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AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

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OFFICE OF THE AUDITOR GENERAL
AREA AUDITOR GENERAL - LATIN AMERICA

2892/201

AUDIT REPORT

USAID/BRAZIL

COUNTERPART FUNDS ALLOCATED TO
RIO GRANDE DO SUL HIGHWAY MAINTENANCE

LOAN No. 512-L-069

3/15 1277

For the period November 8, 1971
through January 31, 1974

Audit Report No. 1-512-74-89
May 10, 1974

COPY No. 11

TABLE OF CONTENTS

	<u>PAGE</u>
SECTION I - SCOPE OF EXAMINATION	1
SECTION II - BACKGROUND	1
SECTION III - SUMMARY	2
SECTION IV - FINDINGS AND RECOMMENLATIONS	3
A. EXPENDITURES	3
1. Procurement of Locally Manufactured Equipment	3
2. Cruzeiro Costs of Consortium Contract	3
a. Frederic R. Harris Engineering Corp. and Harris do Brasil	3
b. Montor-Montreal Organização Industrial e Economia S.A.	3
c. Proenge Projetos e Serviços de Engenharia Ltda.	4
B. INTERNAL CONTROL	4

EXHIBITS

- EXHIBIT A - INELIGIBLE EXPENDITURES FOR LOCAL PORT UNLOADING CHARGES RELATED TO U.S. MANUFACTURED EQUIPMENT PROCURED WITH LOAN No. 512-L-069 FUNDS
- EXHIBIT B - COUNTERPART FUND EXPENDITURES AND EXCEPTIONS TAKEN APPLICABLE TO FREDERIC R. HARRIS ENGINEERING CORPORATION AND HARRIS DO BRASIL LTDA.
- EXHIBIT C - COUNTERPART FUND EXPENDITURES APPLICABLE TO MONTOR-MONTREAL ORGANIZAÇÃO INDUSTRIAL E ECONOMIA S.A.
- EXHIBIT D - DISTRIBUTION OF AUDIT REPORT

REPORT ON EXAMINATION
OF
COUNTERPART FUNDS ALLOCATED TO
RIO GRANDE DO SUL HIGHWAY MAINTENANCE PROJECT
LOAN No. 512-L-069
FOR THE PERIOD
NOVEMBER 8, 1971 THROUGH JANUARY 31, 1974

SECTION I - SCOPE OF EXAMINATION

The Brazil Residency of the Area Auditor General, Latin America (AAG/LA), at the request of the Auditor General's Office of Audit, AID/Washington, has performed an examination of local currency counterpart funds allocated to the Rio Grande do Sul Highway Maintenance Project, Loan No. 512-L-069 dated December 21, 1970. The examination covered the period from November 8, 1971, the date of the Counterpart Agreement, through January 31, 1974.

The principal objective of this examination was to determine the propriety and applicability of expenditures made from the counterpart funds by the Departamento Autônomo de Estradas de Rodagem do Rio Grande do Sul (DAER) under the terms of the Counterpart Agreement and to evaluate the adequacy of internal control exercised by DAER over the funds.

Our examination was made in accordance with generally accepted auditing standards and included such tests of DAER's accounting records and related documentation as were considered necessary in the circumstances.

Before issuance, this report was reviewed with appropriate USAID/Brazil (USAID/B) officials and their comments were given due consideration.

SECTION II - BACKGROUND

On February 5, 1971, DAER entered into a contract with the Consortium of Frederic R. Harris Engineering Corp., Harris do Brasil Ltda. (a wholly owned subsidiary of the former), Montor-Montreal Organização Industrial e Economia S.A. and Proenge Projetos e Serviços de Engenharia Ltda. to provide technical assistance to the DAER in connection with AID Loan No. 512-L-069 for the improvement and expansion of the DAER's highway.

maintenance capability. The scope of the work of the contract contains 26 items for which the Consortium is to provide assistance. These include, but are not limited to, the reorganization of the DAER, developing operational maintenance programs, the training of maintenance personnel, developing maintenance equipment lists, developing procurement procedures and developing a cost accounting system.

In order to assist the DAER in partially funding the costs of locally procured equipment and in funding the local currency costs of the Consortium contract, USAID/B authorized the utilization of Cr\$12,000,000 from the counterpart funds generated from the proceeds of Program Loan No. 512-L-073. This Counterpart Agreement, No. FC-1971-010, was entered into by USAID/B and the Government of Brazil on November 8, 1971. The Agreement provides that the counterpart funds are to be used to assist DAER in (a) purchasing highway maintenance equipment of Brazilian manufacture needed for the maintenance program, and (b) financing the cruzeiro costs of consulting engineers. According to information obtained from DAER, about Cr\$8,600,000 of the counterpart funds are to be used by DAER in connection with the procurement of the equipment and approximately Cr\$3,400,000 for funding the cruzeiro costs of the Consortium contract. The counterpart funds are to be utilized in conjunction with the US\$5.5 million provided by Loan No. 512-L-069^{1/} and Cr\$20 million to be furnished by DAER to cover additional local currency costs.

On the basis of this Counterpart Agreement, DAER entered into Loan Agreement No. RBC-7206 with the Central Bank of Brazil on January 11, 1972 for Cr\$12,000,000 (US\$2,129,547). This amount is to be paid back by DAER within 20 years, including a grace period of 5 years, at an interest rate of 2 1/2 percent per annum. DAER is also responsible for paying a service charge of 1/4 percent based on account activity, plus the exchange risk loss.

In compliance with terms of the Agreement, the Cr\$12,000,000 has been deposited in a special escrow account in the Banco do Estado do Rio Grande do Sul.

As of January 31, 1974, a total of Cr\$11,780,296 had been released by the Banco to DAER for expenditure, leaving an unreleased balance of Cr\$219,704.

SECTION III - SUMMARY

Of a total of Cr\$8,247,597 expended by DAER from the counterpart fund as of January 31, 1974, our examination disclosed ineligible expenditures amounting to Cr\$920,600. Details concerning these items are set forth in Section IV. A. We have recommended that DAER return to the special escrow account an amount equal to the ineligible expenditures.

^{1/} Current final date for disbursement - December 31, 1974.

Due to limited AAG/LA manpower resources, our examination did not include a review of expenditures totaling Cr\$746,611 applicable to overhead costs reimbursed to a contractor based on provisional rates. Consequently, we have recommended that DAER make arrangements to have such an examination performed.

We also noted that DAER's internal control over the counterpart funds appeared to be generally adequate.

The report contains two recommendations for action by USAID/B.

SECTION IV - FINDINGS AND RECOMMENDATIONS

A. EXPENDITURES

As of January 31, 1974, DAER had expended a total of Cr\$8,247,597 of the counterpart funds. Of this amount, Cr\$5,376,884 was applicable to the procurement of locally manufactured highway maintenance equipment and Cr\$2,870,713 was for cruzeiro costs to support the Consortium contract.

1. Procurement of Locally Manufactured Equipment

Our examination disclosed that DAER had paid a total of Cr\$915,852 for Brazilian port unloading charges concerned with U.S. manufactured equipment procured with Loan No. 512-L-069 funds (please see Exhibit A). Such charges are ineligible under the terms of the Counterpart Agreement and should be paid from DAER's own funds.

2. Cruzeiro Costs of Consortium Contract

a. Frederic R. Harris Engineering Corp. and Harris do Brasil (Harris)

As shown in Exhibit B, expenditures applicable to Harris totaled Cr\$1,106,647. Of this, we took exception to Cr\$4,748 which represented reimbursements made to the project director for payments made to a U.S. equipment vendor in order to expedite shipment. Since these payments were concerned with the import of U.S. equipment and not with the purchase of Brazilian equipment, they are not eligible for reimbursement under the Counterpart Agreement.

b. Montor-Montreal Organização Industrial e Economia S.A. (Montor)

Expenditures related to Montor, as shown in Exhibit C, totaled Cr\$1,764,066. Our selective examination of these expenditures did not disclose any ineligible items. We did not, for the reasons explained below, review the overhead expenditures which amounted to Cr\$746,611.

Under the terms of the Consortium contract, Montor's overhead charges are based on provisional rates (132.5% on technician's salaries and 101.7% on support salaries). These rates are subject to adjustment on the basis of a DAER or USAID audit. An appropriate retroactive adjustment is then to be made on the basis of the audit. We have noted that Montor's provisional overhead rates have been historically high. Because of limited AAG/LA manpower resources, we are requesting that DAER make arrangements to have an audit performed of Montor's overhead rates to ensure the propriety and applicability of indirect costs claimed.

Recommendation No. 1

That USAID/B request DAER to (a) perform, or have performed, an audit of Montor's overhead rates applicable to the Consortium contract dated February 5, 1971, and (b) make any required adjustments related to the counterpart funds, as indicated by the audit findings.

c. Proenge Projetos e Serviços de Engenharia Ltda. (Proenge)

Proenge, although a party to the Consortium contract, has not performed any work under the contract. Consequently, no counterpart funds have been expended in this area. We did find, however, that Proenge had obtained a direct contract with DAER to review, update and develop the State of Rio Grande do Sul Highway Plan for 1980. This contract, dated August 16, 1973, is for Cr\$979,101 (about US\$155,000) and is funded from DAER's own funds.

In summary, ineligible expenditures made by DAER from the counterpart funds, as specified above in Section A1 and A2a, totaled Cr\$920,600. In order to rectify this situation, we are recommending that DAER reimburse the special escrow account from its own funds for the amount of the ineligible expenditures.

Recommendation No. 2

That USAID/B request DAER to deposit immediately to the special escrow account in the Banco do Estado do Rio Grande do Sul the sum of Cr\$920,600, representing those expenditures determined to be ineligible under the Counterpart Agreement.

B. INTERNAL CONTROL

As required by the terms of the Counterpart Agreement, the counterpart funds have been placed in a separate bank account in the State of Rio Grande do Sul for DAER's exclusive use in paying authorized program

expenses. We noted that expenditures from this fund bore the prior certification of DAER and the consulting engineers. We also noted that separate and adequate records were maintained by DAER concerning the receipt and utilization of funds.

DAER has also submitted all required semi-annual reports on expenditures to USAID/B. DAER officials stated that all required reports had also been submitted to the Central Bank and SUBIN^{2/}. Additionally, DAER has furnished USAID/B with a monthly accounting of expenditures as specified by the Agreement.

Regarding the processing of contractor's invoices, DAER procedures provide for a pre-audit of supporting documentation and a subsequent thorough review by the Accounting Division prior to authorization of payment. As previously stated, counterpart funds were used to reimburse Harris for costs claimed in expediting the shipment of U.S. manufactured equipment. These transactions were of a peculiar nature, were satisfactorily explained and were not, in our opinion, the result of a breakdown in the processing procedures. Consequently, on the basis of our examination, we concluded that these procedures were generally adequate to ensure that costs claimed were proper and applicable.

DAER's procedures for procurement of locally manufactured equipment were also considered adequate except, as previously mentioned, in the area of payment of port unloading charges associated with U.S. manufactured equipment financed with Loan No. 512-L-069 funds. DAER officials stated that they believed the Loan Agreement with the Central Bank gave some latitude to defray such port charges with counterpart funds. However, the binding agreement for proper utilization of these funds is the Counterpart Agreement which does not authorize such expenditures. Because these expenditures were made as a result of a misunderstanding and since we have already recommended that the amount of such expenditures be returned to the special escrow account, we are not making a recommendation on this matter.

^{2/} Sub-office for International Economic and Technical Cooperation.

EXHIBIT A

INELIGIBLE EXPENDITURES FOR LOCAL PORT UNLOADING CHARGES
RELATED TO U.S. MANUFACTURED EQUIPMENT PROCURED WITH LOAN No. 512-L-069 FUNDS
For the Period November 8, 1971 Through January 31, 1974

<u>Month</u>	<u>File No.</u> <u>(Processo)</u>	<u>Amount</u>
January 1974	17542/73	Cr\$ 65,000.00
December 1973	17543/73	155,000.00
October 1973	16613/73	15,000.00
July 1973	19795/73	107,000.00
" "	29881/72	20,000.00
June 1973	Tractors	55,000.00
May 1973	Equipment	217,728.28
April 1973	16573/73	47,255.09
" "	19795/73	106,269.49
" "	16571/73	55,624.00
" "	16570/73	61,651.83
" "	16573/73	7,744.91
" "	19795/73	730.51
" "	16570/73	<u>1,848.17</u>
Total		Cr\$915,852.28 =====

COUNTERPART FUND EXPENDITURES AND EXCEPTIONS TAKEN
APPLICABLE TO FREDERIC R. HARRIS ENGINEERING CORPORATION
AND HARRIS DO BRASIL LTDA.
For the Period June 1, 1971^{1/} Through January 31, 1974

	Expenditures Paid by DAER	Exceptions Taken	Adjusted Expenditures
Vehicles	Cr\$ 21,404.50	Cr\$ -	Cr\$ 21,404.50
Equipment	9,695.00	-	9,695.00
Furniture and appliances	105,140.40	-	105,140.40
Housing allowances	261,250.99	-	261,250.99
Education allowances	102,946.66	-	102,946.66
Travel and per diem	416,074.37	-	416,074.37
Telephone, telegraph, postage and insurance	96,737.21	-	96,737.21
Accounting fee (Harris do Brasil)	27,000.00	-	27,000.00
Miscellaneous	66,397.48	4,748.06(A)	61,649.42
Total	<u>Cr\$1,106,646.61</u> =====	<u>Cr\$4,748.06</u> =====	<u>Cr\$1,101,898.55</u> =====

^{1/} Certain counterpart fund expenditures were made by DAER prior to the date of the Counterpart Agreement (November 8, 1971). These expenditures were initiated in June 1971, consequently, our scope was expanded to cover such expenditures. The specific costs claimed and reimbursed were found to be justifiable, proper and applicable.

Explanatory Notes

- A) Represents reimbursements made to the project director for payments made to D.C. Andrews International Corp. in order to expedite shipment of U.S. manufactured equipment procured with Loan No. 512-L-069 funds.

EXHIBIT B

Page 2 of 2

Invoice No. 62508 (US\$434.37 at Cr\$6.12)	Cr\$2,657.73
" " 64688 (US\$261.55 at Cr\$6.12)	1,600.69
" " 88625 (US\$ 79.23 at Cr\$6.18)	<u>489.64</u>
Total	Cr\$4,748.06
	=====

Since the above reimbursements were concerned with the import of U.S. equipment and not with the purchase of Brazilian manufactured equipment, they are not eligible for reimbursement under the Counterpart Agreement.

EXHIBIT C

COUNTERPART FUND EXPENDITURES APPLICABLE TO
MONTE-TRÉVIL ORGANIZAÇÃO INDUSTRIAL E ECONOMIA S.A.
For the Period November 8, 1971 Through January 31, 1974

Salaries	Cr\$ 623,563.93
Overhead	746,611.03
Housing allowance	27,600.00
Travel and per diem	189,480.04
Fee - less retention	144,807.03
Miscellaneous	<u>32,003.79</u>
Total	Cr\$1,764,065.82
	=====

NOTE: No exceptions were taken to any of the above expenditures. We did not, however, examine the above overhead expenditures totaling Cr\$746,611.03 for the reasons explained on pages 3 and 4.

EXHIBIT D

DISTRIBUTION OF
AUDIT REPORT
No. 1-512-74-89

	<u>COPY No.</u>	
Mr. Marvin Weissman, Director, United States Agency for International Development Mission to Brazil	1	- 10
State Department - Inspector General of Foreign Assistance (IGA)		11
State Department - Country Director - Office of Brazil Affairs (ARA-LA/BR)		12
AID/W - Executive Director (ARA-LA/MGT/EX)	13	- 14
AID/W - Office of Audit (AG/AUD)	15	- 18
AID/W - Office of Program Operations (LA/OPNS)	19	- 20
AID/W - Operations Appraisal Staff (AG/OAS)		21
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Brazil Audit Residency, AAG/LA	24	- 28

NOTE: All audit work papers are attached to COPY No. 24 which is on file in the Brazil Audit Residency Office, AAG/LA.