PD-ABJ-935

Regional Inspector General for Audit
Singapore

REVIEW OF USAID/PHILIPPINES' IMPLEMENTATION OF THE AUDIT MANAGEMENT AND RESOLUTION PROGRAM

Audit Report No. 5-492-94-015
August 12, 1994

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
OFFICE OF THE REGIONAL INSPECTOR GENERAL FOR AUDIT
— Singapore —

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August 12, 1994

MEMORANDUM FOR: Thomas W. Stukel, Jr.
Mission Director, USAID/Philippines

FROM: Richard C. Thabet, RIG/A/Singapore

SUBJECT: Review of USAID/Philippines' Implementation of the Audit Management and Resolution Program
Audit Report No. 5-492-94-015

Background

In the last few years, USAID management has taken a more active and assertive role in using audits as a means to improve and ensure financial accountability for its programs. USAID amended its standard provisions for grant agreements to include new recipient audit requirements and established the Audit Management and Resolution Program (AMRP) to oversee the Agency's financial audit program. This management effort is important to USAID because accountability is dependent upon audit verification of the proper use of funds provided to grantees and contractors within developing countries. When audits required by this Program are not performed, accountability is not reasonably assured.

The audit provisions required annual audits of recipients of USAID grant funds of $25,000 or more. These provisions went into effect on May 17, 1991, for non-U.S., non-governmental grantees (USAID Handbook 13), and May 1, 1992, for grant agreements with foreign governments (USAID Handbook 3). On May 6, 1994 and subsequent to our field work for this review, the threshold for Recipient-Contracted Audits was raised from $25,000 to $100,000. The USAID General Notice on AMRP, dated April 3, 1992, established a framework for USAID's audit management responsibilities and assigned specific responsibilities to overseas missions

in responding to the audit requirements and in the implementation of the Recipient-Contracted Audit program.

Information Objective

The Regional Inspector General for Audit/Singapore reviewed USAID/Philippines' Implementation of the Audit Management and Resolution Program to answer the following question:

> Has USAID/Philippines obtained the needed audit coverage of its grantees and contractors to verify that USAID funds were used for their intended purposes as required by USAID Handbooks and the Audit Management and Resolution Program?

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

Review Findings

Has USAID/Philippines obtained the needed audit coverage of its grantees and contractors to verify that USAID funds were used for their intended purposes as required by USAID Handbooks and the Audit Management and Resolution Program?

USAID/Philippines obtained the needed audit coverage of its grantees and contractors to verify that USAID funds were used for their intended purposes as required by USAID Handbooks and the Audit Management and Resolution Program except: (1) funds for audits were not provided in a number of agreements; (2) more than one audit was performed in a single fiscal year for several organizations; and (3) Recipient-Contracted Audit reports did not include the independent auditor's report on the organization's general purpose financial statements.

USAID/Philippines established a Management Control Review Committee, designated an Audit Management Official, created an audit inventory data base, established Mission specific guidance on the AMRP program, and adequately documented their efforts under the AMRP program in compliance with the guidance. We concluded the following: (1) the Mission's audit inventory data base was organized and functioning in an acceptable manner; (2) agreements contained the appropriate audit

clauses; (3) and the recipient's compliance with the requirements of the standard audit provisions were being tracked by the Mission in order to ensure that audits were scheduled, performed, and submitted as required. Finally, we found that the Recipient-Contracted Audits were being implemented, monitored, and resolved by the Mission in a well organized and effective manner.

We did, however, find several areas in the Mission's implementation of the AMRP that needed improvement. These areas are discussed below.

Funds Should be Budgeted for All Audits Under the Recipient-Contracted Audit Program

USAID/Philippines did not ensure that funds were set aside for required audits under the Recipient-Contracted Audit Program. Each grant agreement contained the standard audit provision which states:

> *"If the grantee receives $25,000 per year or more under this grant, the grantee agrees that it shall have an audit made of the funds provided under this grant and the financial statements of the organization as a whole."*

USAID General Notice on Audit Management and Resolution Program requires that:

> *"Recipient-Contracted Audits (such as those performed under OMB Circular A-133 or in accordance with other grant agreements will be funded through the provisions in the respective agreements."*

Although the Notice allowed for counterpart contributions or other alternative methods of funding, it still required the information to be included in the respective agreements.

We reviewed all grants over $25,000 that were awarded in fiscal year 1993 for non-U.S., non-governmental grantees. There were 25 such grants awarded totaling $9.8 million. Our review indicated that 5 of the 25 grants had no funds set aside for audit or a discussion in the agreements as to how the audits would be funded. These 5 agreements represented $4.9 million.

Mission officials stated that this was an oversight. The Mission explained that two of the five agreements were for less than $100,000. Therefore, the Mission planned to waive the Recipient Contracted Audits. For the

other three agreements, the Mission will amend the agreements to include funding for the audits.

Multiple Audits Were Performed in a Single Fiscal Year for Some Organizations

The Guidelines for Recipient-Contracted Audits (Guidelines) issued by the Office of the Inspector General (most recently revised in March 1993) require that a single Recipient-Contracted Audit be performed for each organization receiving over $25,000 in a fiscal year.

Our review found that the Certified Public Accounting firms have continued to carry out multiple audits on these type organizations in a single fiscal year. The firms audited individual agreements with organizations and not the total organization as required by the guidance. In fiscal year 1993, for example, three of the eight organizations which submitted Recipient-Contracted Audits had two or more of these audits performed on funds received in a single fiscal year. In each case, the Mission accepted the audit reports.

Auditing individual agreements within an organization, rather than performing a single audit of the organization, increased the number of audits performed by the Certified Public Accounting firms and the audit costs for the recipients. Also, the multiple audits require a significant amount of additional effort by the Mission and the Regional Inspector General in reviewing and administrating these reports.

While Mission officials are aware that only a single audit is required for each organization, officials need to remind the organizations and Certified Public Accounting firms of this and to establish a mechanism to encourage compliance. Mission officials could send each relevant organization a list of all agreements subject to audit with a reminder of this requirement.

Recipient-Contracted Audit Reports Did Not Include the Independent Auditor's Report on the General Purpose Financial Statements

The Guidelines for the Recipient-Contracted Audits require an audit of the organization's Fund Accountability Statement and General Purpose Financial Statements. The guidance goes on to require that the General Purpose Financial Statements and the auditor's report on them should be included in the Recipient-Contracted Audit report.

None of the twelve Recipient-Contracted Audit reports prepared during our review period included the General Purpose Financial Statements, nor did they include the auditor's report. Furthermore, there was no indication in the Recipient-Contracted Audit reports that the General Purpose Financial Statements were audited. This occurred because the Mission official responsible for the RCA program in the Mission was unaware of the requirements in the guidance. Consequently, the Mission could not ascertain from the Recipient-Contracted Audit reports that the organizations to which it provided funding were financially sound.

The Mission did have alternative procedures in place to address this control objective, therefore this non-compliance did not weaken internal controls over the Mission's monitoring of funds. These alternative procedures included requiring that each PVO's audited General Purpose Financial Statements be submitted to the Mission on an annual basis. In addition Mission staff conducted periodic financial assessments and on-site reviews to ascertain the financial soundness of the PVOs receiving USAID funding

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Management Comments and Our Evaluation

USAID/Philippines officials generally agreed with our first finding and have addressed, or are actively addressing the matters we brought to their attention.

USAID/Philippine's officials agreed with the second finding and recognize that the RCA Guidelines recommend that one annual audit be performed covering all USAID funding to a single foreign recipient. They accurately point out that in some cases, the number of awards to a single organization may be so large as to require one or more audit firms to perform the work. We agree that discretion should be used in these rare situations, but reassert the need to minimize the number of audit reports issued by each organization.

USAID/Philippines officials do not agree with the third finding. The Mission states that they are fully aware of the requirement that general purpose financial statements be included as part of each RCA report. During the audit, the Mission official responsible for the processing of the audits stated that she was not aware of this requirement. We have modified the report to reflect that only the Mission official responsible for the RCA program was unaware of the requirement.

The Mission's comments go on to make a valid point that they have alternative procedures in place to ensure that organizations covered by the RCA audit program are financially sound. As a result we have modified our report to reflect the Mission's comments.

Further, the Mission points out that this non-compliance was not previously criticized by the RIG in its review of earlier RCA reports. We acknowledge that some of the provisions in the RCA Guidelines were not universally applied. The IG is at this time considering whether to modify the RCA Guidelines to drop current requirements for RCA reports to include General Purpose Financial Statements. As the Mission has alternative procedures in place to accomplish the control objectives addressed by including General Purpose Financial Statements in the Recipient Contracted Audit reports, we find the mission's practice of not including the statements in Recipient Contracted Audit reports submitted by the Mission for review justifiable, until such time as a final determination on IG policy in this area is made.

A copy of the Mission's comments in their entirety are attached to this report as Appendix II.

SCOPE AND METHODOLOGY

Scope

We reviewed USAID/Philippines' implementation of the Audit Management and Resolution Program (AMRP). The review covered the period from the issuance of the USAID General Notice on AMRP on April 3, 1992 through the end of the field work on December 22, 1993. The field work was performed during the period December 8, 1993 through December 22, 1993 at the USAID/Philippines' offices in Manila.

The review assessed the overall effectiveness of the program by examining all fiscal year 1993 grants, contracts, and cooperative agreements awarded by USAID/Philippines. The review covered 92 agreements totaling $27.5 million from a universe of 404 agreements totaling $733.1 million, representing all active USAID/Philippines' agreements as of September 30, 1993.

Methodology

We interviewed the Acting Controller, financial analysts, project officers, and other Mission personnel responsible for the implementation and operation of the AMRP. We examined documents, files, and reports related to the AMRP system and its implementation. We also examined the 16 Recipient-Contracted Audit reports issued in fiscal year 1993. For the purpose of determining if the grant agreements had the required audit clause and an allowance in the budget for the cost of the audit, we tested all applicable grants awarded in fiscal year 1993. This covered 25 grants totaling $9.8 million out of 92 agreements totaling $27.5 million awarded by the Mission in fiscal year 1993. For contracts above $500,000 awarded to indigenous non-governmental organizations, we ensured that the contracts contained the required audit clause. There was only one such contract for $577,952 awarded in fiscal year 1993. In addition, we

reviewed USAID/Philippines' fiscal year 1993 Internal Control Assessment to determine whether it disclosed any material weaknesses in the implementation of AMRP.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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JUL 20 1994

MEMORANDUM:

TO : Mr. Richard C. Thabet
RIG/A/Singapore

FROM : for Thomas W. Stukel, Jr.
Mission Director, USAID/Philippines

SUBJECT : Review of USAID/Philippines' Implementation of the Audit Management and Resolution Program

Reference : (a) Thabet/Stukel Memo dated May 26, 1994
(b) Egan/Lewellen e-mail dated June 20, 1994

As requested, we are forwarding our comments on subject review. We hope that our comments will be duly considered in finalizing the report.

Finding No. 1: Funds for audits were not provided in a number of agreements. Out of 25 grants awarded in FY 1993, five were found to have no funds set aside for the recipient contracted audit (RCA) nor a discussion as to how the audit will be funded.

Mission Response: The Mission ensured that the applicable audit provisions were incorporated into the grant agreements; however, the Mission inadvertently failed to identify the specific line item in the grant budget, against which audit costs will be charged.

Following is a summary of actions the Mission has taken/is taking to resolve this finding:

(1) Grant No. 492-0447-A-00-3055 with the Financial Executives Institute of the Philippines has been amended to provide funding for the RCA. Likewise, Grant No. 492-0470-G-SS-3033-00 with Medical Ambassadors Philippines, Inc. has been amended to provide funds for Audit, Evaluation and Monitoring. The grant modifications are shown in Attachment 1.

(2) The Mission is currently working with Daughters of Mary Help of Christians, on the amendment of its grant. Based on initial discussions, funds from the line item ""Other Direct Costs" may be realigned to fund audit costs.

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Finding No. 2: "More than one audit was performed in a single fiscal year for several organizations".

Mission Response: The Mission recognizes that the RCA guidelines recommends one annual audit covering all AID funding to a foreign recipient. However, many recipients with large portfolios of USAID grants, elect to have the RCA done by two different auditors as well as independent at their annual audit. RIG/A/S did not pose an objection when we asked if this was permissible. The RCA reports which USAID has submitted over the past two years have been accepted by RIG/A/S as adequate.

Finding No. 3: "Recipient contracted audit reports did not include the independent auditor's report on the organization's general purpose statements." "This occurred because Mission officials were unaware of the requirements in the guidance. Consequently, the Mission could not ascertain, as intended by the guidance, that the organizations to which it provided funding were financially sound."

Mission Response: The Mission does not agree with statements made in finding no. 3. The Mission is fully aware of "the requirements in the guidance." The conclusion drawn in this finding that, "the Mission could not ascertain, as intended by the guidance, that the organizations to which it provided funding were financially sound" is faulty. The Mission did ascertain that grant recipients were financially sound. Each PVO receiving a grant from USAID/Philippines is required to provide the Mission with a copy of its audited general purpose financial statements on an annual basis. In addition to these audited statements, financial soundness of local PVO grantees is further ascertained through periodic financial assessments and on-site reviews by Mission staff.

RIG/A/S, who is charged with audit responsibility, has reviewed and approved the basic scope of work used for all RCAs by USAID/Manila. It has also reviewed RCA reports submitted since 1992. None of these reports were rejected or criticized for not including an audit report on the general financial statements of the grantees. They were accepted by RIG/A/S without objection, and without requests for modifications in this area.

In April 1992, RIG/A/S personnel visited several local CPA firms contracted to do RCA audits for USAID/Philippines. The purpose of the visits was to review RCA workpapers to verify that quality and compliance standards have been met. Although several suggestions were made as to how the firms could improve their performance, no recommendation was made to change the scope of the RCA audit work to include the grantees' general financial statements.

Attachment: Copies of Modification No. 1 for Grant Nos. 0447-A-00-3055-0 and 0470-G-SS-3033-00

APPENDIX III

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