUX APPEARS
 REASONABLE. NO FURTHER COMMENTS ARE PROVIDED HEREFIN.

2. WITH REFERENCE TO RIG COMMENTS REGARDING AID'S
 CONTRACTING PRACTICES, THIS OFFICE WOULD NOTE THAT THE
 CONTRACTING OFFICER PROVIDES CONSENT, NOT APPROVAL, TO
 SUBCONTRACT. THE FAR SPECIFICALLY ADDRESSES RETROACTIVE
 CONSENT, THUS MANY CONTRACTORS CHOOSE TO ASSUME RISK IN
 PROCEEDING PRIOR TO RECEIVING CONSENT.

3. GIVEN THE ABOVE, IT IS NOT THE RESPONSIBILITY OF
 THIS OFFICE TO ENSURE THAT SUBCONTRACTORS ARE AWARE OF
 FEDERAL CONTRACTING REQUIREMENTS. RATHER, IT WAS THE

RESPONSIBILITY OF THE UNIVERSITY OF ILLINOIS TO REQUIRE
 ADHERENCE TO REGULATIONS. UI PLACED ITSELF AT RISK OF
 HAVING COSTS DISALLOWED SINCE IT FAILED TO APPRISE ITS
 SUBCONTRACTOR OF THESE REQUIREMENTS.

4. THIS AUDIT WILL BE HANDLED IN AID/W BY MS/OP/W/HP,
 LORIE DOHENY. APPRECIATE OPPORTUNITY TO COMMENT ON
 DRAFT AUDIT. - BAKER

BT

#9290

NNNN



PASTEUR MÉRIEUX
Sérum & Vaccins

APPENDIX III
Page 1 of 2

Lyon, October 2, 1990

Mr Craig R. Nordby
Mr Falilou Diouf
AGENCY FOR INTERNATIONAL
DEVELOPMENT
Office of the Regional Inspector General
for West Africa
C/o AMERICAN EMBASSY
B.P. 49
DAKAR, SENEGAL

Dear Sirs,

We thank you for the summary of your audit.

We will follow your invitation to comment your findings and appreciations of the conditions in which the subcontract between our Company and the University of Illinois has been implemented.

First of all, it must be pointed out the fact that the work which has been devoted to INSTITUT MERIEUX has been done and the goal which has been assigned has been reached.

As you are already aware, monkeys have received injection of experimental vaccines against Malaria in the frame of the Agreement and the subcontract between AID, the University of Illinois and INSTITUT MERIEUX.

The cost of the works assigned to INSTITUT MERIEUX has been prefinanced by MERIEUX under the assumption of a reimbursement. As the result has been reached, we must consider that our obligation under the Agreement has been fulfilled and we could think, in good faith, that the other parties will be in the position to equally fulfill their obligations.

Secondly, in more specific term, we have to recognise that in a company like ours, which conducts many research programs with a wide variety of partners, it is difficult and maybe impossible to really make accurate affectation of the costs incurred because of the implication between the programs. As example, a travel made by one single person is often organized in order to maximise the activities of the company and many research programs are concerned by the travel. It is the same for equipment which can be used for many extends.

Furthermore, at INSTITUT MERIEUX, we have some inexperience to deal with grants from US official agencies.



Also, you have to take into account that our rules for managing French grants are different.

Last, if in the future, we are facing such situations, we will open a special account to allocate the expenses and the funds.

Yours sincerely,



Yves ROMAND
Legal Department

copy : J. Armand
Y. Moreau

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

APPENDIX IV

COUNSEL TO THE DIRECTOR
GENERAL

JAN - 4 1991

MEMORANDUM

TO: IG/A/PPO, Bruce H. Crandlemire
FROM: IG/LC, Robert J. Perkins ^{RJP}
SUBJECT: RIG/A/Dakar draft audit report Institute Merieux (IM)

This is in response to your 11/19/90 memo with the attached subject draft audit.

There was no approved sub-contract between IM and the University of Illinois (UI) under the requirements of the A.I.D. prime contract with UI. Therefore, the recommendation in the RIG/A/D audit report should go forward as drafted. It is the contracting officer's responsibility to settle this \$194,672 unauthorized commitment with UI.

There is some evidence that there was no sub-contract intended in the first place; however, this can't be proved. In the meantime, OP should assert a claim against UI.

Enclosure:

11/19/90 PPO memo to LC w/attachments

REPORT ON INTERNAL CONTROLS

We have audited costs claimed for reimbursement under the University of Illinois subcontract with Institut Merieux signed in 1988 for services rendered from October 1, 1983 through April 30, 1987 and have issued our report thereon dated January 25, 1991.

We conducted our audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to fairly, objectively and reliably answer the objectives of the audit. Those standards also require that we:

- assess the applicable internal controls when necessary to satisfy that objective; and
- report on the controls assessed, the scope of our work and any significant weaknesses found during the audit.

In planning and performing our audit, we considered Institut Merieux's internal control structure to determine our auditing procedures in order to answer the audit objectives and not to provide assurance on the internal control structure.

Institut Merieux was responsible for maintaining records, documents, other evidence and accounting procedures and practices sufficient to reflect all costs claimed for reimbursement under the subcontract. Such responsibility included establishing and maintaining a system of internal controls sufficient to reasonably assure the integrity of cost data reported for reimbursement under the subcontract. To accomplish our audit objectives, we reviewed IM's controls over (i) procurement of goods and services under the subcontract and (ii) allocation of shared and pooled costs to the subcontract.

Our review showed two reportable conditions relating to the audit objectives:

- Institut Merieux had no system, controls or procedures in place to equitably and reliably allocate shared or pooled costs to the subcontract; and

- its record-retention policy allowed it to dispose of certain supporting documentation prior to the close-out of the subcontract.

These deficiencies in internal controls rendered a large portion of reported subcontract costs unverifiable.

A material weakness is a reportable condition in which the design or operation of the specified internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial reports on funds being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal controls would not necessarily disclose all matters that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe the reportable conditions described herein are material weaknesses.

REPORT ON COMPLIANCE

We have audited costs incurred under the University of Illinois subcontract with Institut Merieux signed in 1988 for services rendered from October 1, 1983 through April 30, 1987, and have issued our report thereon dated January 25, 1991.

We conducted the audit in accordance with generally accepted government auditing standards, which require that we plan and perform the audit to fairly, objectively and reliably answer the audit objectives. Those standards also require that we:

- assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which include designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives) and
- report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing entity conduct. Noncompliance constitutes an illegal act when the source of the requirement not followed or prohibition violated is a statute or implementing regulation. Noncompliance with internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition and is included in our report on internal controls. Abuse is furnishing excessive services to beneficiaries or performing what may be considered improper practices, which do not involve compliance with laws and regulations.

Compliance with laws, regulations and contract provisions is the responsibility of Institut Merieux's management. As part of fairly, objectively and reliably answering the audit objectives, we performed tests of the contractor's compliance with provisions of laws, regulations and the subcontract. However, our objective was not to provide an opinion on overall compliance with such provisions.

Our audit disclosed three significant instances of non-compliance. Institut Merieux did not:

- maintain books, records, documents and other evidence--nor did it establish accounting procedures and practices--sufficient to properly reflect costs incurred under the subcontract;
- comply with terms of the subcontract by (i) claiming reimbursement for travel on foreign air carriers without filing certification that U.S. carriers were unavailable and (ii) not obtaining authorization from the cognizant A.I.D. technical office prior to undertaking international travel; and
- prepare quarterly progress reports as required under provisions of the subcontract.

No other material instances of non-compliance came to our attention.

Report Distribution

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IG	1
AIG/A	1
IG/PPO	2
D/AIG/A	1
IG/RM	12
IG/LC	1
IG/PSA	1
AIG/I	1
RIG/I/Dakar	1
RIG/A/Cairo	1
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