

Programs and Systems Audits

**AUDIT OF SELECTED ASHA GRANTS
PEOPLE'S REPUBLIC OF CHINA**

Report No. 9-000-92-007
May 28, 1992



U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

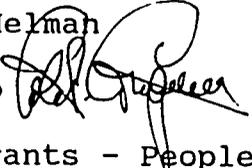
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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

ASSISTANT INSPECTOR GENERAL
FOR AUDIT

MAY 28 1992

MEMORANDUM FOR FHA/ASHA, Howard B. Helman
FROM: AIG/A, John P. Competello 
SUBJECT: Audit of Selected ASHA Grants - People's Republic of
China

Enclosed are five copies of the subject audit report. We have reviewed your comments on the draft report and included them as Appendix III to the report.

From comments made to our draft report, there appears to be A.I.D./ASHA agreement with all the recommendations of this final report except for Recommendation Nos. 11.2 and 11.3. Consequently, these recommendations remain unresolved. Recommendation Nos. 1 to 11.1 are, however, considered resolved and will be closed upon our receipt of evidence that implementing actions have been completed.

Please respond to this report within 30 days, indicating any actions planned or already taken to implement the recommendations. I appreciate the cooperation and courtesies extended to my staff during the audit.

EXECUTIVE SUMMARY

Background

The American Schools and Hospitals Abroad (ASHA) Program was instituted under Section 214 of the Foreign Assistance Act of 1961 for the purpose of providing assistance to schools and hospitals outside the United States that serve as study and demonstration centers for ideas and practices of the United States. The A.I.D. Office of American Schools and Hospitals Abroad (A.I.D./ASHA) in the Bureau for Food and Humanitarian Assistance administers the ASHA Program. Two recipients under the Program were the Fudan Foundation and the American Hospital in Shanghai Foundation (Foundations) which were funded to assist such demonstration centers in the People's Republic of China. Due to Congressional concerns, the Administrator, on November 1, 1991, asked the Inspector General to review past and proposed grants to these Foundations. As of December 31, 1991, the Foundations had received A.I.D.-funded grants totaling \$8.0 million of which approximately \$7.8 million had been spent. (See page 1.) This report presents the results of our audit covering the following specific objectives. Shortly, we will be issuing two additional reports covering the cost accountability aspects of each Foundation.

Audit Objectives

We audited A.I.D.'s Office of American Schools and Hospitals Abroad in accordance with generally accepted government auditing standards to answer the following questions as they relate to the two Foundations:

- Did A.I.D./ASHA follow A.I.D. policies and procedures in selecting the two Foundations? (See page 4.)
- Did A.I.D./ASHA follow A.I.D. policies and procedures in awarding grants to the two Foundations? (See page 9.)
- Did A.I.D./ASHA follow A.I.D. policies and procedures in monitoring the two Foundations' performance? (See page 18.)

Our audit field work was conducted from November 1991 through April 1992. Appendix I contains a complete discussion of the scope and methodology for this audit.

Summary of Audit

While A.I.D. Handbooks 3 and 13 document A.I.D.'s internal control policies and procedures with regard to selecting grant recipients, awarding grants, and monitoring recipients' performance for most A.I.D.-funded grant programs, these Handbooks specifically exempt grants awarded under the American Schools and Hospitals Abroad Program. Furthermore, although A.I.D. Handbook 13 states that A.I.D./ASHA will "determine" policies and procedures applicable to the ASHA Program, A.I.D./ASHA has not formalized its internal control systems for selecting recipients, awarding grants, and monitoring recipients' performance as required by Federal law and policy. (See pages 36 and 37.)

The lack of formalized policies and procedures has contributed to significant problems in selecting the recipients, awarding grants to recipients, and in monitoring recipients' performance. These problems in turn increase A.I.D. vulnerability to waste of U.S. Government funds. (See Audit Findings section below.)

In our opinion, the internal control weaknesses described in this report collectively constitute a material weakness as defined by the Office of Management and Budget; but, A.I.D.'s Management Control Review Committee has not identified them as such in its annual report to the A.I.D. Administrator on material weaknesses. (See pages 41 and 42.)

Audit Findings

Formal Selection Procedures Need to be Established

Although required by Federal law and policy, A.I.D. has not established written policies and procedures covering the selection process for recipients under the ASHA Program. A.I.D./ASHA officials said formal procedures were not established in order to maintain a degree of flexibility in making political accommodations. As a result of not having formal policies and procedures, A.I.D./ASHA selected the two recipients reviewed and expended about \$7.8 million on their projects based more on political considerations than on the merits of the projects and potential for success, while more eligible applicants and projects were by-passed. (See pages 4 through 8.)

**Formal Procedures for Awarding
Grants Need to be Established**

A.I.D. Handbook 13 prescribes A.I.D. policies and procedures for awarding grants including (1) determining the prospective recipients' technical, financial, and management capabilities prior to the award of the grant; (2) ensuring the program descriptions contain benchmarks to measure the recipients' progress in accomplishing program objectives; and (3) determining reasonableness of proposed and negotiated costs. However, A.I.D./ASHA is not required to follow these policies and procedures because the Handbook specifically exempts grants awarded under the ASHA Program, and A.I.D./ASHA had not developed similar policies and procedures. As a result, A.I.D./ASHA could not be assured that the two recipients reviewed were qualified to carry out the grant programs and that the negotiated costs were reasonable. Also, because project descriptions did not contain benchmarks (targets and timeframes), it would be difficult for A.I.D./ASHA and others to assess the progress of the recipients' programs for which A.I.D. had already disbursed about \$7.8 million. Furthermore, because procedures were not established to ensure compliance with the Foreign Assistance Act requirement that financial plans be well developed prior to the award of a grant, at least \$1.1 million had been spent on a building which is not useable and cannot be completed unless an additional \$1.8 million is found to complete the construction. (See pages 9 through 17.)

**Formal Procedures for Monitoring
Recipients' Performance Need to be Established**

To ensure that A.I.D. funds are spent effectively and efficiently as required by the Foreign Assistance Act, A.I.D. Handbook 3 prescribes guidance for A.I.D. officials in monitoring recipients' performance including compliance with the terms and conditions of the grant agreements. However, A.I.D. Handbook 3 does not apply to the ASHA Program and A.I.D./ASHA had not developed similar policies and procedures for monitoring recipients' performance. As a result, the audit found that (1) the recipients did not provide reports required under the grant agreements and consequently A.I.D./ASHA could not use these reports for assessing the effectiveness of \$7.8 million spent by the two recipients, (2) A.I.D.-funded facilities and commodities were not effectively utilized and at least \$2.1 million was spent for technical and construction services and commodities which may not be eligible under the terms of the grants, and (3) completed grants were not properly closed out. Also, the recipients were paid unauthorized contingent fees by the sponsored Chinese institutions totaling almost \$1.1 million. (See pages 18 through 32.)

Summary of Recommendations

This report includes 11 recommendations for action by the Director of the Office of American Schools and Hospitals Abroad. Most of these recommend establishing policies and procedures for selecting recipients, awarding grants to recipients, and monitoring recipients' performance. Other recommendations for the Director include the following:

- Withholding the \$245,000 remaining under the grants until (1) A.I.D./ASHA reassesses whether the recipients have complied substantially with their grant agreements, (2) A.I.D./ASHA determines whether there is adequate funding to complete the activities, and (3) the recipients pay A.I.D. what may be owed for questionable procurements. (See page 5.)
- Requiring the two Grantees to submit a "self-evaluation" and annual institution reports. (See page 19.)
- Determining what action should be taken concerning over \$2 million of goods and services identified in this report where the recipients did not comply with the grant requirements. (See page 26.)
- Closing out the two completed grants covered by this audit. (See page 33.)
- Performing an assessment of internal controls and reporting the material weaknesses in its next report under the Federal Managers' Financial Integrity Act. (See page 43.)

Management Comments and Our Evaluation

In commenting on the draft report A.I.D./ASHA did not disagree with any of the factual information presented. Also, they agreed with all the report's recommendations except, that from their comments, it appears that they do not agree with the second and third part of Recommendation No. 11. Specifically, A.I.D./ASHA states that it will undertake a major effort this fiscal year to introduce more effective internal controls but that it does not anticipate performing a vulnerability assessment (even though one has not been performed within the last five years) because "... a reasonable time is needed to put the procedures in place against which vulnerability should be measured. A.I.D./ASHA views the internal control assessment as the appropriate exercise through which to report on internal control weaknesses which may continue to exist.

We believe the intent of the Federal Manager's Financial Integrity Act is to report material internal control weaknesses as they currently exist. Further, the interval for vulnerability assessments (at least one every five years) is set by OMB Circular A-123 and not by the Agency or the Office of the Inspector General. If A.I.D./ASHA wishes either not to report current weaknesses or not to have its operations included in a vulnerability assessment, we believe appropriate waivers should be sought. We are encouraged by the generally positive management comments and statements of actions planned or started. We have considered management's comments in preparing this final report. Appendix II is a complete text of the A.I.D./ASHA comments to a draft of this report.

Office of the Inspector General

Office of the Inspector General
May 28, 1992

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INTRODUCTION

Background

The American Schools and Hospitals Abroad (ASHA) Program was instituted under Section 214 of the Foreign Assistance Act of 1961. Section 214, in part, states:

The President is authorized to furnish assistance ... to schools and libraries ... and to hospital centers for medical education and research ... outside the United States founded or sponsored by United States citizens and serving as study and demonstration centers for ideas and practices of the United States.

The A.I.D. Office of American Schools and Hospitals Abroad (A.I.D./ASHA) in the Bureau for Food and Humanitarian Assistance is responsible for administering the ASHA Program. Among its administrative responsibilities are reviewing proposals from prospective recipients, recommending prospective recipients and the amount of funds they should receive to the A.I.D. Administrator, awarding grants, and monitoring the recipients' performance.

A.I.D./ASHA awarded its first grants to the Fudan Foundation and the American Hospital in Shanghai Foundation (Foundations) in fiscal year 1987.¹ These grants and additional ASHA funding in fiscal years 1988 and 1989 provided funds for the purchase of commodities, renovation of existing facilities, and the design and construction of new facilities. The funding status of the grants as of April 15, 1992, is noted below (in \$ thousands):

<u>Grantee</u>	<u>Grant Amounts</u>	<u>Disbursements</u>
Fudan Foundation	\$ 4,250	\$ 4,250
American Hospital in Shanghai Foundation	<u>\$ 3,750</u>	<u>\$ 3,505</u>
Total	<u>\$ 8,000</u>	<u>\$ 7,755</u>

¹These Foundations were started by the same individuals, their boards of directors and officers are the same, and they both have the same two part-time employees (there are no full-time employees) occupying the same residential address.

In May 1991, the A.I.D. Administrator had approved an additional \$1.8 million to the Foundations for fiscal year 1991 (\$1.3 million to the Fudan Foundation and \$500,000 to the American Hospital in Shanghai Foundation); but, due to Congressional concerns regarding how the Foundations were selected and whether funds have been spent only for authorized purposes, the grants to the Foundations were not awarded and the \$1.8 million was returned to the U.S. Treasury. Also, A.I.D./ASHA officials stated they had previously (July 1990) suspended further disbursement of the \$245,000 remaining under the American Hospital in Shanghai Foundation grant pending their submission of implementation and financial plans for new construction. On November 1, 1991, the Administrator asked the Inspector General to review the ASHA grants that have been made to these Foundations and the grants that were proposed for FY 1991.

Audit Objectives

The Office of the Inspector General/Programs and Systems Audits audited A.I.D.'s Office of American Schools and Hospitals Abroad Program (A.I.D./ASHA) to answer the following objectives concerning grants awarded to the Fudan Foundation and the American Hospital in Shanghai Foundation (Foundations).

- Did A.I.D./ASHA follow A.I.D. policies and procedures in selecting the two Foundations?
- Did A.I.D./ASHA follow A.I.D. policies and procedures in awarding grants to the two Foundations?
- Did A.I.D./ASHA follow A.I.D. policies and procedures in monitoring the two Foundations' performance?

In answering these objectives, we tested whether A.I.D./ASHA followed applicable internal controls and complied with certain provisions of law, regulation, and policy. Our tests were sufficient to provide reasonable assurance that our answers to the above audit objectives are valid. Also, we included steps to detect abuse or illegal acts that could affect the audit objectives. Furthermore, when we found problem areas, we performed additional work to:

- identify the cause and effect of the problem; and
- make recommendations to correct the condition and cause of the problem.

Appendix I contains a complete discussion of the scope and methodology for this audit.

REPORT OF AUDIT FINDINGS

Did A.I.D./ASHA follow A.I.D. policies and procedures in selecting the two Foundations?

A.I.D./ASHA did not fully follow A.I.D. policies and procedures in selecting the two Foundations.

The Foundations' applications for funding in fiscal years 1987 through 1990 were evaluated against eligibility criteria established by A.I.D./ASHA. The review panel used in the selection process consisted of independent non-A.I.D. reviewers who were knowledgeable about education or hospital programs and each reviewer was provided the same selection guidelines for applying the above criteria.

However, our audit found that available documents indicate that the selection of the applicants for the China projects was based more on political considerations than on the merits of the projects and potential for success. This occurred because A.I.D./ASHA had not established formal policies and procedures as required by Federal law and policy.

Formal Selection Procedures Need to be Established

Although required by Federal law and policy, A.I.D. has not established written policies and procedures covering the selection process for grantees under the ASHA Program. A.I.D./ASHA officials said formal procedures were not established (documented) in order to maintain a degree of flexibility in making political accommodations. As a result of not having formal policies and procedures, A.I.D./ASHA selected the two recipients and expended about \$7.8 million on their projects based more on political considerations than on the merits of the projects and potential for success, while more eligible applicants and projects were by-passed.

Recommendation No. 1: We recommend that the Director of the Office of American Schools and Hospitals Abroad:

- 1.1 Establish and implement written policies and procedures covering the selection of grantees. These policies and procedures should include requiring documentation of the reason(s) for grantee selection.
- 1.2 **Withhold the \$ 245,000 remaining under the grants with the two recipients until (1) A.I.D./ASHA reassesses whether the recipients have substantially complied with their grant agreements, (2) A.I.D./ASHA determines whether there is adequate funding to complete the activities, and (3) the recipients pay A.I.D. what may be owed as determined in other sections of this report.**

The Federal Managers' Financial Integrity Act requires the head of each Federal agency to establish and maintain adequate systems of internal controls. This law further requires that these systems conform to the internal control standards prescribed by the Comptroller General (General Accounting Office) in Standards for Internal Controls in the Federal Government. The prescribed standard for documentation requires that:

Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination.

Office of Management and Budget Circular A-123 requires Federal agencies to design, install, and document a system of controls to provide reasonable assurance that Government resources are safeguarded against fraud, waste, loss, unauthorized use, or misappropriation. A.I.D. Handbooks 13 and 3 (Supplement A) document A.I.D. policy and control system requirements and guidance with regard to the selection process for most A.I.D.-funded grantees. For example, Handbook 13 (Chapter 2) states:

Applications received will be evaluated in accordance with the specified criteria by reviewers who are sufficiently independent to insure that the criteria are applied fairly and consistently.

This A.I.D. procedure was essentially followed by A.I.D./ASHA even though the above cited Handbooks specifically exclude grants awarded under the American Schools and Hospitals Abroad (ASHA) Program. A.I.D. Handbook 13, however, does state that "Policies and procedures applicable to [the ASHA Program] are determined by [A.I.D./ASHA]." A.I.D./ASHA has not followed this Handbook 13 procedure and has not established or documented its internal control systems for the

selection process as also required by the Federal law and policy cited above. A.I.D./ASHA officials said procedures were not formalized in order to maintain a degree of flexibility in making political accommodations.

Other than developing the criteria used in the selection process to establish the eligibility of applicants for ASHA funding, A.I.D./ASHA had not reduced to writing its policies and procedures for selecting grantees. However, there was an informal process that included the use of a review panel normally comprised of non-A.I.D. people who had experience in education or medicine. This panel provides A.I.D./ASHA officials a rank-ordering of applicants based on points given for individual applicant's qualifications based on ten of the eleven criteria (see Appendix II for the criteria). A.I.D./ASHA officials then review the ranking and the applications and apply points for the eleventh criterion, which is the ability to achieve wider geographic dispersion for ASHA projects. These officials also determine the distribution of available funds within the context that only projects that can be completed with available funds will be selected.

Based on the rankings of the review panel, the geographic criterion, available funding, and other factors, A.I.D./ASHA officials send their recommendations (including proposed recipients and funding levels) for the next fiscal year's ASHA Program to the A.I.D. Assistant Administrator and the A.I.D. Administrator for approval. The Administrator then makes some final adjustments as to which recipients will receive funds and the amount of that funding. The A.I.D./ASHA grant officer then awards the grants to those recipients in the designated amounts.

As discussed below, our audit showed that as a result of not establishing and adhering to formal selection policies and procedures similar to those established for other A.I.D.-funded grants, A.I.D./ASHA apparently selected two Grantees and expended about \$7.8 million on their projects based more on political considerations than on a prudent formalized management decision-making process for using public funds, while more eligible applicants and projects were apparently by-passed.

The Fudan Foundation and the American Hospital in Shanghai Foundation (Foundations) first applied for grants under ASHA's Program for fiscal year 1987. There were a total 63 applicants requesting approximately \$92 million. The available ASHA Appropriation for that year was only \$35 million. Both Foundations' initial applications for fiscal year 1987 funding were rejected outright by the Director of A.I.D./ASHA at that time who, in an October 17, 1986 letter stated:

After careful consideration, we have concluded that neither application is eligible to compete for assistance at this time. Under Section 214 of the Foreign Assistance Act we expect at least a fledgling institution to exist with a track record sufficient to justify a major investment of public resources.

The perception we have from reading the applications is that the projects are in the concept stage since there are no plans and project budgets. Moreover, the Foundations have no audited financial statements, no financial resources, have not obtained tax exempt status and have not begun fund raising.

With regard to the American Hospital in Shanghai Foundation, assistance under Section 214 is limited to hospital centers for medical education and research. The clinic and outpatient facility you propose is not within the scope of the legislation.

On December 1, 1986, a Congressman wrote the Director and urged cooperation between A.I.D./ASHA and the American Hospital in Shanghai Foundation. On December 18, 1986, a second Congressman expressed to the A.I.D. Administrator support for the activities of both Foundations. Shortly thereafter, the Foundations submitted revised applications and the second Congressman was assured by the then A.I.D. Administrator that the applications would be considered.

In the ensuing selection process the independent reviewers ranked the Fudan Foundation and American Hospital in Shanghai Foundation 59th and 62nd, respectively, out of the total of 63 applications received. Nevertheless, in February 1987, the A.I.D./ASHA Director at that time sent an Action Memorandum for the Assistant Administrator recommending that 41 applicants be funded, including, the Fudan Foundation (at number 41) for \$1.3 million.

A.I.D./ASHA files did not contain documentation to show how the Fudan Foundation went from such a low position, one essentially guaranteeing no funding, to a position where it was being recommended for funding. ASHA's Director at that time stated that he recommended the Fudan Foundation's project for funding because the A.I.D. Administrator at that time told him it was to be funded.

The final award for fiscal year 1987 to the Fudan Foundation was the full \$2.0 million. Also, although the American Hospital in Shanghai Foundation was not originally selected/recommended for any grant, it was awarded a grant for \$1.0 million. There was no explanation or justification in A.I.D./ASHA's files to support the selection of either Foundation based on the established criteria for selecting recipients under the ASHA Program.

According to A.I.D./ASHA officials, the process was similar for fiscal years 1988 and 1989. Both Foundations' applications received low rankings as shown below, but they were nevertheless funded under the ASHA Program.

<u>Fiscal Year</u>	<u>Hospital Ranking</u>	<u>Fudan Ranking</u>	<u>Total Applicants</u>
1988	77	72	77
1989	73	71	77

Some A.I.D./ASHA officials believe political consideration was once again the reason the Foundations were selected for these two years. A.I.D./ASHA files showed for fiscal years 1988 and 1989 there were continuing expressions of Congressional interest in and support for the Foundations' projects. The Foundations, for those years, were granted an additional \$5 million despite the belief by A.I.D./ASHA officials that these projects should not be funded.

In May 1991, the A.I.D. Administrator had approved an additional \$1.8 million to the two Foundations for fiscal year 1991 (\$1.3 million to the Fudan Foundation and \$500,000 to the American Hospital in Shanghai Foundation); but, a new set of Congressional concerns arose, this time questioning the selection process for the Foundations and whether the funds previously granted had been spent only for authorized purposes. Subsequently, due to these concerns, the 1991 proposed grants to the Foundations were not awarded. A.I.D./ASHA had suspended further disbursement from the \$245,000 remaining under their current grant with the American Hospital in Shanghai Foundation pending their submission of implementation and financial plans for new construction.

In conclusion, we believe the above funding decisions to be "significant events" and as such the rationale or justification behind their making should have been "clearly documented". They were not. Therefore, A.I.D./ASHA needs to establish formal (documented) internal control policies and procedures in accordance with statutory and regulatory requirements. These policies and procedures should include requiring documentation of the reason(s) behind grantee selection. Establishing formal policies and procedures and adhering to them could mitigate the effect of political considerations in the selection process.

We also believe that A.I.D./ASHA should continue to withhold the \$245,000 remaining under the grants with the two Foundations until (1) it reassesses whether the recipients have substantially complied with their grant agreements, (2) it determines whether there is adequate funding to complete the activities, and (3) the propriety of the approximately \$2 million in questioned costs is determined and appropriately resolved. (See page 26.)

Management Comments and Our Evaluation

A.I.D./ASHA stated that A.I.D. appropriately considered House and Senate Committee comments favoring the proposed activities in China. Management further stated that it does have some policy statements and procedures, e.g., criteria for selection, an application form, use of a panel to review applications, and certain memoranda. Nevertheless, A.I.D./ASHA stated it:

.... agrees with the audit's findings that [it] should have documented A.I.D.'s reasons for selecting these activities in China, and A.I.D. should have been more rigorous in establishing that these sponsor-grantees had or would obtain the management and financial capability to implement the projects effectively and to achieve these objectives.

While we agree it is acceptable to weigh Congressional interests when trying to choose between equally eligible activities, we deem inappropriate a process whereby lower-ranked projects are selected when more eligible activities are bypassed due to those interests. Regarding management's assertions that it had certain documented selection procedures, we are uncertain as to the point being raised: first because whatever written procedures that were implemented by A.I.D./ASHA, these are acknowledged in this report; and secondly because the documents mentioned in management's comments, e.g., application forms and memoranda, do not constitute formal procedures. However, we are encouraged that A.I.D./ASHA agrees with the audit's findings and that the recommendation has been accepted by them.

Did A.I.D./ASHA follow A.I.D. policies and procedures in awarding grants to the two Foundations?

A.I.D./ASHA did not follow A.I.D. policies and procedures in awarding grants to the two Foundations.

The grants reviewed were signed by authorized A.I.D./ASHA officials and did include certain standard A.I.D. provisions to protect A.I.D.'s interests. For instance, the officials who signed the grant agreements were delegated authority in accordance with A.I.D. Handbook 5. Also, the agreements contained some standard provisions (e.g., regarding maintenance of records and financial reporting) prescribed in A.I.D. Handbook 13.

However, A.I.D./ASHA needed to establish formal policies and procedures to cover its award process. Procedures should include those which ensure that (1) prospective recipients have acceptable management, financial, and technical capabilities before

a grant is awarded, (2) the program description contains benchmarks to measure progress in accomplishing the grant objectives, (3) the reasonableness of negotiated costs is documented, and (4) sufficient funds are available to complete the proposed project.

Grantees' Capabilities Need to be Determined Prior to Award

According to A.I.D. policies and procedures, the A.I.D. grant officer must, before making most grant awards, determine if a prospective recipient meets certain management, financial, and technical standards specified in A.I.D. Handbook 13. A.I.D./ASHA did not comply with these requirements because A.I.D. Handbook 13 specifically excludes the ASHA Program from these requirements, and A.I.D./ASHA has not developed similar policies and procedures. As a result, A.I.D./ASHA did not have assurance that the two Grantees had the necessary qualifications to achieve the results intended under the grants.

Recommendation No. 2: We recommend that the Director of the Office of American Schools and Hospitals Abroad establish formal policies and procedures for determining that a prospective recipient has the necessary management, financial, and technical capabilities before awarding a grant.

A.I.D. Handbook 13 (Chapter 4) states that before awarding a grant, the A.I.D. grant officer must determine that a prospective recipient has obtained or has the ability to obtain the necessary management, financial, and technical ability and capacity to plan and implement the program for which the funds are provided. To make such a determination, the Handbook further prescribes that the grant officer conduct an informal or desk survey, or establish a formal survey team. The criteria for using a formal survey team include:

- either the grant officer or the A.I.D. technical officer is uncertain about the prospective recipient's capacity to perform technically or financially;
- the prospective recipient has never received an A.I.D. grant; or
- the grant officer otherwise determines it to be in the best interest of the U.S. Government.

Whether by means of a formal survey or through an informal process, the grant officer will, before awarding the grant, (1) review the proposed program description and financial plan for sufficiency, and (2) make a determination that the prospective

recipient is qualified to carry out the program effectively and efficiently. The grant officer is required to prepare a memorandum of negotiation which is to include a discussion of the recipient's management, technical, and financial qualifications to receive the grant.

Neither of the recipients reviewed had ever received an A.I.D. grant and documentation showed that A.I.D./ASHA officials had serious doubts about both recipients' abilities to carry out the intended purposes of their proposed programs. Nevertheless, officials did not initiate a formal survey and there is no evidence additional substantive reviews were made to determine if the recipients met established A.I.D. standards for receiving grant funds. Finally, A.I.D./ASHA did not prepare memoranda of negotiation which discussed the recipients' management, financial, and technical qualifications to receive grants.

A.I.D./ASHA did not make these determinations before awarding the grants partly because A.I.D. Handbook 13 specifically excludes grants awarded under the ASHA Program and because A.I.D./ASHA has not formalized its own policies and procedures for determining prospective recipients' qualifications before awarding the grant.

As a result of not determining the qualifications of the recipients', A.I.D./ASHA did not have assurance that the two recipients had the required management, technical, and financial capabilities. The problems discussed in this report indicate the recipients did not have the required capabilities. Therefore, A.I.D./ASHA needs to establish policies and procedures to ensure prospective recipients are qualified to manage grants before awarding them grants.

Need to Ensure Program Descriptions Contain Benchmarks to Measure Progress

Although A.I.D. procedures strongly emphasize that program descriptions must contain benchmarks with which to measure progress toward program objectives, the grant agreements with the two recipients reviewed did not include such benchmarks. This problem occurred because A.I.D./ASHA was not required to follow normal A.I.D. procedures and had not established similar procedures. The absence of benchmarks makes it difficult, if not impossible, for A.I.D./ASHA and others to assess the progress of these Grantees' programs on which A.I.D. has already disbursed about \$7.8 million.

Recommendation No. 3: We recommend that the Director of the Office of American Schools and Hospitals:

- 3.1 Develop and implement procedures to ensure that benchmarks, which include targets and timeframes, are included in recipients' program descriptions to objectively measure the recipients' progress in accomplishing the program objectives or that such benchmarks be developed within a reasonable period of time after the start of the agreements.**
- 3.2 For the active grant agreements with the two recipients reviewed, require the recipients to develop specific benchmarks (targets and timeframes) with which to measure progress against the stated objectives.**

A.I.D. Handbook 13 (Chapter 4) states that a potential grant recipient should develop an application which, for purposes of good management, provides: a clear summary of what is to be accomplished; the resources and steps required to meet objectives in an identifiable period of time; a realistic financing scheme; and **benchmark measures of progress toward the objectives.** Generally, the recipients' "program description" is the document that includes the benchmarks against which progress is measured. In this regard, A.I.D. Handbook 3 procedures emphasize the importance of the statement of work and state the following:

The statement of work is probably the most important single portion of the ...resultant grant.... The attachment needed here is a document which clearly spells out A.I.D.'s requirement. It should be written with enough specificity so that there will be no doubt of what is required. It must provide for clear target dates which must be met, goals, and objectives for a particular project. **Vague descriptions should always be avoided.**

None of the grants with the two recipients contained benchmarks which could be used to objectively measure the recipients' progress in accomplishing the program objectives. Specific examples where benchmarks are lacking follow:

A grant with the American Hospital in Shanghai Foundation awarded in September 1988 was to strengthen American-Chinese relationships and understanding in medical education by operating health care facilities and medical teaching programs for Chinese medical and other personnel. However, the grant did not contain benchmarks which focused on key indicators for reviewing and evaluating the program's progress. For example, the grant does not identify the number of

teaching programs to be conducted, the number of people to be trained, or related target dates.

- The above grant also required the recipient to procure architectural and engineering services, construction services, and commodities to complete the renovation and to equip the Sino-American Medical Unit at a total cost of \$1.5 million. However, the grant did not identify what specific renovations and commodities were required and the timeframes for completing the necessary actions.
- The objectives of a grant awarded in July 1987 to the Fudan Foundation were to operate two educational institutions: the American Studies Center was to be used to train graduate and postdoctoral students in American culture, history, and political institutions; the Science Center was to be used to train graduate students in the natural sciences with emphasis on genetics and allied fields. However, the grant did not identify how many students were to be trained and the related timeframes.
- A grant awarded to Fudan Foundation in September 1988 required the Foundation to procure architectural and engineering services, construction services, and commodities to build and equip phase one of the Center for American Studies, including classroom, library and support facilities of approximately 4,099 square meters. However, the grant did not identify what specific services and commodities were required under phase one and the timeframes for completing the necessary actions. The authorized expenditures for these services and commodities totaled \$1.8 million.

The absence of benchmarks occurred because A.I.D. policies and procedures contained in A.I.D. Handbook 13 do not apply to the ASHA Program and A.I.D./ASHA has not developed similar policies requiring grants to contain specific benchmarks and procedures to ensure they are included as required. As a result, the grants awarded to the two recipients did not contain specific benchmarks making it virtually impossible for A.I.D./ASHA and others to objectively assess the performance of these grant recipients.

In conclusion, A.I.D./ASHA needs to establish policies and procedures to ensure that either the recipients' program descriptions contain benchmarks that can be used to assess the progress of the program or that such benchmarks are provided within a reasonable period after the agreement starts. For the active grants with the two recipients, A.I.D./ASHA should require the recipients to develop specific benchmarks (targets and timeframes) for measuring project progress.

Need to More Thoroughly Review and Document the Reasonableness of Proposed Costs

A.I.D. Handbook 13 states that before entering into an agreement, each proposed cost element must be reviewed for reasonableness and that the cost is justified. For the grants with the two recipients, A.I.D./ASHA did not review proposed cost elements (e.g., salaries, travel, and other direct costs) and did not have sufficient evidence to support the reasonableness of the proposed and negotiated costs. This problem occurred because A.I.D./ASHA did not follow A.I.D. procedures or establish similar procedures for ensuring the reasonableness of negotiated costs. As a result, A.I.D./ASHA does not have assurance as to the reasonableness of the \$ 8.0 million of proposed costs approved for the two recipients of which over \$ 7.8 million had already been paid to the recipients.

Recommendation No. 4: We recommend that the Director of the Office of American Schools and Hospitals Abroad establish procedures (1) to ensure that all cost elements of a prospective recipient's cost proposal are reviewed and supported to determine the reasonableness of the costs, and (2) to document such reviews.

A.I.D. Handbook 13 (Chapter 4) states that before entering into a grant agreement, each cost element of the program is reviewed for reasonableness and allowability of costs in accordance with the applicable cost principles. Items such as salaries, travel, and other direct costs that are to be reimbursed should be clearly defined and supported, since an analysis of these cost items will be used to determine the amount of funding needed to support the program. The grant officer's memorandum of negotiation is to include a discussion of the proposed budget, **including justification for all cost elements.**

The Handbook further states that the method for negotiating the costs for a specific grant parallel those for a cost-reimbursement type contract. The Federal Acquisition Regulation (Subparts 15.805-1 and 15.805-3), requires that a U.S. Government Contracting Officer make a cost analysis in evaluating the reasonableness of contractors' proposals. The cost analysis should also verify cost or pricing data provided by the prospective contractor and analyze subcontract costs. The Regulation (Subpart 15.805-5) also requires that:

... contracting officers shall request a field pricing report (which may include an audit review [pre-award survey] by the cognizant contract audit activity) before negotiating any contract or modification resulting from a proposal in excess of \$500,000, except as otherwise authorized under agency procedures, unless information available to the

contracting officer is considered adequate to determine the reasonableness of the proposed cost or price. When available data are considered adequate for a reasonableness determination, the contracting officer shall document the contract file to reflect the basis of the determination.

As shown below, A.I.D./ASHA did not comply with the above requirements:

- Each cost element (e.g., salaries, travel, and other direct costs) was not reviewed and, in fact, the proposals and A.I.D./ASHA grant agreements do not identify the breakout of individual cost elements. For example, one grant agreement with the American Hospital in Shanghai Foundation included almost \$1.5 million for: "Procurement of architectural and engineering services, construction services and commodities to complete the renovation and to equip The Sino-American Medical Unit. Commodity related services such as shipping, insurance and installation may be charged to the grant." A.I.D./ASHA officials could not provide any further cost breakout by element such as commodities, construction services, and shipping.
- A.I.D./ASHA officials did not prepare any memorandums of negotiations which discuss the proposed budgets, including justification for all cost elements.
- A.I.D./ASHA officials did not request a field pricing report before negotiating any of the four grants and related modifications with the two Grantees in excess of \$500,000 nor did officials have other available information to substantiate the reasonableness of the proposed and negotiated costs.

The above problems occurred because A.I.D./ASHA did not follow A.I.D. procedures for determining the reasonableness of costs proposed by prospective recipients and did not establish similar procedures for ensuring the reasonableness of negotiated costs. As a result, A.I.D./ASHA does not have assurance as to the reasonableness of the \$8.0 million of proposed costs approved for the two recipients of which \$7.8 million had already been paid to the recipients.

In conclusion, A.I.D./ASHA needs to establish procedures to ensure that all cost elements of a prospective recipient's proposed costs are reviewed and supported to determine the reasonableness of the costs and that such reviews are documented.

Funding Should be Reasonably Assured Prior to Award

The Foreign Assistance Act provides that funds should not be granted until financial and other plans necessary to carry out the assistance, and a reasonably firm estimate of its cost, have been completed. A.I.D./ASHA awarded a grant for new construction without being reasonably assured that funds would be available to complete that construction project because officials there stated their belief that Congress would always support funding of this project until completed. As a result, at least \$1.1 million has been spent on a building which is not complete or useable, and which, A.I.D./ASHA officials estimate, will cost an additional \$1.8 million to complete.

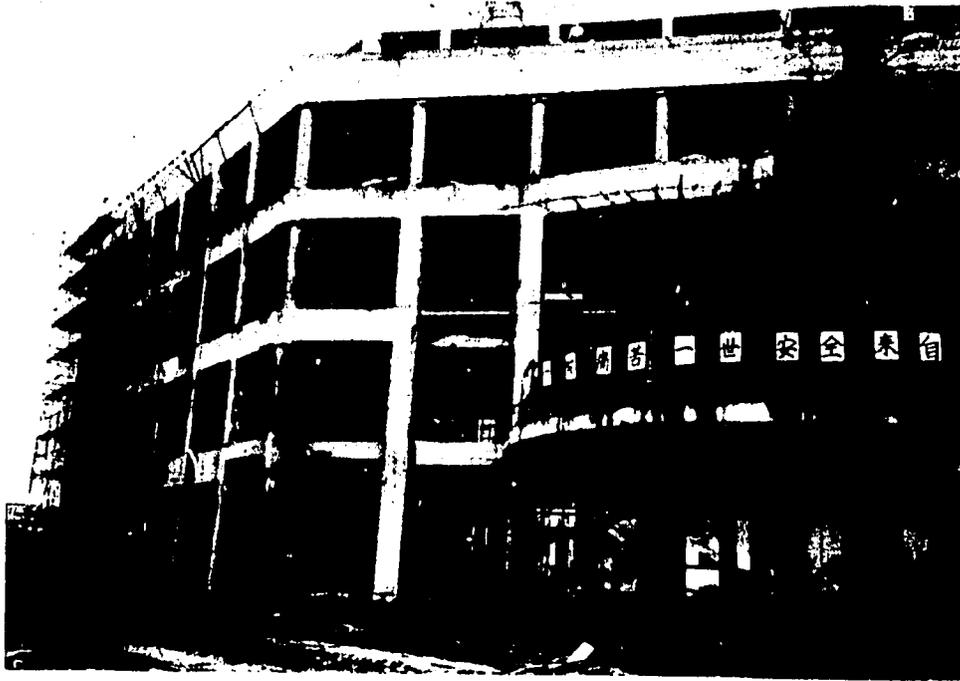
Recommendation No. 5: We recommend that the Director of the Office of American Schools and Hospitals Abroad establish procedures requiring that funds be granted only for projects reasonably expected to be completed and useable with A.I.D.-provided funds and other identified sources of funds.

Section 611 of the Foreign Assistance Act, Completion of Plans and Cost Estimates, states:

No agreement or grant which constitutes an obligation of the United States Government in excess of \$500,000... shall be made for any assistance... if such agreement or grant requires substantive technical or financial planning, until engineering, financial, and other plans necessary to carry out such assistance, and a reasonably firm estimate of the cost to the United States Government of providing such assistance, have been completed....

Thus, A.I.D. is required to be reasonably certain that, prior to award, sufficient funds, either in the grant or other sources of funds, are available to complete the purpose of the grant. As shown and discussed below, A.I.D./ASHA did not have reasonable certainty that funds were available to complete a new Center for American Studies project under a grant to the Fudan Foundation.

In this case, A.I.D./ASHA has already paid the recipient at least \$1.1 million for the construction of the facility. Although approximately \$245,000 remains under the grant, A.I.D./ASHA officials estimate that it would take an additional \$1.8 million to bring the structure to the point where it could be used for its intended purpose.



New Center for American Studies, Fudan University

Although A.I.D./ASHA officials were aware of the Section 611 requirement and that the original grant amount would not be sufficient to complete the facility, they stated it was funded anyway because they believed Congress would continue to "support" this project. Therefore, A.I.D./ASHA officials planned to incrementally fund the project until the facility was completed.

In conclusion, because future availability of Federal funding is never assured, A.I.D./ASHA should establish a procedure whereby a grant for a proposed ASHA project would not be awarded unless sufficient funds have been identified and are reasonably assured to ensure project completion.

Management Comments and Our Evaluation

A.I.D./ASHA stated its belief that it is appropriate for the audit report to use A.I.D. Handbook 13 and 3A guidance as the standard to determine whether A.I.D./ASHA activity in these areas has been prudent and effective because A.I.D./ASHA has not developed and documented formal policies and procedures of its own and because these are the standards used by the rest of the Agency. However, management does not believe it is fair to conclude that it did not comply with policies and procedures which specifically do not apply to the ASHA Program. A.I.D./ASHA further commented that its procedures have been too informal regarding the four problem areas discussed in the report and said it has begun certain actions with regard to familiarizing themselves with new applicants or first-time grant recipients and with regard to improving accountability.

Management comments that we unfairly conclude they did not comply with Handbook 13 procedures when the Handbook specifies that those procedures do not apply to A.I.D./ASHA. If we had not fully disclosed the fact that Handbook 13 exempted A.I.D./ASHA from following its guidance we would agree. However, it was fully disclosed. Furthermore, as reported, Handbook 13 states that A.I.D./ASHA will "determine" policies and procedures applicable to A.I.D./ASHA. Consequently, because of our full disclosure, because formal award procedures had not been "determined" or established, and because Handbook procedures were not followed as reported, we believe our conclusion that A.I.D. policies and procedures were not followed is appropriate.

Did A.I.D./ASHA follow A.I.D. policies and procedures in monitoring the two Foundations' performance?

A.I.D./ASHA did not follow A.I.D. policies and procedures in monitoring the two Foundations' performance.

A.I.D./ASHA did, in fact, make an effort to monitor the performance of the Fudan Foundation and the American Hospital in Shanghai Foundation. For example, A.I.D./ASHA officials provided evidence that they (1) reviewed some progress reports prepared by the Grantees, (2) approved some subcontracts awarded by the Grantees, and (3) made one site visit to China.

However, A.I.D./ASHA needed to establish formal policies and procedures for its monitoring function to include procedures to ensure that (1) the grantees prepare progress schedules and progress reports as required by the grant agreements, (2) A.I.D.-funded facilities and commodities are effectively used, (3) the grantee procures goods and services in accordance with the grant agreements, (4) the grantees do not receive contingency fees which are prohibited by the grant agreements, and (5) completed grants are closed out.

Grantee Progress Schedules and Reporting Need Improvement

The two Grantees were required by their grant agreements to prepare progress schedules and report accomplishments against those schedules in addition to other reporting and evaluation requirements. Although the Grantees did prepare most of the required quarterly progress reports, the Grantees did not prepare the progress schedules or adhere to several other reporting requirements such as annual institution reports and evaluation reports. This problem occurred because A.I.D./ASHA had not established formal procedures for monitoring the Grantees' performance and had not taken necessary actions to ensure the Grantees prepared

the required progress schedules and reports. As a result, A.I.D./ASHA could not objectively assess the effectiveness of \$7.8 million spent by the two Grantees.

Recommendation No. 6: We recommend that the Director of the Office of American Schools and Hospitals Abroad:

- 6.1** Establish procedures to ensure that grantees prepare progress schedules that include measurable targets and time frames to enable an objective assessment of grantee performance.
- 6.2** Establish procedures to ensure that grantees prepare the required progress and other reports and that these reports include an assessment to determine if project activities are on schedule and, if not on schedule, the reasons for variances.
- 6.3** Establish procedures requiring project officers to document their receipt and review of grantees' progress schedules and reports, to notify the grantees in writing when the reports do not comply with the reporting requirements stipulated in the grants, and to follow up with the grantee to resolve problems.
- 6.4** Require the two Grantees to submit a "self-evaluation" report for the two completed grants and an annual institution report.

To measure grantee performance and progress in achieving related project objectives, the reporting requirements in grant agreements should be well-defined in the grants, and reports should include information on achieving established targets. Although in some cases the responsible A.I.D. project officer may be fully aware of grantee performance, good reporting by grantees is still needed to enable all interested parties (e.g., external evaluators and other A.I.D. officials) to objectively measure the performance of the grantee and the progress of the project.

To ensure good reporting, A.I.D. Handbook 3, Supplement A, stipulates that A.I.D. project officers monitor grant implementation and ensure that grantees submit the reports required by the grant agreement. Upon receipt of each report, the project officer should review the document and comment upon the report's adequacy, particularly with regard to discussions of progress toward planned targets and identification of actual or potential problem areas. The project officer should also bring any deficiencies in the reports (e.g., failure to measure progress toward identified targets) to the grantee's attention along with suggestions for rectifying the problems. Depending upon the nature and significance of the problems, the project

officer may wish to record the difficulties in a memorandum to his superior, with a copy to the A.I.D. grant officer and the grantee.

The grant agreements required the Grantees to submit several types of reports to A.I.D./ASHA on project progress and accomplishments. Although the Grantees submitted some reports (e.g., quarterly progress and financial reports), the Grantees did not submit all the required reports and the reports submitted did not always include the required information as illustrated by the following examples:

- Both Grantees were to submit quarterly progress reports which included a section on construction progress. Each report was to show the percentage of completion of each major segment of work (e.g., architect and engineer planning, excavation, and structural work) and to indicate how the rate of work compares with the progress schedule adopted at the inception of the project. The progress schedule (including targets and timeframes) was to be included in each report. The required progress schedule was not adopted at the inception of the project, and none of the quarterly progress reports included a progress schedule and the percentage of completion. Therefore, A.I.D./ASHA could not objectively measure the Grantees' performance and project progress.
- The quarterly progress reports were also to include a section on commodity procurement, which was to describe commodities purchased, the price, the number of quotations/bids, whether the lowest price was accepted, and the place of purchase. The reports, which contained commodity procurement data, only identified item description and price. Even the information reported was not always correct. For example, the American Hospital in Shanghai Foundation's 1989 second quarterly report showed two items, with prices listed totaling approximately \$72,000, which were never purchased. Thus, A.I.D./ASHA's ability to monitor the Grantees commodity procurement practices and the cost of commodities was impaired.
- Each grant required the Grantees to submit "annual institution reports" identifying significant activities, accomplishments, problems, plans for the future, and **the contributions the respective grant was making to the grantee's educational and/or medical endeavors in accomplishing the project objectives.** By the time of our audit, each grantee should have submitted four annual reports but none had been submitted nor had A.I.D./ASHA taken action to obtain them. Thus, A.I.D./ASHA could not use the required reports to objectively measure the Grantees' performance and progress in achieving the projects' objectives.

Each grant requires the grantee to submit a "self-evaluation" report within 12 to 15 months following completion of the project funded under the grant. The evaluations should address how the assistance has increased the funded institution's ability in such areas as improving the understanding between the people of the United States and the area in China served, (2) promoting a favorable image of the United States, and (3) transferring capabilities that promote economic and social development. The Fudan Foundation and the American Hospital in Shanghai Foundation each had one grant that had been fully funded by December 1989 and September 1989, respectively. Although the "self-evaluation" reports were, therefore, due by March 1991 and December 1990, respectively, they had not yet been submitted at the completion of our audit in April 1992. A.I.D./ASHA did notify the grantee in December 1991 that the reports had not been received but the Grantees had not responded. Thus, A.I.D./ASHA could not use these reports to evaluate the Grantees's performance and the success of the projects.

The above problems occurred because A.I.D./ASHA had not established procedures to ensure the grantees submitted the required progress schedules and reports. The absence of control procedures may be due in part to the fact that A.I.D. Handbook 3, Supplement A, which provides A.I.D. monitoring guidance under most grants, specifically excludes ASHA grants from its provisions. Although A.I.D./ASHA officials said they reviewed the Grantees' reports and found them to be "skimpy," there was little documented evidence of such reviews as would be available if A.I.D. Handbook 3 procedures had been adopted.

A 1985 audit report by our office (Audit Report No. 9-000-86-2 dated December 13, 1985) identified similar problems in A.I.D./ASHA's monitoring of ASHA Programs. For example, the report identified that A.I.D./ASHA was not requiring recipients to comply with the grant agreements' requirements for submitting annual reports. The audit report noted that during the year ended March 31, 1985, only 11 of 58 active recipients sent annual institutional reports and none of the 11 reports contained all of the required information. The auditors concluded that a significant portion of A.I.D./ASHA's grant programs were going to recipients whose success in meeting program objectives could not be determined.

In conclusion, we believe A.I.D./ASHA could not objectively measure or evaluate the Grantees' performance and, as a result, could not evaluate the effectiveness of the Grantees' activities for which A.I.D. has already paid \$7.8 million. A.I.D./ASHA should adopt the procedures in A.I.D. Handbook 3, Supplement A, for monitoring grantee performance or establish similar procedures. Also, A.I.D./ASHA should

ensure that the two grantees submit the required "self-evaluation" reports and an annual institution report.

Controls Over Utilization of A.I.D.-Funded Facilities and Commodities Should be Tightened

Although Section 101 of the Foreign Assistance Act requires efficient and effective use of A.I.D. resources to achieve developmental goals, A.I.D./ASHA does not have assurance that this requirement was met for the four grants reviewed because A.I.D./ASHA had not established formal procedures nor implemented procedures to ensure that A.I.D.-funded facilities and commodities were effectively and efficiently used for intended purposes. As a result, millions of dollars in A.I.D.-funded facilities and commodities were either not being utilized, were under-utilized, or were not being used as A.I.D. had intended.

Recommendation No. 7: We recommend that the Director of the Office of American Schools and Hospital Abroad establish procedures that would increase monitoring over the utilization of A.I.D.-funded facilities and commodities under the four grants reviewed.

The Foreign Assistance Act (Section 101) requires efficient and effective use of A.I.D. resources. As of December 31, 1991, a total of \$5.0 million had been spent for facilities and commodities under the four grants reviewed -- \$2.7 million for the Fudan University and \$2.3 million the American Hospital in Shanghai Foundation.

A.I.D./ASHA does not have assurance that the above funds were being used efficiently and effectively for the purposes intended because A.I.D./ASHA had not established procedures to provide such assurance. Our audit showed that millions of dollars in A.I.D.-funded facilities and commodities were either not being utilized, were under-utilized, or were not being used as A.I.D. had intended.

Some examples of these cases are noted below:

Approximately \$1.7 million was spent by the American Hospital in Shanghai Foundation to renovate and equip two hospital floors with seven operating rooms on one floor and 14 semi-private rooms on another floor. The operating rooms appeared well utilized during our visit. However, although we could not gain access to most semi-private patient rooms, we noted that at least two rooms were vacant and three rooms were occupied by only one patient instead of the two patients intended. The low utilization was surprising because Hospital officials

had said earlier during our visit that there was a shortage of beds at the hospital.

The American Hospital in Shanghai Foundation's application for the grant stated that "The patients will be citizens of Shanghai whose income will be very low." Hospital officials, however, told us that approximately 80 percent of the patients who have occupied that facility are "foreigners" and that the fees paid by these patients help in providing the hard currency needed to make support payments to the American Hospital in Shanghai Foundation. Although one exterior sign said "Sino-American Friendship Medical Center", we noted at least three other signs which said "Foreigners' Medical Treatments Friendship Ward" (see picture below). Thus, it appears this A.I.D.-funded facility is used more for generating foreign-exchange than for providing medical services to low income Chinese as intended.



Sign at First People's Hospital, Shanghai

The Fudan Foundation renovated the existing Center for American Studies at Fudan University at a cost of \$620,700 according to A.I.D./ASHA. Although the Foundation's application for the grant stated that all classes would be taught in English, one of two classes we observed during our visit at the Center was being taught in Chinese. During a class break, the auditors attempted to talk to two of the students who indicated they did not speak English.

The Fudan Foundation reported it had procured books for the above Center's library at a cost of \$208,000. None of these books we inspected appeared to have been used, and the library cards in these books were blank. Furthermore, as shown below, one room contained many books that had never been used since they were procured in calendar year 1989. Center officials said the books had to be stored because the library could not support the weight of all the books that had been bought.

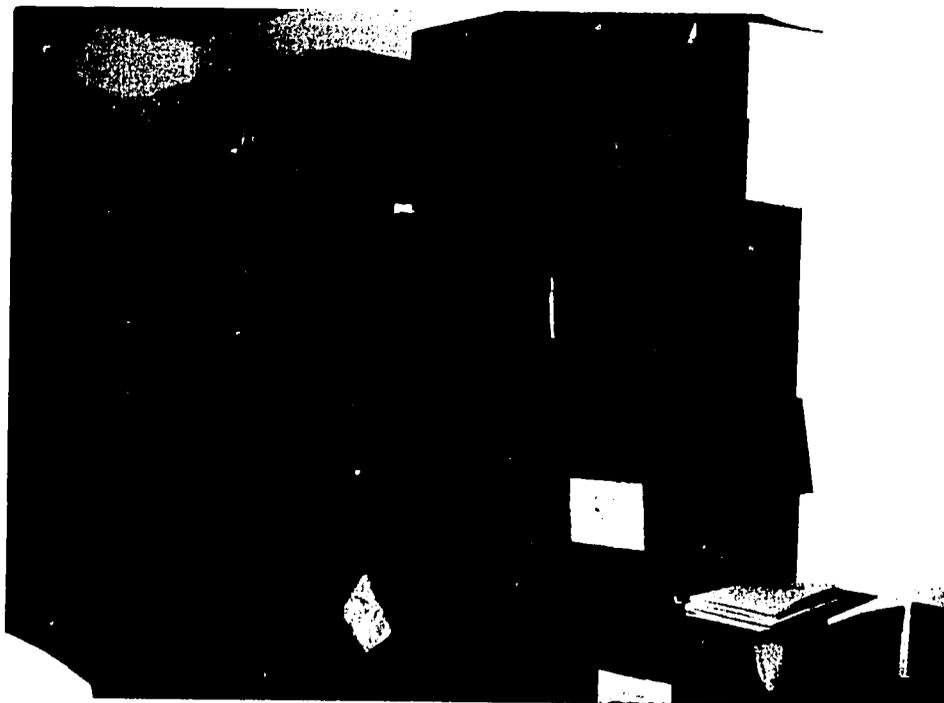


Stored Unused Books -- Fudan University

A.I.D./ASHA documentation shows the Fudan Foundation also funded the renovation and furnishing of a 25-apartment "Faculty Housing" complex at a cost of \$914,000. Program documentation shows that this facility was funded to provide long-term living accommodation, without charge, for visiting Americans who would be teaching at the Center for American Studies. Only 9 of the 25 apartments were occupied at the time of our visit. Only two of the occupants were from the United

States and were teaching American-studies type courses at the University. One of the two stated he did not teach at the ASHA-funded Center, and the other was not there for comment. Therefore, only the one not there for comment may have taught at the Center and thus would have met all the above occupancy criteria. Furthermore, a check of the Faculty Housing guest register showed that the facility was being used more like a motel, with most visitors staying short periods and being charged for their stay. The register showed transient guests from Japan, Britain, Germany, Hong Kong, the United States, and even other parts of the People's Republic of China. When we brought this problem to the attention of A.I.D./ASHA officials, they expressed surprise and stated that while they did encourage income generation for self-sufficiency purposes, the usage described was not what was intended.

A portion (we were unable to determine the amount) of the \$914,000 mentioned above was used to furnish the Faculty Housing Unit. While the items we reviewed, which were reported as procured, were accounted for, we noted some of the commodities had not been effectively used. For example, 25 microwave ovens were shipped in October 1989 at a cost of \$ 9,875. One was placed in an apartment while the remaining 24, most in their original boxes (as shown below), were locked in a storage room in another building.



Microwave Ovens in Storage -- Fudan University

In conclusion, A.I.D./ASHA needs to establish procedures that would increase monitoring over the utilization of A.I.D.-funded facilities and commodities under the four grants reviewed.

**Controls Over Procurement
Need Improvement**

The grant agreements we reviewed set out certain requirements such as the source and origin of commodities and prior approval by A.I.D./ASHA for the grantee to follow when procuring construction services. A.I.D./ASHA officials did not ensure these grant requirements were met because they were not aware of either the requirements or the procurement activities performed by the Grantees. As a result, ineligible commodities and professional services were procured by the Grantees and paid for with A.I.D. funds.

Recommendation No. 8: We recommend that the Director of the Office of American Schools and Hospitals Abroad:

- 8.1 Establish procedures to ensure that grantees comply with the grant requirements for procurement; and**
- 8.2 In consultation with the A.I.D. General Counsel, determine what action (including obtaining a refund from the Grantees) should be taken concerning over \$2 million of goods and services identified in this report section where it appears that the Grantees did not comply with the grant requirements for competition and for source, origin, and nationality.**

Each grant agreement we reviewed sets out certain requirements for the Grantees to follow when procuring goods and services under the grant. Although the requirements differed somewhat depending on what was being procured (i.e., professional services, commodities, or construction), they generally required some degree of competition, that the source, origin, and nationality of the goods or services be from the United States or China, and that A.I.D./ASHA approve certain contracts in writing prior to disbursement of funds.

As discussed below, A.I.D./ASHA officials did not ensure that the grant requirements were met for the various types of procurements because they were either not aware of the requirements or not aware of the subcontracting activities performed by the Grantees.

Professional Services - The grant agreements required that professional services be procured in the United States or China. The agreements also state:

The placement of subordinate agreements (e.g., leases, options, etc.), grants, or contracts with other organizations, firms or institutions and the provisions of such subordinate agreements are subject to prior written consent of A.I.D. if they will be funded hereunder and if A.I.D. so notifies the Grantee in writing that it desires to exercise this right. In no event shall any such subordinate agreement, grant, or contract be on a cost-plus-a-percentage-of-cost basis. Subordinate contractors (including suppliers) shall be selected on a competitive basis to the maximum practicable extent consistent with the obligations and requirements of this grant.

This section would appear to require that any subordinate agreement under the grants would be subject to the same obligations and requirements as in the grant, i.e., having their nationality in either the United States or China.

Although the two prime contracts awarded by the Grantees for professional services were with U.S. firms, at least half of the work was done by subcontractors which were not from the United States or China. Therefore, these subcontracts did not meet the requirements of the grant agreements. A.I.D.'s payments for services billed by these subcontractors totaled between \$1.3 million and \$1.7 million. Also, the Grantees awarded a personal services contract valued at \$30,000 to an individual who did not meet the nationality requirements. The amount paid this individual was not ascertained prior to the audit cut-off date. Thus, in total, A.I.D. paid the Grantees over \$1.3 million for services provided in violation of the terms of the grant agreements.

Also, although the grant agreements stipulated that no grant funds be disbursed for professional services prior to written approval of the contracts for those services by A.I.D./ASHA, this requirement was not always complied with or enforced. For example, although both Grantees had been contracting with one professional service contractor since early 1988 and A.I.D./ASHA had been making disbursements to the Grantees for these contracted services since August 1988, it was not until September 1989 that A.I.D./ASHA officials approved the contracts. These payments may have reflected tacit approval of the contracts, but A.I.D./ASHA should have properly documented its actions.

Construction Services - For construction services, the grant agreements required the Grantees to obtain competition, obtain A.I.D./ASHA's approval of the grantee's bid package, submit to A.I.D./ASHA the grantee's analysis of the bids received along with the architect contractor's recommendations, and the grantee's notice to the

construction contractor not to proceed with construction prior to A.I.D./ASHA approval of the contract.

To test A.I.D./ASHA approval process to ensure compliance with the above requirements, we reviewed two task orders which resulted in one contract for \$252,797 to purchase precast concrete piles, and one for \$131,627 to drive the piles. For the pile purchase, there was no evidence in A.I.D./ASHA files that the grantee had submitted either a bid package or the contract for A.I.D./ASHA approval. Regarding pile driving, data was not sufficiently clear to determine if A.I.D./ASHA approved the contract prior to the start of work.

With regard to competition for construction services, we noted that a significant amount of construction effort was sole source with one construction contractor (i.e., Fudan Office of Campus Construction). Although a waiver for this sole source effort was approved by A.I.D./ASHA, documentation was not available at A.I.D./ASHA to determine if the price of the work performed by them was reasonable. For example, even though the Chinese government standard rate for a level 4.3 laborer was equivalent to 81 cents per day, the grantee agreed upon and paid at the rate equivalent to \$5.00 per day for a job of installing some wood partitions.

The Grantees' "estimators" believed that the higher price was reasonable primarily because "fringes" like housing, education, and retirement should be considered. However, the estimators stated they could not verify the value of the "fringes." Also, the estimators stated that the \$5.00 per day rate is much less than what is normally charged foreign companies (i.e., \$12.00 to \$20.00 per day). Although foreign firms are usually charged the higher rate, this project was sponsored by the Government of China and in such cases the 81 cent per day rate is standard.

Commodity Purchases - The grant agreements required that the source and origin of commodities be the United States and China. The Grantees are also required to obtain quotes from as many alternative sources as may be feasible and to pay only the lowest price available, (except under extenuating circumstances). Commodity procurements at more than the lowest price available are to be supported by a statement furnished to A.I.D./ASHA setting forth the reasons. For commodities costing \$25,000 or more to be procured from the United States, the grantees are required to prepare and submit to A.I.D./ASHA notices of prospective procurement for publication in the A.I.D. Export Opportunities Bulletin. The grantees are also required to ensure that all grant-financed major commodities are marked with the official A.I.D. emblem and that the grantees' records shall include copies of all solicitations made for bids or quotations, all such bids or quotations, suppliers commercial invoices, and other pertinent documents.

Our review of 12 commodity purchases totaling \$482,302 showed that only one of them costing \$11,272 met the requirements of the grant agreements. Examples of purchases not meeting requirements are as follows:

- For only one purchase did the Grantees obtain more than one or two quotes, and in this case the purchase for 24 heat pumps/air conditioners was not made at the lowest price available. This occurred even though the lower-priced units had superior ratings for heating and cooling capacity (the difference in price was \$965 compared to \$900 per unit). Available documentation did not disclose why the higher priced units were purchased. Furthermore, available documentation indicates that the grantee's representative responsible for this purchase is financially related to the firm which supplied this equipment.
- Eight of the 12 commodity purchases reviewed did not meet the "source" and/or the "origin" requirements of the grant agreements.² The cost of the ineligible goods totaled \$111,522.
- Although A.I.D./ASHA officials approved source and origin waivers for several items, they could not provide documentation to justify these waivers. For example, a source and origin waiver was given for medical gas equipment costing \$315,769. The grantee's waiver request stated "U.S. system not suitable for China" but did not provide support for that comment. The A.I.D./ASHA Action Memorandum for waiver approval stated that "...there are no U.S. manufacturer representatives in the PRC [People's Republic of China] to perform repair and maintenance when required." But, A.I.D./ASHA officials were unable to provide documentation supporting that assertion. Furthermore, available documentation indicates the grantee's representative responsible for this procurement may be financially related with the firm which supplied this equipment.
- None of the major items we inspected including air-conditioning units and computers was marked with the A.I.D. emblem as required by the grant agreements.

In conclusion, A.I.D./ASHA needs to establish procedures to ensure that grantees comply with the grant requirements for subcontracting. A.I.D./ASHA should also, in consultation with the A.I.D. General Counsel, determine what action should be taken concerning over \$2 million of goods and services identified in this report

²Source means the country from which a commodity is shipped or purchased. Origin of a commodity is the country where the commodity is mined, grown, or produced.

section where the Grantees apparently did not comply with the grant requirements for competition and for source, origin, and nationality. (Our office is performing two other audits to determine the extent of these problems and therefore we are not recommending that A.I.D./ASHA perform additional reviews concerning this issue.)

**Contingent Fees
Are Being Paid**

Each grant agreement prohibits anyone from obtaining a commission contingent on the grantee's securing A.I.D. funding and, if such a commission is received by anyone, A.I.D. has the right to recover the full amount of the commission paid. The two grantee's were paid commissions (i.e., contingency fees) in U.S. dollars in an amount equal to a certain percentage of the amount of A.I.D. funds provided under the grants reviewed. These commissions occurred because A.I.D./ASHA officials were not aware of the grant provisions prohibiting such activity. As a result, the Grantees were paid unauthorized commissions totaling almost \$1.1 million.

Recommendation No. 9: We recommend that the Director of the Office of American Schools and Hospitals Abroad, in designing and formalizing the A.I.D./ASHA system of internal controls, establish controls to prevent grantees from receiving payments from overseas institutions based upon the grantee's securing of ASHA funding. For example, procedures should be implemented (1) to look for such financing arrangements during the selection process, and (2) to incorporate provisions in ASHA grants prohibiting such arrangements and requiring periodic certifications from grantees that such payments are not being made.

Each grant agreement reviewed included a covenant against contingent fees which states:

The Grantee warrants that no person or selling agent has been employed or retained to solicit or secure this grant upon agreement or understanding for a commission, percentage, brokerage, or contingent fee. For breach or violation of this warranty, A.I.D. shall have the right to cancel this grant without liability or, in its discretion, to deduct from the grant amount, or otherwise recover, the full amount of each commission, percentage, brokerage, or contingent fee.

Available documents show that the Chinese institutions paid the Grantees contingent fees totaling almost \$1.1 million. The Memoranda of Agreement between the American Hospital in Shanghai Foundation and the Shanghai Municipal Health Bureau and between the Fudan Foundation and Fudan University state that support

payments will be made by the Chinese institutions to the Foundations but the agreements do not indicate the reason for these payments. In addition, the calculated support payments to the Foundations from the institutions appear to be based solely on the amount of money channeled by the Foundations to their respective institutions. For example, in the American Hospital in Shanghai Foundation's agreement with the Shanghai Municipal Health Bureau it was agreed that, as the Foundation raised up to \$50 million over a period of time for a hospital project, the Health Bureau, in turn, would "support" the Foundation with up to \$7 million in proportions related to the amounts raised, i.e., 14 percent over that same period. As the Foundations expend A.I.D./ASHA funds they inform their overseas beneficiaries by letter of the amounts expended (i.e. raised) and that, because they have supplied that funding, "support" payments to the Foundations are due. The following is an excerpt from one such letter dated July 1, 1990.

We are pleased to present you with the attached record of expenditures made to date from U.S. Government funds.

...You will note from this report that expenditures to date have totaled U.S. \$3,201,748 of the total planned American Hospital in Shanghai Foundation contribution of U.S. \$3,750,000. This amount is equivalent to total cost sharing support payments due of U.S. \$448,245 (four hundred forty-eight thousand two hundred forty-five), of which the Hospital has already paid U.S. \$433,474 for a remainder due to date of U.S. \$14,771.

The total amount of "support" identified as being owed is the same 14 percent as in the original agreement noted above. When questioned in July 1991 about the fees, the Foundation's officials stated that:

"The support payments are based on a formula calling for support of the Foundation's activities equal to a percentage of funds raised in the U.S. for our joint activities."

Officials representing both Foundations also state that the funds received from the Chinese institution represent the institutions' "commitment" to the projects. In our opinion, the Chinese commitment to the overseas institutions should have been demonstrated by having these institutions contribute funds directly to their projects rather than to the Foundations. The Foundations' officials further stated that the fees it received from the institution were not A.I.D. funds. However, whether or not the fees paid were A.I.D. funds is not relevant to the issue of whether they violated the covenant against contingent fees contained in the grant agreements.

The covenant against contingent fees contains no requirement that the funds utilized to pay the fee be from appropriated U.S. dollars. The prohibition contained in the

covenant is against paying someone a fee to solicit or secure the grant a commission, percentage, brokerage, or contingent fee. The receipt of a fee based upon a percentage of the total amount of money collected is by definition a contingent fee. The agreements between the Foundations and their respective institutions clearly include the receipt of funds under the A.I.D./ASHA grants in the calculation of the percentage to be paid to the Foundations. Therefore, the Foundations violated this covenant.

ASHA officials stated they were aware of the above financial agreements between the Foundations and the overseas institutions but they were not aware of the grant covenant prohibiting such fees. Later, officials stated that the contingent fee provisions were included by error in the grant agreements, but that, nevertheless, payments from the overseas institutions raised significant questions. We also question the efficacy of having an overseas entity, which under the Program should be the ultimate beneficiary, make "support" payments of any amount to an ASHA grantee merely because it (the grantee) has secured A.I.D. funding. That type of arrangement is particularly troublesome in light of the fact that under first ASHA Program criteria for determining the eligibility of prospective grantees it states that the applicant "must demonstrate" financial support for the institution. In the instant case, the reverse is true.

In their comments to a draft of this report, A.I.D./ASHA did not agree that a bill for collection should be issued (our recommendation in the draft report) for several reasons but primarily because: (1) "It is no longer A.I.D. policy to include a contingent fee provision in its grant agreements..." and therefore such a clause should not have been included in their grants; and (2) "The clause in ASHA grants is defective..." as it leaves out key wording. Nevertheless, management is "... concerned that these payments from the PRC may raise significant issues about whether the Foundations are the kinds of founders/sponsors to whom ASHA should be providing assistance...."

We accept management's explanation that errors were made in including the contingent fee provision in the grants and, accordingly, we no longer recommend issuing a bill for collection. However, in line with management's concerns as stated in their comments above and in light of our own concerns as reported herein regarding payments to the Foundations from overseas institutions who, in fact, according to ASHA Program criteria, should be receiving financial support from the Foundations, we believe that the Foundations' support arrangements with their overseas institutions and any similar arrangements should not be permitted within the ASHA Program. Consequently, we have made minor changes to the report and the recommendation related to this problem area.

In conclusion, the Grantees were paid contingent fees totaling almost \$1.1 million because they secured A.I.D./ASHA funding. Therefore, A.I.D./ASHA needs to

establish procedures (1) for preventing such payments or similar arrangements (e.g. incorporating new grant provisions prohibiting this type of activity) and (2) for obtaining periodic certifications from the grantees that fees are not being paid in violation of grant agreement provisions.

**Completed Grants
Were Not Closed Out**

Although A.I.D.'s policies and procedures require completed grants to be closed out, A.I.D./ASHA did not take actions to close out such grants awarded to the two Grantees reviewed. This problem occurred because A.I.D./ASHA did not have policies and procedures requiring closeout of completed grants. As a result, A.I.D./ASHA had not properly determined that all applicable administrative actions and all required work of the grants have been completed by the grantee and A.I.D.

Recommendation No. 10: We recommend that the Director of the Office of American Schools and Hospital Abroad:

- 10.1 Establish policies and procedures for properly closing out completed grants.**
- 10.2 Close out the two completed grants covered by this audit.**

A.I.D. Handbook 13 (Chapter 1) prescribes uniform closeout procedures for A.I.D.-funded grants with recipients. The closeout process is the process by which A.I.D. determines that all applicable administrative actions and all required work of completed grant agreements have been performed by A.I.D. and the recipient. The prescribed closeout procedures include the following requirements:

- the recipient shall immediately refund any balance of unobligated cash that A.I.D. has advanced or paid and that is not authorized to be retained by the recipient for use in other A.I.D.-funded grants;
- A.I.D. shall obtain from the recipient within 90 calendar days after the date of completion of the grant all financial, performance, and other reports required as the condition of the grant;
- the recipient shall account for any property acquired with A.I.D. funds; and
- in the event a final audit has not been performed prior to the closeout of the grant, A.I.D. shall retain the right to recover an appropriate

amount after fully considering the recommendations on questioned costs resulting from the final audit.

A.I.D./ASHA had not closed out the completed grants with the two recipients because A.I.D. Handbook 13 specifically excludes ASHA grants, and A.I.D./ASHA had not established its own policies and procedures for closing out completed grants. The Fudan Foundation and the American Hospital in Shanghai Foundation had completely expended their first grants' funds as of September 1989 and December 1989, respectively. A.I.D.'s payments under these grants totaled \$3.0 million.

As a result of not closing out the grants, A.I.D./ASHA did not properly determine if all applicable administrative actions and all required work of the grant agreements had been completed by A.I.D. and the recipients. For instance, as discussed previously in this report, the Grantees did not submit all financial, progress, and other reports required by the grants and A.I.D./ASHA did not have an accounting for A.I.D.-funded property. Therefore, A.I.D./ASHA should develop procedures for properly closing out completed grants and close out the two completed grants covered by this audit.

Management Comments and Our Evaluation

A.I.D./ASHA, after first acknowledging that it has not developed and documented formal policies and procedures for its monitoring function, then states that, for as many as 11 of the 14 implementation functions" noted in the report, "... procedures to be followed were adequately documented in the ASHA grant agreements or in clearly standard and accepted procedures, e.g., that grants need to be closed out..." Other examples, such as requirements for progress schedules, reporting, source-origin, and A.I.D. approvals, were also mentioned. However, A.I.D./ASHA states it must do more to formalize and document its procedures.

We believe that grant provisions or requirements do not constitute formal or documented internal control procedures. Specifically, one of A.I.D./ASHA's internal control objective should be to ensure the efficient and effective implementation of grants. The control techniques applied to achieve that objective are the procedures. Grant agreements merely set out requirements. To ensure requirements are met, certain procedures must be employed. For example, it serves no purpose to require the grantee to submit an annual institution report when there are no established procedures to, for example, log it in, document it was reviewed by appropriate personnel, document deficiencies (including non-receipt), and document follow-up of deficiencies with the grantee. As reported, no such reports, (although required by the grant agreement) were prepared. After reviewing the "implementation functions" management has presented as Attachment 2 to their comments and in line with the above discussion on procedures, we conclude that all 14 problems they present in

their attachment to be related to A.I.D./ASHA not having formalized monitoring procedures. We are satisfied, however, that A.I.D./ASHA concluded that it "... should identify the Agency's policies and procedures which will be applicable to [ASHA's] program or alternatively that a procedures manual should be developed for ASHA."

REPORT ON INTERNAL CONTROLS

This report summarizes our assessment of internal controls for the three audit objectives and of A.I.D.'s adherence to the Federal Manager's Financial Integrity Act requirements for establishing and reporting on internal controls related to the objectives and includes a recommendation to the Director, Office of American Schools and Hospitals Abroad.

Scope of Our Internal Control Assessment

We performed our audit in accordance with generally accepted government auditing standards which require that we:

- assess the applicable internal controls when necessary to satisfy the audit objectives; and
- report on the controls assessed, the scope of our work, and any significant weaknesses found during the audit.

We limited our assessment of internal controls to those controls applicable to the audit's objectives and not to provide assurance on the auditees' overall internal control structure.

We classified significant internal control policies and procedures applicable to each audit objective by category. For each category of control, we obtained an understanding of the design, when applicable, of relevant policies and procedures and determined whether they have been placed in operation, and assessed control risk. We have reported these categories as well as any significant weaknesses under the applicable section heading for each audit objective.

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act (31 U.S.C. 3512[c]) and Office of Management and Budget (OMB) implementing policies, A.I.D.'s management is responsible for establishing and maintaining adequate internal controls that reasonably assure:

- Obligations and costs comply with applicable law.
- All assets are safeguarded against waste, loss, unauthorized use, and misappropriation.
- Revenues and expenditures applicable to agency operations are recorded and accounted for properly so that accounts and reliable financial and statistical reports may be prepared and accountability of the assets may be maintained.

Section 3512 (d) of the law requires that the head of each agency prepare an annual report stating whether the agency's internal controls meet these standards and describing any material weaknesses in its internal controls.

The General Accounting Office has issued a document titled Standards For Internal Controls In The Federal Government to be used by agencies in establishing and maintaining internal controls. The standard for documentation requires that:

Internal control systems and all transactions and other significant events are to be clearly documented, and the documentation is to be readily available for examination [Underlining added].

The standards further state that complying with the standard requires that the documentation of internal control systems and transactions and other significant events be purposeful and useful to managers in controlling their operations, and to auditors or others involved in analyzing operations.

While A.I.D. Handbooks 13 and 3 (Supplement A) document A.I.D.'s internal control policies and procedures with regard to selecting recipients, awarding grants, and monitoring grantees' performance for most A.I.D.-funded grantees, these Handbooks specifically exclude grants awarded under the American Schools and Hospitals Abroad Program. Furthermore, although A.I.D. Handbook 13 states that A.I.D./ASHA will "determine" policies and procedures applicable to the ASHA Program, A.I.D./ASHA has not established or documented its internal control systems for the above three areas (i.e., selection, awarding, and monitoring) as required by Federal law and policy.

The objectives of internal controls for Federal foreign assistance are to provide management with reasonable--but not absolute--assurance that resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data is obtained, maintained, and fairly disclosed in reports. Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Moreover, predicting whether internal controls will work in the future is risky because changes in conditions may

require additional procedures or the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusion for Audit Objective One

The first audit objective was to determine if A.I.D./ASHA followed A.I.D. policies and procedures in selecting the two Foundations as recipients under the American Schools and Hospitals Abroad (ASHA) Program. In planning and performing our audit, we considered the requirements of Section 214 of the Foreign Assistance Act, the Federal Managers' Financial Integrity Act, the Standards For Internal Controls In The Federal Government prescribed by the General Accounting Office, Office of Management and Budget (OMB) Circular A-123, and appropriate internal control policies and procedures cited in A.I.D. Handbooks 3 (Supplement A) and 13, and the "Final Program Criteria for Screening of Applications for Grants Made by American Schools and Hospitals Abroad (ASHA) Program". For the purposes of this report, we have classified the applicable internal controls into the following categories:

- developing criteria for evaluating proposals from prospective grantees,
- reviewing prospective grantee proposals,
- documenting the selection/recommendation process, and
- making the final selections.

Our audit of the two ASHA Grantees showed that, with the exception of developing criteria for evaluating proposals from prospective grantees, A.I.D. has not formalized internal controls for the categories identified above. The audit disclosed the following significant internal control weaknesses:

- A.I.D./ASHA had not established controls requiring documentation to support (1) the rationale behind selecting recipients; and (2) any other significant events in the selection process.
- A.I.D./ASHA had not established written internal control procedures covering its grantee selection process.

The Office of American Schools and Hospitals Abroad was unable to provide documentation that a vulnerability assessment had been completed in the last five years as required by OMB Circular A-123. An internal control assessment was last performed for A.I.D./ASHA in 1989. In 1990 and 1991 A.I.D./ASHA was assessed as part of its Headquarter's Bureau. While the results of these assessments were documented, there was no supporting documentation to show what was done and

what was found as required by OMB Circular A-123. Neither the 1990 or 1991 assessment for the Bureau disclosed any internal control weaknesses involving the ASHA Program.

Conclusion for Audit Objective Two

The second audit objective was to determine if A.I.D./ASHA followed A.I.D. policies and procedures in awarding grants to the two Foundations. In planning and performing our audit, we considered the requirements of Section 101 of the Foreign Assistance Act, the Federal Managers' Financial Integrity Act, the Standards For Internal Controls In The Federal Government prescribed by the General Accounting Office, OMB Circular A-123, and the appropriate internal control policies and procedures cited in A.I.D. Handbooks 3, and 13. For the purposes of this report, we have classified the applicable internal controls into the following categories:

- having a delegation of authority for awarding the grants,
- including pertinent clauses in grant agreements,
- ensuring prospective recipients have or can obtain the required management, financial, and technical capabilities to successfully carry out the program, and
- developing well-defined program descriptions on what is required from the grantee,
- ensuring the reasonableness of negotiated prices,
- ensuring sufficient funds are available to complete proposed projects.

Our audit of the two ASHA Grantees showed that except for delegations of authority A.I.D. has not formalized internal controls for the categories identified above. The audit disclosed the following significant internal control weaknesses:

- A.I.D./ASHA did not perform preaward surveys or document the results of those surveys to determine that prospective recipients had the necessary management, financial, and technical capabilities to successfully complete the grant programs.
- A.I.D./ASHA did not ensure the program description included specific benchmarks to measure progress in achieving the program's objectives.

- A.I.D./ASHA did not prepare "memoranda of negotiation" or otherwise document determinations as to the reasonableness of proposed costs.
- A.I.D./ASHA had not established written internal control procedures covering its grant award process.

The Office of American Schools and Hospitals Abroad was unable to provide documentation that a vulnerability assessment had been completed in the last five years as required by OMB Circular A-123. An internal control assessment was last performed for A.I.D./ASHA in 1989. In 1990 and 1991 A.I.D./ASHA was assessed as part of its Headquarter's Bureau. While the results of these assessments were documented, there was no supporting documentation to show what was done and what was found as required by OMB Circular A-123. Neither the 1990 or 1991 assessment for the Bureau disclosed any internal control weaknesses involving the ASHA Program.

Conclusion for Audit Objective Three

The third audit objective was to determine if A.I.D./ASHA followed A.I.D. procedures for monitoring the two ASHA Grantees reviewed. In planning and performing our audit, we considered the requirements of the Foreign Assistance Act Sections 101 and 214, the Federal Managers' Financial Integrity Act, the Standards For Internal Controls In The Federal Government prescribed by the General Accounting Office, OMB Circular A-123, and the appropriate internal control policies and procedures cited in A.I.D. Handbooks 3 and 13. For the purposes of this report, we have classified the applicable internal controls into the following categories:

- Receipt and review of grantee reports/evaluations,
- Utilization of A.I.D. funded resources,
- Procurement of services and commodities,
- Oversight of grant contingent fee provisions, and
- Closeout of completed grants.

Our audit of the two ASHA Grantees showed that A.I.D. has not formalized internal controls for the categories identified above. The audit disclosed the following significant internal control weaknesses:

- A.I.D./ASHA did not always document deficiencies in grantee reporting nor did they establish formal procedures for following-up with the Grantees when their reports or evaluations were deficient or overdue.
- A.I.D./ASHA did not have the controls necessary to determine if A.I.D.-funded resources were being effectively utilized.
- A.I.D./ASHA did not have controls necessary to ensure that recipients subcontracted for goods and services in accordance with the grant agreements.
- A.I.D./ASHA did not close out completed grants.
- A.I.D./ASHA had not established written internal control procedures covering its monitoring function.

The Office of American Schools and Hospitals Abroad was unable to provide documentation that a vulnerability assessment had been completed in the last five years as required by OMB Circular A-123. An internal control assessment was last performed for A.I.D./ASHA in 1989. In 1990 and 1991 A.I.D./ASHA was assessed as part of its Headquarter's Bureau. While the results of these assessments were documented, there was no supporting documentation to show what was done and what was found as required by OMB Circular A-123. Neither the 1990 or 1991 assessment for the Bureau disclosed any internal control weaknesses involving the ASHA Program.

Establish Internal Controls and Reporting on Problem Areas as Required by the Federal Managers' Financial Integrity Act

As previously discussed under the General Background on Internal Controls section, A.I.D. is required, under the Federal Managers' Financial Integrity Act and the Standards For Internal Controls In The Federal Government prescribed by the General Accounting Office, to ensure that (1) internal control systems and all transactions and other significant events are clearly documented, and the documentation is readily available for examination, and (2) material internal control weaknesses are identified and reported as part of A.I.D.'s internal control assessments. Within A.I.D., the Management Control Review Committee (MCRC) is responsible for reviewing internal control assessments prepared by A.I.D.'s components and recommending to the Administrator which internal control problems should be reported as material weaknesses.

The Office of Management and Budget (OMB) Circular A-123 defines a material weakness as one which would:

... significantly impair the fulfillment of an agency component's mission; deprive the public of needed services; violate statutory or regulatory requirements; significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; or result in a conflict of interest.

An August 3, 1991 memorandum from the Office of Management and Budget states that, since the above factors are judgmental and can be widely interpreted, each material weakness should meet one or more of the following additional criteria:

- merits the attention of the agency head/senior management, the Executive Office of the President, or the relevant Congressional oversight committee;**
- exists in a major program or activity;**
- could result in the loss of \$10 million or more, or 5 percent or more of the resources of a budget line item; or**
- its omission from the report could reflect adversely on the management integrity of the agency.**

In our opinion, the internal control weaknesses described in this report collectively meet the definition of a material weakness. Also, as noted for each audit objective, A.I.D./ASHA has not formalized internal controls for the selection of recipients, awarding grants, and monitoring grantee performance under the ASHA Program.

The MCRC has not identified the problems affecting the ASHA Program as a material weakness because neither A.I.D./ASHA nor the Bureau for Food and Humanitarian Assistance has identified the internal control weaknesses we found, i.e., that A.I.D./ASHA lacked formal policies and procedures to cover its selection, award, and monitoring functions.

Therefore, to improve A.I.D.'s compliance and reporting under the Federal Managers' Financial Integrity Act, we are making the following recommendation.

Recommendation No. 11: We recommend that the Director of the Office of American Schools and Hospitals Abroad:

- 11.1 Establish formal internal control systems for selecting recipients, awarding grants, and monitoring grantee performance under the American Schools and Hospitals Abroad Program as required under the Federal Managers' Financial Integrity Act and Standards For Internal Controls In The Federal Government prescribed by the General Accounting Office.**
- 11.2 In preparing the next report under the Federal Managers' Financial Integrity Act, perform an assessment of the internal controls and report any material weaknesses.**
- 11.3 Recommend to the Management Control Review Committee that they include the lack of established internal controls for the American Schools and Hospitals Abroad Program as a material weakness in the Committee's next annual report to the A.I.D. Administrator.**

Management Comments and Our Evaluation

A.I.D./ASHA states it "... will undertake major efforts to introduce more effective internal controls this fiscal year and will conduct an internal control assessment at the end of the fiscal year." However, even though a vulnerability assessment has not been performed in the last five years, they do not anticipate performing one this year because "... a reasonable time is needed to put the procedures in place against which vulnerability should be measured." In light of this they request we revise the recommendation.

We are encouraged by management's positive statement of action to be taken but we cannot change our recommendation based on the information presented. Furthermore, that a vulnerability assessment be made at least at five-year intervals is a requirement stipulated by OMB Circular A-123 not by the Office of the Inspector General.

REPORT ON COMPLIANCE

This section summarizes our conclusions on A.I.D.'s compliance with applicable laws, regulations, and binding policies, and the two Grantees' compliance with the applicable grant requirements.

Scope of Our Compliance Assessment

We conducted our audit in accordance with generally accepted government auditing standards which require that we:

- assess compliance with applicable requirements of laws and regulations when necessary to satisfy the audit objectives (which includes designing the audit to provide reasonable assurance of detecting abuse or illegal acts that could significantly affect the audit objectives); and
- report all significant instances of noncompliance and abuse and all indications or instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

We tested A.I.D.'s compliance with the Foreign Assistance Act (Sections 101, 214, and 611), the Federal Managers' Financial Integrity Act, the Standards for Internal Controls In The Federal Government prescribed by the General Accounting Office, the Federal Acquisition Regulation (Subparts 15.805-1, 3, and 5), and OMB Circular A-123. We also tested the two Grantees' compliance with their grant agreements.

General Background on Compliance

Noncompliance is a failure to follow requirements, or a violation of prohibitions, contained in statutes, regulations, contracts, grants and binding policies and procedures governing entity conduct. Noncompliance constitutes an illegal act when there is a failure to follow requirements of laws or implementing regulations, including intentional and unintentional noncompliance and criminal acts. Not following internal control policies and procedures in the A.I.D. Handbooks generally does not fit into this definition of noncompliance, and is included in our report on internal controls. Abuse is distinguished from noncompliance in that abusive

conditions may not directly violate laws or regulations. Abusive activities may be within the letter of laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

The Office of American Schools and Hospitals Abroad has overall responsibility to ensure compliance with applicable laws, regulations, and the grant agreements. The grantee is of course responsible for complying with the terms and conditions of the grant agreement.

A.I.D.'s Management Control and Review Committee, is responsible for reporting material instances of noncompliance with the Federal Managers' Financial Integrity Act of significant importance to the President and Congress. To determine if a weakness is material, the Office of Management and Budget (OMB) has established that each material weakness should meet certain criteria including that they:

- Significantly impair the fulfillment of an agency or component's mission.
- Violate statutory or regulatory requirements.
- Significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets.
- Exist in a major program or activity.
- Could result in the loss of \$10 million or more, or 5 percent or more of the resources of a budget line item.

Conclusion on Compliance

A.I.D. has not formalized internal controls required by the Federal Managers' Financial Integrity Act and Standards for Internal Controls in the Federal Government prescribed by the General Accounting Office for selecting recipients, awarding grants, and monitoring grantee performance under the American Schools and Hospitals Abroad Program.

Also, the Office of the American Schools and Hospitals Abroad did not ensure compliance with certain requirements of the Foreign Assistance Act and the Grantees did not comply with certain requirements of the grant agreements as discussed below:

- Under Audit Objective No. 2, the Office of American Schools and Hospitals Abroad did not ensure financial plans necessary to carry out

projects were complete as required by Section 611 of the Foreign Assistance Act. (See page 16.)

- Under Audit Objective No. 3, the Office of the American Schools and Hospitals Abroad did not ensure A.I.D. funds were spent efficiently and effectively, which Section 101 of the Foreign Assistance Act declares is necessary to achieve the goals of United States development policy. (See page 22.)
- Under Audit Objective No. 3, the two Grantees did not comply with the grant agreements' requirements for submitting reports, procuring goods and services from authorized countries, and having contingent fee arrangements. (See pages 18, 26, and 30.)

Except as described, the results of our tests of compliance indicate that, with respect to the items tested, A.I.D., and the two Grantees reviewed, complied in all significant respects with the provisions referred to in the fourth paragraph of this report. With respect to items not tested, with the exception of certain allegations concerning the two Grantees that are being investigated by the General Accounting Office, nothing came to our attention that caused us to believe that these parties had not complied, in all significant respects, with those provisions.

SCOPE AND METHODOLOGY

Scope

The Office of the Inspector General/Programs and Systems Audits audited A.I.D.'s controls over the American Schools and Hospitals Abroad (ASHA) Program in accordance with generally accepted government auditing standards. We conducted the audit from November 21, 1991 through April 15, 1992, and covered A.I.D.'s systems and procedures for selecting, awarding, and monitoring ASHA grants. Our audit was limited to determining if A.I.D. followed these procedures with regard to the applications received by the Office of ASHA from the Fudan Foundation and the American Hospital in Shanghai Foundation for the Fiscal Years 1987 through 1991, and grants awarded to those Foundations in Fiscal Years 1987, 1988, and 1989. The audit covered A.I.D. disbursements of \$7.8 million to these Foundations.

The audit objectives did not include determining the propriety of all costs incurred by the two recipients and related A.I.D. payments because separate cost-incurred audits are being performed concurrently with this audit. The audit identified questionable costs and payments resulting from the recipients' failure to comply with certain grant agreement requirements for the purchase of professional services, construction services, and commodities.

We conducted our field work in Washington, D.C. at the offices of the ASHA Program, the Fudan Foundation, and the American Hospital in Shanghai Foundation. Field work was also conducted at the offices of the Grantees' contractors and subcontractors in Hong Kong, and at the First People's Hospital and the Fudan University in Shanghai, People's Republic of China.

Methodology

The methodology for each audit objective follows:

Audit Objective One

The first audit objective was to determine if A.I.D./ASHA followed A.I.D. policies and procedures in selecting the two Foundations. To accomplish this objective we audited the selection process for the applications submitted by the Fudan Foundation and the American Hospital in Shanghai Foundation for the Fiscal Years 1987 through 1991.

We first determined if there were formal (written) policies and procedures for ASHA personnel to follow. Because there were none, other than certain selection criteria, we determined and summarized the procedures followed in actual practice by interviewing A.I.D./ASHA personnel. After determining that a panel normally consisting of outside (non-A.I.D.) reviewers is chosen each year to rate each prospective recipient's applications/proposals against the selection criteria, we reviewed how the panel members were chosen, the instructions they were given and their biographical data (to determine educational or medical background and if any impairment to their independence may have existed), and which criteria were used by the panel in rank-ordering applications for ASHA funding.

We obtained all applications filed by the Foundations with A.I.D./ASHA and determined how applications were rated by the individual panel members. If individual rating sheets, prepared by each panel member for each application, were available in A.I.D./ASHA files, these too were obtained. Noting the original low rankings of the Foundations' Fiscal Year 1987 applications by the review panel, we decided to apply the same criteria they had applied against them to see if we would reach the same conclusions. We did.

We determined if discussions or meetings took place between panel and A.I.D./ASHA officials and whether these were documented. We then determined what A.I.D./ASHA officials did with the panel's rankings, what criteria and other factors they applied to come up with their recommendations to the Assistant Administrator and Administrator. After that, we determined if justification or rationale existed and was documented which would explain changes to recommendations and the final selections made.

Due to personnel turnover, interviews had to be conducted with former as well as current A.I.D. officials.

Audit Objective Two

The second audit objective was to determine if A.I.D./ASHA followed A.I.D. policies and procedures in awarding grants to the two Foundations. To accomplish this

objective, we audited the award process followed for the two grants awarded to the Fudan Foundation and the two grants awarded to the American Hospital in Shanghai Foundation.

After first determining that A.I.D./ASHA did not have formalized procedures covering the award process, we attempted to determine procedures used by interviewing ASHA personnel. We contrasted procedures practiced with procedures required in the award of non-ASHA type grants as discussed in A.I.D. Handbook 13, and A.I.D. Handbook 3 (Supplement A) to determine if there were procedures/internal controls which would also be beneficial to ASHA awards.

We interviewed A.I.D./ASHA officials and/or reviewed grant documentation to determine if (1) pre-award surveys of the Foundations were conducted, (2) a basis for negotiation (e.g., a field pricing report and a cost analysis) was supported and documented, and (3) program descriptions were well defined and included benchmarks for measuring program progress. We also reviewed the requirements of Section 611 of the Foreign Assistance Act and reviewed files and made site visits to determine if its provisions were being met.

Finally, to determine if authorized officials were signing ASHA grants, we reviewed A.I.D. delegations of authority.

Audit Objective Three

The third audit objective was to determine if A.I.D./ASHA followed A.I.D. policies and procedures in monitoring the performance of the two Foundations. To accomplish this objective we audited the monitoring process for the two grants awarded to the Fudan Foundation and the two grants awarded to the American Hospital in Shanghai Foundation.

After first determining that A.I.D./ASHA did not have formal policies or procedures to follow, we interviewed A.I.D./ASHA officials to determine what is actually done to monitor ASHA grants. To understand what was to be accomplished and, therefore, monitored, all four grants and their amendments were obtained and reviewed. Because reporting was critical to the effectiveness of the monitoring function and because it was required by the grant agreements, we reviewed grantee reports first to determine if they were submitted in a timely manner, and then to determine if they contained required and useful information, e.g., was progress being reported in terms of previously adopted progress schedules, benchmarks, or milestones. ASHA files were then reviewed to determine if receipt of report and A.I.D. comment thereon was documented, and, if reporting had not been forthcoming or was deficient, was A.I.D./ASHA following-up with the Grantees to correct those

problems. Grant terms and ASHA files were also reviewed to determine if self-evaluations were required and prepared.

To determine if A.I.D./ASHA maintained oversight of A.I.D.-financed resources other than by relying upon Grantee reporting, we inquired whether site visits were made either to the Grantees' offices or to the overseas entities being assisted. Documented evidence of such site visits in the form of trip reports was then requested and reviewed. We visited the Grantees' offices and the project sites at the Fudan University and the First People's Hospital in Shanghai, and held discussions with officials of those institutions to determine the utilization of the A.I.D.-financed renovations and associated commodity purchases. In particular, we looked at the utilization of the classrooms, library, computer room, faculty housing facility, the partially completed Center for American Studies, and the two-floor hospital renovation. We judgementally selected commodities bought to furnish and equip those facilities for the purpose of verifying their physical existence. We compared the results of our visit with those reported by ASHA personnel in their trip reports.

To determine if compliance with grant agreement procurement provisions was being monitored, we first reviewed the grants to determine the requirements and interviewed ASHA officials and reviewed supporting documentation in their files to determine if these were being monitored. In particular, we reviewed requirements regarding competition, source/origin/nationality of goods and services or suppliers thereof, and A.I.D. approvals of certain procurement actions.

Although not initially a step in our audit, we determined whether the grant agreements' covenants prohibiting the payment of contingent fees were being complied with and monitored. In doing this, we reviewed memoranda of agreement between the Foundations and their overseas institutions, sought legal counsel, and interviewed A.I.D./ASHA personnel.

Finally, we reviewed grant closeout procedures as contained in A.I.D. Handbook 13, and interviewed A.I.D./ASHA personnel to determine if they had closed out their completed grants in accordance with those procedures or other alternative procedures.

**Criteria for Screening of Applications
for Grants Made by the American Schools and
Hospitals Abroad Program**

(From the Federal Register, November 26, 1979)

Preamble

Pursuant to Section 214 of the Foreign Assistance Act of 1961, as amended, grant assistance is made available to selected schools, libraries, and hospitals overseas founded or sponsored by United States citizens and serving as study and demonstration centers for ideas and practices of the United States and as centers for medical education and research. Grants made under this program help such institutions demonstrate to people overseas the achievements of the United States in education and medicine.

In evaluating requests for assistance A.I.D. will apply the following criteria:

Criterion 1. The applicant should be a nonprofit U.S. organization which either founded or sponsors the institution for which assistance is sought. Preferably, the applicant should be tax-exempt under Section 501 (c) (301) of the Internal Revenue Code of 1954.

The applicant must demonstrate a continuing supportive relationship with the institution. Evidence of this would be the provision of financial and management support for the institution.

Criterion 2. An instruction program must serve the secondary or higher level and must reflect American educational ideas and practice (education at the elementary school level will not be supported).

A school offering a broad-based academic program must include instruction on the history, geography, political science, cultural institutions or economics of the United States. English should be used in instruction or taught as a second language. However, the foregoing subject matter and language requirements need not apply to a school offering a specialized course of study.

Criterion 3. Institutions are expected to reflect favorably upon and to increase understanding of the United States.

Criterion 4. A hospital center, in addition to being a treatment facility, must be involved in medical education and research.

Programs for post graduate training of staff in the United States and programs for the exchange of personnel with American institutions will be regarded as evidence of ability to demonstrate American ideas and practices in medicine.

Criterion 5. The faculty and staff of a school or a hospital center should include a significant number of U.S. citizens or other persons trained in U.S. institutions who are in residence and teaching at the school or hospital center on either a full-time or part-time basis.

Criterion 6. The majority of the users of any institution, e.g. students or patients, must be citizens other than the United States.

Criterion 7. An existing institution must demonstrate competence in professional skills and must exhibit sound management and financial practices. An applicant for a new institution must demonstrate the ability to achieve professional competence and to operate in accordance with sound management and financial practices.

Criterion 8. The institution must be open to all persons regardless of race, religion, sex, color or national origin. (The above shall not be construed to require enrollment of students of both sexes at an educational institution enrolling boys or girls only.) Assistance may not be used to train persons for religious pursuits or to construct buildings or other facilities intended for worship or religious instruction.

Criterion 9. The institution must be located outside the United States and should not be under the control or management of a government or any of its agencies. The receipt of financial or other assistance from a government or government agency or the observance of national educational or medical standards required by the country where the institution is located does not in itself mean that the institution is "under the control or management" of such government.

Criterion 10. An applicant requesting capital construction assistance must provide information sufficient to permit a firm estimate of the total cost to the U.S. Government of the construction for which assistance is requested. Such an applicant must also provide information and assurances with respect to rights to the land on which construction is planned.

Criterion 11. To help achieve the objectives of the Foreign Assistance Act and ensure that the American Schools and Hospitals Abroad Program is as geographically balanced as possible, special consideration will be given to applications for institutions which increase the geographic distribution of the Program and contribute to the economic and social progress of areas that are the focus of A.I.D.'s development efforts.



U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

May 14, 1992

MEMORANDUM FOR IG/A/PSA, Coinage N. Gothard, Jr.

FROM: FHA/ASHA, Howard B. Helman *MM for*

SUBJECT: Draft Report for the Audit of Selected ASHA Grants -
People's Republic of China

Enclosed please find a copy of ASHA's comments on the subject draft report for IG consideration. Also included are two attachments for your review supporting our comments.

Clearance: GC/FHA, S.Tisa *SD* 5/15/92

MM
FHA/ASHA:HHelman:MM:hh:5/14/92:PRC.AUD

COMMENTS ON IG SYSTEMS REVIEW OF ASHA

The Administrator of A.I.D. asked the Inspector General to review grants ASHA has made and proposed to make to the Fudan Foundation and the American Hospital in Shanghai Foundation because of the Administrator's concern about accountability in A.I.D. programs. The Office of the Inspector General decided to use these projects as the basis for a systems audit of the ASHA program. We appreciate the Inspector General's review, both because it has been helpful in identifying critical shortcomings in the grant-projects implemented by the two Foundations, and because it identifies issues ASHA must face in being responsive to A.I.D.'s emphasis on accountability. Although we wish to make the following comments, ASHA accepts the recommendations in the draft audit report except number 9 and the supplemental recommendation regarding vulnerability for the reasons described below.

A. Applicant Selection

1. Political Considerations. A.I.D. considered appropriate policy interests in selecting activities in China for ASHA support during the period audited. The purpose of the ASHA program, as set forth in section 214 of the Foreign Assistance Act (FAA), is to demonstrate American ideas and practices. The opportunity to do so in a communist state like the Peoples Republic of China (PRC), which at the time was viewed as a country which might have been open to change, was considered an important United States objective by both the Appropriations Committees of Congress and the Executive Branch. House and Senate Committee reports contain the following comments about the ASHA program in China, most of which relate to the projects audited:

- H. Rept. 99-747, dated August 5, 1986 states at page 59: "Recent Chinese economic and political reforms provide new opportunities for improved Sino-American relations. The establishment of ASHA sponsored educational activities and other projects in China could help set a firm foundation for improved relations."

- H. Rept. 100-283, dated August 6, 1987, after reviewing its comments made the previous year, states at page 73: "The Committee is very pleased to note that three such model projects have been established and assisted by the AID/ASHA program in FY 1987. The Committee believes these projects merit continued support so that they can build a solid foundation and operate as effective examples of stronger ties between the U.S. and China."

- S. Rept. 100-395, dated June 22, 1988, states at page 116: "The Committee has received very positive reports about the progress of these projects in China. They will serve not only as

demonstration centers for American teaching programs, but also as showcases for American products and services thus creating goodwill and trade opportunities for U.S. business."

- S. Rept. 101-131, dated September 14, 1989, states at page 120: "The Committee believes that the administration was correct in choosing not to suspend funding these [China] programs in the wake of the June 4 crackdown on student supporters of democracy in Tianeman Square. As the Chinese people struggle to regain the freedoms lost that day, the Committee feels it would be tragic for the United States to voluntarily retreat from the constructive role it has played in the country's modernization process."

- S. Rept. 101-519, dated October 10, 1990, states at page 98 regarding FY 1991: "The programs are a crucial link between the people of the United States and the people of China. The Committee believes that these programs are among our most important conduits for explaining American values and ideals to the Chinese citizenry anxious to accelerate the process of modernization in their country."

These foreign policy interests have been shared by the American Embassy in China as well as the Department of State, and ASHA provided funding to all applicants for projects in China during this period. The sponsors for the projects audited made strong representations that they would mobilize major private resources and would have the commitment of the PRC (which they have had). The objectives stated by the Congressional Committees that oversee the appropriation of funds for foreign assistance, which were adopted and shared by the Executive Branch, represent a collaborative effort to achieve the important statutory interests of the ASHA program.

Nevertheless, ASHA agrees with the audit's findings that we should have documented A.I.D.'s reasons for selecting these activities in China, and A.I.D. should have been more rigorous in establishing that these sponsor-grantees had or would obtain the management and financial capability to implement the projects effectively and to achieve these objectives.

2. Selection Procedures. The report concludes that ASHA does not have procedures for selection of applicants. Although we agree that the selection policies and procedures should be improved and documented better, ASHA does have the following policy statements and procedures for selection of grantees, with sample documentation provided in Annex 1:

- a. there are published criteria for selection among applicants;

- b. a standard application form is used to elicit the same kinds of information from all applicants;
- c. ASHA instituted and institutionalized the use of individuals (the majority from outside A.I.D., but also a few A.I.D. staff) to review applications and provide advice about the applicants, the institutions for which assistance is requested, and the projects proposed;
- d. the findings of the reviewers are documented, and there are also end-of-process documents which are established requirements: an action memorandum for approval of activities recommended by ASHA and a Congressional notification.

These action memoranda generally have not been formally "approved", and they have not adequately documented responsible decisionmaking. ASHA will improve and document its policies and procedures as well as A.I.D.'s reasons for grant awards as part of the process of closing this audit.

B. Award and Monitoring Policies and Procedures

Pages 8 and 16 of the draft audit report contain the statements that ASHA did not follow A.I.D. policies and procedures for awarding and monitoring grants. These conclusions are based on ASHA's not adhering to the A.I.D. guidance on these subjects in Handbooks 13 and 3A, but the report also points out that these Handbooks specifically exclude ASHA from their scope. (See pages iii and 8 of the draft report.)

We believe it is appropriate for the audit report to use this A.I.D. guidance as the standard to determine whether ASHA activity in these areas has been prudent and effective since ASHA has not developed and documented formal policies and procedures of its own, these are the standards used by the rest of the Agency, and the draft audit certainly identifies serious shortcomings in ASHA's grantmaking and monitoring. As a technical matter, however, we do not believe it is fair to conclude that ASHA did not comply with policies and procedures which specifically do not apply to the ASHA program.

1. Award of Grants. ASHA procedures have been too informal in the four areas cited in the report (pre-award review of applicants, activity descriptions, cost estimation/negotiating memoranda and financial planning). With reductions in staff and operating expense budgets, manpower constraints have hampered ASHA's ability to be more effective in these areas. There is a special need to address pre-grant award familiarization with new applicants or first-time grant recipients. ASHA has started the following actions:

- a. program funds have been set aside for necessary survey and evaluative work; this will include visits to all the new and first-time grant recipients who rank high enough to be considered for a grant;
- b. the application form has been revised to seek more complete information about financial planning (ASHA already has insisted on revised financial plans or redefinition of project components from a number of 1992 applicants); and
- c. ASHA intends to make fewer grants in 1992 and to ensure that each grant project will have a financial plan with adequate funding identified to complete the project as defined in the grant agreement.

ASHA already has planned to take the following additional measures to improve accountability which has been identified as a strategic objective in the ASHA Strategic Planning Exercise in order to improve performance in this area and in grant implementation. We believe they also will be responsive to the audit findings and recommendations:

(i) a full time staff person is being sought from the Foreign Service Personnel complement, hopefully for six months to one year, to lead the accountability review;

(ii) a purchase order is being prepared to permit site visits to all potential new and first-grant recipients; this will be complemented by desk review of all grantees;

(iii) ASHA is reviewing how it will make adjustments to proposed projects based on the amount of assistance that will be made available to selected applicants and the redefinition of the use of those resources in order to: provide refined description of the activities to be financed (and how they are to be performed) and obtain fuller financial information on the cost of their implementation as well as a financial plan for their completion;

(iv) ASHA is studying how it may best develop activity cost estimates and complement them with the financial planning and a summary of significant events in the grant negotiating process; this will require difficult adjustment in the near term, because of manpower constraints; in the longer term there is better ability to organize ways to increase manpower resources and to tailor the workload to capacities; and

(v) ASHA has acted significantly to expand evaluation and financial review in order to gain insights into performance issues; this will provide valuable feedback about whether and where pre-grant preparations are contributing to implementation problems.

2. **Grant Implementation.** The draft audit concludes that ASHA does not have procedures for specific monitoring functions or internal controls to oversee that performance was occurring in the areas where procedures should have been operative.

There are not two, but three, elements to the management system: (1) procedures that are to be followed; (2) performance in following the procedures; and (3) oversight or controls to monitor compliance. We agree with draft report that internal controls to monitor compliance were lacking. Of the fourteen implementation functions noted in the report, however, we concluded that for perhaps as many as eleven of them, the procedures to be followed were adequately documented in the ASHA grant agreement or in clearly standard and accepted procedures (e.g., that grants need to be closed out), and were well understood (see Attachment 2). In many instances, there was not an absence of procedure, but a failure to adhere to the procedure. ASHA must do more, however, to formalize and document its procedures.

The distinction being made is not splitting hairs. Emphasizing and documenting procedures will not bring about compliance when the problem is manpower, attitude, or the need to develop systems that will improve staff capability to respond to implementation problems. ASHA intends to move strongly to document procedures and to address the practical problem of accommodating workload implications. We recognize that ASHA should identify the Agency's policies and procedures which will be applicable to our program or alternatively that a procedures manual should be developed for ASHA. We wish to reiterate, however, that ASHA follows clearly recognized practices, many of which are documented in the ASHA grant instruments, specifically:

- a. progress schedules for grant implementation;
- b. reporting requirements;
- c. source-origin requirements;
- d. contract and sub-contract approvals; and
- e. grant close-out procedures (although they were not followed).

3. Contingent Fee. GC/FHA informed the IG's Office at the exit conference that ASHA cannot accept recommendation 9 of the draft audit report, which asks A.I.D. to issue a bill of collection to the Foundations for violating the provision in the grant agreement regarding contingent fees, and we request that you delete this recommendation from the report. GC/FHA will not support issuing a bill of collection for the following reasons:

a. It is no longer A.I.D. policy to include a contingent fee provision in its grant agreements. As indicated in the materials provided during the conference, this kind of a clause was deleted from Handbook 13 grants years ago after GC reviewed its statutory basis and concluded that the restriction applied only to contracts, not grants. There is no other administrative requirement for such a provision in grants.

b. The clause in ASHA grants is defective because it does not have the exception, which was contained in Handbook 13 grant agreements, for "bone fide employees or selling agencies maintained by the grantee for securing business". This same exception is in the statutory provision that requires a covenant against contingent fees only in government contracts. 41 U.S.C. § 254(a).

c. The FAR provision implementing this statutory requirement in government contracts contains a definition making it clear that the restriction applies even in contracts only when "improper influence" is used to obtain a contract award, and it means "influence that induces or tends to induce a Government employee or officer to give consideration or to act regarding a Government contract on any basis other than the merits of the matter." This concept is not included in the ASHA clause which does not even address, therefore, the danger that such a clause is designed to prevent.

d. The effort of the Federal Government to deal with "influence" in the award of Federal grants, as well as some contract restrictions, is implemented through the Byrd amendment (31 U.S.C. § 1352) and OMB guidance published in Vol. 55, No. 38 of the Federal Register (dated February 26, 1990) which prohibit the use of appropriated funds to influence grant awards and require only disclosure when other funds are used for that purpose.

e. On its face, the clause in the ASHA grant agreement could violate the first amendment right of speech. The reason the statutory restrictions cited above satisfy first amendment standards is that the provision in 41 U.S.C. § 254 is implemented in the FAR to deal with "improper influence", which the

government certainly has a compelling reason to prevent, and the prohibition in 31 U.S.C. § 1352-a applies only to appropriated funds, the use of which may be conditioned without violating the first amendment.

f. The clause applies to payments made by the grantee to solicit or secure the grant, and not payments made to the grantee by other parties in connection with the grant-project. In addition, this clause does not specifically require a refund, but lists it as one of several remedies available.

For these reasons, GC/FHA is convinced that issuing a bill of collection would be fruitless. The Foundations would properly resist it, and if pressed, this action would result in a lawsuit which the government would not win.

Although not an actionable contingent fee, ASHA is nevertheless concerned that these payments from the PRC may raise significant issues about whether the Foundations are the kinds of founders/sponsors to whom ASHA should be providing assistance based on the expectations they created about their private fundraising capabilities. These are issues for review and determination by Agency management; they do not represent a material non-compliance with provisions of the grant agreement.

ASHA will, of course, consult with GC/FHA about whether claims action is appropriate regarding other apparent violations of the grant agreements by the Foundations identified in the draft audit report when the IG provides the additional information mentioned on page 28 of the draft.

C. Assessment of Internal Controls

The draft audit report also contains a supplemental recommendation calling upon ASHA to perform a comprehensive assessment of internal control weaknesses, reporting material weaknesses in the next report under the Federal Managers' Financial Integrity Act. The audit points out that ASHA did not conduct an Internal Control Assessment for the Office in FY 91 (it was done at the Bureau level) and that a vulnerability assessment has not been conducted in the past five years.

ASHA will undertake major efforts to introduce more effective internal controls during this fiscal year and will conduct an internal control assessment at the end of the fiscal year. ASHA does not anticipate performing a vulnerability assessment this year, because a reasonable time is needed to put the procedures in place against which vulnerability should be measured. ASHA views the internal control assessment as the

appropriate exercise through which to report on material weaknesses which may continue to exist. We would appreciate your revising the recommendations in the final report to reflect these actions ASHA has planned and this schedule.

HH4.SRT--5/13/92

- ATTACHMENT I: ASHA DOCUMENTS REGARDING SELECTION PROCEDURES
- Attachment 1A: List of Grants Proposed fy FY 1987
- Attachment 1B: Memorandum for File from David Santos
Resulting from 3/4/87 Meeting With A/AID
- Attachment 1C: Changes in ASHA FY 1987 Program Recommendations
Resulting From Discussion With A/AID 3/9/87
- Attachment 1D: Guidelines for Reviewers in Evaluation of
ASHA Applications - Recent Update
- Attachment 1E: Information Memorandum to Administrator
March 18, 1983, Evaluation of FY 1983
Applications.

Office of the Inspector General Note: Except as acknowledged in the audit report, the above do not constitute formal policy statements and procedures for selection of grantees. Therefore, these sometimes lengthy documents were not considered necessary for inclusion.

ATTACHMENT 2: AREAS OF DEFICIENCY
PROCEDURE VS. IMPLEMENTATION FAILURE

Attachment 2
FHA/ASHA AUDIT by I

ATTACHMENT # 2 - Areas of Deficiency - Procedure vs. implementation failure

There are many areas of questioned performance which are cited. These are presented below with indication of whether the problem was one of absence of procedure or performance in implementation:

<u>item</u>	<u>proc.</u>	<u>imp.</u>
1. failing to document why the decision was made to make grants to the China projects		x
2. not signaling omission, late arrival or insufficiency of required reporting		x
3. not recognizing that construction sub-contractors were neither Chinese nor U.S.		x
4. not insisting on approving the construction contractor and contract initially		x
5. not monitoring more closely documentary information which would have shown source-origin in commodity procurement		x
6. not recognizing that the payments arrangement by the Chinese Municipal Health Bureau to the sponsors raised concerns under the contingent fee provision [see discussion of contingent fee provision below]		x
7. not insisting on a financial plan which would assure that resources required to complete construction were committed to the project	x	
8. not determining that prospective recipients have the management, financial and technical capabilities before awarding the grant [note: ASHA criteria need to be strengthened on this point; ASHA needs to establish a pre-grant review which is either a desk review or a pre-audit visit or survey or both]	x	
9. not making findings about the reasonableness of the negotiated costs and documenting them [note: this includes obtaining sufficient cost information in proposals or before awarding the grant; doing cost estimation, documenting cost analysis, including a field pricing report, and providing written findings -- ASHA has procedure; which were not fully followed, but which need to be strengthened]	x	x
10. prepare a memorandum of negotiations for		x

grant agreements

- | | |
|--|---|
| 11. not providing specific enough language in the scope of work to set clear boundaries for the project and provide target and time related benchmarks for performance | x |
| 12. close out grant agreements | x |
| 13. provide back-up documentation for source-origin waivers | x |
| 14. failure to assure use of AID emblems | x |