

PD 1114-716

AUDIT OF FUNDS PROVIDED FOR  
PROGRAM DEVELOPMENT AND SUPPORT  
PROJECTS 940-1005 and 940-0001

AUDIT REPORT NO. 9-000-89-002

OCTOBER 19, 1988

AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON D C 20523

October 19, 1988

MEMORANDUM FOR AA/PRE, Neal Peden  
D/PRE/H, Peter Kimm

FROM: IG/PSA, *Mervin F. Boyer, Jr.*  
Mervin F. Boyer, Jr.

SUBJECT: Audit of Funds Provided for Program Development and  
Support, Project Numbers 940-1005 and 940-0001

This report presents the results of an audit of funds provided for program development and support (PD&S). This audit is part of a series of PD&S fund audits worldwide. A summary report that addresses broader issues than those identified by the individual audits, will subsequently be developed. Five copies of the report are enclosed for your action.

The draft report was submitted to you for comments and your comments are attached as Appendix 1. The report contains one recommendation which is considered closed and requires no further action. We appreciate the cooperation and courtesy extended by our staff during the audit.

### Background

A.I.D. policy on use of PD&S funds is defined in Handbook 18, Section III, Appendix D, as those activities whose purpose is the identification, design, and evaluation of programs or projects and activities that cannot be easily or appropriately charged to the individual project or activity.

PD&S funds are portions of development assistance appropriations that are allocated to the bureaus by the Bureau for Program and Policy Coordination. Each bureau is responsible for establishment of policy and management of its PD&S funds, as well as maintaining accountability over availability and use of funds. This funding is provided for program development and support activities and for project development activities including feasibility surveys in the eight A.I.D. purpose categories, such as Food Supply, Rural Development, and Nutrition. Additionally, they are used to fund such efforts as sector studies and evaluations broader in

scope than an individual project or activity, evaluation of completed projects, multicountry evaluations, and studies to develop indicators of progress for general use.

The Bureau for Private Enterprise (PRE) had two PD&S projects in Fiscal Year 1987, numbers 940-1005 and 940-0001. PRE issued PD&S policy guidance on March 14, 1988, which specifies four prioritized activities acceptable for use of PD&S funds:

1. project development and feasibility studies;
2. evaluation and financial management/audit activities, including the development of project monitoring and accounting systems, data collection and evaluation systems;
3. Country Program Strategy Statement related studies and sector assessments. Studies which enhance policy dialogue efforts or sharpen understandings of technical or institutional constraints;
4. general purpose activities such as seminars, workshops, and special surveys, and bridge funding between terminating and follow-on projects.

Fiscal year 1989 Congressional Presentation shows funding for PRE's PD&S activities as follows:

	Fiscal Year 1987 Obligations (000s)	Fiscal Year 1988 Estimate (000s)
PD&S (940-1005)	\$ 600	\$1,000
PD&S (940-0001)	908	733
	<u>\$1,508</u>	<u>\$1,733</u>

#### Audit Objectives and Scope

The Inspector General's Office of Programs and Systems Audits made an audit of PD&S funds provided to the Bureau for Private Enterprise. The audit objectives were to determine the appropriateness of the use of PD&S funds and to evaluate the effectiveness of administrative and accounting controls in place in the Bureau.

The scope of the review was limited to a sample of the obligations incurred during fiscal year 1987. Of the \$1.5 million in PD&S obligations for fiscal year 1987 the auditors

reviewed 8 of the 18 obligations totalling \$.9 million, or 60% of fiscal year 1987 obligations. The audit sample was selected on the basis of high dollar amounts and activity descriptions which indicated potential inappropriate use of PD&S funds. The review of compliance and internal controls was limited to the findings in this report.

Audit work was conducted from April to July 1988 and included interviews with Bureau officials, review of A.I.D. and Bureau guidance, obligating documents, reports, financial records and correspondence. The audit was made in accordance with generally accepted government auditing standards.

### Results of Audit

Using the guidance in Handbook 18 and PRE's expanded guidance, the audit showed that the Bureau had, on occasion, inappropriately used PD&S funds and had not complied with Agency guidance. The Bureau used PD&S funds to support on-going project activities and did not maintain adequate oversight of PD&S funds issued to missions.

1. Project Expenses Were Funded from the PD&S Account - Handbook 18 provides guidance that PD&S funds are not to be used to support individual project activities. The Bureau for Private Enterprise issued a contract which primarily included services that were for day to day revolving fund project management and other Bureau management support responsibilities. This occurred because the PRE guidance on PD&S failed to adequately define appropriate uses of PD&S funds and because Bureau managers had not requested project or operating funds to support the revolving fund project. As a result a significant portion of the \$710,045 in PD&S funds was to support the revolving fund project.

Discussion - Although the guidance on uses of PD&S funds in Handbook 18 lacks some specificity, it does clearly state that PD&S is for activities that "cannot be easily or appropriately charged to the individual project/activity". This means that PD&S funds are available for design of programs and projects and other purposes, such as for special studies and evaluations.

The costs for day to day administration of the private enterprise revolving fund, such as, developing budgets, making credit checks etc., were not budgeted as part of the original project. Consequently the Bureau used PD&S funds to supplement this project shortfall.

According to Handbook 3, project officers are responsible for developing and implementing project monitoring systems and Handbook 19 places responsibility for financial management activities on the Controller's office. These types of activities may be contracted when direct-hire staff is not available. But, costs relating to such activities are appropriately charged to project or operating expense funds. A.I.D. Handbook 19 further corroborates this and states that the use of consultants and contractors engaged primarily in Agency management and support functions will be funded under operating expenses.

The Bureau entered into a contract using \$710,045 of PD&S funds to perform evaluations and conduct credit and financial analyses of potential revolving fund loans. Included in the scope of work was: drafting specific evaluation scopes-of-work for subprojects; assisting with arrangements for logistics support of evaluations; conducting credit reviews of existing and proposed revolving fund investments (loans); preparing five year and annual forecasts of revolving fund cash flow; providing financial analysis of approximately 50 loan proposals; and assisting in the analysis of ten banks. These functions were specific revolving fund project management functions which should have been the responsibility of the project or PRE management and should have been funded from project or operating expenses. Current PRE guidance does not make this clear and has been interpreted to allow these project specific expenses to be charged to PD&S. As a result, a significant portion of the \$710,045 contract charged to PD&S was used to administer an on-going Bureau project.

Bureau officials stated that in the administration of the revolving fund, each loan was viewed as a distinct project activity and, therefore, the work involved in evaluating the proposals and other preapproval work was of a PD&S nature.

The revolving fund project was Congressionally approved at a specific funding level, thus, work relating to administration of the project should be charged to the project or Bureau operating expense funds. In addition, each loan under the revolving fund project is, at most, a subproject which is part of the overall revolving fund project. Financial as well as project management and other functions can be contracted out in appropriate circumstances, however, operating expense or project funds should be used to pay the contract.

While we are not making a recommendation, we believe the Bureau should give additional attention to its use of PD&S funds. A sharp distinction should be made between program/project design, support and special studies for which PD&S fund use is

appropriate and functions involved in actually administering already designed and approved projects. Some ways in which revolving funds are managed include using funds from interest on loans and surcharges or funds appropriated specifically for program/project management purposes.

2. On-going Project Funding was Augmented by PD&S Funds - Based on Handbook 18, the intended use of PD&S funds precludes funding an existing project. The audit showed that the Bureau's Housing and Urban Program Office had issued incremental funding using PD&S funds for a technical assistance contract to support on-going project 940-1001.93, Housing the Urban Poor. This occurred due to a misunderstanding by Bureau officials of the appropriate uses of PD&S funds. As a result, the Bureau provided \$202,000 of PD&S funds for the supplemental funding of the project.

Discussion - Handbook 18 states that PD&S refers to activities that cannot be easily or appropriately charged to the individual project or activity. Therefore, costs relating to an existing project should not be charged to the PD&S account.

In March 1986, a contract was issued to supply specific project funding through March 1988 for technical assistance in housing finance, urban planning, community development, shelter policy formulation and institution building. In September 1987, the Bureau authorized an additional \$202,000 of PD&S funding to support on-going activities of the project, not changing the scope of work. This resulted because Bureau officials were confused over the acceptable uses of PD&S funds and they believed additional work could be supported by PD&S funds. As a result, the Bureau inappropriately augmented project funding and misused PD&S funds.

Although we are not making a recommendation, the Office of Housing and Urban Programs should clarify its procedures on the use of PD&S funds to prohibit their use for augmenting project specific activities.

Bureau officials stated that some of the supplemental funding using PD&S funds was to support program design activities in other countries outside of the routine project effort. Although the auditors were given no support to confirm this position the Bureau officials agreed with the auditor's interpretation that PD&S should not be used for on-going project purposes. The officials stated that their guidance will reflect that rule.

3. Appropriate Use of PD&S Funds Issued to Missions Not Assured - According to Handbook 3, project officers are responsible for developing and implementing monitoring systems to assure accountability of funds. The Bureau issued PD&S funds to missions without requiring disclosure, reporting or backup evidence on actual uses of these funds. This occurred because the Bureau had not issued specific guidance on reporting PD&S obligations to include actual uses. Therefore, the Bureau had not controlled the uses of these PD&S funds.

Discussion - Handbook 3, Chapter 11 states that the primary responsibility for monitoring a project lies with the Project Officer to whom that project has been assigned, so that A.I.D. can assure itself that U.S. funds are being disbursed in accordance with statutory requirements. In an effort to support the Housing Guarantee Program, PRE issued \$240,000 in fiscal year 1987 PD&S funds to several missions to assist in developing this program. The audit showed that although PRE remained accountable for the obligations, they did not require the missions to report specifically on how the PD&S funds were spent. The missions did report obligations of PD&S funds, however, it was unclear from the report that the obligations were, in fact, for PD&S activities. As a result, the Bureau was not able to properly monitor the use of PD&S funds. In order for PRE to ensure that allotted PD&S funds are used appropriately they should require the mission to report on the specific use of these funds.

Recommendation No. 1

We recommend that the Assistant Administrator for Private Enterprise develop policy guidance for the missions on acceptable uses of the Program Development and Support funds and on reporting requirements on how the funds were used.

The Director, Office of Housing and Urban Program commented that additional guidance was issued on August 9, 1988, and that an improved monitoring system will be implemented to ensure that PD&S funds are actually used for PD&S purposes. This action satisfies the recommendation, therefore, it is considered closed.

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON D C 20523

Appendix 1  
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ASSISTANT  
ADMINISTRATOR

September 6, 1988

MEMORANDUM

TO: IG/PSA, Mervin F. Boyer, Jr.

FROM: AA/PRE, Neal Peden *NP*

SUBJECT: Draft Inspector General Report, Audit of Funds  
Provided for Program Development and Support Project  
Numbers 940-1005 and 940 0001

PRE has reviewed the entire subject audit with interest. However, PRE will respond only to its initial element. As explained to your auditor (and his supervisor) at the initial review of the audit findings with PRE staff, the Office of Housing is no longer an associated element of the Bureau for Private Enterprise. The Office of Housing, presumably, will be responding to the remaining elements of the audit separately.

From PRE's perspective, and as noted in the audit, there are grounds for differing interpretations of the audit's findings. Nonetheless, the auditor appears to have followed an acceptable, and logical pattern in implementing the audit; he reviewed most of the relevant guidance during the course of the audit. However, we feel that some relevant guidance was overlooked, and that the audit's inaccurate conclusion, i.e., that... "a significant part of \$378,540 in PD&S funds was inappropriately used.", is based upon an invalid and inappropriate definition of the role, function, and operation of the Private Sector Revolving Fund (PSRF).

Permissible Uses of PD&S Funds

One of the principal audit arguments is that PD&S funds were used ... "for day to day management of The Private Enterprise Revolving Fund such as project evaluation, audit, etc." ..., i.e., functions requiring the use of project and/or operating expense funds. We have no quarrel with the basic validity of such an argument; however, the services provided to the PSRF, and which are being questioned by the audit, do not involve "day to day management."

As noted by the auditors, PD&S funds were used to contract for evaluation and credit/financial services needed to assist project managers. These services were not "day to day management" services; they were services provided on a retainer-like basis to meet special ad hoc requirements of the PSRF. Such a use of PD&S funds is permitted by PRE policy guidance.

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Further, on advice of Agency counsel, and per OMB Circular No. A-76 (not cited as having been reviewed during the audit), we reject as unfounded the auditor's assertion that evaluation and financial management/audit activities are reserved to A.I.D. controllers, and inappropriate for contracting out.

#### Understanding of the Private Sector Revolving Fund

The PSRF is unique; there are other revolving fund activities within the U.S. Government, but none of them operate within the legislative guidelines especially established for this program.

The PSRF is a "fund" created within the U.S. foreign affairs legislation that functions in a manner differing from normal A.I.D. development assistance operations. The PSRF is not another A.I.D. project; unlike A.I.D. projects, it functions as a financial entity empowered by its legislation to design and implement loans to private sector entities in support of development objectives. Consequently, PRE strongly disagrees with the contention of the auditors that "...the revolving fund is a Congressionally approved project and work relating to administration of the project should be charged to project or Bureau operating expense funds.

PRE is charged with the prudent financial management of the PSRF. In line with sound management practice, it has hired the services of contractors to separate the project design and implementation management functions of the PSRF from its financial analysis and evaluation functions. This is done to ensure the integrity of comparative financial and evaluation analyses of the feasibility and success of PSRF activities. PRE management maintains that it is vital that these functions be performed by impartial outsiders who do not have a vested interest in the ongoing program.

Acceptance of the audit's claim that the financial analysis, audit, and evaluation functions of projects established under the PSRF are administrative functions that can only be performed by operating expense budget funded personnel of the Agency would be tantamount to jeopardizing the financial integrity of the PSRF. We believe the audits conclusions to be incorrect; they are totally inappropriate as a basis for discharge by PRE of its PSRF financial management responsibilities.

AGENCY FOR INTERNATIONAL DEVELOPMENT  
WASHINGTON DC 20523

Appendix 1  
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MEMORANDUM

September 15, 1988

TO: IG/PSA, Mervin F. Boyer, Jr.

FROM: Fredrik Hansen, Deputy Director  
Office of Housing and Urban Programs

SUBJECT: Draft Inspector General Report: Audit of Project #940-1005

The following is our response to the subject report. We address only the report's discussion of the PRE/H Project No. 940-1005.

Recommendation #1

Item #2: Ongoing Project Funding Augmented by PD&S Funds

We would like the audit report to reflect that the "existing project" referred to was actually a regional technical assistance contract. The contract funded technical assistance to Housing Guaranty projects in some countries but also funded consultants who were engaged in program design activities in countries in which there are no ongoing projects. It was for this latter activity and because the incremental funding was covering only the final months of the contract extension that we used PD&S funds. We accept the IG interpretation that, generally, PD&S funds should not be co-mingled with Project funds and our guidance to RHUDOs will reflect that rule. However, in this case, the PD&S funding can be correlated against discrete project design work.

Recommendation #1: Policy Guidance on PD&S Funds Issued to Missions

PRE/H, in preparation for its FY 89 budget activities, issued the attached guidance to its Regional Housing and Urban Development Offices (RHUDOs) which covers the appropriate use of PD&S and various functional account funds. In order to ensure an improved monitoring system for accountability of funds, PRE/H and RHUDOs will: (1) reach agreement at the outset of the Fiscal Year on programming the specific uses of PD&S funds (as well as different functional account funding) to be allotted to each RHUDO; and (2) PRE/H will require from RHUDOs a more detailed reporting format on specific funding uses whereby PRE/H can ensure that allotted PD&S funds were used for agreed upon appropriate uses.

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