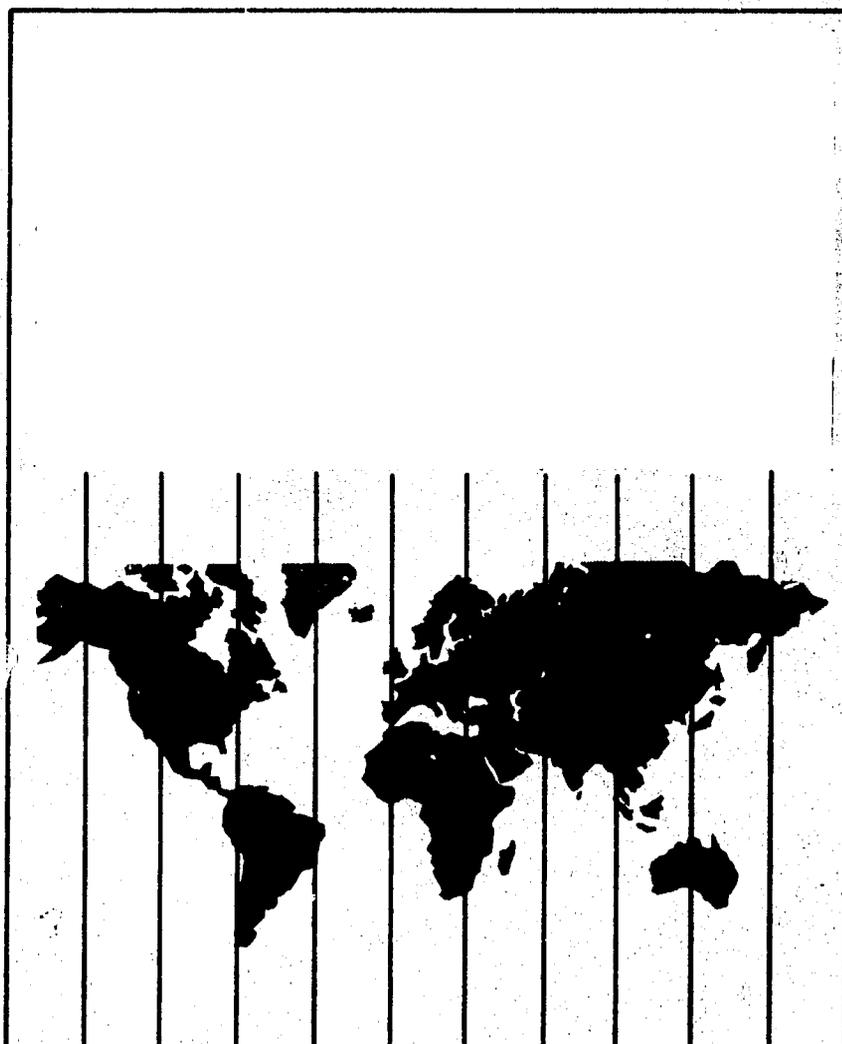


UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit
SINGAPORE

PD-ABD-084

**AUDIT OF THE CONTROLS OVER
SPECIAL ACCOUNTS USED TO FUND
THE CAMBODIAN NONCOMMUNIST
RESISTANCE GROUPS' ACTIVITIES**

Project No. 442-0100

Audit Report No. 5-442-91-06

July 31, 1991

The Office of the A.I.D./Representative for Khmer Affairs had the Cambodian noncommunist resistance groups establish separate bank accounts for each discrete activity financed by A.I.D., such as medical programs, administrative operations, civic action programs, and training programs. Although the office closely monitored activities financed through these accounts, it did not adequately document the internal control systems and procedures related to the accounts nor require that the accounts be interest-bearing. USAID/Thailand's Controller Office needed to more thoroughly review vouchers supporting A.I.D.-financed special account activities.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL FOR AUDIT
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July 31, 1991

MEMORANDUM FOR

William B. Erdahl,
A.I.D./Representative for Khmer Affairs

Amanda Levenson
Acting Controller, USAID/Thailand

FROM:


James B. Durnil, RIG/A/Singapore

SUBJECT:

Audit of the Controls Over Special Accounts Used To
Fund the Cambodian Noncommunist Resistance
Groups' Activities (Audit Report No. 5-442-91-06)

Enclosed are five copies of our subject audit report. In preparing this report, we reviewed your comments on the draft report and included them as an appendix to this report. Based on your comments, all recommendations are considered closed.

I appreciate the cooperation and courtesies extended to the audit staff during the audit and the prompt actions taken to respond to the report findings and recommendations.

Background

Under special legislative authority enacted in 1985, A.I.D. has provided nonlethal assistance to the two noncommunist resistance (NCR) groups opposed to the Vietnamese-installed regime in Cambodia. The objectives of the assistance are (1) to demonstrate tangible U.S. support for the Association of Southeast Asian Nations' strategy of applying political and military pressure on Vietnam to bring an end to the conflict and (2) to help sustain the NCR groups as viable independent forces which should enhance their political stature as alternatives to the Vietnamese-backed government in Phnom Penh and the communist Khmer Rouge.

A.I.D.'s assistance to the NCR groups consists primarily of material support, including medicines and medical supplies as well as nonmedical equipment and vehicles. Training, mainly in the medical, vocational, and community development areas, has also been provided. Beginning in calendar year 1991, A.I.D. expanded this program to include providing the NCR groups with food, clothing, housing, and other support. As of March 31, 1991, A.I.D. obligations and expenditures amounted to \$21.9 million and \$20.4 million, respectively. Approximately \$940,000 of this assistance was provided through various special accounts established to help finance the day-to-day expenses of the NCR groups, such as fuel for transport and power generation, repair and maintenance of facilities and vehicles, and perishable food for patients in the medical program. These special accounts were started in May 1989.

The Office of the A.I.D./Representative for Khmer Affairs (hereafter referred to as the Office of Khmer Affairs or O/KA), located in Bangkok, is responsible for administering and overseeing A.I.D.'s assistance.

Audit Objectives

The Office of the Regional Inspector General for Audit/Singapore audited A.I.D.'s assistance to the noncommunist resistance forces to answer the following audit objective:

- **Did the Office of Khmer Affairs and USAID/Thailand follow A.I.D. procedures in establishing and monitoring the special accounts used to fund various activities of the noncommunist resistance groups?**

This is our second audit of A.I.D.'s assistance to the noncommunist resistance forces. The first audit was conducted in 1990 and covered the Office of Khmer Affairs' control of pharmaceutical supplies provided to the noncommunist resistance forces (Audit Report No. 5-442-90-10, July 16, 1990). We decided to focus our audit on the special accounts because of the potential vulnerability of these accounts to fraud, waste, and abuse and the increasing use of these accounts by A.I.D. to fund noncommunist resistance forces' activities. This audit report does not cover a transportation agreement the Office of Khmer Affairs entered into with a cooperating Thailand agency to provide transportation support for the noncommunist resistance forces' program. This agreement is the subject of a separate audit report.

In answering the audit objective, we tested whether the Office of Khmer Affairs and USAID/Thailand (1) followed applicable internal control procedures, and (2) complied with certain provisions of laws, regulations, and program agreements. Our tests were sufficient to provide reasonable—but not absolute—assurance of detecting abuse or illegal acts that could significantly affect the audit objectives. However, because of limited time and resources, we did not continue testing when we found that,

for the items tested, the Office of Khmer Affairs and USAID/Thailand 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 conclusively determine that the Office of Khmer Affairs and/or USAID/Thailand were 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.

Our discussion of the scope and methodology for this audit is in Appendix I and our reports on internal controls and compliance are in Appendices III and IV.

Audit Findings

Did the Office of Khmer Affairs and USAID/Thailand follow A.I.D. procedures in establishing and monitoring the special accounts used to fund various activities of the noncommunist resistance groups?

The Office of Khmer Affairs (O/KA) and USAID/Thailand did not always follow A.I.D. procedures in establishing and monitoring the special accounts used to fund noncommunist resistance (NCR) groups' activities.

In addition to directly procuring commodities, equipment, and other items for the NCR groups, O/KA also helps finance the day-to-day expenses of the groups, such as fuel for transport and power generation, repair and maintenance of facilities and vehicles, and perishable foods for patients in the medical program. To finance these and other activities, O/KA had the NCR groups establish separate bank accounts for each discrete activity it supported, such as the medical programs, administrative operations, civic action programs, and training programs. Once a special account is established, O/KA replenishes it according to a predetermined plan, but only against actual original receipts and a voucher submitted to O/KA for review. After O/KA's review, the voucher and supporting documentation are submitted to USAID/Thailand's Office of Financial Management for certification and issuance of a replenishment check. As of March 31, 1991, there were ten special accounts with total reimbursements of approximately \$940,000.

O/KA officials closely monitored activities financed through the special accounts. Monitoring included routinely visiting NCR sites to observe activities financed by A.I.D., reviewing receipts submitted by the NCR groups, and working with and training NCR staff to develop better accounting controls and systems. However, the audit noted the following three areas where O/KA and the USAID/Thailand Office of Financial Management could improve their controls over funds disbursed through the special accounts.

- O/KA did not document the internal control systems and procedures related to these accounts.
- USAID/Thailand's Office of Financial Management needs to more thoroughly review vouchers submitted by O/KA to comply with legal certification requirements.
- Although the NCR groups established bank accounts for each discrete activity financed by O/KA, only three of the ten accounts were interest-bearing.

O/KA Needs To Better Document Internal Control Systems And Procedures

O/KA did not fully document aspects of its internal control systems and procedures related to the use of the special accounts as required by General Accounting Office standards for internal controls and was, therefore, not in compliance with the requirements of the Federal Managers' Financial Integrity Act of 1982. This occurred because the number of accounts and the number of A.I.D.-financed NCR activities had multiplied, and as a result O/KA staff spent more time on hands-on monitoring of NCR accountability and less on documenting controls associated with the special accounts. In addition, in early 1991, O/KA took over the funding of certain activities previously supported by another donor without prior knowledge of the scope of many of these activities. The lack of properly documented internal control systems increases the vulnerability of the special accounts to fraud, waste, and abuse and makes it more difficult to determine the allowability, reasonableness, and allocability of amounts claimed for reimbursement by the NCR groups. We identified transactions totalling \$151,000 for which we could not determine allowability, allocability, or reasonableness, indicating a need for better documentation.

Recommendation No. 1: We recommend that the Office of Khmer Affairs:

- 1.1 Document the internal control objectives and techniques related to the special accounts used to fund noncommunist resistance activities, including establishing definitive criteria for each special account detailing the type of expenditures allowable for reimbursement and establishing written procedures on the roles and responsibilities of Office of Khmer Affairs'**

staff in reviewing and monitoring special account activities; and

- 1.2 Review the \$151,000 of questioned costs cited in this report to determine if the costs are allowable, reasonable, and allocable and, if not, recover the amounts in question from the noncommunist resistance forces.**

The Federal Financial Managers' Financial Integrity Act of 1982 requires renewed focus on the need to strengthen internal controls in the Federal Government and requires agencies to periodically evaluate internal control systems to determine, among other things, if such systems meet the objectives of internal control and conform to standards established by the General Accounting Office (GAO). These standards, specified in GAO's 1983 "Standards For Internal Controls In The Federal Government" require:

...written evidence of (1) an agency's internal control objectives and techniques and accountability systems and (2) all pertinent aspects of transactions and other significant events of an agency. Also, the documentation must be available as well as easily accessible for examination.

We reviewed the procedures followed by O/KA in establishing the special accounts and monitoring activities financed through these accounts. Our review indicated that O/KA attempted to closely monitor such activities by requiring and reviewing expenditure receipts but did not fully comply with the documentation standards for internal control systems. For example, we found that O/KA had not

- documented the internal control objectives for each account and the control techniques that would be used to achieve these objectives;
- established written definitive criteria for each account detailing the type of expenditures allowable for reimbursement; and
- established written procedures on the roles and responsibilities of O/KA staff in reviewing and monitoring special account activities.

Examples of the lack of adequate documentation and the resulting problems are listed below:

- Under a special account established for the reimbursement of one NCR group's medical program expenses, the group was reimbursed about \$4,400 for "other medical costs." These expenditures were of a discretionary nature and were paid for a variety of reasons such as: **extra food, awards for bravery, allowances for night duty and hard work, and payments for blood collection.** Although receipts were provided by the NCR group, it was **difficult to assess the reasonableness and allowability** of the costs since O/KA had not established written procedures concerning the type and amount

of expenses allowable under this category.

- One special account was reimbursed for almost \$5,600 of **musical instruments** (a Yamaha keyboard, trumpets, drums, etc.) as part of its expenditures for "equipment and materials." Again, O/KA had no definitive written guidance specifying the type and amount of NCR expenditures allowable. Since O/KA guidance was lacking in some instances, **the determination of the allowability of NCR expenditures for O/KA reimbursement was open to interpretation.** Although receipts had been provided, we could not determine if the costs were reasonable and allowable as there were no definitive written procedures concerning the purchase of musical instruments.
- We noted a problem with a \$25,000 reimbursement made to another special account for personnel operating costs. According to the group's allowance schedule, each person was entitled to less than \$1. However, our analysis indicated that based on the unit's size, O/KA should have reimbursed the NCR group only about \$12,600. **Therefore, about \$12,400 may have been overpaid.** This problem occurred because O/KA did not require the NCR group to document its unit size; such documentation would have allowed O/KA officials to assess the reasonableness of the allowances being claimed.
- Under another special account, the NCR groups were claiming reimbursements for various allowances paid to unit members to allow them to purchase food locally and for other items. However, since **O/KA had not fully documented the allowable payments based on the size of the group,** it could not be determined whether the allowances being reimbursed by O/KA were reasonable and allowable. For instance, one NCR group requested and was reimbursed approximately \$97,000 to cover purchases of food items for the group's units. Our analysis of these costs indicated that while the cost per person for 75 percent of the units was about \$5.40, the cost per person for the remainder of the units ranged from \$6.00 to \$11.00. **There was no documentation explaining or justifying why there should be such wide variation in costs per person.** We could not determine if the costs were reasonable and properly allocable to the program because there were no written procedures concerning the amount and type of food that should be purchased.
- O/KA established a special account to support certain activities of one NCR group's administrative office located in Bangkok. O/KA's memorandum establishing the account indicated that O/KA would finance activities related to running the office (office supplies, postage, phone and fax), public relations and publications, and special purchases of office equipment (e.g., photocopier). O/KA funded costs of \$24,000 based on receipts provided by the NCR office. Receipts were comprised of invoices for phone calls (\$8,000), printing (\$6,000) and postage (\$10,000). However, **O/KA did not establish written procedures**

indicating the level of supporting documentation required for reimbursement. The receipts submitted by the office for reimbursement do not fully establish that the expenditures are allowable, reasonable, and allocable. For instance, it cannot be determined from the phone bill if the calls being reimbursed by O/KA were made for official purposes and were necessary.

The above examples of expenses for which we could not determine the allowability, allocability, or reasonableness—expenses totalling about \$143,400—indicate a need for O/KA to better document its internal control systems related to the special accounts. Some additional examples, totalling approximately \$7,600, are contained in Appendix V.

By not documenting its internal control systems and procedures and periodically evaluating such systems to ensure they meet the standards set forth in GAO's 1983 "Standards For Internal Controls In The Federal Government", O/KA did not comply with the requirements of the Federal Managers' Financial Integrity Act of 1982. Such documentation is critical to preventing payments for unauthorized purposes.

O/KA officials acknowledge the need for better documentation. They stated that they have had to spend considerable time and effort in establishing the accounts, training NCR officials in setting up rudimentary accounting systems, and monitoring activities funded through the accounts by reviewing receipts submitted by the NCR groups for account reimbursements—activities that left little time to properly document the internal controls systems related to these accounts. In addition, in early 1991, O/KA took over the funding of certain activities previously supported by another donor without prior knowledge of the scope of these activities or how the previous donor accounted for and monitored these activities.

**USAID/Thailand's Office of Financial Management
Needs To More Thoroughly Review O/KA Vouchers**

USAID/Thailand's Office of Financial Management voucher reviews of O/KA-financed special account activities were not adequate to fully comply with the requirements of the Certifying Officer's Act or to provide an independent financial review of O/KA-financed activities. This occurred because the USAID/Thailand Controller believed that the NCR program was designed to allow O/KA a great deal of flexibility, and his voucher reviews were therefore limited to confirming that O/KA-funded activities were within approved budget or line-item categories, and checking the mathematical accuracy of the vouchers. As a result, the voucher reviews were not of sufficient depth to determine unallowable costs and to detect questioned costs such as those described in the previous section, or to provide an independent financial review of O/KA activities.

Recommendation No. 2: We recommend that the USAID/Thailand Controller strengthen his office's review of the Office of Khmer Affairs' by requiring

voucher examiners to review the vouchers and supporting documentation against written criteria, such as project implementation letters, established by the Office of Khmer Affairs to assure the allowability, allocability, and reasonableness of expenditures being reimbursed by A.I.D. (This may require establishing an additional position, funded by the Office of Khmer Affairs, within the USAID/Thailand's Office of Financial Management devoted full-time to reviewing the Office of Khmer Affairs' vouchers and supporting documentation.)

USAID/Thailand's Controller is the certifying officer for vouchers submitted by the Office of Khmer Affairs. The Certifying Officer's Act (31 U.S.C. 3528) holds authorized certifying officers individually and personally responsible for their acts with respect to the certification of vouchers for payment. In certifying vouchers it is therefore essential that the certifying officer review all vouchers to ensure the validity and correctness of the facts stated in the voucher.

Our discussions with the voucher examiner assigned by USAID/Thailand's Controller office to review vouchers submitted by the Office of Khmer Affairs disclosed that the examiner was only concerned with assuring the mathematical accuracy of the supporting documentation attached to the vouchers—i.e., footing the numerous receipts submitted by the noncommunist resistance groups to determine that the totals agreed with amounts included in the voucher. This examiner **did not review the supporting documentation to determine the reasonableness, allowability, or allocability of amounts being claimed.**

USAID/Thailand's Controller maintained that voucher examinations were adequate for certification purposes. The Controller noted that the NCR program was purposely designed to allow O/KA a great deal of flexibility in terms of what A.I.D. would fund and that given this flexibility certification reviews were adequate. The Controller further stated that when reviewing O/KA vouchers dealing with the special account activities, the office was mainly concerned that amounts being claimed for reimbursement by the NCR groups were within the broad guidelines approved by O/KA (that is, approved categories or line items of expenditure).

While we recognize that the NCR program is quite flexible in terms of what can be funded by A.I.D., we believe that the USAID/Thailand Office of Financial Management's voucher review process must provide for a more thorough review of O/KA vouchers to assure the allowability, allocability, and reasonableness of expenditures being reimbursed by O/KA and to provide for an independent review of O/KA financed activities. More thorough voucher reviews would have detected the type of questioned costs we identified in the previous section and prevented the payment of such potentially unallowable costs.

At the completion of our audit, O/KA officials advised that they were in the process of hiring a personal services contractor with accounting experience and Thai and Khmer

language ability to review voucher documentation before submitting vouchers to the USAID/Thailand Office of Financial Management for certification and payment. We believe that this position should be transferred to the USAID/Thailand Office of Financial Management and report directly to the USAID/Thailand Controller. This will strengthen the Controller's office voucher review function and provide for a more independent financial review of O/KA financed activities.

O/KA Needs To Establish Interest-Bearing Accounts

Cash management practices dictate that whenever possible, accounts such as those being used by the NCR groups be interest-bearing accounts. However, we found that only three of the ten NCR accounts were interest-bearing. This occurred because O/KA did not instruct the NCR groups to use interest-bearing accounts. As a result, we estimate the U.S. Government lost about \$1,100 in interest income from the seven accounts during the six month period, September 1, 1990 through February 28, 1991.

Recommendation No. 3: We recommend that the Office of Khmer Affairs ensure that the noncommunist resistance forces use interest-bearing accounts where appropriate for activities financed by A.I.D.

Cash management practices dictate that accounts such as those being used by the NCR forces be interest-bearing to maximize the use of U.S. resources. Although there are no specific A.I.D. regulations governing the use of accounts by the NCR groups, other A.I.D. and U.S. Government regulations strongly indicate that interest-bearing accounts should be used whenever possible. For example, A.I.D. Handbook 13, Appendix 4C, dealing with Grants, requires grantees to maintain advances of funds from A.I.D. in interest-bearing accounts. Additionally, a February 1987 revision to Office of Management and Budget Circular A-110, "Uniform Administrative Requirements, Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations" requires that recipients of Federal cash advances maintain the advances in interest-bearing accounts and that interest earned be remitted promptly to the Federal agencies that provided the funds.

Although O/KA properly instructed the NCR groups to open separate bank accounts to better control and monitor the use of A.I.D. funds, it did not instruct the NCR groups to use interest-bearing accounts. As a result, the groups established interest-bearing accounts for some activities and noninterest bearing accounts for others. Of the ten accounts established, seven did not accrue interest. We estimate that these accounts could have earned about \$1,100 in interest income—**income that was lost to the U.S. Government**—during the six month period September 1, 1990 through February 28, 1991.

According to O/KA and USAID/Thailand officials, Thailand banks do not offer interest-bearing checking accounts. While checking accounts may be necessary to make timely

payment of bills, officials acknowledged that in some cases the NCR groups had opened checking accounts when they should have opened savings accounts. In these cases, checks were written only to withdraw funds which were subsequently used to make cash purchases. The USAID/Thailand Controller indicated that he preferred the NCR groups to open checking accounts only when checks were to be used to pay bills directly, and to open interest-bearing savings accounts in all other cases.

Management Comments and Our Evaluation

The Office of Khmer Affairs (O/KA) generally concurred with our findings and recommendations and took the necessary actions to implement all recommendations. O/KA's actual response is contained in Appendix II.

Concerning Recommendation No. 1.1, O/KA stated it issued new Project Implementation Letters which are intended to document the noncommunist resistance (NCR) forces' internal control objectives and dictate the techniques and accountability systems expected from the NCR groups. O/KA also placed staff in two field locations on a full time basis tasked with the responsibility of monitoring and assisting the NCR groups in project related management issues. O/KA also established written procedures on the roles and responsibilities of its staff in reviewing and monitoring special account activities. Based on O/KA's actions, Recommendation No. 1.1 is considered closed.

Concerning Recommendation No. 1.2, O/KA reviewed the \$151,000 of costs questioned in the audit report and determined that the costs were allowable, reasonable and allocable. O/KA acknowledged, however, that the lack of internal O/KA documentation made such determinations difficult for audit staff who were not always familiar with the day-to-day activities of the program.

O/KA further stated that in response to our valid audit concerns it has added a staff member to draft explanatory documentation and is in the process of hiring a Khmer-speaking accounting specialist to assist in the development and implementation of the systems which are being documented; to train NCR management staff to maintain the systems; and to closely monitor the special accounts to assure that the systems and reports conform to established procedures and practices. O/KA also anticipates contracting with a local accounting firm to evaluate NCR accounting systems and practices; to assist in the setting up of any additional systems deemed necessary; and to provide training to the NCR groups as necessary.

Based on O/KA's review of the costs questioned in the audit report and actions taken to improve accounting controls, Recommendation No. 1.2 is considered closed.

O/KA and the USAID/Thailand Controller's Office do not believe it is necessary to establish a new position within the controller's office to review O/KA vouchers as suggested by Recommendation No. 2. O/KA believes that the voucher review process

would become more straight forward as it improves the documentation process related to the special accounts in response to Recommendation No. 1.1. The USAID/Thailand Acting Controller has given the appropriate voucher examiners a copy of the audit report with instructions to be more alert to the types of problems highlighted and to review vouchers and supporting documentation against written criteria, such as project implementation letters, established by O/KA. Based on O/KA and the USAID/Thailand Controller's Office comments, Recommendation No. 2 is considered closed.

O/KA concurred with Recommendation No. 3 and instructed the NCR groups to open interest-bearing accounts to handle all funds provided by A.I.D. We adjusted the computation of interest income lost to the U.S. Government based on deducting a prorata share of \$100 per year to enable a grantee to defray the cost of administering each interest-bearing account, as O/KA suggested. Recommendation No. 3 is considered closed.

SCOPE AND METHODOLOGY

Scope

We audited the Office of the A.I.D./Representative for Khmer Affairs' (O/KA) controls over special accounts used to fund Cambodian noncommunist resistance groups' activities in accordance with generally accepted government auditing standards. We conducted the audit from December 6, 1990 through April 11, 1991, and covered systems and procedures related to the special accounts from May 1, 1989, when O/KA first starting using such accounts, through March 31, 1991. Activities funded through the special accounts amounted to approximately \$940,000 out of total A.I.D. expenditures of \$20.4 million for the Cambodian noncommunist resistance program. Our audit tested about \$223,000 of special accounts expenditures.

We conducted our audit work in the O/KA, USAID/Thailand Controller Office, and the field offices of the two noncommunist resistance groups located near the Thai/Cambodia border. This work included interviewing appropriate O/KA, USAID/Thailand, and noncommunist resistance group officials; reviewing any documentation developed by O/KA establishing what could or could not be funded from the special accounts; visiting the NCR sites to obtain information on procedures and systems used by the NCR groups to account for A.I.D. funds; observing procedures followed by O/KA officials when reviewing documentation submitted by the NCR groups for reimbursement; and, reviewing, for items selected for testing, actual documentation submitted by the Cambodian resistance groups supporting expenditures.

Methodology

To accomplish the audit objective, we determined whether O/KA and USAID/Thailand (1) documented the internal control systems and procedures related to the use of the special accounts; (2) properly reviewed vouchers submitted by the NCR groups for reimbursement; and (3) required the NCR groups to used interest-bearing accounts.

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To determine whether O/KA and USAID/Thailand had adequately documented internal control systems related to the special accounts, we obtained and reviewed all pertinent documents relating to establishing the accounts and interviewed O/KA officials responsible for monitoring activities financed through these accounts. We also reviewed receipts submitted by the NCR groups supporting their reimbursement requests to determine if the expenditures incurred were reasonable, allowable, and allocable based on written guidelines established by O/KA for each account.

We focused our audit testing on the six-month period from September 1, 1990 to February 28, 1991, when the majority of expenditures were incurred (\$690,000 out of a total of \$940,000). In order to gain an understanding of the activities funded in each account, we selected at least one month's expenditures from each account and examined individual receipts totalling \$223,000 supporting these expenditures. For the balance of receipts, totalling \$717,000, we scanned transactions and activities we considered vulnerable based on conversations with O/KA officials, site visits, and previous experience to determine the allowability, allocability, and reasonableness of the expenditures.

To determine whether vouchers submitted by the NCR for reimbursement were being properly reviewed for certification purposes, we interviewed O/KA and USAID/Thailand Office of Financial Management officials to determine the procedures followed. We scanned vouchers and supporting documentation to determine the level of voucher review and discussed the extent of review with the voucher examiners.

To determine whether O/KA and USAID/Thailand required the NCR groups to use interest-bearing accounts, we reviewed instructions provided by O/KA to the NCR groups concerning establishing the special accounts and discussed the matter with appropriate O/KA and USAID/Thailand officials. We also reviewed all bank statements on file at the O/KA for all ten special accounts to determine if interest was being earned and to estimate the amount of interest lost to the U.S. Government.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF KHMER AFFAIRS

APPENDIX II
PAGE 1 OF 10

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USAID
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เลขที่อาคาร 10400, ถนนพหลโยธิน

MEMORANDUM

July 28, 1991

TO: James B. Durnil,
RIG/A, Singapore

FROM: 
William B. Erdahl,
AID Representative
Office of Khmer Affairs

SUBJECT: Draft Audit Report No. 5-422-91- , received July 1, 1991.

Thank you for the copies of the subject audit report and for the opportunity to offer Office of Khmer Affairs (O/KA) comments on the draft findings and recommendations. Firstly, we would like to thank the audit staff for the understanding reflected in the Report of the constraints O/KA staff have faced in implementing this non traditional A.I.D. program. Secondly, as a result of the recent Washington policy decision to support a civilian oriented program with FY91 funds, the Forces' revolving accounts, which were funded for only one month but which presented such problems for our respective staffs, are no longer supported by A.I.D., thus removing one source of uncertainty.

In general, the audit findings are reasonable and we share your view that the recommendations are called for. Because your staff had talked to us about a number of these shortcomings during the course of their audit work, we have already taken action in response to these informal discussions, as discussed below. We understand that the three formal recommendations are open but resolved pending the completion of 'appropriate actions' by the Office of Khmer Affairs to implement the recommendations. In response to the draft findings, O/KA has taken the following steps to close the recommendations.

Recommendation No. 1:

- 1.1 *Document the internal control objectives and techniques related to the special accounts used to fund noncommunist resistance activities, including establishing definitive criteria for each special account detailing the types of expenditures allowable for reimbursement and establishing written procedures on the roles and responsibilities of Office of Khmer Affairs' staff in reviewing and monitoring special account activities.*
- 1.2 *Review the \$151,000 of questioned costs cited in this report to determine if the costs are allowable, reasonable, and allocable and, if not, recover the amounts in question from the noncommunist resistance forces.*

Mission Response

1.1 Project Implementation Letters (PILs) governing the implementation and management of the FY'91 programs of A.I.D. assistance have been issued by A.I.D. and counter signed by the respective Cambodian Non Communist Resistance (CNCR) leaders. These PILs are intended to "document the CNCR internal control objectives" and dictate the "techniques and accountability systems" expected from the CNCR.

The FY'91 A.I.D. funded programs primarily support medical and community development activities and they are administered through the civilian offices of the CNCR. We have issued four PILs, one for each of the two programs, for each of the two groups. Copies of the letters were provided to the RIG/Singapore Audit staff. Included in these PILs are i) a detailed description of the program to be supported, ii) the implementation plan and budget discussion, and iii) the financial and administrative procedures to be followed by the CNCR. Included as attachments are detailed project budgets and individual line item discussions concerning what types of expenses may and may not be included in each category.

Four new bank accounts have already been established by the two CNCR groups to control the FY'91 funds for the planned core medical and community development activities and any future optional activities which A.I.D. may agree

to fund. These are interest bearing accounts requiring two signatories for any withdrawal. Further details regarding the management of the accounts are included in the PILs.

Attached as Annex One are descriptions of the various management positions in the Office of Khmer Affairs, with special attention paid to the roles taken in the monitoring and control functions. In order to ensure that the CNCR factions expend FY'91 funding in accordance with A.I.D. regulations and instructions, O/KA staff will continue to make regular site visits to monitor accounting procedures and review expenditures. This practice ensures that items that are not allowable under the program are not submitted to A.I.D. for reimbursement. Any questionable receipts are normally eliminated before a voucher is submitted to the A.I.D. voucher examiner for review.

Depending upon the complexity of the activity and the amount of funding provided, O/KA staff also regularly review each activity in the field. Since the time period covered by the draft audit report, O/KA has placed staff in both Surin and Aranyaprathet on a full time basis. These field representatives are now tasked with monitoring and assisting the CNCR in project related management issues. During their regular monitoring visits, these O/KA field staff members examine inventory records and account ledgers, review expenditures and, in general, trouble shoot-- identifying problems and providing corrective guidance.

When the monthly or quarterly expenditure reports are submitted by the CNCR for the respective activity, O/KA staff review them before they are submitted to the USAID Office of Finance. O/KA staff focus on the mathematical accuracy of the financial information provided and review the individual receipts to ensure the allowability, reasonableness and allocability of expenses.

1.2 My office has reviewed the \$151,000 of costs questioned by the draft Audit Report to determine if they were allowable, reasonable and allocable. This review has shown that given the nature of the program, the costs in question are allowable, reasonable and allocable, and therefore no funds need to be recovered from the CNCR. In the case of the musical instruments, the correspondence from Washington concerning the procurement, together with the AID Representative's authorization, has been added to the procurement files.

As the report has pointed out, a lack of internal O/KA documentation made these determinations difficult for Audit staff, who were not always familiar with the day-to-day activities of the program. In response to this very valid finding, O/KA has added a staff member, to draft the documentation. In addition, we are in the process of hiring a Khmer speaking accounting specialist, to assist in the development and implementation of the systems which are being documented, to train CNCR management staff to maintain the systems, generate the required reporting, and to closely monitor the accounts to assure that the systems and reports conform to established procedures and practices. Further, in conjunction with the USAID/Thailand Office of Finance, O/KA anticipates contracting latter in the year with a local accounting firm to evaluate CNCR accounting systems and practices, to assist in the setting up of any additional systems deemed necessary and to provide training to the CNCR as necessary.

In your fax, REF 91-666, O/KA concurrence with the \$150,000 in questionable costs is requested. Based on the review conducted by my staff in response to Recommendation 1.2, we feel that these costs are not in question, as the following discussion will show. Therefore O/KA does not concur with the determination that \$150,000 in costs is questionable. The individual examples are discussed below.

- The \$4,400 referred to in example one were allocated to "Other Medical Costs" because the Khmer accounting staff have English only as a second language and lacked the vocabulary to correctly allocate these costs. The budget line items have been more clearly defined in the new PILs to prevent, as far as possible, a repeat of this problem.
- A.I.D. regulations (HB1:Sup B and HB15) require the AID Representative to authorize the expenditure (of \$5,600) to purchase musical instruments. This authorization was obtained and is included in the financial records pertaining to this purchase.
- The \$25,000 reimbursed for personnel operating costs was questioned because documentation on group size was deemed lacking. This documentation had, in fact, been provided by the group in question. The amount paid did not correspond with the unit figures because some expense items had been incorrectly allocated to the ledger account for personnel operating costs.

- The \$97,000 questioned in example four is wholly in order. The discrepancy suggested by the Audit calculations arises because different units have different assignments and are supported at different levels which are calculated under different assumptions. Hence, a 30 man unit going on a long term, long distance assignment will get more cash per head than a 30 man unit on a long term assignment, but going a short distance, where they can be more easily resupplied. Units of the same size would also receive different allowances if the time they remained within Cambodia varied. A small group of senior officials going on a political mission receive more per head than either of the other groups as they have higher expenses.
- In the case of the \$24,000 cited in the last example, interviews with the group in question confirm that they do have procedures in place to control phone calls and so any office calls are regarded as official. The printing and postage were also allowable office expenses in the original agreement. However, to avoid potential problems in the future, O/KA has decided to support line items that are more easily documented and less open to interpretation as far as allowability and reasonability are concerned. For this reason, USAID support for the Bangkok administrative offices of the CNCR will be limited to rent, utilities (power and water) and personnel allowances.

The additional examples cited in Appendix V are discussed hereunder:

General Medical Training Expenses (\$4,000): These expenses were incurred prior to O/KA taking over direct control of the program, however, examination of documentation in our possession suggests that these expenses were labelled inadequately, preventing a more precise allocation.

Field Trip (\$2,000): Review of the records showed that funding was approved under other line items. In addition, receipts were reviewed by O/KA staff prior to disbursement to make sure the receipts in question were for allowable and reasonable expenses.

Cash for food (\$600): It is common practice for the Cook to sign for a regular, periodic amount of cash which is then used for the almost daily purchase of fresh

items from various vendors in the marketplace, where receipts are not typically available.

Yearly salary (\$480): This item represents the allowance for the director of one hospital, and it has now been included as part of a regular line item in the medical budget.

Miscellaneous Medical Expenses (\$217): The amount in question represents numerous small individual expenses where receipts were not available.

Per diem for 3 day trip (\$200): This amount was first approved, by internal CNCR managers, for a senior official who was traveling with an entourage of over 10 people. In addition to supporting these individuals, it is also standard and expected practice for such officials to make small gifts of money to needy individuals along the way. The amount had also been questioned by O/KA staff at the time of reimbursement and it was approved then on the basis of the information given above.

Surin Hotel Bill (\$137): From time to time, AID supports the work of volunteer Foreign doctors who come for a month or so to train the CNCR medical cadre. Sometimes the Surin house does not have enough rooms to accommodate all the visiting experts. On those occasions, hotel rooms are necessary.

Again, we acknowledge that all of the Audit questions arose because of the lack of documentation on the part of O/KA, and not because the validity of the amounts was in doubt. For this reason, we cannot concur with the \$150,000 of questioned costs cited in connection with Recommendation 1.2.

Recommendation No. 2 We recommend that:

We recommend that the USAID/Thailand Controller strengthen his office's review of the Office of Khmer Affairs' vouchers by requiring voucher examiners to review the vouchers and supporting documentation against written criteria, such as project implementation letters, established by the Office of Khmer Affairs to assure the allowability, allocability and reasonableness of expenditures being reimbursed by A.I.D. (This may require establishing an additional position, funded by the Office of Khmer Affairs, within the USAID/Thailand's Office of Financial Management devoted full-time to reviewing the Office of Khmer Affairs' vouchers and supporting documentation.)

Mission Response

The Audit Report suggests that this strengthening may require establishing a full time O/KA funded position, which would be located in the Controller's office and report to the Controller. This person would review only O/KA vouchers. While we are prepared to fund such a position from project resources, discussions between my staff and the Controller suggest that the projected workload may not warrant a full time position.

We further believe that the detailed review of vouchers and supporting documentation, to detect questionable costs will become more straight forward as the systems of review referred to in Recommendation One are put in place. As a consequence, unless there is an unexpected increase in vouchers, we believe that the present USAID/Thailand voucher examiners have the time necessary to comprehensively review all O/KA program vouchers. The Auditor Staff were very helpful in pointing out the areas where the need for documentation is most critical and we believe that the PILs are a start to this documentation process.

Secondly, the accounting specialist referred to above is a fluent Khmer speaker and it is planned that he will spend at least half of his time working with the CNCR, monitoring their project management and reporting, and assessing the allowability, reasonableness, and allocability of the costs submitted for reimbursement, before the vouchers are officially submitted to USAID's Office of Financial Management. Also in response to Auditors' informal comments, O/KA staff are more fully

documenting the end use checking and other monitoring activities they undertake.

Finally, the USAID/Controller has given the appropriate Office of Finance voucher examiner a copy of the Draft Audit Report with the instructions that she be more alert to the types of problems highlighted and that she review the vouchers and supporting documentation against written criteria, such as project implementation letters, established by the Office of Khmer Affairs. Specifically, she will look for problems in allowability, allocability and reasonability.

Recommendation No. 3: We recommend that:

The Office of Khmer Affairs ensure that the noncommunist resistance use interest-bearing accounts where appropriate for activities financed by A.I.D.

Mission Response

On O/KA instructions, the CNCR have opened interest bearing accounts to handle all funds provided by A.I.D. However, it should be noted that the first Agreed Minute and the next four amendments stipulated that non interest bearing accounts were to be used. These documents were approved by Washington and O/KA was following these instructions. Secondly, the Agreement covering the program of support to the CNCR suggest that it is closer to a Handbook Three grant than a Handbook 13 grant. As you are aware, Handbook Three normally stipulates non interest bearing accounts. Those points made, we would concur with your calculation of potential interest lost if interest bearing accounts had been used, after the \$100 per year per account (which the CNCR are allowed to retain to offset their additional work load) is deducted from the \$1400 calculation. We understand that these deductions would be allowed to enable a grantee to defray the additional cost of administering each interest bearing accounts.

Conclusion

We hope that these actions address the problems which gave rise to the recommendations in the draft Audit Report and that your office can issue the final report with the recommendations closed. If this is not possible, please let us know so that we may discuss any additional steps required.

ANNEX ONE:

The O/KA Field Representatives

These two O/KA staff members, one each resident in Surin and Aranyaprathet, are the initial point of contact between the CNCR and AID. The field representatives work almost daily with the CNCR senior personnel who have overall responsibility for control of AID funding and accounting personnel who actually do the financial ledgers and reports. This regular contact allows the field representatives to provide advice and assistance if any questions or issues arise concerning the use of AID funding. This is important to ensure that funding is only used for approved activities and, once the funds have been spent, to ensure that expenditures are recorded properly in the financial ledgers.

Periodically (monthly for the most part), financial information is summarized in standardized reports, which are included as part of the respective PIL. These are supported by original documentation. The documentation conforms to the standards laid out in the relevant PIL. The field representatives assist and monitor the process of compiling these reports, including verifying that the source books of accounts are correctly and accurately maintained during the period. Then, when completed, the reports are formally submitted to the field representatives who again review the general allowability, allocability and reasonableness of the expenditures. If the field representatives have a question about a particular expenditure, they consult the CNCR, O/KA or O/FIN to resolve the issue. When the field representatives have completed their reviews the reports are passed on to O/KA in Bangkok.

The Program Development Office

The General Development Officer and the Khmer speaking Project Management Specialist support the Field Representatives on an 'as needed' basis. The General Development Officer (GDO) was most active in conducting the 'needs assessment' of the CNCR financial accounting capability and developing the necessary systems. In conjunction with the Surin Field Representative, the new systems of accounts were established and Khmer administrators were given initial training. Training is ongoing, but conducted more by the Field representatives and the new Program Management Specialist. Later this year, O/KA, with the Office of Financial

Management, will hire an accounting firm to upgrade the existing systems, with the goal making them more easily audited in the future.

The Project Management Specialist has extensive USAID accounting and audit expertise. For this reason it is anticipated that he will assist the field staff by taking on some of the more detailed and specialized documentation examination and review functions, prior to the preparation of the vouchers. Based on these detailed reviews, he will guide and assist O/KA field staff in the conduct of end use checks, price comparisons and other internal audit activities. As this person is a new hire in a new position, the exact composition of his job and area of responsibility will evolve over time.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objective.

Scope of Our Internal Control Assessment

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 objective of the audit. Those standards also require that we:

- assess the applicable internal controls when necessary to satisfy the audit 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 A.I.D.'s internal control structure to determine our auditing procedures in order to answer the audit objective, and not to provide assurance on the internal control structure.

For the purposes of this report, we have classified significant internal control policies and procedures applicable to the audit objective 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. We have reported these categories as well as any significant weaknesses under the section heading for the audit objective.

General Background on Internal Controls

The management of A.I.D., including O/KA, 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

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agencies and other managers as delegated legally responsible for establishing and maintaining adequate internal controls. Also, the General Accounting Office (GAO) 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 Control Systems in the Federal Government." According to these guidelines, management is required to assess the expected benefits versus the related costs of internal control policies and procedures. The objectives of internal control policies and procedures for federal foreign 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 is 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.

Conclusion for Audit Objective

This objective concerns the special accounts used to fund various activities of the Cambodian noncommunist resistance groups. In planning and performing our audit of these accounts, we considered the relevant internal control policies and procedures cited in A.I.D. Handbook 19 and GAO's "Standards for Internal Controls in the Federal Government." For the purpose of this report, we have classified the relevant policies and procedures into the following categories: (1) establishing the special accounts; (2) documenting internal controls systems related to the accounts; and (3) certifying vouchers replenishing the accounts. We reviewed the Office of Khmer Affairs and USAID/Thailand's Office of Financial Management internal controls related to these policies and procedures. Our tests showed that the controls were logically designed and consistently applied except that:

- The Office of Khmer Affairs did not require the noncommunist resistance forces to use interest-bearing accounts where appropriate.
- The Office of Khmer Affairs did not fully document aspects of its internal control systems related to the use of the special accounts.
- USAID/Thailand's Office of Financial Management was not conducting adequate reviews of vouchers submitted for reimbursement for the special accounts.

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USAID/Thailand's April 1991 internal control assessment which covered the Office of Khmer Affairs did not report any of these problems. However, the report states that the mission had a low degree of confidence in the noncommunist resistance groups' budgeting and financial management systems and that, accordingly, additional accountability measures are being put in place to increase confidence that A.I.D. funds are being used for intended purposes.

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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 may 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 that the reportable conditions described under our audit objective are material weaknesses.

REPORT ON COMPLIANCE

This section summarizes our conclusion on the Office of Khmer Affairs (O/Ka) and USAID/Thailand's compliance with applicable laws and regulations.

Scope of Our Compliance Assessment

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.

We tested O/Ka and USAID/Thailand's compliance with the sections of the Foreign Assistance Act authorizing the assistance for the Cambodian noncommunist resistance forces, the Federal Financial Manager's Financial Integrity Act, and the Certifying Officer's Act as they could affect our audit objective. However, our objective was not to provide an opinion on O/Ka or USAID/Thailand's compliance with these provisions.

General Background on Compliance

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

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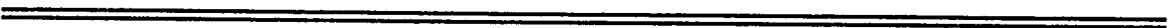
internal controls. Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the better of the laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with laws, regulations, and contractual agreements applicable to A.I.D.'s assistance to the noncommunist resistance groups is the overall responsibility of O/KA's management. As part of fairly, objectively, and reliably answering the audit objective, we performed tests of O/KA, USAID/Thailand, and the noncommunist resistance groups' compliance with certain provisions of Federal laws and regulations, and contractual agreements.

Conclusion on Compliance

The results of our tests of compliance indicated that, with respect to the items tested, O/KA and USAID/Thailand complied with the sections of the Foreign Assistance Act authorizing the assistance for the Cambodian noncommunist resistance forces, the Federal Managers' Financial Integrity Act, and the Certifying Officers' Act except that:

- The O/KA did not comply with the requirement of the Federal Managers' Financial Integrity Act of 1982 that it determine if its internal control systems conform to standards established by the General Accounting Office. (See pages 3 to 7)
- USAID/Thailand's voucher reviews did not fully comply with the requirements of the Certifying Officer's Act. (See pages 7 and 8)



Additional Examples of Questioned Costs

<u>Amount</u>	<u>Type of Expenditure</u>	<u>Reason Questioned</u>
\$4,000	General medical training expenses incurred from September 1, 1990 through February 28, 1991.	Although these general type expenses accounted for 25 percent of total expenses reimbursed by O/KA, there was no specific criteria on the type and amount of expenses allowable under this category.
2,000	Field trip for Khmer orphans and dependents	Neither the purpose of the field trips, nor prior O/KA approval, were documented. Field trips were not provided for in the approved budget.
600	Cash given to cooks to purchase food for a teacher training course.	No food receipts provided.
480	Yearly salary for a medical director.	Salary was not included in approved budget for activity.
217	Miscellaneous medical expenses.	No supporting documentation could be located.
200	Per diem for 3-day trip inside Cambodia.	Amount appears excessive. No written criteria specifying per diem amounts.
137	Surin hotel bill.	Expense appears unnecessary since a house was already being rented for office and lodging purposes.
<u>\$7,634</u>		