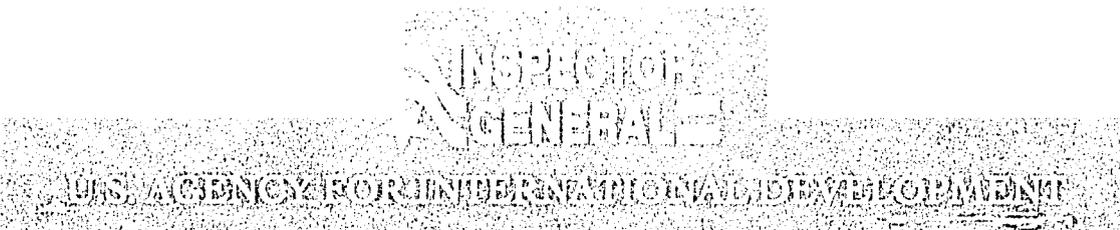


PL REF 079
2001

**Regional Inspector General for Audit
Singapore**

**AUDIT OF LOCAL COST
SUPPORT COMPONENTS OF
USAID/NEPAL PROJECTS**

**Audit Report No. 5-367-93-06
November 30, 1992**



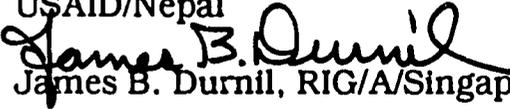


U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

November 30, 1992

MEMORANDUM

TO: Kelly C. Kammerer, Mission Director
USAID/Nepal

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

SUBJECT: Audit of Local Cost Support Components of USAID/Nepal
Projects (Audit Report No. 5-367-93-06)

Enclosed are five copies of the subject final report. Our audit work and the written representations made by USAID/Nepal confirmed that the Mission followed A.I.D. policies and procedures to plan and account for local support costs. This report, however, does address two problem areas where USAID/Nepal needs to improve its procedures for processing cash advances.

Your comments to the draft report were very responsive; therefore, both recommendations in this report are resolved and will be closed when the agreed to actions are completed. Your comments are summarized after each finding and are presented in their entirety in Appendix II of this report.

Please provide us information within 30 days indicating any actions planned or taken to close the recommendations. I appreciate the cooperation and courtesies extended to my staff during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

Background

As of March 31, 1992, USAID/Nepal was administering six active bilateral projects which had local support cost elements in their project budgets. For these projects, A.I.D. obligations and expenditures amounted to \$13.0 million and \$9.1 million, respectively. (See page 1)

For the purpose of this audit, we defined local support cost to be the dollar-financed local currencies provided by A.I.D. to the host government for financing the recurring operating costs of a project. As a general rule, Missions finance the dollar costs of the project budget and the host government finances the local currency costs. The dollar costs may cover such inputs as technical services, commodities and training. In cases where the recipient is unable to finance the local costs of a project A.I.D. may assist in financing these local costs. (See page 2)

Audit Objectives

The Office of the Regional Inspector General for Audit/Singapore audited USAID/Nepal's local support costs for bilateral projects in accordance with generally accepted government auditing standards. The audit was conducted from April 13, 1992 through October 9, 1992. We conducted our field work at USAID/Nepal's offices in Kathmandu, Nepal. The audit was conducted to answer the following audit objectives:

- Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects? (See page 2)

- Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook in accounting for local support cost inputs for bilateral projects? (See page 2)

A detailed description of our scope and methodology is included as Appendix I of this report.

Summary of Audit

USAID/Nepal followed the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects. The Mission (1) included the rationale for providing local support costs in project papers; (2) defined essential conditions to be fulfilled before releasing A.I.D. funds for local support costs and included these conditions in the project papers; (3) performed assessments of the Host Country's accounting capabilities; and (4) included audit clauses in Project Agreements. (See page 4)

USAID/Nepal also followed the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook to account for the local support cost inputs for bilateral projects except the procedures for processing cash advances need to be improved. The Mission (1) recorded budget, earmark, commitment, and disbursement amounts accurately in its accounting system; (2) obtained the Controller's approval and appropriate signatures on documentation supporting accounting transactions; (3) obtained the project officers' administrative approval on invoices; and (4) obtained the Controller's certification on payment schedules. (See page 5)

The following problem areas came to our attention:

- USAID/Nepal did not require the Government of Nepal to properly support cash advances. (See page 6)
- USAID/Nepal provided the Government of Nepal excessive cash advances. (See page 8)

Summary of Recommendations

We recommended that USAID/Nepal establish and implement procedures requiring:

- submission of required forms (See page 6) and
- preparation of monthly expenditure reports and limitations on the amount of advances provided (See page 8).

Management Comments and Our Evaluation

Mission officials agreed with both recommendations. They discussed the finding with the Government of Nepal's Financial Comptroller General and prepared new procedures for implementation beginning the start of the next Nepali fiscal year on July 15, 1993. Since the actions planned by USAID/Nepal are responsive to our findings, both recommendations are resolved on issuance of this report. These recommendation can be closed when the agreed to actions are completed.

The comments received from USAID/Nepal were carefully considered when preparing this final report. These comments along with our evaluation are summarized after each finding and presented in their entirety in Appendix II of this report.



Office of the Inspector General
November 30, 1992

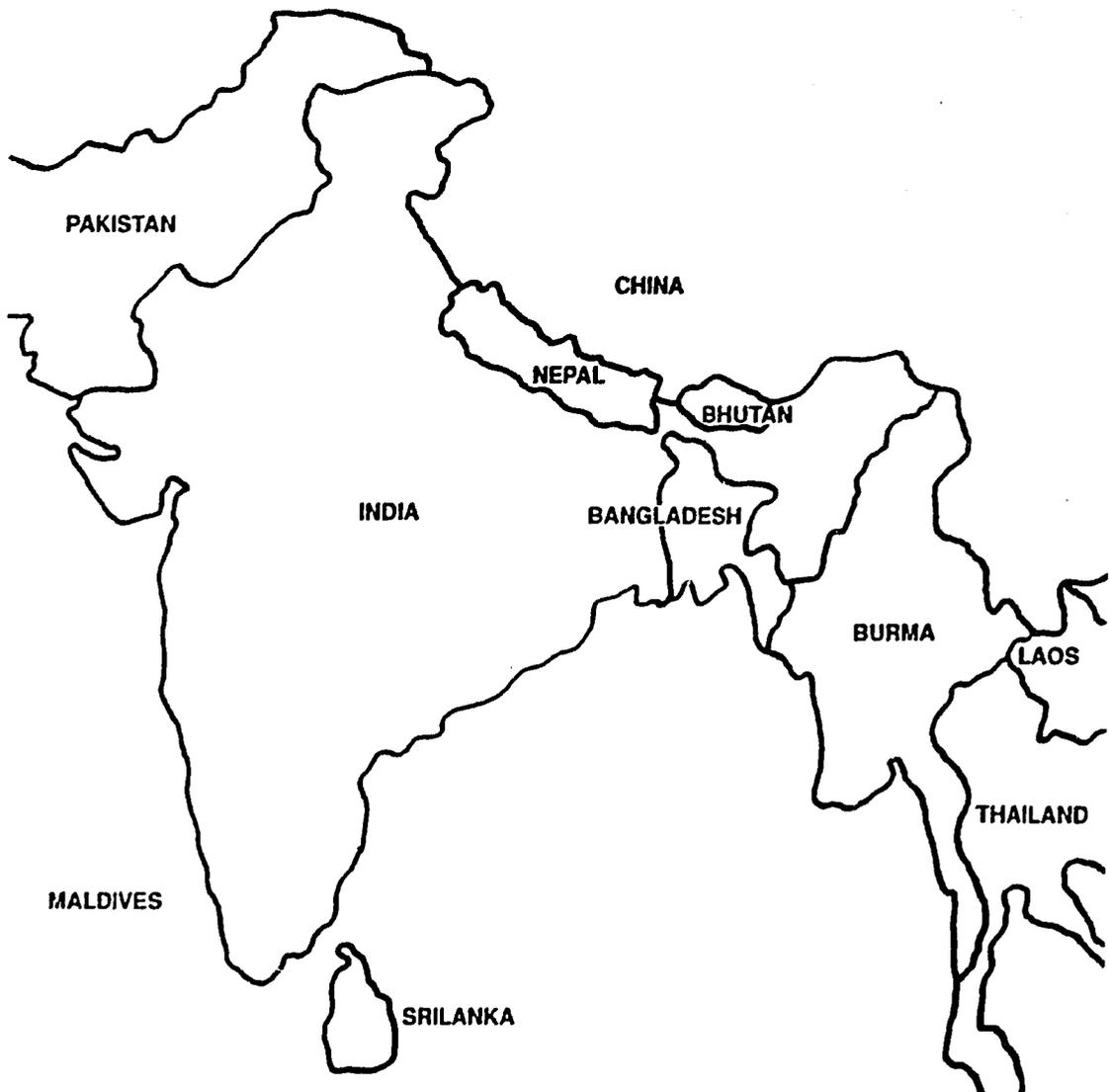


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INTRODUCTION

Background

We audited USAID/Nepal's local support costs for bilateral projects in accordance with generally accepted government auditing standards. The audit was conducted from April 13, 1992 through October 9, 1992. We conducted our field work at USAID/Nepal's offices in Kathmandu, Nepal.

As of March 31, 1992, according to Mission records, USAID/Nepal was administering six active bilateral projects which had local support cost elements in the project budgets. The following table lists these projects and summarizes the obligations and expenditures for local support costs.

PROJECTS WITH A LOCAL SUPPORT COST ELEMENT as of March 31, 1992						
<u>Project Title</u>	<u>Project Number</u>	<u>Start Date</u>	<u>End Date</u>	<u>Local Support Cost</u>		
				<u>Obligated</u>	<u>Committed</u>	<u>Expended</u>
Irrigation Management	367-0153	8/85	6/94	\$1,440,000	\$820,000	\$755,000
Institute of Forestry	367-0154	8/87	7/95	920,000	661,000	574,000
Rapti Development	367-0155	7/87	7/95	5,689,000	5,185,000	4,291,000
Forestry Development	367-0158	9/89	8/95	3,000,000	3,000,000	3,000,000
Child Survival/Family Planning Services	367-0157	6/90	7/95	1,799,000	1,121,000	514,000
Econ. Liberalization	367-0161	9/91	9/96	150,000	31,000	0
Total Local Support Cost Element				<u>\$12,998,000</u>	<u>\$10,818,000</u>	<u>\$9,134,000</u>

We audited USAID/Nepal's project elements identified as local support costs. Local support costs are not specifically defined in A.I.D. Handbook 3 or Handbook 19. For the purpose of this audit, we defined local support costs to be the funds provided by A.I.D. to host governments in that country's currency. This local currency is used for procuring project operating items that are available within the host country, such as maintenance for buildings and equipment, office supplies, and fuel for vehicles. As a general rule, Missions finance the dollar costs of the project budget and the host government finances the local currency costs. The dollar costs may cover such inputs as technical services, commodities, and training. In cases where the recipient is unable to finance the local costs of a project, A.I.D. may assist in financing these local costs. USAID/Nepal assists the Government of Nepal by funding local operating cost for the six project in the above table.

Audit Objectives

The Office of the Regional Inspector General for Audit/Singapore audited, based on the approved 1992 Audit Plan, the local support cost components of USAID/Nepal's projects to answer the following audit objectives:

- Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects? (See page 3.)
- Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook in accounting for local support cost inputs for bilateral projects? (See pages 4.)

Our audit tests were designed to provide reasonable assurance that the answers to the audit objectives were valid. We tested whether USAID/Nepal followed applicable internal control procedures and complied with the binding policies of A.I.D. Handbook 1, Supplement B. When we found problem areas, we performed additional work to:

- conclusively determine that USAID/Nepal was not following a procedure or not complying with a legal requirement,

- identify the cause and effect of the problem, and
- make recommendations for correcting the condition and cause of the problem.

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

REPORT OF AUDIT FINDINGS

Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects?

USAID/Nepal followed the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects. From the six active projects as of March 31, 1992 with a local support cost component, we selected Project 367-0157 to test planning. We selected this project based on the project start date and its financial activity (obligations, commitments, and disbursements). All other projects in our audit universe were planned prior to 1990 or had no financial activity, and, in our judgement, would not be good indicators of current planning procedures.

Based on a review of Project 367-0157's project paper and project agreement, USAID/Nepal's report assessing the host government's accounting capabilities, Mission orders, and interviews with Mission officials, we concluded that USAID/Nepal:

- included an explanation of the rationale and use of local support costs in the project papers;
- defined essential conditions to be fulfilled before releasing A.I.D. funds for local support costs, and included these conditions in project papers;
- made no disbursements for local support costs, prior to the conditions precedent being fulfilled;
- performed assessments of the host country's accounting capabilities; and
- included audit clauses in project agreements.

Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook in accounting for local support cost inputs for bilateral projects?

USAID/Nepal followed the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook in accounting for local support cost inputs for bilateral projects except that the procedures for processing cash advances need to be improved.

From the audit universe of projects active as of March 31, 1991, with a local support cost element, we reviewed judgmental samples of financial documents including project agreements, project implementation letters, and vouchers. Based on these samples, which included from 14 to 31 percent of the items in each category, we concluded that the accounting procedures included the significant controls listed below. USAID/Nepal:

- accurately recorded the budget amounts into its accounting system and properly documented all transactions;
- accurately recorded obligation, earmark, and commitment amounts into the its accounting system and properly documented all of these transactions;
- prevalidated obligation documents;
- approved obligation, earmark, and commitment documents;
- accurately recorded local support cost disbursements in its accounting system;
- administratively approved local support cost vouchers and the supporting invoices; and
- certified payment schedules that contained vouchers for local support costs.

Improvements, however, could be made for processing cash advances. USAID/Nepal did not follow the guidance of A.I.D. Handbook 19 because it advanced funds without the Government of Nepal submitting the required form or providing forecasts of cash needs; and exceeded its authority by issuing advances above the 120-day cash requirements of the

Government of Nepal. These two problem areas are discussed in detail below.

USAID/Nepal Did Not Require the Government of Nepal to Submit Cash Forecasts

USAID/Nepal did not require the Nepal Government to support cash advances by submitting the required forms and forecasting cash requirements. Instead, the Mission estimated the Government's cash needs by using historical costs. This system was implemented so cash flow would not be interrupted due to the Government's inability to provide prompt expenditure reports. However, by not obtaining forecasts, USAID/Nepal increased the risk of advances not reflecting the actual cash requirements of the Government.

Recommendation No. 1: We recommend that USAID/Nepal establish and implement procedures to obtain from the Government of Nepal "Request for Advance or Reimbursement" forms prior to disbursing cash advances. These forms must include forecasts of the Government of Nepal's cash requirements.

USAID/Nepal established a policy of advancing funds to the Government of Nepal through a working capital system. Under this policy, project advances were made to Nepal's Ministry of Finance. The Ministry of Finance redistributed the funds to the individual host government agencies which were responsible for project implementation.

USAID/Nepal's procedures, however, did not conform to the requirements of A.I.D. Handbook 19 because they provided advances without the Government submitting a "Request for Advance or Reimbursement" form and because they did not require the Government of Nepal to calculate cash requirements for each of the months of the advance period.

Handbook 19 states that nonprofit recipients are required to submit "Request for Advance or Reimbursement" Standard Form 270, which serves as a request as well as a forecast of the recipient's cash needs. This requirement is necessary in order to comply with the binding policies of A.I.D.'s Handbook 1, Supplement B, which requires A.I.D. to monitor the cash management practices of nonprofit institutions to ensure that Federal funds are not advanced in excess of that required for immediate disbursement needs.

To ensure a smooth flow of funds to A.I.D.-assisted projects, USAID/Nepal developed a system of providing advances to the Government even though the Government was unable to submit timely expenditure data. The Mission attributed the Government's slow invoicing cycle to its numerous remote and inaccessible field locations. Mission officials stated that their system had positive results in that it reduced outstanding advance balances because outstanding advances from one project could be offset against other projects.

The working capital system achieved the Mission's goals of a smooth flow of funds to the Government and lowered outstanding advance balances. However, USAID/Nepal overlooked the Agency's requirement that recipients should submit requests for advances and forecasts cash needs.

We reviewed advances for the period of July 1991 through June 1992 for four of the six projects in our audit universe. For all four projects reviewed, USAID/Nepal disbursed advances to the Government of Nepal without the Government submitting a "Request for Advance or Reimbursement" form or forecasting its cash requirements for the period of the advance. The Mission issued advances to the Government of Nepal which were calculated without current expenditure information or the recipient's forecast of immediate cash needs. Thus, the risk of advances exceeding the recipient's needs was unnecessarily high.

To improve the management of cash advances for local support costs, USAID/Nepal should follow the guidance of A.I.D. Handbook 19 and require recipients to submit the required forms and financial forecasts. With these cash forecasts, USAID/Nepal could accurately determine immediate cash needs of recipients and ensure that the advance funds were needed.

Management Comments and Our Evaluation

Mission officials agreed with the recommendation and stated the following procedure would be implemented:

At the start of each fiscal year, after the signing of that year's Budget PIL, the implementing agencies of the project or the Office of Comptroller General would request advance of funds representing a trimesterly cash need along with an analysis of advance requirements using standard Form 270 "Request for Advance or Reimbursement".

These advances will be replenished either monthly or every 120 days after the Government of Nepal submits a request for reimbursement on form 270 giving the status of outstanding advances and a projection of cash needs. Mission officials stated they discussed these procedures with the Government of Nepal's Financial Comptroller General who has suggested that the changes be implemented beginning the start of the next Nepali fiscal year on July 15, 1993.

Actions planned by USAID/Nepal are responsive to the recommendation so it is resolved on issuance of this report. The recommendation can be closed upon establishment of evidence that the revised procedures are implemented.

USAID/Nepal Should Limit Cash Advances to 120-Day Cash Needs

USAID/Nepal disbursed cash advances to the Government of Nepal prior to liquidating outstanding advance balances. As a result, the advance balances often exceeded the recipient's 120-day needs which was not in compliance with A.I.D. policy. This occurred because USAID/Nepal misinterpreted a 120-day advance waiver requirement. The Mission interpreted the waiver to mean that the Government's billing cycle could be on a 120-day basis, whereas the waiver was intended to limit outstanding advance balances to a recipient's 120-day cash needs.

Recommendation No. 2: We recommend that USAID/Nepal establish and implement procedures:

- 2.1 Requiring the Government of Nepal to submit expenditure reports monthly, and**
- 2.2 Limiting outstanding advance balances to the Government of Nepal's 120-day cash requirements.**

A.I.D. policy limits outstanding advance balances to the recipient's 90-day cash needs. However, following the guidance of A.I.D. Handbook 1, Supplement B, the Agency Controller granted USAID/Nepal a waiver allowing advances to the Government of Nepal to go beyond the 90-day limit to a 120-day advance cycle. USAID/Nepal used this waiver as criteria for granting trimester (120 days) advances to the Government of Nepal.

USAID/Nepal interpreted the waiver to mean that the Government's billing cycle could be on a trimester basis, whereas the waiver was only intended to allow advances of up to 120-day cash needs. The monthly billing cycle was not to be affected. However, the Government of Nepal only submits bills after the completion of the four month advance period instead of a more common monthly billing cycle. This system prevents advances from being liquidating within the 120-day advance period and results in multiple trimester advances being outstanding at the same time. When these advances overlap, the outstanding advance balances exceeded the 120-day cash requirements of the recipient agencies.

The Government of Nepal did not submit monthly bills to reduce the outstanding advances. As a result, even though the Government had used the advanced cash, USAID/Nepal's records showed the full 120-day advance as outstanding. For the projects that we reviewed, this record-keeping time lag was usually one month. To compensate for this lag-time and maintain a smooth flow of cash to A.I.D.-funded projects, USAID/Nepal disbursed advances for the ensuing 120-day periods prior to receiving the Government of Nepal's expenditure reports. When these new advances were combined with the outstanding advance balances, the resulting balance exceeded the Mission's 120-day advance authority.

We reviewed advances for four of the six projects in our audit universe that were outstanding during the period of July 1991 through May 1992. For each of these projects, there were periods when outstanding advance balances exceeded the 120-day cash needs. For example, USAID/Nepal issued half of Project No. 367-0155's trimester III advance on April 1, 1992 and half on May 5, 1992. Both of these advances were disbursed prior to May 11, 1992, when USAID/Nepal recorded the liquidation of the trimester II advance. Therefore, for 40 days the trimester II advance and half of the trimester III advance were outstanding. For six days, the full advances for both trimester II and III were outstanding.

The Government's 120-day cash requirements were sometimes over-advanced and sometimes under-advanced, the surpluses and shortages offsetting each other. Therefore, this problem area has a minimal dollar impact. Even though the monetary effect is insignificant, however, the problem is serious because it pertains to the Mission's compliance with binding policies of the Agency. Because USAID/Nepal officials did not limit the Government of Nepal's outstanding advance balance to 120-day cash requirements, they exceeded the authority granted them by the Agency Controller's waiver. Therefore, USAID/Nepal did not comply with the policies of A.I.D. Handbook 1, Supplement B which makes A.I.D.'s cash management policies mandatory.

USAID/Nepal should take immediate action to revise its procedures for issuing local support cost advances. These procedures must ensure that outstanding advance balances do not exceed the 120-day cash requirements of the Government of Nepal. To comply with the 120-day advance authority granted by the Agency Controller and still maintain a smooth flow of funds to the projects, the Mission must require the Government of Nepal to report expenditures on a cycle of fewer than 120 days. This timely reporting will ensure that funds will be available for additional advances.

Management Comments and Our Evaluation

The Mission officials agreed with the recommendation but suggested that the Government of Nepal be allowed to follow either of these two alternatives for replenishing their advances:

At the end of each month, submit actual expense reports for the previous month along with an advance request for next 120 days on Form 270 giving the status of outstanding advance and projection for the next four months' cash needs.

OR

At the end of each trimester submit actual expense reports for the previous trimester along with an advance request for next 120 days on Form 270 giving the status of outstanding advance and projection for the next four months' cash needs.

Both actions planned by USAID/Nepal are responsive to the recommendation. Therefore, the recommendation is resolved on issuance of this report and can be closed upon establishment of evidence that the revised procedures were implemented.

REPORT ON INTERNAL CONTROLS

Scope of Our Internal Control Assessment

We conducted our audit in accordance with generally accepted government auditing standards which require that we (1) assess the applicable internal controls when necessary to satisfy the audit objectives and (2) report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit. We limited our assessment of internal controls to those controls applicable to the audit's objectives and not to provide assurance on the auditee's overall internal control structure.

For the purposes of this report, we have classified significant internal control policies and procedures applicable to each audit objective by event cycles. For each event cycle, 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 applicable section heading for each audit objective.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act and Office of Management and Budget's implementing policies, A.I.D.'s management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal controls for U.S. foreign assistance 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 internal controls

will work in the future is risky because changes in conditions may require additional procedures and the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusion for Audit Objective One

The first audit objective was to determine if USAID/Nepal followed the policies and procedures of A.I.D. Handbook 3 in planning for the local support cost inputs for bilateral projects. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 3. For the purposes of this report, we have classified the relevant policies and procedures into the following event cycles: project paper development and project agreement negotiation and implementation. Our test showed that USAID/Nepal's internal controls were logically and consistently applied.

Conclusion for Audit Objective Two

The second audit objective was to determine whether USAID/Nepal followed policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook in accounting for local support cost inputs for bilateral projects. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 19 and the A.I.D. Controller's Guidebook. For the purposes of this report, we classified the relevant requirements into the following categories: (1) reviewing and recording budget allowances and obligation documents, (2) reviewing and recording earmarking and commitment documents, and (3) processing disbursement vouchers.

Our test showed that USAID/Nepal's internal controls were logically and consistently applied except for the following internal control weaknesses:

- USAID/Nepal did not require the Government of Nepal to support cash advances by submitting the required forms which include forecasts of cash requirements (See page 6) and
- USAID/Nepal provided the Government of Nepal with cash advances that exceeded 120-day cash needs (See page 8).

Reporting Under Federal Managers' Financial Integrity Act

USAID/Nepal did not report the above weaknesses in the internal control assessment report required under the Federal Manager's Financial Integrity Act. USAID/Nepal should consider the significance of these weaknesses during the next internal control assessment and make a determination as to whether the weaknesses should be reported.

REPORT ON COMPLIANCE

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards which 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 and 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 USAID/Nepal's compliance with the provisions of A.I.D. Handbook 1, Supplement B, as they related to our audit objectives. However, our objective was not to provide an opinion on USAID/Nepal's overall compliance with such 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 there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition of noncompliance, and is included in our report on internal controls (page 11). Abuse is distinguished from noncompliance in that abusive conditions may not directly violate laws or regulations. Abusive activities may be within the letter of laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with laws and regulations applicable to the technical assistance contracts is the overall responsibility of USAID/Nepal's management.

Conclusions on Compliance

USAID/Nepal's complied with the provisions of A.I.D. Handbook 1, Supplement B, as they related to our audit objectives except for the following:

- Audit Objective No. 2 - USAID/Nepal officials exceeded the authority granted them by the Agency Controller under A.I.D. Handbook 1, Supplement B, Chapter 15C by issuing advances over the Government of Nepal's 120-day cash requirements (See page 8).
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SCOPE AND METHODOLOGY

Scope

We audited USAID/Nepal's local support costs for bilateral projects in accordance with generally accepted government auditing standards. The audit was conducted from April 13, 1992 through October 9, 1992. We conducted our field work at USAID/Nepal's offices in Kathmandu, Nepal. USAID/Nepal had six active projects included a local support cost component. As of March 31, 1992, the obligations and disbursements for the local support costs of the six active projects was \$13.0 million and \$8.8 million, respectively.

Methodology

The methodology for each audit objective follows:

Audit Objective One

The first audit objective was to determine if USAID/Nepal followed A.I.D.'s policies and procedures in planning the local support cost inputs for bilateral projects. To accomplish this objective, we reviewed the Mission's 1991 Risk Assessment and identified control objectives, event cycles, and control techniques that related to our audit objective.

To test the controls, we selected one of the six projects, active as of March 31, 1992, that had a local support cost component. We selected our sample based on the project start dates and the financial activity (obligations, commitments, and disbursements) of the projects as of March 31, 1992. A project with a recent start date is indicative of USAID/Nepal's

current planning procedures and one with significant financial activity make it a good indicator of the effectiveness of USAID/Nepal's financial controls, addressed in our second audit objective. Project 367-0157 was selected because it satisfied our selection criteria better than the other five projects in our audit universe. All other projects in our audit universe were planned prior to 1990 or had no financial activity, so they would not be good indicators of current planning procedures.

For Project 367-0157, we reviewed the project paper, the project agreement, and USAID/Nepal's assessment of the host government's accounting capabilities. We also reviewed Mission orders relating to project planning and implementation and interviewed USAID/Nepal officials to discuss the adequacy of their planning process.

Our review of one project was sufficient to test the first audit objective, i.e. the operation of USAID/Nepal's system for planning the local support cost project element. Since we did not identify any problems with USAID/Nepal's planning for local support costs, we did not expand our sample.

Audit Objective Two

The second audit objective was to determine if USAID/Nepal followed the policies and procedures of A.I.D. Handbook 19 and the Controllers Guidebook in accounting for local support cost inputs for bilateral projects. To accomplish this objective, we reviewed the Mission's 1991 Risk Assessment and identified control objectives, event cycles, and control techniques that related to our audit objective. We also reviewed one of RIG/A/Singapore's prior audit reports on USAID/Nepal's technical assistance contracting which had a similar financial audit objective. Based on the positive conclusion of the prior audit report, we determined that the audit risk for this objective is very low.

To test the operation of the financial controls we reviewed a judgmental sample of obligation, commitment and disbursement transactions. Our sample was selected from the six projects with a local support cost element that were active as of March 31, 1991. As indicated below, we sampled from 14 to 31 percent of the items in each category.

<u>Item</u>	<u>Audit Universe</u>	<u>Judgmental Sample</u>	<u>Percentage Reviewed</u>
Obligations	\$12,998,750	\$1,799,421	14%
Commitments	10,817,470	3,374,382	31
Disbursements	8,754,241	1,554,488	18

We reviewed financial documents including Advice of Budgets, the Project Agreements and amendments, Project Implementation Letters, and vouchers.

To test cash advances, we reviewed the four projects (the other two projects did not receive advances) in our audit universe that had outstanding advances during the period of July 1, 1991 through May 31, 1992, Projects 367-0153, 367-0154, 367-0155, and 367-0157. For each of these projects, we reviewed Project Implementation Letters, annual budgets, fund control cards, and vouchers. We also reviewed the Mission order relating to advances and the A.I.D Controller's waiver allowing advances to cover periods up to 120 days, and we interviewed USAID/Nepal officials and officials from the Government of Nepal to discuss their procedures.

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November 13, 1992

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MEMORANDUM

TO: James Durnil
RIG/A/Singapore

THRU: Kelly C. Kammerer, Director *KCC*
USAID/Nepal

FROM: Homi Jamshed, Controller *Homi Jamshed.*
USAID/Nepal

SUBJECT: Mission's response to the draft Audit Report on
Local Cost Support

We received the subject audit report on November 3, 1992. USAID/Nepal accepts both recommendations contained in the audit report. Anticipating the recommendations and based on the findings discussed during the exit conference, a meeting was held with Mr. Yagya Man Bajracharya, Financial Comptroller General of the GON on September 9, 1992 in the Office of the Comptroller General in order to explore ways for implementation of these recommendations. The Comptroller General suggested that any changes required in the current system should be considered for implementation beginning the start of the next Nepali fiscal year on July 15, 1993 in order to avoid disruption of the project implementation activities during the current year. The suggested changes could be implemented as follows.

- A. At the start of each fiscal year, after the signing of that year's Budget PIL, the implementing agencies of the project or the Office of Comptroller General would request advance of funds representing a trimesterly cash need along with an analysis of advance requirements using standard Form 270 "Request for Advance or Reimbursement."

B. To replenish the advances the GON could follow either of the following two alternatives.

At the end of each month, submit actual expense reports for the previous month along with an advance request for next 120 days on Form 270 giving the status of outstanding advance and a projection for the next four months' cash needs.

OR

At the end of each trimester submit actual expense reports for the previous trimester along with an advance request for the next 120 days on Form 270 giving the status of outstanding advances and a projection for next four months' cash needs.

Before we further negotiate and finalize these proposed changes we have to meet several times with GON Officials, ascertain the effect of the proposed changes on project implementation and document the final decision. We have started the process and hope to complete it soon. We request you to consider the recommendations as resolved. We will keep you informed of the developments towards their implementation.

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REPRESENTATION LETTER

TO: James B. Durnil
Regional Inspector General/Audit
Singapore

This is in response to your request that I provide an audit Representation Letter in connection with your audit of USAID/Nepal's local support cost for bilateral projects for the audit period July 1991 through June 1992. The audit was intended to answer the following audit objectives:

1. Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 3 in planning the local support cost inputs for bilateral projects? and
2. Did USAID/Nepal follow the policies and procedures of A.I.D. Handbook 19 and the Controller's Guidebook to account for the local support cost inputs for bilateral projects?

Pursuant to your request, I hereby confirm the following representations made to your auditors during the audit of USAID/Nepal's local support cost for bilateral projects:

1. For USAID/Nepal's local support cost for bilateral projects, I, as Mission Director, have overall responsibility for the internal control system; for compliance with applicable U.S. laws, A.I.D. regulations and binding legal requirements; and for the fairness and accuracy of the accounting and management information.
2. To the best of my knowledge and belief, I confirm that USAID/Nepal has made available to RIG/A/S auditors all the records related to the above stated audit objectives.
3. To the best of my knowledge and belief, I confirm that those records are accurate and complete and give a fair representation as to the status of the matter under audit.
4. To the best of my knowledge and belief, I confirm that USAID/Nepal has disclosed any known material irregularities related to local support cost for bilateral projects under audit which we consider substantive involving either Mission employees with internal control responsibilities or the recipients of such local support costs.

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5. To the best of my knowledge and belief, I confirm that USAID/Nepal is not aware of any material instances where financial or management information on matters directly relating to this audit have not been properly and accurately recorded and reported, other than the findings in the audit report.
6. To the best of my knowledge and belief, acting not in my capacity as a lawyer, but as a layman, I confirm that USAID/Nepal has reported to the auditors all known instances of material noncompliance with A.I.D. policies and procedures or violations of U.S. laws and regulations.
7. To the best of my knowledge and belief, I confirm that USAID/Nepal has reported to the auditors all known instances of any material noncompliance with the terms of the local support costs in the bilateral project agreements under audit.
8. After review of your draft audit report and further consultation with my staff, I know of no other facts as of the date of this later (other than those expressed in our Management Comments to the draft report) which, to the best of my knowledge and belief, would materially alter the conclusions reached in the draft report.

I request that this Representation Letter be considered a part of the official Mission comments on the draft report, and be published as an annex to the final report.

Date: 11/16/92

Kelly C. Kammerer
Director



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