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EXCESSIVE CASH ADVANCES ARE COSTING THE
FEDERAL GOVERNMENT OVER \$2.5 MILLION
IN INTEREST ANNUALLY

AUDIT REPORT NO: 0-000-82-73

May 25, 1982

AID Federal Reserve Letters of Credit (FRLC) recipients are maintaining excessive cash advances totaling \$15.3 million. This practice is costing the Federal Government more than \$2.5 million in interest annually. Some FRLC recipients are using the excessive cash advances to finance activities not funded by AID. Other recipients are receiving interest on the cash advances and not reporting the interest earned to AID. The Agency must improve its internal controls to ensure FRLC recipients do not maintain excessive cash advances. If FRLC recipients are not willing to take measures to improve their cash management, then AID should rescind the FRLC authorization and pay for AID-financed activities on another payment basis.

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EXECUTIVE SUMMARY

Introduction

The Federal Reserve Letter of Credit (FRLC) authorizes an AID recipient organization to draw cash advances from the Treasury through its commercial banks. There are 201 organizations that use FRLC cash advances to pay for AID activities under 625 grants and contracts. The FRLC cash drawdowns made by these organizations average about \$325 million annually.

In the grant agreement or contract the FRLC recipient organization commits itself to (1) initiating cash drawdowns only when actually needed for disbursements; (2) timely reporting of cash disbursements and balances; and (3) imposing the same standards upon secondary recipients. The failure of the recipient to adhere to these conditions may result in the suspension or revocation of the FRLC authorization. (See page 1)

The Administration and the Congress are sensitive to the impact cash management of federal program recipients has on the national debt. The Senate Committee on Appropriations has called for federal agencies to take aggressive action to improve the management of cash advances provided to recipients of federal programs. In July 1981 the Director, Office of Management and Budget urged the heads of federal departments to review their systems for monitoring cash balances of recipient organizations to assure that excessive drawdowns did not go undetected. (See page 2)

Because of these concerns, we performed a survey in September 1981 of AID's FRLC procedures. Our survey work indicated AID was having difficulty monitoring FRLC transactions and apparently many recipients were maintaining excessively high FRLC cash balances. The significance of the survey findings supported a major review of AID's system for management of the FRLC process. (See page 3)

Purpose And Scope Of Review

Our review objectives were to determine (1) the extent recipients were maintaining excessive cash balances; (2) the effectiveness of the recipients' cash management systems, (3) the degree of controls recipients have over the receipt and disbursement of cash advances, and (4) the actions necessary to improve AID's management of the FRLC process.

To meet these objectives, we (1) analyzed data obtained through a questionnaire returned by recipients on their cash management procedures; (2) analyzed the recipients' daily cash drawdowns and disbursements for the months of August and September 1981, (3) reviewed ten recipients' financial records and procedures regarding

the control and accountability of FRLC cash; and (4) reviewed AID's management of the FRLC process. (See page 3)

AID Recipients Are Abusing The FRLC Authority

AID recipient organizations are abusing their authority to drawdown cash advances through the FRLC process. They are drawing down FRLC advances far in excess of their immediate disbursement requirements. Many entities are placing the excessive funds in interest bearing accounts and not reporting the interest earned to AID. Other organizations are using the funds for unintended purposes. Most recipients are tardy in submitting required FRLC cash transaction reports and the reports that are submitted contain omissions or inaccurate financial information. These cash management deficiencies are widespread and have been occurring for a period of several years.

AID Recipients Are Maintaining Excessive Cash Advances -- This Practice Is Widespread And Deeply Rooted

Most of the 201 FRLC recipient organizations are maintaining excessive cash advances in their bank accounts. This practice is costing the U.S. Government more than \$2.5 million annually in interest. The primary beneficiaries are the commercial banks that have free use of federal funds totaling \$15.3 million. (See page 4)

Most of the recipient organizations are maintaining FRLC cash advances many times their average daily disbursement requirements. Normally recipients of FRLC should not have on hand more cash than necessary to meet three days of disbursements. One organization has retained a cash advance of \$4 to \$4.5 million for a period of several months. This money represents several months of cash requirements. Another organization has retained a cash advance of about \$1 million for the 21 months period beginning January 1980. Disbursement for the same period only averaged \$32,300 per day. Thirty-eight other organizations are retaining cash advances which will take more than 30 days to expend. (See page 5)

Misuse of the FRLC authority is a long standing problem among AID recipients. In early 1977, the Department of Treasury found recipient organizations were making FRLC drawdowns when there was apparently no actual cash requirement. In June 1977, we reported that AID grantees were drawing down FRLC funds beyond their immediate disbursement needs. In January 1979, the Department of Treasury expressed concern to AID about FRLC recipients who were maintaining excessive cash advances. In January 1982, Treasury again voiced disapproval to AID over the cash management practices of AID's FRLC recipients. (See page 6)

Interest Earned On Federal Funds Not Reported Or Returned To AID

Department of Treasury regulations require that all interest earned on FRLC cash advances be returned to AID and deposited in the General Account of the U.S. Treasury. We found several instances where recipient organizations had earned interest on FRLC cash advances. But the interest earned was not reported nor returned to AID as required by Treasury regulations. For example, one grantee earned about \$130,000 in interest on advances deposited in 14 savings accounts. Most of the savings accounts--totaling \$900,000--remained dormant for long periods of time. Another entity earned interest of \$32,830 but had not reported the amount earned to AID. Two other organizations earned interest totaling \$7,400 on FRLC advances that had been deposited in overseas bank accounts. Neither had reported the interest earned to AID. (See page 6)

FRLC Advances Used For Unintended Purposes

Some organizations are using FRLC advances to finance private endeavors or programs of other U.S. Government agencies. For example, one organization used \$113,200 to pay for non-AID activities such as business lunches, labor negotiation expenses, credit card charges, life and property insurance, and privately funded development projects. Another used FRLC advances of \$269,900 to pay for program activities of the International Communication Agency and the State Department. The same organization could not account for FRLC cash shortages of amounts up to \$284,500 in July and August 1981. Still another organization had FRLC cash shortages of up to \$701,700 in August and September 1981. Because these organizations commingle FRLC funds with other funds, we were unable to determine how the money was actually spent. (See page 5)

Cash Transaction Reports Are Untimely And Inaccurate

The federal cash transactions report (SF 272) is used by AID to monitor the cash management practices of FRLC recipient organizations. Only a few FRLC recipients are meeting their reporting responsibilities. Most of the 201 recipients are delinquent in submitting the reports and the reports that are submitted contain omissions or questionable financial information. AID has no internal control system of follow-up on the reports. Even though a report may show gross deficiencies in the recipient's cash management practices, AID rarely takes aggressive action to correct the problem. (See pages 12, 30, 41)

AID's Internal Control System For The FRLC Process Must Be Improved

OMB Circular A-123 published in October 1981 states that there are numerous instances of fraud, waste, and abuse of U.S. Government resources and mismanagement of federal programs. These problems frequently result from weaknesses in internal controls or from breakdowns in compliance with internal controls. We believe that AID's internal control system over FRLC financial transactions is a classic example of a system that is not only weak but has broken down. The result has been widespread abuse of the FRLC authority by recipient organizations. Aggressive action by AID management is needed to improve the Agency's internal controls to ensure that FRLC recipients do not drawdown federal funds in excess of their immediate disbursement requirements.

Appropriateness Of Existing FRLC Authorizations Should Be Reviewed

The FRLC was intended to reimburse U.S. organizations from the Treasury through commercial banking channels concurrently with disbursements made in payment of federal program liabilities. The FRLC recipient should also be able to timely and accurately report on its disbursement and cash balances. There are at least 60 FRLC recipient organizations that are either located outside the United States or most of the FRLC advances are actually disbursed in overseas locations. It is difficult, if not impossible, for AID to effectively monitor the cash management practices of these organizations. Generally these organizations are either late or do not submit the required cash transaction reports. Moreover, the reports that are submitted contain questionable financial information. It is Treasury's position that FRLC recipients who cannot meet their reporting responsibilities should be financed by another payment method. In this regard, we believe AID should review the appropriateness of the FRLC authorizations for recipients who are located or spend most of the FRLC advances in locations outside the United States. (See page 8)

Personnel Resources Should Be Increased

AID has four employees who monitor the cash management practices of over 201 FRLC recipients that drawdown about \$325 million annually. These employees spend most of their time processing and recording hundreds of FRLC transaction and expenditure reports. Consequently, little time is spent by AID personnel to monitor the cash management practices of FRLC recipients. AID personnel review the cash transaction reports on an ad hoc basis and make few recipient site visits. In contrast, AID has eight employees that audit travel vouchers totaling \$3.2 million annually. We believe that AID management should review the adequacy of the personnel resources devoted to the FRLC operation relative to other operations. (See page 15)

Criteria Should Be Developed On Suspension Or Revocation Of FRLC Authorizations

AID procedures place the primary responsibility for suspending or revoking the FRLC authorization with the contract or grant officer. However, this is not realistic since there may be several contracting/grant officers associated with one FRLC authorization. We believe that this responsibility should be shifted to the Office of Financial Management. This office is in the best position to monitor the consolidated cash position of FRLC recipients. There are also weaknesses in AID procedures on when to suspend or revoke an FRLC authorization. We believe the procedures should be clarified on when it may be necessary to take such actions. (See page 17)

FRLC Advances Should Be Placed In Separate Bank Accounts For Some Recipients

AID procedures should be revised to require a separate bank account for recipients that prematurely draw down FRLC funds or otherwise abuse the FRLC authority. This would strengthen the control and accountability over the use of federal funds. It also would provide AID another mechanism besides suspension or revocation of the FRLC authorization to ensure FRLC recipients effectively manage AID funds. (See page 18)

Computerized System Should Be Developed For Monitoring FRLC Recipients

AID is in the embryo stage of developing a computerized system to assist in managing the FRLC process. There are shortcomings in the planned use of the system. We believe the planned computerized management reports could be improved by pinpointing the cash management deficiencies of FRLC recipients. For instance, the computer could be used to (1) identify FRLC recipients that are delinquent in submitting required cash transaction reports; (2) analyze the cash position of FRLC recipients; and (3) generate trend analysis reports on the overall status of FRLC recipient cash management practices. (See page 19)

Conclusions And Recommendations

Our review shows that most of the 201 FRLC recipients are prematurely drawing down federal funds. With the Administration's emphasis on holding down the federal budget and the high cost of money, this situation can no longer be tolerated. AID must take aggressive action to ensure that recipient organizations do not take undue advantage of the FRLC authorization. Therefore, we are recommending that AID carry out several corrective measures to control FRLC advances and improve the management of the FRLC process. These measures include:

- Immediately requesting FRLC recipients to return the cash on-hand that is excessive to their short-term disbursement requirement.
- Immediately requesting FRLC recipients to return interest earned on federal funds.
- Making adjustments to the personnel resources devoted to managing the FRLC process relative to other AID operations.
- Requiring AID personnel to make periodic and random visits to FRLC recipient business sites to review their cash management practices.
- Placing a monthly drawdown restriction on FRLC recipients who have shown an unwillingness to abide by Department of Treasury cash management and reporting criteria.

We believe that implementation of these and other recommendations will improve the overall management of the FRLC process. (See page 22)

Summary of Management Comments

In the response to our draft report, the Office of Financial Management (FM) stated it generally agreed to the report's findings, conclusions, and recommendations. But the body of the response took exception to the significance of the report's findings and most of the recommendations. For instance, FM contends that the report overstates the amount (\$15.3 million) of the excessive cash on-hand held by recipient organizations. FM stated:

"The main findings of the audit are based on the belief that recipients should not draw down cash under the FRLC that exceeds 3 days need. Treasury Department Circular No. 1075, states that "The timing and amount of cash advances shall be as close as is administratively feasible to the actual disbursements by the recipient organization...". This same language is also found in the Treasury Fiscal Requirements Manual. Administratively feasible is the criterion to follow in determining if a recipient is holding excess cash. All of the PVO's receiving advances under the FRLC are carrying out activities overseas. It is not administratively feasible to require the recipient to use 3 days need as a rule in draw downs...When one examines the alternative financing

arrangement of a cash advance by Treasury check (see page 8 of your report), the 30 day draw rule that AID uses for overseas expenditures is both reasonable and practical."

We do not believe the report overstates the amount of cash on-hand that is excessive to the recipients' operating requirements. As a matter of fact, we are of the opinion this figure is conservative. Most of the 173 FRLC recipients that responded to our questionnaire consider cash transfers made overseas as disbursements. Consequently, the computer analysis was made primarily on FRLC funds that are retained in U.S. bank accounts. We estimate that about \$13 million of the \$15.3 million represents excessive cash held in U.S. banks. If all foreign bank balances were analyzed, the \$15.3 million figure would undoubtedly be higher.

As for the reasonableness of using the 3 day rule in computing the excess balances of FRLC recipients, this is in line with Treasury, OMB and even AID guidelines. The OMB officials we spoke with wholeheartedly support the 3 day rule. Treasury would be even more restrictive than OMB. In correspondence to AID, Treasury stated that "To minimize these interest charges (to the U.S. Government), Treasury regulations specifically state "that advances of federal funds be limited to the minimum amounts necessary for immediate disbursement needs." AID Handbook 19 also supports strict compliance with maintenance of minimum cash balances. The Handbook states that the FRLC advance payment method "enables the recipient to withdraw cash from the Treasury, through commercial banking channels, concurrently with disbursements made in payment of program liabilities, thereby minimizing the maintenance of federal cash balances."

FM also contends that the computer analysis used to determine the excessive balances of FRLC recipients contains data that is suspect. Therefore, FM suggests that the table on page 4 does not accurately reflect the cash balances of the FRLC recipients. However, FM did not provide us specific examples where this might be the case. The computer analysis was made on data that was sent to us by 173 FRLC recipient organizations. While it would not be practical to verify the data received by every recipient, we found that it was accurate for the 10 organizations visited. Therefore, we have no reason to believe the data received from the other 163 recipients is not generally accurate.

FM agrees with us that it has not in the past effectively monitored advances provided to FRLC recipient organizations. However, FM does not believe the report adequately supports the finding of widespread abuse of the FRLC authority by recipient

organizations. Accordingly, FM has agreed to implement only three of the report's twelve recommendations. More specifically, FM stated it will:

- Send letters to all FRLC recipients advising them to maintain FRLC cash balances at reasonable levels.
- Make more visits to recipient business sites to review their cash management practices.
- Make adjustments, if appropriate, to the personnel resources devoted to managing the FRLC process.

In our view, carrying out these measures--while important--does not go nearly far enough. We are convinced that other more substantive measures are required if FM is to improve its management of the FRLC process. For example, in late March 1982, we provided FM's FRLC branch a complete copy of the aforementioned computer analysis. We did this so that AID personnel could take timely action by following up on the FRLC recipients that were maintaining excessive cash balances. AID personnel took no action. We still believe AID can effectively use the results of the computer analysis. AID should immediately inquire about the current cash position of the organizations identified as having excessive cash on-hand. Those remaining in an excess position should be directed to return the excessive advance to AID.

We also believe that the report's remaining recommendations should be implemented. Unless serious consideration is given to implement them, we have no doubt a follow-up review by us three years hence will disclose conditions similar to that which exist today. Since it does not appear feasible to charge interest on excessive FRLC cash balances, AID must actively monitor the cash management practices of FRLC recipients. In summary, the abuse of the FRLC authority by recipient organizations simply will not go away without major changes in AID's system for managing the FRLC process.

BACKGROUND

The Federal Reserve Letter of Credit (FRLC) is an instrument that authorizes an AID grantee or contractor--generally a non-profit organization such as a private voluntary organization or U.S. university--to draw cash advances when needed from the Treasury, through a Federal Reserve bank and the recipient's commercial bank. The FRLC instrument may cover several grants or contracts awarded to a recipient organization. The FRLC authorization is also open ended in that the recipient organization can withdraw the entire amount authorized even though it may take months or even years to actually spend the advance. The use of the FRLC is covered in the grant or contract wherein the recipient organization commits itself to: (1) initiating cash drawdowns only when actually needed for its disbursements; (2) timely reporting of cash disbursements and balances as required by AID; and (3) imposing the same standards upon secondary recipients. The failure of the recipient organization to adhere to these provisions may cause the unobligated portion of the letter-of-credit to be suspended or revoked by AID or by the Department of Treasury.

FRLC cash advances should be limited to the minimum amounts needed and should be timed with the actual, immediate cash requirements of the recipient organization in carrying out the purposes of the approved program or project. Excessive federal funds should be promptly refunded to AID. Excessive funds are those on-hand which exceed three days of disbursements. Recipient organizations are required to report 1/ to AID at least quarterly on their FRLC cash position. If more than three days cash requirements are on-hand, they are required to explain why the drawdown was made prematurely, or other reasons for the excess cash. Recipient organizations are also required to return to AID any interest earned on FRLC deposits.

AID is required to monitor the recipient organization's FRLC cash drawdowns and other financial practices to ensure against excessive withdrawals of federal funds. When a recipient organization has demonstrated an unwillingness or inability to establish procedures that will minimize the time elapsing between cash advances and applicable disbursements, AID can terminate the advance financing and require the FRLC recipient to finance AID activities with its own working capital. The payments can then be made by Treasury check for actual cash disbursements.

1/ Federal Cash Transactions Report (SF 272) prescribed by Office of Management and Budget Cir. No. A-110.

AID Uses FRLC Extensively For Project Financing

AID uses the FRLC method of financing grants and contracts extensively. There are 201 recipient organizations that AID authorizes to drawdown cash advances through the FRLC mechanism. The actual FRLC cash drawdowns by AID recipients averages about \$325 million annually. The cash drawdowns pay for goods and services under 625 AID grants and contracts. As of September 30, 1981 there were over \$1.5 billion in active AID issued Federal Reserve Letters of Credit.

FRLC Authorizations By Location

<u>Location</u> <u>Of Recipients</u>	<u>Number</u> <u>Of Recipients</u>	<u>Authorized</u> <u>Amount</u> (In 000)
Washington, D. C.	51	\$ 267,164
New York City	40	366,008
Continental United States	84	381,770
Outside Continental United States	<u>26</u>	<u>499,710</u>
Total	<u>201</u>	<u>\$1,514,652</u>

The Administration And Congress Are Concerned About The Management Of Federal Funds

The Administration and the Congress are very sensitive to the impact cash management of federal funds has on the national debt. The Senate Committee on Appropriations last year called for U.S. Government agencies to carry out three steps to improve the management of cash advances provided for federal programs. These steps were:

1. Reviewing periodic reports filed by grant recipients to ascertain whether they are drawing and holding cash in excess of their current needs;
2. Auditing a sufficient number of recipient accounts to determine whether they are filing accurate reports of cash on-hand; and
3. Initiating immediate recovery action whenever recipients are found to have drawn excess cash, in violation of Treasury circular 1075.

In July 1981, the Director, Office of Management and Budget urged the heads of federal departments and establishments to instruct their staff to do all they can to carry out the recommendations of the Senate Committee On Appropriations. In cases where individual recipients persist in drawing excess cash or refuse to cooperate in efforts to control drawdowns, the Director stated that "consideration should be given to rescinding letter-of-credit arrangements with them, or placing monthly restrictions on their letters-of-credit." In addition, the Director noted that federal agencies should review their systems for monitoring cash balances to assure that they are adequate to prevent excessive drawdowns from going undetected. AID has done little to carry out the recommendations of the Senate Committee or the instructions of the OMB Director.

Purpose and Scope

Because of the Administration and Congressional concern over the management of cash advances received by recipients of federal programs, we performed a survey of AID's FRLC procedures. The survey which took place in September and October 1981 indicated AID was having considerable difficulty in monitoring FRLC transactions of recipient organizations. The volume of FRLC transactions coupled with AID's manual system for reviewing them and personnel ceilings makes it virtually impossible to effectively manage the FRLC process. Our survey also indicated many recipient organizations were apparently maintaining excessively high FRLC cash balances.

The significance of the survey findings supported a major review of AID's system for management of the FRLC process. Our review objectives were to determine (1) the extent recipients were maintaining excessive cash balances; (2) the effectiveness of the recipients' cash management systems, (3) the degree of controls recipients have over the receipt and disbursement of cash advances, and (4) the actions necessary to improve AID's management of the FRLC process.

To meet these objectives, we (1) analyzed data obtained through a questionnaire sent to the recipients on their cash management procedures; (2) analyzed the recipients' daily cash drawdowns and disbursements for the months of August and September, 1981, (3) reviewed ten recipients' financial records and procedures regarding the control and accountability of FRLC cash; and (4) reviewed AID's monitoring and management of the FRLC process.

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

FRLC Recipients Are Maintaining Excessive Cash Balances And Using AID Funds For Unauthorized Purposes

The practice of maintaining excessive cash advances is widespread among FRLC recipients.^{1/} We found that 103 of the 173 recipients that responded to our questionnaire are maintaining cash advances totaling \$15.3 million in excess of their short-term disbursement requirements. This is costing the U.S. Government more than \$2.5 million a year in unnecessary interest payments. FRLC recipient organizations are maintaining cash balances many times their average daily disbursements. One entity has a history of retaining cash advances that will take several months to expend. Thirty-eight other organizations are maintaining FRLC cash advances exceeding one month of disbursements. The following table summarizes the cash balances of the FRLC recipients and the estimated annual interest cost to the U.S. Government.

<u>No. of Recipients</u>	<u>Days of Cash O/H</u>	<u>Average Daily Cash O/H</u>	<u>Annual Interest Costs</u> ^{a/}
31	4-10	\$ 1,122,600	\$ 184,100
23	11-20	1,489,900	244,300
11	21-30	701,900	115,100
<u>38</u>	31 and over	<u>11,987,500</u>	<u>1,966,900</u>
<u>103</u>		<u>\$15,301,900</u>	<u>\$2,510,400</u>

a/ A rate of 16.4 percent was used to compute the interest cost.

As part of our review, we visited 10 recipient organizations and evaluated their cash management practices. At every location, we found significant deficiencies. The Case Studies beginning on page 25 provide a detailed analysis of the cash management practices of 6 recipient organizations. Below are brief summaries of the problems found.

- One organization had a history of drawing down FRLC funds far in advance of operational needs. In 1981 it maintained a cash balance of \$850,000 to \$1,000,000 in 14 interest bearing accounts. It earned about \$130,000 in interest but did not return the interest to AID. In January 1982, at our request, the entity returned \$122,202 in interest to AID. It closed the 14 savings accounts and transferred the funds

^{1/} Advances are considered excessive when cash on-hand exceeds three days of disbursements.

to one consolidated account. Future interest earned will be returned when credited to the consolidated account. (See page 25)

- Another organization was maintaining excessive FRLC cash balances ranging from \$4 to \$4.5 million. It will take the entity several months to expend the FRLC cash balance. This practice is costing the U.S. Government as much as \$720,000 annually in interest payments. Moreover, the practice only benefits the commercial banks which have free use of the federal funds deposited in non-interest bearing checking accounts. This organization agreed to:
(1) initiate a study of the U.S. and overseas accounts;
(2) return to AID the amount of cash on-hand which is excessive to its immediate operating requirements; (3) determine whether its overseas accounts are earning interest and if so, return the interest to AID; and (4) implement management procedures so that cash balances will be maintained at minimal levels in the future. (See page 28)
- A third organization used the cash received from the FRLC drawdowns to finance programs of other federal agencies. To a lesser extent, the AID funds were also used to finance its private endeavors. For instance, in July and August 1981, the actual cash in the entity's bank accounts averaged \$318,885. However, the FRLC book balance averaged \$491,070 per day. The difference of \$172,185 was used to pay for program activities of other federal agencies and private endeavors. The net result of this practice allowed the organization to maintain an investment portfolio at a level that could not otherwise be maintained. Presently, the organization has income producing investments of about \$5 million. It has since reduced its FRLC balance to about three working days plus the time required to process the FRLC payment vouchers. (See page 32)
- A fourth organization earned interest of \$4,587 on its overseas bank accounts that had not been reported to AID. During 1981 the entity also made FRLC drawdowns in large amounts (\$150,000 to \$500,000) about every two weeks. The rationale for the infrequent drawdowns was the time (about one-half hour) required to submit and process FRLC payment vouchers. The organization also used \$113,189 of the AID funds to pay for non-AID activities. The items paid for with AID funds included business lunches, labor negotiation expenses, credit card charges, private development projects, and life and property insurance premiums. The organization has taken corrective actions to improve its cash management of federal funds. It returned the interest to AID and will return future interest earned when reported by the sub-grantee. The organization has also instituted procedures to prevent the disbursement of AID funds for non-AID activities. (See page 35)

- A fifth organization has a history of maintaining large and excessive FRLC cash balances. For instance, during the 21 month period beginning January 1980, the FRLC cash balance averaged about \$1 million per day. However, disbursements of FRLC funds only averaged about \$32,300 a day for the same period. In August and September 1981 there were 12 days in which the total cash in the bank accounts averaged \$463,280 less per day than the average FRLC book cash balance. The entity was unable to adequately explain the reason for the large FRLC cash shortages. AID plans to actively monitor the FRLC cash position of this entity. If the organization does not improve its cash management practices, AID should seriously consider revocation of the FRLC authorization. (See page 38)

We believe that the cash management deficiencies discussed in detail in the Case Studies are common to many of the other FRLC recipient organizations. For instance, several of the other recipients that responded to our questionnaire stated that the FRLC funds are placed in U.S. or overseas interest bearing accounts. One organization earned interest of \$32,830 but had not reported the amount earned to AID. Two other organizations earned interest totaling \$7,400 on FRLC advances that had been deposited in overseas bank accounts. Neither organization had reported the interest earned to AID. AID personnel have been advised of this and have followed up with these entities. In addition, it also seems reasonable to assume that other organizations are using the excessive FRLC advances to pay for non-AID activities. Unless AID aggressively monitors FRLC recipients, there is no assurance that federal funds are not being used on a wide scale for questionable or inappropriate purposes.

Ineffective Monitoring Of FRLC Recipients--A Long Standing Problem

In June 1977, we reported that AID grantees were drawing down FRLC funds beyond their immediate disbursement needs.^{1/} A test of 19 FRLC recipient organizations showed that the number of days cash on-hand ranged from 26 to 450 days. We also noted in this report that the Department of Treasury had periodically reported serious deficiencies in AID's handling and controlling FRLC funds. As part of its follow-up activity, the Treasury had brought to the attention of AID numerous grantee irregularities of a substantive nature. Most often the Treasury had expressed concern about AID's non-compliance with the regulations regarding monitorship and reporting. In early 1977, the Department of Treasury stated:

^{1/} Audit Report 77-164, dated June 30, 1977

"Needless to say, we are distressed to uncover such extensive abuse of Treasury regulations regarding advance funding by letter of credit. All five of these recipient organizations made drawdowns when there was apparently no actual cash requirement...

"Further, the average daily balances of Federal funds in the hands of these recipient organizations from the date of the first drawdown to the end of the reporting period are considerable and represent an estimated interest cost to the Government of approximately \$113,000."

In January 1979 the Department of Treasury again expressed concern about FRLC recipient organizations who were maintaining excessively high cash balances. Moreover, the Treasury noted that some of the FRLC recipients could not provide daily FRLC disbursement information. The Treasury concluded that such organizations probably should not be under the FRLC method of financing U.S. Government programs. Treasury suggested two alternatives be considered when recipient organizations are unwilling or unable to establish adequate cash management procedures. The alternatives are described in Treasury's Fiscal Requirement Manual and quoted below:

"Section 2075 - TERMINATION OF ADVANCE METHODS OF FINANCING GRANT AND OTHER PROGRAMS

2075.10 - Reimbursement Method. When a recipient organization receiving cash advances by a letter of credit or by direct Treasury check has demonstrated to a Federal program agency an unwillingness or inability to establish procedures that will minimize the time elapsing between cash advances and the disbursement thereof, the Federal program agency, unless prohibited by the statute(s) governing the program(s) in question, shall terminate advance financing and shall require the recipient organization to finance its operations with its own working capital, and payments to the recipient organization shall be made by the direct Treasury check method to reimburse it for actual cash disbursements. Federal program agencies shall process such reimbursements expeditiously so as to minimize the time elapsing between disbursement by and payment to the recipient organization.

2075.20 - Working Capital Advance Method. In those cases when the reimbursement method described in ITFRM 6-2075.10 is not feasible, arrangements may be made whereby the operations of the recipient organization are financed on a working capital advance basis. On this basis, funds are advanced to the recipient organization to cover its estimated disbursement needs for

a given initial period. The period of time, "a given initial period," is to be decided by the Federal program agency but normally should not exceed a 30 day requirement. Thereafter, payments are made to the recipient organization for the amount of its actual cash disbursements. The amount of the initial advance shall be geared to the reimbursement cycle so that after the initial period the payments are approximately equal to the average amount of the recipient organization's unreimbursed program payments."

In April 1979 we made a follow-up on the of June 1977 report and Treasury's January 1979 evaluation of AID's monitorship over FRLC recipients. We were informed by AID officials that new procedures were being implemented to more effectively monitor the cash management practices of FRLC recipients. Because of the positive response to our inquiry, we did not make a detailed review of the FRLC process at that time.

On September 18, 1981 the Department of Treasury requested that AID have 25 selected FRLC recipients complete a daily FRLC cash transaction report for July 1981. The purpose of the request was to determine whether the sample organizations were drawing FRLC funds in excess of immediate disbursement requirements. AID responded on October 28, 1981 stating that "It appears the majority of these particular respondents make drawdowns reasonably close to the time of making disbursement. However, this conclusion is tentative since approximately one-half of the respondents indicate their accounting systems provide data less frequently than daily." The tentative conclusion reached by AID officials was not valid. As discussed on page 4, most of the FRLC recipients are maintaining excessive cash advances. Furthermore, on January 26, 1982 the Department of Treasury responded to AID stating,

"...Basically, your recipients share two common problems which are interrelated; they are not drawing money as often as they should and they are holding excessive cash. Because the recipients usually draw money only once a month they draw large amounts which they gradually disburse. During this interval, while Treasury pays high interest charges on the government borrowings, the cash on hand for the recipient may or may not earn some interest. To minimize these interest charges, Treasury regulations specifically state "that advances of Federal funds be limited to the minimum amounts necessary for immediate disbursement needs."

Use Of FRLC Inappropriate For Many Organizations

The FRLC advance payment method of financing AID activities is not appropriate for many AID recipient organizations. These organizations either have overseas field offices, subgrantees, or are

actually located in foreign countries. They cannot meet the Treasury conditions for FRLC authorizations. Moreover, AID cannot effectively monitor the cash management practices of these organizations.

The FRLC was intended for U.S. organizations which can make withdrawals of cash from the U.S. Treasury concurrently with disbursements made in payment of federal program liabilities. The FRLC recipient is also required to report timely and accurately on its disbursements and cash balances. If the FRLC recipient cannot meet these conditions, the federal agency should use another method of financing.

There are at least 40 organizations which are located in the United States which transfer FRLC funds to overseas subgrantees or field offices. During the fiscal year ended September 30, 1981, FRLC funds totaling at least \$40 million were transferred to over 850 subgrantees and numerous field offices located primarily in developing countries. We found several examples where the U.S. entity was having difficulty maintaining adequate accountability over funds transferred to foreign countries.

- One organization did not have adequate control over FRLC cash transfers to its field offices to enable effective cash forecasting. Delays in receiving and recording field office disbursement data distorted the entity's control account balances. Consequently, the entity maintains FRLC cash balances in excess of immediate needs so as to provide a reservoir of funds for field office transfers.
- Another organization needs better control over field office cash advances. This entity gives advances to its field offices prior to liquidating outstanding advances. This allowed the field offices to maintain excessive FRLC cash balances.
- A third organization lacks a system for estimating the cash needs of its subgrantees. This entity initially advances 4 months of working capital to its subgrantees without regard to their actual cash needs. This practice resulted in some subgrantees receiving excessive advances. See page 37, for more details.
- A fourth organization allows its field offices to maintain cash balances in foreign bank accounts which will take months to expend. The rationale for this practice was the inordinate amount of time it takes to transfer funds to developing countries. See page 28, for more details.

A representative of one organization summed up the problems of controlling and transferring funds to overseas locations by stating:

- "1. The laws governing currency conversions in the countries where we operate. For example, in Colombia the government imposed a regulation which prohibits the exchange of dollars into local currency. The procedure requires us to purchase an "Exchange Certificate" which can only be cashed upon maturity. The maturity dates vary from four months to six months.
- "2. The logistical time it takes to have a U.S. check presented at a local bank credited to our account in local currency. We have countries where this time lag is six weeks. In addition there are countries where hard-currency conversions must be cleared through the government central bank, and we have experience where the central bank, even after receiving the funds, withholds issuing the credit to our local bank.
- "3. While to me and your office, cash-flow is our primary responsibility, we must take into account the reality under which our field people must operate. For example, drawdowns have been made to satisfy payments anticipated on a normal basis and a civil war flares in the vicinity where the work is being done. Under these conditions when work ceases, the need for the payment has to be temporarily suspended. This has been particularly true in Lebanon. These are but a few of the conditions under which we operate."

There are 24 organizations located in foreign countries that have FRLC authorizations. The following table depicts the extent the FRLC is used to finance the activities of these organizations.

<u>Location Of FRLC Recipient</u>	<u>FRLC Authorization a/ (In 000)</u>
Taiwan, Republic of China	\$ 2,724
Accra-North, Ghana	6,517
Santo Domingo, Dominican Republic	2,745
San Jose, Costa Rica	2,639
Rome, Italy	2,510
Beirut, Lebanon	9,200
Dacca, Bangladesh	3,800
Manila, Philippines	800
Manila, Philippines	15,412
Cali, Colombia	4,350
London, England	2,162
London, England	71,008
Pradesh, India	1,942
Rome, Italy	200,000
Ibadan, Nigeria	8,450
Addis Ababa, Ethiopia	7,950
Mexico City, Mexico	3,484
Lima, Peru	7,000
The Hague, Netherlands	23,602
Rio de Janeiro, Brazil	284
Mayaguez, Puerto Rico	3,801
Geneva, Switzerland	3,750
Geneva, Switzerland	94,717
Geneva, Switzerland	5,333
	<hr/>
Total	<u>\$ 484,180</u>

a/ FRLC authorized amount as of September 30, 1981.

The FRLC recipients located in foreign countries are generally delinquent in providing AID the required cash transaction reports. Eleven of the 24 recipients are not submitting the reports to AID. Other recipients are as late as 3 months in submitting the reports. Some of the reports that are submitted contain questionable financial information. For example, for the quarter ended September 30, 1981, one recipient (located in Bangladesh) reported FRLC drawdowns and disbursements of exactly \$400,000. The report also showed zero beginning and ending cash balances. Another organization (located in India), reported FRLC drawdowns and disbursements of exactly \$750,000 for the quarter ended September 30, 1981. The beginning and ending balances were reported as zero. We find it difficult to believe the financial data in these reports are reliable. A third organization (located in Colombia) reported to AID a positive ending cash balance of \$1,175,000 as of September 30, 1981. However, the same entity reported to us a negative cash balance of \$766,953 on the same date. We are not certain which of the figures is correct.

As discussed on page 7, the Department of Treasury noted that organizations that cannot account for FRLC cash balance on a daily basis probably should be under another method of financing. We found that some organizations which are located and make all their disbursements in the United States cannot account for FRLC funds on a daily basis. This problem is magnified many times for organizations that transfer FRLC funds to the lessor developed part of the world. We, therefore, believe that a more appropriate method of financing these organizations would be through cash advances by Treasury check. Under this advance payment method, the impact on Treasury financing cost and level of the public debt can be minimized. The advances can be scheduled so that the Treasury check is available immediately before the disbursement of funds in accordance with the entity's regular disbursement cycle (monthly, biweekly, or other interval).

Recipient Cash Transaction Reporting Untimely And Inaccurate

The Federal Cash Transactions Report (SF 272)--hereafter referred to as the cash transaction report--is used by AID and other federal agencies to monitor cash advanced to FRLC recipient organizations. If the reports are not submitted on a timely basis or do not contain accurate financial information, AID cannot effectively monitor the cash management practices. In actual fact, we found only a few of the FRLC recipients are meeting their reporting responsibilities. Most of the 201 recipients are delinquent in submitting reports. The reports that are submitted contain omissions or questionable financial information. Because AID does not have a system of report review and follow-up, action is rarely taken to ensure that recipients meet reporting responsibilities.

When funds are advanced through letters of credit, the FRLC recipient organization is required to submit a cash transaction report to AID within 15 working days after the end of the reporting period. Recipient organizations that receive cash advances exceeding \$1 million annually should be required to send AID cash transaction reports monthly. Those with cash drawdowns of less than \$1 million annually should submit reports at least quarterly. Below is the format of the cash transaction report.

PERIOD COVERED BY THIS REPORT			
		FROM (month, day, year)	TO (month, day, year)
STATUS OF FEDERAL CASH	a. Cash on hand beginning of reporting period		\$
	b. Letter of credit withdrawals		
	c. Treasury check payments		
	d. Total receipts (Sum of lines b and c)		
	e. Total cash available (Sum of lines a and d)		
	f. Gross disbursements		
	g. Federal share of program income		
	h. Net disbursements (Line f minus line g)		
	i. Adjustments of prior periods		
	j. Cash on hand end of period		\$
THE AMOUNT SHOWN ON LINE J, ABOVE, REPRESENTS CASH RE- QUIREMENTS FOR THE ENSUING DAYS	OTHER INFORMATION		
	a. Interest income		\$
	b. Advances to subgrantees or subcontractors		\$
REMARKS			

We found that 42 of the 201 FRLC recipients are not submitting the cash transaction reports to AID. ^{1/} Most of the other recipients are delinquent in sending the reports to AID. Many of the FRLC recipients send in reports several months after the reporting period. Unless reports are submitted promptly, they are of little value to AID in monitoring cash management practices of recipients. The following table shows the scope of this problem for the 159 FRLC recipients that are submitting the cash transaction report.

^{1/} Fifteen of the 42 recipients are submitting another report developed internally by AID called the "Status of Federal Funds Report." This report will be discontinued and replaced by the standard cash transaction report. The other 27 recipients are not submitting any reports on FRLC cash disbursements and balances.

<u>Number of Recipients</u>	<u>Days Submitted After Reporting Period</u>
23	1-15
27	16-30
33	31-45
27	46-60
32	Over 60
<u>142</u> a/	

a/ Omission of date--a key reporting requirement--prevented classification of 17 recipients.

Another important aspect of the cash transaction report is the period covered by the report. The longer the period, the less useful the report is to AID in monitoring FRLC recipients. We found 46 FRLC recipients are submitting reports that cover a period of 2 months or more even though they should be submitting monthly reports. Ten reports covered a period of 6 months to more than a year. Six of these reports covered periods of 12 to 15 months. These reports are of no value to AID in monitoring the FRLC cash management practices. The following table shows the periods covered by the cash transaction reports.

<u>Number of Recipients</u>	<u>Days Covered By Reports</u>
30	30
5	60
106	90
14	Over 90
<u>155</u> a/	

a/ Four recipient organizations failed to state the period covered by the report.

We also found other widespread cash transaction reporting deficiencies. Over 75 percent of the 159 reports contained omissions or financial data of questionable accuracy. The most common omission was the failure of FRLC recipients to note the number of days the ending cash balance represents in terms of disbursements. The FRLC recipient is supposed to enter the estimated number of days during which the cash on-hand will be expended. If more than three days'

cash requirements are on hand, the recipient is required to provide an explanation under "Remarks" as to why the drawdown was made prematurely. Only one of the 44 reports that had positive ending cash balances showed the number of days the cash on-hand represented in disbursements. See the Case Studies for specific examples of FRLC recipients that are not meeting their reporting responsibilities.

We believe that AID must be more aggressive in requiring FRLC recipients to submit timely and accurate cash transaction reports. Those recipients not willing to meet this responsibility should be financed by another payment mechanism. In addition, on a periodic and random basis, AID should also request daily cash transaction reports from FRLC recipients. These reports show the daily FRLC cash disbursements and balances for a sample one or two month period. Submission of the daily cash transaction report is important because of a basic flaw in the periodic cash transaction report. This report only reflects the beginning and ending cash balances for a stated period (generally one or three months). However, the entity can make large FRLC drawdowns shortly after the beginning of the reporting period and disburse the funds shortly before the end of the period. Consequently, the cash transaction report may reflect reasonable cash balances. But the daily cash transaction report for the same period would show large cash balances during the period.

Personnel Resources Insufficient To Effectively Manage FRLC Process

Because AID personnel devote most of their time to processing recurring FRLC transactions and expenditure reports, little time is left to effectively manage the FRLC process. The most important area being shortchanged is the monitoring of recipient cash management practices.

AID's Office of Financial Management, Program Accounting Division (FM/PAD) has the responsibility for managing the FRLC process. Presently, there are four employees assigned to process FRLC transactions and monitor the cash management practices of 201 recipient organizations that drawdown \$325 million annually. By contrast, there are 8 AID employees assigned to audit travel vouchers amounting to \$3.2 million annually. The functions performed by FRLC Branch employees are predominantly accounting oriented. They process and record hundreds of FRLC transactions and expenditure reports monthly. This takes up about 90 percent of their time. Consequently, little time is left to monitor FRLC drawdowns and take necessary remedial measures in the event of excessive withdrawals. In this respect, AID employees review the cash position of FRLC recipients on an ad hoc basis and make very few visits to recipient sites to review the adequacy of their cash management practices and procedures.

Turnover of personnel that perform FRLC functions has also been a problem. During the last three years 33 persons have been assigned FRLC duties. In our opinion, this high turnover of personnel adversely effects the operations of the FRLC Branch.

The FM/PAD chief estimates 1,040 hours per month (equivalent to six full-time persons) is required to adequately accomplish all FRLC functions. The table below provides a breakdown of this estimate.

<u>Function Performed</u>	<u>Documents Processed</u>	<u>Staff Hours</u>	<u>Percentage</u>
Processing and recording FRLC authorizations	65	135	13
Processing and recording FRLC drawdown vouchers	220	31	3
Processing Recipient Expenditure Reports	170	272	26
Processing federal cash transactions reports	170	180	17
Monitoring FRLC recipients by telephone and written correspondence	N/A	260	25
Site visits to FRLC recipient locations	N/A	40	4
Other administrative duties	<u>N/A</u>	<u>122</u>	<u>12</u>
	<u>625</u>	<u>1,040</u>	<u>100</u>

While we cannot say with certainty whether these estimates are realistic, it seems to us that the staff hours projected for visiting FRLC recipient locations is understated. It has been our experience that a minimum of three days is required to adequately review the recipient's cash management practices and procedures. The 40 staff hour estimate means only one or at the most two FRLC recipients can be visited monthly.

Procedures For Suspension Or Revocation Of FRLC Authorizations Should Be Strengthened

AID internal procedures for suspension or revocation of FRLC authorizations are inadequate. The procedures now in existence are inappropriate because they were based on individual FRLCs for each grant or contract instead of the consolidated FRLC now used by AID.

AID procedures (Handbook 19, Chapter 3) requires FM/PAD to determine if the FRLC recipient has been drawing down advances in excess of immediate disbursing need. FM/PAD also is supposed to verify the accuracy and timeliness of financial reporting by the FRLC recipient. If these reports are consistently received late or if the recipient continues to drawdown excessive funds, FM/PAD is supposed to recommend suspension or revocation of the FRLC to the contract or grant officer. The contract or grant officer has the primary responsibility for deciding whether or not to suspend or revoke an FRLC authorization.

Before 1977 one FRLC authorization was usually used to finance each grant or contract. In 1977 AID began the process of consolidating the FRLCs by recipient organizations. Presently, 218 FRLCs are used to finance about 625 grants and contracts.

The concept behind the consolidation was to authorize one FRLC for each of the recipient organizations. Only a few of the 201 recipient organizations now have more than one FRLC. As organizations received new grants or contracts, the consolidated FRLC authorizations were increased by the amount of the new grants or contracts. The consolidated FRLC has two major advantages: (1) It reduces administration costs for both AID and the recipient organization; and (2) It presumably allows AID to better control FRLC drawdowns and monitor recipient organizations.

In our view, the rationale for using the consolidated FRLC is sound. However, AID procedure for controlling FRLC drawdowns of recipient organizations are not in line with the consolidation concept. AID procedures place the responsibility of suspending or revoking the FRLC with the AID contract or grant officer. This is not realistic since a consolidated FRLC generally covers several contracts or grants for which there are different contract and grant officers (some assigned to different geographic bureaus). It is our opinion that the decision to suspend or revoke a FRLC authorization should be made by the Office of Financial Management. This office is in the best position to monitor the complete cash position of the FRLC recipients. Of course, any such decision made by the Office of Financial Management should be coordinated with the applicable contract or grant officers.

There are also other weaknesses in AID procedures for suspending or revoking an FRLC authorization. The procedures lack definitive criteria on when it may be necessary to take such actions. For instance, the procedures do not provide clear and concise guidance on when to suspend a FRLC if the recipient is in an excessive cash on-hand position. For example, we found one entity that had FRLC cash on-hand that would cover several months of disbursements. However, AID procedures do not provide specific guidance on how much cash on-hand it would take to suspend the FRLC authorization. We found other examples where FRLC recipients were continually two to three months late in submitting required cash transaction reports. Again the procedures are nebulous as to when to suspend or revoke the FRLC authorization of recipients who are not meeting their reporting responsibilities.

FM/PAD officials stated the procedures for suspension or revocation of a FRLC authorization are sufficient. They contend the procedures were written to allow flexibility in making these determinations. In our opinion, the procedures are so loose it is impossible to make a decision. We believe the procedures as presently written are one reason why AID has never suspended or revoked an FRLC authorization.

Procedures Should Require A Separate Bank Account For Some FRLC Recipients

AID should require that FRLC cash advances be placed in a separate bank account in cases where the recipient organization draws down funds prematurely or otherwise abuses the FRLC authority. This would strengthen the control and accountability over the use of federal funds.

Only 17 of the 173 recipients who responded to our questionnaire deposit FRLC cash advances in a separate bank account. When AID funds are placed in a general bank account the control and accountability over funds are reduced. This does not present a problem when the organization maintains a minimal FRLC cash balance. However, when FRLC funds are drawn down prematurely, the organization can use the funds in the general bank account(s) to finance non-AID activities. For example, one entity during the period of July and August 1981, maintained an average daily FRLC book balance of \$491,070. But the actual cash in the organization's general bank accounts only averaged \$318,885 per day. The difference (\$172,185) was used to finance non-AID activities. (See page 32). Another organization, during August and September 1981 had FRLC cash shortages ranging from \$26,145 to \$701,678 for 12 days during this period. The organization was not able to adequately explain the reason for the large FRLC cash shortages. (See page 41) We also could not determine how the AID funds were used by these organizations because the funds lose identity when commingled in a general bank account.

On the other hand, funds placed in a separate bank account provides for better control and accountability. Because it is relatively easy to determine how the money was spent. For example, we found that one organization had used AID funds totaling \$113,189 to pay for non-AID activities such as business lunches, cost of labor negotiations, insurance premiums and privately-funded development projects. (See page 37) Because this organization deposited the FRLC advances in a separate bank account, it was easy to determine how the money was spent. However, if the organization had placed the advances in its general bank account, it would have been near impossible to do this.

In response to our draft report, FM stated AID would have to receive a waiver from OMB to require grant recipients to put FRLC funds in separate bank accounts. Our discussions with OMB officials does not support this. We were informed that while OMB would not approve a blanket requirement for separate bank accounts, it would support procedures requiring separate bank accounts for recipient organizations that have shown an inability to effectively manage federal cash advances. Furthermore, AID can enforce this procedure without prior notification to OMB. OMB would, however, require AID to send a memorandum to the cognizant OMB office giving the name of the applicable organization(s).

Computerized System Is Needed To Effectively Manage The FRLC Process

FM/PAD is presently operating a manual system for processing and recording FRLC transactions. Since FM/PAD personnel devote most of their time to manually processing FRLC transactions, little time is left for monitoring cash management practices of recipients. FM/PAD should computerize most of its FRLC operations. This would free FM/PAD personnel to do more effective monitoring.

AID had planned to implement an upgraded, automated system for the entire Office of Financial Management operations by April 1982. But this goal will be missed by several months. The plans include automating most of the FRLC operations. It is intended that the computer will be programmed to receive the FRLC drawdowns and disbursements information required for evaluating the cash management practices of all FRLC recipients. Moreover, there are plans for the computer to generate management reports for monitoring the cash management practices of FRLC recipients. There are, however, shortcomings in these planned management reports. While the reports planned will contain most of the information required for monitoring FRLC recipients, they will not identify on an "exception" basis the specific organization that is experiencing cash management problems. The reports could be improved by pinpointing the cash management deficiencies of FRLC recipients. Below are some of the features the computer can do to improve AID's effectiveness in monitoring FRLC recipients.

- On an exception basis, the computer could name FRLC recipient organizations that are delinquent in submitting cash transaction and expenditure reports. AID could then take immediate follow-up action on recipients that do not meet the reporting responsibilities.
- The computer could analyze the cash position of recipient organizations by using the data contained in the federal cash transactions reports (SF 272). On an exception basis, the computer could identify those recipients that are in an excessive cash balance position. AID could then take immediate follow up action to require the recipient to return the excessive cash on-hand.
- The computer could analyze the recipient's history of meeting its reporting and cash management responsibilities. On an exception basis, the computer could flag recipients with chronic problems in these areas. AID could then decide what corrective measures should be taken.

The Department of Health and Human Services (HHS) has an operational computer system for monitoring FRLC recipients. This system can do some of the computer operations discussed above. For example, HHS personnel use the computer reports to take one or more of the following actions.

1. Request explanation for federal cash on-hand that exceeds immediate disbursement requirements.
2. Request immediate return of federal cash on-hand considered in excess of that normally required for immediate disbursement.
3. Request a recipient paid by letter of credit to explain the need to retain cash in excess of that required for immediate disbursement and adjust such recipient's letter of credit accordingly.
4. Change payment to cash request or reimbursable basis when a recipient repeatedly draws down funds in excess of its immediate disbursement requirements.
5. Suspend further payment if the certification statement is not signed by a proper official and dated.
6. Suspend further payment if reporting requirements are not met unless the recipient provides written confirmation of a verbally granted late report submission prior to the report's due date.

AID is in the early stages of developing a computer capability to assist in managing the FRLC process. We believe a comprehensive computer system is required if AID is to improve its monitoring of recipients that receive FRLC cash advances.

Conclusions And Recommendations

Most of the 201 FRLC recipient organizations are retaining excessive cash balances. This practice is costing the Federal Government over \$2.5 million in interest payments annually. This practice primarily benefits the commercial banks that have free use of federal funds that are for the most part deposited in non-interest bearing checking accounts. The recipients that do deposit the FRLC funds in interest bearing accounts are not reporting or returning the interest to AID. Some of the recipients are also using FRLC funds to finance private endeavors or other U.S. Government programs. The net effect of this practice is to allow the FRLC recipient to maintain an investment portfolio at a level that could not otherwise be maintained.

FRLC recipients either are not submitting, or are sending in required federal cash transaction reports months after the end of reporting period. When reports are submitted, they do not contain the necessary financial information for effective monitoring. AID has no system of follow up on the reports. They are reviewed on an ad hoc basis by AID personnel. Even though the report may show gross deficiencies in the recipient's cash management practices, AID rarely takes aggressive action to correct the cash management deficiencies. We are aware of no instance in which a FRLC authorization was suspended or revoked because the recipient was maintaining excessive cash balances.

We believe that many organizations that presently have FRLC authorizations should not be funded by this advance payment mechanism. The organizations either are located outside the United States or disburse most of the FRLC funds overseas. For these organizations, it is difficult, if not impossible, for AID to effectively monitor cash management practices. In addition, the FRLC advance payment mechanism was not intended to be used for such organizations. U.S. Treasury regulations require that FRLC recipients should have procedures to minimize the time elapsing between the transfer of funds from the Federal Reserve bank and the actual disbursements of the funds. In the case of organizations that are located overseas or where the funds are disbursed by subgrantees overseas, there is an inherent problem in meeting this requirement. For example, in Colombia the government imposed a regulation which prohibits the exchange of dollars into local currency. The Government requires the purchase of "Exchange Certificates" which can only be cashed upon maturity. The maturity dates vary from four to six months.

AID procedures should be revised to reflect the current practice of consolidating FRLC authorizations. The present procedures are predicated on individual FRLCs for each grant or contract. Consequently, the grant or contract officer, has the procedural responsibility for determining when the FRLC should be suspended or revoked. Under the consolidated FRLC, however, there may be several grants and contracts under one FRLC administered by different contracting or grant officers. As a result, no one grant or contract officer is in a position to monitor FRLC recipients cash management practices. The Office of Financial Management is the only office in AID that can monitor the total cash position of FRLC recipients.

AID procedures also lack definitive criteria on when it may be necessary to suspend or revoke a FRLC authorization. Until this is clarified, AID personnel can avoid taking revocation action even though a recipient may have a long history of deficient cash management practices.

We also believe that AID procedures should be revised to require a separate bank account for FRLC funds in those cases where recipients have shown an inability to effectively manage AID funds. This would put another instrument at AID's disposal to ensure federal funds are appropriately used.

AID currently has a manual system for monitoring recipients and processing FRLC documentation. This system is time consuming and cumbersome. Consequently, AID personnel have little time to devote to monitoring the cash management practices of FRLC organizations. There are plans to computerize most of the FRLC operations, but, the planned reports have shortcomings. They could be improved by pinpointing FRLC cash management deficiencies and evaluating the FRLC process.

FM/PAD should take a number of immediate actions to improve the cash management practices of FRLC recipient organizations. Accordingly, we recommend that:

Recommendation No. 1

The Controller, Office of Financial Management
direct FM/PAD to:

- (1) Request applicable FRLC recipients to return cash on-hand in excess of immediate disbursement requirements to AID;
- (2) Request applicable FRLC recipients return interest earned on cash advances to AID;
- (3) Send letters to all recipients strongly advising them to maintain FRLC cash advances at a reasonable level.

Further, we believe that there are system weaknesses that must be corrected if long term improvements are to be made in the management of the FRLC process. Accordingly, we recommend that:

Recommendation No. 2

The Controller, Office of Financial Management determine the appropriateness of current FRLC authorizations. The organizations that do not meet U.S. Treasury criteria or cannot be effectively monitored by AID should be financed by another payment mechanism.

Recommendation No. 3

The Controller, Office of Financial Management take the lead in revising AID Handbook 19 so that:

- (1) The procedures give primary responsibility to FM for control over FRLC authorizations;
- (2) The procedures contain clear and concise criteria for suspension or revocation of FRLCs; and
- (3) The procedures require FRLC advances be placed in a separate bank account for recipients who abuse the FRLC authority.

Recommendation No. 4

The Controller, Office of Financial Management assure the effective use of the planned computerized system. The computer should be programmed to generate management reports for monitoring FRLC recipients and evaluation of the FRLC process.

We also believe that AID can take other actions to improve the control and accountability over FRLC funds. Accordingly, we recommend that:

Recommendation No. 5

The Controller, Office of Financial Management:

- (1) Make adjustments to the personnel resources devoted to manage the FRLC process relative to other AID operations.
- (2) Require FM/PAD personnel to make periodic and random visits to FRLC recipients to review cash management practices and systems.
- (3) Require FM/PAD personnel to request and review daily transaction reports of FRLC recipients on a periodic and random basis.
- (4) Place a monthly drawdown restriction on FRLC recipients who have shown an unwillingness to abide by Department of Treasury cash management and reporting criteria.

CASE STUDIES

INTRODUCTION

This exhibit includes six examples of inadequate cash management of FRLC funds. We believe these deficiencies are common to many of the 201 FRLC recipient organizations. Therefore, we have not identified by name the organizations reviewed. We also believe the problems noted in the examples resulted in large part because of weaknesses in AID's system for monitoring FRLC recipients. The results of our work were discussed with the organizations involved and appropriate AID officials. Corrective action has been or will be taken to improve the cash management of the sample organizations.

EXAMPLE A

This organization was incorporated in November 1945, during the period of the post-war famine in Europe. Its overall program now includes development activities in some 37 countries in Asia, Africa, Latin America and the Middle East. About 20 percent of these development endeavors are financed by AID. As of November 20, 1981 this organization had a total FRLC authorization amounting to \$13.4 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$2.7 million.

Excessive FRLC Drawdowns And Interest Not Returned To AID

This organization has a history of drawing down FRLC funds far in advance of its operational needs. In 1981 it maintained a FRLC cash balance of between \$850,000 and \$1,000,000 in 14 interest bearing accounts. Most of the accounts remained dormant for long periods of time. This organization received about \$130,000 in interest on these accounts. But the interest received had not been returned to the U.S. Treasury.

Below are examples of three accounts in which large excessive cash balances were maintained for long periods of time. These examples are typical of what occurred in most of the other savings accounts.

<u>Country Account</u>	<u>Date</u>	<u>Interest</u>	<u>Balance</u>
Bangladesh	10/9/81	\$ 14,496	\$10,650

Large excessive cash balances were maintained in the account for long periods of time. For example, on April 25, 1977 the account had a balance of \$100,154. On August 2, 1977 (123 days later) a \$200,000 FRLC deposit was credited to the account. This left a balance of \$301,170 which included \$1,016 in interest. On October 20, 1977 (56 days later) another \$100,000 FRLC deposit was credited to the account. This left a new balance of \$404,089 which included \$2,919 more interest. Eight days later the recipient withdrew \$261,153 from the account to pay for AID financed expenditures. This left a balance of \$142,936 in the account which was maintained for 200 days until another withdrawal of \$138,880 was made on May 16, 1978. During this period \$4,300 in interest was credited to the account.

<u>Country Account</u>	<u>Date</u>	<u>Interest</u>	<u>Balance</u>
Haiti	9/30/81	\$ 6,829	\$125,603

The organization drew down large amounts of FRLC funds far in advance of disbursement requirements. For example, on February 25, 1981 a FRLC deposit of \$500,000 was made to the account. The next day \$300,000 was withdrawn from the account to pay for project expenditures. However, the balance of \$219,236 stayed in the account for 162 days. On August 7, 1981 another \$50,000 in FRLC funds was deposited in the account. Three days later \$150,000 was withdrawn to cover project expenditures. This left a balance of \$123,357 which still remains in the account. Between February 25, 1981 and December 1, 1981 interest earned on the account amounted to \$6,367.

<u>Country Account</u>	<u>Date</u>	<u>Interest</u>	<u>Balance</u>
Sierra Leone	10/9/81	\$58,990	\$193,268

As of October 9, 1981, this account has been inactive for the 207 days. During that period \$7,097 in interest was credited to the account. There are also several other examples where large cash balances were idle for long periods of time. For instance, on December 7, 1979 the cash on-hand was \$258,484. It was 88 days before a withdrawal of \$63,235 was made to pay for AID financed expenditures. It was another 33 days before a withdrawal was made to pay for additional AID financed expenditures. During the total 171 day period \$5,353 in interest was credited to the account.

Cash Transaction Reporting Untimely And Ineffective

This organization generally submits federal cash transaction reports to AID on a quarterly basis. However, the reports are sometimes submitted two months after the end of the reporting

period. They are, therefore, of marginal value to AID in monitoring the entity's FRLC cash position. In addition, the reports do not contain the necessary financial information for effective monitoring. Even when reports indicate an excessive cash position and disclose the amount of interest earned on the federal cash on-hand, AID did little, if any, follow-up on them.

For example, the organization submitted a cash transaction report to AID for the period January 1, 1980 through March 31, 1980. Although the entity was required to submit the report by April 15, 1980, it was not submitted until June 18, 1980. Also, the report did not reflect the days of disbursements the ending cash balance represented. This is a reporting requirement. Based on the disbursement experience of the three-month reporting period, the ending cash balance of \$931,869 represented about 150 days of disbursements. The report did show, however, the interest earned on federal cash amounting to \$57,786. But AID took no action to have the organization reduce the large excessive cash on-hand balance nor require the entity to return the interest earned to the U.S. Treasury.

Some of the more recent cash transaction reports submitted by this entity covered 30-day periods. However, the reports were on an individual grant basis and like the quarterly reports did not contain the financial information necessary for effective monitoring. By submitting reports on an individual grant basis, AID is not able to monitor the organization's total FRLC cash position. Moreover, the monthly reports were not submitted until 45 days after the reporting period.

Actions Taken To Improve Management Of Federal Funds

As a result of our review, this organization has taken measures to improve its cash management over federal funds received through the FRLC process.

- On January 18, 1982 the organization returned to AID \$122,202 in interest earned on the 14 savings accounts. The 14 savings accounts were closed out and applicable funds were transferred to one savings account. All future interest earned on the new single savings account will be immediately refunded to AID after it is credited to the account.
- A review is in process to determine the FRLC cash on-hand that is excessive to short-term disbursement requirements. The federal cash on-hand in excess of immediate disbursement requirements will be returned to AID.
- All future federal cash transaction reports will be on a consolidated basis. The organization has promised to provide all required financial information in the reports and be more timely in their submission.

EXAMPLE B

This is a private voluntary organization that has a worldwide network in some 77 countries. Its programs include community development, housing, education, agriculture, health care, industrial development and social welfare. In fiscal year 1980, AID obligated \$12.5 million to finance projects sponsored by this organization. About 25 percent of its revenues are received from various U.S. Government agencies. As of September 30, 1981, this organization has a total FRLC authorization amounting to \$27.8 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$9.95 million.

History Of Maintaining Excessive FRLC Cash Balances

Our review indicates this organization is maintaining excessive FRLC cash on-hand that amounts to \$4 to 4.5 million dollars. These large cash balances in the U.S. and overseas represents several months of disbursements. This practice is costing the federal government as much as \$720,000 annually in interest payments. The practice only benefits the commercial banks that have free use of federal funds that are deposited in the non-interest bearing accounts.

FRLC drawdowns made by this organization are initially deposited in a U.S. non-interest bearing checking account (called the umbrella account). The funds are thereafter transferred to other U.S. non-interest bearing accounts that are dedicated to 33 country fund accounts. From the country accounts the funds are transferred to overseas banks. Most of the FRLC funds received are disbursed at overseas locations. Only a small portion of the FRLC funds are used to pay for U.S. expenditures. However, most of the FRLC cash on-hand is in the U.S. program dollar accounts. Consequently, the funds in the U.S. programs remain idle until a request is made to transfer the funds to overseas locations. The table below shows the make up of the total estimated cash on-hand as of August 31, 1981.

U.S. Program Dollar Accounts	\$ 3,019,000
U.S. Umbrella Dollar Account	768,600
Local Currency Accounts	<u>1,136,000</u>
	<u>\$ 4,923,600</u>

While most of the excessive cash on-hand is maintained in the U.S. dollar country program accounts, the umbrella dollar account and local currency accounts also have had excessive balances. The following table shows the average daily balances of the umbrella account for fiscal year ending September 30, 1981.

		<u>Umbrella Account Average Daily Balances</u>
1981	September	\$ 1,051,393
	August	670,425
	July	525,342
	June	544,978
	May	643,382
	April	1,016,293
	March	1,338,156
	February	1,146,024
	January	1,527,551
1980	December	1,511,102
	November	2,255,295
	October	2,750,210

The table below illustrates the cash flow of the Sudan local currency account. It is a typical example where the local currency on-hand far exceeds immediate or short-term disbursement requirements.

	<u>Local Currency Account</u>		<u>Ending Cash Balance</u>	<u>Months Of Cash O/H</u>
	<u>Cash Available</u>	<u>Total Expenditures</u>		
<u>1981</u>				
Oct. (Note A)	\$168,193	\$ 33,527	\$ 134,666	4.2
Sept.	168,193	33,527	134,666	4.2
Aug. (Note A)	199,826	38,106	161,720	5.0
July	199,826	38,106	161,720	5.0
June	252,572	70,398	182,174	5.6
May	232,135	15,523	216,612	6.7
April	116,269	26,522	89,747	2.8
March	134,132	24,646	109,486	3.4
Feb.	115,200	23,310	91,890	2.8
Jan.	150,074	28,000	122,074	3.8
<u>1980</u>				
Dec.	119,821	34,271	85,550	2.6
Nov.	87,963	22,738	65,225	2.0
Total		\$ 388,674		
Average		\$ 32,390		

Note A

Figures for October and August 1981 were not available. For comparison purposes, September 1981 and July 1981 figures were used for these months.

AID Decision Was A Major Cause For The Excessive FRLC Cash Balances

An inappropriate AID decision was a major cause for the organization's excessive FRLC cash position. In March 1980 the entity withdrew \$2 million in FRLC funds to pay for activities related to a Indonesia project. However, the Indonesia project was not authorized under the FRLC. Rather, the project was being financed by periodic advances. The entity informed AID that it had inadvertently withdrew the \$2 million. AID directed the entity to submit an advance voucher for \$2 million to cover the Indonesia project. But AID also directed the entity to keep the \$2 million in FRLC funds. In our view, AID should have told the organization to return the \$2 million. If the \$2 million had been returned, the entity would presently be in a more appropriate, but still excess, FRLC cash position.

Cash Transaction Reporting Untimely And Ineffective

This organization submits the required federal cash transaction reports between 2 and 3 months after they are due. In addition, the reports are incomplete and do not contain the necessary financial information for AID to effectively monitor the FRLC cash position. For instance, on October 6, 1981 AID received a series of federal cash transactions reports for the period ending June 30, 1981. One of the reports showed the consolidated FRLC cash position for June 1981. This report was backed up by separate reports on 7 grants. However, the entity also has 18 other grants that are financed by the FRLC. The organization did not submit backup reports for the other 18 grants.

AID did perform some follow-up on the reports received on October 6, 1981. A form letter was sent by AID to the organization requesting that certain corrections be made to the reports. But AID did not question the unusually large cash balances reflected in the reports. While the reports did not show the days of cash on-hand, an analysis of the reports would have revealed a major cash management problem. Our analysis of the reports indicate the entity had months of cash on-hand as shown in the table below:

-----As of June 30, 1981-----				
<u>Report</u>	<u>Days Covered By Report</u>	<u>Days Delinquent In Submission</u>	<u>Ending Cash O/H ^{1/}</u>	<u>Months of Cash O/H ^{1/}</u>
Consolidated	30	83	<u>\$5,188,107</u>	4.8
Grant A	61	76	658,631	4.5
B	61	78	59,096	5.4
C	61	75	268,869	6.1
D	181	77	143,657	6.5
E	181	76	346,305	13.7
F	61	78	150,290	6.1
G	151	67	<u>31,215</u>	3.6
Grants Backed Up By Reports			\$1,658,063	
Cash O/H Not Accounted For			<u>3,530,044</u>	
Total			<u>\$5,188,107</u>	

^{1/} The days of cash on-hand were derived by dividing the ending cash balance by the average daily disbursements experienced during the reporting period. The results were divided by 30 days to arrive at the months of cash on-hand.

Actions Taken To Reduce FRLC Cash Balance And Improve Cash Management

On January 15, 1982 we sent a letter to the organization stating our concern over its practice of maintaining large amounts of idle cash in commercial bank accounts. It was noted that while we did not know the exact amount of the FRLC cash on-hand that was excessive to its immediate or short-term operating needs, the amount could be several million dollars. In this respect, we requested that the organization: (1) take immediate steps to review its overall FRLC cash position and return to AID the amount that will not be used to cover its immediate or short-term operating requirements, and (2) implement cash management procedures so that the cash on-hand in the future will be maintained at a reasonable level. The organization basically agreed with our position and is taking corrective measures to reduce the FRLC cash balance and improve its cash management procedures. More specifically the organization agreed that it would:

- Initiate a study on the U.S. and local currency accounts to determine the cash on-hand amount which is excessive to its immediate operating requirements.

- Return to AID the amount of cash on-hand which is excessive to its immediate operating requirements.
- Determine whether its local currency accounts are earning interest and return to AID the amount of interest earned.
- Work with AID on ascertaining the amount of FRLC cash on-hand that it can maintain in its bank accounts.
- Implement cash management procedures so that cash balances will be maintained at minimal levels in the future.

EXAMPLE C

This is a private voluntary organization that promotes educational development in Africa through a variety of training programs. The programs provide academic, technical and on-the-job training for Africans, both in the U.S. and in Africa. About 75 percent of this entity's operations and development programs are financed by AID grants and contracts. This organization presently has an AID FRLC authorization amounting to \$23.1 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$7 million.

FRLC Funds Used To Finance Non-AID Activities

This organization has used the cash received from AID FRLC drawdowns to finance programs of other federal agencies. To a lesser extent, the AID FRLC funds have been used to finance the organization's private endeavors. The net result of this practice allows the organization to maintain an investment portfolio at a level that could not otherwise be maintained. As of December 1981, the organization had income producing investments of about \$5 million.

An analysis of the organization's financial records for August and July 1981 showed a significant difference between the FRLC cash on-hand and the actual cash in the entity's bank accounts. For the two-month period, the actual cash in the bank accounts averaged about \$172,200 less per day than the daily average FRLC cash balance as shown on the table below.

	<u>Average Daily Balance</u>		
	<u>July</u>	<u>August</u>	<u>Both Months</u>
FRLC Cash that should be O/H	\$538,703	\$443,437	\$ 491,070
Actual Cash O/H	<u>332,096</u>	<u>305,673</u>	<u>318,885</u>
Cash Shortage	<u>\$206,607</u>	<u>\$137,764</u>	<u>\$ 172,185</u>

A significant portion of the AID FRLC cash on-hand during these months was used to finance programs sponsored by the International Communications Agency (ICA) and the Department of State. The total amount of ICA and State program activities paid for with AID FRLC funds in this period was \$269,895. The table below shows the daily average cash on-hand of the AID, ICA, and State funded programs for the months of July and August 1981.

<u>FRLC</u>	<u>Average Daily Cash On-Hand</u>	<u>Average Daily Disbursements</u>	<u>Days of Cash O/H</u>
AID	\$ 491,070	\$ 15,754	31
ICA	(148,731)	8,270	(18)
State	<u>(4,988)</u>	<u>331</u>	(15)
Total	\$ 337,351	<u>\$ 24,355</u>	14
Less Actual Cash In Bank	<u>\$ 318,885</u>		
Net Cash Shortage	<u>\$ 18,466</u>		

Taking into consideration all federal programs, the organization still had an average daily cash shortage of \$18,466. This means the entity was using federal funds to finance its private endeavors. This point is made more clear when the AID FRLC is analyzed on a daily basis. For instance, there were several days in the sample months where the net AID FRLC cash on-hand shortage (exclusive of AID FRLC cash that was used to pay for ICA/State Programs) represented amounts up to \$284,500. On these days the AID FRLC funds were used to finance non-federal activities. The net effect was that the organization did not have to liquidate some of its investments to pay for these private endeavors. The table below shows the status of the entity's cash balances for those days.

<u>July</u>	<u>AID FRLC Cash O/H</u>	<u>Less Actual Cash O/H</u>	<u>Gross Cash Shortage</u>	<u>Less ICA/State Cash O/H</u>	<u>Net Cash Shortage</u>
7	\$484,585	(\$258,012)	\$ 226,573	(\$180,770)	\$ 45,803
8	470,542	(223,410)	247,132	(189,190)	57,942
9	465,883	(205,099)	260,784	(193,291)	67,493
13	457,725	(191,967)	265,758	(208,861)	56,897
14	657,553	(176,164)	481,389	(217,424)	263,965
15	608,897	(247,245)	361,652	(243,680)	117,972
23	526,455	(217,425)	309,030	(24,522)	284,508
24	515,354	(207,791)	307,563	(29,515)	278,048
25	515,354	(207,791)	307,563	(29,515)	278,048
26	515,354	(207,791)	307,563	(29,515)	278,048
27	512,493	(434,749)	77,744	(32,048)	45,696
28	709,599	(423,555)	286,044	(35,339)	250,705
29	706,714	(402,057)	304,657	(36,410)	268,247
30	703,841	(592,195)	111,646	(45,624)	66,022

August

1	652,458	(531,998)	120,460	(72,109)	48,351
2	652,458	(531,998)	120,460	(72,109)	48,351
12	416,387	(225,477)	190,910	(86,748)	104,162
17	525,551	(221,818)	303,733	(136,661)	167,072
18	507,618	(177,865)	329,753	(137,791)	191,962
19	503,486	(303,234)	200,252	(173,986)	26,266
24	452,591	(219,338)	233,253	(93,322)	139,931
25	451,117	(202,440)	248,677	(101,947)	146,730

Cash Transaction Reporting Untimely And Ineffective

Since this organization's FRLC drawdowns exceeds \$1 million annually, it should submit to AID federal cash transaction reports monthly. The reports are also required to be submitted no more than 15 days subsequent to the reporting period. The entity has not been meeting the reporting deadline. Additionally, the reports that are submitted do not contain the necessary financial information to allow effective monitoring of its cash position. For example, it was not until October 1981 that the organization submitted the federal cash transaction reports for July and August 1981. In addition, neither of these reports disclosed the number of days requirements the cash on-hand represented.

Actions Taken To Improve Management Of Federal Funds

This organization has a sophisticated computerized accounting system. In November 1981, the entity began testing a computer program to give them a daily summary of cash receipts, disbursements and on-hand balance of each contract and grant funded by AID or other federal agencies. The new report should significantly improve the entity's management of federal funds. On October 30, 1981 the entity reported to AID that it had decreased its FRLC cash on-hand to three days plus the additional time required by the commercial bank to process the FRLC drawdown voucher.

AID officials responsible for monitoring FRLC transactions have been advised of the results of our review. They intend to actively monitor the entity's FRLC drawdowns and federal cash transaction reports.

EXAMPLE D

This is a private voluntary organization that supports family planning services in Africa, Asia, Latin America and the Middle East. It conducts international communications network of information on family planning; supports and conducts international, national and regional medico-scientific conferences; and supports development of national associations for family planning. Most of the revenues it receives are from AID grants. As of April 30, 1981 this organization had a total FRLC authorization amounting to \$46.4 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$9.6 million.

Interest Earned On FRLC Funds Not Reported

This organization provides FRLC cash advances to numerous subgrantees located overseas. An analysis of the entity's internal audit reports showed that several of the subgrantees were earning interest on these cash advances. We advised this organization that U.S. Treasury and AID regulations require that the interest earned be reported to AID and returned to the U.S. Treasury. On December 15, 1981 the entity sent a check to AID in the amount of \$4,586.61 for the interest identified in the audit reports.

Premature And Infrequent FRLC Drawdowns Causes Excessive Federal Cash On-Hand

During calendar year 1981 this organization made FRLC drawdowns in large amounts (\$150,000 to \$500,000) about once every two weeks. The effect of this practice has been the retention of FRLC cash balances in excess of the entity's immediate or short-term operating

needs. The rationale provided for the infrequent drawdowns was the time (estimated at about one-half hour) required to submit and process the FRLC payment voucher at the commercial bank. We do not find this to be a reasonable justification.

The table below demonstrates the adverse effect the premature and large FRLC drawdowns have had on the daily cash on-hand balances for August 1981.

Date	FRLC Deposits Ending Cash Balance of Previous Months	FRLC Disbursements	Cash On-Hand -0-
1			
2			
3	\$ 500,000.00	\$ 58,758.72	\$363,329.97
4		23,420.64	339,909.33
5		2,741.29	337,168.04
6		166,037.31	171,130.73
7			171,130.73
8			171,130.73
9			171,130.73
10		113,932.77	57,197.96
11	400,000.00	10,455.79	446,742.17
12		784.21	445,957.96
13			445,957.96
14		35.00	445,922.96
15			445,922.96
16			445,922.96
17		2,333.09	443,589.87
18		63,327.95	380,261.92
19		38,270.00	341,991.92
20		5,000.00	336,991.92
21			336,991.92
22			336,991.92
23			336,991.92
24			336,991.92
25		18,812.26	318,179.66
26			318,179.66
27		96,910.50	221,269.16
28			221,269.16
29			221,269.16
30			221,269.16
31		169,362.02	51,907.14
Total	\$ 900,000.00	\$ 770,181.55	

FRLC Funds Used To Finance Non-AID Activities

This organization maintains a separate checking account for AID FRLC drawdowns and disbursements. But the entity uses the checking account to pay for non-AID activities. Checks were cashed to pay for business lunches, cost of labor negotiations, insurance premiums and privately-funded development projects. While the AID FRLC checking account was generally reimbursed within two months, this practice is inappropriate in principle and not in compliance with U.S. Treasury or AID regulations. For the fiscal year ending September 30, 1981 the entity issued FRLC account checks amounting to \$113,189 for non-AID activities.

<u>Description of Items</u>	<u>Amount</u>
Life and Property Insurance Premiums	\$ 18,917
State and Local Taxes	8,657
Private Development Projects	50,320
Payroll Withholding Taxes	25,627
Miscellaneous	<u>9,668 a/</u>
Total	<u>\$113,189</u>

a/ Includes FRLC account checks written for business lunches, labor negotiation expenses, credit card charges, and other incidental items.

Estimating Cash Advances Required By Subgrantees Is A Problem

This organization administers 39 subgrants in 31 overseas countries. As of September 30, 1981 the amount of FRLC cash on-hand in the subgrantee bank accounts totaled \$524,527. It is very probable some of the subgrantees are maintaining excessive cash advances because this entity lacks a system for estimating the cash needs of its subgrantees.

A recent consultant's study revealed that many of the subgrantee projects were suffering because of delays in receiving funds. Occasionally personnel salaries were not paid and project activities ceased. Sometimes there was more than three months delay from approval of the project to receipt of funds by the project administrator. Much of the delays in transfer of funds was thought to be caused at the country bank level. The evaluation report recommended alternative mechanisms for transmitting funds be reviewed. Some suggested possibilities were:

- Increasing the initial disbursement of funds;
- Investigate the possibility of transferring funds through AID channels; and
- Consider the direct mailing of checks to grantees.

The organization choose the method of initially advancing 4 months of working capital. The subgrantee is then reimbursed for actual expenditures. This practice probably results in some subgrantees receiving excessive advances and others not receiving enough in cash advances.

Cash Transaction Reports Were Not Submitted

This organization has not been submitting the required federal cash transaction reports. The entity was not aware of this requirement and AID has not requested submission of the reports.

Actions Taken To Improve Management Of Federal Funds

Several actions have been taken to improve the management over FRLC funds.

- Future interest earned on FRLC funds will be returned to AID immediately after receiving the internal audit reports.
- The entity is making more frequent drawdowns and maintaining a more reasonable FRLC cash balance.
- The entity has instituted procedures to prevent the disbursement of AID FRLC funds for non-AID activities.
- An internal evaluation is being made to effect a more logical and systematic approach to advancing funds to subgrantees.
- AID has instructed the entity to submit the federal cash transaction reports on a monthly basis.

EXAMPLE E

This organization is a private voluntary organization. Its general purpose is to develop and support family planning programs in developing countries. It presently administers family planning programs in Africa, Asia, Latin America and the Middle East. About

50 percent of the organization's activities are financed by AID. It presently has one AID grant valued at \$64.3 million. The entire amount of the grant is financed by a FRLC authorization. As of September 30, 1981 the unobligated portion of the grant amounted to \$7.9 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$11.1 million.

Excessive FRLC Cash Balances

This organization has a history of maintaining large and excessive FRLC cash balances. For example, during a 21 month period beginning January 1980, the FRLC cash balance has averaged about \$1 million per day. However, disbursements of FRLC funds only averaged \$32,300 per day for the same period.

The following table provides a prospective on the entity's FRLC cash position for the 21 month period:

<u>1980</u>	<u>Drawdowns</u>	<u>Ending Balance</u>	<u>Days of Cash O/H</u>
January	\$1,000,000	\$ 940,951	29
February	1,000,000	1,205,263	37
March	2,000,000	1,216,261	38
April	1,000,000	1,181,787	37
May	1,000,000	1,415,141	44
June	1,000,000	1,686,711	52
July	1,125,348	1,895,075	59
August	1,000,000	1,874,299	58
September	700,000	1,225,266	38
October	600,000	1,188,775	37
November	500,000	1,053,757	33
December	1,000,000	994,493	31
<u>1981</u>			
January	1,000,000	1,514,075	47
February	-0-	738,724	23
March	500,000		
	1,000,000	745,519	23
April	700,000	395,849	12
May	1,500,000	323,223	10
June	1,293,504	751,162	23
July	1,000,000	644,506	20
August	1,000,000	1,011,017	31
September	1,000,000	835,976	26
Average		\$1,087,515	34

This organization does not effectively time FRLC drawdowns with FRLC disbursements. The FRLC drawdowns average about \$1 million every month and usually only one drawdown is made each month. But FRLC disbursements are made much more frequently. Consequently, this organization has idle cash in bank accounts for long periods of time. Since the entity deposits the FRLC funds in non-interest bearing accounts, the only beneficiaries of this practice are the commercial banks that have free use of federal funds. The following table shows the effect of this practice for the month of September 1981.

SEPTEMBER 1981

Date	FRLC Deposit	FRLC Disbursements	Cash on-Hand
	Ending Cash Balance of Previous Months		\$1,055,878.83
1			1,055,878.83
2		\$ 5,390.04	1,050,488.79
3		8,486.84	1,042,001.95
4			1,042,001.95
5			1,042,001.95
6			1,042,001.95
7			1,042,001.95
8			1,042,001.95
9		40,638.00	1,001,363.95
10			1,001,363.95
11		178.18	1,001,185.77
12			1,001,185.77
13			1,001,185.77
14			1,001,185.77
15		6,217.81	994,967.96
16	\$1,000,000.00		1,994,967.96 a/
17			1,994,967.96 a/
18		48,132.00	1,946,835.96 a/
19			1,946,835.96 a/
20			1,946,835.96 a/
21			1,946,835.96 a/
22		96.55	1,946,739.41 a/
23		124,009.71	1,822,729.70
24		263,091.24	1,559,638.46
25		366,109.13	1,193,529.33
26			1,193,529.33
27			1,193,529.33
28			1,193,529.33
29		154,623.45	1,038,905.88 a/
30		157,864.10	881,041.78
Total	\$1,000,000.00	\$1,175,941.95	

a/ On these dates the actual cash balance in the organization's bank accounts was substantially less than the FRLC cash balance. This is discussed in detail in the next section.

FRLC Funds Used for Non-AID Purposes

Our review of the organization's bank statements and FRLC cash transaction reports indicates federal funds have been used for non-AID purposes. For instance, in August and September 1981 there were 12 days in which the total cash in bank accounts was significantly less than the FRLC cash balances for the same days.

	<u>Bank Cash Balance</u>	<u>FRLC Cash Balance</u>	<u>FRLC Cash Shortage</u>
August 13	\$ 993,166	\$1,345,879	(\$352,713)
14	949,621	1,345,879	(396,258)
15	969,621	1,345,879	(376,258)
16	969,621	1,345,879	(376,258)
September 16	1,624,335	1,994,968	(370,633)
17	1,720,709	1,994,968	(274,259)
18	1,267,759	1,946,836	(679,077)
19	1,267,759	1,946,836	(679,077)
20	1,267,759	1,946,836	(679,077)
21	1,298,915	1,946,836	(647,921)
22	1,245,061	1,946,739	(701,678)
29	1,012,557	1,038,702	(26,145)

The organization was not able to adequately explain the reason for the large FRLC cash shortages. It also was not possible for us to reconcile the difference between the total cash in the bank accounts and the FRLC cash on-hand. In any event, the FRLC cash shortages would not have occurred if the entity had been more effective in its cash management of the receipt and disbursement of federal funds.

AID Monitoring Ineffective

This organization has not met federal cash transaction reporting deadlines. In February 1981, AID became quite concerned about the untimeliness of the entity's federal cash transaction reporting. According to AID files, one AID official noted that the organization's "financial staff continually express willingness and intention to improve financial reporting, but it seems the further they go, the behinder they get. We plan to continue our "jawboning" and perhaps make a site visit to their offices to keep pressure on for submission of reports but, more importantly, to improve cash management. I don't believe the stronger course of action (revocation of FRLC or initiate periodic check advance) would necessarily improve this recipient's cooperation or long-term performance, but it is an option." AID did no further follow-up after this expression of concern over the organization's cash management practices.

This organization is presently delinquent in meeting its cash transaction reporting responsibilities. As of February 24, 1982 it had not submitted to AID the required cash transaction reports for November, December 1981 and January 1982.

Actions Taken To Improve Management Of Federal Funds

AID plans to actively monitor the FRLC cash position of the organization. If the entity does not improve its cash management practices, AID should seriously consider revocation of the FRLC authorization.

EXAMPLE F

This organization was incorporated in 1971 as a private organization to mobilize financial support for development projects in Africa. AID began supporting its operations in November 1974 through a Development Program Grant. Since 1975, AID has provided about 90 percent of the entity's operational support and project financing. The cumulative authorized AID funding to date under the AID FRLC is \$9.1 million. FRLC drawdowns during fiscal year ending September 30, 1981 totaled \$2.1 million.

Interest Earned On Federal Funds Not Refunded

A subgrantee to this organization, reported interest earned totaling about \$2,800 from June 30, 1979 through September 30, 1980. The interest was credited to project expense rather than refunded to AID. In essence, this increases grant funding by the amount of interest earned.

Treasury regulations specifies that interest earned on federal funds shall be promptly refunded. The AID grant also specifies that interest to the grantee, or to any person to whom the grantee makes such funds available, shall be refunded to AID. The financial director of this organization believes that crediting project expenses was an acceptable way of treating interest income, but agreed to comply with the requirement of refunding interest income to AID.

Excessive FRLC Cash Balance Maintained

Our analysis of the organization's financial records for the months of August and September 1981 showed excessive FRLC cash

balances were being maintained. For example, the entity had a daily FRLC cash balance of over \$334,000 for the first 13 days of August but a total of only \$77 was disbursed during the same period. Also, for the period August 1 thru August 30, it carried a daily balance of at least \$325,000 whereas daily disbursements averaged less than \$300. The following table illustrates how daily FRLC cash balances have been maintained for August 1981.

AUGUST 1981

Date	FRLC Deposits	FRLC Disbursements	Cash On-Hand
	Ending Cash Balance of Previous Months		\$ 334,437
1		\$	334,437
2			334,437
3			334,437
4			334,437
5			334,437
6		77	334,360
7			334,360
8			334,360
9			334,360
10			334,360
11			334,360
12			334,360
13			334,360
14		2,516	331,844
15		6,057	325,787
16			325,787
17			325,787
18			325,787
19			325,787
20			325,787
21			325,787
22			325,787
23			325,787
24			325,787
25		120	325,667
26		45	325,622
27			325,622
28		161	325,461
29			325,461
30			325,461
31		124,078	201,383
Total		\$ 133,054	

Cash Transaction Reporting Untimely

This organization generally submits federal cash transaction reports to AID on a quarterly basis. The entity has been tardy in its submissions of reports. Thus, they are of marginal value to AID in monitoring the organization's FRLC cash position. As shown below, reports are being submitted some two months or more after the end of the reporting period.

<u>Period Covered</u>	<u>Date Submitted</u>
10/1/80 thru 12/31/80	3/19/81
1/1/81 thru 3/31/81	6/15/81
4/1/81 thru 6/30/81	10/09/81

Actions Taken To Improve Management Of Federal Funds

Based on our review, certain actions were initiated to correct problems in the organization's management of FRLC funds.

- AID requested a refund of interest earned on the FRLC funds. AID also notified the entity, that pursuant to its grant provisions, any future interest earned with grant funds must be returned to AID.
- The organization has promised to comply with the three-day rule in retention of FRLC cash balances. It also agreed to be more timely in the submission of the required federal cash transaction reports. AID plans to closely monitor the entity.

LIST OF REPORT RECOMMENDATIONS

	<u>Page</u>
<u>Recommendation No. 1</u>	22
The Controller, Office of Financial Management direct FM/PAD to:	
(1) Request applicable FRLC recipients to return cash on-hand in excess of immediate disbursement requirements to AID;	
(2) Request applicable FRLC recipients return interest earned on cash advances to AID;	
(3) Send letters to all recipients strongly advising them to maintain FRLC cash advances at reasonable level.	
<u>Recommendation No. 2</u>	23
The Controller, Office of Financial Management determine the appropriateness of current FRLC authorizations. The organizations that do not meet U.S. Treasury criteria or cannot be ef- fectively monitored by AID should be financed by another payment mechanism.	
<u>Recommendation No. 3</u>	23
The Controller, Office of Financial Management take the lead in revising AID Handbook 19 so that:	
(1) The procedures give primary responsibility to FM for control over FRLC authorizations;	
(2) The procedures contain clear and concise criteria for suspension or revocation of FRLCs; and	
(3) The procedures require FRLC advances be placed in a separate bank account for recipients who abuse the FRLC authority.	

LIST OF REPORT RECOMMENDATIONS (Cont)

Recommendation No. 4

23

The Controller, Office of Financial Management assure the effective use of the planned computerized system. The computer should be programmed to generate management reports for monitoring FRLC recipients and evaluation of the FRLC process.

Recommendation No. 5

24

The Controller, Office of Financial Management:

- (1) Make adjustments to the personnel resources devoted to manage the FRLC process relative to other AID operations.
- (2) Require FM/PAD personnel to make periodic and random visits to FRLC recipients to review cash management practices and systems.
- (3) Require FM/PAD personnel to request and review daily transaction reports of FRLC recipients on a periodic and random basis.
- (4) Place a monthly drawdown restriction on FRLC recipients who have shown an unwillingness to abide by Department of Treasury cash management and reporting criteria.

LIST OF REPORT RECIPIENTS

Deputy Administrator (DA/AID)	3
Assistant to the Administrator for Management (AA/M)	1
Assistant Administrator/Bureau For Africa (AA/AFR)	1
Assistant Administrator/Bureau For Asia (AA/ASIA)	1
Assistant Administrator/Bureau For Latin America and the Caribbean (AA/LAC)	1
Assistant Administrator/Bureau For Near East (AA/NE)	1
Assistant Administrator/Bureau For Food For Peace and Voluntary Assistance (AA/FVA)	1
Controller, Office of Financial Management (M/FM)	5
Director, Office of Contract Management (M/SER/CM)	1
Office of Legislative Affairs (LEG)	1
General Counsel (GC)	1
Office of Public Affairs (OPA)	1
Office of Evaluation (PPC/E)	1
Office of Development Information and Utilization (S&T/DIU)	4
Inspector General (IG)	1
RIG/A/EA	1
RIG/A/EAFR	1
RIG/A/Egypt	1
RIG/A/NESA	1
RIG/A/WA	1
RIG/A/LA	1
IG/PPP	1
AIG/II	1
AIG, II/AFR	1
IG/EMS/C&R	35