

**Regional Inspector General for Audit
Singapore**

**AUDIT OF USAID/SRI LANKA'S CONTROLS
OVER THE SRI LANKAN GOVERNMENT'S
COST SHARING CONTRIBUTIONS**

**Audit Report No. 5-383-94-001
November 29, 1993**





U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

November 29, 1993

MEMORANDUM

TO: Mr. Terrence Liercke, Acting Mission Director, USAID/Sri Lanka

FROM: Richard Thabet, RIG/A/Singapore 

SUBJECT: Audit of USAID/Sri Lanka's Controls Over the Sri Lankan Government's Cost Sharing Contributions

Enclosed are five copies of the subject report. Our audit work and written representations confirmed that USAID/Sri Lanka management implemented many procedures to improve controls over cost-sharing contributions in response to the new 1991 Agency guidance on Cost Sharing Contributions. USAID/Sri Lanka increased efforts to obtain reports from the Sri Lankan government on its contributions to A.I.D.-funded projects, and to verify the accuracy of the reported amounts.

While USAID/Sri Lanka has made significant improvements in tracking contributions, some of the procedures required by the 1991 guidance had not been implemented at the time of the audit. We believe these procedures were not implemented largely because management had not yet established new Mission procedures to include the requirements of the 1991 guidance. Therefore, Mission staff did not receive proper direction from management.

We made five recommendations to improve Mission operations, including a recommendation to finalize and release new Mission procedures for use by Mission staff. The Mission's reply to these recommendations and the draft report were fully considered in finalizing this report. Based on the Mission's comments, Recommendation Nos. 1, 3 and 4 are resolved and closed upon issuance of the report, and Recommendation Nos. 2 and 5 remain unresolved. Management comments are summarized after each finding and presented in their entirety in Appendix II.

Please provide us information within 30 days indicating any actions planned or taken to implement the remaining open recommendations. Thank you for the excellent cooperation and courtesies extended to my staff during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

The Foreign Assistance Act requires assurances from foreign governments that they will finance at least 25 percent of A.I.D.-financed activities. Audits conducted by the Office of Inspector General and the General Accounting Office between 1982 and 1987, disclosed significant problems with A.I.D.'s willingness or ability to hold foreign governments accountable for their financial commitments. Since 1987, however A.I.D. has established procedures to correct these problems, the most recent being established in 1991. To comply with these procedures, USAID/Sri Lanka was responsible for ensuring that the Sri Lankan Government provided contributions to 13 projects. As of March 31, 1993, the Sri Lankan Government agreed to provide \$146 million in contributions. A.I.D. authorized \$187 million for these projects (page 4).

The Office of the Regional Inspector General for Audit/Singapore conducted an audit to determine whether USAID/Sri Lanka followed A.I.D.'s 1991 procedures to: (1) obtain and record information on host government contributions; (2) include in agreements or Project Implementation Letters, a requirement that the host government report at least annually on its contributions; (3) review the adequacy of the contributions and test the reliability of the reports on these contributions; and (4) compute and document the value of contributions. The audit was conducted from March 1, 1993 to May 4, 1993 (page 4 and Appendix I).

USAID/Sri Lanka responded to the 1991 Agency guidance, and is in the process of designing and implementing procedures to increase controls over host government contributions. The Mission prepared a draft Mission Order which includes procedures to:

- Establish host government reporting requirements;
- Review the status of contributions during Project Implementation Reviews;
- Determine the reasonableness of reported contributions; and

- Adhere to the prescribed Agency procedures for computing the dollar value of these contributions.

Specific offices have been assigned the responsibility for implementing these procedures, and, although these procedures have not yet been finalized and distributed for use by Mission staff, the Mission has begun implementing many of them.

However, while USAID/Sri Lanka had started designing and implementing new controls over host country contributions, further progress is needed:

- USAID/Sri Lanka had not yet designed a system to obtain and record information on contributions: therefore, many of the proposed procedures were not yet implemented (page 8).
- For 5 of 13 projects, the Mission did not include in agreements or Project Implementation Letters, a requirement that the host government report at least annually on its contributions. As a result, the Mission did not achieve the intended level of accountability for the \$66.6 million of host government contributions required under these five projects (page 12).
- The Mission did not review or document the adequacy of actual contributions against required contributions during Project Implementation Reviews. As a result, the Mission could not ensure that the total required contributions of \$146 million for the 13 projects would be made (page 17).
- The Mission did not ensure that Project Officers determined the reasonableness of host government contribution reports. As a result, the financial reviews done to verify the \$77 million in reported contributions have not been entirely effective (page 23).
- USAID/Sri Lanka did not define the value of in-kind or real resources ("in-kind" or non-cash contributions) committed to the projects at project inception. As a result, real resources were neither identified nor valued for the total agreed-upon contributions of \$146 million (page 29).
- USAID/Sri Lanka applied exchange rates in effect as of project inception to compute the U.S. dollar value of host government contributions. As the Agency's policy on the application of exchange rates is unclear, we could not determine if USAID/Sri Lanka complied with the Agency procedures for computing the

dollar value of the host government contributions. (page 33).

This report contains five recommendations to correct problem areas, including recommendations to:

- Amend and finalize the proposed procedures and release them to Mission staff for implementation (page 8);
- Establish reporting requirements for any of the five active projects without such requirements (page 12);
- Analyze and document the adequacy of the host government contributions during Project Implementation Reviews (page 17);
- Establish procedures to ensure the reasonableness of the host government's reports on these contributions (page 23), and;
- Identify and define the value of real resources contributions at project inception (page 26).

In responding to the draft report, the Mission maintained that while the audit reported a number of constructive recommendations, it did not go far enough in reflecting the efforts, systems and results of the Mission in ensuring adequate host country contributions. We acknowledge that several improvements have been made to improve the system to track and verify contributions—especially during the audit and following the completion of audit fieldwork. We considered certain additional information provided by the Mission and made necessary changes to the draft report. While we are aware of the Mission's ongoing efforts, we concluded that at the time of the audit, the Mission had not yet completely designed and implemented procedures to improve controls over host government contributions.

Based on the Mission's corrective action taken on the five recommendations, Recommendation Nos. 1, 3 and 4 are resolved and closed while Recommendation Nos. 2 and 5 remain unresolved. A summary of management's comments and our evaluation follow each finding, and the entire Mission comments are included as Appendix II.

Office of the Inspector General
Office of the Inspector General
November 29, 1993

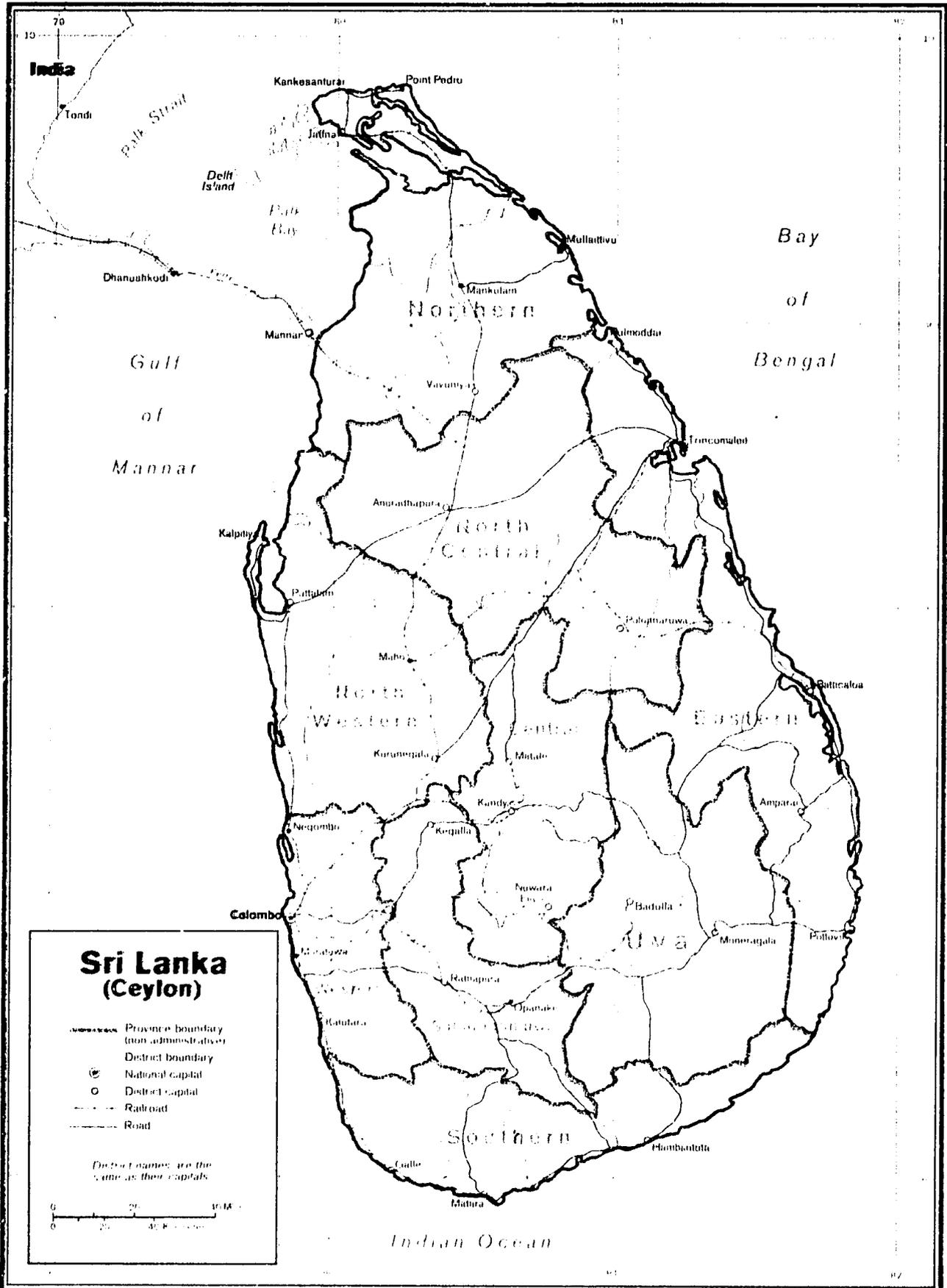


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INTRODUCTION

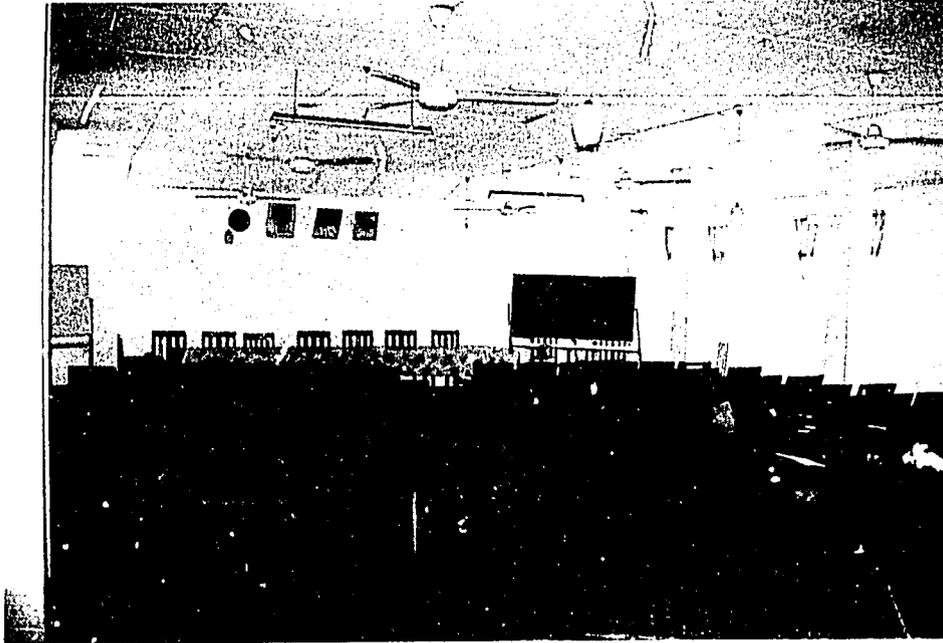
Background

Section 110 of the Foreign Assistance Act of 1961, as amended, requires foreign governments to make contributions towards the cost of foreign aid programs to ensure that these host governments have a vested interest in the success of A.I.D.-financed activities. This is required in much the same way that cost sharing contributions are required for Federal domestic aid programs.

Contributions by foreign governments are made either in the form of cash, or the more common "in-kind" contributions, consisting of such resources as office space, land, vehicles, or staff salaries—all of which should be necessary for the successful implementation of the program or project. The Government of Sri Lanka, for example, provided the following 'in-kind' contributions for meeting its cost sharing obligation to A.I.D.-financed activities:



A 16 hectare nursery contributed by the Government of Sri Lanka for A.I.D.'s Mahaweli Agricultural and Rural Development Project.



This training center, part of a Sri Lanka Government field office, was also part of the host country's contribution to A.I.D.'s Mahawell Agricultural and Rural Development Project

Section 110 of the Foreign Assistance Act of 1961, as amended, requires that:

No assistance shall be furnished by the United States Government to a country under sections 103 through 106 of this Act until the country provides assurances to the President, and the President is satisfied that such country provide at least 25 per centum of the costs of the entire program, project, or activity with respect to which such assistance is to be furnished, except that such costs borne by such country may be provided on an 'in-kind' basis.

While this section of the Act applies only to bilateral, government-to-government activities funded with development assistance appropriations and the Development Fund for Africa (Section 496d), A.I.D. has extended this requirement to many activities funded by the Economic Support Fund.

Recurrent problems with host government contributions have been repeatedly identified in Office of the Inspector General and General Accounting Office audits. Project designs typically contain overly optimistic assessments of host government ability to provide the necessary financial support to projects. Furthermore, A.I.D. missions have often not attached importance to proper accounting for host government contributions.

The Inspector General noted these problems in a 1987 memorandum to the Assistant Administrator of the Office of Program and Policy Coordination, and reported that for 146 project audits conducted from 1982 to 1987, 59 audit reports included a recommendation for managers to require host governments to provide and account for their contributions. The Inspector General further pointed out that the problems existed worldwide, affecting all bureaus, and that the Agency needed to issue additional guidance in several areas.

A.I.D. responded to this memorandum with additional policies providing details about the application, definition, and calculations of host government contributions, for example, and such procedures as the preparation of pro forma host government contribution budgets early in the project design process.

In 1991, A.I.D. established its latest procedures (Department of State Cable number 138349, dated April 27, 1991) requiring missions to:

- *Ensure that systems are in place to obtain information on host government contributions and ensure that such information is recorded in the official records/files of the mission;*
- *Include in agreements or Project Implementation Letters, a requirement for the host government to report at least annually on its contributions;*
- *Review the adequacy of the host government contributions during Project Implementation Reviews and test the reliability of the reports with mission site visit reviews and evaluations; and*
- *Adhere to A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41 for computing the value of in-kind contributions and applying the proper rate of exchange to calculate host government contributions.*

As of March 31, 1993, USAID/Sri Lanka had 11 active projects and 2 recently completed projects requiring host government contributions. A.I.D. authorized \$187 million for these projects and the Sri Lankan Government agreed to provide \$146 million—or 44 percent of the total cost of the projects. A.I.D. obligations and expenditures for the projects amounted to \$145 million and \$105 million, respectively, and total Government of Sri Lanka contributions were reported at \$77.3 million, of which the Mission has verified \$65 million.

Audit Objectives

The Office of the Regional Inspector General for Audit/Singapore audited USAID/Sri Lanka's controls over the Sri Lankan Government's cost sharing contributions to answer the following audit objectives:

- **Did USAID/Sri Lanka follow A.I.D.'s new 1991 procedures to ensure that systems were in place to obtain information on host government contributions and that such information was recorded in the official records/files of the Mission?**
- **Did USAID/Sri Lanka follow A.I.D.'s new 1991 procedures to include in agreements or Project Implementation Letters a requirement for the host government to report at least annually on its contributions?**
- **Did USAID/Sri Lanka follow A.I.D.'s new 1991 procedures to (1) review the adequacy of the host government contributions during Project Implementation Reviews and (2) test the reliability of the reports with Mission site visit reviews and evaluations?**
- **Did USAID/Sri Lanka adhere to A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41 for computing the value of in-kind contributions and applying the proper rate of exchange to calculate host government contributions?**

In answering these audit objectives, we tested whether USAID/Sri Lanka followed applicable internal controls and complied with certain legal requirements. We also included steps to detect abuse or illegal acts which

could affect the audit objectives. Mission management provided written representations which we considered essential to answering the audit objectives and assessing internal controls and compliance. These written representations have been included as part of the Mission comments in Appendix II.

For problem areas, we did additional work to identify the cause and effect of the problem, and made recommendations to correct the problem and the cause. Appendix I contains a complete discussion of the audit scope and methodology.

REPORT OF AUDIT FINDINGS

Did USAID/Sri Lanka Follow A.I.D.'s New 1991 Procedures to Ensure That Systems Were in Place to Obtain Information on Host Government Contributions and That Such Information Was Recorded in the Official Records/Files of the Mission?

USAID/Sri Lanka is in the process of designing a system to obtain information on host government contributions and to record such information in the official records and files of the Mission. While much has been done to obtain such information, USAID/Sri Lanka has not yet completed the design or implementation of the new system.

In response to the Agency guidance dated April 27, 1991, USAID/Sri Lanka increased accountability and monitoring over host government contributions and later prepared a draft Mission Order in early 1993. Although the newly proposed procedures were only in draft form, management believed the implementation of the new system to be well underway. The drafted procedures, which are an amendment to a prior Mission Order established in 1988, require that:

- Agreements or Project Implementation Letters include details of how the contributions are to be captured and reported;
- Reporting requirements are complied with;
- The status of contributions are reviewed during Project Implementation Reviews;
- Total contributions as stated in the project agreement are received—including instances where the expected contributions exceed the minimum 25 percent requirement;

- Project Officers obtain cost sharing reports from the host government counterparts, include a statement on the reasonableness of such information in relation to project activity, and file the original reports in the project/program files, and;
- A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.4i for computing the value of in-kind contributions and applying the rate of exchange to calculate host government contributions, are adhered to.

While the above procedures address most of the requirements under the Agency guidance, the procedures need to also require that:

- 1) Reporting requirements are for at least annual reporting, and;
- 2) The host government maintains documentation in support of the reported contributions.

Also, while the Mission procedures identified the "official" accounting records as the Mission Accounting and Control System (MACS), and assigned the responsibility for recording contributions into this system to the Controller, the MACS system is still in the process of being designed and therefore, does not yet have the capability to record host government contribution information. The Mission should ensure that the official recording system, as identified by the Mission, has the capability to track host government contributions.

The Mission has shown increased attention over the accountability for host government contributions by establishing tracking systems in the Projects Office and the Controller's Office (see Exhibit I); conducting financial reviews of contribution reports being received from the Government of Sri Lanka; and including an assessment of the status of each project's host government contributions in Mission project reviews.

However, while USAID/Sri Lanka has initiated many activities to improve the monitoring of contributions, management has not yet designed Mission procedures. Management prepared a draft Mission Order two years after the issuance of the Agency's 1991 guidance, but the procedures have not yet been finalized or released for use by Mission staff.

A System To Obtain and Record Contributions Has Not Yet Been Designed

Contrary to Agency requirements, USAID/Sri Lanka has not yet designed a system to obtain and record information on host government contributions. The proposed Mission procedures have not been finalized because management did not give priority to preparing and releasing the procedures for use by Mission staff. As a result, many of the required procedures have not yet been implemented.

Recommendation No. 1: We recommend that USAID/Sri Lanka:

1.1 Amend the drafted procedures to include requirements to:

a) include in agreements or Project Implementation Letters, a requirement that the host government report *at least annually* on its contributions to A.I.D.-financed projects,

b) ensure that the host government counterpart agencies maintain documentation in support of the reported contributions, and

c) designate as the "official" accounting records, only those systems with the present capability for tracking host government contributions.

1.2 Finalize the drafted Mission Order and immediately release the new procedures for use by Mission staff.

To remind missions of management's strong interest in the subject of host government contributions and to provide additional guidance for monitoring counterpart contributions to A.I.D.-financed programs, projects or activities, the Agency issued guidance to the missions in April, 1991. The main focus of this guidance was to require missions to:

...insure that systems were in place to obtain information on host government contributions and that such information was recorded in the official records/files of the Mission.

Although the Agency guidance was issued in April 1991, USAID/Sri Lanka did not prepare written Mission procedures until March 1993, and as of May 4, 1993, these procedures have not yet been finalized or released for use by Mission staff. Mission staff were either unaware of the new procedures proposed in the draft Mission Order or incorrectly believed that the procedures had been fully implemented. For instance, we were told by Mission staff that annual reporting requirements had been established for all projects when, in fact, five of the projects did not have such a requirement. It was later discovered that Mission staff incorrectly believed that a requirement to submit annual *budgets* was acceptable. Also, based on discussions, some Mission staff were not aware of the requirement for Project Officers to review the reasonableness of reports upon receipt from the Sri Lankan Government, or of the need to define and value the real resources to be contributed by the host government, at the time the project agreement is signed.

USAID/Sri Lanka had not given priority to establishing written procedures for obtaining and recording information on host government contributions. The draft Mission Order was not prepared shortly after receipt of the Agency guidance, but rather was delayed two years—until the commencement of this audit. Management said that they believed the system was in place and that many of the required procedures were in the process of being implemented, regardless of the fact that Mission procedures had not been formally designed. Management also said that due to the time-consuming process of preparing Mission procedures, the Mission planned to defer finalization of the draft Mission Order pending issuance of the audit report. The intent behind this delay was to incorporate the audit concerns and recommendations into the final Mission Order. However, Mission management was responsible for designing and implementing Mission procedures upon receipt of the 1991 guidance on host government contributions and should not have awaited the outcome of an audit on this subject.

The monitoring of host government contributions has been a low priority for USAID/Sri Lanka management in the past, as evidenced by the repeated problems identified in no less than four Office of Inspector General audit reports issued since 1987. One of these was an audit of Controls Over Government of Sri Lanka Contributions to A.I.D.-Financed Projects in Sri Lanka, (1987), which recommended that the Mission—among other things—obtain periodic reports from the Government of Sri Lanka on its staffing, financial, and logistical support contributions to A.I.D.-financed projects. In response to this recommendation, USAID/Sri Lanka established a Mission Order in July 1988 which included a requirement for the Sri Lankan Government's

Ministry of Finance and Planning to summarize its contributions to each project annually in February. However, the Mission did not ensure that this procedure was implemented—as reported in another Inspector General audit report: Audit of Diversified Agricultural Research Project in Sri Lanka, issued in 1991. This report made the same recommendation but again, although contribution reports were received for some projects, corrective action has not been taken to require these reports for all projects. The recommendation is now being made for the third time in this audit report (see page 12).

As a result of not designing a system and circulating the new procedures for use by Mission staff, many of the required procedures have not been implemented. The Mission did not:

- Establish reporting requirements in agreements or Project Implementation Letters, for 5 of the 13 projects (see page 12);
- Ensure that the total contributions as stated in the project agreement were received—including instances where the expected contribution exceeded the minimum 25 percent (see page 17);
- Require Project Officers to determine the reasonableness of reported contributions (see page 23); and
- Define real resources for computing the value of in-kind contributions at project inception. (see page 29).

In the 1987 audit referred to above, the Mission was commended for initiating actions, "*...especially in the past year and prior to this audit.*" One such action included the issuance of a draft Mission Order in March 1987 to establish procedures for ensuring that required financial contributions were made. The same can be said of this audit. In the few months prior to this audit, the Mission accelerated its efforts to increase the tracking of host government contributions and then prepared a draft Mission Order shortly after commencement of the audit. USAID/Sri Lanka needs to design a system for obtaining and recording information on host government contributions as part of the Mission procedures and ensure continual implementation of that system.

Management Comments and Our Evaluation

In their response to the draft report, the Mission disagreed that Recommendation No. 1.1 a., relating to the establishment of reporting requirements, was being made for the third time, citing reports on contributions that were received in certain instances since 1988. However, the Mission did not require the host government to report on their contributions on five projects as reported, and no reports were received for 2 projects.

Further, as evidenced by the list of additional documentation provided by the Mission to support corrective actions taken (see page 2 of the Mission comments), it is clear that these actions were taken in the years 1987, 1988 and in 1993. Although A.I.D.'s cable guidance was issued in April 1991, the Mission only commenced designing procedures early in 1993. Also, the Mission did not ensure that the procedures established in 1987 in response to the prior audit report were continually implemented. As such, we maintained that these deficiencies in the system had not been corrected.

In responding to Recommendation No. 1, the Mission included the requirements as recommended in the revised Mission Order, which has now been finalized and issued. Accordingly, all parts of Recommendation No. 1 are considered both resolved and closed upon issuance of this report.

Did USAID/Sri Lanka Follow A.I.D.'s New 1991 Procedures to Include in Agreements or Project Implementation Letters a Requirement for the Host Government to Report at Least Annually on Its Contributions?

USAID/Sri Lanka generally followed A.I.D.'s 1991 cable guidance requiring Missions to include in agreements or Project Implementation Letters, a requirement that the host government report at least annually on its contributions to A.I.D.-financed projects. USAID/Sri Lanka established reporting requirements for 8 of the 13 projects. However, the Mission did not establish such requirements for the remaining 5 projects.

Host Government Reporting Requirements Were Not Established

USAID/Sri Lanka did not include in agreements or Project Implementation Letters for 5¹ of 13 projects, a requirement that the host government report at least annually on its contributions as required under the new guidance. The Mission proposed new procedures to establish and enforce reporting requirements. However, the proposed procedures had not been finalized or released for use by Mission staff. As a result, the Mission did not achieve the intended level of accountability for \$66.6 million of host government contributions required under the 5 projects.

Recommendation No. 2: We recommend that USAID/Sri Lanka establish annual reporting requirements for any of the 5 projects lacking reporting requirements that are still active as of the date of this report.

The A.I.D. 1991 guidance was intended to strengthen accountability over the host government's financial commitments by ensuring that the host government reported its contributions to every A.I.D.-financed program, project or activity requiring contributions. The guidance requires that:

¹ - Diversified Agricultural Research Project, Irrigation Systems Management Project, Agricultural Planning and Analysis Project, Rehabilitation Assistance Project and the Agro-Enterprises Project.

Missions should include in agreements or PILS a requirement for host governments to report annually (more frequently if appropriate) on their contribution (cash and in-kind) to the AID financed program/project/activity. Where such requirements do not exist, an ideal time for adding this language would be when the project is amended to provide incremental funding, or when issuing the annual budget PIL if such procedures are utilized.

In response to this directive, USAID/Sri Lanka drafted new procedures requiring Project Officers to include in agreements or Project Implementation Letters, details concerning how the contributions are to be captured and reported, and to ensure compliance with established reporting requirements. The new Mission procedures, however, had not been finalized or released for use by Mission staff.

Of the five projects lacking annual reporting requirements, three² of the projects' Project Implementation Letters included statements requiring the counterpart agencies to provide evidence that the agreed-to contributions had been included as part of the Government's budget. USAID/Sri Lanka officials believed that such statements should be considered acceptable as reporting requirements under the new Agency guidance. The guidance however, clearly calls for reports on **actual** contributions—not budgets. As for the remaining two projects, management was not aware that reporting requirements had not been established.

The Mission had properly complied with the 1991 guidance for most of the projects beginning after the guidance was issued. However, the same level of effort was not given to existing projects lacking previously established requirements. To this effect, the new A.I.D. procedures provided specific guidance for establishing formal reporting requirements to existing projects and even specified when and where this should be done. With many projects lasting several years, the reporting requirement is necessary to gain increased accountability over the projects' contributions for the years remaining. USAID/Sri Lanka needs to inform the Sri Lankan Government of the Agency's increased attention to the accountability and reporting of contributions by including such a requirement in an official document signed by both parties.

² - Diversified Agricultural Research Project, Irrigation Systems Management Project, and the Rehabilitation Assistance Project.

Accordingly, USAID/Sri Lanka needs to instill values of accountability within the host government over these contributions by establishing annual reporting requirements through the suggested means for **all** projects and then consistently enforcing those requirements. For 2 of the 13 projects³ which had been underway for several years, the Mission had received the first reports from the counterpart agencies in only the last 5 months. Some of these reports included cumulative contributions for prior years which were either estimates or averages based on budgets or current year expenditures—neither of which are *actual*.

Because reporting requirements were not always established or enforced, USAID/Sri Lanka did not achieve the intended level of accountability for required contributions of \$66.6 million⁴ for the 5 projects, and annual reports were not always received for the total \$146 million due from the Government of Sri Lanka for all 13 projects.

As stated previously in this report, two prior Office of Inspector General audits included recommendations for USAID/Sri Lanka to receive periodic reports from the Government of Sri Lanka. This problem has persisted since 1987—corrective action must be taken now.

In conclusion, USAID/Sri Lanka needs to amend its procedures to specify the need for at least annual reporting by the host government and then implement the Mission procedures, as amended, and ensure compliance for all projects. For any of the five projects which lack reporting requirements and are still active, the Mission should establish these requirements and hold the Government of Sri Lanka accountable for compliance with the reporting requirements.

Management Comments and Our Evaluation

The Mission disagreed with our conclusion that the intended level of accountability for host country contributions was not achieved for the five projects. The Mission indicated that one of the projects requiring \$20.5 million in contributions only commenced in May 1992, and the intended level of accountability for the other 4 projects was achieved as of

³ - Development Studies and Training and the Private Sector Policy Support Project.

⁴ - The \$66.6 million includes \$20.5 million in required contributions for the Agro Enterprises Project, which only commenced in May 1992. Of the remaining \$46.1 million, \$25 million in contributions have been verified by the Controller's office.

September 15, 1993. This was six months after the audit cut-off date of March 31, 1993. However, we recognize the improvements made since the completion of our audit field work.

In responding to Recommendation No. 2, the Mission requested that the recommendation be revised to require action to be taken on only one of the five projects (AGENT Project) as the remaining four projects have been completed, or are nearing completion. Recommendation No. 2 has been revised accordingly. The Mission has also indicated it is planning to send a letter to the contractor regarding reporting requirements for the AGENT project. While this is a good first step, the recommendation cannot be resolved until the Mission determines the necessary action the technical assistance contractor should take to coordinate and report contributions under this project. This recommendation will be closed when the Mission effectively implements the system and receives acceptable reports for the contributions made.

Did USAID/Sri Lanka Follow A.I.D.'s New 1991 Procedures to (1) Review the Adequacy of the Host Government Contributions During Project Implementation Reviews and (2) Test the Reliability of the Reports with Mission Site Visit Reviews and Evaluations?

USAID/Sri Lanka generally followed A.I.D.'s 1991 guidance to review the adequacy of host government contributions during Project Implementation Reviews and to test the reliability of the reports by Mission site visit reviews and evaluations. However, the Mission did not review the adequacy of the reported contributions against those required, or ensure that Project Officers determined the reasonableness of reported contributions.

The Mission implemented a system for tracking and reviewing the status of contributions during Project Implementation Reviews as proposed in the new draft Mission procedures. Also, for the September 1992 Project Implementation Review the Mission included a detailed review of host government contributions for all active projects. This detailed review was done for this quarter only as part of the Mission's emphasis on selected topics for each quarterly review. In addition to the financial information provided, the Mission reviewed and documented descriptions of the counterpart agencies' systems of accounting for contributions, the effectiveness of these systems and suggestions for improvement. All quarterly reviews to date, however, reported only *unverified* contributions and measured contributions as a percentage of total project costs to date (A.I.D. and Government of Sri Lanka), without regard to the dollar amount contributed, as discussed later.

Through the Controller's Office, the Mission tested the reliability of reports on host government contributions by conducting financial reviews—or verifications of reported contributions. This effort had previously been very limited, often consisting of reviews for only two or three projects per year conducted on an "ad hoc" basis, until early fiscal year 1993 when an additional financial analyst was hired to assist in the process. Although some deficiencies were not identified during the reviews, this verification process did identify several deficiencies in reported contributions. For example, the financial analysts appropriately questioned:

- Unallowable contributions;

- Unsupported cash and 'in-kind' contributions;
- The omission of allowable contributions;
- The cost basis applied; and
- Improper reporting format.

For each financial review the financial analysts documented these deficiencies in Memoranda which were forwarded to the Mission's Projects Office. The verified amounts were then to be included in the quarterly Project Implementation Review reports. However, this had not been done. Therefore, all quarterly reports of Project Implementation Reviews issued as of May 4, 1993 reported unverified host country contributions.

As discussed below, the Mission did not:

- Review the adequacy of the reported contributions against required contributions or document these reviews in the Project Implementation Reviews; and
- Ensure that Project Officers determined the reasonableness of reported contributions.

The Mission Needs to Review the Adequacy of Actual versus Required Contributions

Contrary to A.I.D. procedures, USAID/Sri Lanka did not review or document the adequacy of actual reported contributions against required contributions during Project Implementation Reviews. The Mission did not yet establish procedures to ensure that the adequacy of contributions is reviewed during these reviews. As a result, the Mission could not be assured that the total required Sri Lankan Government contributions of \$146 million for the 13 projects would actually be made.

Recommendation No. 3: We recommend that for all on-going and future projects, USAID/Sri Lanka:

- 3.1 Extend procedures to include 1) an analysis of contributions reported to date against the total required contributions, and to 2) document the results of these analyses in Project Implementation Review reports; and**

3.2 Include an analysis of cumulative contributions reported to date against the required contributions for each project as part of the Mission's tracking system.

To better ensure continual Mission monitoring of the host government's provision of agreed-upon contributions, the new A.I.D. procedures require:

The adequacy of the HG contribution should be reviewed during Project Implementation Reviews (PIR's)...

The guidance also extends management responsibilities to go farther than obtaining assurances, or waiting until the project is completed to monitor contributions to the A.I.D.-financed project. The guidance also specifically states that when agreements call for contributions in excess of 25 percent, the Mission must ensure that the agreed total contribution amount is provided so that project/program objectives are met.

This requirement supplements A.I.D. Handbook 3, Chapter 11, which stresses that project monitoring by missions is critical to project success, and that the primary responsibility for monitoring lies with the project officers who are required to:

- work with Borrower/Grantee to assure contributions are budgeted for and funds released in timely and sufficient amounts;
- ensure the timely and coordinated provision of inputs; and
- compare expenditures with targets as of the current year.

A system for measuring compliance with the level of contributions specified in the project agreement is necessary to confirm that the host government actually contributes the total amount it has agreed to. This is necessary to alert management of potential implementation problems so that appropriate action can be taken—either by obtaining the additional inputs or, if necessary, redesigning the project. This requirement is further necessitated by Handbook 3, Appendix 14A which requires a summary of planned versus actual inputs by the host government to be included as part of the Project Assistance Completion Reports.

USAID/Sri Lanka, however, did not review the adequacy of planned versus actual contributions during Project Implementation Reviews for any of the 11 projects for which reports on contributions were received.

The Mission's review of the status of contributions consisted of comparing the *percentage* of reported contributions against total project costs to date (A.I.D. and the counterpart agency) with the required percentage for each project. This information was then documented in the Project Implementation Review reports. USAID/Sri Lanka officials, therefore, believed the Sri Lankan Government contributions were properly being reviewed as required. However, the review should also include a look at whether the *amount* contributed to date compares well with the total amount to be contributed to the project by the Sri Lankan Government.

Mission officials focused on percentages only because they did not believe that the host government should be held to its agreed-to amount for projects where the A.I.D. contribution had been significantly reduced as a result of changes in project design. While this is logical, a reduction in A.I.D. funding requires an amendment to the project agreement, therefore, the host government contributions should simultaneously be reduced when appropriate. While a reduction in the host government's contribution was considered appropriate for two projects, the Mission did not reduce the anticipated contributions in the project agreement amendments.

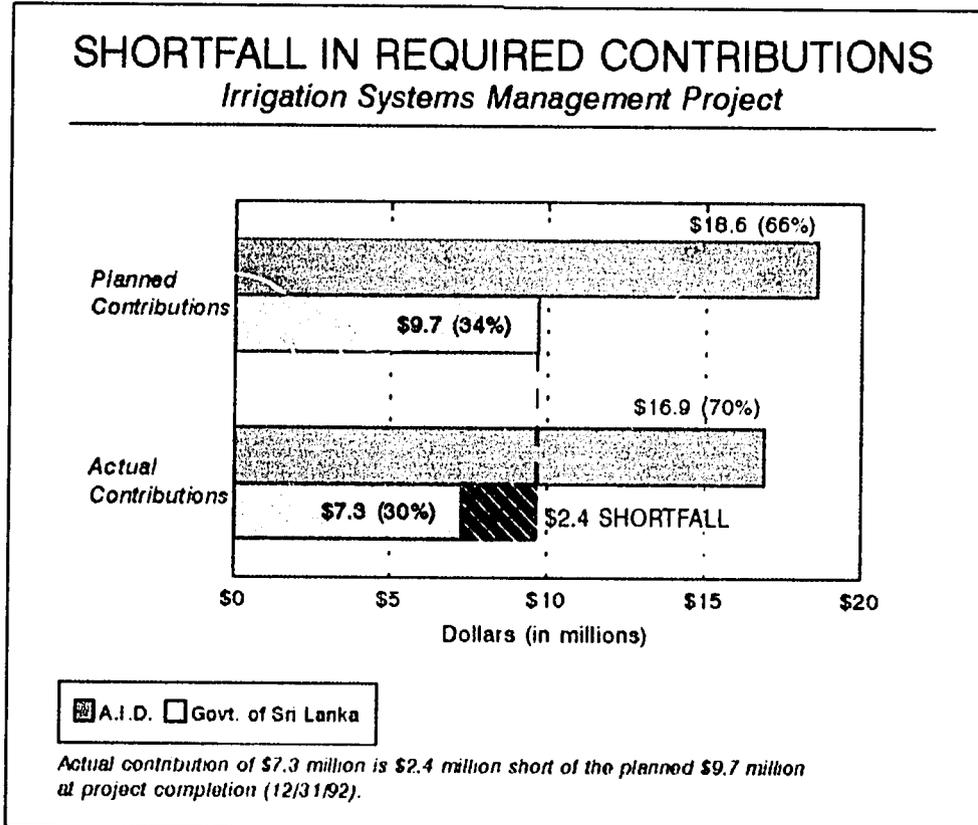
In USAID/Sri Lanka's draft Mission Order on Host Government Contributions, the newly proposed procedures require reviews of the status of contributions but do not specify that a comparison of actual versus planned contributions should be made. The drafted procedures should include a requirement to review actual versus planned host government contribution and to document the results of these reviews in the Project Implementation Review reports, highlighting any projects which may be behind schedule.

Without identifying projects with a shortage of host country contributions, the readers of 1992 Project Implementation Reviews—both USAID/Sri Lanka and A.I.D./Washington management—were not informed when the Sri Lankan Government's contributions were behind schedule. Without being made aware of this, responsive action could not be taken to prevent potential adverse effects on project activities.

Because the Mission's review of the status of contributions consisted of looking at only the percentage of contributions made, and not the dollar amount contributed, the significance of any shortfalls were understated.

For example, at project completion the Irrigation Systems Management Project had reported contributions of \$7.3 million, or 30 percent of total project costs. Because this percentage is only 4 percent below the 34

percent required by the Project Agreement, the shortfall was not considered significant and was not highlighted in the Project Implementation Review Report section that calls for comments on shortfalls in contributions. However, when considering the dollar amount (\$7.3 million), the contribution was actually 25 percent below the required amount due, i.e. \$2.4 million short of the anticipated \$9.7 million. The following chart illustrates this example.



In another instance, the Mission reported contributions of \$4.7 million for the Mahaweli Downstream Support Project in September 1992. This represents only 23 percent of the required \$20.1 million. Although A.I.D.'s total life of project funding had significantly been reduced as a result of project activities being scaled down, the Mission did not simultaneously reduce the host government's amount. Therefore, a shortfall of \$15.4 million in Government of Sri Lanka contributions existed at the completion of the project on December 31, 1992. This shortfall, however, was neither highlighted in the quarterly Project Implementation Report, nor did the Mission take action to correct the situation in a timely manner. At the end of the audit fieldwork in early May 1993, Mission officials indicated that a project agreement amendment

to reduce host government contributions **was being drafted**—4 months after the completion of the project.

In addition, contributions reported in the Project Implementation Review reports were inflated. The total \$76.7 million of host government contributions reported in September 1992 were based solely on reports received from the counterpart agencies without verifying the reported amounts. For example, the Mahaweli Enterprise Development project had reported contributions of \$2.9 million. However, a subsequent verification done in February 1993 proved that only \$1.7 million was actually supportable. With the Mission's recent increased efforts in verifying reported amounts, the Mission intends to include only reported amounts which have been verified in the December 1992 report and all those subsequently issued. However, as of the end of audit fieldwork (May 4, 1993), the December 1992 report was not yet available.

Without reviewing the adequacy of \$77.3 million in reported contributions, the Mission had no assurance that contributions would be made as necessary for successful project implementation. USAID/Sri Lanka should establish Mission procedures for reviewing the adequacy of contributions during Project Implementation Reviews and for documenting projects which are behind schedule. These procedures should then be incorporated into the Mission's current tracking system.

Management Comments and Our Evaluation

The Mission indicated that certain procedures were initiated during the time of the audit to reduce the required host government contributions as a result of reduced A.I.D. funding, and to verify reported contributions and maintained that these efforts were not reflected in the audit report. While we recognize that the Mission did initiate these procedures to correct the problems identified during the audit, the contributions levels should have been reduced at the time when A.I.D. planned contributions were revised, or soon after the 1991 guidance on contributions was issued -- not after the projects have ended.

The Mission Comments (see page 6 of Appendix II) state that RIG/A/S did not properly address their actions in the draft report. They stated that the Mission amended the project agreements to reduce the required contributions and that "this information was provided to the audit team at the time of the audit...". At the exit conference, however, of the audit on May 4, 1993, Mission officials indicated that a project agreement amendment was being drafted and will be signed soon. Also, in an earlier

memorandum to RIG/A/S dated August 25, 1993, the Mission stated that "these actions [project amendments] were taken as a result of your ongoing audit exercise" and that "you [RIG] may wish to take credit for this action". We therefore categorize this portion of the Mission's comments as inaccurate.

In addition, we were aware that contributions were being verified by the Mission during the time of the audit but our finding addresses the fact that the reported contributions were not being reviewed during project implementation reviews. We have accordingly included necessary comments in the relevant paragraphs above.

The Mission responded to the recommendation by including the necessary information in the FY 1993 Quarterly Project Implementation Reviews, and in the Mission's tracking system for host country contributions. Based on actions taken by the Mission, Recommendation No. 3 is considered both resolved and closed upon issuance of this report.

Reports on Sri Lankan Government Contributions Are Not Yet Reliable

Contrary to A.I.D. procedures, USAID/Sri Lanka did not ensure that Project Officers determined the reasonableness of the Sri Lankan Government's contributions for 11 of the 13 projects for which reports on contributions were received. The Mission did not yet establish procedures requiring Project Officers to make such a determination. As a result, the verification process for testing the reliability of reported contributions has not been entirely effective.

Recommendation No. 4: We recommend that USAID/Sri Lanka design and implement procedures requiring Project Officers to:

- 4.1 Determine the reasonableness of reported contributions and evidence this by signing each report received; and**
- 4.2 Reject reports received from the Sri Lankan Government when the reported contributions are found to be unsupported or otherwise unreasonable.**

To ensure that data provided in reports on host government contributions is reliable, the new A.I.D. procedures require that Project Officers review and provide a statement as to the reasonableness of the reports and that the Mission test the reliability of reports during site visits and evaluations:

The reliability of the reports [should be] tested by Mission site visit reviews and evaluations. The Project Officer/Manager should obtain the HG 'cost sharing' report and, after signing the report indicating the report's reasonableness in relation to project activity, staffing progress, etc., file the report in the official Mission project/program files.

USAID/Sri Lanka, however, did not ensure that Project Officers determined the reasonableness of the reports upon receipt from the Sri Lankan Government, as would be evidenced by a signature. Project Officers, instead, submitted all reports received for the 11 projects directly to the Controller's Office without providing the required statements that the \$77.3 million included in these reports were reasonable in relation to project activity, staffing progress, etc.

In addition to not approving the reports as reasonable, USAID/Sri Lanka also did not reject the reports when they were generally incomplete, in an unacceptable format or included unsupported contributions. The reports received from the counterpart agencies were often so poor, the Financial Analysts were unable to use these reports in the verification process and essentially had to re-construct the information from the Government of Sri Lanka's records in determining actual contributions. Also, the problems the host government had in preparing these reports were seldom brought to Mission management's attention. Therefore, the problems persisted.

Project Officers were not determining the reasonableness of reports on contributions because the Mission did not establish procedures to inform staff of the need to do so. In response to the new A.I.D. guidance, USAID/Sri Lanka revised its old Mission procedures on the monitoring of host government contributions, however, the Mission had not yet finalized the Mission Order, or released it for use by Mission staff.

To ensure the reliability of contributions, Project Officers said that they relied on the certifications made by the Sri Lankan Government, and the verifications by the Financial Analysts. Also, Mission management said that while Project Officers play a significant role in reviewing and tracking actual contributions, the sole responsibility for financial verification of reported contributions lies with the Controller.

Because the Project Officers did not review the reasonableness of the reports—as evidenced by signing the reports—the verification process was not conducted effectively. Project Officers are more directly involved with the project activities—and assumedly more familiar with types of contributions made—therefore, reviews of applied cost basis, etc. by Project Officers could have been more effective than delegating such responsibilities to the financial analysts. In addition, if Project Officers rejected unacceptable reports and returned them to the implementing agency, the burden of preparing a more reasonable (or supportable) report would lie with that agency, rather than with Mission staff. The financial reviews did not disclose the following problems with reported contributions which were identified during the audit:

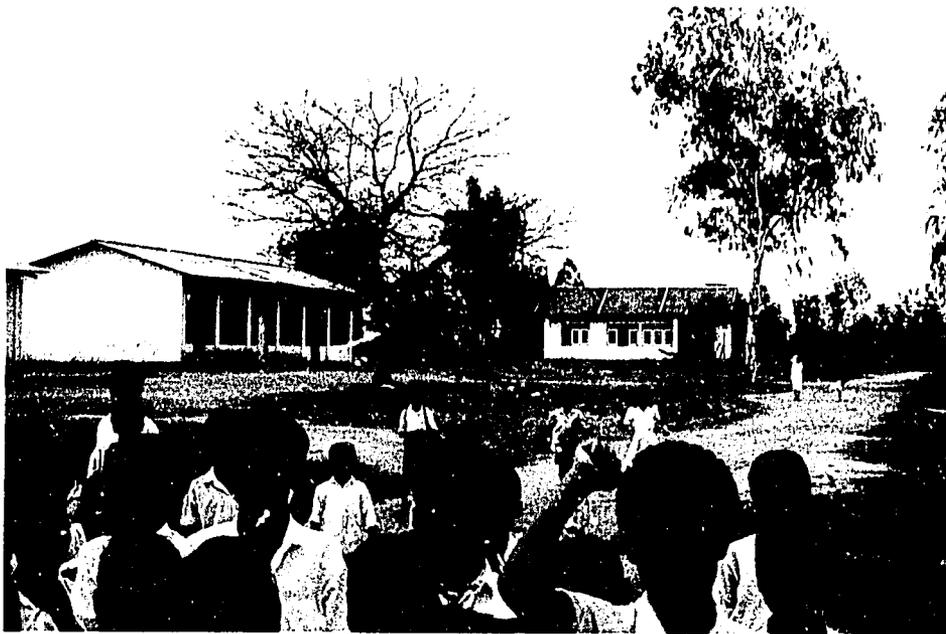
- improper inclusion of contributions from other donors;
- unapproved cost basis for allocating 'in-kind' costs;
- incomplete reporting/irregular expenditure patterns; and
- unsupported/unallowable contributions.

Significant levels of contributions made by other donor agencies were included as part of the Sri Lankan Government's costs on at least two projects. Rehabilitation Assistance Project's contributions of \$24.6 million were based on estimates extracted from a 1991 Government of Sri Lanka Project Report (the Multi-Donor Emergency Reconstruction and Rehabilitation Program) which included other donor contributions. Also, part of the costs of approximately 100 buildings constructed with Saudi Arabia loan funds in one of A.I.D.'s project areas (the Mahaweli Downstream Support project) were included as host government contributions. Funds in the amount of \$2.8 million—or 33 percent of total reported contributions for this project were inappropriately included. Further, these Saudi contributions were not directly associated with the intended use of A.I.D. funds under this project, nor were they defined in the agreement as part of the Government of Sri Lanka's funding.

The following photographs show some of these 100 buildings:



Buildings constructed in Aselapura with loan funds from Saudi Arabia were improperly included as Sri Lankan Government contributions to the Mahaweli Downstream Support Project.



This school, funded with Saudi Arabian loan funds was inappropriately included as Sri Lankan Government contributions to the Mahaweli Downstream Support Project.

In addition, the basis for allocating in-kind costs was not reviewed by Project Officers for at least three projects. Under the Natural Resources and Environment Policy Project, the basis for allocating \$256,712 was neither documented nor approved by A.I.D, nor was \$14.9 million in contributions under the Rehabilitation Assistance Project. The \$14.9 million were PL-480 Title 1 funds accepted solely on the basis of a certified statement received from the Government of Sri Lanka. Also, reported in-kind contributions of \$1.8 million under the Agricultural Planning and Analysis Project consisted entirely of salaries and operating expenses for six years calculated on an unapproved cost basis. Clearly, the Mission should consider whether these costs, which are nothing more than the everyday overhead costs of the host government, were actually incurred for project purposes.

Also, operational office costs of \$5.5 million for the Mahaweli Downstream Support project were inappropriately accepted in full when approximately 30 percent of these costs (\$1.6 million) related to other donor activities. The following photograph shows one of the Sri Lankan Government Offices observed during the audit fieldwork:



Operating costs for this Sri Lankan Government office were incorrectly allocated at 100 percent when 30 percent of the office was used for other donor activities.

Incomplete/irregular expenditure patterns were also not reviewed or resolved. This occurred under the Natural Resources and Environment Policy Project. Reports received from the implementing agency included reported contributions from seven different participating agencies. Of the reports received, many showed extremely irregular expenditure patterns, i.e. zero amounts reported on some quarters or extremely high/low amounts from quarter to quarter for generally fixed, recurrent-type costs.

The director of the one of the seven participating agencies said that: "It's unlikely that most of the reported contributions, which were based entirely on budget estimates, were actually incurred or even associated with this project."

Upon questioning one participating agency, it was clear that this agency played a very insignificant role in project activities and, in fact, received no budget allocation from the Government of Sri Lanka's Ministry of

Finance for its involvement with the project. The Director of this agency said that it's unlikely that most of the reported contributions, which were based entirely on budget estimates, were actually incurred or even associated with this project. It was evident that reporting these contributions was a low priority for this agency and that the reports did not reflect actual supportable contributions, therefore, the irregular expenditure patterns existed. While Mission officials believed this to be an isolated case, there is clearly a need for Project Officers to take a more active interest in reviewing and approving reported contributions.

Because Project Officers are more closely related to the projects, they should be more actively involved in the verification process and not rely entirely on the work of the Financial Analysts. Such involvement should include reviews and approvals of the contribution reports received from the Government of Sri Lanka agencies and the return of unacceptable reports. Only then will the Sri Lankan Government agencies improve the quality of the reports submitted to A.I.D. This effort by Project Officers should reduce efforts by the financial analysts by restricting them to the verification of amounts already reported, rather than discounting reports received from the implementing agencies and then compiling their own reports.

Management Comments and Our Evaluation

In their response to this finding, the Mission stated that the recommended procedures have been appropriately incorporated in the finalized Mission Order, a copy of which was provided to us. Project Officers now review reports on host government contributions and ensure the reasonableness of contributions made. Accordingly, Recommendation No. 4 is considered resolved and closed upon issuance of this report.

Did USAID/Sri Lanka Adhere to A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41 For Computing the Value of In-Kind Contributions and Applying the Proper Rate of Exchange to Calculate Host Government Contributions?

USAID/Sri Lanka adhered to AID Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41, for calculating host government contributions. However, the Mission did not adhere to the Handbooks for defining the value of real resources ("in-kind" or non-cash contributions) at project inception. The Mission also applied exchange rates in effect as of project inception. As the Agency's policy on the application of exchange rates is unclear, we could not determine if USAID/Sri Lanka complied with the Agency procedures for computing the dollar value of the host government contributions.

For all 13 projects reviewed under the audit, USAID/Sri Lanka properly calculated the level of Sri Lankan Government contributions based upon the total cost of each project. Contributions by other donors were properly excluded in the calculation of Sri Lankan Government contributions and the Sri Lankan Government's share was shown both in terms of U.S. Dollars and as a percentage of total project costs.

USAID/Sri Lanka, however, did not define the value of the host government's real resource contribution at project inception by including specific values of contributions in Project Agreements. The Mission calculated the level of host government contributions using exchange rates existing at the time of signing the project agreements; however, A.I.D. Handbook 1, part VII, 2.41 is unclear.

Real Resource Values Were Not Defined at Project Inception

USAID/Sri Lanka did not define the value of the host government's real resources committed to the projects in calculating host government contributions as required by A.I.D. procedures. The Mission did not establish procedures to ensure compliance with the applicable Handbooks. As a result the Mission did not determine the host government's absolute real resource contribution for agreed-upon contributions of \$146 million.

Recommendation No. 5: We recommend that USAID/Sri Lanka establish and implement procedures to adhere to Handbook 1,

Part VII, 2.41 and Handbook 3, Appendix 2G for defining the value of the host government real resource contribution at project inception.

A.I.D. Handbook 1, Part VII, 2.41 indicates that the host government's real resources should be valued in calculating the required contributions at the inception of the projects. Section 2.41 of this policy requires that:

The value of the real resource contribution provided by a host country for a project or program should generally be obtained by first pricing the host country's real resource contribution in local currency.

Thus at the signing of an assistance agreement, the host government's real resource contribution is to be expressed both in terms of absolute dollars and a percentage of the total project. This forms the basis for determining host government's absolute real resource contribution...

In order for such real resources to be properly valued, they must first be identified. This is required by Appendix 2G (Section D.2.a) of Handbook 3 which explains the requirements of the recipient country assurances:

The assurances should list and state the value of the items which the [host] government will contribute to the project being assisted by A.I.D. The assurance would be cited in the Project Paper...

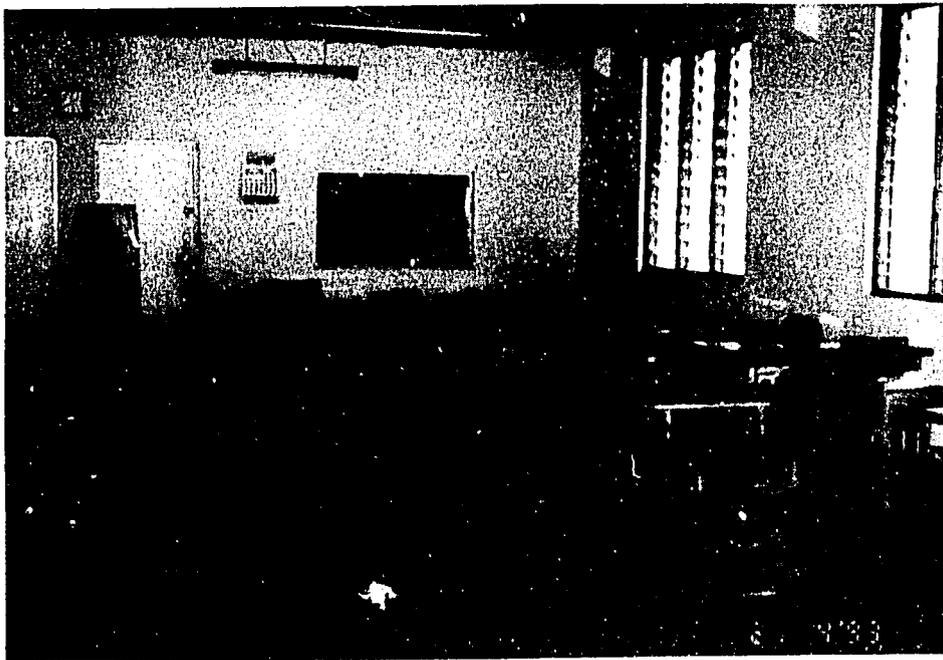
A.I.D.'s 1991 Cable Guidance reminded Missions of these requirements:

Missions should follow guidelines in referenced Handbook [3] and Handbook 1, Part VII, 2.41 for computing the value of in-kind contributions and rate of exchange to be used in calculating the HG contributions.

Contrary to the above, USAID/Sri Lanka did not define the basis for valuing Sri Lankan Government contributions in project agreements. None of the loan/grant agreements for the 13 projects identified and valued the real resources. Although three project agreements included the amount of in-kind contributions to be made and Project Papers discussed Government of Sri Lanka and private sector contributions in certain cases, the specific type and value of the resources to be

contributed over the life of the project were not identified. Instead, only dollar amounts for general budget line items such as technical assistance, operational support, training, construction, grants, and logistical support were included in the project financial plans.

For example, the project agreement for the Mahaweli Downstream Support project identified the types of Sri Lankan Government contributions only as technical assistance, construction and settlement assistance. However, when actual contributions were reported five years later, over 95 percent of the contributions consisted of recurrent type costs for operating three government offices (excluding the Saudi construction costs discussed on pgs. 22 and 23). The costs associated with operating one of these offices, the Siddhapura field office (shown below) amounted to a total of \$1.2 million for a five-year period.



Although not identified up front as contributions necessary for project implementation, operating costs for this field office totalling over \$1.2 million were reported as Sri Lankan Government contributions to one of A.I.D.'s projects.

The Mission did, however, include more details on the types of contributions intended to be made by the Government of Sri Lanka under the Agricultural Planning and Analysis Project. When the implementing agency later reported \$1.8 million in contributions, however, the very non-specific recurrent type expenditures were incomparable to what was

detailed in the Project Paper. The Mission did not investigate the deviation. The intended purpose of identifying and valuing the contributions up front is to assist management in ensuring that the resources needed for the proper implementation of the project are, in fact, contributed.

Mission officials had opposing views on the need to define and value the real resources to be contributed by the host government at project inception. One view was that it was difficult—if not impossible—to specifically determine the required Government of Sri Lanka contributions, at the inception of projects. It was considered more practical to briefly describe the contributions and include the total required amounts in agreements, thereby allowing for flexibility in the types and values of in-kind contributions to be made over the life of the project. Another Mission official was of the view that anticipated contributions should, in fact, be detailed up front in order that actual contributions could later be verified and assured as a necessary contribution to the project. This is necessary in order to more effectively monitor contributions during project implementation and minimize later problems in assigning values to non-cash contributions. While this later view was in line with the intentions of Agency policy, this policy has not yet been complied with.

Because Handbook I, Part VII was issued in 1987, the Mission was responsible for its compliance long before the 1991 Agency guidance which was issued as a *reminder* to adhere to this Handbook section. However, while this guidance required missions to ensure such compliance, USAID/Sri Lanka did not establish specific procedures to do so. The Mission had prepared a draft Mission Order including a general statement to this effect. However, because the draft was not yet finalized or released for use by Mission staff, it was not implemented. Also, the draft procedures need to be more specific by explaining what this Handbook section required since discussions with Mission staff showed a lack of awareness regarding this requirement.

Project Officers need a measurable basis for the Mission to verify resource contributions such as manpower, overhead, real property and other in-kind contributions. To ensure that the Government of Sri Lanka and A.I.D. have a common understanding of the actual resources, the quantity, and value of these resources that are required as contributions, the Mission should, at the inception of projects, set these out in detail and ensure agreement with the Government of Sri Lanka.

Management Comments and Our Evaluation

The Mission has included implementing procedures in the newly issued host country contributions Mission Order, and they indicated that these procedures will be adhered to in defining and valuing the host government real resources at the inception of future projects. While we appreciate Mission's efforts to implement our recommendations, the Mission should ensure that real resources are defined and valued for all ongoing active projects, so as to ensure that the resources needed for the proper implementation of the project are agreed to and contributed by the host government. Accordingly this recommendation will be resolved when the Mission confirms implementation action for the existing active projects. The recommendation can be closed when the Mission provides documentation to support the effective implementation of the proposed actions.

Agency Instructions for Valuing Host Government Contributions Are Unclear

USAID/Sri Lanka applied historical exchange rates, or rates existing at the time of signing the Project Agreements, in accounting for host government contributions. A.I.D. Handbook 1, Part VII suggests that historical exchange rates should be applied; however, because of the ambiguity found in paragraph 2.41 of the guidance, the Mission wanted interpretation of this guidance from a legal standpoint and, therefore, went to A.I.D.'s legal counsel. Based on the advice received, the Mission determined that the Agency guidance intended that historical exchange rates should be used.

When historical exchange rates are used to convert dollars to local currency, however, the Sri Lankan Government would be required to provide less local currency than it would if current or annual exchange rates were used since the value of the local currency depreciates against the dollar. Therefore, as a result of using historical rates, less real resources would be provided as the project progresses.

In an attempt to clarify, reaffirm, and extend A.I.D. exchange rate policy, in 1987, A.I.D. issued new procedures (Department of State cable number 1860822 which were subsequently incorporated into A.I.D. Handbook 1 as Part VII). These procedures attempted to define the Agency's new policy governing the appropriate exchange rate at which A.I.D. accounts for—among other things—host government contributions to projects. Paragraph 2.41 of this policy requires that:

*The value of the real resource contribution provided by a host country for a project or program should generally be obtained by first pricing the host country's real resource contribution in local currency. This figure then is **converted into dollars at the HR (highest exchange rate) current at the time of the project agreement** so that A.I.D. and host country contributions can be expressed in one common monetary unit and so that the real resource contribution by the host country can be expressed in percentage and dollar-equivalent terms.*

*Thus at the signing of an assistance agreement, the host government's real resource contribution is to be expressed **both in terms of absolute dollars and a percentage of the total project** based on the domestic and foreign prices and the exchange rate existing at that date. **This forms the basis for determining host government's absolute real resource contribution and percentage share of the total project throughout its life, and insulates the host government's contribution from the effect of any exchange rate fluctuations which may occur.***

Examination of the above policy shows that it is unclear and, depending on the intent of the guidance, Section 2.41 could be interpreted in one of two ways: First, the *exchange rate* stated in the project agreement should be used throughout the life of the project to value the host government's contributions, thereby benefiting the host government in fixing its rate. Second, the *dollar value* of the real resource contribution should be obtained, regardless of exchange rate fluctuations—thereby benefitting the U.S. government in fixing the dollar amount (in a declining local economy). The last sentence of Paragraph 2.41 is confusing in that it does not state whether the historical exchange rate, or the absolute dollar amounts, should be used in determining actual contributions. Further, the insulation of the host government's contribution, in local currency or dollars, from the effects of fluctuations in exchange rates could be interpreted as insulation as it relates to A.I.D.'s dollars.

Initially, USAID/Sri Lanka applied exchange rates existing at the time the contributions were made to calculate the dollar value of reported contributions. However, because this policy was unclear, the Mission requested an opinion from legal counsel. This request led to a number of varying opinions on the interpretation of Handbook 1, Part VII. After much consideration, the Mission decided to follow the advice of the Regional Legal Advisor and apply historical rates. This advice was based

on the concept that at the time of signing the agreements, neither the host government nor A.I.D. assumes a risk of a devaluation of its own contribution. This basis is consistent with A.I.D. policy, and with the general principles of law governing agreements. The Mission later revised the amount of contributions reported to date (March, 1993) by applying the historical exchange rates existing at the time each project agreement was signed.

Application of the policy—as interpreted in this way—ensures that the host government knows precisely how much it should contribute to A.I.D.-financed activity and prevents the host government from being subjected to the effects of fluctuations in exchange rates. However, A.I.D.'s policy on the application of exchange rates remains unclear and the possibility of a misunderstanding on the amount of contributions required and made by the Government of Sri Lanka is very likely. Because the intent of the Agency guidance is unclear, we have referred this matter to the IG Legal Counsel for consideration. This issue will be brought to the attention of AID/Washington in the final capping report on the worldwide audits of host government contributions.

USAID, COLOMBO, SRI LANKA
STATUS OF HOST COUNTRY CONTRIBUTION
AS AT March 15th 1993

PROJECT NAME #		TOTAL PJT COST US\$	AGREED HCC US\$	HCC% OF PROJECT COST	PER CENT OF LOP COMPLETED	HCC TARGET AS PER LOP COMPLETED	HCC REPORTED			HCC VERIFIED		
							ACTUAL HCC REPORTED US\$	PER CENT OF HCC TARGET	PER CENT OF HCC AGREED	CTR-HCC VERIFIED US\$	PER CENT OF HCC TARGET	PER CENT OF HCC AGREED
DARP	383-058	\$20,997,437	\$6,700,000	31.91%	89%	5,963,000	5,587,481	94%	83%	3,305,185	55%	49%
ISMP	383-080	\$28,300,000	\$9,700,000	34.28%	96%	9,312,000	7,336,109	79%	76%	3,710,722	40%	38%
APAP	383-083	\$9,300,000	\$2,700,000	29.03%	86%	2,322,000	1,973,000	85%	73%	3,044,220	131%	113%
DS&T	383-085	\$10,085,000	\$2,535,000	25.14%	82%	2,078,700	1,670,000	80%	66%	1,946,375	94%	77%
MARD	383-086	\$34,000,000	\$11,000,000	32.35%	64%	7,040,000	6,269,000	89%	57%	@ 0	0%	0%
MED	383-090	\$24,000,000	\$9,000,000	37.50%	57%	5,130,000	2,867,000	56%	32%	1,695,951	33%	19%
PSPS	383-100	\$41,943,000	\$19,943,000	47.55%	52%	10,370,360	21,371,136	206%	107%	26,960,233	260%	135%
MDS	383-103	\$27,159,330	\$20,097,000	74.00%	95%	19,092,150	4,696,780	25%	23%	8,567,416	45%	43%
RAP	383-107	\$48,000,000	\$27,000,000	56.25%	83%	22,410,000	24,590,444	110%	91%	14,897,610	66%	55%
TIPS	383-108	\$18,735,000	\$6,735,000	35.95%	26%	1,751,100	426,000	24%	6%	466,082	27%	7%
NAREP	383-109	\$26,135,000	\$7,135,000	27.30%	32%	1,280,000	515,000	40%	7%	393,893	31%	6%
SUBTTL		\$288,654,767	\$122,545,000	42.45%	71%	\$86,749,310	\$77,301,950	89%	63%	\$64,987,687	75%	53%
AGENT	383-111	\$34,500,000	\$20,500,000	59.42%	* 0	0	0	0%	0%	0	0%	0%
PPI	3873-118	\$9,500,000	\$2,500,000	26.32%	* 0	0	0	0%	0%	0	0%	0%
TOTALS		# \$332,654,767	# \$145,545,000	43.75%	60%	\$86,749,310	\$77,301,950	89%	53%	\$64,987,687	75%	45%

* New Projects that commenced recently

@ Controller verification in progress as of 3/15/93

Total AID LOP contribution \$187,109,767

7
14

SCOPE AND METHODOLOGY

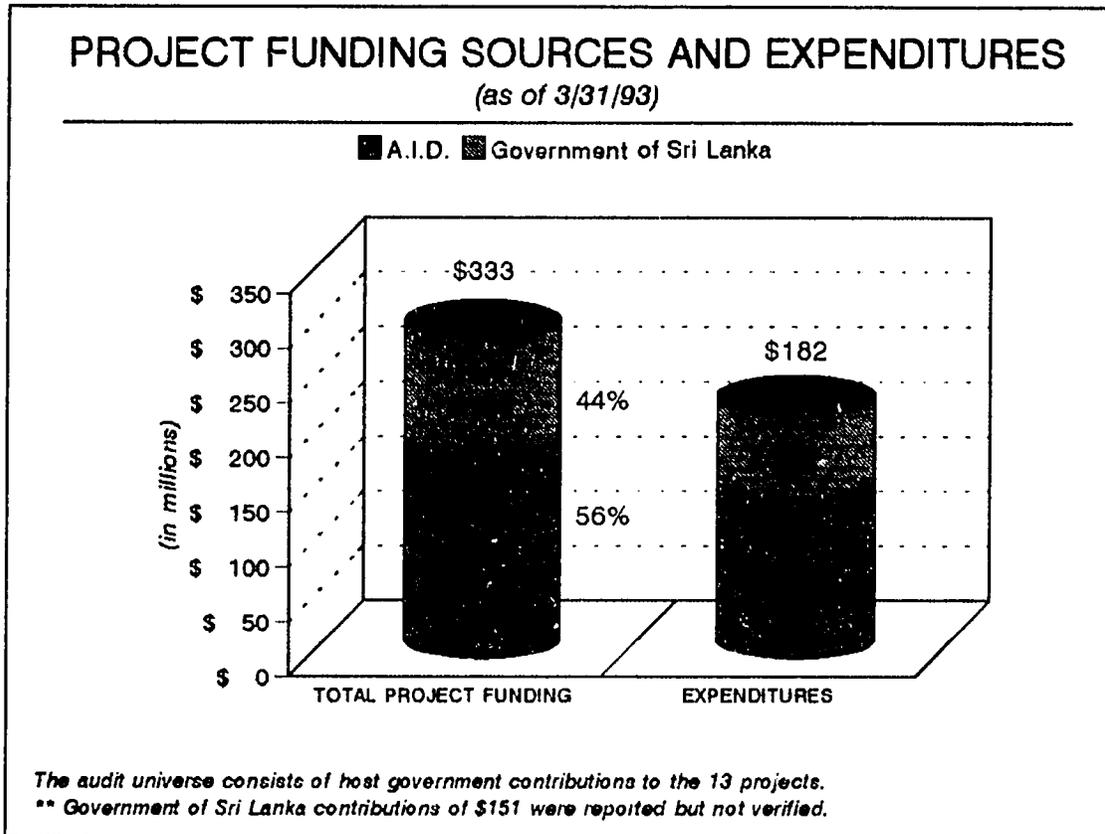
Scope

We audited USAID/Sri Lanka's controls over the Sri Lankan Government's cost sharing contributions in accordance with generally accepted government auditing standards. The audit was conducted from March 1, 1993 through May 4, 1993. Field work was done at the offices of USAID/Sri Lanka, the Government of Sri Lanka ministries and implementing agencies in Colombo, their various field offices and selected project sites relating to five projects. Our audit was confined to testing the Mission's implementation of four control requirements identified in the 1991 A.I.D. procedures on host government contributions (Department of State cable 138349).

USAID/Sri Lanka had 12 active projects as of March 31, 1993 including a project requiring contributions almost entirely from Private Voluntary Organizations, therefore, this project was excluded from the audit universe. We also included 2 recently completed projects (12/31/92). This brings the audit universe to 13 projects, having a total A.I.D. Life of Project funding of \$187 million. As of March 31, 1993, A.I.D. obligations and expenditures for the 13 projects were \$145 million and \$105 million, respectively. We also reviewed two recently completed projects as part of our secondary follow-up work on prior IG audit recommendations.

According to the Mission's March 1993 status report on Host Government Contributions, the Sri Lankan Government budgeted a total of \$146 million for the 13 projects—or 44 percent of the total project costs of \$333 million. This report also included actual reported contributions of \$77 million, of which \$65 million had been verified by the Mission.

In addition to the methodology described in the following section for each audit objective, USAID/Sri Lanka's management provided written representations which we considered essential for answering our audit objectives and for assessing internal controls and compliance.



Methodology

The methodology for each audit objective is described below.

Audit Objective One

The first objective was to determine whether USAID/Sri Lanka followed A.I.D.'s new 1991 procedures to ensure that systems were in place to obtain information on host government contributions and that such information was recorded in the official records/files of the Mission. To accomplish this objective, we evaluated the Mission's controls with respect to the procedures set forth in A.I.D.'s 1991 cable.

We interviewed USAID/Sri Lanka Office Directors, the Controller, the

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Financial Analysts, and selected Project Officers to obtain their views on the Mission's compliance with the new standards set forth in the 1991 guidance and their roles and responsibilities for establishing and implementing the system for obtaining, recording and filing information on host government contributions. We obtained copies of the existing and the newly revised draft Mission Order and any other documentation identifying the system in place. Also, we incorporated the results of objectives two, three and four to determine whether the Mission fully implemented the procedures established through the draft Mission Order.

Audit Objective Two

The second objective was to determine whether USAID/Sri Lanka followed A.I.D.'s new 1991 procedures to include in agreements or Project Implementation Letters, a requirement for the host government to report at least annually on its contribution. To accomplish this objective, we evaluated the Mission's controls with respect to the procedures set forth in A.I.D.'s 1991 cable.

We obtained copies of the Project Agreements and/or selected Project Implementation Letters for all 13 projects, and other correspondence identifying host government contribution reporting requirements. We reviewed these documents to determine the inclusion of at least reporting requirements. We also determined if the Mission enforced the established reporting requirements by obtaining copies of all host government contribution reports on file and then determined if the reports were submitted on time and in the proper format (as required by the reporting requirements). Finally, we discussed our findings with Mission officials.

Audit Objective Three

The third objective was to determine whether USAID/Sri Lanka followed A.I.D.'s new 1991 procedures to (1) review the adequacy of the host government contribution during Project Implementation Reviews and (2) test the reliability of the reports with Mission site visit reviews and evaluations. To accomplish this objective, we evaluated the Mission's controls with respect to the procedures set forth in A.I.D.'s 1991 cable.

We reviewed host government contribution reports for all 11 projects (reports for 2 new projects were not due yet) and then (1) determined if

the reports contained written statements by Project Officers verifying their reasonableness, and (2) checked the amounts reported in the Mission's summary reports on host government contributions. To determine if reported contributions were verified during Mission field trips, we held discussions with Project Officers of seven selected projects and reviewed any documentation provided. We also reviewed and discussed the financial reports for all 11 projects with the financial analysts.

We judgementally selected five projects and visited the respective Ministries and implementing agencies of the Sri Lankan Government to verify (1) the validity of reviews completed by the Controller's Office, and (2) that these agencies have documented, auditable evidence in support of the amounts reported.

Finally, we obtained and reviewed the 1991 and 1992 (fourth quarter) Project Implementation Review reports, and the Controller's Office detailed summary of 13 "Host Government Contribution" reports to determine if the Mission had reviewed the adequacy of the Sri Lankan Government's contributions.

Audit Objective Four

The fourth objective was to determine whether USAID/Sri Lanka adhered to A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41 for computing the value of in-kind contributions and rate of exchange to be used in calculating host government contributions. To accomplish this objective, we evaluated the Mission's controls with respect to the policies and procedures set forth in Handbooks 1 and 3.

We examined all Project Agreements and determined compliance with the applicable Handbook provisions. We also examined the Mission's most recent status report, host government contribution reports, and financial reviews for seven projects to determine whether the host government and the Mission were using the above criteria in accounting for the actual contributions provided by the host government. We also followed up on problems identified in the reports on financial reviews to determine if corrective action had been taken. Finally, we reviewed the Mission's correspondence with legal council on the interpretation of the Handbook provisions related to exchange rate policy.



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APPENDIX II
PAGE 1 OF 10

October 4, 1993

Mr. Richard C. Thabet
Regional Inspector General
RIG/A/Singapore
#17-03 Peninsula Plaza
111, North Bridge Road
Singapore 0617

Response to the Draft Audit Report of USAID/Sri Lanka's Controls of
the Sri Lankan Government's Cost Sharing Contributions

Dear Mr. Thabet:

Mission appreciates the positive comments in your letter transmitting the draft report, as well as the opportunity to respond to the comments in the draft report itself. As your report mentions, since 1987 A.I.D. has established procedures to obtain "assurances from foreign governments that they will generally finance at least 25 percent of A.I.D.-financed activities." This Mission has given host country contributions considerable attention from as far back as 1987, as illustrated in our attachments to this letter. Upon receipt of A.I.D.'s 1991 guidelines, the Mission reviewed the instructions and has endeavored to put an improved system in place for tracking and monitoring compliance with the host country contributions which in turn has provided useful management information. We would like to make a few observations on the Executive Summary and the Appendix, as well as specific comments keyed to the recommendations which address the actions we have taken in the expectation that these subsequent actions will be used to resolve and close the audit recommendations. We are also attaching a copy of our Representation Letter and our newly issued Mission Order.

USAID/Sri Lanka would like the following paragraph to be included as part of the Mission's response at the beginning of the audit report under the Executive Summary:

"USAID/Sri Lanka is proud of our results. As the Mission Response in the back of this audit report makes clear, USAID/Sri Lanka has verified \$106 million (US dollar equivalent) in host country contributions for the 13 projects audited, as of September 15, 1993. This represents 35 percent of the corresponding USAID total project costs, well over the 25 percent requirement of Section 110 and over even the amounts promised by the Government of Sri Lanka. These are impressive numbers and the best evidence of this Mission's strong commitment to better track and verify host country contributions. This is no coincidence. As the record shows, beginning in 1987 and increasing after the 1991 guidance was issued, the Mission has greatly improved the way it tracks, verifies and reports on host country contributions. While the audit report does not elaborate on the system which the Mission has established, illustrative actions taken since 1987 are attached to the Mission response. A Mission Order taking into account the audit's constructive suggestions has now been issued."

The draft report makes numerous references to the Mission Order on host country contributions not being issued in final. The report implied that this demonstrated improper management of host country counterpart requirements. We question whether one Mission Order should be used to support the conclusion that management of counterpart requirements have been less than effective. Even though a formalized Mission Order had not been officially issued, a system was in place to track and monitor host country contributions of projects. This system has been developed in close collaboration with all the project implementation and financial management oversight staff. Since the receipt of the draft report, the project officers were asked to frankly describe their understanding of their HCC reporting requirements and have confirmed in writing their awareness of the system the Mission has in place. We therefore do not agree with the report's assertion that Mission personnel were unaware of Mission procedures.

Attached to this letter are numerous documents which demonstrate that even though a formal Mission Order had not been officially issued, a system was in place to adequately track and monitor the host country contributions of the Mission's projects:

- Attachment 1: Letter, dated March 4, 1987, from the Chief Accountant, Department of Agriculture, to the USAID/Sri Lanka Project Officer, attaching a statement of host country contributions for the period ending December 31, 1986.
- Attachment 2: Letter, dated August 21, 1987, from the Project Officer to the Chief Accountant, Department of Agriculture, requesting the basis of costs allocated under DARP.
- Attachment 3: Memorandum, dated December 1, 1987, from the Chief of Projects to the other Mission Division Chiefs requesting planned host country contributions of projects for 1988.
- Attachment 4: Letter, dated December 15, 1987, from the Project Officer to the Irrigation Management Division, requesting host country contribution details of the ISM project.
- Attachment 5: Memorandum, dated January 6, 1988, from the DARP Project Officer, attaching the statement of host country contributions as of September 30, 1987, submitted by the Chief Accountant of the Department of Agriculture.
- Attachment 6: Mission Order on Monitoring Project Budgets, dated July 1988, which includes Mission procedures to track host country contributions.
- Attachment 7: A discussion paper, dated January 12, 1993, to the Director from the Projects Office which was the basis of discussion at a meeting held to review host country contribution issues. This was a direct result of the April 1991 guidance.

- Attachment 8: Memorandum, dated September 17, 1993, along with attachments, on actions taken by the Mission to comply with the April 1991 cable guidance on host country contribution monitoring.
- Attachment 9: Mission Representation Letter, dated September 15, 1993, with attached clearance page.

Executive Summary:

The Mission seriously questions the broad generalized statements listed on page ii. USAID/Sri Lanka demonstrably did have a system in place to obtain data on host country contributions. Additionally, although the five projects mentioned did not specifically state reporting requirements in the Project Agreements or Project Implementation Letters (PIL) host country contribution reports have been received regularly on four of the projects. The fifth project is new and reporting requirements are currently being established with a letter to the TA contractor to be issued in the near future.

Appendix:

Page 2 of Appendix 1, contains a bar chart related to the Indonesian audit. This will need to be corrected. Further, paragraph 3 of Appendix 1 compares the Government of Sri Lanka budgeted HCC total of \$146 million over the total life of project with the actual reported contributions of \$77 million and the amount verified of \$66 million. However, it must be noted that as of March 31, 1993, the host country contribution target for the 13 projects as per the Life of Project completed was only \$86.7 million.

Our detailed responses to the specific recommendations together with a description of the actions taken to address the recommendations follow:

Recommendation No 1.: We recommend that USAID/Sri Lanka:

1.1 Amend the drafted procedures to include requirements to:

a) include in agreements or Project Implementation Letters, a requirement that the host government report at least annually on its contributions to A.I.D.-financed projects,

b) ensure that the host government counterpart agencies maintain documentation in support of the reported contributions, and

c) designate as the "official" accounting records, only those systems with the present capability for tracking host government contributions.

1.2 Finalize the drafted Mission Order and immediately release the new procedures for use by Mission staff.

Management Comments:

The drafted procedures were revised to include the requirements as stated above in 1.1 a), b) and c). As stated in the audit report, the official accounting system designated for use overseas, MACS, does not enable counterpart contribution tracking or reporting. We consider this to be a serious lack and until MACS has been corrected, the Controller's Office will track and record host country contributions on a Lotus spreadsheet. The drafted procedures were finalized and a Mission Order released for use by Mission staff. A copy of the Mission Order appears in Attachment 10. Based on these actions taken, the Mission requests that Recommendation No. 1.1a, 1.1b, 1.1c, and 1.2 be considered resolved and closed with the issuance of this audit report.

The statement (page 13) that the first GSL report on government contribution was received within the past five months is not accurate. Project Officers had requested information on GSL financial commitment (letter included in Attachment 8) and received reports for 1988 and 1989 (included in Attachment 8). The Mid-Term Evaluation also analyzed the GSL adequacy of the GSL contribution.

The Mission would also like to note in this section that the Mission Order on Monitoring Project Budgets, dated July 1988, contains a requirement to obtain from the Ministry of Finance and Planning, the summarized GSL contributions to each of our projects and that these figures be incorporated into the quarterly PIR's of the Mission. (See Attachment 6.) Paragraph 3 on page 9 of this audit report states that no corrective action was taken with regard to a 1987 audit recommendation to obtain periodic reports from the Government of Sri Lanka on its staffing, financial and logistical support contributions to A.I.D.-financed projects. In addition to issuing this Mission Order, the Mission has been obtaining regularly, the required host country contributions reports as evidenced in Attachments 1, 2, 5 and 8. We thus do not believe it is accurate to contain a statement that the recommendation was being made for the third time (1987, 1991 and 1993) and that no corrective action had been taken to date by USAID/Sri Lanka.

Recommendation No. 2: We recommend that USAID/Sri Lanka establish at least annual reporting requirements either in a project amendment or in the annual budget project implementation letter for the 5 projects lacking reporting requirements.

Management Comments:

As per the Thabet/Brown E-mail message received in September 1993, the Mission understands that this recommendation will be modified to require the establishment of annual reporting requirements in only two of the five projects as the other three projects mentioned in this recommendation have terminated with expired PACDs (Project Assistance Completion Date). So, the two projects requiring the establishment of annual reporting requirements are APAP, with a PACD of December 31, 1993, and our new project - AGENT.

The Mission requests that APAP also be excluded from this recommendation as the PACD is only 3 months hence. A project implementation letter establishing an annual reporting requirement for host country contributions would be meaningless at this stage in the project. In addition to which, the host country contributions for the APAP project have already exceeded the amount agreed upon and the Mission has verified \$2.9 million compared to the \$2.7 million host country contribution requirement for this project. As a matter of Mission procedure the close out reports will also review Host Country Contributions.

The Mission is working with the technical assistance contractor on the AGENT project and details are being worked out to establish private sector contribution reporting requirements. A letter to the technical assistance (TA) contractor will be issued in the near future. Based on the above actions, the Mission requests that this recommendation be resolved with the issuance of this audit report and closed upon the receipt by the auditors of an acceptable letter to the TA contractor for the AGENT project.

The Mission notes on pages 11 and 13 of the draft audit report, a statement that USAID/Sri Lanka did not achieve the intended level of accountability for required contributions of \$66.6 million for the 5 projects, as a result of not establishing formal reporting requirements. Our figures find this statement to be incorrect. For 4 out of 5 projects (excluding AGENT) there have been reported contributions of \$39.5 million of which \$24.9 million have been verified as of March 31, 1993. Further, as of September 15, 1993, for the 4 projects listed above, the total amount verified is \$33.1 million which exceeds the agreed amount of \$30.5 million. The fifth project, which commenced only in May 1992, has an agreed HCC of \$20.5 million. We therefore would appreciate your reconsidering the conclusion reached on pages 11 and 13 of the report that the intended level of accountability for \$66.6 million in counterpart requirements has not been achieved, as, even when it is compared with the March 31, 1993 figures. The verified amounts of host country contributions have not been taken into consideration in your conclusion.

Recommendation No. 3.: We recommend that USAID/Sri Lanka:

- 3.1 Extend procedures to include 1) an analysis of contributions reported to date against the total required contributions, and to 2) document the results of these analyses in Project Implementation Review reports; and**
- 3.2 Include an analysis of cumulative contributions reported to date against the required contributions for each project as part of the Mission's tracking system.**

Management Comments:

The Mission has regularly reviewed the adequacy of planned versus actual contributions during its quarterly Project Implementation Reviews. At the end of each quarter, the Controller's office prepares a comprehensive analysis on Lotus which highlights the required host country contribution amounts and compares with the reported and verified amounts for each of the Mission's projects. An example of this data sheet appears as Exhibit 1 to the draft audit report.

Three project agreements were amended in April 30, 1993 to reduce the GSL contributions due to the USAID funding reductions (namely MDS, ISMP and RAP). Therefore, you may wish to reconsider the statement in page 17 of your report that the Mission did not reduce the counterpart contributions based on a reduction of the Mission's Planned contribution. This was accomplished while the host country contributions audit was in progress.

The Mission does not agree with the comment made in the last paragraph on page 17 in the draft audit report. As of the project assistance completion date the Irrigation System Management Project (ISMP) had reported contributions of \$7.3 million and this amount did not include the GSL in-kind contributions. At the time of the audit the Controller verification of the ISMP host country contributions was in progress to capture the 1991 and 1992 GSL cash and in-kind contributions. On completion of this verification the total amount verified amounted to \$9.5 million. The Mission plans a further de-obligation of this project during this fiscal year. Once this is done the required GSL contributions will be \$9.4 million. The final GSL verified contribution will be \$0.1 million more than the anticipated required contribution. Mission advised the audit team that the verification of the ISM project for 1991 and 1992 was in progress and did not at any time take the position that the shortfall of 4% was not significant.

Paragraph 2 on page 18 of the audit report stated that a shortfall of GSL contributions was neither highlighted in the quarterly PIRs, nor did the Mission take corrective action. The Mission has amended the Project agreements to reduce the GSL contributions as a result of the reduction in the USAID contributions. This information was provided to the audit team at the time of the audit and this is not properly addressed in the report. Accordingly, the verified contributions of the MDS Projects represents 114% of the required \$7.5 million and not 23% of the required \$20.5 million as stated in the report.

The PIR's of the Mission for the first and the second quarters of FY 1993 have compared the reported counterpart contributions and verified the counterpart contributions to the total agreed contributions as required in 3.1 of the audit report. Prior to these PIR's, the Mission did a comparison on reported counterpart contributions against the total agreed counterpart contributions.

As part of the Mission's tracking system the statement in Exhibit 1 of the audit report is done quarterly by the Controller's Office. It is a detailed analysis of cumulative contributions reported to date against the required contributions for each project.

Based on the above Mission requests that recommendation Nos.3.1 and 3.2 be resolved and closed on issuance of the final audit report.

Recommendation No. 4: We recommend that USAID/Sri Lanka design and implement procedures requiring Project Officers to:

- 4.1 Determine the reasonableness of reported contributions and evidence this by signing of each report received,
- 4.2 Reject reports received from the Sri Lankan Government when the reported contributions are found to be unsupported or otherwise unreasonable.

Mission Comments:

USAID/Sri Lanka has incorporated the procedures required by recommendation Nos. 4.1 and 4.2 in the Mission Order No. 440.18, dated September 24, 1993. (See attachment 10). Based on the procedures implemented the Mission requests that recommendation Nos. 4.1 and 4.2 be resolved and closed on the issuance of the audit report.

The last two paragraphs on page 24 refer to a comment made by a disgruntled employee of the Coast Conservation Department. This Department is one of seven agencies which report to the main implementing agency of the project which is Ministry of Environment and Parliamentary Affairs. This Department's contribution towards the implementation of the NAREP project is approximately 15% of the HCC requirements and is therefore insignificant. Thus the above referred comment is an exception and not the case with the other implementing agencies under NAREP. Your highlighting of this statement on page 24 of the report does not accurately reflect the efforts of the Mission and Government counterparts to track HCC.

Recommendation No. 5: We recommend that USAID/Sri Lanka establish and implement procedures to adhere to Handbook 1, Part VII and Handbook 3, Appendix 2G for defining the value of the host government real resource contribution at project inception.

Mission Comments:

Implementing procedures are detailed in the host country contributions Mission Order No. 440.18, dated September 24, 1993, and will be adhered to in the future at the inception of a project. (See Attachment 10.) Based on the above, Mission requests that recommendation No. 5 be resolved and closed with the issuance of the audit report.

In conclusion we find that while the audit reports a number of constructive recommendations, it does not accurately reflect the efforts, systems and results of the Mission in ensuring adequate host country contributions in its project portfolio.

Sincerely,



Terrence Liercke
Acting Director

Attachment/Exhibit: a/s



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APPENDIX II
PAGE 8 OF 10

September 15, 1993

Mr. Richard C. Thabet
Regional Inspector General/Audit
Singapore

**Re: Audit of USAID/Sri Lanka's Controls of the Sri Lankan
Government's Cost Sharing Contributions**

Dear Dick:

You have asked for a Representation Letter in connection with your audit of USAID/Sri Lanka's Controls of the Sri Lankan Government's Cost Sharing Contribution. Your staff has informed us that this audit covered all projects administered by USAID/Sri Lanka having a completion date after 12/31/91 and for the period April 27, 1991 through February 26, 1993, and that the audit was intended to answer the following audit objectives:

- (A) Did USAID/Sri Lanka follow AID's new 1991 procedures to ensure that systems were in place to obtain information on host government contributions and that such information is recorded in the official records/files of the Mission?
- (B) Did USAID/Sri Lanka follow AID's new 1991 procedures to include in agreements or Project Implementation Letters a requirement for the host government to report at least annually on its contribution?
- (C) Did USAID/Sri Lanka follow AID's new 1991 procedures to (1) review the adequacy of the host government contributions during Project Implementation Reviews and (2) test the reliability of the reports with Mission site visit reviews and evaluations?
- (D) Did USAID/Sri Lanka adhere to A.I.D. Handbook 3, Chapter 2, Appendix 2G and Handbook 1, Part VII, 2.41 for computing the value of in-kind contributions and applying the proper rate of exchange to calculate host government contributions?

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For activities under audit during the audit period, USAID/Sri Lanka is responsible for the Mission's controls over Sri Lankan Government cost sharing and matching contributions under audit, for the internal control system, for compliance with applicable U.S. laws, regulations, Project Agreements and Project Implementation Letters; and for the fairness and accuracy of the accounting and management information.

I asked appropriate members of my staff, particularly those in the Controller's office, Projects office, and project officers, to make available to you all records in our possession, relating to projects administered by USAID/Sri Lanka during the audit period for the purpose of the audit.

Based on representations made to me by my staff and their written concurrence with the representations made in this letter, and in reliance on your office which has not informed me of any difficulty in obtaining records or information, or of any difficulty in obtaining the full cooperation of the various offices and staff involved, I confirm, as a layman and not as a lawyer, the following representations with respect to the subject matter of the audit and the audit objectives:

- (1) To the best of my knowledge and belief, USAID/Sri Lanka has made available to your staff all the financial and management information associated with the Mission's controls over Sri Lankan Government cost sharing and matching contributions.
- (2) To the best of my knowledge and belief, there are no instances which we consider material where financial or management information has not been properly and accurately recorded and reported.
- (3) To the best of my knowledge and belief, there have been no irregularities relevant to this audit involving Mission management or employees who have roles in the internal control structure; irregularities involving any other organization that could effect the Mission's controls over Sri Lankan Government cost sharing and matching contributions; nor communications from any other organization concerning noncompliance with or deficiencies in the Mission's controls over Sri Lankan Government cost sharing and matching contributions.
- (4) To the best of my knowledge and belief, USAID/Sri Lanka has reported all known instances which, in the Mission's judgment, evidence material noncompliance with AID policies and procedures for the Mission's controls over Sri Lankan Government cost sharing and matching contributions or violations of applicable U.S. laws and regulations, Project Agreements or Project Implementation Letters.

- (5) After review of your draft audit report and further consultations with my staff, to the best of my knowledge and belief there are no other facts as of the date of this letter (other than those expressed in our Management Comments to the draft report) which we believe would materially alter the conclusions reached in the report.

Yours sincerely,

A handwritten signature in black ink, appearing to read "R. Brown", written in a cursive style.

Richard M. Brown
Director

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