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AUDIT OF
A.I.D. GRANT NO. PDC-0092-G-SS-6090-00 TO
THE INSTITUTE FOR CONTEMPORARY STUDIES

AUDIT REPORT NO. 9-000-88-2
OCTOBER 30, 1987

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

Deputy
Inspector General

October 30, 1987

MEMORANDUM FOR SER/OP, Terrence J. McMahon
AA/PPC, Richard E. Bissell

FROM: D/IG, James B. Durnil

SUBJECT: Audit of A.I.D. Grant No. PDC-0092-G-SS-6090-00 to the Institute for Contemporary Studies (ICS)

This report presents the results of audit of A.I.D. Grant No. PDC-0092-G-SS-6090-00 to the Institute for Contemporary Studies (ICS). Please provide us written notice within 30 days of any additional information related to action planned or taken to implement the recommendations. I appreciate the cooperation and courtesy extended to my staff during the audit.

Background

The Institute for Contemporary Studies (ICS) is a nonprofit organization founded in 1972 and incorporated in the state of California. Governed by a Board of Directors, the organization is managed by a president who acts as the Chief Executive Officer. In addition to the subject grant from A.I.D., the ICS is supported by grants and contributions from foundations, corporations and individuals and from sales of books and publications that it produces.

The purpose and objective of the ICS is to provide leadership and excellence in the research and analysis of domestic and international affairs in order to aggressively market and promote the development of prudent public policy for the long term benefit of a free society and the enhancement of personal dignity and achievement. ICS attempts to achieve these ends by sponsoring the development of and disseminating public policy studies in the areas of economics, political science, sociology and the law. ICS's main office is located in San Francisco, California. It also maintains an office in Panama City, Panama to coordinate activities under the grant.

A.I.D.'s grant to the ICS is intended to finance a prorata share of one of ICS's programs, the International Center for Economic Growth (ICEG).

ICS founded the ICEG in 1985 to sponsor research on economic growth and disseminate it through an international network of "correspondent institutes." The Center's program includes support to ongoing research and a publication program on critical issues of economic growth. Books, monographs, and a quarterly are distributed to network members who in turn are expected to distribute these materials to policymakers, journalists, and other opinion-makers around the world. A.I.D.'s support greatly expands the Center's capacity to: a) publish studies on growth issues for distribution to the network, and b) enhance public policy development capability of the independent network members.

A.I.D.'s grant to the ICS is a cost-sharing arrangement where A.I.D. has agreed to fund 63 percent of program costs allowable under the provisions of Office of Management and Budget (OMB) circulars A-110 1/ and A-122 2/ and the grant agreement itself. The $4.5 million grant extends for five years from June 1, 1986 with A.I.D. Washington's planned contribution being $800,000 annually and USAID participation estimated to provide the remaining $500,000. Under the terms of the agreement, ICS's contribution may be met through cash or the value of in-kind contributions given to the program. A Federal Reserve Letter of Credit arrangement has been established to allow ICS to draw down on A.I.D.'s funds to meet the immediate disbursement needs of the ICEG program.

Audit Objectives and Scope

We conducted a limited scope financial and compliance, and program results review of grant activities and transactions for the first year of the grant covering the period June 1, 1986 through May 31, 1987. Our audit objectives were to determine whether the grantee had complied with the conditions of the grant agreement, whether grant funds during the review period were properly accounted for and billed, and whether program objectives were accomplished as planned.

1/ OMB circular A-110 - Grants and Agreements with Institutions of Higher Education, Hospitals, and other Nonprofit Organizations - Uniform Administrative Requirements July 1, 1976.

2/ OMB circular A-122 - Cost principles for nonprofit organizations.

Our review was conducted at ICS's main office in San Francisco, California during the period September 1 through 11, 1987. We reviewed documentation on subproject progress, comparing it to the schedule specified in the grant, and we also reviewed summary accounting records and selected supporting source documentation as a basis for evaluating compliance and financial matters. Responsible ICS officers were interviewed and consulted in their area of expertise.

While we did assess and gain a general understanding of ICS's accounting system, especially as regards ICEG activities financed by the grant, we did not do a detailed financial audit. Therefore, the possibility exists that some of the financial information which we present later in this report may be subject to adjustment, although we would expect adjustments to be minor. An audit of ICS's financial statements by independent auditors was scheduled to commence immediately after our site visit ended.

Our audit was made in accordance with generally accepted government auditing standards.

Results of Audit

We found that ICS had complied with most of the conditions of the grant and that program objectives were now being accomplished in an adequate manner after a delayed start up of ICEG activities. Even though ICS was now accomplishing the program objectives, we did find serious financial management problems. ICS had not properly accounted for and billed grant funds. ICS had claimed in-kind contributions from itself and outside organizations for work that had been accomplished before the grant began. ICS had received guidance from A.I.D. that A.I.D. would disallow these costs. Also, ICS had drawn over twice the amount that it was entitled from its Federal Reserve Letter of Credit (FRLC).

The in-kind contributions that we questioned were not in accord with A.I.D. guidance nor were the amounts substantiated in accordance with government cost principles for nonprofit organizations. Therefore we recommend that all claims for in-kind costs for work not related to the grant be disallowed. Additionally, ICS's excess drawdowns of government funds under the FRLC arrangement amounted to ICS giving itself an interest free loan from U.S. government funds. We therefore recommend that ICS be directed to cease drawing money through the FRLC until such time that the excess advances are applied to the grant program or repaid directly to A.I.D. Interest should be charged from the time the advances were made until either of these repayment modes satisfy the debt. Each of the above issues are discussed further below.

1. <u>Grantee's Claimed In-Kind Contributions to the Grant Included Unallowable Costs</u> - The Institute for Contemporary Studies (ICS) claimed in-kind contributions from itself and outside organizations for work that had been accomplished before the grant began even though guidance had been received from A.I.D., that these costs could not be included as in-kind contributions. The grant agreement required that ICS provide a specific amount of nongovernment resources to the program either in cash or through in-kind contributions. A.I.D. further provided supplementary guidance intended to preclude ICS from claiming in-kind contributions for most costs incurred before the grant began. However, contrary to what A.I.D. intended, ICS interpreted A.I.D.'s supplementary guidance to mean that prior period in-kind costs could be counted. After disallowance of these prior period in-kind contributions, ICS's first year contribution to the program was about $90,000 less than specified in the grant budget.

<u>Discussion</u> - ICS obligations under the grant are spelled out in the grant agreement. Under this agreement, ICS consented to cost share 37 percent of the total program costs over the five years of the grant in accordance with the standard provision of the grant entitled "Cost Sharing." The standard provision allows the grantee to meet its contribution either with cash or in-kind contributions. The agreement further detailed that ICS's expected contribution during the first year of the program was to be about $401,000.

During the first year of the grant ICS requested clarification from A.I.D. on whether it would be able to count as in-kind contributions money spent or committed prior to the beginning of the grant which furthered the purposes of the grant. A.I.D.'s reply was that ICS could only use in-kind contributions received as of the effective date the grant began, except that ICS books transferred to the grant program could be counted at their inventory value on that date. We discussed this issue with the A.I.D. technical sponsor of the grant and were told that costs incurred prior to the beginning of the grant could not be counted except for the transferred books.

We found, however, that ICS followed a different interpretation. It considered that A.I.D. guidance allowed prior period costs to count as in-kind contributions as long as the contributions were received or first recognized after the grant began. As a result one-half of ICS's sponsorship costs for a book originally begun under another ICS program were claimed as in-kind contributions and the costs that two organizations claimed to have spent researching economic topics. One of these organizations' work began more than five years before the grant started and the accumulated costs were so high and so poorly documented that ICS was reticent to claim the whole amount as an in-kind contribution. ICS also increased the inventory value of the books transferred to the grant program to include past author costs of one book that had not previously been reflected in the books' inventory valuation.

Absent the supplementary guidance provided by A.I.D. in response to the grantee's inquiries, the criteria for valuing in-kind contributions is described in government cost principles for nonprofit organizations (OMB Circular A-122). To be allowable under a grant, costs must be reasonable in amount, be consistent with the policies and procedures that apply uniformly to both federally financed and other activities of the organization, be determined in accordance with generally accepted accounting principles (GAAP) and be adequately documented.

Most of the in-kind costs that A.I.D. must disallow do not meet any of the above criteria. For instance, the mark-up of the inventory value mentioned above does not meet the criteria of consistency and would be disallowed. Also, the costs associated with the research done by the two organizations were poorly documented and found to be unauditable. ICS had no detailed source documentation to back up the claimed costs, nor did it have documentation to establish that the Federal Government had not previously sponsored any of these costs under another grant or agreement. On the basis of inadequate documentation alone these costs would be disallowed. Additionally there are questions as to whether GAAP would allow recognition of these costs even had the documentation been adequate. The value of the research to ICS (which could be different from its costs) should possibly be recognized as a gift of a nonmonetary item, or the costs should not be recognized because it would be improper to recognize as contributed services work that was done independently of the grant.

Excluding the prior period costs and inventory mark-up from ICS's claimed in-kind contributions reduces their dollar amount of claimed in-kind from $389,371 to $101,972. The $101,972 represents the book value of the inventory transferred to the program and work done during the first year of the grant by the World Bank.

In addition to its claimed in-kind costs, ICS also claimed to have contributed $209,157 of cash. Between the cash contribution and allowable in-kind contributions, ICS would have contributed about $311,000. However, the first year grant budget required an ICS contribution of $401,000, leaving ICS about $90,000 short in its contribution.

The A.I.D. technical sponsor was unaware of the interpretation taken by ICS with regard to prior period costs. When informed of these facts, concern was expressed as to the potential effect that this situation might have on the grantee. There are two issues that need to be kept in mind. First, there is no basis to allow the fair market values of prior period costs to be counted as cost sharing. Second, it should be further kept in mind that permitting past accumulated costs to be counted will put ICS in a position where it will almost certainly be able to meet its cost sharing obligation under the grant without spending any of its own money. This result would be complete circumvention of the intent of cost sharing and contrary to the general A.I.D. policy to seek the largest possible financial participation from the grantee. One of the basic reasons for cost sharing and A.I.D. policy in this area is A.I.D.'s desire to enhance the likelihood that the program will be continued once A.I.D. support is withdrawn. If ICS is not forced to develop a growing base of nonfederal contributors for the grant program then it is most likely that the program will not survive without continued A.I.D. funding. Also, without cost sharing by the grantees, serious questions arise as to whether the program or grant is actually needed.

Recommendation No. 1

We recommend that in-kind contributions claimed by ICS which represent costs incurred prior to the effective date of the grant be disallowed. Also, A.I.D. should not allow in-kind contributions for costs from outside contributors until ICS enters into formal agreements with the outside contributors.

2. Grantee Drew Much More of A.I.D.'s Funds Than It Was Entitled - At the end of the first year of the grant, the Institute for Contemporary Studies had drawn about $420,000 more than the amounts required to meet the grant's immediate disbursement needs. Guidance furnished to ICS required that drawdowns could only be made when actually needed for the grantee's immediate disbursing needs. However, ICS's pattern of drawdowns against the letter of credit indicates that it was unaware of the guidance. ICS generally followed a procedure of drawing funds to reimburse for recorded expenses, some of which did not involve cash outlays. Further, ICS's drawdowns were not reduced to reflect cash contributions that ICS claimed to have made and the drawdowns were not restricted to only meet immediate needs. Consequently, ICS has used government funds to finance ICS's nongovernment activities.

Discussion - Under the grant agreement, A.I.D. established a Federal Reserve Letter of Credit to finance grant activities. The standard provision "Payment - Letter of Credit" provided that payments under the letter of credit were to be in accordance with the terms of the letter of credit and any instructions issued by A.I.D.'s Office of Financial Management. A.I.D.'s Office of Financial Management sent ICS a pamphlet explaining the letter of credit arrangement. This guidance provided that drawdowns were to be made only for immediate disbursement needs.

We analyzed ICS accounting information to ascertain ICS's cash management practices under the Federal Letter of Credit. Exhibit 1 compares ICS's actual outlays together with calculated overhead amounts during the first year of the grant with the monies received from A.I.D. At ICS's request A.I.D. provided a $110,000 cash advance in August 1986 and in October 1986 A.I.D. established the letter of credit. ICS made cash drawdowns against the letter of credit in January, April and May 1987.

The outlays and drawdowns reflected in Exhibit 1 indicates that ICS ignored its own contributions and attempted to finance the program totally with A.I.D. funds. Also, evident is neither A.I.D. nor ICS was closely monitoring the amount of A.I.D. funds received and comparing this amount to the grant's cumulative expenses. It appears that ICS periodically compared A.I.D. funds received to cumulative program expenses and made drawdowns against the letter of credit.

Ignoring their own contributions and drawing more funds than required immediate needs was definitely contrary to the guidance provided to ICS. ICS appeared to have no real awareness of the A.I.D. guidance.

Another problem with ICS's management of its letter of credit arrangement was cash drawdowns were based on recorded expenses rather than cash outlays. Exhibit 1 shows that after considering ICS's last drawdown in May 1987, ICS had drawn about $211,000 more in A.I.D. funds than it needed to meet the total program's cash outlays for the entire year. The reason this happened was ICS based the drawdowns on recorded expenses. Recorded expenses included about $389,000 of in-kind contributions, $77,500 of future commitments and a 27.8 percent overhead on these two amounts. Neither of these recorded expenses involved immediate outlays nor required anything other than a negligible amount of overhead.

The net result is ICS received government funds which it used nongovernment activities. Exhibit 1 also shows how much excess A.I.D. funds ICS retained throughout the year and the amount of the excess at the end of the grant year.

OMB circular A-110 provides that interest earned on advances of Federal funds shall be remitted to the Federal Agency providing the grant. Although not authorized, ICS in effect received excess cash advances from A.I.D. in the amounts indicated by the last column of Exhibit 1. ICS did not necessarily earn interest on these particular funds by placing them into an interest bearing account, but the money was used for other ICS activities. ICS was therefore able to keep certain of its investments in place and fund operations that otherwise would have required financing through loans. ICS was in fact borrowing successively larger sums during the first year of the grant to finance an expansion of its activities. Additionally, it earned over $14,000 in interest during its fiscal year. If advances to ICS were considered debts to the government, then the interest rate charged on the monthly amounts would have been 8 percent during 1986 and 7 percent during 1987. At these rates of interest ICS would have owed the government about $9,000 at May 31,1987, the end of the grant year, with interest accumulating on the year end balance of $420,000 at a rate of about $2450 per month. We believe that ICS should be required to pay the government interest on its excess cash advances at the above indicated rates of interest until it liquidates the excess amounts.

Recommendation No. 2

We recommend that the Grant Officer:

a. ICS be precluded from making further cash drawdowns until such time that the cumulative allowable expenditures for the grant, less ICS's cash contributions equals the amounts of A.I.D. funds already received.

b. Future cash advances under the letter of credit should be limited to immediate disbursement needs after applying the cash contributions that ICS claims as part of its cost sharing obligation under the grant.

c. ICS be required to pay interest on the excess advances of A.I.D. funds and interest be collected until the excess funds advanced to ICS meet the grant program outlays or until such time ICS returns the excess cash advance to A.I.D.

Exhibit No. 1

Excess A.I.D. Funds Held By Grantee
During First Year of the Grant
1 June 1986 to 31 May 1987

Month Ending	col. 1 Out of pocket expenditures 1/	col. 2 Program income 1/	col. 3 Cumulative net out of pocket expenditures	col. 4 Cumulative Net out of pocket expenditures plus calculated overhead (col. 3 x 1.278)	col. 5 Cumulative monies received from A.I.D.	col. 6 A.I.D. money held in excess of immediate disbursement needs of total program (col. 5 - col. 4)	col. 7 Cumulative cash contributions to program claimed by ICS	col. 8 Amount of excess A.I.D. funds held by grantee 5/
6-30-86	$ 10757.24	$ 7733.32	$ 3023.92	$ 3864.57	$ -	$ (3864.57)	$ 70000.00	$ 0.00
7-31-86	7114.44		10138.36	12956.82	-	(12956.82)	75000.00	0.00
8-31-86	12787.46		22925.82	29299.20	110000.00	80700.80	125000.00	110000.00
9-30-86	26201.50		49127.32	62784.71	110000.00	47215.29	125000.00	110000.00
10-31-86	22741.25		71868.57	91848.03	110000.00	18151.97	125000.00	110000.00
11-30-86	25346.18		97214.75	124240.45	110000.00	(14240.45)	125000.00	110000.00
12-31-86	32473.99	29657.28 3/	100031.46	127840.20	110000.00	(17840.20)	165000.00	110000.00
1-31-87	114855.29 2/		214886.75	274625.26	370000.00	95374.74	192500.00	287874.49
2-28-87	47161.97		262048.72	334898.26	370000.00	35101.74	192500.00	227601.74
3-31-87	57157.60		319206.32	407945.67	370000.00	(37945.67)	209157.00	171211.33
4-30-87	64190.26		383396.58	489980.82	530000.00	40019.18	209157.00	249176.18
5-31-87	77223.07		460619.65	588671.91	800000.00 4/	211328.09	209157.00	420485.09

1/ Based on accounting information that had not undergone financial audit or final adjustments as of the date of our site visit.

2/ Jump in monthly expenses was due to correction of understated labor costs from earlier months and expenses of hosting a conference.

3/ This program income was actually earned over the 11 months ended 5-31-87. We applied the full amount to the midpoint of the period because we did not obtain information on the income by month.

4/ This figure is actually the net of the two transactions that occured in early June 1987.

5/ This column represents the amounts of A.I.D. funds that would remain after funding expenses not met by ICS's contributions. The calculation is col. 5 minus any deficit left over after subtracting col. 7 - col. 4.

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