PD-ABC-806

isn-71672

Audit of USAID/Philippines' Accelerated Agricultural Production Project No. 492-0385

Audit Report No. 2-492-91-05
May 30, 1991

USAID/Philippines has not measured the level of benefits achieved by the project, could better monitor the utilization of project inputs and needs to assess the extent that counterpart contributions have been provided.

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
RESIDENT AUDIT OFFICE
MANILA

UNITED STATES POSTAL ADDRESS
USAID/RAO/M
APO SAN FRANCISCO 96528

INTERNATIONAL POSTAL ADDRESS
c/o AMERICAN EMBASSY
MANILA, PHILIPPINES

DATE: May 30, 1991

MEMORANDUM

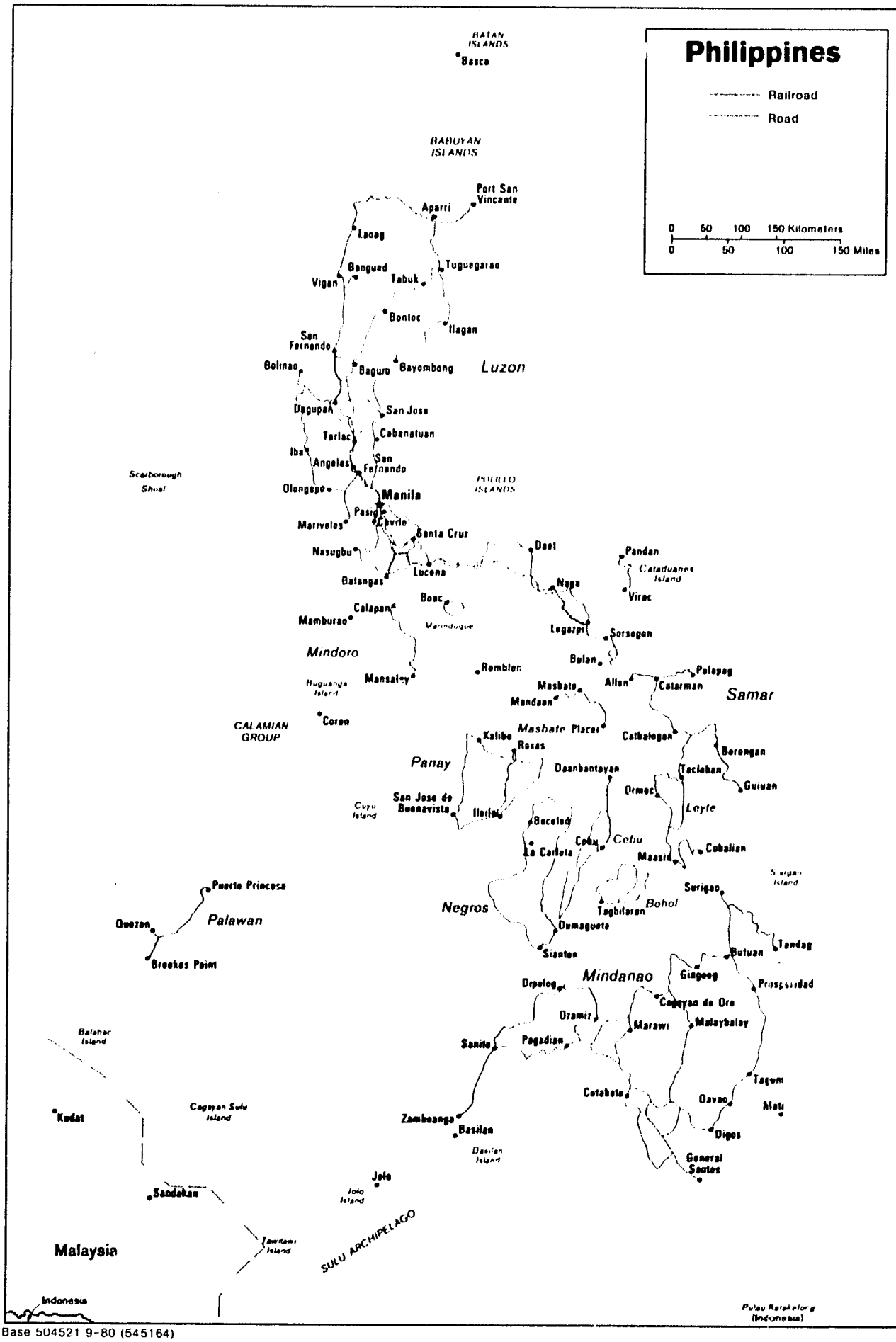
TO: Mr. Malcolm Butler
Director, USAID/Philippines

FROM: Dennis L. Smith
Resident Auditor, RAO/Manila

SUBJECT: Audit of USAID/Philippines' Accelerated Agricultural Production Project No. 492-0385
Audit Report No. 2-492-91-05

The Resident Audit Office/Manila has completed its audit of USAID/Philippines' Accelerated Agricultural Production Project. Five copies of the report are provided for your action. The draft report was submitted to you for comment and your comments are attached to the report. The report contains four recommendations. Recommendation No. 1 is closed on report issuance. Recommendations No. 2 and 3 are open pending agreement on responsive courses of action. Recommendation No. 4 is resolved and can be closed when the actions in process are completed.

I appreciate the cooperation and courtesy extended to my staff during the audit.



Base 504521 9-80 (545164)

EXECUTIVE SUMMARY

The objective of the $41 million Accelerated Agricultural Production Project is to increase the profitability and productivity of agriculture in the Philippines by improving governmental support services to farmers, identifying and supporting more efficient markets for agricultural products, and improving the methodology for agricultural policy and program formulation. The project provides funds for technical assistance, commodities, training and operational support to implementing agencies. On August 30, 1986, A.I.D. and the Government of the Philippines signed a $20 million grant agreement with project completion scheduled for December 31, 1991. Two subsequent amendments to the agreement increased A.I.D. funding to $30 million. The Philippine government cash and "in-kind" contributions are to total $10 million. In addition, participating universities and non-governmental organizations are to contribute at least $725,000, including "in-kind" costs.

The audit was conducted from July through November 1990 in accordance with generally accepted government auditing standards. The specific objectives for this audit are listed on pages 2 and 3 of the report and the audit scope and methodology are described in Appendix I. Internal controls and compliance issues related to the audit objectives were reviewed and are discussed on pages 17 through 22.

The audit revealed that this project did not include certain design and control features necessary to ensure effective management of project resources as follows:

- The elements necessary for measuring developmental impact were not designed into the project.

- Some commodities were not being used effectively to achieve project purposes, and some commodities and project sites were not marked to ensure that A.I.D. publicity requirements were met.

- Control procedures for voucher review and approval under buy-ins to centrally-funded contracts were not in compliance with A.I.D. regulations.

- There is no assurance that $11 million of counterpart contributions are being provided as planned.

Four recommendations were made to correct the weaknesses described above. USAID/Philippines officials generally agreed with our findings and conclusions and have initiated or are considering corrective actions, as appropriate. Management comments on our draft report are included as Appendix II.

Office of the Inspector General

Office of the Inspector General
May 30, 1991

TABLE OF CONTENTS

	Page
EXECUTIVE SUMMARY	i
INTRODUCTION	1
Background	1
Audit Objectives	2
REPORT OF AUDIT FINDINGS	4
Has USAID/Philippines measured the developmental impact of the project?	4
Does USAID/Philippines monitoring ensure the effective utilization of project inputs?	8
Commodity Monitoring Needs Improving	9
Are USAID/Philippines control procedures adequate to ensure the effective use of AID-provided project funds?	12
Administrative Approval Needed	12
Has USAID/Philippines assured that counterpart contributions are being provided by the host country, participating universities and non-governmental organizations as planned?	14
REPORT ON INTERNAL CONTROLS	17
REPORT ON COMPLIANCE	21

	Appendix
SCOPE AND METHODOLOGY	I
MANAGEMENT COMMENTS	II
REPORT DISTRIBUTION	III

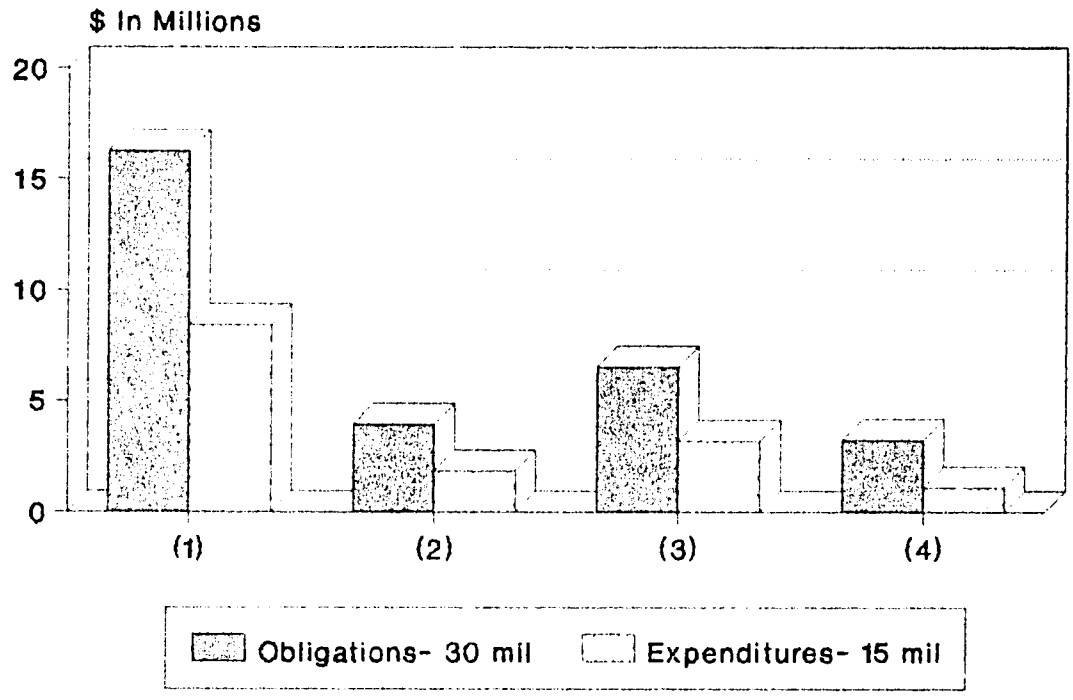
INTRODUCTION

Background

The objective of the $41 million Accelerated Agricultural Production Project is to increase the profitability and productivity of agriculture in the Philippines by improving governmental support services to farmers, identifying and supporting more efficient markets for agricultural products, and improving the methodology for agricultural policy and program formulation. The project provides funds for technical assistance, commodities, training and operational support to implementing agencies.

On August 30, 1986, A.I.D. and the Government of the Philippines (GOP) signed a $20 million grant agreement for this project with project completion scheduled for December 31, 1991. Two subsequent amendments to the agreement increased A.I.D. funding to $30 million.

OBLIGATIONS & EXPENDITURES
AS OF SEPTEMBER 30, 1990



(1) Services to Farmers (2) Market Dev.
(3) Economic Analysis, Planning and Statistics (4) Project Management

The GOP cash and "in-kind" contributions are to total $10 million. In addition, participating universities and non-governmental organizations are to contribute at least $725,000, including "in-kind" costs.

Project outputs are to include:

- irrigation systems managed by farmer organizations;
- farm technology demonstration sites;
- a decentralized planning, budgeting and financing system for the Department of Agriculture;
- action plans for the privatization of government corporations;
- policy studies on banking laws, investment incentives, trade, grain stabilization and transportation and
- market information services that would promote marketing arrangements between businessmen and farmers.

The GOP's Department of Agriculture (DA) and National Irrigation Administration are the project implementing agencies. A Project Management Office within the DA was established to coordinate and monitor the subproject activities of implementing units within the DA. Several Philippine universities, private agribusiness firms and private voluntary organizations provide technical support, conduct agricultural research and perform studies.

Audit Objectives

The Resident Audit Office/Manila conducted a performance audit of the Accelerated Agricultural Production Project to answer the following audit objectives:

1. Has USAID/Philippines measured the developmental impact of the project?

2. Does USAID/Philippines monitoring ensure the effective utilization of project inputs?

3. Are USAID/Philippines control procedures adequate to ensure the effective use of AID-provided project funds?

4. Has USAID/Philippines assured that counterpart contributions are being provided by the host country, participating universities and non-governmental organizations as planned?

To answer the audit objectives, we tested whether USAID/Philippines (1) followed applicable internal control procedures and (2) complied with certain provisions of laws, regulations, grants and contracts. Our tests were sufficient to provide reasonable--but not absolute--assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. Because of limited time and resources, we did not continue testing when we found that, for the items tested, USAID/Philippines followed A.I.D. procedures and complied with legal requirements. Therefore, we limited our conclusions concerning these positive findings to the items actually tested. When we found problem areas, we performed additional work

- to determine if USAID/Philippines was not following a procedure or not complying with a legal requirement,

- to identify the cause and effect of the problems and

- to make recommendations to correct the condition and cause of the problems.

Appendix I contains a complete discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

Has USAID/Philippines measured the developmental impact of the project?

The developmental impact of the $30 million A.I.D. grant cannot be measured until the Accelerated Agricultural Production project is modified to include the elements necessary for measuring impact.

> **Recommendation No. 1: We recommend that USAID/Philippines revise the logical framework for the Accelerated Agricultural Production Project to include the following elements necessary for measuring developmental impact of the project:**
>
> - **explicit and achievable objectives;**
> - **descriptions of conditions prior to implementing project activities;**
> - **targets with time-specific progress indicators and**
> - **anticipated results which relate to the project goal and purpose.**

Section 621A(b) of the Foreign Assistance Act of 1961 requires A.I.D. to establish a management system that includes

- defined objectives and programs for U.S. foreign assistance,
- quantitative indicators for measuring progress toward these objectives and

- methods for comparing actual results of programs and projects with those anticipated when they were undertaken.

A.I.D. Handbook 3, Chapter 12, Section B(2) and Appendix 3K require that the design of A.I.D. projects include elements for measuring impact. These elements are (1) explicit and achievable objectives, (2) analysis of conditions prior to implementing project activities, (3) time-specific progress indicators and (4) an explanation of the relationship between anticipated results and the goals and purposes of the project.

USAID/Philippines cannot measure the level of benefit achieved by the project because the elements for measuring impact were not included in the design of the project or its subprojects. We reviewed the goal and purpose statements contained in the project logical framework, which revealed that the project goal and purpose are broad and do not include the design elements needed to effectively measure progress. For example, according to the logical framework contained in the project paper, the goal of the project is to restore and accelerate agricultural growth. Achievement of this goal is to be measured by increases achieved in the production and value of rice, corn, other food crops, feedgrains and non-traditional exports resulting from project activities. However, the logical framework does not quantify the volume and value of increases to be achieved. A USAID/Philippines project official said that the goal and purpose statements are intentionally broad to allow flexibility in responding to GOP development problems in agriculture.

The project purpose is to increase the profitability and productivity of farmers. The logical framework indicates that increases in profitability and productivity can be determined by measuring improvements in

- yields of major crops,
- the use of purchased inputs by farmers,
- farmer income and
- farmer participation in irrigation management.

We assessed the indicators in the logical framework. The indicators that would measure achievement of project purpose are expressed in general terms and are not quantified. Therefore, they cannot be used to measure whether the project purpose is being or has been achieved. For instance, the indicator, increased yields of major crops, does not identify the types, numbers, and amounts of increases in crop yields to be achieved. The indicator, increased use of purchased inputs, does not identify the types of inputs and amounts of increases. Another indicator, increased farmer income, does not specify the number of farmers and the levels of increases to be achieved. The indicator, greater farmer participation in irrigation management, does not specify the number of farmers participating in irrigation management prior to the project or the increase to be realized.

We reviewed the project paper to determine whether baseline data on conditions prior to the project were included, targets with progress indicators tied to specific time frames had been established and anticipated results of the project were discussed in relation to the project goal and purpose. Baseline data were not included, targets had not been established and the anticipated results of the project in relation to its goal and purpose were not discussed. A mid-term project evaluation, completed in late 1989, recommended the gathering of baseline data. However, the recommendation was not implemented because project officials believed that the data would not be beneficial since little time was left before project completion in December 1991.

Likewise, subproject design did not include the elements necessary for measuring impact. We reviewed workplans for two subprojects to determine whether the elements necessary for measuring impact were included. The purpose of the first subproject was to improve irrigation systems; the second was to institutionalize agricultural research and extension activities within the GOP's Department of Agriculture.

The objective of the irrigation subproject, as stated in the workplan, is to increase the adequacy and reliability of water delivery and distribution at the farm level by improving the operation and maintenance of irrigation systems. The subproject objective is broad and cannot be measured because the workplan does not include information needed to measure subproject progress. On the other hand, the subproject workplan for research and extension presents a measurable

and quantified statement of objectives. The workplan indicates that the subproject objective is to institutionalize a decentralized planning process for agricultural research and extension. Achievement of this objective is accomplished when 13 regional plans for research and extension and agricultural development of local governments have been prepared. However, the other elements necessary for measuring impact are not discussed in the workplans for either subproject. These include baseline data on conditions prior to the implementation of the subprojects' activities, targets with progress indicators tied to specific time frames, and the relationship between anticipated results and the goal and purpose of the project. As a result, progress toward achievement of subproject objectives cannot be measured.

The developmental impact of this project has not been determined because project design did not include the elements necessary for measuring impact. Both USAID/Philippines project officials and a project amendment justification indicated that the project was conceived at a time of institutional and political change in the Philippines. Also, this project was initiated using the "rolling design concept," which made it difficult to establish specific measurable objectives. USAID/Philippines project officials explained that because of the urgent need for the project, a detailed and comprehensive project design was not completed. Although there may have been an urgent need for the project, USAID/Philippines officials agreed that they could have developed the elements necessary for measuring impact after project implementation had started and project objectives were more defined.

Systems for measuring impact have not been implemented for the overall project nor incorporated into the design of subprojects. Therefore, USAID/Philippines cannot measure the developmental benefit derived from the $30 million A.I.D. grant for project activities.

Management Comments and Our Evaluation

USAID/Philippines agreed that project design did not include the elements necessary for determining impact. However, neither USAID nor AID/Washington anticipates any follow-on activities which would benefit from an evaluation of this project. Therefore, there will be no final evaluation of this

project. In the absence of the need for measurement criteria to effect revision of the project during the limited remaining life, or to facilitate a final evaluation, USAID does not believe that revision of the logical framework would be cost effective.

We agree that revising the project design to include criteria for measuring developmental impact would serve no useful purpose if a final evaluation is not performed. Accordingly, Recommendation No. 1 is closed on report issuance.

Does USAID/Philippines monitoring ensure the effective utilization of project inputs?

USAID has ensured that most project inputs were being utilized effectively. However, some A.I.D. commodity inputs were not being used effectively to achieve project purposes, and some commodities and project sites were not A.I.D. marked.

We reviewed the $17 million services to farmers project component that includes subprojects whose purposes are to improve irrigation systems and to institutionalize research and extension activities. We found that A.I.D.'s input to the two subprojects was used effectively to achieve project objectives. For instance, about $6 million was spent to repair irrigation systems and organize or strengthen farmers' associations. Also, about $3 million was spent to establish demonstration farms in project areas and 115 national and 271 communal irrigation systems, with a service area of about 18,800 acres, underwent repairs. In addition, A.I.D. funded the costs of planting materials, farm implements and labor for the demonstration farms.

However, some motorcycles and office equipment were not used effectively to achieve project objectives and A.I.D.'s publicity requirements were not being met for some commodities and project sites. These are discussed below.

Commodity Monitoring Needs Improving

Some commodities are not being used effectively to achieve project purposes and others have not been marked to ensure that A.I.D. publicity requirements are met. This occurred because some commodity inputs have not been monitored effectively. As a result, A.I.D. assistance has been used for other than approved purposes and recipients are not aware that the assistance was provided by the people of the United States as required by A.I.D. regulations.

Recommendation No. 2: We recommend that USAID/Philippines:

2.1 develop a system for reporting on the use of A.I.D. commodity inputs so that actions to ensure their effective utilization may be taken and

2.2 ensure that project commodities are marked with the AID-handclasp emblem and that project sites are appropriately identified to indicate participation by the United States.

A.I.D. Handbook 15, Chapter 10 requires that a monitoring system be established for commodities to ensure that they are used effectively for project purposes. The system should include the submission of periodic reports that identify the use of A.I.D. inputs. In addition, Chapter 9 of the Handbook requires that compliance with marking requirements be monitored.

Information necessary to ensure the effective utilization and marking of A.I.D. commodity inputs is not available to project officials. For example, the project provided four motorcycles to provincial level offices of the Department of Agriculture (DA), in Iloilo and Albay provinces, for use in coordinating activities under the research and extension subproject. During site visits to the two provinces, we found that some of the motorcycles were not being used for project purposes. For example, two motorcycles distributed to two municipalities within Iloilo province were being used to implement other DA projects because insurgency problems in the two municipalities precluded the implementation of subproject activities. Also, one of the two motorcycles provided to Albay province was assigned to a researcher who was involved only part-time in coordinating the research and extension activities of the project.

The motorcycles provided to these provinces could have been more effectively utilized. For example, another municipality in Iloilo province was selected to implement a research and extension subproject but was not provided with a motorcycle. This municipality implemented the research and extension activities without the use of a motorcycle. Also, a municipality in Albay province implemented research and extension activities without a motorcycle. GOP officials explained that the distribution of the motorcycles was limited to two motorcycles for every province. Had information been made available to project officials, actions could have been taken to transfer the three motorcycles not being used effectively for project purposes to the municipalities that needed them.

In addition to the vehicle usage problems, we found that some commodities provided under the research and extension and irrigation subprojects were not being utilized because either spare parts were not locally available or the commodities were not needed. For example, four electric typewriters, valued at about $4,500, were provided to the National Irrigation Administration but were not being used because typewriter ribbons were not available in the local market. Had project officials been aware of the problem, arrangements could have been made to procure the ribbons elsewhere. In addition, we found that a $1,200 binding machine, purchased over a year prior to our visit to the Department of Agriculture, had not been used. Employees said that they do not need this piece of equipment. Had project officials known, action could have been taken to transfer the binding machine to another office.

The Foreign Assistance Act of 1961, Section 641 requires programs carried out overseas to be identified as "American Aid." A.I.D. Handbook 1, Supplement B, Chapter 22 requires AID-financed commodities to be marked with the AID-handclasp emblem. In addition, project sites must be marked so that participation by the United States is indicated. The project grant agreement, Annex II, Section B.8 requires A.I.D. marking on AID-provided resources. The intent of the requirement is to promote the goodwill of the American people to the recipients. A.I.D. Handbook 15, Chapter 9 requires that a monitoring system be implemented to ensure compliance with A.I.D. publicity requirements.

A.I.D. publicity requirements were not being met. The auditors visited project sites and conducted a physical inventory of commodities provided under the research and extension and irrigation subprojects. The audit showed that AID-financed commodities were not marked with the AID-handclasp emblem. In addition, project sites were not marked to indicate participation by the United States. GOP project officials explained that commodities and project sites do not have A.I.D. markings because of insurgency threats in the areas. The issue of security has merit, but waivers must be authorized by the Mission Director when compliance with the requirement is considered to be impractical. Since no waivers had been approved for the project, the publicity requirements should have been complied with. A USAID/Philippines project official agreed to instruct the implementing agencies about A.I.D.'s publicity requirements and provide them with sufficient emblems for the commodities.

These problems occurred because project design did not provide for the submission of reports concerning the use and marking of commodities and project sites. The auditors reviewed project implementation documents to determine whether sufficient guidance was provided for a project commodity monitoring system. We found that the project paper and other guidance did not establish the criteria for the submission of reports concerning the use and marking of commodities and project sites. USAID/Philippines project officials explained that because of the urgent need for the project after the political and institutional changes in the Philippines, a detailed and comprehensive project design was not completed. Although there may have been an urgent need for the project, USAID/Philippines could have developed criteria for the submission of reports on the use and marking of commodities after project implementation began. USAID/Philippines and GOP project officials agreed to improve the system for monitoring the use and marking of project commodities.

About $2.5 million in computer equipment is to be procured during the remaining life of the project. Without an effective reporting system, project officials have no assurance that the commodities will be used effectively for project purposes or that the commodities will be marked to indicate participation by the United States. As a result, maximum benefit from A.I.D. inputs may not be achieved.

Management Comments and Our Evaluation

USAID/Philippines did not comment on Recommendation No. 2; therefore, the recommendation remains open until agreement is reached on a responsive course of action.

Are USAID/Philippines control procedures adequate to ensure the effective use of AID-provided project funds?

Internal control procedures were adequate to ensure the effective use of A.I.D. funds for all items tested except those under buy-ins to centrally-funded contracts. Our limited test of expense vouchers, totaling about $30,000, at two of the three National Irrigation Administration field offices visited was positive. For the items tested, the expenses reimbursed were allowable under the terms and conditions of the project agreement. However, lack of administrative approval of expenses reimbursed under buy-in arrangements reduced the likelihood that these reimbursements were made only for allowable costs.

Administrative Approval Needed

Control procedures for voucher review and approval under buy-ins to centrally-funded contracts were not in compliance with A.I.D. regulations because vouchers paid by AID/Washington were not being administratively approved by the project officer. As a result, there was no assurance that A.I.D. funds were used in accordance with the terms and conditions of the project agreement for $800,000 provided under buy-in arrangements.

> **Recommendation No. 3: We recommend that USAID/Philippines coordinate with AID/Washington's Bureau for Science and Technology to establish a system for administrative approval of project vouchers paid by AID/Washington that assures the validity of these payments.**

A.I.D. Handbook 19 Appendix 3A states that project officers are required to administratively approve all vouchers for payment. The intent is to use the

project officer's familiarity with the project to prevent significant errors in making payments to contractors. Likewise, it specifies that effective management controls are necessary to ensure that project funds are used only for authorized purposes and to safeguard them against waste, fraud and abuse. About $800,000 of project funds were used for buy-ins to centrally-funded projects.

After almost a year of implementing the buy-in arrangements, AID/Washington had reported only about $8,000 in disbursements. We reviewed these disbursements and verified that they were not administratively approved by the project officer. Since administrative review of expenses incurred under buy-ins to centrally-funded projects had not been required at the Mission level, effective internal control procedures were not followed for these payments. As a result, an important control technique to ensure the validity of payments made under A.I.D. project agreements was not utilized. Thus, assurance was not available to the certifying officer that payments under the buy-in arrangements were being made only for approved project purposes.

Management Comments and Our Evaluation

USAID officials agreed with the recommendation, indicated that a new procedure had been developed and requested that the recommendation be closed on issuance of the report. USAID advised that AID/Washington had issued new guidance for handling buy-in contracts. This new procedure will assure that elements of the contract which are attributable to overseas Mission operations are billed directly to the Mission while elements attributable to operations in the United States are billed to AID/Washington. This new procedures was effective with the issuance of Office of Procurement Administrative Memorandum (OPAM) No. 90-9, issued on August 20, 1990, and will be used for buy-in contracts which begin after that date. Existing contracts will not be amended.

While this change provides assurance of better control over payments made under future buy-in arrangements, it does not correct the problem for this project. Administrative approval should be performed by the project officer for the $800,000 in payments to be made under this project even if it is necessary for the project officer's review to be performed after payment has been made. Any

adjustments to the amounts paid could be made retroactively, if necessary. Accordingly, Recommendation No. 3 will remain open pending agreement on a responsive course of action.

Has USAID/Philippines assured that counterpart contributions are being provided by the host country, participating universities and non-governmental organizations as planned?

USAID/Philippines does not know whether the agreed-to counterpart contributions of the Government of the Philippines (GOP), participating universities and non-governmental organizations are being provided. Because USAID/Philippines did not monitor counterpart contributions, there is no assurance that about $11 million of counterpart contributions will be provided.

> **Recommendation No. 4: We recommend that USAID/Philippines take action to ensure that the Government of the Philippines, participating universities, and non-governmental organizations meet the agreed-to contributions; such action should include**
>
> - **implementing a system for tracking cash and "in-kind" contributions and**
>
> - **determining the value of past cash and "in-kind" contributions to the project.**

The Foreign Assistance Act of 1961, Section 110 requires host countries to provide at least 25 percent of the total project cost. Section 3.2(b) of the project grant agreement with the GOP, as amended, requires the GOP to contribute not less than $10 million, including "in-kind" costs, and universities and non-governmental organizations are to contribute not less than $725,000, including "in-kind" costs. According to the project grant agreement, GOP counterpart contributions will be provided through the implementing agencies, the Department of Agriculture (DA) and National Irrigation Administration (NIA).

USAID/Philippines cannot determine whether the counterpart contributions of the host country, participating universities and non-governmental organizations are being provided. To determine whether counterpart contributions are being provided, we reviewed financial reports of USAID/Philippines, the GOP, and non-governmental organizations and held discussions with USAID/Philippines and GOP project officials.

USAID/Philippines quarterly reports did not provide information concerning counterpart contributions. Financial reports prepared by management units at DA and NIA provided only limited information concerning GOP contributions. For instance, the DA financial report of September 1990 showed cash contributions of $1.4 million with $1 million in expenditures. The financial report did not provide information regarding DA "in-kind" contributions. GOP project officials said that they did not track "in-kind" contributions. The September 1990 financial report from NIA did not provide information on NIA cash or "in-kind" contributions.

USAID/Philippines does not have assurance that the $725,000 in counterpart contributions of participating universities and non-governmental organizations are being provided. For example, a $2 million grant was awarded in June 1989 to a Philippine non-governmental organization which agreed to counterpart contribution of about $400,000 over a three-year period. After almost two years, the progress report of September 1990 showed that only $200,000 of the counterpart contribution had been provided. With just over a year left before the grant is completed, USAID/Philippines can not be assured that the agreed-to contribution of $400,000 will be met. Also, USAID/Philippines does not know whether the counterpart contributions of five other universities and non-governmental organizations will be met.

USAID/Philippines officials agreed that they cannot determine whether counterpart contributions are being made because they do not yet have an effective system for tracking cash and "in-kind" contributions. Realizing the need to develop a system for tracking counterpart contributions in its projects, USAID/Philippines hired a contractor on October 8, 1990. The purpose of this contract was to determine the extent that implementing agencies were reporting counterpart contributions and to recommend appropriate systems where contributions were not being reported. An initial report of the study showed that

after almost four of the five years of project implementation, GOP cash contributions were only about $1 million as of June 1990, which is 10 percent of the agreed to $10 million counterpart contribution. The extent of GOP "in-kind" contributions was not known. The contractor is still attempting to determine the cash and "in-kind" contributions of participating universities and non-governmental organizations.

A system for tracking counterpart contributions was not implemented. As a result, USAID/Philippines cannot be sure that the GOP, participating universities and non-governmental organizations are meeting the agreed-to contributions.

Management Comments and Our Evaluation

In September 1990 USAID funded a study to eliminate the problem, identified earlier, of lack of data covering counterpart contributions. Additional funding was provided later to complete the study by June 1991. The results of the study are expected to 1) provide the current status of host-country counterpart contributions under Mission-funded projects and programs and 2) make recommendations for an appropriate periodic reporting system.

USAID is taking a responsive course of action on Recommendation No. 4. Accordingly, this recommendation is resolved and can be closed once the periodic reporting system, implemented as a result of the study, is in place.

REPORT ON INTERNAL CONTROLS

We have audited USAID/Philippines Accelerated Agricultural Production Project for the period August 30, 1986, through September 30, 1990, and have issued our report thereon dated May 30, 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 the audit objectives 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 A.I.D.'s internal control structure to determine our auditing procedures in order to answer each of the four audit objectives and not to provide assurance on the internal control structure.

The management of A.I.D. including USAID/Philippines, is responsible for establishing and maintaining adequate internal controls. Recognizing the need to re-emphasize the importance of internal controls in the Federal Government, Congress enacted the Federal Managers' Financial Integrity Act (the Integrity Act) in September 1982. This Act, which amends the Accounting and Auditing Act of 1950, makes the heads of executive agencies and other managers as delegated legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining such controls.

In response to the Integrity Act, the Office of Management and Budget has issued guidelines for the "Evaluation and Improvement of Reporting on Internal Controls Systems in the Federal Government." According to these guidelines, management is required to assess the expected benefits versus related costs of internal control policies and procedures. The objectives of internal control policies and procedures for federal assistance programs are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether a system will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

For purposes of this report, we have classified significant internal control policies and procedures applicable to each of the audit objectives by categories. For each category, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation--and we assessed control risk. In doing this work, we found certain problems that we consider reportable under standards established by the Comptroller General of the United States. Reportable conditions are those relating to significant deficiencies in the design or operation of the internal control structure which we become aware of and which, in our judgment, could adversely affect USAID/Philippines' ability to assure that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

Audit Objective One

This audit objective is to determine whether the developmental impact of the project has been measured. The sources of information included the project paper, the workplans for irrigation and research and extension subprojects, the 1989 mid-term evaluation report, and USAID/Philippines and GOP monitoring reports. For this objective, we noted that USAID/Philippines cannot measure the

developmental impact of the project because the elements necessary to measure impact were not developed in project design nor incorporated into the design of subprojects.

Audit Objective Two

This audit objective is to determine whether A.I.D. inputs are being utilized effectively. To accomplish this audit objective, we reviewed the project paper's procurement plan, the needs assessment for computer equipment, the project grant agreement, site visit reports and inventory listings. In addition, we held discussions with USAID/Philippines and GOP project officials. We noted that maximum benefit may not be achieved from some A.I.D. inputs because USAID/Philippines did not implement a system for monitoring the effective utilization and marking of A.I.D. inputs.

Audit Objective Three

This audit objective is to determine whether control procedures were adequate to ensure the effective utilization of A.I.D. funds. To accomplish this audit objective, we compared internal control policies and procedures cited in A.I.D. Handbook 19 with procedures utilized by USAID/Philippines. We noted that USAID/Philippines did not perform administrative review of expenses incurred under buy-ins to centrally-funded projects.

Audit Objective Four

This audit objective is to determine whether counterpart contributions of the host country, participating universities and non-governmental organizations are being provided as planned. To accomplish this audit objective, we reviewed financial reports of USAID/Philippines, the GOP and non-governmental organizations and held discussions with USAID/Philippines and GOP project officials. We noted

that USAID/Philippines could not assure that counterpart contributions were being provided because a system for monitoring counterpart contributions of the host country, participating universities and non-governmental organizations had not been implemented.

• • •

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 project 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 under audit objectives one, two, three and four are material weaknesses.

REPORT ON COMPLIANCE

We have audited USAID/Philippines' Accelerated Agricultural Production Project for the period August 30, 1986, through September 30, 1990, and have issued our report thereon dated May 30, 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 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 includes 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, contracts and grants applicable to the project is the overall responsibility of USAID/Philippines management. As part of fairly,

objectively, and reliably answering the audit objectives, we performed tests of USAID/Philippines, Government of the Philippines, and grantee compliance with certain provisions of Federal laws and regulations, contracts and grants. However, our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests of compliance disclosed the following significant instance of noncompliance:

- Audit Objective No. 2 - Some AID-financed commodities and project sites were not marked as being provided by the people of the United States as required by Section 641 of the Foreign Assistance Act of 1961.

Except as described, the results of our tests of compliance indicate that, with respect to the items tested, USAID/Philippines, the GOP and grantees complied, in all significant respects, with the provisions referred to in the fourth paragraph of this report. With respect to items not tested, nothing came to our attention that caused us to believe that USAID/Philippines, the GOP and grantees had not complied, in all significant respects, with those provisions.

SCOPE AND METHODOLOGY

Scope

We audited USAID/Philippines' Accelerated Agricultural Production Project in accordance with generally accepted government auditing standards. We conducted the audit from July through November 1990, and we covered expenditures of about $3 million, or about 20 percent of total A.I.D. expenditures through September 30, 1990. We conducted our field work in the offices of USAID/Philippines and the Government of the Philippines (GOP). We reviewed the services to farmers component which represented 60 percent of the total A.I.D. commitments to the project. We also visited project sites of the irrigation and the research and extension subprojects.

Methodology

The methodology for each audit objective follows:

Audit Objective One

To accomplish the first audit objective, we reviewed the project paper, workplans for the irrigation and research and extension subprojects, progress reports of USAID/Philippines and the GOP, and the 1989 mid-term evaluation report. To give us an update of project progress, we held discussions with USAID/Philippines and GOP project officials.

Audit Objectives Two, Three and Four

To accomplish the second, third and fourth audit objectives, we determined whether (1) a monitoring system was established; (2) the monitoring system was adequate to ensure the effective use of A.I.D. inputs and compliance with A.I.D. rules and regulations; (3) internal control procedures were adequate to ensure the effective use of A.I.D. funds; and (4) counterpart contributions were being provided. To accomplish these purposes, we reviewed the project paper and USAID/Philippines and GOP monitoring reports. At two of the three National Irrigation Administration field offices visited during the audit, we verified a judgmental sample of expense vouchers to supporting documents to test whether funds were properly used. The sample vouchers of about $30,000 covered disbursements for a three-month period ending September 30, 1990. Because information was not available at USAID/Philippines, we analyzed the GOP and non-governmental organization financial reports on counterpart contributions. We reviewed commodity procurements of about $1.8 million and conducted a physical inventory of about $400,000 of AID-financed commodities to determine their use and compliance with A.I.D. rules and regulations. We also visited project sites and held discussions with USAID/Philippines and GOP project officials.

OPTIONAL FORM NO. 10
MAY 1962 EDITION
GSA GEN. REG. NO. 27

5010-106

UNITED STATES GOVERNMENT

Memorandum

APPENDIX II

TO : Mr. Dennis Smith
Resident Auditor, RAO/M

DATE: MAY 10 1991

RECEIVED MAY 10 1991

FROM : Malcolm Butler, Director MB
USAID/Philippines

SUBJECT : Draft Report: Audit of Accelerated Agricultural Production Project - Project No. 492-0385

REF. : Montoney/Butler Memorandum dated February 14, 1991

We have reviewed the subject draft report, and our comments on this report are as follows:

Page 7 - Recommendation 1. "We recommend that USAID/Philippines revise the logical framework for the Accelerated Agricultural Production Project to include the following elements necessary for measuring developmental impact of the project:

- explicit and achievable objectives;
- descriptions of conditions prior to implementing project activities;
- targets with time-specific progress indicators; and
- anticipated results which relate to the project goal and purpose."

This project has less than a year to completion, and no extension of the completion date will be allowed. Further, both the Mission and Washington have determined that a final evaluation on this project will not be undertaken. We are in agreement with the observation that the design did not include the elements necessary for determining impact. This project was the first project agreement signed with the new Government of the Philippines after the election in 1986, and the need to show support for that new government created a situation in which the time available for the design did not allow for proper development of the impact measurement criteria. Neither the Mission nor Washington anticipates any follow-on activities which would benefit from an evaluation of this project. It is for this reason that a final evaluation will not be completed. In the absence of the need for measurement criteria to effect revision of the project during the limited remaining life, or to facilitate a final evaluation, we feel that revision of the logical framework would not be cost effective. We therefore ask that this recommendation be closed upon issuance.

Although it is not possible to effectively measure the impact of this project, there were several areas in which positive accomplishments did take place. The major accomplishments include: (1) 48,000 hectares owned by 35,000 farmers under Communal Irrigation Systems have been privatized, turning over maintenance and operation of those systems to the farmers that use them resulting in better managed irrigation systems and greater crop yields; (2) repairs on irrigation systems covering 49,410 hectares of land owned by 40,000 farmers has resulted in greater crop yields and higher incomes; (3) five private sector groups and two major Philippine universities are now actively involved in agricultural policy analysis, formulation and advocacy, thus increasing democratic pluralism and much more open debate on national policy matters; (4) decentralization of the Department of Agriculture has led to more local control over government operations at the regional and provincial levels resulting in more client oriented programs with greater local accountability; (5) $18 million worth of government owned agricultural businesses have been sold to private owners helping remove government competition with the private sector; (6) the financial systems of the Department of Agriculture have been computerized resulting in a significant decrease in funds flow delays thus accelerating program implementation; (7) the Bureau of Agricultural Statistics operations has been computerized making production and marketing data more readily available to farmers and businessmen; and (8) Department of Agriculture policy analysis and advocacy has resulted in a greater understanding of the negative impact of poor macroeconomic policies on the agriculture sector, adding weight to the need for macroeconomic policy reform.

Page 18 - Recommendation 3. "We recommend that USAID/Philippines coordinate with AID/Washington Bureau of Science and Technology to establish a system for administrative approval of project vouchers paid by AID/Washington that provides verification of disbursements and assures the validity of these payments."

AID Washington has issued new guidance for handling buy-in contracts. This new procedure will assure that elements of the contract which are attributable to overseas Mission operations are billed directly to the Mission, while elements attributable to operations in the United States are billed to AID Washington. This new procedure was effective with the issuance of Office of Procurement Administrative Memorandum (OPAM) No. 90-9 issued on August 20, 1990, and will be used for buy-in contracts which begin after that date. Existing contracts will not be amended. This action is responsive to Recommendation 3, and we ask that it be closed upon issuance.

Page 21 - Recommendation No. 4 "We recommend that USAID/Philippines take action to ensure that the Government of the Philippines, participating universities, and non-governmental organizations meet the agreed to contributions; such action should include

- implementing a system for tracking cash and "in-kind" contributions and

- determining the value of past cash and "in-kind" contributions to the project."

In March, 1990 the Mission identified as a problem a lack of data covering counterpart contributions. Unfortunately, we did not have funds available under PD&S funding to fund a study until September, 1990. At that time we funded a study to a) determine the current status of host government counterpart contributions under Mission funded projects and programs and b) in consultation with the government, make recommendations for an appropriate periodic reporting system. The proposals exceeded the amount of funding available which required a reduction in the scope of work. When additional funds became available we funded an expansion of the study, which is currently in process. We anticipate completion during June, 1991. We believe this is responsive to Recommendation No. 4 and asked that it be resolved upon issuance.

cc: IG/PPO
ENE/DP/F:Jack Winn

APPENDIX III

REPORT DISTRIBUTION

	No. of Copies
Mission Director, USAID/Philippines	5
Assistant Administrator, Bureau for Europe and the Near East (AA/ENE)	1
Office of Development Planning (ENE/DP)	1
Office of East Asian Affairs (ENE/EA)	1
Bureau for External Affairs (AA/XA)	2
Office of Press Relations (XA/PR)	1
Office of Legislative Affairs (LEG)	1
Office of the General Counsel (GC)	1
Assistant to the Administrator for Management Services (AA/MS)	2
Office of Financial Management (PFM/FM/FS)	2
Directorate for Food and Agriculture (S&T/FA)	1
Center for Development Information and Evaluation (PPC/CDIE)	3
U.S. Ambassador to the Philippines	1

	No. of Copies
Office of the Inspector General	
Inspector General (IG)	1
Assistant Inspector General for Audit (AIG/A)	1
Deputy Assistant Inspector General for Audit (D/AIG/A)	1
Financial Audits (IG/A/FA)	1
Policy, Plans and Oversight (IG/A/PPO)	2
Programs and Systems Audits (IG/A/PSA)	1
Office of Legal Counsel (IG/LC)	1
Office of Resource Management (IG/RM)	12
Assistant Inspector General for Investigations (AIG/I)	1
Regional Inspectors General	
RIG/A/Cairo	1
RIG/A/Dakar	1
RIG/A/Europe	1
RIG/A/Nairobi	1
RIG/A/Singapore	1
RIG/A/Tegucigalpa	1
RIG/I/Singapore	1