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AUDIT OF
USAID/YEMEN SUPPORT TO
TECHNICAL ASSISTANCE CONTRACTORS

AUDIT REPORT NO. 3-279-89-13
March 20, 1989

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
REGIONAL INSPECTOR GENERAL/AUDIT

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March 20, 1989

MEMORANDUM FOR DIRECTOR, USAID/YEMEN, Kenneth H. Sherper

FROM: Richard C. Thabet, RIG/A/Nairobi *Richard C. Thabet*

SUBJECT: Audit of USAID/Yemen Support to Technical Assistance Contractors

The Office of the Regional Inspector General for Audit, Nairobi completed an audit of USAID/Yemen's support to technical assistance contractors. Five copies of the audit report are enclosed for your action.

The draft audit report was submitted to you for comment, and your comments are attached to the report. The report contains one recommendation, which is considered closed and requires no further action.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Background

Prior to April 1987, technical assistance contractors working on the Yemen Agricultural Development Support Project (ADSP) maintained their own vehicle maintenance facility and obtained building maintenance services and office supplies from local sources. To reduce overall costs and standardize services, USAID/Yemen in April 1987 assumed responsibility for providing the support from its own internal capability. During fiscal year 1988, USAID/Yemen reimbursed its operating expenses account about \$350,000 for the cost of supporting ADSP contractors, and charged this amount to ADSP Project funds.

Audit Objectives and Scope

The Office of the Regional Inspector General, Nairobi made an audit of the support USAID/Yemen provided its technical assistance contractors. The audit objectives were to determine whether USAID/Yemen provided efficient and effective support, used project funds appropriately in providing the support, and used sound procurement practices in acquiring supplies and materials purchased for contractors.

We reviewed procedures used by USAID/Yemen to support the contractors for the period April 1987 through September 1988. We reviewed data available in reports from USAID/Yemen's cost accounting system and its Mission Accounting and Control System. We reviewed payment, procurement and administrative files and observed warehouse operations and procedures. We also interviewed USAID/Yemen and ADSP contractor officials. The audit was made in December 1988 in Sana'a, Yemen.

The audit covered about \$350,000 charged to project funds in fiscal year 1988. This amount consisted of expenses relating to personal service contracts, purchases of supplies and miscellaneous charges.

We examined internal controls over the procurement of supplies purchased for the contractors, and the payment of invoices for the supplies. There were no prior audit findings relating to the area under review. The audit was made in accordance with generally accepted government auditing standards.

Results of Audit

No serious problems were noted that prevented USAID/Yemen from providing cost effective and efficient support to its technical assistance contractors. In fact, supported contractors stated that the overall quality of services was very good. Although adequate records did not exist to enable a calculation of savings resulting from the consolidation of services, both contractor and USAID/Yemen personnel cited changes in procedures and practices that resulted in more economical operations.

However, USAID/Yemen charged ADSP Project funds an excessive amount for the services provided. Further, although USAID/Yemen's procurement in support of contractors was generally in accordance with A.I.D. requirements, some problems were noted, which are discussed in the Other Pertinent Matters section of this report.

Excessive Charges Made to Project Funds for Support of Contractors - A.I.D. Handbook 19 stated that support costs were to be charged to projects to the extent they could be identified and segregated. USAID/Yemen installed a cost accounting system to segregate its support costs in order to provide a basis for charging projects for support services provided contractors. USAID/Yemen, however, charged the ADSP Project for non-allowable charges. This occurred because management believed the cost accounting system was understating its actual cost of providing support services, and because it incorrectly believed that AID/Washington guidance authorized its actions. As a result, USAID/Yemen overcharged the ADSP Project for support provided its contractors by about \$63,000.

Discussion - A.I.D. Handbook 19 stated that established criteria should be strictly followed in distinguishing between operating expenses and program-funded costs. Operating expenses represented salaries, benefits and support costs of personnel engaged primarily in Agency management and support functions. In addition, costs of general management support services, such as office space, utilities and the Mission motor pool were to be charged to the operating expenses account. The cost of support provided contractors was to be charged to projects to the extent they could be identified and segregated.

USAID/Yemen installed a cost accounting system to identify and segregate support costs applicable to each user, and thereby provide a basis for determining how much to charge the ADSP Project for the cost of support services provided its contractors.

In practice, however, USAID/Yemen did not rely on its cost accounting system. Instead, it charged the project for various personnel, materials and overhead costs originally paid from the operating expenses account, as follows:

Cost of American Supervisor	\$ 99,300
Cost of Eight Direct Employees	120,000
Materials and Supplies	50,000
Overhead	<u>80,700</u>
FY 1988 Charge to Project Cost	<u>\$350,000</u>

These charges conflicted with A.I.D. Handbook 19 guidance. The following paragraphs discuss the nature of the costs and why Handbook 19 guidance would prevent charging them to the project.

- American Supervisor. The American Supervisor, the assistant GSO for Maintenance, was a USAID/Yemen management employee. He was responsible for all vehicle, office, residential and grounds maintenance for the entire Mission complex. He supervised 40 employees in carrying out these duties. Therefore, he was performing a general management activity and his payroll costs of \$99,300 were required to be paid from the operating expenses account, according to Handbook 19, except for that portion that could be allocated to project support through the cost accounting system.

- Eight Direct Employees. USAID/Yemen could not justify charging the entire payroll cost of the eight other employees to project funds. The employees were generally those individuals previously employed by ADSP contractors who were hired by USAID/Yemen when it started supporting the contractors directly. Since then, however, the employees worked in a pool

arrangement on whichever customer needed support at the time. Most of the employees' time was spent on general mission support, and consequently, according to Handbook 19, should not have been charged to the project.

- Overhead. The overhead charge of \$80,700 was computed by charging the percentage of time, ranging from 10 percent to 30 percent, that six other USAID/Yemen management employees were assumed to spend on duties relating to supporting ADSP contractor personnel. The management personnel were the Controller, the General Services Officer (GSO), two Assistant GSO's, the Executive Officer, and a Financial Analyst. A.I.D. Handbook 19 required that personnel engaged primarily in agency management and support functions be funded under the operating expenses account, and that costs from a single commitment not be split between project funds and operating expenses. Therefore, these overhead costs should not have been charged to project funds.

Thus USAID/Yemen charged the ADSP Project for \$350,000 of support costs for categories of cost that could not be justified by A.I.D. Handbook 19. Based upon its response to a draft of this report, the actual support costs during fiscal year 1988 were about \$287,000, which means charges to the ADSP Project were about \$63,000 more than they should have been.

This situation occurred because USAID/Yemen management believed the cost accounting system understated the mission's actual cost of supporting the ADSP contractors. USAID/Yemen was concerned that its operating expenses account would subsidize the ADSP Project if it used costs as identified by the system.

USAID/Yemen cited AID/Washington guidance as also justifying the level of charges to the ADSP Project. The guidance, citing a shortage of operating expenses funding, suggested that the cost of personal service contracts be paid from program funds to the extent possible. However, we believe that if such costs are charged to program funds, there must be a reasonable basis for allocating the amount charged.

In conclusion, A.I.D. Handbook 19 authorized charging support costs to projects to the extent they could be identified and segregated. USAID/Yemen installed a system to identify these costs, but stopped relying on it when the costs seemed low. It then used an alternative system that was contrary to the established criteria. We believe that USAID/Yemen should not have stopped relying on its cost accounting system, but instead should have adjusted the system as necessary to correctly identify costs attributable to contractor support.

Recommendation No. 1

We recommend that USAID/Yemen make adjustments as necessary to its cost accounting system to accurately identify its cost of providing support to contractors, and reimburse its operating expenses account based upon data as compiled by the system.

In responding to the draft audit report, USAID/Yemen stated that it agreed with the recommendation and had taken corrective action. Management stated that it adjusted the cost accounting system retroactively to October 1, 1988, in order to provide a basis for allocating contractor support costs to the ADSP Project. As a result, USAID/Yemen determined that the appropriate support costs for fiscal year 1988 should have been \$287,413, as compared with the \$350,000 previously charged, or the \$97,800 that the system previously estimated for fiscal year 1988. Management also stated that it would use the costs as determined by the cost accounting system as the basis for charging the ADSP Project for the cost of support provided the project's contractors.

USAID/Yemen also stated that it had initiated measures to correct deficiencies in the procurement process described in the Other Pertinent Matters section of this report.

Our review of data supporting USAID/Yemen's comments showed that the mission's adjustments to the cost accounting system appeared appropriate. The system should now properly segregate charges to the ADSP Project for the cost of support provided the project's technical assistance contractors. Further, the mission outlined specific procedures to reimburse its operating expenses account based upon data as compiled by the system. Accordingly, Recommendation No. 1 is considered closed, and requires no further action.

Other Pertinent Matters

USAID/Yemen's procurement in support of contractors was generally in accordance with A.I.D. requirements, although some problems were noted. We selected seven procurement actions totalling \$79,421 for testing, and found that requisitions for two items were missing and receiving and inspection reports for four items could not be found. Further, there was no record that competition was sought for any of the seven procurement actions. As a result, A.I.D. may not have obtained the lowest available competitive prices, and internal controls over the procurement function were weakened. USAID/Yemen should enforce procurement procedures in accordance with A.I.D. regulations.

AUDIT OF
USAID/YEMEN SUPPORT TO
TECHNICAL ASSISTANCE CONTRACTORS

APPENDICES

UNITED STATES GOVERNMENT

memorandum

DATE: March 11, 1989

REPLY TO
ATTN OF: Kenneth H. Sherper, ^{KHS} Director, USAID/Yemen

SUBJECT: Audit of USAID/Yemen's Support to Technical Assistance Contractors

TO: Richard Thabet, RIG/A/Nairobi

We have carefully reviewed the subject draft audit report and were disappointed it did not take into consideration most of the points raised in my memo to you of December 26, 1988 (copy attached). We would like to provide comments on the draft report and advise you of actions we have taken since the audit was conducted in December 1988.

Again, we accept the recommendation as stated in the audit report. It has stimulated us to fully review the system we have for cost determination and cost recovery under Contractor Support Services (CSS). We have conducted a thorough analysis of the basis for determining labor rates and overhead rates based upon cost accounting records maintained since the CSS system was initiated in April 1987. This data has provided the basis for adjusting the cost accounting system in order to determine reasonably accurately what the CSS costs are. For a complete explanation of our analysis, computation and how the cost basis was determined, please refer to the enclosed copy of the Jamshed/Sherper memo and its attachments dated March 11, 1989. The system used in FY 88 has been discontinued and the new system has been put in place retroactive to October 1, 1988. We believe the new cost accounting system meets fully the requirements of the audit recommendation. We therefore request that the audit recommendation be closed upon issuance of the final report.

We would like to provide the following comments on the draft audit report.

1. We do not agree with repeated statements in the draft audit report that in FY 88 USAID/Yemen overcharged the ADSP project by \$252,200 for CSS. The amount for CSS support of \$97,800 stated in the report grossly underestimated actual CSS costs to USAID.

We do agree with the report that the cost accounting system was deficient and, therefore, did not capture all the CSS costs. When CSS costs for ADSP in FY 88 are determined by applying the new cost accounting system that we now have in place, the costs total \$287,743, which is an overcharge of \$62,257 in FY 88. The analysis and computation for determining these costs is included in the attachments to the Jamshed/Sherper memo, which we believe accurately reflect the situation.

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2. We acknowledge that most of \$53,380 in auto repair parts purchased more than one year ago remain unused. However, these parts were imported because they are frequently unavailable in Yemen. There are a total of 60 USAID and CSS supported vehicles maintained by USAID and it is important to stock a reasonable amount of spare parts to reduce vehicle deadline time. Since requirements for auto repair parts (other than for preventive maintenance) cannot usually be anticipated and it takes months to receive imported parts, we believe it is prudent management to keep a well stocked inventory of spare parts. Since we have standardized on one make of vehicles and we plan to continue to use these vehicles for several years, we expect to utilize our inventory of spare parts. The cost (purchase price) of the vehicle fleet maintained by USAID is approximately \$812,000 and the total value of our spare parts inventory is about \$75,000. This is 9% of the value of the vehicles maintained, which we do not consider to be an excessive supply of spare parts.

3. We have initiated measures to correct deficiencies in the procurement process and records. Specifically, we will insure that requisitions, receiving and inspection reports, and records of competitive bids are carried out in accordance with A.I.D. regulations and proper records are maintained. We have replaced our procurement supervisor and taken other actions to insure procurement procedures are correctly followed.

In sum, we believe that we have corrected the deficiencies cited in the draft audit report. In particular the cost accounting system has been adjusted based on a sound analysis to determine accurately costs for providing support to ADSP through CSS. Therefore, we request that the recommendation in the draft audit report be closed upon issuance of the final report.

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