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AUDIT OF

INTEREST ACCUMULATION AND  
UTILIZATION UNDER ECONOMIC  
SUPPORT FUND PROJECTS IN THE  
PHILIPPINES  
USAID/PHILIPPINES

AUDIT REPORT NO. 2-492-87-02

October 27, 1986

UNITED STATES GOVERNMENT

# Memorandum

TO : Mr. Frederick W. Schieck  
Director, USAID/Philippines

FROM : Leo L. LaMotte  
RIG/A/M

DATE: October 27, 1986

RIG/EA-87-017

SUBJECT: Memorandum Audit Report No. 2-492-87-02, of Interest Accumulation And Utilization Under Economic Support Fund Projects in the Philippines

This report presents the results of audit of interest accumulation and utilization under Philippine Economic Support Fund (ESF) projects. Please advise RIG/A/Manila within 30 days of the action taken or planned to clear the report recommendation. Thank you for the courtesies extended to the audit staff on this assignment.

## Background

The Philippine ESF Secretariat was responsible for administration of the ESF program. Since its inception in 1980, the ESF program has provided \$426.6 million of American aid to the Republic of the Philippines. ESF grants have been used to ensure that local funds (\$167 million in equivalent pesos appropriated by the Government of the Philippines) were available for seven major economic development projects. The pesos were placed in ESF Special Accounts at the Philippine National Bank. The ESF Special Accounts generated interest at commercial bank rates. The projects were primarily concerned with developing and implementing numerous subprojects designed to improve the Philippine infrastructure. Projects included construction or renovation of roads, schools, markets, slaughterhouses, etc. The program also provided grants totaling \$292.5 million making local currency available for non-project assistance and budget support. The cash transfers of United States dollars were available for payment of Philippine foreign debts. These non-project assistance funds were not placed in interest bearing accounts.

## Audit Objectives and Scope

This was primarily a financial and compliance audit to determine the disposition of accumulated interest income totaling \$14.4 million in equivalent pesos generated in the ESF Special Accounts. We reviewed Philippine agency and USAID/Philippines financial documents and other documents relating to the interest income and utilization. We also interviewed Philippine government and USAID/Philippines personnel regarding the utilization of the interest. Audit work included review of

interest deposits in the ESF Special Accounts and a recomputation of interest for a sample time period. The audit was performed during the period March through August 1986 in accordance with generally accepted government auditing standards.

The issue of interest generated from ESF funds first arose during an audit of the Elementary School Construction Project<sup>1</sup> performed by the Regional Inspector General's office in Manila in early 1982. However, the audit report made no specific recommendations about the interest issue.

### Results of Audit

Interest Credited to Economic Support Fund Special Accounts Is Adequately Controlled But Unutilized - In April 1982 AID General Counsel said that it is AID/Washington policy that interest generated in the Economic Support Fund (ESF) Special Accounts should be used to assist in financing AID-supported projects or such other activities as may be mutually agreed upon by AID and the Philippine Government. As of August 1986, interest totaling \$14.4 million in equivalent pesos has accumulated in the ESF Special Accounts but had not been utilized for development or any other purpose. This occurred primarily because there was no agreement between AID and the Philippine Government which specifically delineated the utilization of the interest. As a result, the interest income was not utilized efficiently.

### Discussion

The principal in the ESF Special Accounts is jointly controlled by the Philippine Government and USAID/Philippines. A "Joint Project Implementation Letter" specifies that the Mission shall approve releases from the ESF Special Accounts after reviewing appropriate documentation. The agreement does not distinguish between principal and interest. The Philippine Government has not, in the past, considered itself legally bound to apply the agreement's terms to interest. For instance, the Philippine Government withdrew \$1.38 million in interest from the Special Accounts in 1983-4 without prior approval from AID. However, according to USAID/Philippines officials, the Philippine Government had, since that withdrawal, tacitly agreed that interest in the Special accounts would be subject to the Joint Project Implementation Letter, even though the specific uses of the interest were not covered by that letter.

In April 1982 the Office of the AID General Counsel issued an opinion regarding the utilization of interest generated from the ESF Special Accounts. This opinion noted that the Project

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<sup>1</sup> USAID Inspector General Audit Report No. 2-492-82-12, dated July 14, 1982.

Agreements specified that earnings on project funds "...disbursed by A.I.D. to the Grantee (the Philippine Government)... prior to the authorized use of such funds..." had to be "returned" to A.I.D. However, the General Counsel also determined that the pesos, having been provided by the Philippine Government and having been deposited in an account owned by that Government, could not be considered to be funds "disbursed by A.I.D." The opinion stated that

"The interest at issue was earned on pesos owned by the "Government of the Philippines" prior to transfer of the dollars by the United States, and the pesos continued to be owned by the (Government of the Philippines) after the pesos were transferred into the special account... (T)he United States did not buy or otherwise own the pesos prior to deposit in the special account and the pesos continued to be owned by the (Government of the Philippines) while in that account."

In April 1984, the AID General Counsel cabled further clarification of the interest issue. The AID General Counsel reaffirmed that the interest generated in the ESF Special Accounts was accrued by the Philippine Government. The cable continued, stating

"(AID/Washington) believes it appropriate as a matter of policy to obtain (Philippine Government) Agreement to use the interest earned on the Special Account to assist in financing A.I.D. supported (Development Assistance) or ESF projects or such other activities as may be mutually agreed upon in writing by the (Philippine Government) and A.I.D."

As of August 1986, interest totaling \$14.4 million <sup>1</sup> in equivalent pesos had accumulated in the ESF Special Accounts but has not been utilized for development or any other purpose. The interest is growing at about \$3.3 million annually.

In November 1984, USAID/Philippines began monitoring the interest activity in the ESF Special Accounts through monthly reviews of postings to the Special Accounts bankbooks. These internal controls were set out in a formal agreement with the ESF Secretariat. As a result, USAID/Philippines reviewed all activity in the ESF Special Accounts, including the crediting and debiting of interest.

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<sup>1</sup> Dollars computed at ₱20 = \$1.00.

In November 1985, the Philippine Government attempted to dispose of the interest issue unilaterally. According to an official government order, 60 percent of the interest generated in the ESF Special Accounts would be used to fund ESF projects "including newly identified projects, variation orders and price escalation". The remaining 40 percent would support the operations of the ESF Secretariat. USAID/Philippines objected to this plan as it enabled the Philippine Government to approve and fund projects which had not received prior AID approval. The plan was not implemented.

In January 1986, USAID/Philippines intensified its monitoring of the ESF Special Accounts in anticipation of the upcoming Philippine presidential elections. At that time, the Mission began reviewing bankbooks on a weekly basis.

In March 1986, the Philippine Commission on Audit (COA), an independent Philippine Governmental audit agency, issued a statement in the news media that ESF interest monies amounting to the peso equivalent of \$1.1 million were "missing" from the ESF Special Accounts and had been transferred to a "Confidential Fund" under the control of the former President Ferdinand Marcos. The "Confidential Fund" was presumably to be used for election purposes.

Upon review of documents provided by COA to USAID/Philippines, it became apparent that the "Confidential Fund", was in fact established by the ESF Secretariat. The Philippine Government provided initial funding from the Philippine Treasury's General Fund Account (a non-ESF account) with the proviso that total withdrawals from the "Confidential Fund" could not exceed the amount of interest on deposit in the ESF Special Accounts.

USAID officials concluded that it was the intention of the Philippine Government to use the ESF interest to reimburse the Philippine Treasury for its initial allotments to the "Confidential Fund". USAID strongly objected to the apparent intention of the Philippine Government to use the interest for this purpose and reminded the Government in writing that the interest continued to be subject to the provisions of the Joint Project Implementation Letter No. 1. As a result, the transfer of ESF Special Accounts interest to the "Confidential Fund" never took place. Although the peso equivalent of \$1.1 million had been disbursed from the "Confidential Fund" immediately prior to the election, those pesos did not originate in the ESF Special Accounts, nor were they reimbursed from those accounts.

In April 1986, the Chief of Operations, ESF Secretariat, requested that USAID/Philippines draft an option paper regarding acceptable arrangements for handling the ESF interest earnings. USAID officials told us that the matter was discussed with ESF Secretariat and it was mutually agreed that the ESF Secretariat would draft the option paper, since the purpose of that paper

was to present the recommendation of an executive agency of the Philippine Government to the President of the Philippines.

On August 12, 1986, the ESF Secretariat advised USAID officials that the Secretariat was preparing an action memorandum for the Philippine President that would propose how the interest earnings could be utilized. USAID/Philippines has advocated retaining the interest in the ESF Special Accounts to be used for ESF project purposes.

On August 18, 1986, the Director, USAID/Philippines, informed the Acting Executive Director, ESF Secretariat, that USAID wanted to meet with the Secretariat as soon as possible so that mutually acceptable alternative methods for the disposition of the interest earnings could be agreed upon before the President was asked to make a final decision. The Director noted that the USAID could quickly develop with the Secretariat a Joint Project Implementation Letter on interest utilization. The Director explained that the agreement on the interest matter must be properly documented through a Joint Project Implementation Letter.

A draft option paper was prepared in August 1986 by the ESF Secretariat and was reviewed by USAID. The draft noted that the USAID had consistently pressed for the joint determination by the United States and Philippine Governments of the utilization of the ESF Special Accounts interest accruals. In a cable dated September 23, 1986, the Mission advised AID/W of the options and requested AID/W views of the acceptability of certain approaches for using the ESF Special Accounts interest.

In summary, interest generated but not utilized in the ESF Special Accounts totaled the peso equivalent of \$11.4 million through May 1986. In our view, the specific uses of the ESF Special Account interest should be delineated at the earliest possible time. USAID/Philippines was adequately monitoring accumulated interest through its periodic review of bank statements of the ESF Special Accounts to ensure funds were not used for questionable purposes. However, the Philippine and United States Governments have not reached any formal agreement delineating future use of ESF Special Accounts interest. Thus, the interest amount is growing at about \$3.3 million annually and is not serving any development or other useful purpose.

#### Recommendation

We recommend that USAID/Philippines

- a. hold negotiations as soon as possible with concerned Philippine Government officials directed toward reaching a final agreement with the Philippine Government on the use of the interest generated in the Economic Support Fund Special Accounts, and

- b. monitor the use of the interest earned in the Economic Support Fund Special Accounts in accordance with appropriate procedures.

Management Comments

USAID has stated agreement with the resolution of the interest issue along the lines indicated in the draft report. USAID said it will continue to intensify its already substantial efforts to bring the issue to closure.

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PART III - APPENDICES

UNITED STATES GOVERNMENT

# Memorandum

APPENDIX 1

TO : Mr. Leo L. LaMotte, RIG/A/M

DATE: October 17, 1986

FROM : John S. Blackton, Acting Mission Director



SUBJECT : Mission Response on Draft Audit Report on the  
Interest Accumulation & Utilization Under  
Economic Support Fund Projects in the Philippines

The Mission fully agrees with the draft audit report view that there is a need for the specific uses of interest in the ESF Special Accounts to be delineated in an agreement with the Government of the Philippines. Sound management and the financial interests of the United States Government are best served by a clear resolution of the issue along the lines indicated in the draft report. The Mission will continue its efforts to achieve that goal. In this regard, Mission officials attended a negotiating meeting with Government of the Philippines (GOP) officials on the interest issues on October 15, 1986. At that meeting the GOP officials agreed to submit a proposal for use of the interest funds to USAID. We will continue to intensify our already substantial efforts to bring this issue to closure.

Thank you for the opportunity to comment upon this report. We share with RIG/A/Manila an appreciation of the importance of this issue both for our program and in the context of a worldwide Agency concern regarding the control of interest earned on funds provided to carry out AID programs.



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