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Briefing Report to
Senator Edward M. Kennedy

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THE PHILIPPINES

Accountability and Control of U.S. Economic Assistance

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UNITED STATES GENERAL ACCOUNTING OFFICE
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NATIONAL SECURITY AND
INTERNATIONAL AFFAIRS DIVISION

May 2, 1986

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The Honorable Edward M. Kennedy
United States Senate

Dear Senator Kennedy:

In response to your November 7, 1985 letter, we have examined the accountability and control over U.S. assistance given to the Philippines since 1978. This report discusses economic assistance. We are providing you a separate report on military assistance used to purchase U.S. defense articles, training, and related services.

Between fiscal years 1978 and 1985, the United States made available to the Philippines almost $1.3 billion in Economic Support Fund (ESF), Development Assistance (DA), Public Law 480 food aid, and military assistance. The Agency for International Development (AID) monitors ESF and DA project activities, the related expenditures, and food aid.

In recent years, the bulk of development-related assistance has been provided through the ESF program under which the United [illegible] the government of the Philippines (GOP). The dollar transfers are not tied to any specific purpose but may be used for repaying the Philippines' foreign debt or financing imported goods or services or for other purposes. When the U.S. funds are transferred, the GOP deposits an equivalent amount of its currency in separate special accounts to fund agreed-upon "nonproject" and "project" development activities. Nonproject assistance is to be used as the GOP's contribution to a selected group of World Bank, Asian Development Bank, and DA projects. Project assistance, on the other hand, is used to fund development activities, such as construction of schools and roads, which can be directly attributed to the ESF program.

NO CONTROL OVER U.S. DOLLAR TRANSFERS

We did not determine the disposition or use of ESF dollar transfers ($226.6 million as of Feb. 28, 1986) because the funds were commingled with other receipts in a general fund of the GOP Treasury. In keeping with its development priorities and as agreed with the GOP, AID monitors only the local currency expenditures associated with the implementation of the ESF projects.

Allegations concerning massive diversions, misuses and transfers of funds out of the Philippines highlights questions we have previously raised concerning transferring U.S. dollars to ESF recipients without measures to account for and control them. For example, in 1984, we reviewed such transfers to three Central American countries. At that time, the dollars were deposited directly to the recipients' bank accounts where they were commingled with funds from other sources. The Congress subsequently legislated that in one of these countries, El Salvador, a separate account be established for such transfers. Proceeds from the account are used to import eligible goods and services from the United States and other designated sources. AID subsequently reviews disbursements from the account for eligibility. The account must be reimbursed for any ineligible purchases. While the process provides a semblance of control, it does not preclude using ESF assistance to replace U.S. dollars from other sources, which could then be misused or diverted.

Our previous reviews of ESF programs, particularly the report on three Central American countries, also raised questions about the degree of control which is practical considering U.S. economic, political, and security objectives in a particular country. In the Philippines, for example, the ESF program was initiated to ensure continued U.S. access to Subic Naval Base, Clark Air Base, and other military facilities.

We believe these questions about accountability and control, and the relationship to other U.S. objectives remain valid.

NONPROJECT ASSISTANCE IS NOT CLOSELY MONITORED

The United States has provided $92.5 million in ESF dollars for nonproject assistance--$47.5 million was transferred in December 1984 and $45 million in December 1985. Upon receipt, the GOP deposited an equivalent amount of its currency in a special account for nonproject assistance. The equivalent of the initial $47.5 million was transferred to the GOP general fund, as agreed, after AID approved the activities to receive this type of assistance. According to AID the equivalent of $11.2 million of that transfer has been disbursed from the general fund for agreed-upon nonproject activities. The remaining equivalent of $36.3 million should still be on deposit in the general fund, commingled with other GOP receipts. The equivalent of the second transfer was reported by AID to still be on deposit in a special account. The Agency does not review, approve or account for final expenditures or reconcile account balances with bank records and reported transfers. At the time of our fieldwork, the GOP declined to give us a detailed

accounting of the expended and unexpended funds. AID relies mainly on quarterly GOP reports on the disposition of nonproject assistance local currency. We could not independently verify the expended and unexpended balances, because of the change of government near the end of our fieldwork. We are continuing our efforts to confirm the balances and will report the results to you as soon as possible.

It should be noted that AID transferred the additional $45 million in December 1985, although only the equivalent of $11.2 million of the initial $47.5 million had reportedly been used. According to AID, the GOP needed the additional funds to meet International Monetary Fund (IMF) guidelines for continued assistance from that organization.

USE OF LOCAL CURRENCY PROJECT ASSISTANCE

Unlike the U.S. dollar transfers, which are commingled with other funds, and ESF nonproject assistance, which requires only quarterly reports and is not closely monitored, AID must concur in all requests for local currency disbursements of ESF project assistance before the funds can be withdrawn from the special accounts. Concurrence is based on compliance with project agreements, inspections, and progress reports. All documents were properly reviewed and approved and reimbursements processed for three construction projects we examined in detail.

As of February 28, 1986, the GOP had disbursed an equivalent of $111.9 million of the $134.1 million for project assistance, leaving an unexpended balance of the equivalent of $22.2 million.

OTHER U.S. AND MULTILATERAL ASSISTANCE

Established procedures govern monitoring of DA project expenditures and food assistance. Prior GAO and AID Inspector General reports generally were intended to evaluate the management of U.S. development assistance to the Philippines and did not focus on misuse of that assistance. Two AID reports, however, did disclose that funds had not been used for intended purposes.

The principal multilateral organizations, of which the United States is a member, have made about $7.1 billion in assistance available to the Philippines between 1978 and 1985. These organizations have several mechanisms to account for and control assistance. However, we did not test these systems in operation because we have no audit authority to examine the operations of these organizations.

VIEWS OF RESPONSIBLE AGENCY OFFICIALS

A draft of this report was reviewed by AID's mission in Manila. The mission stated that it was in broad agreement with the report, and noted that we found no evidence of diversions of U.S. economic assistance to the Philippines. It generally agreed, however, that the report raises concerns about whether the agency's requirements for oversight are "optimal" where there is the potential for officially sanctioned diversions and misuses of public resources, and that commingling of financial resources defeats control and tracking systems. The mission said that in the Philippines, AID is in the difficult position of balancing its responsibility to account for and control expenditures of economic assistance against (1) U.S. foreign policy interests, (2) the GOP's view that ESF assistance is compensation for allowing continued U.S. access to air and naval facilities, and (3) U.S. economic and development objectives. The mission stated that there are risks associated with working in such an environment, and there are no proven techniques for fully eliminating such risks. While we agree, we believe the risks of diversions and misuses should be minimized to the extent possible. The mission stated that it is initiating checks of the quarterly reports on nonproject assistance, including the equivalent of $11.2 million which has been expended. We believe this positive step should, at a minimum, include sufficient verification to assure that the funds were disbursed for the intended purposes.

We also discussed the draft of this report with State Department and AID officials in Washington. All comments were incorporated where appropriate.

OBJECTIVES, SCOPE, AND METHODOLOGY

Our principle objectives were to identify (1) amounts and purposes of economic and other nonmilitary assistance the United States gave the Philippines between 1978 and 1985, (2) diversions of funds for unintended purposes, and (3) control and monitoring mechanisms for the assistance. We conducted our review in two phases. During November and December 1985, we did preliminary work in Washington and the Philippines to ascertain the extent we could respond to your concerns. During January and February 1986, we returned to the Philippines to continue our evaluation. During both visits, our ability to obtain information from host government officials was constrained by their reluctance to discuss sensitive issues.

During our second visit, this problem was compounded by their involvement in the ongoing political campaign. We could

not conduct all planned ESF project site visits because of violence and unrest in certain areas. We did, however, meet with several host country representatives, including the then-Chairman of the Commission on Audit and other GOP representatives.

We also interviewed State Department and AID officials in Washington and Manila. In the Philippines, we reviewed selected files and records provided by AID and, to a limited extent, by the GOP; visited ESF project sites; and obtained independent cost analyses of selected ESF construction activities which showed the amounts paid for the facilities were reasonable.

We reviewed several allegations concerning misuse of U.S. assistance. None of these could be substantiated. We also reviewed documents ex-President Ferdinand Marcos and others had brought with them to the United States. None of these referred to U.S. assistance.

We conducted this review in accordance with generally accepted government auditing standards.

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Details of our findings are contained in appendixes I to IV.

We are sending copies of this report to the Department of State, AID, appropriate congressional committees and making copies available to others upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Director

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ABBREVIATIONS

ADB	Asian Development Bank
AID	Agency for International Development
CARE	Cooperative for American Relief Everywhere
CIP	Commodity Import Program
DA	Development Assistance
ESF	Economic Support Fund
GAO	General Accounting Office
GOP	Government of the Philippines
IFC	International Finance Corporation
IG	Inspector General
IMF	International Monetary Fund
PVO	private and voluntary organization
UN	United Nations
UNDP	United Nations Development Program

AMOUNTS, TYPES, AND REQUIREMENTS FOR MONITORING ECONOMIC ASSISTANCE

Between fiscal years 1978 and 1985, the United States made almost $1.3 billion in bilateral assistance available to the Philippines, most of which has been for economic support, Development Assistance (DA), and food aid activities. The Agency for International Development (AID) monitors the implementation of these programs.

During this period, the United States also helped provide more than $7.1 billion in aid through participating in multilateral assistance institutions.

AMOUNT AND TYPE OF ASSISTANCE

Table I. 1 summarizes total U.S. assistance to the Philippines since 1978.

Table I.1: U.S. Assistance to the Philippines[a]
Fiscal Years 1978-85

Program	(millions)	Total
Economic Support Fund		$ 327.5
Development Assistance		319.6
Public Law 480:		
Title I	$ 61.0	
Title II	125.3	186.3
Security Assistance:		
Foreign Military Sales	$299.1	
Military Assistance Program	108.6	
International Military Education and Training	8.7	416.4
Peace Corps		36.4
Total		$1,286.2

[a]The amounts for Economic Support Fund, Development Assistance, Public Law 480, and Peace Corps represent obligations. Security assistance amounts are appropriations.

In recent years, increasing assistance to the Philippines has been an outgrowth of the 1979 amendment and 1983 memorandum of agreement to the Philippines-United States Military Bases Agreement, which governs operations at Subic Naval Base, Clark Air Base, and other facilities. In return for continued access to these bases, the Administration pledged its best efforts to obtain congressional approval and appropriations for the amounts listed in table I.2.

Under the 1979 amendment, assistance was made available for fiscal years 1980-84. The memorandum of agreement addresses assistance efforts for fiscal years 1985-89.

Table I.2: ESF and Military Assistance Pledges

	Amount		
	1979 amendment	1983 agreement	Total
	(millions)		
Economic Support Fund	$200.0	$475.0	$675.0
Foreign Military Sales	250.0	300.0	550.0
Military Assistance Program	50.0	125.0	175.0
Total	$500.0	$900.0	$1,400.0

ESF ASSISTANCE SERVES SEVERAL PURPOSES

Overall, the ESF program is intended to promote U.S. political and economic stability in countries of special economic, political, or security interest to the United States. The ESF program in the Philippines actually provides several types of assistance.

First, U.S. dollars are transferred to the government of the Philippines (GOP) Treasury. They may be used for repaying foreign debts or financing imported goods and services or for other purposes. The funds are actually transferred electronically from the U.S. Treasury to the Central Bank of the Philippines through the Federal Reserve Bank, New York. The payee is the Treasurer of the Philippines.

Second, the GOP, as required, deposits an equivalent amount of local currency, appropriated through its budget process, in separate special accounts. The amount is calculated at the highest legal exchange rate when the U.S. dollar funds are

transferred. This local currency can be used for two purposes: "nonproject" and "project" assistance, as follows:

--Nonproject assistance is intended to help maintain the implementation pace of a selected group of International Bank for Reconstruction and Development (World Bank), Asian Development Bank (ADB), and AID DA projects affected by GOP budget cuts.

--Project assistance provides funds for development-related activities specifically identified with the ESF program.

According to AID records, the Congress has appropriated $340 million (or about 50 percent) of the $675 million pledged for ESF assistance as of fiscal year 1985. Table I.3 shows the status of the amounts which have been appropriated as of February 28, 1986.

Under the ESF program, the United States obligates funds for agreed-upon nonproject and project activities. As the funds, which are provided as grants, are transferred, the GOP provides an equivalent amount of its currency to finance the local costs of the programs. Nonproject and project activities supported by ESF assistance are discussed below.

Table I.3: Status of U.S. ESF Assistance as of February 28, 1986

Status	Amount of assistance		
	Nonproject	Project	Total
	(millions)		
Obligated	$92.5	$235.0	$327.5
Transferred to GOP	$92.5	$134.1	$226.6
Expended[a]	$11.2	$111.9	$123.1

[a]Amounts represent the U.S. dollar equivalent of local currency expenditures.

Nonproject Assistance

ESF nonproject assistance funds were obligated for the following programs:

--Rural Productivity Support Program: Provides the equivalent of $47.5 million to maintain the implementation pace of selected World Bank, ADB, and AID

DA projects. All U.S. funds related to this project were transferred to the GOP Treasury in December 1984.

--Development Support Program: Provides the equivalent of $45 million for the same purposes as the Rural Productivity Support Program. All U.S. funds were transferred for this project in December 1985.

Project Assistance

ESF project assistance funds were obligated for the following activities:

--Project Design: The local currency equivalent of $9 million to facilitate identification and development of projects eligible for ESF support and fund the Secretariat, the GOP organization which manages the ESF program.

--Elementary Schools Construction: The equivalent of $18 million for constructing and furnishing elementary schools. All funds have been expended and the project has been completed.

--Municipal Development: The equivalent of $55 million to finance infrastructure projects for cities and towns affected by the bases used by U.S. forces.

--Regional Development: The equivalent of $121.5 million to construct schools and roads and support regional and provincial capital improvement projects and obtain the services of consultants, architectural and engineering firms, and other enterprises.

--Markets: The equivalent of $21 million to improve public market operations and construct or rehabilitate such markets.

--Rural Energy Development: The equivalent of $6 million to assist development of energy resources in rural areas.

--Clark Access and Feeder Roads: The equivalent of $4.5 million to provide access roads and soil and water improvements in areas around the Clark Air Base.

DEVELOPMENT ASSISTANCE

Consistent with understandings reached in negotiating the 1979 amendment, DA remained relatively stable--averaging about $40 million each year--in the period from fiscal year 1978

through fiscal year 1984. Since 1985, DA levels for the Philippines have been established according to AID's worldwide priorities as matched against the total availability of this type of assistance. The program focuses on developing nonirrigated (rain-fed) rural areas, promoting small- and medium-size rural enterprises, improving the capacity of local governments to plan and implement poverty-oriented development programs, and reducing population growth.

FOOD AID

In 1985, the United States initiated a Public Law 480, title I, program which provides concessional credits on a year-by-year basis for purchases of U.S. agricultural products. The agreement requires the GOP to undertake self-help measures aimed at deregulating the importation and trading of food grains and related agricultural commodities as a means of promoting increased production and lower food costs. The commodities or local currency proceeds accruing from their resale are to be used for activities which benefit the poor: small infrastructure projects, agricultural research, loans for fertilizer and marketing, price stabilization measures, and policy development. Title II, a longer term program, provides donated food for malnourished children through maternal and child health-care and school feeding activities conducted by private and voluntary organizations (PVOs). This program also provides emergency food aid as necessary.

MONITORING U.S. ECONOMIC ASSISTANCE

Through its Manila mission, AID provides oversight of DA and ESF activities and Public Law 480 food aid. Host country institutions--GOP ministries, provincial, city and municipal governments, contractors, and PVOs--implement the DA projects and distribute the food. Mission staff monitor progress by maintaining contact with the implementing GOP agencies and PVOs, visiting project sites, and reporting on the status of activities.

At the time of our fieldwork, the ESF program was managed by a Secretariat, which served as the technical support staff of an ESF Council under the GOP's Office of the President. The Council was responsible for reviewing ESF project proposals and making recommendations to the President for final approval. The Council was chaired by the Minister of Human Settlements (Mrs. Imelda Marcos). The Vice-Chairman was the Director General of the National Economic Development Authority, the organization traditionally responsible for coordinating all external assistance activities.

AID worked with the Secretariat in formulating policy and in preparing implementing procedures and project approval documentation. In the interest of placing primary reliance for project approval and monitoring responsibilities on the Secretariat, AID initially established systems to ensure compliance with mutually agreed procedures and a detailed review of only large, complex project activities. However, as the ESF program progressed, AID increased its monitoring of project documentation and construction activities to include all detailed designs, cost estimates, and contractor-payment requests. AID also reviewed vouchers for completed activities before agreeing to release local currency from special accounts.

MULTILATERAL ASSISTANCE

Numerous multilateral organizations provide developmental, economic, and humanitarian financial and technical assistance to the Philippines. Organizations such as the World Bank and ADB extend assistance for construction projects such as dams; power stations; irrigation systems; agriculture and natural resource development activities; and services designed to improve social conditions, such as rural development, education, health, and low-cost housing. The International Finance Corporation (IFC), a World Bank affiliate, promotes private enterprises by direct investments in projects which establish new businesses or expand, modify, or diversify existing businesses. IFC provides its own financing, either by loan and/or equity subscriptions, or seeks financial support from other sources. The International Monetary fund (IMF) seeks to lessen the impact of imbalances in international balance of payments by conditioning assistance on monetary policy and budget reforms.

The United Nations (UN), through its affiliate organizations, such as the United Nations Development Program (UNDP), also provides assistance. UNDP funds have been provided for modernizing institutions through training and research and for preinvestment studies for infrastructure development, chiefly for roads and telecommunications.

Table I.4 shows the amount of assistance made available to the Philippines by the principal multilateral organizations.

Table I.4: Multilateral Assistance to the Philippines 1978-85

Organization	Amount (millions)
World Bank	$ 3,171.3
Asian Development Bank	1,511.1
International Monetary Fund	2,229.0
International Finance Corporation	132.3
United Nations Development Program	53.8
Other	85.2[a]
Total	$7,182.7

[a]Represents assistance provided by other multilateral organizations--United Nations Fund for Population Activities and Children's Fund, the World Food Programme, and the International Development Association--between 1978 and 1984 (the latest available data).

OVERSIGHT OF ESF DOLLAR TRANSFERS AND NONPROJECT ASSISTANCE

ESF dollar transfers are commingled with other GOP receipts in a general fund. Also, nonproject assistance--funds provided for budget support--is not being closely monitored. In the past, we have reported on the lack of controls over similar assistance to other countries and the difficulty of obtaining any real monitoring of such aid to see that it is used for authorized purposes. The need for better oversight is becoming an important issue given the (1) increases in aid not tied to development projects, (2) problems AID is encountering in quickly disbursing funds through projects, and (3) growing concerns over potential misuses or diversions of U.S. assistance.

NO CONTROL OVER ESF DOLLAR TRANSFERS

Under ESF, AID transfers U.S. dollars to the GOP Treasury, for project and nonproject assistance. The amount transferred for project assistance is equivalent to the estimated local currency needed to carry out project activities during the upcoming quarter. In exchange, the GOP deposits that amount of its currency into special accounts to finance the local costs of the activities.

Commingling of Funds

When U.S. dollars are transferred, they are commingled with other GOP receipts and can be used for repaying foreign debts or financing purchases of imported commodities and services or for other purposes. They are not, however, used to purchase the local currency which finances ESF nonproject and project activities. With AID's assistance, we asked the Prime Minister to confirm our understanding that the funds are commingled. In a letter dated February 19, 1986, the GOP's Acting Treasurer responded, in part:

> "The dollar transfers become part of the general pool of free foreign exchange of the Philippine Government. Since these funds are fungible and commingled with other foreign exchange holdings it would be difficult to specify how the portion pertaining to the ESF dollar transfers were utilized."

Consequently, we did not determine the use for which the U.S. dollars may have been expended. We reviewed documents ex-President Ferdinand Marcos and others had brought with them

to the United States. None of these referred to U.S. assistance.

GAO Review of Cash Transfers to Other Countries

In the past, we have reported on ESF programs in several countries. For example, in 1984, we reviewed $590 million in ESF cash transfers to three Central American countries.[1] Like the Philippines, the dollar transfers were commingled with other funds. AID did, however, include covenants and conditions in all three agreements in an effort to control the funds. The agreements, for example, required that recipient countries attribute an equivalent amount of dollars to import raw materials and spare parts from the United States and document the purchases.

AID obtained documentation from central banks showing purchases of U.S. goods and services in amounts equivalent to the dollar transfers. The normal imports from the United States by the countries, however, exceeded the transfers. Overall, the transfers merely enhanced the recipient countries' ability to import whatever was needed from any source.

The report also noted that recipient countries were responsible for limiting illegal foreign exchange practices, such as capital flight--the illegal movement of funds to another country. One way this can occur is for importers to have vouchers overstated. Authorities such as central banks can review import prices to limit such practices.

After our 1984 review and in response to a legislative requirement, El Salvador established a separate account for the ESF cash transfers. Proceeds from the account are used to pay for imported goods and services from the United States and other designated sources. AID subsequently reviews disbursements from the account to ensure they were used to purchase eligible goods and services. The account must be reimbursed for any ineligible purchases. However, even this process does not preclude using ESF assistance to replace U.S. dollars which would normally be used to make such purchases. These dollars could then be misused or diverted.

Recognizing the U.S. economic, political, and security objectives of the United States in Central America, the report raised questions concerning

--expectations and objectives of cash-transfer-type assistance,

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[1] U.S. Economic Assistance to Central America (GAO/NSIAD-84-71, Mar. 8, 1984.)

--influence AID can or should exert over using such assistance,

--usefulness of attributing cash transfers to specific purposes, and

--practicality of controls in light of overall U.S. objectives in the area.

Allegations concerning massive diversions and capital flight in the Philippines would indicate that these questions remain valid.

ESF NONPROJECT LOCAL CURRENCY ASSISTANCE IS NOT CLOSELY MONITORED

Of the $226.6 million which has been transferred to the GOP, $92.5 million was for nonproject assistance--$47.5 million for the Rural Productivity Support Fund program was transferred in December 1984 and $45 million for the Development Support Fund program was transferred in December 1985. The GOP deposited an equivalent amount of local currency, appropriated through its budget process, in a special account. As AID approves selected World Bank, ADB, and AID non-ESF development projects to receive this type of assistance, the funds are transferred from the special account to the GOP general fund where they are commingled with other receipts.

We confirmed the transfer of $92.5 million to the GOP and the subsequent transfer of the local currency equivalent of the initial $47.5 million from the special account to the general fund by examining bank records provided by AID. Also, the GOP reported to AID that the equivalent of $11.2 million had been disbursed from the general fund for approved purposes. This should leave a balance of the equivalent of $36.3 million associated with the December 1984 transfer in the general fund and the equivalent of $45 million associated with the December 1985 transfer in the special account. All the local currency associated with the December 1984 transfer was to have been expended by the end of 1985. According to AID this was not achieved, in part, because of IMF restrictions on the size of the budget deficit which the GOP could incur. Also, AID requested the GOP not to disburse any funds associated with the second transfer until the unexpended balance associated with the first transfer is drawn down.

In February 1986, we attempted to verify the disposition and remaining balances of the local currency associated with nonproject assistance. The Secretariat declined to provide such information--saying it was obligated to submit only quarterly reports to AID. Additional efforts on our part to verify the

blances were disrupted by civil unrest and the change of governments. We are still pursuing these issues.

In accordance with agency policy, AID relies mainly on the Secretariat's certification through the quarterly reports that the local currency funds have been disbursed to the designated activities and the undisbursed balances remain on deposit. AID does not account for final expenditures of assistance to World Bank or ADB projects or reconcile reported balances and transfers with bank records. In responding to a draft of this report, AID stated that it checked the local currency status of its non-ESF projects and made informal contact with the ADB to ensure projects which should receive support associated with ESF nonproject assistance were receiving local currency from the GOP. However, since the source of the funds is not identified, it is difficult to ascertain if the support represents supplemental ESF nonproject assistance or the GOP's standard contribution to development projects financed by donor organizations. In its response, AID also informed us of plans to check the accuracy of the quarterly reports, including the equivalent of $11.2 million which has reportedly been disbursed.

ESF NONPROJECT LOCAL CURRENCY ASSISTANCE COULD INCREASE

The administration has recently indicated that more aid may be made available to the Philippines. AID officials said it would be difficult to add large amounts of resources for thousands of small projects scattered throughout the country. Additionally, project assistance is normally the slowest disbursing mode of aid.

Nonproject assistance generally requires less staff and oversight. AID's staff resources in the Philippines are limited and are projected to be reduced to 34 in fiscal year 1986 (from 49 in fiscal year 1980) due to agency-wide reductions. Consequently, nonproject assistance may become the predominate form of activity. If so, the need to find alternative ways to establish or maintain control and accountability over nonproject assistance is increasingly important.

Alternative Modes of Assistance Can Provide More Oversight

Two alternatives AID uses elsewhere can, if properly managed, quickly disburse funds and provide more oversight than nonproject assistance as it is now being implemented in the Philippines, although neither alternative would involve a level of control and accountability comparable to project assistance.

These are sector assistance and Commodity Import Programs (CIPs).

Sector assistance provides support to a specific defined area addressing a key development problem, for example, agriculture. One drawback is that AID's guidelines for sector assistance are not well defined.

Commodity Import Programs provide foreign exchange to import specified (usually U.S.-supplied) goods. The local currency generated from the sale of the foreign exchange is used for purposes agreed upon by AID and the recipient government. Such assistance is not necessarily faster disbursing or more flexible than project assistance, however, because of the time necessary for overseas procurement and the need for both AID and the recipient government to review the procurements to ensure they comply with regulations and prices are reasonable. Also, disbursements may be slow because importers may have access to other sources of foreign exchange whereby they can import items without concern for CIP regulations. AID has also expressed concern that such aid (1) is mainly public sector oriented, (2) is not sufficiently directed toward developmental goals, and (3) is not an adequate mechanism for institution building, a primary AID development objective.

Rent Versus Assistance Issues in the Philippines

The issue of alternative modes of ESF assistance in the Philippines is complicated by differing views over the nature of the funds. While AID views ESF as an additional resource to support long-term development, the GOP views it as rent for the bases.

In responding to a draft of this report AID noted that Congress expressed a desire at the beginning of the ESF program that the resources be used to directly benefit the people of the Philippines. Thus, project assistance was fostered instead of the unrestricted transfers anticipated by the GOP. Eventually, the GOP did accept a program focusing on rural construction activities and monitoring of the expenditures.

In a prior report[2] on the ESF program in the Philippines, we found that there were delays in organizing the program which stemmed, in part, from delays in designating a host country agency to coordinate the program and from disagreements over how much control the United States should exercise over the aid.

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[2]Economic Support Fund Assistance to the Philippines (GAO/NSIAD-84-44, Jan. 27, 1984.)

Key issues, including agreement on the purposes of the aid, needed to be resolved. Based on our current review, we believe resolving this issue would help AID decide on the appropriate degree of oversight.

OVERSIGHT OF ESF LOCAL CURRENCY DISBURSEMENTS AND CONSTRUCTION ACTIVITIES

Financial and administrative controls were adequate to ensure that ESF local currency disbursements for project activities were justified. Our limited review of selected financial transactions showed approved amounts had been disbursed and received by contractors.

We examined AID inspection reports and visited ESF project sites to ensure expenditures were financing actual construction activities. The facilities either were completed or were under construction. AID inspects a high percentage of sites, even in remote areas.

MONITORING ESF LOCAL CURRENCY DISBURSEMENTS

Although the disposition of ESF dollar transfers to the GOP Treasury cannot be traced, AID does monitor the GOP's disbursements of its local currency to implement ESF development activities. The extent of AID's oversight of local currency expenditures is more extensive for project assistance than for nonproject assistance. For example, AID reconciles and confirms ESF local currency project assistance disbursements with special account bank records.

After February 1984, ESF local currency requirements were no longer estimated--nor dollars transferred--on an annual basis. This is now done quarterly. The change was a result of large local currency balances which had accumulated in the special accounts due to a slower than expected pace of project implementation activities and, thus, disbursements. For example, AID transferred $1.3 million for the Clark Access and Feeder Roads Project in December 1982. By mid-1985, only one-sixth of the local currency equivalent had been disbursed from the special account because of implementation problems. In February 1983, AID transferred almost $6.3 million for constructing a waste disposal facility and three public markets using Municipal Development Fund resources. By mid-1985, when it was decided to resume transferring funds, but on a quarterly basis, construction of one of the markets had still not started, although most of the work on the other facilities had been completed. Between February 1984 and April 1986, AID made only one transfer--$16 million in August 1985--for project assistance because of the backlog of local currency in the special accounts.

Initially, disbursements for ESF project activities are made from a GOP general fund. The ESF Secretariat then requests

AID to concur in all reimbursements to the general fund from the ESF local currency special account. AID reviews supporting documentation, such as progress reports and certifications submitted by contractors, construction management and engineering services firms, and local implementing agencies. The extent of progress is confirmed by AID engineers who visit project sites. There are also various levels of approval within AID's mission, and requests for reimbursement have been rejected. For example, between July and September 1985, AID reviewed over 1,400 requests for local currency reimbursements totaling the equivalent of about $8.5 million. Of these, AID rejected 34 requests totaling about $478,000--mostly for technical or documentary deficiencies. The requests could be resubmitted with additional support or clarifications. After requests for reimbursement are approved, AID verifies that funds are actually transferred from the special accounts by reviewing bank records and ESF Secretariat disbursement vouchers.

In order to evaluate AID's ESF project disbursement review process, we examined transactions connected with three ESF subprojects: a large public market, a school, and a road. For all three subprojects, we examined the Secretariat's requests for approval of special account disbursements, internal AID memorandums discussing these requests, AID approvals, Secretariat disbursement vouchers, and bank documents showing that the disbursements had actually been made. All documents were properly reviewed and approved and reimbursements processed.

We visited the public market and met with officials, including representatives of the construction management and engineering services firm which oversees day-to-day construction activities for the Secretariat, the city government, GOP's Commission on Audit, and AID. Progress reports prepared by the contractor (which lead to periodic payments) are reviewed by the construction management engineering services firm, the city officials, and the Secretariat. We reviewed the reports which were certified by the designated officials, AID reports of site visits which confirm progress, and other AID documents concurring in the payments. The contractor told us that it had received all progress payments in full.

AID's Regional Inspector General (IG) did, however, report that the ESF Elementary Schools Construction Project had not been administered in accordance with the project authorization and agreement. Specifically, the IG found that funds for this project had been withdrawn by the GOP from the special account and placed in long-term local currency certificates of deposit and that construction activities were financed with other GOP funds. AID officials disagreed with the IG based on their

understanding of GOP budget and disbursement procedures.[1] As a result of the audit, however, AID informed us that the GOP had canceled the certificates and deposited the proceeds in the Treasury to reimburse the funds which were previously advanced for school construction.

In December 1985 and February 1986, we met with the following Commission on Audit officials: the then Chairman; the Manager, National Government Audit Office; and the Manager, ESF Secretariat Audit Office. We asked if the Commission had ever found evidence of diversions of ESF or other U.S.-assistance funds. The officials told us they had found no such evidence.

AID Reviews the Secretariat's Operational Funding

The Design Project funds most of the Secretariat's operating expenses through quarterly advances based upon an annual operating budget approved by AID. AID approved only one quarter of the Secretariat's fiscal year 1985 budget request because this conformed with previous expenditure patterns.

The Secretariat submits monthly expenditure reports to AID to liquidate quarterly advances. Again, AID memorandums discussed and questioned many of the expense items in the reports. AID often requested additional information and justifications.

CONTRACTING PROCEDURES AND CONTROLS ARE REVIEWED AND APPROVED BY AID

Four ESF projects fund construction activities--the Markets Project, the Municipal Development Fund, the Clark Access and Feeder Roads Project, and the Regional Development Fund. AID follows established procedures in monitoring and controlling contracting under the ESF program. Most contracting is administered by the GOP implementing agencies. AID has reviewed and concurred in GOP contracting procedures. Pre-bid construction cost estimates are prepared by consultants and are reviewed and approved by the Secretariat and AID. Contracts must be awarded to the lowest bidder (providing that the bid is below the approved cost estimate). AID officials, including the Regional IG for Inspections, have attended bid openings and reported observing no irregularities. AID reviews and approves individual contracts in accordance with criteria established by

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[1] Elementary School Construction, Project Design (Regional Inspector General Report Number 2-492-82-12, July 14, 1982).

project agreements and project implementation letters. In the case of the Municipal and Regional Development Fund projects, AID must review all contracts exceeding the equivalent of $500,000 but in practice has reviewed additional contracts when deemed appropriate.

Schools constructed under the Regional Development Fund--Schools and Roads Project--are built under AID's fixed amount reimbursement system. The project is building more than 1,000 standardized elementary schools and more than 1,000 local roads--using about 35 percent of all ESF construction funds committed to date. Under this system, the Secretariat and AID agree to the estimated cost of schools and roads based on agreed-upon designs and specifications. The Secretariat then arranges to build these facilities at the agreed price. This reduces the need for AID to review and approve bidding procedures, contractor selection, etc., for each school or road. However, AID still verifies that construction actually takes place by making periodic site visits.

Oversight of ESF Construction Activities

Construction activities are monitored by the Secretariat, local implementing agencies, and the construction management and engineering services firms hired by the Secretariat. In addition, AID regularly monitors ongoing ESF program construction activities. AID physically inspected 95 percent of the more than 1,000 ESF-financed schools. AID also inspected 88 percent of the ESF-financed roads.

We tried to visit as many ESF project sites as possible. However, our inspections were limited by violence and unrest in certain areas. We did visit a market in 1 province and 12 schools, 4 roads, and 1 public market in another region. All projects were either under construction or were completed.

A recent incident illustrates AID's awareness of ESF-type construction activities in the Philippines. During his political campaign, ex-President Marcos referred to numerous development activities which would be funded with ESF resources. In mid-January, AID's field engineers noted that construction of schools and markets at numerous sites had begun. None of the projects, however, were approved by AID. Furthermore, normal bidding procedures were not followed in many instances and prices exceeded cost estimates. Local authorities indicated their understanding that ESF funds were financing the construction and that the Secretariat had authorized the projects and had provided advances to contractors.

AID informed the Secretariat of its concerns, noting the possible breach of administrative arrangements governing the use of ESF local currencies, and requested that no funds be disbursed for unauthorized purposes. AID also intensified its monitoring of special account disbursements. There was no indication of withdrawals from the accounts for unauthorized construction activities. Evidently, the funds came from other GOP resources.

ALLEGATIONS OF MISUSE OF U.S. ASSISTANCE

During this assignment, we received several allegations concerning the misuse of U.S. assistance, such as incomplete or nonexistent facilities, overcharges, and substandard construction. We interviewed the individuals making the allegations and tried to document instances of abuse. We could not substantiate the charges. One allegation centered on a particular region. We planned to visit AID projects there but were precluded because of travel restrictions imposed by the U.S. embassy for security reasons. As an alternative, however, we spoke with AID's engineer responsible for the area and reviewed AID inspection reports. We found that the projects were visited regularly and construction was reported as progressing. The same person related instances of substandard construction of a major highway linking the region to the Manila area. AID did not fund that major highway project in the Philippines.

Cost Estimates

We also received an allegation that cost estimates for ESF projects were substantially inflated and that contractors and GOP officials were profiting from the practice. We engaged the services of a consultant familiar with construction activities in the Philippines to review (1) contracting procedures and (2) the costs of the same projects which we used as examples of financial controls. The consultant reported that documents related to the market showed

> ". . . there was no evidence of misdirected wrong doing or misinformation on this project."

Regarding the road project, the consultant reported:

> ". . . we did not determine a misrepresentation of overall costs nor does it appear to have taken place from information provided. The overall total price appears within reason given the scope of work."

Regarding the school project, the consultant's report stated:

> ". . . the project appears reasonable for the total project effort being provided."

In summary, the consultant did not determine any major difficulties with procurement procedures or with diversion or misappropriation of funds for the three projects analyzed. Also the Secretariat's cost estimates and contractors' bids appeared reasonable.

OVERSIGHT OF OTHER U.S. AND MULTILATERAL ASSISTANCE

AID oversees DA and food aid activities to ensure resources are being used for intended purposes. Disbursements for DA projects are reviewed and approved using AID policies and procedures. The title II food commodities are received and distributed by PVOs. AID monitors that process.

We reviewed prior GAO and AID Inspector General reports issued between 1978 and 1985. They generally focused on DA and food aid program management and implementation issues, not on diversions of resources. However, in addition to the IG's audit concerning the financing of ESF schools, which was discussed earlier, the IG also recently found that not all disaster assistance had been used as intended and that false vouchers had been submitted to AID for payment.

The multilateral assistance organizations have various management and financial controls to ensure resources are used as intended. We did not, however, test these procedures in operation because we do not have authority to audit international organizations.

MONITORING DEVELOPMENT ASSISTANCE AND FOOD AID

DA and food aid to the Philippines are monitored and controlled under AID policies and procedures. Various local currency disbursement mechanisms are used for DA activities. These include advances to GOP implementing agencies and PVOs and reimbursements to contractors. The disbursement methods are detailed in grant agreements, project implementation letters, or contracts. Whatever the method used, DA expenditures undergo review by AID to ensure that

--expenditures do not exceed the budget;

--funds are available; and

--documentation, such as vouchers and purchase authorizations, is complete and satisfactory.

Our review of selected disbursement records showed invoices and vouchers were properly certified and authorized for payment.

We discussed the accountability and control of food aid with U.S. officials in Manila. In the case of title II, AID essentially relies on PVOs (Catholic Relief Services and CARE) to maintain day-to-day oversight. AID approves these agencies'

requests for commodities. The U.S. Department of Agriculture provides the commodities to the PVOs in the United States. The PVOs must arrange for shipment from the United States to the Philippines. The freight forwarder and the PVOs must inspect all deliveries. The GOP is responsible for funding storage and inland transportation, while the PVOs are responsible for accountability and final distribution to program beneficiaries. AID makes spot checks throughout the process to ensure compliance with agreed-upon procedures and controls.

When we completed the fieldwork, the title I commodities had only recently arrived in the Philippines. According to AID, none of the commodities had been sold. Therefore, we could not evaluate AID's oversight activities, because no local currency had accrued from their sale. Plans to inventory the commodities during our fieldwork were overcome by events in Manila.

PRIOR GAO AND AID REPORTS

We reviewed 20 of our reports and 31 AID IG reports issued between 1977 and 1985 which concerned development assistance and food aid to the Philippines. Except for the IG's recent audit of disaster assistance, which is summarized below, none were primarily intended to focus on diversions of U.S. assistance.

Our reports generally focused on broader management issues, using the Philippines to illustrate how AID implements a particular type of program in several countries. For example, a 1984 report concluded that the lack of personnel trained in basic accounting and related financial management functions adversely affected the performance of foreign assistance programs in developing countries, including the Philippines.[1]

The IG generally focused on management issues and project implementation activities. For example, a 1984 report on an area development project involving water supplies observed that it may not have been economically viable and that the GOP was not providing adequate financial and technical assistance for effective operation and maintenance of irrigation systems.[2] In another example, the IG reported in 1983 that improvements were needed in a PVO's recordkeeping, reporting, and commodity controls over food aid.[3]

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[1] Financial Management Problems in Developing Countries Reduce the Impact of Assistance (GAO/NSIAD-85-19, Nov. 5, 1984).

[2] Bicol Integrated Area Development II Project: More Government Assistance Will Be Needed If This Project Is to Succeed (Regional Inspector General Report Number 2-492-84-10, Sept. 21, 1984).

[3] P.L. 480 Title II Program in the Philippines (Regional Inspector General Report Number 2-492-83-08, July 29, 1983).

In 1985, AID's Regional IG reported on disaster assistance to the Philippines, stating that over $305,000 had not been spent for agreed-upon purposes and that false vouchers had been submitted for an additional $108,000. AID recovered the $305,000 and stopped payment on the vouchers.[4]

MONITORING OF MULTILATERAL ASSISTANCE

Multilateral organizations use various mechanisms to monitor expenditures of resources and implementation of development programs. Large organizations, such as the World Bank, use a series of administrative, management, and oversight procedures to help ensure resources are used for intended purposes. Smaller organizations, such as IFC and UNDP, channel assistance through private enterprises or use affiliates to help achieve development objectives.

Our review of World Bank Guidelines for Financial Reporting and Auditing and Guidelines for Withdrawal of Loan Proceeds and discussions with senior managers responsible for bank activities in the Philippines show several mechanisms available to help ensure proceeds are used as intended. These include, for example, periodic status reports; independent financial audits using bank standards; appraisals by bank personnel which can address technical, institutional, economic, and financial issues; and project visits by bank staff.

ADB uses this same general framework to monitor implementation but has the added advantage of being headquartered in Manila. It therefore has a better opportunity to oversee project activities.

IMF assistance is contingent on the GOP's ability to achieve agreed-upon monetary targets and its willingness to implement certain economic reforms. The IMF does not monitor the use of its assistance, since the funds are provided for budget support purposes, and continued assistance is contingent on achieving budgetary targets and economic and monetary reforms.

IFC monitors the use of assistance by segregating funds in separate accounts, periodically consulting with the recipient enterprise's management, conducting site visits, receiving progress reports and other information which affect the company's business, and independent audits of financial statements. The agreements provide for accounting and financial

[4]Disaster Relief Provided to the Philippines National Electrification Administration (Regional Inspector General Report Number 2-492-85-06, Sept. 18, 1985).

reporting. The IFC has representatives in Manila, which facilitates oversight.

UNDP projects are usually implemented by other UN-affiliated agencies with expertise in a given area, the larger being the United Nations Food and Agriculture Organization, the Children's Fund, the Department of Technical Co-Operation and Development, the International Atomic Energy Agency, and the Civil Aviation Organization. In the Philippines, such agencies are implementing 38 of 45 ongoing projects. Activities being implemented by UN-affiliated agencies have an estimated cost of $38.3 million. Those implemented by GOP agencies are estimated to cost $3.9 million. Funds are held in separate accounts.

None of the officials of the multilateral organizations we spoke with were aware of diversions of assistance. However, we did not review any of these organization's controls in operation because we do not have authority to audit these organizations.

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