

**Regional Inspector General for Audit  
Singapore**

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**AUDIT OF THE  
CASH TRANSFER PROGRAM  
AND ENERGY SECTOR PROJECT  
IN MONGOLIA**

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**Audit Report No. 5-438-94-009  
March 31, 1994**



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U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

March 31, 1994

MEMORANDUM FOR AA/ANE, Margaret Carpenter

FROM: AIG/A, *James B. Durnil*  
James B. Durnil

SUBJECT: Audit of the Cash Transfer Program and Energy Sector  
Project in Mongolia Report No. 5-438-94-009

*Assistant Inspector  
General for  
Audit*

The Office of the Inspector General has made an audit of the Cash Transfer Program and Energy Sector Project in Mongolia. Attached are five copies of the final report.

This audit report discloses significant problems which occurred in both programs, programs which were designed and implemented on short notice and without sufficient USAID resources made available to oversee the assistance.

The report contains recommendations addressed to the USAID Regional Contracting Office, the Controller of USAID/Thailand, and your office. Recommendation Nos. 1, 2 and 3 are addressed to your office. Your written comments to the draft report and to the recommendations were considered when finalizing the audit report. The comments are summarized after each finding and presented in total as an Appendix. Based on your comments, Recommendation Nos. 1.1 and 1.3 are resolved and Recommendation No. 1.2 is unresolved. Recommendation No. 2 is unresolved. Recommendation No. 3.1 is closed; Recommendation No. 3.3 is resolved; and Recommendations Nos. 3.2, 3.4, and 3.5 are unresolved. The Office of the Inspector General is prepared to work closely with your Bureau to reach meaningful solutions to the recommended actions.

However, during our audit, the most responsible and knowledgeable USAID officials for the activities audited declined to provide us written confirmations that we considered essential for rendering conclusions on all aspects of the activities audited. Therefore, we were unable to fully answer the audit objectives and make positive conclusions on our audit results.

I appreciate the cooperation and courtesies your office extended to my staff during the audit. Please provide me a response within 30 days indicating the actions planned or taken to fully implement the three recommendations addressed to your office.

Attachments: a/s



U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

March 31, 1994

MEMORANDUM

TO: Regional Contracting Officer, Thomas M. Stephens  
USAID/Thailand

Assistant Inspector  
General for  
Audit

FROM: AIG/A, James B. Durnil

SUBJECT: Audit of the Cash Transfer Program and Energy Sector  
Project in Mongolia Report No. 5-438-94-009

Attached are three copies of our final audit report on the Cash Transfer Program and Energy Sector Project in Mongolia.

The report contains one recommendation for your action. In responding to our draft report, the Asia/Near East Bureau relayed your comments about the applicable finding and recommendation. Based on those comments, we have clarified the finding. Recommendation No. 4, which is addressed to you, is unresolved. All other recommendations are addressed to either the Bureau or the Controller, USAID/Thailand.

Please provide us information within 30 days indicating any actions planned or taken to implement the open recommendation. I appreciate the cooperation and courtesies extended to my staff.

Attachments: a/s



U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

March 31, 1994

MEMORANDUM

TO: Controller, James C. Stanford  
USAID/Thailand

Assistant Inspector General for Audit FROM: AIG/A, James B. Durnil

SUBJECT: Audit of the Cash Transfer Program and Energy Sector Project in Mongolia Report No. 5-438-94-009

Attached are three copies of our final audit report on the Cash Transfer Program and Energy Sector Project in Mongolia.

The report contains one recommendation for your action. In responding to our draft report, the Asia/Near East Bureau summarized your comments about the applicable finding and recommendation. Based on those comments, we have clarified the finding. Recommendation No. 5, which is addressed to you, is unresolved. All other recommendations are addressed to either the Bureau or the Regional Contracting Officer, USAID/Thailand.

Please provide us information within 30 days indicating any actions planned or taken to implement the open recommendation. I appreciate the cooperation and courtesies extended to my staff.

Attachments: a/s

## EXECUTIVE SUMMARY

In 1990, Mongolia became a democratic state. To support this new democracy, the United States Government decided to initiate an emergency and economic aid program in 1991. Most of this aid has been in the form of a \$10 million Cash Transfer Program and a \$35 million Energy Sector Project. These programs were to provide Mongolia with balance of payments support and to keep the country's power plants running during its harsh winters. As of June 1993, \$10 million and \$11 million had been expended on these programs respectively.

The Office of the Regional Inspector General for Audit/Singapore made an audit to determine: (1) how the \$10 million in the Cash Transfer Program was used, and what the program accomplished; (2) whether USAID established sufficient managerial controls over the deposit, use, and accounting for the Cash Transfer Program funds; (3) what the Energy Sector Project accomplished and how USAID funds were used; and (4) whether USAID established sufficient managerial controls over technical services and commodities for the Energy Sector Project.

We were unable to fully answer the audit objectives because the responsible USAID officials were unable to agree on and did not provide written representations which we considered essential to answering the audit objectives. These representations included statements about whether all essential information was provided to us, whether the information was accurate and complete, and whether all known instances of non-compliance had been reported. In the absence of such representations, this report is qualified to the extent that we can only provide conclusions on problem areas which we were able to identify from the available information.

According to USAID records, the \$10 million in the Cash Transfer Program was disbursed into a bank account established by the Mongolian Government. These records showed that USAID's dollar funds were used primarily to finance equipment and spare parts for coal mines and power plants, petroleum lubricants, medical supplies, batteries and tires. USAID, however, could not measure what this program accomplished. Due to pressure from the Department of State to begin delivering the assistance within a few months, USAID rushed the program's design and did not

carefully define the problems/needs that should be addressed or the expected outcomes of USAID's assistance.

Time constraints for delivering the assistance also impaired USAID's ability to establish close managerial controls over the deposit, use, and accounting for the Cash Transfer Program funds. USAID administered the program without having sufficient staff and oversight responsibilities assigned to the field. USAID sent one officer to Mongolia, but he was not directly responsible for the program. The officer was also hindered by the lack of prior USAID exposure to Mongolia and the country's administrative systems. USAID did contract for two financial reviews which identified many problems. However, USAID did not follow-up on many of the recommended solutions to these problems because of staff turnover and confusion over responsibility. The following are some of the problems identified in the program.

- Much of the commodities either arrived too late or did not arrive at all to help alleviate the 1991-92 emergency.
- USAID neglected to incorporate a relevant U.S. legislative provision prohibiting procurement from certain countries into the Cash Transfer Agreement. Thus, two payments totalling \$282,800 were made to prohibited sources.
- The local currency equivalent of \$10 million was generated and disbursed without the knowledge or required approval of USAID. USAID has not confirmed whether these funds were used as intended.

USAID also could not measure what the Energy Sector Project accomplished. According to USAID records, Mongolia faced an impending crisis due to a growing lack of spare parts and inadequate maintenance for its power plants by 1992. Again, USAID rushed into this project due to pressures to begin the assistance. USAID authorized the project without carefully developing a project design. Among the guidance missing were good implementation and procurement plans and a clear definition of the project's objectives. Expecting to identify and address problems with power plants initially, USAID was thus unprepared when it found out that urgent assistance was needed for coal mining to supply fuel for the power plants. USAID did change the thrust of the project. According to the available records, most of the \$11 million was used to purchase equipment and technical assistance for coal mining in addition to assistance for power

plants. Reportedly, this assistance did help to keep the power plants operating and ease the severity of the 1992-93 winter for 600,000 people.



*This power plant—seen operating in the distance—is one of the plants which heat Ulaanbaatar, the Mongolian capital with about 600,000 people.*

As with the Cash Transfer Program, USAID management was too geographically stretched to establish close controls over the Energy Sector Project. The USAID Project Officer and a part-time engineer were located in Washington D.C., and USAID's contracting and disbursing offices in Thailand. Meanwhile, contractors were located in Massachusetts, New Jersey, Pennsylvania and Mongolia while project activities were in Mongolia. The USAID Project Officer, who has primary responsibility for monitoring a project, did not travel to Mongolia to observe the project operations. Again, the sole USAID officer in Mongolia was not delegated direct oversight or decision-making responsibility for the program. As a result, the program encountered severe implementation problems.

- More than \$2.5 million worth of equipment, purchased because of the perceived emergency, was either unused, used in non-emergency situations or not received in time to be installed for the winter emergency. To speed the delivery of equipment, USAID/Washington issued a waiver for all source

and origin restrictions. In the end, some of the equipment could have been obtained from American sources.

- A Russian cargo plane was chartered at a cost of \$466,000 to carry \$679,000 worth of equipment. Only \$280,000 worth of this equipment was urgently needed. Less costly shipping arrangements were available.
- The prime contractor engaged a freight forwarder through a purchase order, totalling \$1 million, which was inconsistent with the prime contract and the Federal Acquisition Regulation. This freight forwarder was closely linked to several companies that provided services to the project. USAID paid about \$98,000 of the questionable costs of the freight forwarder.
- The Mongolian Government established poor inventory controls over the receipt, distribution and accounting for USAID-funded commodities.

During the audit, USAID strengthened its technical expertise, employing a local engineer and sending an American engineer to Mongolia. A stop order was also issued to the freight forwarder.

This report contains five recommendations. In commenting on a draft of this report, USAID officials generally agreed with the findings and recommendations. However, the officials provided additional information to clarify certain facts and to provide better perspective for the findings. We have considered this information in finalizing the report. The full text of Agency comments to our findings and recommendations are presented as an Appendix to this report.

*Office of the Inspector General*

Office of the Inspector General  
March 31, 1994

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# INTRODUCTION

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## **Background**

In 1990, Mongolia held its first democratic elections and became a democratic state. The Mongolian People's Revolutionary Party gained a strong majority with a platform to reform the centrally-planned economy to a free market along traditional Mongolian lines. Prior to 1990, Mongolia's economy was tied almost exclusively to Soviet bloc countries. Mongolia's movement to democracy, however, contributed to the collapse of Mongolian/Soviet trade and aid.

The United States and several other donor countries responded to the cessation of Soviet aid with economic and emergency aid to Mongolia. The United States Government wanted to signal strong support for Mongolia's democratic efforts with immediate emergency and economic aid. According to available records, USAID has provided Mongolia with a Support for Economic Transition Project of \$5.2 million, a Public Law 480 Title II food program of \$8 million, a Cash Transfer Program of \$10 million, and an Energy Sector Project totalling \$35 million since fiscal year 1991. The last two were the subject of this audit.

The Cash Transfer Program Agreement was signed in August 1991 and involved a \$10 million transfer into a designated U.S. dollar special account opened by the Mongolian Government. These dollar funds were to provide emergency balance of payments support to Mongolia for its transition to a market-based economy. In addition, the U.S. dollars were also to be used for the purchase of essential goods required to sustain the Mongolian economy.

By 1992, Mongolia reportedly faced growing problems with its power plants which were threatening the country's ability to stay warm during winter. USAID responded immediately in July 1992 by authorizing an emergency program to assist the Mongolians during their severe winters with average temperatures of minus 20 degrees Fahrenheit and below. This \$35 million Energy Sector Project was to provide the essential energy systems with assistance to enable them to operate for the next three years or until rehabilitation measures undertaken by other donors became effective. The project was expected to end by September 30, 1997.

USAID's Project Officer responsibilities for the Cash Transfer Program and Energy Sector Project were assigned to the Asia/Near East Bureau. USAID's contracting and financial management responsibilities for these programs were assigned to USAID/Thailand. A USAID representative, who was sent to Mongolia to serve as a liaison, established the Office of the USAID Representative to Mongolia.

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## **Audit Objectives**

The Office of the Regional Inspector General for Audit/Singapore audited the Cash Transfer Program and the Energy Sector Project. The audit was made to answer the following objectives:

- **What was the \$10 million in the Cash Transfer Program used for, and what did the program accomplish?**
  - **Did USAID establish sufficient managerial controls to ensure that the Mongolian Government deposited, used and accounted for the Cash Transfer Program dollar funds and the generated local currency, consistent with applicable U.S. Laws and USAID policy?**
  - **What were USAID funds used for in the Energy Sector Project, and what did the project accomplish?**
  - **In planning and monitoring the Energy Sector Project, did USAID establish sufficient managerial controls to ensure that technical services and commodities were necessary, were procured at a fair price and from qualified contractors, and were received and accounted for consistent with applicable U.S. Laws and regulations?**
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## REPORT OF AUDIT FINDINGS

We are unable to fully answer our audit objectives because USAID's management declined to provide us all the information essential for us to render professional conclusions on all aspects of the activities audited.

For example<sup>1</sup>, the responsible USAID officials would not provide written confirmation that to the best of their knowledge and belief:

- They had made available to the auditors all information associated with the Cash Transfer Program and the Energy Sector Project;
- There were no material instances related to the audit objectives where information had not been properly and accurately recorded and reported; and
- There have been no irregularities involving management and employees who have roles in the internal control structure related to the audit objectives.

Without such written confirmations from the USAID officials who are the most knowledgeable and responsible about the activities audited, we do not have reasonable assurance to provide conclusions on the positive aspects of the activities audited and USAID's performance.

While we cannot attest to the positive aspects of the activities audited and USAID's performance, this lack of management confirmation has not precluded us from reporting on the problem areas which came to our attention. Based on the information which USAID management provided and the tests which we were able to make, the following came to our attention.

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<sup>1</sup> A complete description of the essential information that USAID management would not confirm in writing is provided in the Scope section of this report.

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## **What Was the \$10 Million in the Cash Transfer Program Used For and What Did the Program Accomplish?**

As discussed above and in the Scope section of this report, we cannot fully answer this audit objective. However, the records which were made available showed that USAID transferred \$10 million into a U.S. bank account opened by the Mongolian Government to support the country's transition to a market-based economy. This dollar transfer provided hard currency for Mongolia to finance imports to help sustain the economy. The Mongolian Government then extended the dollars to 11 importers, either in the form of U.S. dollar letters of credit or bank transfers. In January 1992, an accounting firm reviewed the \$1.6 million disbursed from the special dollar account and determined that disbursements of \$1.4 million were proper. This firm also determined that an additional \$8.5 million of procurement in process was for eligible commodity imports. A summary of the commodities financed by the Cash Transfer Program, according to available records, is as follows:

<u>COMMODITIES FINANCED</u>	<u>COST</u> (in millions)
Power plant equipment, spare parts and supplies	\$2.6
Coal mine equipment, spare parts and supplies	2.9
Medicines and medical supplies	0.6
Lubricants	1.0
Miscellaneous (batteries, tires, textiles, food, etc.)	<u>2.8</u>
Total*	\$9.9

\*\$28,000 remained unobligated by the Mongolian Government.

USAID, however, could not measure the program's accomplishments. Under reported pressure from the Department of State to begin delivering the assistance within a few months, USAID rushed the program's design and did not carefully define the problems or needs to be addressed. The program's objectives were too broad and did not provide a clear vision of the program's expected outcomes. Data showing the conditions at the outset of the program were missing, and performance indicators were not established to enable USAID to measure the program's achievements. Thus, USAID could not assess the amount of progress made by the program in addressing Mongolia's balance of payments problems. We are not making any recommendation to address the flaws in the design of the Cash Transfer Program because the program is nearly complete.

## Management Comments and Our Evaluation

Officials of the Asia/Near East Bureau generally concurred with the finding, but claimed that the Cash Transfer Program was a success. According to Bureau Officials:

After ending its satellite relationship with the Soviet Union, Mongolia required emergency assistance. Massive Soviet aid of \$900 million a year to Mongolia abruptly ended. Soviet technicians who designed and operated large parts of the energy system were withdrawn.

The urban sector depended on Soviet inputs to maintain electric power and heating services.

The Secretary of State asked us to assist Mongolia's immediate needs to avert collapse of the economy of a nation in transition from communism.

The urgency of needs did not allow time for ordinary USAID design processes. Mongolian economic institutions were inexperienced in normal international trade and donor practices. The energy sector operated with poor Soviet technology and with ineffective management practices typical of a communist system.

When the **Cash Transfer Program** was approved in 1991, economic activity in Mongolia was in a nose dive. Mongolia could not get sufficient imported parts and material to keep power plants operating, and the effectiveness of the energy system was in rapid decline. The Cash Transfer Program funded enough urgent imports to avoid total collapse for a year.

This was a total success against the Cash Transfer's limited short term objectives.

Without well-defined program objectives and quantitative performance indicators, USAID's assessment of the program's success is very subjective. As noted in the next section of this report, (1) much of the USAID-funded imports needed for the 1991-92 emergency arrived too late, and (2) USAID did not know to what extent the \$10 million local currency component had achieved the objective of helping to implement structural economic changes as negotiated with the International Monetary Fund.

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**Did USAID Establish Sufficient Managerial Controls to Ensure That the Mongolian Government Deposited, Used, and Accounted For the Cash Transfer Program Dollar Funds and the Generated Local Currency Consistent With Applicable U.S. Laws and USAID Policy?**

As discussed on page 3 and in the Scope section of this report, we cannot fully answer this audit objective. Nevertheless, based on the information which was made available to us, USAID did not establish sufficient managerial controls over the Cash Transfer Program. USAID could not ensure that the Mongolian Government deposited, used, and accounted for the U.S. dollar funds and the local currency generations in conformance with applicable U.S. Laws and USAID policy.

USAID contracted an accounting firm to review the Mongolian Government's financial capability at the outset of the program and, subsequently, to review the use of USAID funds. These reviews identified and recommended ways to address implementation constraints and problems.

As discussed below, however, USAID did not assign sufficient resources to control the Cash Transfer Program.

**USAID Did Not Assign Sufficient Resources to Control the Cash Transfer Program**

USAID did not establish sufficient managerial controls over USAID funds because of time constraints placed on delivering the assistance. The sole USAID officer assigned to Mongolia was not delegated direct responsibility for this new program. He was also impaired by the lack of prior USAID exposure to Mongolia and its administrative systems. USAID did contract for two financial reviews which identified many problems. However, USAID did not follow up on many of the reviews' recommendations because of staff turnover and confusion over who was responsible. Due to insufficient USAID resources assigned to Mongolia, USAID was unable to prevent, identify or resolve the many significant problems which arose.

**Recommendation No. 1: We recommend that the Assistant Administrator of the Asia/Near East Bureau:**

- 1.1 Assist the Mongolian Government to either obtain the commodities already paid for by the two importers or obtain a refund of the \$205,140 transferred to Russian banks;**
- 1.2 Obtain an accounting for the \$10 million worth of local currency funds generated under the Cash Transfer Program and verify whether these funds were used for the mutually agreed-upon purposes; and**
- 1.3 Establish a completion date for the Cash Transfer Program.**

The General Accounting Office issued standards for executive agencies to follow in establishing systems of internal control as required by the Federal Managers' Financial Integrity Act of 1982 (31 U.S. Code 3512(b)).

Contrary to those standards, USAID did not establish sufficient controls over the use of USAID funds for the Cash Transfer Program. Although USAID was unfamiliar with Mongolia's administrative and procurement systems, neither the Cash Transfer Agreement nor Implementation Letters provided for a close oversight role by USAID in the procurement and disbursement processes. Moreover, the USAID-assigned officer to Mongolia was not delegated direct responsibility for the program. Direct responsibility was retained at the Asia/Near East Bureau in Washington D.C., thousands of miles from Mongolia.

By retaining the program's oversight responsibilities in Washington, D.C. and not assigning sufficient resources to Mongolia, many problems ensued. They were not prevented, not identified for corrective action, or were identified but not resolved. As discussed below, these problems include: (1) much of the commodities were not received in time to help alleviate the 1991-1992 emergency; (2) \$282,800 worth of commodities and services obtained from ineligible sources; and (3) about \$10 million in local currency generated from the program which was not disbursed in accordance with the Cash Transfer Agreement.

**Commodities Were Not Received**

Due to the lack of good reporting, the Asia/Near East Bureau and the Office of the USAID Representative did not know that Mongolian importers had

significant problems acquiring commodities. These problems include the following:

- Much of the commodities needed for the 1991-92 emergency arrived too late. For example, one importing company experienced a one-year delay between placing an order and obtaining delivery on \$934,000 worth of petroleum lubricants from a Russian vendor. This company eventually obtained a refund and obtained the lubricants from another source.
- A second importing company paid for \$150,040 worth of commodities in 1991 but had not received the commodities as of May 1993. The company requested refunds without success. Company officials said that the Russian bank had frozen the funds and would not release them without the approval of a bank committee. It is not clear why the funds remain frozen. This company pointed out that the lack of a refund was adversely affecting its operations, a condition contrary to that desired under the Cash Transfer Program.
- A third company encountered difficulties obtaining commodities costing \$356,000. This company advanced \$34,400 for one order of transformers in November 1991 and another \$20,700 for a transformer in November 1992. Both orders remained undelivered as of May 1993.

Such lengthy time periods hindered the Mongolian importers' effective use of USAID's funds. USAID could have identified and helped resolve this problem by establishing a good reporting system on the use of its funds.

Although the Cash Transfer Agreement required the Mongolian Government to make reports quarterly on the use of USAID's funds, USAID did not hold the Mongolian Government accountable for complying with these requirements. The Mongolian Government submitted only one report, in December 1991. However, it did not conform to the format recommended by an earlier USAID-funded financial assessment team. Both the USAID Project Officer in Washington D.C. and the USAID Representative to Mongolia did not require the Mongolian Government to submit such supporting documentation as bank statements, or to resubmit the report in a more informative format.

USAID contracted for a 1991 review of the Mongolian Government's capabilities and a 1992 review of cash transfer transactions. Little was done with the recommendations produced from these two reviews,

including the recommendations on reporting. Therefore, USAID was unaware of the problems faced by the importers which remained unresolved in May 1993.

**Commodities Were Obtained  
From Ineligible Sources**

USAID did not prohibit the Mongolian Government from using USAID funds for the procurement of commodities and services from China and Eastern Europe countries<sup>2</sup>.

In accordance with Federal legislation, USAID policy requires that project and program agreements incorporate language which prohibits procurement from certain countries that have been designated as ineligible by U.S. Law. The design of the Cash Transfer Program recognized this legislation and prohibited procurement those countries.

USAID, however, did not apply this prohibition in either the Cash Transfer Agreement or Project Implementation Letters. Without this prohibition, the legal basis for recovering USAID funds when ineligible procurement was made was also diminished. In the absence of such a formal prohibition, Mongolians—who lacked experience with U.S. laws and regulations—undertook procurement from China and other ineligible countries such as the former Yugoslavia, as the following illustrates:

- Mongolian officials paid a Yugoslavian firm \$200,000 of USAID funds to design and construct a luxury hotel. As additional funding is unavailable, the construction of this hotel has been suspended.
- Mongolian officials used \$82,000 of USAID funds to procure 360 tons of millet from China.

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<sup>2</sup> USAID did not establish a program completion date either.



*An ineligible payment of \$200,000 was made to a Yugoslavian company to design this unfinished luxury hotel in Ulaanbaatar.*

USAID was unaware of these ineligible procurements (the \$200,000 paid to the Yugoslavian firm for the hotel and the \$82,000 for the millet from China) until they were disclosed by the USAID-funded financial review in January 1992. The USAID Representative promptly notified the Mongolian Government that these procurements were ineligible and that USAID would have to request a redeposit if the Government did not drop these transactions from financing under the grant. If the Mongolian Government had reviewed the legality of this demand, recovery could have become problematic because of the flawed Cash Transfer Agreement. Fortunately, the Mongolian Government cooperated and redeposited the \$282,000.

### **Local Currency Was Not Disbursed In Accordance With the Cash Transfer Agreement**

USAID also did not establish good managerial controls over the local currency generated under the Cash Transfer Program. Although the program's design stipulated that the generation of local currency was, in fact, not the intention of the program, the Mongolian Government generated local currency totaling 400 million tugriks (approximately \$10 million). USAID did not hold the Mongolian Government accountable for complying with the Cash Transfer Agreement's provisions that the local currency conversion rate be mutually determined by both parties and established through a Project Implementation Letter<sup>3</sup>. Instead, the Mongolian Government determined this rate. Moreover, the Mongolian Government was not held accountable for obtaining USAID's concurrence on the use of these funds and on reporting the actual uses, as required by the Cash Transfer Agreement.

USAID only found out that the Mongolian Government had withdrawn the 400 million tugriks in the local currency account, in violation of the Cash Transfer Agreement, through the USAID-funded financial review in January 1992. This review recommended that these funds be recovered. After being notified of this breach, the Government informed USAID that it had deposited the amount withdrawn into a new local currency account. In April 1992, it obtained USAID's concurrence for the following uses of these funds:

- To increase the minimum level of pensions for the aged and the indigent (tugriks 45.5 million);
- To develop small- and medium-sized enterprises (tugriks 158.4 million); and
- To procure equipment and spare parts for the energy and coal mining sectors (tugriks 196.2 million).

Neither USAID/Washington nor the Office of the USAID Representative to Mongolia verified that the local currency was used for the above purposes. Since program inception, the Mongolian Government has not complied with the Cash Transfer Agreement's requirements for reports on the use of the

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<sup>3</sup> There are many inconsistencies in the documentation relating to the Cash Transfer Program. In this instance, the program design indicates that there will not be a local currency component while the Congressional Notification and the Cash Transfer Agreements are written with a local currency component in mind.

funds. When we attempted to verify the disbursements from the local currency account for the above purposes, Mongolian officials could not readily provide specific information about the disbursements. Thus, the Mongolian Government has not provided USAID with evidence to show that the 400 million tugriks were used as agreed.

Because of the risks involved with a new program and the need to account for the cash transfer funds, the program's design stipulated that periodic financial reviews of the program were necessary. Nevertheless, only two reviews were made. As discussed below, USAID failed to implement many of their recommendations.

Most of the recommendations, made in an August 1991 financial assessment of Mongolian Government's capabilities to implement the Cash Transfer Program, were not implemented. For example;

- A report format for quarterly reports was not provided to the Mongolian Government for dissemination to State Bank and Ministry of Finance offices;
- No action was taken regarding the absence of a written organization chart and procedure manuals for the State Bank and two importing companies; and
- No action was taken on identifying the potential local currency generation by the sale of pharmaceutical products.

Likewise, many of the recommendations from the subsequent January 1992 financial review were not implemented. In May 1992, USAID officials reported that, since the heads of both the Central and State Banks had been replaced, little could be done until their replacements were announced. Twelve months later, action had still not been taken. USAID had appointed new officers as Project Officer in Washington, D.C. and as the USAID Representative in Mongolia who were confused as to who was responsible. Moreover, the financial review had been contracted out of USAID/Philippines. However, USAID's accounting station for Mongolia was reassigned to USAID/Thailand. Neither the USAID Representative to Mongolia nor USAID/Thailand had a copy of the 1992 financial review. When the lack of follow-up on the report's recommendations was brought to the attention of USAID officials in 1993, these officials expressed confusion as to who was responsible for the follow-up. The USAID Controller in Thailand decided to assume responsibility.

\* \* \* \* \*

When advised of problems like missing commodities, procurement from ineligible sources and problems with the local currency component, Asia/Near East Bureau officials and the USAID Representative to Mongolia responded positively and indicated they would correct the problems. Asia/Near East Bureau officials, however, also indicated that the problems which arose with this program were acceptable for a number of reasons. The Assistant Administrator of the Asia/Near East Bureau said:

- We certainly agree that these activities were designed on short notice. The alternative would have been to ignore the requests of the Secretary of State to help a country newly emerging from 69 years of control by the Soviet Union and to refuse to provide essential emergency assistance during a crisis.
- The need for rapid responses led to the 1991 Cash Transfer and the 1992-95 Energy Sector Project. Both were emergency activities under which we accepted greater risks than normal to prevent collapse of the economy and vital services....
- While we all agree that USAID has less staff and less operating expense funding than we would like for the difficult assistance tasks we face in Mongolia, we attempted to overcome these shortages by reducing the management burden of our projects and by identifying qualified contractors for in-depth financial and management oversight....

With respect to the interim audit results on the Cash Transfer, I note that there may not be any actionable conclusion other than that specific uses of cash transfer resources are difficult to track. This was well known when the activity was authorized. The fact that the overall Mongolian economy survived very difficult financial times is probably the only result we can claim, but it was the result we sought in the authorization.

USAID did face significant constraints in designing and administering this new assistance program on short notice and with limited resources. While USAID accepted greater risks than normal, these risks were not spelled out in the program authorization, the program design, or the Advice of Program Change which USAID provided to the U.S. Congress. In fact, USAID advised the Congress that:

The program will provide emergency balance of payments support for the Government of Mongolia's transition to a market-based economy....The Government of Mongolia will establish a separate account for deposit of the dollars **in accordance with legislative requirements and USAID guidance**.... Local currency will be used to support the Mongolian Government's efforts to implement structural economic changes **as recommended by and negotiated with the International Monetary Fund (IMF)**. The administrative arrangements, including a separate account for the local currency deposits, will be done **in accordance with legislative requirements and USAID guidance** (emphasis added).

USAID did not advise the Congress that (1) it had decided to bypass USAID's normal program design and implementation controls, (2) it had decided to accept higher risks than normal, or (3) what the risks were and what the likely outcomes would be of these decisions. Rather, the Advice inferred that normal accountability requirements would prevail.

While USAID's assistance reportedly helped the Mongolian economy, problems administering the program limited its impact. As mentioned previously, much of the dollar-financed goods did not arrive in Mongolia in time to help the economy during the 1991-92 crisis. Also, the payments to Russian vendors for undelivered products helped the Russian economy at the expense of the Mongolian economy. As for the \$10 million local currency component, USAID does not know the impact of these funds on helping to implement the structural economic changes advocated by the International Monetary Fund.

In conclusion, the Asia/Near East Bureau needs to work with the Mongolian Government in assisting the two importers to obtain the commodities already paid for or obtain a refund for the \$205,140 transferred to the Russian bank. The Bureau should also obtain an accounting for the \$10 million worth of local currency and verify that this money was used for the agreed purposes. Finally, the Bureau should establish a completion date for the Cash Transfer Program.

### **Management Comments and Our Evaluation**

Officials of the Asia/Near East Bureau generally concurred with the finding and recommendation. Recommendation No. 1.1 is resolved. The USAID Representative to Mongolia is assisting the Mongolian Government to obtain the commodities. To date, \$55,170 of the \$205,140 worth of commodities identified in the report have been received. For the remaining amount, the

USAID Representative to Mongolia has agreed to a Mongolian proposal to offset this amount against an existing Mongolian debt to the Russian Bank. The USAID Representative plans to assist the Mongolian Government in negotiating this proposal with officials of the Russian Bank. Based on these actions, the Bureau requested that the recommendation be closed. While we concur with the plan of action, corrective action has not yet been fully implemented. Therefore, this part of the recommendation will be closed when the Asia/Near East Bureau provides documentary evidence that (1) the \$55,170 worth of commodities were received, and (2) the \$150,040 have been offset against the Mongolian Government's existing debt to the Moscow bank.

Recommendation No. 1.2 is unresolved. The Asia/Near East Bureau obtained a report which accounted for the \$10 million worth of local currency funds generated. The Bureau mistakenly believed that we had verified the transactions during our audit and, therefore, did not provide a plan to verify this report as called for by the recommendation. The recommendation will be closed when the Bureau verifies that these funds were used for agreed-upon purposes.

Recommendation No. 1.3 is resolved. The Asia/Near East Bureau plans to establish a completion date of April 30, 1994, for the Cash Transfer Program. This part of the recommendation will be closed when the Bureau provides evidence that a completion date has been established.

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## **What Were USAID Funds Used For in the Energy Sector Project, and What Did the Project Accomplish?**

As discussed on page 3 and in the Scope section of this report, we cannot fully answer this audit objective. However, available records showed that USAID funds were used to purchase equipment, spare parts and technical assistance for Mongolia's coal mines and power plants. For example, USAID expended \$1.1 million on the cost of equipment, spare parts and a Russian air charter to airlift these commodities into Ulaanbaatar in December 1992. According to officials, this first USAID airlift into Mongolia achieved an unexpected high-profile public relations success for the Agency. Reportedly, many dignitaries and local press were waiting at the airport when the airplane landed. They voiced their gratification when they witnessed the delivery of items such as electrical equipment for one of Ulaanbaatar's key power plants, air tubes for coal mines, and wire ropes for excavators as the following photograph shows.



*According to available information, USAID delivered wire ropes and spare parts to keep coal excavators such as this operating during the 1992-1993 energy crisis.*

According to available information, USAID-funded technical assistance also contributed to the continued operations of a key power plant, and provided

training in the efficient use of coal mine explosives. Experts said that this training should increase the effectiveness of the explosives by 25 to 50 percent and reduce their cost by one-third.

Although USAID's assistance reportedly helped to keep the power running and ease the severity of the 1992-93 winter for 600,000 urban Mongolians, USAID did not design any measurable performance objectives to assess project accomplishments. Compounding USAID's inability to assess the effectiveness of its assistance were reports that Mongolia's power plants and coal mines required both emergency and long-term assistance, much more than that provided through USAID's Energy Sector Project. The Mongolian Government was also unable to properly define and prioritize its needs for USAID financing. As a result, more than \$2 million in USAID funds intended for the Mongolian winter emergency of 1992-93 was expended on equipment and spare parts not used in the emergency.

Project implementation faced serious problems because USAID developed neither a clear definition of the expected outcomes of USAID's assistance nor good implementation and procurement plans. As discussed below, USAID should redesign the project.

### **USAID Should Redesign the Project**

The Asia/Near East Bureau initiated the Energy Sector Project without following most of USAID's managerial controls for designing and authorizing project assistance. The Asia/Near East Bureau did not follow these controls because the time involved in implementing such controls would have significantly delayed the delivery of emergency assistance. Because USAID's controls were not followed, there were serious project implementation problems. Also, USAID has little means to measure and control the effectiveness of this \$35 million project.

#### **Recommendation No. 2: We recommend that the Assistant Administrator of the Asia/Near East Bureau redesign the Mongolia Energy Sector Project to:**

- 2.1 Establish measurable project objectives and performance indicators as required by Section 621A of the Foreign Assistant Act; and**
- 2.2 Develop a complete authorization package as required by USAID policies and procedures.**

USAID developed the Energy Sector Project in 1992 to focus on a threat to Mongolia's economic survival—a continuing deterioration of the energy sector. USAID recognized that long-term solutions to Mongolia's energy problems would require significant investments by multilateral and bilateral donors, and that it would be at least three years until such assistance was available. Mongolia, however, faced a more immediate problem—an impending crisis during the 1992-1993 winter due to the growing lack of spare parts and inadequate maintenance for its power plants. Accordingly, USAID decided to provide emergency engineering and commodity assistance for the energy sector. Under pressure to begin the assistance immediately, the Assistant Administrator of the Asia/Near East Bureau authorized the Energy Sector Project to:

...provide emergency assistance to enable essential energy systems to operate for the next three years or until interim and permanent rehabilitation measures assisted by other donors are effective.

USAID Handbook 3 contains, among other things, USAID's managerial controls for designing and authorizing project assistance. In this regard, a detailed Project Paper is a key element as it serves: (1) as the basis for approval of the project; and (2) as a historical record of the project rationale, description of project elements, analyses supporting the proposed design, and initial project implementation and monitoring plan. According to USAID Handbook 3, Chapter 3, the following information should be provided in Project Papers:

- Project Rationale and Description - A brief review of the rationale for the project explaining why it should be undertaken, and presented in the context of USAID's development strategy and the host country's own development plans.
- Cost Estimate and Financial Plan - A breakdown of costs by foreign exchange and local currency sources. The method used in estimating project costs should be explained.
- Conditions Precedent and Covenants - Those which are proposed for inclusion in the Project Agreement should be listed and the reasons for their inclusion cited.
- Project Analyses - Economic, financial, technical, administrative, environmental, etc.

- Implementation Plan - This plan should cover the period from the authorization of the project to its completion and describe the responsibilities of the host country and USAID.
- Monitoring Plan - A description of the arrangements for monitoring, including an assessment of USAID staff for administering the monitoring tasks.
- Evaluation Arrangements - A description of arrangements to be made for the collection of baseline data (if not yet completed), for follow-up surveys and analysis of such data preparatory to or as part of project evaluations. All projects should include an information component to provide data for monitoring and evaluation during implementation.
- Annexes - Annexes would include such data as a Logical Framework Matrix, Statutory Checklist of Legislative Requirements, Implementation Schedule, and a Procurement Plan (showing the kinds of commodities and services to be procured, their probable sources, the contracting modes and procedures to be used, and the procurement and contracting responsibilities envisioned for the host country and USAID).

It is clear from these requirements that the Project Paper should describe the project in detail, how it will be implemented, and the impact it is expected to have. In addition, USAID must ensure that the project is consistent with Agency policy and legislative requirements.

When the Project Paper has been approved, a project authorization package is prepared. This authorization package consists of the following:

- An Action Memorandum - which summarizes the substance of what is proposed for signature.
- The Authorization Document - which must be included as part of the Project Paper after it has been signed.
- The Project Data Sheet - which contains operational and recording information.
- The Project Paper - which was discussed.
- Waiver Requests and Justifications - which should be prepared for those regulations and procedures to be waived.

The Asia/Near East Bureau did not follow most of these extensive USAID managerial controls in designing and authorizing the Energy Sector Project. The Bureau did not develop and include a Project Paper as part of the Authorization package. This package was largely limited to the Project Rationale and Description, the Action Memorandum, the Authorization Document, Waiver Requests and Justification, and a Statutory Checklist of Legislative Requirements. The flaws were many.

- Although the Authorization package provided a Cost Estimate and Financial Plan, costs were too general and were not broken down by foreign exchange and local currency sources. There was no information provided for major line items such as technical assistance, commodities, freight costs, training, etc. Also, the method used in estimating project costs was not explained. For one project component, \$2.9 million of \$7.7 million budgeted was simply identified as a contingency.
- An Implementation Plan included in the Authorization package did not meet the requirements for providing details. This plan did not have: (1) a detailed description of responsibilities to be assumed by the host country, contractors, and USAID; and (2) appropriate annexes, including a procurement plan.
- The Authorization package did not include a Monitoring Plan.
- The Authorization package did not include economic, financial, technical, administrative, and environmental analysis. For the environmental analysis, the package said that no significant environmental impact was expected from the initial assistance. However, no analysis was provided to explain how USAID assistance to the coal-fueled power plants would have no significant environmental impact.
- The Authorization package said that an evaluation would be made but did not describe the Evaluation Arrangements. There was no description of arrangements to be made for the collection of baseline data and other information to provide data necessary for adequate monitoring and evaluation.
- The Authorization package lacked most of the required Annexes. No Logical Framework Matrix was included to define the projects objectives specifically and to establish measurable performance standards for monitoring and evaluating the

project. An implementation schedule and procurement list was not provided.

- The Authorization package did not incorporate an energy sector survey with which to focus the Energy Sector Project, its involvement in power plants and coal mines, and the extent and direction of USAID's assistance.
- The Authorization package did not develop any plan for coordinating project activities with the work of other donor agencies and international organizations. Japan for example, reportedly contributed at least \$20 million to the Mongolia energy sector in 1992-93. Other major donors included Germany and the World Bank.

Because the Asia/Near East Bureau did not adhere to USAID's managerial controls for designing and authorizing project assistance, project implementation faced serious problems and USAID could not measure and control the effectiveness of this \$35 million project. Discussed below are some of the problems, such as: (1) non-emergency purchases for the 1992-1993 winter emergency, and (2) an emergency Russian air charter which carried mostly non-emergency equipment.

#### **Non-emergency Purchases Were Made For the 1992-93 Winter Emergency**

Due to the rush to implement the project, the lack of sufficient on-site USAID staff, no Project Paper, USAID/Washington-based technical monitoring, and a late start-up (considering that the heating season in Mongolia commences in September each year), many "emergency" purchases were not urgently required and were not used as intended during the 1992-93 heating season. Although USAID issued a blanket waiver for the purchase of non-American source origin commodities for the first year of the project, many were subsequently unused or exceeded immediate requirements. More than \$1 million in USAID funding was not used to purchase and deliver emergency goods and services to Mongolia. Some prominent examples of the non-emergency purchases include the following:

- A new \$650,000 excavator, purchased from Russia for the winter emergency, was approved for use at a coal mine 280 kilometers north of Ulaanbaatar. Upon its arrival, Mongolians redirected it to a remote coal mine about 700 kilometers east of Ulaanbaatar as shown in the following photograph.



*This \$650,000 Russian excavator, intended for a coal mine near the capital, was used for a coal mine 700 kilometers away.*

This coal mine does not even have rail or road links to Ulaanbaatar. The mine has only one rail line—for export of coal into Siberian Russia. According to the mine's General Manager, about 120,000 metric tons of excess coal from the mine were exported to Russia in 1992.

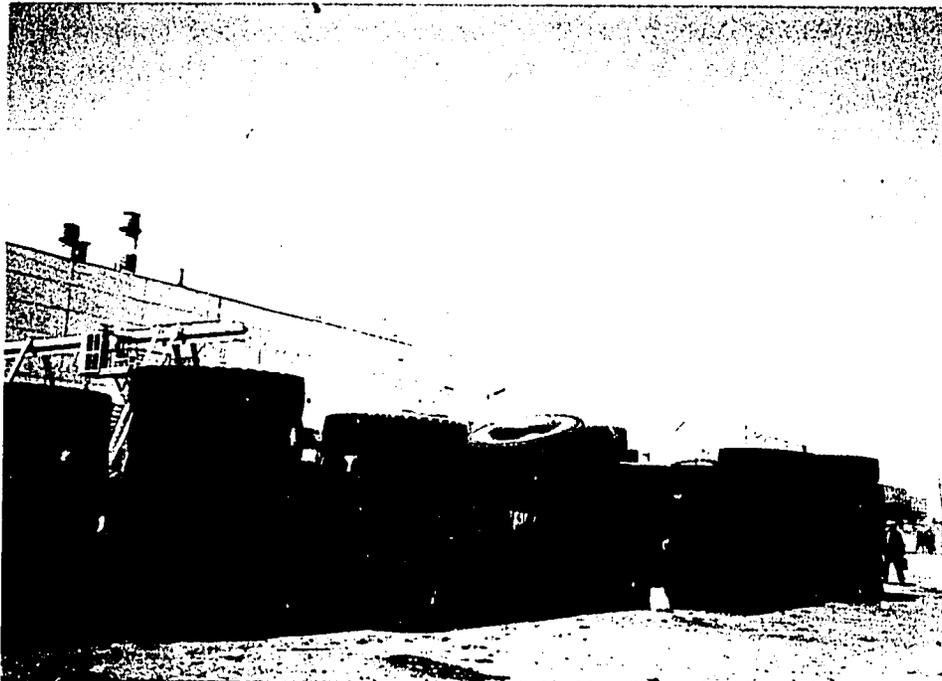
- \$22,846 worth of batteries and electrolyte were unnecessarily included in the December 1992 Russian air charter. Under the earlier Cash Transfer Program, over 10,000 batteries, costing \$366,286, were imported between September 1991 and December 1992. In May 1993, we visited one importer and counted 374 batteries still on hand. As some batteries received under the Cash Transfer Program remained unused in May 1993, the additional batteries financed under the Energy Sector Project did not require shipment by the emergency airfreight in December 1992.
- Ten crates of graph paper, used with sensing equipment to record power plant operations, were purchased in the United States at a cost of \$80,297 and flown to Mongolia on the

December 1992 Russian air charter. Much of this paper was not needed for the emergency. As of May 1993, only 1 of these 10 crates had been opened and distributed to the power plants. The balance was still stored in the purchasing company's warehouse as shown in the following photograph.



*Ten crates of graph paper such as these were air freighted to Ulaanbaatar, but only part of one crate was used for the 1992-1993 winter emergency.*

- Vehicle tires and tubes costing \$149,080 that were supplied exceeded emergency requirements. Half of the 174 tires ordered, valued at \$75,269, was air-freighted to Mongolia in December 1992 and then distributed to two coal mines. We observed stacks of these unused tires at one coal mine in January 1993. The other half of the order was shipped by sea in containers and transported over rail through Russia. These were received in March 1993. In May 1993, we observed 26 large dump truck tires costing \$1,662 each and 85 off-road tires costing \$408 each lying in warehouses. Because some of the \$436,100 worth of tires imported under the Cash Transfer Program were received in 1992, we conclude that the \$149,080 order of tires and tubes were not required that urgently. The following photograph shows some of the tires which were not needed for the 1992-1993 winter emergency.



*Russian-made tires such as these were not needed for the winter emergency.*

**An Emergency Russian Air Charter  
Carried Mostly Non-emergency Equipment**

In December 1992, USAID authorized an air charter from New York to Mongolia. The eventual cost: \$466,000 for a large Russian cargo plane which carried only \$679,000 of commodities, as listed below:

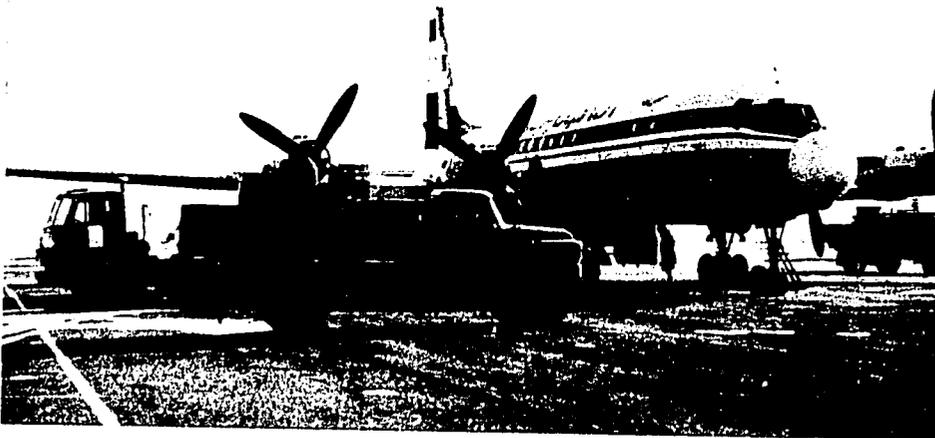
Electrical equipment	\$ 215,520
Power cables for coal mines	197,812
Graph paper for power plants	80,297
Dump truck tires and tubes	75,269
Boiler tubes	44,967
Wire ropes for coal excavators	27,001
Vehicle batteries and electrolyte	22,846
Air tubes, couplings, repair kit for coal mines	<u>15,520</u>
TOTAL	\$ 679,232

The need for this Russian air charter is questionable because: (1) the cost of the charter and handling was 69 percent of the value of the equipment and spare parts air-freighted, and (2) over \$400,000 worth of the equipment and spare parts was either not of an emergency nature, was in excess of

immediate requirements, or had not been used six months later due to unknown or incorrect technical specifications.

A senior Mongolian Government official said that the most important item included in the Russian air charter was the wire rope for the coal excavators. While providing the wire rope was reportedly a success, it cost only \$27,000 as compared to \$466,000 for the air charter.

The wire ropes could have been shipped by normal commercial airfreight with other urgent items such as the air tubes, and electrical and boiler equipment. In fact, USAID management did, at the request of the Mongolian Government to conserve funds, cancel a second planned charter of a large Russian plane from the United States. Instead, the urgent equipment was sent using commercial airfreight from the United States into Moscow, and from there to Mongolia in February and March 1993. Each air charter from Moscow into Mongolia cost about \$36,000.



*This commercial airfreight from Moscow to Ulaanbaatar only cost about \$36,000.*

In conclusion, the Asia/Near East Bureau did not follow USAID's managerial controls to develop the information for most of the essential elements of a Project Paper. The Project Authorization package was also incomplete. USAID did not obtain Congressional waivers to the Foreign

Assistance Act as it had done with other emergency programs<sup>4</sup>. Consequently, USAID was required to comply with the Foreign Assistance Act. The Bureau, however, did not follow the managerial controls which USAID established to comply with the Foreign Assistance Act, including Section 621A:

...the President shall establish a management system that includes: the definition of objectives and programs for United States foreign assistance; the development of quantitative indicators of progress toward these objectives; the orderly consideration of alternative means for accomplishing such objectives; and the adoption of methods for comparing actual results of programs and projects with those anticipated when they were undertaken. The system should provide information to the agency and to Congress that relates agency resources, expenditures, and budget projections to such objectives and results in order to assist in the evaluation of program performance....

Since the project lacked, and still lacks, the waivers and required justification to depart from the Foreign Assistance Act and USAID policies and procedures, USAID should redesign the project. Because USAID plans to continue providing project assistance to Mongolia's energy sector, USAID should adhere to USAID Handbook 3 procedures for developing a Project Paper and a complete authorization package.

### **Management Comments and Our Evaluation**

The Asia/Near East Bureau disagreed with draft Recommendation No. 2 in our draft report to terminate the project and establish controls to withhold project authorizations without completing the planning process. Bureau officials said that they had no choice but to act immediately on the emergency situation without doing all the planning normally included in a Project Paper. The Bureau decided to authorize the project when it did as the only alternative to unacceptable harm. Bureau officials pointed out that USAID Handbook 3, Chapter 4.B.1 provides USAID the ability to waive the documentary requirements for projects financed with Economic Support funds. The Bureau said that the authorization record for the Energy Sector Project clearly provided the reasons for departing from standard documentation requirements. Also, the Bureau pointed out that a recent value engineering exercise brought project planning up to date and that

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<sup>4</sup> Such as the "Notwithstanding" language of the Eastern Europe program or the emergency procurement authority that USAID obtained for Somalia.

management improvements since the audit gave USAID confidence that adequate planning has been done for the remainder of the project. The Bureau's response implied, however, that it did not want to define the objectives of this assistance with any more specificity or to establish quantitative indicators. The Bureau said:

One general cause of confusion in the audit is that the Energy Sector Project dealt with a sector-wide emergency and not just with specified power plants and coal mines... we could not predict where emergencies would arise...we understand the Mongolians desire to use our assistance where the needs of the moment indicate rather than for a specifically planned part of the [energy] system. While we are insisting that they clear such changes with our mission, they are not inconsistent with the concept that we are assisting the sector, not just specified pieces of it....

Based on the Bureau's response, we revised the finding and changed the recommendation from terminating the project to requiring the establishment of measurable project objectives and performance indicators and to develop a complete authorization package for the current project. The recommendation remains unresolved pending the Bureau's assessment of the changes to this report. Contrary to USAID procedures, the authorization package did not clearly define which USAID documentary procedures were to be waived. Even if a waiver had been issued for some of those procedures, the Asia/Near East Bureau was responsible for either obtaining Congressional waivers from the Foreign Assistance Act or complying with the Act.

We believe that the value engineering exercise and management improvements which the Bureau has undertaken should help the Bureau better define the project's objectives with the legislated quantitative performance indicators and develop a more complete authorization package.

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**In Planning and Monitoring the Energy Sector Project, Did USAID Establish Sufficient Managerial Controls to Ensure That Technical Services and Commodities Were Necessary, Were Procured at a Fair Price and From Qualified Contractors, and Were Received and Accounted For Consistent With Applicable U.S. Laws and Regulations?**

As discussed on page 3 and in the Scope section of this report, we cannot fully answer this audit objective. Nevertheless, based on the information made available, USAID did not establish sufficient managerial controls to ensure that technical services and commodities were necessary, procured at a fair price and from qualified contractors, and received and accounted for consistent with applicable U.S. Laws and regulations.

USAID management was too geographically stretched to establish effective managerial controls. The USAID Project Officer and engineers were located in Washington D.C., while USAID's contracting and disbursing offices were in Thailand. Meanwhile, contractors were located in New Jersey, Massachusetts, Pennsylvania and Mongolia, and project activities were in Mongolia. The Office of the USAID Representative to Mongolia was understaffed, and the sole USAID officer in Mongolia was not delegated direct oversight or decision-making responsibility for the program.

The following section discusses the problems which can ensue when USAID initiates an assistance program without assigning enough resources for monitoring and on-site decision making.

**USAID Did Not Assign Enough Resources for Monitoring and On-Site Decision Making**

Contrary to Federal standards for internal control, USAID did not assign enough resources to establish and maintain adequate managerial controls over USAID funds. The responsible USAID personnel were too geographically stretched to provide effective administration and supervision of project activities. Difficulties in communicating between the various locations of USAID staff, the host government, and contractors compounded matters. Consequently, USAID's \$35 million Energy Sector Project suffered serious problems.

**Recommendation No. 3: We recommend that the Assistant Administrator of the Asia/Near East Bureau:**

- 3.1 Assign sufficient personnel and responsibility to Mongolia to properly administer and oversee USAID's assistance;**
- 3.2 Withhold authorization of any further commodity assistance to Mongolia until USAID certifies that an adequate system of inventory controls is in place to account for USAID-financed commodities;**
- 3.3 Require the Mongolian Government to account for the use of commodities furnished under the Energy Sector Project, including the \$650,000 excavator which was diverted to Eastern Mongolia, and the unaccounted explosives and \$80,000 dump truck;**
- 3.4 Verify the accuracy of the Mongolian Government's accounting for the use of commodities; and**
- 3.5 Issue a Bill for Collection to the Mongolian Government for the costs of all commodities which are not accounted for or have been used for unauthorized purposes.**

**Recommendation No. 4: We recommend that the Regional Contracting Officer, USAID/Thailand:**

- 4.1 Determine the allowability of all costs incurred by the prime contractor in connection with its purchase order with the freight forwarder, a purchase order which was inconsistent with the Federal Acquisition Regulation and the prime contract;**
- 4.2 If a determination is made to allow the purchase order, ensure that a full audit for reasonable, allocable, and necessary costs of the freight forwarder is undertaken (including amounts paid for the services of affiliated companies of this freight forwarder and for the feasibility study), in accordance with the prime contract and the Federal Acquisition Regulation; and**
- 4.3 Recover all amounts paid for those costs which are determined to be unallowable.**

**Recommendation No. 5: We recommend that the Controller, USAID/Thailand:**

- 5.1 Strengthen controls over the Project Officer Administrative Approval process by establishing procedures to withhold certification of any payment voucher which lacks the required attestation that the Project Officer has reviewed the supporting documentation to the voucher; and**
- 5.2 Instruct voucher examiners to more closely review the supporting documentation for payment vouchers from contractors and to reconcile the amounts claimed with the eligible costs specified in the contracts.**

The General Accounting Office has issued standards for executive agencies to follow in establishing internal controls as required by the Federal Managers' Financial Integrity Act of 1982 (31 U.S. Code 3512(b)).

Contrary to those Federal standards for internal control, USAID did not assign enough resources to establish adequate managerial controls over USAID funds for the Energy Sector Project. From the inception of the project in July 1992 to February 1993, the Office of the USAID Representative to Mongolia did not have an on-site technical officer. The technical monitoring rested with Asia/Near East Bureau's engineering section, USAID/Washington's engineers who made three short trips to Mongolia, and technical assistance contractors. The Project Officer located in the Bureau never visited Mongolia to observe operations. While the new USAID Representative actively monitored the project, this effort was largely confined to troubleshooting because of limited resources, and technical and operating environmental constraints. The authority and role of the USAID Representative was not defined with regard to the project. Project authority remained in USAID/Washington. Moreover, financial management responsibility rested first with the Controller in USAID/Philippines before being transferred to USAID/Thailand.

As a result of stretched USAID management and communication difficulties, critical problems occurred. These problems could have been prevented or minimized with competent on-site technical expertise and decision-making. The problems include: (1) USAID did not comply with the Federal Acquisition Regulation when it procured the services of the prime contractor; (2) USAID did not hold the prime contractor accountable for reporting project progress; (3) the prime contractor engaged a freight forwarder through a purchase order which was not in accord with the

prime contract and Federal Acquisition Regulation; (4) more than \$1.5 million worth of equipment purchased because of the perceived emergency was unused or not received in time to be installed for the winter emergency; and (5) the Mongolian Government established poor inventory controls over the receipt, distribution, and accounting for USAID-funded commodities.

**USAID Did Not Comply With the Federal Acquisition Regulation When It Procured Technical Services**

USAID did not comply with the Federal Acquisition Regulation when it procured the services of the prime contractor under procedures which did not provide for full and open competition. The authority to waive full and open competition is provided under 10 U.S. Code 2304(c)(2) and 41 U.S. Code 253(c)(2). According to the Federal Acquisition Regulation:

When the agency's need for the supplies or services is of such an unusual and compelling urgency that the Government would be seriously injured unless the agency is permitted to limit the number of sources from which it solicits bids or proposals, full and open competition need not be provided for....

**This statutory authority requires that agencies shall request offers from as many potential sources as is practical under the circumstances** (emphasis added).

The Federal Acquisition Regulation adds that a contracting officer shall not commence negotiations for a sole source contract unless the contracting officer justifies the use of this action in writing, certifies the accuracy and completeness of the justification, and obtains the approval required by Section 6.304 of the Federal Acquisition Regulation.

In authorizing the project, the Assistant Administrator of the Asia/Near East Bureau gave the required approval to waive full and open competition and to award a sole source contract to the prime contractor.

In selecting this contractor, however, USAID did not comply with the statutory requirements for requesting offers from as many potential sources as was practical. A major reason for selecting the prime contractor was that it had working experience in Mongolia. However, a second contractor also had experience in Mongolia. This second contractor had the technical capabilities for working with both power plants and coal mines, while the contractor selected specialized in power plants. When questioned why an offer was not requested from this second contractor, the Regional

Contracting Officer in Thailand said that he did not know of its presence in Mongolia. He added that he negotiated the sole source contract based on the information provided by USAID/Washington.

Subsequently, USAID found that Mongolia's needs were greater for coal mines than power plants. However, the project did not have the expertise to address those needs. Accordingly, USAID instructed the prime contractor to execute a subcontract with this second, more qualified contractor. Eventually, USAID selected the second contractor to replace the prime contractor after the completion of Phase I of the project.

### **USAID Did Not Hold the Prime Contractor Accountable For Reporting Requirements**

While the prime contractor prepared several required reports on the status of procurement, it did not prepare any required reports on the status of project activities. The prime contractor's contract with USAID required several interim reports to be prepared. One was an Installation Strategy Report which was submitted in February 1993, four months late. The contract also required an activity summary report:

An activity summary report, noting accomplishments of first phases including installed drawings, for new feedwater (FW) evaporators only, and equipment list will be delivered by December 30, 1992.

As of May 1993, this activity summary report had still not been prepared. The lack of reports was due to the USAID contract which did not provide clear reporting requirements and quantifiable performance standards by which the contractor could report progress. As a result, the responsible USAID/Washington officials received very little information about the project's progress in Mongolia. When problems came to USAID/Washington's attention, it was often too late for USAID to take corrective action. For example:

- A coal mining complex and town partially froze up from January to March 1993 because all five boilers in the town's only heating plant broke down from poor maintenance and insufficient replacement parts. USAID's Washington-based engineer had visited Mongolia in December 1992, identified the deteriorating situation, and found that the prime contractor showed no interest in even going to this town. By then, however, it was too late and well into the winter to do

anything. Fortunately, the town suffered no deaths from the failure at the heating plant. The mine's director said that it was partly because the Mongolian Government provided the town residents with monetary aid and portable kerosene heaters.

- The prime contractor never visited a second coal mine that was only 40 kilometers from Ulaanbaatar and linked by a good highway. In December 1992, a subcontractor finally visited this mine, a visit which resulted in the order of air tubes and water pumps. The air tubes were used to pump air into the unflooded parts of the mine. Other than the water pumps and air tubes, however, USAID did not supply the mine with any other urgently required spare parts or equipment. More USAID assistance to this mine could have alleviated a coal shortage crisis. Instead, emphasis was placed on assisting distant coal mines where the coal produced could only be delivered by long rail journeys. The press reported that Mongolia was having rail shipment problems. Rail cars were barely arriving before the coal needed to fuel the power plants ran out.

**A Freight Forwarder Was Obtained Through a Purchase Order Which Was Inconsistent With the Federal Acquisition Regulation and Prime Contract**

The prime contractor used a purchase order which was inconsistent with the Federal Acquisition Regulation and prime contract to obtain the services of a freight forwarder, which eventually cost more than \$1 million. Although the Asia/Near East Bureau and Regional Contracting Officer approved the selection of the freight forwarder, no one in USAID asked to see or reviewed the subcontract. With USAID's responsibilities for the Mongolia program so geographically stretched, the prime contractor's reimbursement claims were not reviewed sufficiently.

The USAID/Washington Project Officer did not give proper Administrative Approval to any of the prime contractor's payment vouchers. Contrary to the terms of the contract, the prime contractor did not provide detailed documentation to the Project Officer in support of reimbursement claims. USAID Handbook 19 required the Project Officer to review documentation supporting voucher payment requests under USAID direct contracts and to make a specific statement that this process had been done. The Project Officer, however, only obtained a cost summary from the USAID/Thailand

paying office and provided a statement of Administrative Approval by electronic mail which was inconsistent with the required approval statement. The USAID paying office did not question these inappropriate Administrative Approvals. Therefore, the vouchers were paid without the required reconciliation of the documentation with the Project Officer's knowledge of the project.

Far removed from project activities in Mongolia and the Project Officer in the United States, the paying office at USAID/Thailand did not thoroughly check the vouchers for consistency with the contract as required by USAID Handbook 19. Combined with the lack of a proper Project Officer review, the lack of sufficient USAID involvement and review of the subcontracting process, and the inadequate Certifying Officer review, questionable payments such as the following were made.

- The freight forwarder imposed a 12 percent mark-up on its labor costs, and general and administrative costs, more than the 10 percent limit prescribed in the Federal Acquisition Regulation.
- The freight forwarder or its affiliated companies received rebates of 5 to 7 ½ percent on the cost of insuring the shipments and additional mark-ups on the cost of packing and shipping. The freight forwarder informed the prime contractor about its close affiliation to these companies, but no one questioned it.
- The freight forwarder made a \$67,000 feasibility study which was not in the USAID-approved prime contract.
- The indirect cost rate applied by the freight forwarder—56 percent general and administrative—was neither approved nor established by any contracting agency.
- The prime contract prohibited premium pay for overtime, but the subcontract with the freight forwarder allowed a 50 percent premium for overtime.
- The prime contractor approved \$334.62 per day for the freight forwarder's director, a rate which exceeded the maximum FS-01 rate of \$321.16 per day in 1992.

- Documents such as the form 1450-4 (Suppliers' Certificate and Agreement) and receiving reports were not properly executed or even included in most of the vouchers.

In preparation for our audit, the prime contractor reviewed the freight forwarder's claims to April 8, 1993, with respect to the contract terms (but excluding USAID's and Federal Acquisition Regulation provisions for procurement) and identified about \$98,000 in questioned costs. The prime contractor's summary of the review highlights its findings:

The findings of this [review] indicate that much of the items were paid [by the prime contractor] in advance of available receipts and proper back up being available [by the freight forwarder]. In many cases the item was an estimate of costs.

**More Than \$1.5 Million Worth of Equipment Was Not Used or Arrived Too Late**

USAID's prime contractor did not include a required penalty clause in procurements from former Soviet bloc countries for either late delivery or failure to deliver. As a result, over \$1.5 million worth of commodities, designated as priority items in August 1992, were received after March 1993, well after the 1992-93 winter emergency.

USAID Handbook 13, Appendix 4D, requires penalty clauses in contracts:

...contracts in excess of \$10,000 shall contain contractual provisions or conditions that will allow for administrative, contractual or legal remedies in instances in which contractors violate or breach contract terms, and provide for such remedial actions as may be appropriate.

All non-U.S. purchase orders, issued by USAID's prime contractor, did not include any such penalty clauses. The prime contractor explained that suppliers in former Soviet bloc countries found the provisions to be unacceptable. In some cases, standard provisions, including ones for audit, were crossed out by the suppliers before signing. Because the commodities were urgently required and with no alternative sources reportedly available, all these non-U.S. purchase orders were issued without legal recourse for late delivery or non-performance.

The main reason for non-U.S. purchases was timeliness in delivery, as explicitly mentioned in a cable to USAID/Washington in October 1992:

...the key emphasis needs to be placed on timeliness, for critical spare parts available in the U.S. but not deliverable in Mongolia in time for installation and use this winter, repeat, this winter, we will authorize non U.S. procurement by the GOM. So long as the same or comparable items can be procured in the ex-Soviet countries in time for use this winter, we intend to move immediately to code 935 procurement, either directly by [the prime contractor] or through GOM procurement....

Due to a lack of legal recourse against the Russian and other Eastern Bloc suppliers for late deliveries, several critical purchases were not received when they were needed, in some cases with serious consequences:

- Water pumps required for a flooded coal mine were not received until six months after the need was identified. The coal mine (which reaches a depth of 400 meters), had been closed since December 1992 from the 180-meter level and below due to flooding and an underground fire. Mining at this coal mine in 1993 dropped considerably, as the following production and employment statistics show:

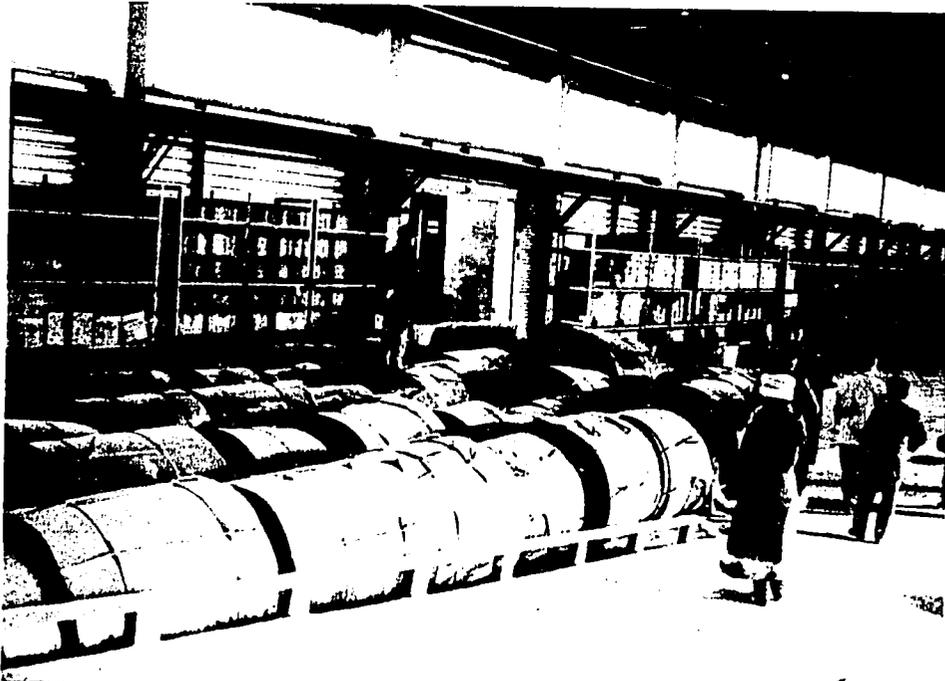
Reporting Period	No. of Employees	Production
Year ended December 31, 1990	above 1,500	300,000+ tons
Year ended December 31, 1991	1,500	240,000 tons
Year ended December 31, 1992	1,350	150,000 tons
Quarter ended March 31, 1993	780	11,600 tons

Source: General Manager, Nalaikh coal mine.

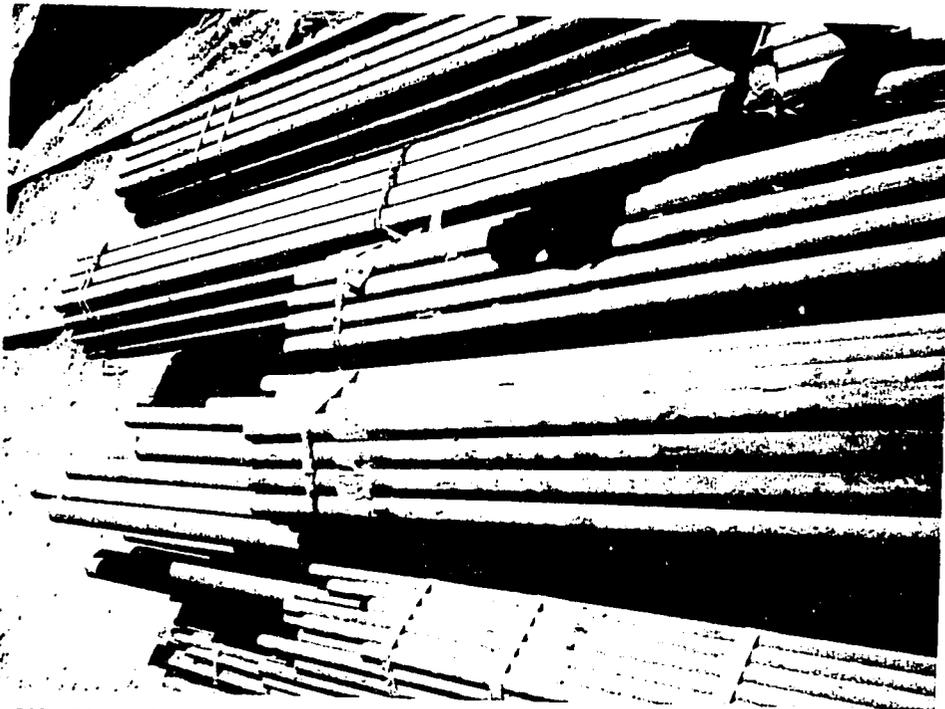
The General Manager of the mine said that the local town's economy was severely threatened because of the lost jobs.

- Conveyor belts and boiler tubes were undelivered or were being installed in May 1993. Although some belts arrived in January 1993, they could not be installed until parts of the plants were shut down for regular maintenance during the non-heating season. The non-heating season usually commences in

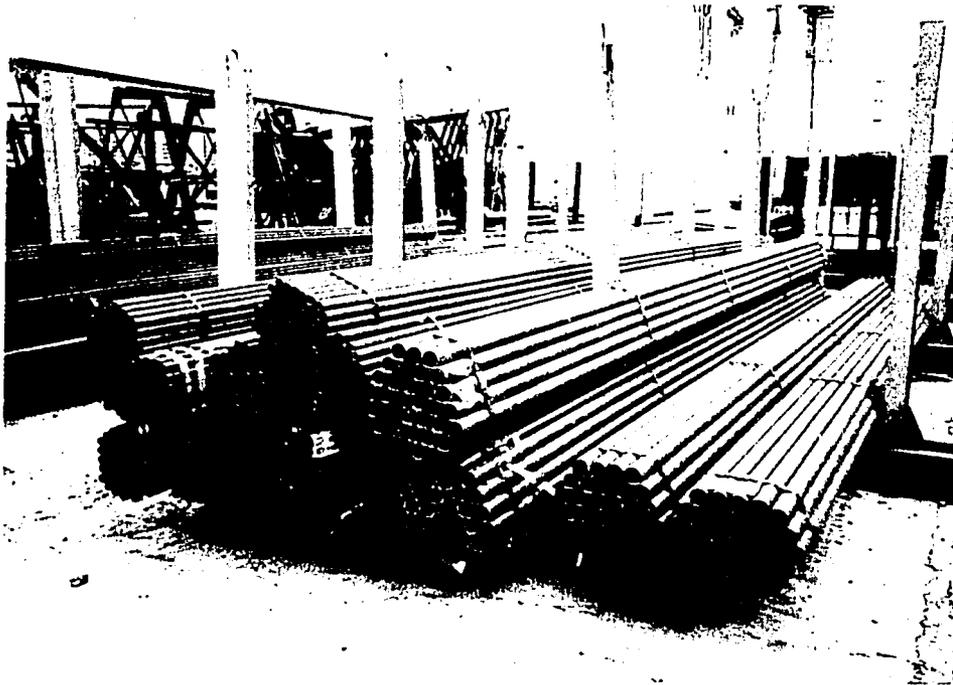
May/June. Most of the boiler tubes, such as a \$964,000 order from Russia, had not been received.



*Conveyor belts such as these were purchased from Russia, but still arrived too late for the 1992-1993 winter emergency.*



*USAID funds purchased Russian-made boiler tubes such as these, but the boiler tubes still arrived too late for the 1992-1993 winter emergency.*



*These boiler tubes also arrived too late, but they are American-made.*

- 1,000 tons of Russian-manufactured explosives, worth \$570,000 to be used primarily in breaking ground during the winter, were not received until March 1993. The terms of the order were that the explosives arrive in two shipments, latest by January 1993.

### **The Mongolian Government Did Not Establish Proper Inventory Controls**

USAID did not ensure that adequate inventory controls over USAID-funded commodities were established at the coal mines and power plants. Inventory records were not updated. Periodic inventory counts and reconciliations were not made with the records. Moreover, the manual systems were outdated and unable to cope with the complex equipment and spare parts received. Additionally, warehouses employed inadequate warehousing practices, sometimes receiving and issuing commodities without a record of the movements. The fact that nearly all records are in Russian or Mongolian complicated USAID's verification process.

During our visits in February and May 1993, we made several surprise inventory counts of selected USAID-financed equipment and spare parts. Based on our tests, we formed the following opinions:

Sites visited	Opinion	Remarks
1. Nuurs warehouse and yard, Ulaanbaatar.	Unsatisfactory	Inventory records were not updated. Test count of tires did not agree with records.
2. Power Plant No. 3, Ulaanbaatar.	Unsatisfactory	Records not maintained for some critical spare parts. Dirty, and supplies kept in several locations.
3. Sharyn Gol coal mine	Unsatisfactory	No inventory record on 311 tons of explosives. Poor physical security for consumables such as tires.
4. Baga Nuur coal mine	Satisfactory	Based on a limited review of five items.
5. Erchimimpex warehouses, Ulaanbaatar	Satisfactory	Based on a limited review of five items.
6. Power plant No. 4, Ulaanbaatar	Satisfactory	Based on a limited review of six items.

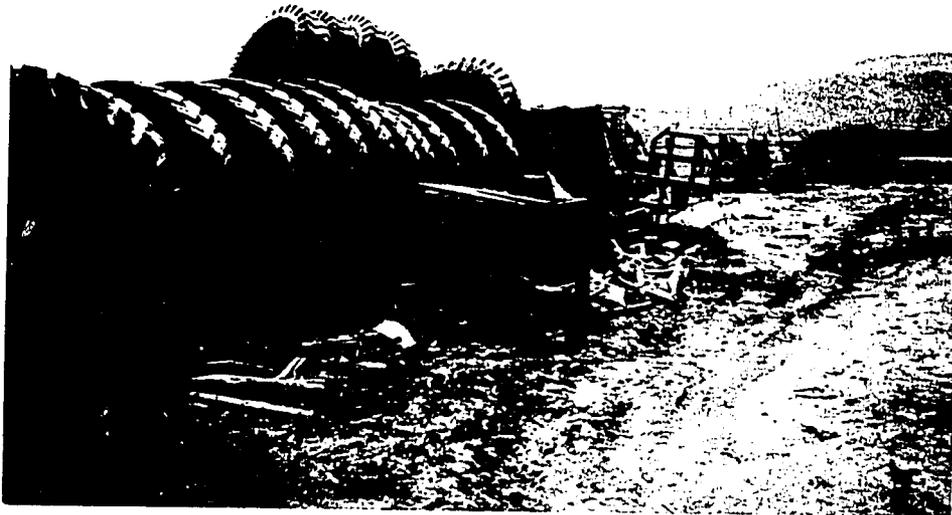
At site number two, we observed officials of the centralized purchasing company distributing cartons of spare parts and detonators the day following their arrival. These had not yet been counted and verified against the packing list of the air charter, especially important since half of the crates had been opened during shipment. Also, there was no official written record of receipt and issuance or other acknowledgement of physical possession by any responsible person. Moreover, records were not maintained for steel balls used in coal-crushing machines, nor for power cables. Also, the records for steel sheets and conveyor belts had not been updated regularly.

When we identified large discrepancies between the records and the inventory of explosives at site number three, the officials proceeded to sort their records. However, they were unable to properly account for the

differences. We were not shown any records, but only figures which were computed on scraps of cardboard paper for our benefit.



*These boxes of detonators were distributed without establishing accounting records for receipt and issuance.*



*Physical security at this store yard is nonexistent, as depicted by the gaps in the fencing at the end of the tires, each costing more than \$1,300.*

Although inventory records and controls at site number four were satisfactory, one of three dump trucks costing \$80,000 was missing. Officials said that the truck had been loaned to site number three. When we checked this site three days later, the officials denied ever receiving or even requesting a dump truck from site number four.

\* \* \* \* \*

When informed about some of the most significant problems which had occurred because USAID did not assign enough resources for monitoring and on-site decision making, the Asia/Near East Bureau provided some additional perspective on the nature of these problems and USAID's efforts to minimize problems. According to Bureau officials:

The Director of ASIA/DR and the Energy Advisor for the Asia Bureau met the energy evaluation contractor in Ulaanbaatar while the procurement plan was being developed....The PRE/CAP chief engineer inspected conditions in Mongolia before presiding over the first value engineering review.

PRE/CAP provided the project engineer who has carried out two trips to Mongolia during periods when commodities arrived and recently managed the second value engineering review in Ulaanbaatar. We were also helped at the design stage by the Office of Procurement and the General Counsel. The USAID Representative concluded the Project Agreement and negotiated differences with the Mongolians over our insistence on greater U.S.-source procurement. We have long planned that the finance and contracting offices in Bangkok would support activities in Mongolia and other East Asia countries without full USAID resident staffing....

Your 'INTERIM AUDIT RESULTS' section summarizes a number of problems which relate to Mongolia's limited accounting and management capabilities and lack of experience as an aid recipient. We have been aware of these problems from the start...The comment that 'controls over inventories and the distribution of commodities within the country are almost nonexistent' is a statement of a development problem within Mongolia's system which we hope to address in the current general contract by technical assistance, but without expectation of overnight miracles....

The Mongolians had difficulty prioritizing emergency needs as the technicians responsible for procurement planning had left when the Soviets pulled out. When we started the project, we found enormous transportation obstacles ranging from finding cargo aircraft willing to land in the Siberian winter in Ulaanbaatar to waiting for a back-up of 2,000 Russian rail cars to be cleared to cross the Mongolian border....

We feel we have delivered timely and effective emergency assistance under difficult conditions with the management resources we had at hand.

Although USAID reportedly removed some obstacles to delivering the assistance, this report identifies many problems which adversely affected the impact of USAID's assistance. USAID faced too many constraints in trying to deliver aid on short notice to a unfamiliar country and then, to oversee the assistance from Washington, D.C. and Thailand.

The USAID Handbooks recognize that developing countries lack experience in accounting and management. For this reason, the USAID Handbooks

require that controls be designed and put in place before the assistance begins, not one year or more later.

We believe that, if USAID is to properly administer and oversee USAID's assistance, sufficient personnel and responsibility should be assigned to Mongolia. Moreover, no commodity assistance should be provided until USAID has obtained adequate assurances that these commodities can be accounted for. For the commodities already delivered, USAID needs to obtain an accounting of how those commodities have been used. The Regional Contracting Officer needs to determine whether to allow costs incurred under the subcontract to the freight forwarder and recover all amounts paid for costs which are unallowable. The Controller needs to strengthen controls over the administrative review and voucher examination processes. Billing from contractors should not be paid without reconciling the amounts claimed with the contractual agreement. Also, vouchers should not be processed for payment without the proper Project Officer Administrative Approval.

### **Management Comments and Our Evaluation**

The responsible USAID officials did not fully agree with the finding and recommendations. The Asia/Near East Bureau did agree that a number of management and accounting problems in the Mongolian energy sector occurred and need correction. The Bureau, however, emphasized that commodity assistance is indispensable under the continuing emergency situation. The Bureau added that, consistent with its sectoral approach, USAID's commodity support has fed into a pool of sectoral resources and, until the emergency is past, USAID expects adjustments to planned uses of commodities as the sector-wide needs of the moment become apparent. The Bureau also raised a number of points, indicating some disagreement or confusion with our finding and recommendations.

Recommendation No. 3.1 is closed based on actions taken to improve the administration and oversight of USAID's assistance by assigning additional personnel and transferring project management responsibilities to Mongolia. An American contract engineer (as envisioned in the original implementation plan) and a Mongolian engineer are now assigned full-time to the project. In addition, all project management responsibilities have been transferred from Washington, D.C. to Ulaanbaatar.

Recommendation No. 3.2 is unresolved. The Asia/Near East Bureau said that additional inventory controls are being instituted which should mitigate vulnerabilities to acceptable levels. However, the Bureau said that it is unrealistic to establish inventory controls which USAID could certify

as adequate by normal standards within the project life. The Bureau requested that the recommendation be qualified by a phrase such as "If practicable under the emergency circumstances of the energy sector". In our view, if USAID wants to accept a higher threshold of risk in providing commodity assistance, that threshold should be defined and approved in the Authorization Package. Depending on the materiality of this threshold, the Bureau may also need a legal opinion to ascertain whether Congress should be notified of the higher risks. Then, USAID should use this threshold to assess and certify the adequacy of controls.

Recommendation No. 3.3 is resolved. The Asia Near/East Bureau said that all commodities have been accounted for. This recommendation will be closed upon receipt of documentary evidence of this accounting.

Recommendation No. 3.4 is unresolved. The Asia Near/East Bureau said that it believed it could verify the accuracy of the Mongolian Government's accounting of USAID-funded commodities. However, the Bureau provided no plan of action for doing so. The recommendation will be closed when the Bureau verifies the accounting of the commodities.

Recommendation No. 3.5 is unresolved. The Asia Near/East Bureau said that all commodities have been used for authorized purposes, but the Bureau also agreed that at least the excavator was not used for authorized purposes. The Bureau reports that the Mongolian Government replaced the USAID-funded excavator with a Mongolian-funded excavator. To resolve and close this recommendation, evidence is needed to document that the replacement of the USAID-funded excavator was acceptable and the commodities have been used for authorized purposes. Otherwise, a Bill for Collection should be issued for any amounts determined to have been used for unauthorized purposes.

Recommendation No. 4 is unresolved. The Regional Contracting Officer did not formally respond to the finding and recommendation but did provide a "brief response" to the Asia/Near East Bureau. Basically, the Regional Contracting Officer disagreed because he believed that we questioned the subcontracting document on the basis of it being called a "purchase order". In fact, we questioned the substance of the "purchase order" which we found to be inconsistent with the Federal Acquisition Regulation and the prime contract. We have modified the finding to clarify this point. We believe that the Regional Contracting Officer needs to determine the allowability of the "purchase order"/subcontract. Moreover, we do not believe that the prime contractor's internal review of the costs claimed by the subcontractor can provide the same level of assurance as an independent audit.

Recommendation No. 5 is unresolved. No direct response to the finding and recommendation has been received from the responsible official, the Controller, USAID/Thailand. The Asia/Near East Bureau noted that the USAID requires summary fiscal data and vendor invoices in vouchers. However, no plan of action was provided to address the finding that the Project Officer did not make the required review of the vendor invoices in vouchers. Also, the Bureau mistakenly said that the draft report did not provide any example of any problem with any voucher. Our finding cites problem payments to the freight forwarder, such as a salary rate in excess of the FS-01 limit, premium overtime pay prohibited in the prime contract, the \$67,000 feasibility study that was not in the prime contract, the lack of supplier's certificates and receiving reports, etc.

Finally, the Asia/Near East Bureau provided additional comments about the late arrival of commodities, emphasizing that these commodities were still needed—particularly for the 1993-1994 winter. We do not question the need for these commodities. Rather, we question the procurement of certain commodities from Russia and the use of a Russian air charter during the 1992-1993 winter emergency, when most of those commodities were not used for the 1992-1993 winter emergency and could have been procured from the United States or shipped by alternative means.

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## SCOPE AND METHODOLOGY

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### Scope

We audited USAID's controls over the Cash Transfer Program and the Energy Sector Project in accordance with generally accepted government auditing standards, except that USAID's management could not agree on and did not provide written representations which we considered necessary to fully answer the audit objectives. Management's refusal to make such representations constitutes a limitation on the scope of our audit. The information which the most responsible and knowledgeable USAID officials would not confirm, to the best of their knowledge and belief, follows:

- Whether they are responsible for the internal control systems, compliance with applicable laws and regulations, and the fairness and accuracy of the accounting and management information on matters relating to the audit objectives;
- Whether they provided us with all the financial and management information associated with the activities audited;
- Whether they know of any irregularities in those activities;
- Whether they know of any material instances in which financial or management information related to the audit objectives has not been properly and accurately recorded and reported;
- Whether they are aware of any instances of noncompliance with USAID policies and procedures, laws, regulations and contractual agreements related to the audit objectives; and
- Whether they know of any events subsequent to the period under audit which could affect the above representations.

The answers to the above questions are so fundamental to the basic concepts of accountability and auditing that it is not possible for us to render any positive conclusions without them. Thus, we cannot risk giving positive conclusions about matters which managers will not even confirm in writing to the best of their knowledge and belief.

While we cannot render any positive conclusions without such representations, this lack of management confirmation does not preclude us from reporting on the problem areas which came to our attention.

The field work was done between February 10, 1993 and May 21, 1993 at the offices of the USAID Representative to Mongolia, prime contractor and Mongolian Government in Ulaanbaatar; four power plants and four coal mines in Mongolia; contractors' offices in Boston, Philadelphia, and Newark; the Asia/Near East Bureau and Department of State offices in Washington, D.C., and the Controller and Contracting offices in Thailand.

Our audit of the Cash Transfer Program covered the \$10 million transfer into the dollar account held by the Mongolian Government in Washington D.C. The audit of the Energy Sector project covered obligations of \$11.8 million, commitments of \$10.6 million, and disbursements of \$4.9 million as of May 21, 1993. Our audit of the receipt and distribution of commodities for the Energy Sector also extends to May 21, 1993.

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## **Methodology**

### **Objective One**

To determine what the funds under the Cash Transfer Program were used for, we reviewed the financial capability and follow-up reports issued in 1991 and 1992 on the Cash Transfer Program, undertaken by a USAID-contracted Certified Public Accounting firm based in the Philippines.

We visited the Mongolian Ministry of Finance and State Bank in Ulaanbaatar, and held discussions with the Deputy Minister, senior officials, and accounting staff of both institutions. We obtained the State Bank report on the U.S. dollar transactions made under the Cash Transfer Program. We selected seven importers, which accounted for about 93 percent of the dollar funds expended, and held discussions with the

respective organizations' officials. We obtained supporting documentation for selected items which we reconciled with existing records where possible to ascertain the correctness of the accounting entries.

To determine what the Cash Transfer Program achieved, we reviewed the Office of the USAID Representative to Mongolia's files, USAID/Washington Project Officer files, a contractor assessment report and a contractor financial review report, and held discussions with the previous Project Officer now based in Thailand. We could not determine whether the assistance provided was achieving results commensurate with the funds expended because the program's objectives were too broad.

### **Objective Two**

To answer the monitoring objective, we reviewed USAID/Washington and Office of the USAID Representative to Mongolia files and analyzed the financial review reports, pertinent cables and documentation to assess whether applicable U.S. Laws and USAID policy were followed. We held discussions with officials in the Office of the USAID Representative to Mongolia and Asia/Near East Bureau. We also held discussions with Mongolian officials from the State Bank and the Ministry of Trade and Industry. We obtained copies of the U.S. dollar bank statements and reviewed material transactions. We examined documentation supporting a redeposit of 400 million tugriks disbursed without USAID concurrence. However, we were unable to verify the subsequent use of the 400 million tugriks because supporting documents were not readily available.

### **Objective Three**

To determine how the funds were used on the Energy Sector Project, we held discussions with officials of USAID/Thailand, staff of the prime contractor in Boston and Philadelphia, and the Project Officer, engineering officer and Department of State officials in Washington, D.C. We also reviewed pertinent reports and files. In Ulaanbaatar, we held discussions with the USAID Representative to Mongolia, the United States Ambassador, USAID engineers, and officials from the Ministry of Fuel and Power, including those from NUURS the procurement company for the Mongolian coal mines, and Erchimimpex the procurement company for the power plants. We also discussed the project with the prime contractor's engineers

and material receiving inspector, as well as engineers/specialists from the mining subcontractor. We reviewed their respective reports.

To determine what the project achieved, we visited some power plants and coal mines which were selected because they received most of the USAID-financed commodities. Power plants visited were at Choibalsan, Darhan, and Ulaanbaatar. Coal mines visited were at Aduunchuluun, Baga Nuur, Nalaikh and Sharyn Gol. We observed operations and held discussions with the engineers or directors, accounting staff, and warehouse personnel. We reviewed selected reports with assistance from the Office of the USAID Representative which translated the documents. In all our trips we were accompanied by Mongolian officials from NUURS, Erchimimpex, or the Office of the USAID Representative to Mongolia.

#### **Objective Four**

To answer the monitoring objective, we evaluated USAID management against criteria established in USAID Handbooks 1 Supplement B and 11. We held discussions with the Project Officer, Mongolia Desk officer, and engineering officer in Washington, D.C. We also held discussions with the prime contractor's engineering, management, and procurement staff in Boston and Philadelphia. In Boston, we reviewed the prime contractor's procurement procedures for selected equipment such as boiler tubes, conveyor belts, bulldozers, explosives, excavators, freight forwarding contract and mining subcontract. We reviewed the supporting documentation at the prime contractor's accounting office in Philadelphia. In addition, we went to Newark, New Jersey where we held discussions with the freight forwarder and obtained copies of supporting documents for review.

To determine whether USAID-funded commodities were received and accounted for, we held discussions with the USAID Representative to Mongolia, the prime contractor's receiving inspector, and the freight forwarder's agent. During our visits to the power plants, coal mines, warehouses and yards of the Mongolian procurement companies, we judgmentally selected some commodities from the records provided to us and test counted the selected items. We also observed an air shipment of commodities which arrived at Ulaanbaatar on February 17, 1993, and the inspection procedures in the warehouse of Power Plant No. 3.

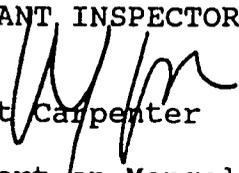
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U.S. AGENCY FOR  
INTERNATIONAL  
DEVELOPMENT

MAR 9 1994

MEMORANDUM FOR THE ASSISTANT INSPECTOR GENERAL FOR AUDIT

FROM: AA/ANE, Margaret Carpenter 

SUBJECT: Draft Audit Report on Mongolia Cash Transfer Program  
(438-0004) and Energy Sector Project (438-0003)

Your memorandum of November 10, 1993 transmitted draft Audit Report No. 5-306-94-XX on two Mongolia energy activities for our comment. Your memo also requested a representation letter. This memo constitutes the ANE Bureau's response to the draft Audit Report. I request that it be included as an attachment to the published Audit Report.

OVERVIEW

After ending its satellite relationship with the Soviet Union, Mongolia required emergency assistance. Massive Soviet aid of \$900 million a year to Mongolia abruptly ended. Soviet technicians who designed and operated large parts of the energy systems were withdrawn.

The urban sector depended on Soviet inputs to maintain electric power and heating services.

The Secretary of State asked us to assist Mongolia's immediate needs to avert collapse of the economy of a nation in transition from communism.

The urgency of needs did not allow time for ordinary USAID design processes. Mongolian economic institutions were inexperienced in normal international trade and donor practices. The energy sector operated with poor Soviet technology and with the ineffective management practices typical of a communist system.

When the **Cash Transfer Program** was approved in 1991, economic activity in Mongolia was in a nose dive. Mongolia could not get sufficient imported parts and materials to keep power plants operating, and the effectiveness of the energy system was in rapid decline. The Cash Transfer Program funded enough urgent imports to avoid total collapse for a year.

This was a total success against the Cash Transfer's limited, short term objectives.

The 1992 **Energy Sector Project** focuses on the greatest threat to Mongolia's economic survival, the continuing deterioration of the energy sector. When this project was designed, we recognized that long term solutions to Mongolia's critical energy problems would require significant investments by multilateral and bilateral donors, and that it would be at least three years until such assistance was available. We are providing emergency engineering and commodity assistance for that timeframe.

The Project is a success to date -- it helped continue basic energy service for two winters. However, the capacity and efficiency of the existing Soviet-era power plants, coal mines and railroads is still declining, and the energy system is still teetering on the brink of collapse. Some small systems have collapsed leading to abandonment of modern buildings and economic activities in isolated communities. Coal supplies at major power plants are measured in days at best.

Given these conditions, we see no alternative but to continue the Project for its originally planned life.

Other donors are beginning to support Mongolia's energy needs while we continue emergency assistance. We are laying the groundwork for improved energy management practices. Our contractor advisers have improved the efficiency of use of explosives in the coal mines, and they are helping the Energy Ministry improve inventory controls. We believe these measures will produce better results from other donors' larger investments in the energy sector.

The draft Audit Report notes the emergency nature of these activities in the background section. The draft then makes some findings and recommendations appropriate for normal assistance situations. We believe some recommendations are not relevant to the emergency circumstances of these Mongolia activities -- particularly Recommendation 3 that AA/ANE terminate the present project because it didn't follow standard Project Paper (PP) procedures.

We agree with the draft Audit Report that a number of management and accounting problems in the Mongolian energy sector occurred and need correction. The emergency situation does not allow us time to develop fully satisfactory management practices before helping avert disaster. We need to meet emergency demands and build management systems at the same time.

We are satisfied that Mongolian counterparts recognize the problem and are working with our advisers to address it. The Mongolian Energy Minister recently wrote our A.I.D. Representative:

The inventory controls for some materials and spare parts provided under the A.I.D. assistance program for Sharyn gol, Baga nuur coal mines and Power Plant No. 3 were inadequate. . . . . The Ministry has been correcting its inventory controls and is working with Morrison Knudsen to improve the procurement/record systems. Many of the problems are already corrected. [Full text Tab A.]

Generally, we have only minor differences (noted below) with most draft Audit Report findings of management and accountability problems in Mongolia. The formal audit process and informal comments of auditors to our staff helped us identify areas for seeking corrections and for targeting contractor technical assistance. We appreciate this help in improving our assistance to Mongolia.

We have not provided a representation letter. We appreciate the efforts of IG Washington and RIG/A/Singapore personnel to provide models of representation letters that might fit this situation. However, we could not come to closure on a letter with all the parties involved.

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**Comment on Draft Audit Recommendations**

Listed below are all the Recommendations of the draft Audit Report and our comments.

Recommendation No.1: We recommend that the Assistant Administrator of the Bureau for Asia:

- 1.1 Assist the Mongolian Government to either obtain the commodities already paid for by the two importers or obtain a refund of \$205,140 transferred to Russian banks.

**Comment:** The A.I.D. Representative commented on January 21, 1994:

As the draft audit report points out, two transfers of funds were made to the Vnesheconom Bank in 1991: \$100,000 for 1,500 tons of sugar and \$50,040 for 69,500 disposable respirators. As of this date, no goods have been delivered, nor has the money (or equivalent value) been returned to the GOM. The GOM, through its Ministry of Trade and Industry (including its Moscow Mission) has discussed this issue many times with the Vnesheconom Bank and with Russia's Ministry of Finance, and its Ministry of Foreign Economic Relations, but without success. The GOM's Ministry of Trade and Industry is now trying to gain full GOM approval to withhold an offsetting amount of payment due to the Russian Government. The GOM currently owes the Vnesheconom Bank a sum of approximately \$250,000 for the purchase of newsprint; the idea now is to withhold the advance for the USAID commodities (\$150,000) against the amount. At this writing, a delegation of Vnesheconom Bank is in Mongolia. The First Deputy Minister of Trade and Industry has asked the AIDREP to meet with the delegation (which I have agreed to do) in order to try and help resolve this issue.

The draft report refers to two transactions for transformers, totaling \$355,700 (rounded to \$356,000), which had not been received as of the time of the audit. The first transaction was for a transformer costing \$20,700, and AID auditors confirmed that an advance of the full amount was made by the GOM in November 1992. The second transaction, according to the draft audit report, was for transformers costing a total of \$335,000, against which the auditors showed that the GOM advanced \$34,500 in November 1991.

In fact, GOM records show that in February 1991, Contract #096-0404/14023-426 was signed for a sum of \$1,337,464.50 for several items, including -- transformers (listed as Annex #1 of the contract). However, in November 1992 Annex #1 of this contract (pertaining to the transformers) was annulled by Annex #5. The same Annex #5 agreed to purchase two types of transformers (4 nos of TM-400/I0-0,4 and 2 nos of TM-630/I0-0,4) for the sum of \$34,470. These six transformers were received in Ulaanbaatar on August 18, 1993.

Regarding the pre-payment of USAID funds of \$20,700 made in November 1992 (according to the draft audit report) as of February 26, 1993, the transformers had not arrived. On that date, Erchim Impex wrote to the Trade and Development Bank, asking to separate the \$20,700 into two sums of \$10,273 and \$10,427 and to transfer both into two separate accounts for two Russian producers, as follows: A) "Uralelectrotyashmash", and B) "25th of October", with the two sums of money transferred to these accounts, respectively. The \$10,273 in the Uralelectrotyashmash contract (#589/00212736/000118-55) purchased seven different kinds of spare parts for the energy sector. These parts were shipped on April 15, 1992 and reported received in Ulaanbaatar. The "25 of October" contract (#61-01VTF/MVTK) was written on July 21, 1992 in the amount of \$80,853. This was a barter contract which required that 30 percent of the contract price be paid in hard currency in advance. The \$10,427 was used to satisfy a portion of this 30 percent requirement. The list of items to be imported under the barter agreement were spare parts for diesel motors (a detailed list is included in Attachment #1 to the agreement). These parts were shipped on December 24, 1992 and reported received in Ulaanbaatar.

In view of the above record of energetic pursuit of a solution to the payments problems with Russian banks by the Mongolians and the A.I.D. Representative's aggressive assistance to this effort, we suggest that this Recommendation be closed. We see no point in keeping it open while negotiations, which may be lengthy, to adjust accounts between Mongolia and the Russian banking system go on. There is no indication that the Mongolians are slack in pursuing full value from this USAID assistance.

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Recommendation No.1: We recommend that the Assistant Administrator of the Bureau for Asia:

- 1.2 Obtain an accounting for the \$10 million worth of local currency funds generated under the Cash Transfer Program and verify whether these funds were used for the mutually agreed-upon purposes.

**Comment:** The A.I.D. Representative commented on January 21, 1994:

By letter dated April 29, 1992, Robert Friedline, (then) AID Representative to Mongolia, agreed to the GOM's proposal to use the 400 million Tugriks in the following way:

- Financing to increase the minimum level of pensions to the aged and indigent: Tugriks 45.4 million
- Financing the development of small and medium size enterprises: Tugriks 158.4 million
- Financing for the procurement of equipment and spare parts for the energy and coal mining sectors: Tugriks 196.2 million

The GOM has now given a more complete breakdown of these expenditures. These expenditures, provided by the Ministry of Finance, are broken down by organization, geographic district, or purposes for which the funds were used (See Tab B.) During the auditors' visit to Mongolia, the Ministry of Finance opened its books to the auditors and randomly checked some of the transactions to see if the records were accurate. No problems or inconsistencies were found.

In view of the accounting the A.I.D. Representative has obtained, we suggest that this Recommendation be closed.

Recommendation No.1: We recommend that the Assistant Administrator of the Bureau for Asia:

- 1.3 Establish a completion date for the Cash Transfer Program; and
- 1.4 Enforce reporting requirements to ensure that the remaining funds (\$28,000 as of May 1993) are used in accordance with cash transfer provisions, reprogrammed or recovered.

IG Note: Rec. 1.4 has been omitted from the final report.

**Comment:** The A.I.D. Representative commented on Recommendation 1.4 on January 26, 1994:

The GOM reports that the auditors claim that \$28,000 of the \$10 million cash transfer was unobligated as of May 1993 is incorrect. The Ministry of Trade and Industry has produced a computer printout, dated May 26, 1993, which shows that as of that date, only \$2,890.37 remained unobligated (copy of the printout is attached - Tab C). It appears that the obligations listed in the printout are consistent with the categories of approved uses pursuant to USAID's April 29, 1992 letter to the GOM. Therefore only the \$2,890.37 remains to be programmed. The GOM has renewed its intention to use these remaining funds in accordance with the agreed categories, and USAID will continue to work with the GOM to that end.

ANE Bureau reviewed these Recommendations with the A.I.D. Representative in early March 1994 and concluded that a completion date of April 30, 1994 should be established for the Cash Transfer to allow a brief period for final actions to account for the last \$2,890.37 of Cash Transfer funds. We suggest these Recommendations be kept open until the A.I.D. Representative reports completion of these actions.

Recommendation No. 2: We recommend that the Assistant Administrator of the Bureau for Asia:

- 2.1 Terminate the Mongolia Energy Sector Project, a project which was authorized without a complete authorization package; and
- 2.2 Establish controls to withhold authorization of any project assistance which has not been developed, designed, and reviewed in accordance with USAID's managerial controls for project assistance, including the control procedures for developing a Project Paper.

**Comment:** Basically, in 1992 we had no choice but to act immediately. There wasn't time, nor did we have enough knowledge of the causes of the emergency, to do all the planning normally included in a Project Paper (PP). We decided to authorize when we did as the only alternative to unacceptable harm.

The draft Audit Report does not question the existence of an emergency nor the need for urgent delivery of assistance.

The guidance on exceptions to the general project system in effect when we authorized the Energy Sector Project in 1992 were in Handbook 3, Chapter 4, Section 4.B.1, date September 30, 1982. This Section provides an exception for Economic Support Fund (ESF) projects like the Energy Sector Project, with this guidance:

Although it is desirable to use the project documentation system applicable to Development Assistance, it is recognized that there are numerous factors including political considerations, timing, etc., which are overriding in the case of Supporting Assistance and Economic Support-type funding which may not permit the appropriate Geographic Bureau to satisfy the basic documentation requirements. When departures from the standard documentation are proposed, the PID should identify them. If the need for departures is discovered subsequently, a written request and justification therefor should be submitted to the sponsoring Bureau and PPC.

The project authorization record made clear the reasons for departure from standard documentation. This record was not submitted to "PPC" because no such office existed in 1992 and all project authorization authorities had been delegated to the regional bureau Assistant Administrators since the 1982 HB 3 guidance was prepared. Also the Administrator and other senior officers of USAID were aware of the Mongolia emergency and were seeking rapid ASIA Bureau response to it.

Accordingly we consider that, if any procedural fault occurred at all, it was at most a technical oversight in not informing the non-existent PPC of our expedited authorization process.

Draft Recommendation 3.2 suggests that we now cease present and future assistance under the Project until a PP is done. We know that emergency needs continue and our assistance plans are strong. Therefore, delay of assistance at this time for an exercise to prepare a PP document does not make sense.

We believe the most recent value engineering exercise brought project planning up to date. Also, management improvements since the audit (transfer to project management from Washington to the field and a new competitively awarded implementation contractor with emphasis on operating rather than design experience) give us confidence that adequate planning has been done for the remainder of planned Project life.

We suggest that this Recommendation be withdrawn or closed.

Recommendation No. 3: We recommend that the Assistant Administrator of the Bureau for Asia:

- 3.1 Assign sufficient personnel and responsibility to Mongolia necessary to properly administer and oversee USAID's assistance;

**Comment:** The A.I.D. Representative commented on January 21, 1994:

Since the field audit was completed, several changes have taken place which should improve management of the Project. First, all Project management responsibilities have been transferred from Washington to Ulaanbaatar. Second, a full-time American Personal Services Contractor Engineer has been recruited and is resident in Mongolia, serving as the first-line project manager. Third, a full-time Mongolian Engineer, with considerable power plant experience, has been recruited and is working full-time on the Project. Fourth, USAID/Mongolia has effected personnel changes in the composition of the resident technical team, including a stronger manager of the team, and a stronger procurement component for the team. Fifth, telephonic communications have greatly improved, making it much easier and faster to communicate with the contracting and legal officers in Bangkok. With new fax capabilities, the USAID also has direct access to AID/W, which has also improved USAID's ability to administer and oversee the Project.

ANE Bureau reviewed this Recommendation with the A.I.D. Representative in early March 1994. We concluded that there are adequate resources in his control to administer and oversee this Project. We note that the provision of a personal services engineer and transfer of project management from Washington to Ulaanbaatar were in accordance with the implementation plan in the original project authorization. We suggest that this Recommendation be closed.

Recommendation No. 3: We recommend that the Assistant Administrator of the Bureau for Asia:

- 3.2 Withhold authorization of any further commodity assistance to Mongolia until USAID certified that an adequate system of inventory controls is in place to account for USAID-financed commodities:

**Comment:** There are valid audit findings and ample implementation experience that the provision of commodity assistance has been marred by inadequate inventory controls. Improving those controls is one task of the present implementation contractor, Morrison Knudsen (MK). Moreover, the Mongolian Government recognizes the problem.

The Mongolian Minister of Energy commented on the draft Audit Report by letter of January 24, 1994. It states in part:

8. The inventory controls for some materials and spare parts provided under the A.I.D. assistance program for Sharyn gol, Baga nuur coal mines and Power Plant No. 4 [sic] were inadequate. For example 256.8 MT steel pulverized balls, \$135,000, were sent out without receipt documents. The Ministry has been correcting its inventory controls and is working with Morrison Knudsen to improve the procurement/record systems. Many of the problems are already corrected. After taking these shortcomings into consideration, the Ministry has developed a special order system for spare parts and materials which [are] financed by USAID.

The letter goes on to describe receipt and distribution procedures. Full text of the letter is attached (Tab A).

Ministry procedures described in the letter do limit vulnerability to loss. The A.I.D. Representative has tracked down most project commodities, albeit with more difficulty than would be acceptable under normal assistance circumstances. However, while we are encouraged that progress is occurring, it is unrealistic to expect Mongolian inventory control procedures that USAID could certify as adequate by our normal standards within planned project life.

Accordingly, we reviewed the commodity assistance situation with our A.I.D. Representative to Mongolia in early March 1994. We concur with his view that, despite shortcomings in inventory controls, commodity assistance is indispensable under the continuing emergency situation. It would require major redesign (and unacceptable delay under emergency circumstances) for us to find a way to help the Mongolians improve inventory controls without continuing planned help for urgent commodity needs.

Other donor support is coming on-stream, so we are reasonably confident that we can end commodity assistance in the next two years. During this time the A.I.D. Representative will continue work with the Mongolian energy agencies on inventory controls and other management practices. If they can be brought into line with international standards, Mongolia will get greater development benefits from international donor support.

We will continue to review the situation with the A.I.D. Representative to monitor whether assistance for improving inventory controls and other management practices is having positive effects.

We suggest that draft Recommendation 3.2 be qualified by a phrase such as "If practicable under the emergency circumstances of the energy sector....." Alternatively, this Recommendation might be merged with a revised Recommendation No. 2 that new procedures cover authorizations of assistance under circumstances when we cannot expect satisfactory accountability conditions in the recipient agencies.

Recommendation No. 3: We recommend that the Assistant Administrator of the Bureau for Asia:

- 3.3 Require the Mongolian Government to account for the use of commodities furnished under the Energy Sector Project, including the \$650,000 excavator which was diverted to Eastern Mongolia, and the unaccounted for explosives and \$80,000 dump truck;

**Comment:** The A.I.D. Representative commented on January 21, 1994:

Regarding the excavator: We believe the GOM has now adequately accounted for this piece of equipment. They diverted the USAID-funded excavator, intended for Baganuur, to Adunchuulun Mine in the far east, because of a more urgent need for the equipment at Adunchuulun at the time. When the GOM-funded piece of equipment arrived, the GOM transferred it from Tumurt Ovoo to Baganuur on April 5, 1993 to replace the piece purchased with USAID funds. The GOM clearly should have sought USAID permission before taking the course they took, but the intent of the USAID purchase was met, albeit months later than would have been the case had the diversion not occurred. We have instructed the GOM on the proper course of action to seek USAID concurrence before action is taken should such issues arise in the future.

The draft audit report claims that "About \$285,000 worth of power cables.....were purchased without sufficient technical specifications and support." We are convinced that the audit team was badly misinformed about the specifics regarding the cables that were purchased. The current principal contractor under the Project (not the same contractor responsible for procuring the equipment) concluded, as do we, that the document used to identify Russian manufactured cable "contains sufficient information to purchase equivalent USA manufactured cables and the 13 reels of cables that were purchased and furnished disputes this -- refers to the draft audit report -- evaluation." Moreover, the contractor's report goes on to say that "These furnished cables are of excellent quality, meet USA Federal Specifications for usage in American mines and the cables that have been installed are operating satisfactorily."

ANE Bureau concurs with these comments. We suggest this Recommendation be closed.

Recommendation No. 3: We recommend that the Assistant Administrator of the Bureau for Asia:

- 3.4 Verify the Mongolian Government's accounting for the use of commodities; and
- 3.5 Issue a Bill of Collection to the Mongolian Government for the costs of all commodities which cannot be accounted for or have been used for unauthorized purposes.

**Comment:** The A.I.D. Representative commented on January 21, 1994:

Through the American and Mongolian PSC engineers, and through the technical contract team (currently six full-time Americans, and plus full-time Mongolians), we believe we can adequately verify the accuracy of the GOM's accounting of USAID-funded commodities.

All commodities have been accounted for and have been used for authorized purposes.

ANE Bureau concurs with these comments. We suggest these Recommendations be closed.

Recommendation No. 4: We recommend that the Regional Contracting Officer, USAID/Thailand:

- 4.1 Determine the allowability of all costs incurred by the prime contractor in connection with its unauthorized \$1 million purchase order with the freight forwarder;
- 4.2 If a determination is made to retroactively allow the purchase order, ensure that a full audit for reasonable, allocable, and necessary costs of the freight forwarder is undertaken (including amounts paid for the services of affiliated companies of this freight forwarder and for the feasibility study), in accordance with the terms of the prime contract and applicable sections of the Federal Acquisition Regulation; and
- 4.3 Recover all amounts paid for those costs which are determined to be unallowable.

**Comment:** The Regional Contracting Officer commented briefly on this Recommendation November 23, 1993 and repeated his comment to RIG/A/S. A copy of his comment is attached (Tab D). ANE Bureau supports his interpretation that the use of the term "purchase order" in the general commercial context does not mean the same as in the U.S. Government sense.

The ANE Bureau project manager has frequently called the freight forwarder issue to the attention of the prime contractor's present project manager and accounting personnel. They have reported that an audit was conducted. However, the prime and the subcontractor freight forwarder have not resolved all legal issues. Hence, the prime is not yet prepared to report conclusions to us.

The prime contractor also reports other delays in final vouchering for work under the expired contract. Confusion within their firm followed a major corporate reorganization which led to departure of the former project manager. We have cautioned that the time for final vouchering for reimbursement is passing rapidly as the work was completed five months ago.

We suggest this Recommendation be kept open until the prime contractor reports its conclusions about this subcontract and we have an opportunity to review them. We may also request relevant information from RIG/A/S or IG/A Washington in reviewing the prime contractor's report when it is received.

Recommendation No. 5: We recommend that the Controller, USAID/Thailand:

- 5.1 Strengthen controls over the Project Officer Administrative Approval process by establishing procedures to withhold certification of any payment voucher which lacks the required attestation that the Project Officer has reviewed the supporting documentation to the voucher; and
- 5.2 Instruct voucher examiners to more closely review the supporting documentation for payment vouchers from contractors and to reconcile the amounts claimed with the eligible costs specified in the contracts.

**Comment:** The Controller, USAID/Thailand has commented that the standard A.I.D. Documentation for Payment clause (AIDAR 752.7003) applied to the prime contract in question. This clause requires only summary fiscal data and vendors invoices in vouchers for reimbursement. No other "supporting documentation" is required in keeping with the concept that such summary vouchers will be paid promptly without full pre-audit but are subject to post-audit.

ANE Bureau concurs with the Controller, USAID/Thailand that the required submissions with vouchers were received and reviewed before administrative approval or were referred to voucher examiners for correlation in terminology and funding between the contractor's summary fiscal data and supplier invoices.

ANE Bureau notes that this Recommendation is presented in the context of draft Audit Report comments on the adequacy of staffing for project management. We also note that no example of any problem with any approved voucher is cited in the draft Audit Report. We recognized when we authorized the project that there initial operating difficulties, as we had to for the first year. However, no unreasonable risk was taken while meeting an emergency need.

Finally, as originally planned in the authorization process, transfer of project management to Ulaanbaatar has made the process easier and less risky. The A.I.D. Representative's comments on Recommendation 3.1 (above) cover the improvements in the management situation since the transfer.

We suggest this Recommendation be closed.

#### Other Comments

The Sector Concept: One general cause of confusion in the audit is that the Energy Sector Project dealt with a sector-wide emergency and not just with specified power plants and coal mines. The authorization record made clear that our objective was to prevent the worst collapse of the key systems for the major cities. It stated that we were concerned with the power plants, coal mines, transport of coal to the power plants (railroads), and the distribution systems for heat and electricity.

Through the value engineering exercise we focused on a few power plants and coal mines for most of our limited resources. However, we could not predict where emergencies would arise, and have had to help the Mongolian operating agencies deal with their sector-wide responsibilities. There would be no success if we kept a few parts of the system operating while the rest of the system came apart.

There have already been some losses of heating services in isolated communities rendering buildings unusable with consequent humanitarian and economic losses. Thus, we understand the Mongolians desire to use our assistance were the needs of the moment indicate rather than for a specifically planned part of the system. While we are insisting that they clear such changes with our mission, they are not inconsistent with the concept that we are assisting the sector, not just specified pieces of it.

Consistent with this sectoral approach, our commodity support fed into a pool of sectoral resources. The draft Audit Report comments that some items that were airshipped were not immediately used. The A.I.D. Representative notes (below) that explosives and boiler tubes we supplied replenished insufficient stocks in plants or mines against regular needs and emergencies. Inventories had to be rebuilt with our shipments to last until the next expected international order.

This was not the most efficient way of doing business. We hope inventory control assistance will improve sectoral procurement planning and management. However, until the emergency is past, we must expect adjustments to planned uses of commodities as the sector-wide needs of the moment become apparent.

Explosives: The A.I.D. Representative commented January 21, 1994:

The draft reports states that "1,000 tons of Russian manufactured explosives costing \$570,000 to be used primarily in breaking ground during the winter, were also not received until March 1993 --- after the thaw." It is true that the explosives which were ordered in December 1992 (after funding was available to USAID for the project), however, the report reads as if these materials were not longer useful for the Project. In fact, explosives are consumables which are continuously used up and which need to be replaced every year. Also contrary to the draft report, explosives are used at some of the mines, such as Sharyn Gol, year-round; not just during the winter months. To illustrate the point of recurring need, in November, 1993, the AIDREP was requested personally by the Ministry of Energy to approve a waiver, on an expedited basis, for the purchase of 24,700 metric tons of explosives because he was afraid that Sharyn Gol Mine would run out of explosives by the end of the month.

The draft report notes that as of May 1993, Mongolia was still waiting for a shipment, worth \$964,000, of boiler tubing from Russia. According to a GOM report, with data verified by the Morrison-Knudsen American sub-contractor, by the end of November 1993 seventy-nine percent (dollar value) of all purchased equipment and parts for the 1992/93 heating season had been used. Fifty-five percent (by weight) of all the boiler tubes had been used. Of the remaining boiler tubes, sixty-seven percent are in five different sizes for the small heating plants (which are not a part of the Central Energy System).

Boiler Tubing: The A.I.D. Representative commented January 21, 1994:

To quote from the sub-contractor's report: "The remaining tubes for the major power plants were contingency tubes for the 92/93 heating season and will probably be used in 1994." (See Tab F). In point of fact, some of the boiler tubes were used for emergency problems which occurred at Power Plant #4 in Ulaanbaatar and at the Darhan Power in December 1993 and January 1994.

Attachments: (not included in this report)

Tab A - Energy Ministry letter

Tab B - Breakdown of uses of local currency

Tab C - Breakdown of uses of Cash Transfer funds

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