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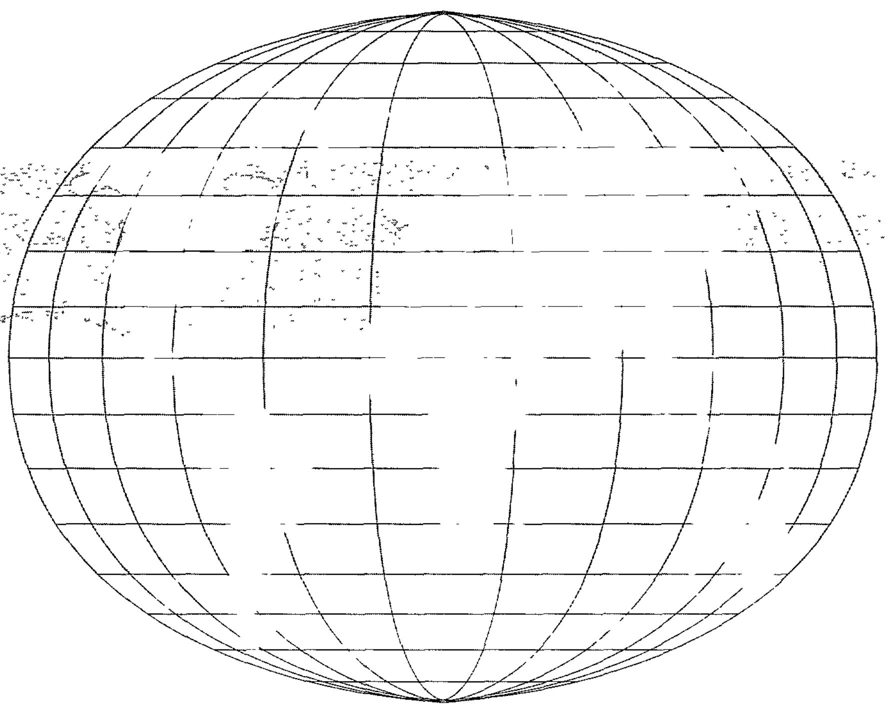
Report of Audit

Audit of Accountability for Local Costs of U.S.-Based Grantees and Contractors in the Philippines

Audit Report No. 5-492-00-002-P
June 22, 2000



Regional Inspector General
Manila

OFFICE OF INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

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Regional Inspector General for Audit
Manila

Audit of Accountability for Local Costs of U.S.-Based Grantees and Contractors in the Philippines

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MEMORANDUM

June 22, 2000

TO: Director, USAID/Philippines, Patricia K. Buckles

FROM: RIG/Manila, Paul E. Armstrong

SUBJECT: Audit of Accountability for Local Costs of U.S.-Based Grantees and Contractors in the Philippines, Audit Report No. 5-492-00-002-P

This is our report on the subject audit. We reviewed your comments to the draft report and included them in their entirety as Appendix II. The report questioned a total of $8,678 of costs. In addition, as a result of our Recommendation No. 2, we note that you have identified $1,225 in additional questionable costs for a grand total of $9,903 in questioned costs. You have also determined that $8,411 of these questioned costs were unallowable. We concur with your management decisions on all five recommendations. Furthermore, we acknowledge that you have taken final action on Recommendations No. 4 and 5. However, final action is still pending on Recommendations No. 1, 2 and 3. Information related to final action on the remaining recommendations should be provided to USAID's Office of Management Planning and Innovation, with a copy to us.

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

Background

The U.S. Government provides development assistance to the Government of the Philippines through a variety of mechanisms, including nonprofit organizations and contractors based in the United States. Many of these organizations have offices in the Philippines, which implement their development programs.

While the costs incurred by these local offices are subject to the same rigorous regulations applied to U. S. costs, these local costs are not normally the focus of in-country financial audits. In fact, USAID's Audit Management and Resolution Program stresses that costs incurred by U.S.-based grantees and contractors are to be covered by the entities' organization-wide audits performed to satisfy the requirements of Office of Management and Budget Circular No. A-133 (A-133) and the Federal Acquisition Regulation (FAR) [1], respectively. This approach may pose significant risk to USAID/Philippines management because expenditures which are material to the Mission's country program may be considered immaterial—and therefore not tested—when measured against the total expenditures of a large grantee or contractor.

[1] Circular A-133 addresses audits of states, local governments, and non-profit organizations whereas the FAR addresses audits of "for profit" entities.

Audit Objective

As part of its Fiscal Year 2000 Audit Plan, The Office of the Regional Inspector General, Manila (RIG/Manila), audited USAID/Philippines to answer the following audit objective:

- **Are the existing measures used by USAID/Philippines to monitor the local costs of U.S.-based grantees and contractors adequate to ensure that these costs are allowable, allocable and reasonable?**

Audit Findings

The audit showed that USAID/Philippines does take adequate steps to ensure that local costs incurred by its U.S.-based grantees and contractors are allowable, allocable and reasonable. However, as explained below, we do have concerns regarding what we consider to be limited testing of overseas transactions during organization-wide audits of U.S.-based grantees and contractors.

Financial audits of U.S. grantees and contractors are generally performed by either non-federal auditors or cognizant federal audit agencies; are generally organization-wide in scope; and normally include review of financial statements, internal control structure, direct costs, indirect cost rates and auditee compliance with applicable laws and regulations. While such audits serve as the primary basis for determining the allowability of costs, compliance with agreement terms, and the adequacy of the internal control system, the usefulness of such audits may be limited by the fact that costs incurred overseas might have been subjected to limited, if any, testing.

For example, in examining the organization-wide audits of three non-profit organizations[2] and one contractor, we found only one case where, in our opinion, adequate organization-wide testing was done on overseas costs (even in that case, none of the approximately $424,000 of costs incurred in the Philippines were tested). In another case, a DCAA audit covering three years of a contractor's worldwide operations did not test $17 million in foreign direct costs incurred on USAID contracts.[3] The two remaining A-133 audits we reviewed disclosed that only one transaction for about $5,000 was tested out of almost $3.2 million of

[2] One of the non-profit organizations selected, Management Sciences for Health, Inc., is operating under a contract with USAID/Philippines.

[3] While the auditor appropriately disclaimed an opinion on the foreign costs, USAID was left without any assurance concerning the propriety of those costs.

direct local costs. Such limited testing may pose a significant risk to individual USAID mission's that rely on these organization-wide audits to determine the propriety of locally-incurred costs.[4]

In light of this, we assessed USAID/Philippine's practices and determined that the Mission successfully addressed this risk by developing and implementing procedures for financial management system reviews. These reviews are conducted by the Mission's Office of Financial Management staff, are included in the job description for Financial Analysts and are assessed in the Analyst's performance evaluation. We believe these factors point out the importance USAID/Philippine's management places on financial management system reviews.

With respect to these reviews, we found that the Mission had recently conducted financial management system reviews of the internal control systems and allowability of local costs on two of the U.S.-based grantees we reviewed. The Financial Analyst not only found weaknesses in the grantees' internal control systems, but also took steps to follow-up on recommendations made in a prior review to ensure that they had, in fact, been implemented. Furthermore, his report not only noted that disbursements billed to USAID/Philippines had been tested to ensure that costs were allowable, but also made recommendations to improve the grantees' internal control systems. The Financial Analyst reported that he was in the process of following-up on the recommendations to ensure they are implemented.

In addition to the above, the Mission's FY 2000 Financial Audit Plan includes two Agency Contracted Audits of two U.S.-based contractors' locally incurred costs which will include the sub-grantees or subcontractors. Furthermore, that plan includes four Cost Effectiveness Audits as well as reviews of several accounting, billing & performance reporting systems.

Supplementing its internally conducted reviews, in late 1997 the Mission entered into a Participating Agency Service Agreement with the Defense Contract Audit Agency (DCAA) to conduct financial reviews and audits of selected USAID/Philippines grantees and contractors. The Mission took the action after they found from prior audits that local incurred costs were not always audited. In one case USAID/Philippines used DCAA to audit about $15 million of local costs of a U.S.-based contractor, which had never been audited. Although, the findings of that audit were not material, the agreement with DCAA has given the Mission added resources to determine if local costs—which may not be tested in organization-wide audits—are allowable, allocable and reasonable.

In another area we consider to be vulnerable, subgrantee cost, we found that the Mission had engaged DCAA to do a comprehensive review of seven subgrantees (100%) of a

[4] U.S. auditing standards indicate that auditors must use professional judgement when planning, performing and evaluating a sample. However, since we believe that such limited testing may pose a significant risk to individual USAID missions, we shared our draft report and discussed our findings with staff of the USAID Inspector General's Financial Audit Division (IG/A/FA) –which reviews the quality of select A-133 audits—for further review and action, as necessary. Accordingly, we are not making a formal recommendation concerning this issue at this time.

U.S.-based non-profit organization. As a result of the findings, the non-profit organization, in partnership with the Mission, was able to take steps to improve and strengthen its subgrant monitoring system, which will in effect give greater assurance that billed costs are allowable, allocable and reasonable.

During the audit, we judgmentally selected for review four organizational audits—three non-profit organizations and one contractor. We found that, in our opinion, testing during the sampled A-133 or FAR organization-wide audits was insufficient to determine whether specific costs incurred in the Philippines were allowable, allocable and reasonable. However, our testing of local costs incurred by the three grantees and our review of a DCAA audit report—commissioned by the Mission and focusing on local costs incurred by the USAID contractor—found that those costs, in general, were allowable, allocable and reasonable.

Certain Unallowable Costs Were Found

During our review, we did find the following minor unallowable costs and conditions:

1. **Management Sciences for Health, Inc., (MSH)**. MSH is an U.S.-based non-profit organization with headquarters located in Boston, Massachusetts. MSH's A-133 audit report for fiscal year ending June 30, 1998 reported approximately $49 million of USAID federal expenditures of which about $1.8 million were costs incurred in the Philippines. Both MSH and audit firm staff indicated that while costs incurred under the Philippines' contract were tested during MSH's FY1997 A-133 audit, the Philippines work was not considered to be a high risk for FY1998 and, therefore, no testing of local costs was done.

   Since the MSH's FY 1998 A-133 audit did not include any testing of local costs, RIG/Manila performed tests of USAID/Philippines Contract No. AID-492-0480-C-00-5093-00 to determine what unallowable costs USAID/Philippines might have paid. We tested four months of cash receipt transactions for compliance with FAR 31.2[5] Contract Cost Principles and Procedures for Contracts with Commercial Organizations, Federal Travel Regulations and USAID agreement terms to determine whether costs were allowable, allocable and reasonable.

   Our tests revealed no material questionable costs. However, we did find that MSH was reimbursed $641 for a dinner party on a cruise ship for a director's meeting (21,793 Philippines Pesos from Voucher Nos. 97/1648, dated December 9, 1997 and 97/1657, dated December 12, 1997). Also, in connection with the meeting, $41 was reimbursed to MSH for gifts purchased for the directors (1,381.25 Philippine Pesos, Voucher No. 97/1656 dated December 12, 1997). FAR 31.205-14, states that costs of amusement, diversions, social activities, ceremonial and costs relating there to, such as meals, lodging, rental, transportation, and gratuities are unallowable.

[5] The contract clause for allowable costs is 52.216-07, Allowable Costs and Payment, which incorporates FAR 31.2.

Therefore, we consider the costs to be questionable.

Moreover, FAR 31.201-4 states that allocable costs must be assignable or chargeable to one or more cost objectives based on benefits received. Therefore, we do not consider cost incurred for gifts to be of direct benefit to the project. We also determined that MSH paid for office coffee and billed USAID/Philippines. In our opinion we believe that FAR 31.201-4 would be applicable for this cost as well, therefore, making this cost questionable.

Finally, we found that MSH paid the meal and incidental expense portion of per diem at the full day's rate for Temporary Duty (TDY) travel that was 10 hours or more. Federal Travel Regulations (FTR) Part 301-7-7[6] only allows for this per diem to be paid at three-fourths of the applicable rate for such travel.

Based on our review of four months of MSH's local cash disbursements, we are making the following recommendations:

Recommendation No. 1: We recommend that USAID/Philippines make a management decision on the questioned cost associated with a Directors dinner cruise of $682 as detailed above, and recover from the Management Science for Health, Inc. all amounts determined to be unallowable.

Recommendation No. 2: We recommend that USAID/Philippines: 1) determine the local cost of office coffee and excess payments for temporary TDY travel billed to USAID/Philippine by Management Science for Health during MSH fiscal year 1998, 2) make a management decision on those questionable costs, and 3) recover all amounts considered to be unallowable.

2. **Program for Appropriate Technology in Health, (PATH)**. PATH is an U.S.-based non-profit organization with headquarters located in Seattle, Washington. PATH's A-133 audit report for December 31, 1998 reported approximately $11.8 million of USAID expenditures of which about $1.4 million were related to costs incurred in the Philippines. RIG/Manila's review of the non-Federal auditor's workpapers determined that the auditors tested only one transaction for about $5,000 billed to USAID/Philippines by PATH for the year ending December 31, 1998.

   Because PATH's December 31, 1998, A-133 audit did not include testing of local costs in the Philippines (except for the one transaction for about $5,000), we performed tests of USAID/Philippines Cooperative Agreement No. 492-0473-A-00-3107-00 to determine what unallowable costs might have been billed to and paid by USAID/Philippines. Four months of FY1998 local cash transactions were tested for

[6] The FTR's are incorporated under FAR 31.205-46 Travel Costs, prevision (a)(2)(iii).

compliance with OMB Circular No. A-122 (A-122)[7] and the agreement terms to determine whether costs were allowable, allocable and reasonable.

RIG/Manila found that USAID/Philippines reimbursed PATH for drinks and lodging costs incurred by employees at a mountain resort. The amount billed USAID/Philippines was $811 for staff development (33,642 Philippine Pesos, from CV Nos. 00170 and 00171 dated November 18, 1998 and November 23, 1998 respectively). A-122, Attachment B, Section 18, states that costs of goods or services for personal use of the organization are unallowable regardless of whether the cost is reported as taxable income to the employee.

We also found that USAID/Philippines reimbursed PATH $53 for printed Christmas cards, which were not considered to be project related (2,300 Philippine Pesos, CV No. 0010345 dated October 5, 1998). A-122, Attachment B, Section 1, states that the only advertising costs and public relations costs allowable are those which are for the sole purpose of recruitment of personnel, procurement of goods and services, the disposal of surplus goods and services and the specific requirements of the agreement.

Additionally, USAID/Philippines also reimbursed PATH for $851 in telephone bills for which PATH had no support (36,731 Philippine Pesos, CV No. 0010346 dated October 5, 1998). The billings covered the period March 16, 1998 through September 15, 1998 and—according to PATH—official statements were never received. Therefore, PATH does not have supporting source documentation that correlates the calls to USAID project functions or adequately documents the costs as required by Circular A-122, Attachment A, Section A.2.g. As a result of this lack of documentation we consider the associated costs to be questionable.

Based on our review of four months of PATH's local cash disbursements, we are making the following recommendation:

<u>Recommendation No. 3:</u> We recommend that USAID/Philippines make a management decision on the above questioned costs of $1,715 ($864 ineligible and $851 unsupported), and recover all unallowable amounts from the Program for Appropriate Technology in Health.

3. **<u>The Asia Foundation, (TAF).</u>** TAF is an U.S.-based non-profit organization with headquarters located in San Francisco, California. TAF's A-133 audit report for the year ended September 30, 1998 reported approximately $17 million in USAID federal expenditures of which about $424,000 were local costs related to USAID/Philippines projects. Our review of the non-Federal auditor's working papers determined that the auditors had not tested any local costs billed to USAID/Philippines. The auditors stated that they rotated the testing of TAF's overseas transactions among its overseas locations. In FY 1998, the focus was

[7] Circular A-122 addresses cost principles for non-profit organizations.

Cambodia; therefore no testing was done on costs incurred in the Philippines. Our review of the auditor's working papers did indeed confirm that audit tests had been performed on TAF's transactions in Cambodia by the auditor's affiliate office in Vietnam.

Because TAF's FY1998 A-133 audit did not include any testing of costs in the Philippines, we performed tests to determine to what extent unallowable costs might have been billed to—and paid by—USAID/Philippines. Four months of FY1998 local cash transactions were tested for compliance with A-122 and the agreement terms to determine whether costs were allowable, allocable and reasonable.

While we found no exceptions to the above cost principles, we did determine that TAF was not in compliance with a Standard Provision of the grant agreement. This provision requires TAF to ensure that subrecipients adopt standards and procedures for determining the allowability, allocability and reasonableness of costs in accordance with A-122. RIG/Manila found that TAF had no monitoring system in place to ensure that local subrecipient costs met those requirements. TAF had regularly monitored local subrecipient costs until 1997, but since then little monitoring had taken place.

Effective monitoring of subrecipients is exceptionally important—a fact that was emphasized by the results of several DCAA reviews of TAF's seven subrecipients. Four of these reviews identified significant problems such as:

- The absence of—or inadequacies in—subrecipient accounting systems.
- The absence of a timekeeping system.
- Inadequate supporting documentation for subrecipient costs.
- The "borrowing" of subgrant funds to pay for other projects; and
- The commingling of TAF/USAID funds with funds from another TAF-funded project.

These initial DCAA reviews provided guidance to the subrecipients on steps of how to improve their systems. TAF has taken follow-up corrective action with the subrecipients to ensure the resolutions of these problems. In addition, the Mission is using DCAA to take follow-up action on the findings. DCAA is in the process of scheduling their follow-up reviews, which will be based upon the responses given to them by the subrecipients on the initial reviews. Upon completion of DCAA's review they will issue follow-up reports.

The new local representative of TAF acknowledged that monitoring of subrecipients was a very important process and that he would reestablish the monitoring program to ensure that local costs incurred by subrecipients were allowable, allocable and reasonable and that problems such as the above were identified and resolved.

Based on our review of four months of TAF's local cash disbursements, we are making the following recommendation:

<u>Recommendation No. 4:</u> We recommend that USAID/Philippines ensure that The Asia Foundation establishes and implements an adequate subrecipient monitoring system.

4. <u>**Louis Berger International, Inc., (LBII)**</u>. LBII is an U.S.-based contractor with headquarters located in East Orange, New Jersey. DCAA performed an incurred cost audit for the Fiscal Years Ending June 30, 1995, 1996 and 1997[8]. Because the contractor maintains original source documents supporting foreign costs (local costs) at their overseas locations, DCAA was unable to verify these costs. Therefore, when DCAA issued its organization-wide report on LBII, it disclaimed any opinion on LBII's almost $17 million of overseas' cost.

   In addressing this risk, USAID/Philippines requested that DCAA's Pacific Branch Office perform an incurred cost audit of LBII's local expenditures on Contract No. AID-492-0456-C-00-5135-00 to determine the allowability, allocability and reasonableness of those tests for the period September 1, 1995 through June 30, 1999. In their report[9], DCAA indicated they had questioned only $6,281 of the more than $15 million in costs claimed by LBII. Based on our review of DCAA's report, we agree that these costs appear to be questionable.

   Again, at the request of USAID/Philippines, DCAA's Pacific Branch Office preformed an agreed-upon procedures review to assess the cost effectiveness of LBII's project in the Philippines. The application of the agreed upon procedures disclosed no significant problems.

   Based on our review of DCAA's report, we are making the following recommendation:

   <u>Recommendation No. 5:</u> We recommend that USAID/Philippines make a management decision on the questioned cost of $6,281 as detailed on page 7, Note 5., of DCAA's report, and recover from Louis Berger International, Inc. all amounts determined to be unallowable.

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[8] DCAA Report Nos. 6201-99P10250970 & 98P1025000/610 dated September 30, 1999, issued by the Northern New Jersey Branch Office.

[9] USAID/Philippines engaged DCAA to audit the contractor's local costs. As a result, DCAA's Pacific Branch Office issued its Audit Report no. 4201-1999F10100001, dated March 25, 2000.

Management Comments and Our Evaluation

USAID/Philippines agreed with our recommendations and has already taken substantive action. We concur with the Mission's management decision on Recommendations No. 1 through 5. Furthermore, Recommendations No. 4 and 5 are closed upon issuance of this report.

SCOPE AND METHODOLOGY

We performed an audit of how USAID/Philippines monitored the local cost of U.S.-based grantees and contractors. The audit was performed in accordance with generally accepted government auditing standards and was conducted from December 7, 1999 through May 9, 2000 at USAID/Philippines.

The audit covered a judgmental sample of three U.S.-based non-profit organizations and one contractor that maintain offices and staff in the Philippines. We performed field visits in the U.S. at the headquarters of the non-profit organizations, as well as their auditors, to determine the extent to which costs incurred in the Philippines under USAID/Philippines projects were tested during their A-133 audits. We also met with the Defense Contract Audit Agency auditor that performed the organization-wide audit of the selected contractor.

Our audit work also included interviews with USAID/Philippines personnel, examining applicable documentation to identify existing measures used by the Mission to monitor the local costs of U.S.-based grantees and contractors, and assessing specific work performed by the Mission to monitor local costs of the selected grantees and contractor. Because of time constraints—and because it was not directly related to our audit objective—we did not audit the financial information the Mission provided from its accounting system, nor the totals for the annual local billings to USAID/Philippines provided by the grantees.

To determine the extent that unallowable local costs may not have been reported to USAID/Philippines, we interviewed grantee personnel and tested grantee cash disbursements. Our voucher testing included steps to determine if the local costs billed to USAID/Philippines were in compliance with cost principles stated in the agreement for the two non-profit organizations with grants, OMB Circular No.A-122 and FAR 52.216-07, Allowable Costs and Payment, which incorporates FAR 31.2, Contracts with Commercial Organizations, as well as FTR Part 301-7-7 for the one grantee and contractor tested with contracts.[10] So as to not duplicate work already performed by the Mission, we relied on the findings of an Agency Contracted Audit of the contractor on local costs performed by the Defense Contract Audit Agencies Pacific Branch Office.

[10] See Footnote No. 2 on page 2 of this report.

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JUN 9 2000

MEMORANDUM

TO : Mr. Paul Armstrong
RIG/Manila

FROM : Patricia K. Buckles
Mission Director
USAID/Philippines

SUBJECT : Draft Report on the Audit of Accountability for Local Costs of U.S.-Based Grantees and Contractors in the Philippines
Audit Report No. 5-492-00-00x-P

USAID/Philippines appreciates RIG/Manila's efforts and cooperation in completing the subject audit, and for acknowledging that the existing measures used by USAID/Philippines to monitor local costs of U.S.-based grantees and contractors are adequate to ensure that these costs are allowable, allocable and reasonable.

The Mission agrees with the five recommendations cited in the subject report.

Listed below are the actions the Mission has taken to reach management decisions and to obtain closure on these recommendations, along with the Mission's other comments on the draft report, for RIG/Manila's incorporation into the final audit report:

Recommendation No. 1: We recommend that USAID/Philippines make a management decision on the questioned cost associated with a Directors' dinner cruise of $681.63 as detailed above, and recover from the Management Science for Health, Inc. all amounts determined to be unallowable.

Actions Taken:
A review of the $681.63 questioned cost identified above disclosed that this amount should have been broken down into: (a) $641.00 for the cost of the Directors' dinner cruise; and (b) $40.63 for the cost of gifts given to the Directors.

A management decision has been reached. The Mission determined that $40.63 is unallowable; while $641.00 (P21,793) is allowable-- based on the Mission's validation that:

a) December 11, 1997, the date of the Directors' dinner cruise, was the only available and most opportune date for gathering all of the Directors from the Department of Health's (DOH's) Regional Offices and DOH's Central Office Service Units.

b) A Dinner Cruise, instead of a daytime meeting, was also the only setting available for all the Directors to gather as this group was already occupied in attending a series of DOH conferences and meetings at daytime and on the week that the dinner meeting was held.

c) The meeting served as the venue for the DOH's initial planning and consensus building for better implementation in 1998 of the Local Government Units' Performance Program (LPP) component of the USAID-funded Project (no. 492-0480).

d) Being a Christmas season, very few function rooms were available during nighttime. Based on MSH's solicitation of price quotations from two Hotels, the Directors' dinner cruise proved to be the most reasonable, especially if the meeting were to be held on a different date. The cost analysis, details of which are shown in **Attachment A,** is as follows:

Traders' Hotel: P550(meal)+ P2,850(accomodation)@ 30 pax
= **P102,000**

Bayview Park
Hotel Manila : P360(meal)+ P1,800(accomodation)@ 30 pax
= **P 64,800**

Dinner Cruise
(International
Golden Horizon
Cruise & Travel
Inc.) : **P 21,793** ($641.00)

On the basis of the above management decision, the Mission requests that Recommendation No. 1 be considered resolved upon RIG/Manila's issuance of the final audit report. Closure for this recommendation shall be requested upon Mission's recovery from MSH of the $40.63 unallowable cost.

<u>Recommendation No. 2</u>: **We recommend that USAID/Philippines: 1) determine the local cost of office coffee and excess payments for temporary TDY travel billed to USAID/Philippines by Management Science for Health during MSH fiscal year 1998; 2) make a management decision on those questioned costs, and 3) recover all amounts considered to be unallowable.**

<u>Actions Taken:</u>
The Mission conducted a detailed review of the costs in question. For FY 1998 and using an exchange rate of $1:P34 the cost of coffee amounted to P6,914 ($203)-**Attachment B**, while the excess Meals and Incidental Expenses (MI&E) payments for temporary TDY travel billed to the Mission by MSH totaled P34,753 ($1,022)- **Attachment C**. The latter amount also includes P14,874 ($732), representing the net excess M&IE payment for travel of more than 24 hours. Total costs in question, therefore, amounted to P41,667 ($1,225).

A management decision has been reached. The Mission determined that the total amount of P41,667 ($1,225) is unallowable and should be recovered from MSH.

On this basis, the Mission requests that Recommendation No. 2 be considered resolved upon RIG/Manila's issuance of the final audit report. Closure for this recommendation shall be requested upon Mission's recovery of the P41,667 unallowable cost from MSH.

<u>Comments:</u>
Page 5, par. 2, first sentence: Please replace the words "10 hours or <u>more</u>" with **"12 hours or <u>less</u>"** to be consistent with the FTR revision contained in USAID/General Notice dated 02/18/97. MSH would also like to clarify that it is not MSH's practice to make M&IE payments at full day's rate for travel that was 12 hours or less, that it was an oversight on its part to have missed being updated on the FTR revisions and, that since February 2000, it has been implementing the revised FTR rules.

<u>Recommendation No. 3:</u> **We recommend that USAID/Philippines make a management decision on the above questioned costs of $1,715.40 ($864.15 ineligible and $856.25 unsupported), and recover all unallowable amounts from the Program for Appropriate Technology in Health.**

<u>Actions Taken:</u>
The $864.15 ineligible cost identified above is broken down into: $810.85 for staff development cost involving personal drinks and lodging costs; and $53.30 for cost of Christmas Cards.

The $851.25 unsupported cost represents telephone billings from 03/16/98 to 09/15/98 reimbursed to PATH by USAID. Please note that $851.25, and not $856.25, should have been the correct amount reflected in this recommendation. Based on the telephone billings/Statement of Accounts that PATH was able to obtain from PLDT for the months of May, June and October 1998, Mission was able to validate $437.60 (P18,863.66)-**Attachment D**. PATH shall continue to make regular follow-ups with the PLDT regarding the Statements of Accounts for the months of July, August, and September 1998.

A management decision has been reached. Of the total $1,715.40 ($864.15 + $851.25) in questioned costs, Mission determined that $864.15 is unallowable, while $437.16 is allowable. The Mission will recover from PATH all unallowable costs and will validate the remaining $414.19 (17,867.83) in unsupported cost upon PATH's submission of the relevant telephone billings.

On the basis of these actions, the Mission requests that Recommendation No. 3 be considered resolved upon RIG/A's issuance of the final audit report. Closure for this will be requested upon Mission's recovery from PATH of all costs identified to be unallowable. PATH has agreed to deduct such costs from its forthcoming invoice to USAID.

<u>Recommendation No. 4:</u> We recommend that USAID/Philippines ensure that The Asia Foundation establishes and implements an adequate subrecipient monitoring system.

<u>Actions Taken:</u>
The Mission conducted a detailed review and verification of TAF's completed, ongoing, and planned actions (**Attachment E**) in response to this Recommendation.

The review indicated that both TAF's internal auditor [based in San Francisco] and TAF's locally hired internal auditor

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based in the Philippines are actively engaged in the monitoring of TAF's internal controls and sub-grantee financial performance. The review also disclosed that TAF/Manila has documented: (a) a general methodology and approach on the financial monitoring of its Philippine subgrantees, (b) an internal control questionnaire for sub-grantees' use and compliance, (c) actual and planned visits until the end of the year, and (d) a compilation of subgrantees' deficiencies and sub-grantees' responses based on TAF/Manila's monitoring reports.

TAF/San Francisco's grant monitoring system is expected to operate in October 2000. This was initially demonstrated at the Representatives' Conference in Bangkok and subsequently, to TAF's senior management in San Francisco. It is currently in beta test in its Sri Lanka and Pakistan offices. TAF/San Francisco stated that they are currently writing the installation and user manuals for this.

A management decision has been reached. The Mission determined that TAF has established and is currently implementing an adequate subrecipient monitoring system.

On this basis, the Mission requests that Recommendation No. 4 be considered resolved and closed upon RIG/Manila's issuance of the final audit report.

Comments:
Page 7, last par. before Recommendation No. 4 - Please replace "PATH's" with "**TAF's**" as this section pertains to TAF.

Recommendation No. 5: We recommend that USAID/Philippines make a management decision on the questioned cost of $6,281 as detailed on page 7, Note5., of DCAA's report, and recover from Louis Berger International, Inc. all amounts determined to be unallowable.

Actions Taken:
A management decision has been reached. The Mission determined that the $6,281 questioned cost is unallowable.

Shown in **Attachment F**, is LBII's May 2000 invoice supporting LBII's Senior Vice President's decision (per LBII letter dated 05/23/00) to refund the full amount by deducting this from LBII's billed expenses for the month of May.

Based on this, the Mission requests that Recommendation No. 5 be considered resolved and closed upon RIG/Manila's issuance of the final audit report.

<u>Other Comments:</u>

USAID/Philippines, in coordination with RIG/Manila, will discuss with the IG and OP offices in USAID/Washington the issue of the sample size used by the auditors in testing, during their organization-wide audits, overseas (local) cost transactions incurred by the 4 U.S-based organizations covered by this RIG/Manila audit. This is to ensure that future audits on these organizations, as well as on all other U.S.-based organizations, as required by the Federal Acquisition Regulations and OMB Circular A-133, include a sample size that is more appropriate and adequate for determining compliance with Awards conditions--to include allowability, allocability and reasonableness of costs under U.S. Federal awards. USAID/Philippines will continue its financial review program to identify areas of risk, to enhance the annual financial audit program of U.S.-based organizations, and to supplement the financial audit, as USAID/Philippines deems appropriate.

cc: SKroll, OP/PS/CAM, USAID/W
MTurner, M/MPI, USAID/W
JGaughran/ECromartie, IG/A/HLC, USAID/W