PD-ABF-643

Regional Inspector General for Audit
Bonn

Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

Report No. 8-180-93-03
March 31, 1993

INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Agency for International Development
Washington, D.C. 20523

Assistant Inspector General
for Audit

March 31, 1993

MEMORANDUM FOR ACTING DAA/EUR, Frank Almaguer

FROM: AIG/A, Richard C. Thabet Richard C Thabet

SUBJECT: Audit Report, Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

Attached are ten copies of our audit report on Grants and Cooperative Agreements Under the Economic Restructuring Component, Audit Report No. 8-180-93-03.

We have reviewed your comments to the draft report and included them as Appendix II to this report. We also acknowledge receipt of the representation letter that you provided and which we found meets the need of this audit.

Based on your comments and cited actions, Recommendation Nos. 4.2 and 4.3 are closed upon report issuance. Recommendations Nos. 1, 2, and 4.1 are resolved and can be closed upon receipt by this office of evidence that the actions cited by your comments are complete. The remaining recommendations in the report (Recommendation Nos. 3 and 5) do not concern your office.

Please provide us information within 30 days indicating actions planned or taken to implement the open recommendations. I appreciate the courtesies provided to my staff during the audit.

Attachment: a/s

Agency for International Development
Washington, D.C. 20523

Assistant Inspector General
for Audit

March 31, 1993

MEMORANDUM FOR FA/OP, Frederick A. Will

FROM: AIG/A, Richard C. Thabet

SUBJECT: Draft Audit Report, Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

Attached are five copies of our audit report on Grants and Cooperative Agreements Under the Economic Restructuring Component, Audit Report No. 8-180-93-03.

We have reviewed your comments to the draft report and included them as an appendix to this report. We also acknowledge receipt of the representation letter that you provided and which we found meets the need of this audit.

Based on your comments and cited actions, Recommendation No. 5 is resolved upon report issuance and can be closed upon completion of the action cited in your response to the draft report. The remaining recommendations in the report do not directly concern your office.

Please provide your response within 30 days concerning actions taken or planned to implement Recommendation No. 5. I appreciate the courtesies provided to my staff during the audit.

Attachment: a/s

Agency for International Development
Washington, D.C. 20523

Assistant Inspector General
for Audit

March 31, 1993

MEMORANDUM FOR FA/FM/CONT, Michael G. Usnick

FROM: AIG/A, Richard C. Thabet

SUBJECT: Draft Audit Report, Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

Attached are five copies of our audit report on Grants and Cooperative Agreements Under the Economic Restructuring Component, Audit Report No. 8-180-93-03.

We have reviewed your comments to the draft report and included them as an appendix to this report. We also acknowledge receipt of the representation letter that you provided and which we found meets the need of this audit.

Based on your comments and cited actions, Recommendation No. 3 is closed upon report issuance. The remaining recommendations in the report do not concern your office.

I appreciate the courtesies provided to my staff during the audit.

Attachment: a/s

C

EXECUTIVE SUMMARY

Background

As of March 31, 1992, A.I.D.'s Bureau for Europe had awarded 45 grants and cooperative agreements under the Economic Restructuring Component of the Support for East European Democracy (SEED) Act. Activities under the Economic Restructuring Component were to promote the development of free market economic systems. The 45 agreements had obligations and disbursements, as of March 31, 1992, totalling about $72.0 million and $10.4 million, respectively.

A grant or cooperative agreement is in the nature of a gift in support of an agreed-upon purpose. As such, the grant or cooperative agreement is awarded to support a nongovernmental organization whose program activities are consistent with A.I.D.'s own objectives. A cooperative agreement differs from a grant in that it is characterized by A.I.D.'s more direct involvement in the performance of the recipient's program.

Audit Objectives

We audited grants and cooperative agreements under the Economic Restructuring Component in accordance with generally accepted auditing standards. Our field work was conducted from May 5, 1992 through December 11, 1992 to determine whether the Bureau for Europe, the Office of Financial Management, and the Office of Procurement, as appropriate, were following A.I.D. policies and procedures, as modified for Central and Eastern Europe, for (1) planning; (2) awarding; (3) obligating, expending, and accounting; and (4) monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component.

Summary of Audit

The Bureau for Europe, the Office of Financial Management, and the Office of Procurement were following A.I.D. policies and procedures, as modified for Central and Eastern Europe, in planning, awarding, obligating, expending, and accounting for grants and cooperative agreements under the Economic Restructuring Component. For example, the Bureau for Europe, Office of Procurement, or the Office of Financial Management, as appropriate:

- properly approved and authorized the agreements in the audit sample;
- selected the proper assistance instrument;
- determined that costs were reasonable and included appropriate audit requirements in the grants and cooperative agreements;
- assured that amounts obligated did not exceed budget allowances or funds reservations;
- accurately entered fund reservation, obligation, and expenditure data into the accounting system; and
- introduced an evaluation system.

However, the Bureau for Europe was not following A.I.D. policies and procedures, as modified for Central and Eastern Europe, in (1) seeking competition, (2) including mandatory cost-sharing provisions in grants and cooperative agreements, or (3) monitoring grants and cooperative agreements under the Economic Restructuring Component. In addition, the Office of Financial Management was not ensuring that project officers administratively approve financial reports on liquidation of advances.

Audit Findings

Need to Enhance the
Competitive Environment

Although A.I.D. procedures require that competition be sought to the maximum possible extent, the audit determined that the process of awarding grants and cooperative agreements was not competitive. The Bureau for Europe competed only two of nine applicable agreements. Further, the Bureau's justification for waiving competition was inadequate in three other cases. The Bureau did not seek competition because it wanted to implement the program quickly and because legislation sometimes earmarked funding to a specific recipient. As a result, the Bureau's planning process excluded other potential approaches and possibly increased costs for awards totalling about $17.5 million (see pages 7 to 10).

Need to Formally Address
Cost-Sharing Provisions

Agency procedures require that authorizing officials either ensure that recipients share in project costs or waive cost sharing. The audit determined, however, that for five of nine agreements for which cost sharing was applicable, the Bureau neither required nor waived cost sharing. This occurred because cost sharing was a low priority to the Bureau for Europe and the Office of Procurement did not ensure that cost sharing was used. Had the awards to the five recipients included the suggested 25 percent cost-sharing arrangement, the recipients would have been required to provide about $5.7 million towards their assistance agreements (see pages 11 to 14).

Need to Improve Controls Over
Administrative Approval Of Vouchers

A.I.D. procedures require that, as part of the internal control process, project officers administratively approve use of Agency funds. The Agency's financial files, however, showed that the project officers had not administratively approved 41 of 46 financial reports that showed liquidation of advances obtained under the letter-of-credit system. As a result, advances totalling approximately $17.5 million were liquidated without ensuring that the A.I.D. official most familiar with the agreement was reviewing use of the funds (see pages 16 to 17).

Need to Improve Performance Monitoring

The Bureau for Europe did not follow A.I.D. procedures for monitoring grants and cooperative agreements in several important respects, such as reviewing workplans and reports and visiting implementing activities. This occurred because of organizational immaturity, project proliferation, and the project officers' distance from program implementation. Ineffective monitoring could result in some implementation activities not accomplishing planned results or increase the potential for abuse, which may have occurred with the International Executive Service Corps in Hungary (see pages 19 to 26).

Summary of Recommendations

This report contains five recommendations to strengthen the Bureau for Europe's, the Office of Procurement's, and the Office of Financial Management's controls over grants and cooperative agreements, including recommendations to establish procedures to ensure that:

- competition is sought unless a waiver is fully justified (see page 7);
- cost sharing is required or waived (see page 11);
- project officers administratively approve financial reports detailing use of advances (see page 16);
- recipients provide country-specific implementation plans, and project officers and A.I.D. Representatives work together in the monitoring effort (see page 19); and
- the International Executive Service Corps' agent in Hungary is no longer being reimbursed for finders' fees (see page 19).

The above recommendations concerning competition, cost sharing, recipients providing country-specific implementation plans, and the International Executive Service Corps are resolved upon report issuance. The recommendations on administrative approval and making sure that project officers and A.I.D. Representatives work together in monitoring are closed on report issuance.

Management Comments and Our Evaluation

The Bureau for Europe, Office of Procurement, and the Office of Financial Management generally agreed with the report's findings and cited actions that they had either planned or taken in response to the report's recommendations.

We considered the Bureau for Europe's, the Office of Procurement's, and the Office of Financial Management's comments in preparing this final report. Their comments are included in their entirety as Appendices II, III, and IV, respectively, to the final report.

Office of the Inspector General

Office of the Inspector General
March 31, 1993

Eastern Europe

Central and Eastern Europe

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INTRODUCTION

Background

U.S. economic assistance to Central and Eastern Europe is provided under the Support for Eastern European Democracy Act of 1989 (the SEED Act). A.I.D. management of the assistance effort is centralized in Washington, D.C. Under this centralized management structure, much of the A.I.D. work, which is normally performed at overseas missions, is performed by the Bureau for Europe and the Regional Mission for Europe which are co-located in Washington. Thus, most planning, procuring, accounting and monitoring is performed from Washington. A limited number of A.I.D. direct-hire staff is located in Offices of A.I.D. Representatives in European countries to primarily coordinate the in-country assistance and provide support to the A.I.D./Washington staff.

Projects being implemented under the SEED Act fall into one of three program components:

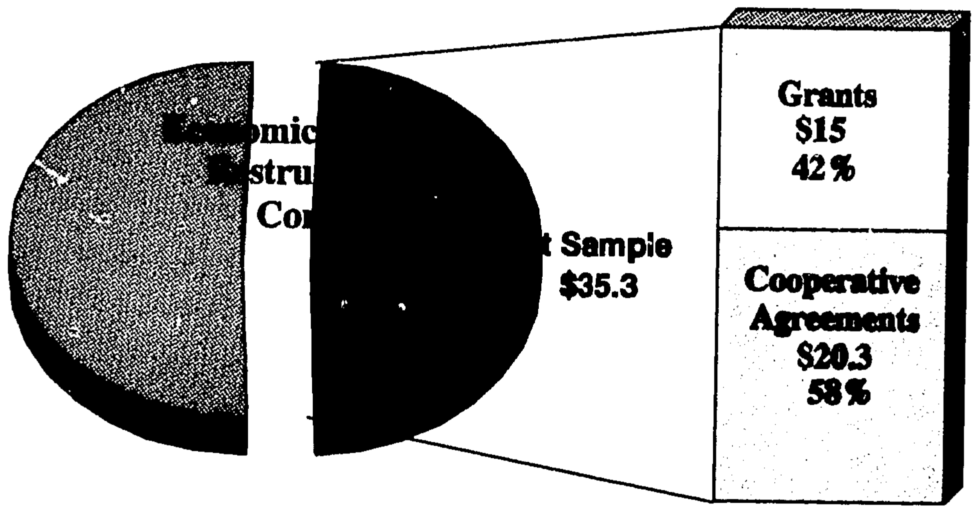
- Strengthening Democratic Institutions,
- Economic Restructuring, and
- Quality of Life.

This audit involves grants and cooperative agreements awarded under the Economic Restructuring Component, which was established to promote the development of free market economic systems.

A grant or cooperative agreement is in the nature of a gift in support of an agreed-upon purpose. As such, the grant or cooperative agreement is awarded to support a nongovernmental organization whose program activities are consistent with A.I.D.'s own objectives. In this regard, A.I.D. is supporting a program designed and implemented by a nongovernmental organization. This program may be designed in response to an A.I.D. request or it may be an unsolicited proposal which A.I.D. finds worth supporting. A cooperative agreement differs from a grant in that it is characterized by A.I.D.'s involvement in the performance of the recipient's program.

From the beginning of the 1989 SEED Act through March 31, 1992, A.I.D.'s Bureau for Europe had awarded 45 grants and cooperative agreements to non-governmental and international organizations with obligations and disbursements totalling about $72.0 million and $10.4 million, respectively, to support projects under the Economic Restructuring Component of the SEED Act. The following charts show a profile of the grants and cooperative agreements administered by the Bureau for Europe under the Economic Restructuring Component during the period, as well as the size of the audit sample:

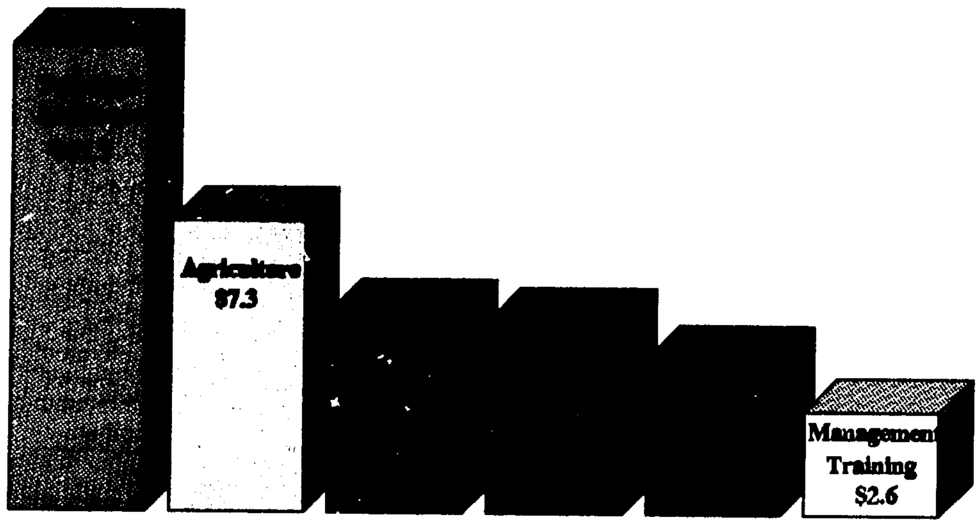
U.S. Assistance to Central and Eastern Europe
Grants and Cooperative Agreements
Audit Sample in Millions of Dollars
(as of March 31, 192)



The Audit Sample Represents 49 % of the Dollars in the Audit Universe

Source: Bureau for Europe listing of grants and cooperative agreements active as of March 31, 1992. Data pertaining to the audit sample were audited, the remaining data were not audited.

U.S. Assistance to Central and Eastern Europe
Awards in the Audit Sample by Project
Economic Restructuring Component



Audit Sample = $35.3 Million Dollars

Source: Bureau for Europe listing of grants and cooperative agreements active as of March 31, 1992. Data were audited.

Audit Objectives

Based on the Inspector General's Fiscal Year 1992 Audit Plan, we audited grants and cooperative agreements under the Economic Restructuring Component to answer the following audit objectives:

1. Did the Bureau for Europe follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in planning grants and cooperative agreements under the Economic Restructuring Component?

2. Did the Bureau for Europe and the Office of Procurement follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in awarding grants and cooperative agreements under the Economic Restructuring Component?

3. Did the Bureau for Europe and the Office of Financial Management follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in obligating, expending, and accounting for grants and cooperative agreements under the Economic Restructuring Component?

4. Did the Bureau for Europe follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component?

Our audit tests were sufficient to provide reasonable--but not absolute--assurance in answering the audit objectives and detecting abuse or illegal acts that could affect the audit objectives. Appendix I contains a complete discussion of the scope and methodology for the audit.

REPORT OF AUDIT FINDINGS

Did the Bureau for Europe follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in planning grants and cooperative agreements under the Economic Restructuring Component?

The Bureau for Europe followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in planning grants and cooperative agreements under the Economic Restructuring Component.

The audit determined that the Bureau for Europe did several important things well concerning the planning process. For example:

- The Bureau followed the Action Plan (which provided A.I.D. procedures for implementing the SEED Act) in approving and authorizing the grants and cooperative agreements in the audit sample.

- The grants and cooperative agreements were supported by project decision papers that were consistent with the Action Plan and the SEED Act.

- Concerning the authorization process, 10 of the 12 grants and cooperative agreements reviewed were addressed by a project memorandum, as was required by the Action Plan.

- The audit also determined that the project implementation orders used by the Bureau to describe the nature of the proposed grant or cooperative agreement (1) were consistent with the project memorandum and (2) had been approved by appropriate officials.

The above actions resulted in grants and cooperative agreements that had been planned in accordance with Agency procedures, as modified for Central and Eastern Europe.

Did the Bureau for Europe and the Office of Procurement follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in awarding grants and cooperative agreements under the Economic Restructuring Component?

The Bureau for Europe and the Office of Procurement followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in awarding grants and cooperative agreements under the Economic Restructuring Component, except that the Bureau and the Office of Procurement needed to enhance the competitive environment and formally consider the need for cost sharing.

The audit determined that the Bureau for Europe and the Office of Procurement followed A.I.D. Handbook 13 provisions in several respects. The Bureau for Europe and the Office of Procurement used the appropriate award mechanism (grant or cooperative agreement) in awarding grants and cooperative agreements. Further, the Office of Procurement (1) determined that costs were reasonable when required, and (2) included appropriate audit requirements in grants and cooperative agreements. Finally, the Office of Procurement generally followed A.I.D. procedures in determining that recipients were qualified to carry out the assistance agreement (although, as discussed under separate cover, some of the reviews of qualifications could have been more substantive).

Our audit, however, identified two areas needing improvement. The Bureau for Europe, in coordination with the Office of Procurement, needed to:

- enhance the competitive environment, and
- formally address cost-sharing provisions.

These subjects are discussed in more detail below.

Need to Enhance the
<u>Competitive Environment</u>

A.I.D. procedures require that competition be used to the maximum extent possible or that it be waived when not used. The audit determined, however, that the process of awarding grants and cooperative agreements was not very competitive in that (1) the Bureau competed only two of nine agreements subject to competition, and (2) the Bureau's justification was inadequate in three of six cases where it waived competition. Use of competition was hampered by the Bureau's desire during the early stages of the SEED Program to implement the program quickly and by limitations imposed by legislative language. The result was that the Bureau excluded other possible approaches and potentially increased costs for awards totalling about $17.5 million.

> **<u>Recommendation No. 1</u> We recommend that the Director, Bureau for Europe, in coordination with the Office of Procurement, formalize procedures in a mission order that (1) emphasizes the importance of seeking competition unless a waiver is fully justified and (2) requires that formal management review processes, such as project authorization, examine the planning and need for competition.**

A.I.D. Handbook 13, Chapter 2, states that competition should be used to the maximum practicable extent when awarding grants or cooperative agreements. The Handbook prescribes five circumstances[1] under which competition is not required; however, for these circumstances to apply, the technical office (in this case the Bureau for Europe) must justify the exception in writing and provide sufficient evidence to clearly show that the exception was proper. Handbook 13 states further in Chapter 5 that competition is not required for awards to public international organizations.

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[1] The five circumstances are (1) proposals not solicited by A.I.D. that are unique, innovative, or proprietary; (2) awards for which one recipient is considered to have exclusive or predominant capability; (3) amendments to existing assistance awards; (4) follow-on assistance awards intended to continue or further develop an existing assistance relationship; and (5) other circumstances considered to be critical to the objectives of the foreign assistance program.

The audit determined that the Bureau did not consistently follow the above requirements. Of the nine agreements in the audit sample subject to competition:

- Two grants were awarded competitively following appropriate procedures for technical review, negotiation, and award.

- A.I.D.'s Office of Procurement awarded six grants or cooperative agreements noncompetitively, primarily on the basis of waivers prepared by the Bureau for Europe. As discussed below, we believe that the justification for three of these six awards did not provide sufficient evidence to clearly show that the exception was proper.

- The Bureau for Europe justified one grant for noncompetitive award on the basis that it was made to a public international organization. However, as discussed below, the recipient has not been officially designated as a public international organization.

As stated above, three of six noncompetitive awards in the audit sample were based on waivers prepared by the Bureau for Europe that did not satisfy the Handbook 13 provision to require sufficient evidence to clearly show that the waiver was proper.

- The Bureau originally justified the waiver of competition for the Cooperative Agreement with the International Executive Service Corps (IESC), on IESC's presumed "exclusive or predominant capability, based on experience, specialized facilities or technical competence." However, the Bureau presented no evidence of IESC's predominant capability. In fact, the Bureau's files actually showed that it had planned to award the agreement to IESC all along. The minutes of the November 29, 1990 meeting held to discuss the project authorization clearly showed that the Bureau had already decided to award the agreement to IESC.

  Having already awarded the initial cooperative agreement to IESC, the Bureau continued to waive amendments thereto on the basis of the fact that IESC already had an existing award. This was so even though one of the amendments--for the Defense Conversion Initiative--was for a subject matter far different than the initial cooperative agreement. Through March 31, 1992, a total of $11.7 million had been awarded to IESC noncompetitively under terms of its original cooperative agreement.

- The Bureau justified the noncompetitive award to **Georgetown University** based on the "language in the appropriate section of the FY 1990 Appropriations Act which states that 'funds appropriated under this heading shall be made available for the [Georgetown University's] International Student Exchange Program **notwithstanding any other provision of law**'" (emphasis added). Thus the Bureau did not base the noncompetitive award to Georgetown on A.I.D. Handbook 13 waiver provisions, but on the notwithstanding other provisions of law clause. The Bureau should have applied A.I.D. Handbook 13 provisions for waiving competition rather than relying on the other provisions of law clause, which we believe should be reserved for use only under extraordinary or unusual circumstances.

- The Bureau did not waive competition in amending its grant with Agricultural Cooperative Development International (**ACDI**). Instead the Bureau amended the existing grant with ACDI quickly, without a waiver, even though the subject matter for the amendment was far different that the original grant.

In addition, the Bureau justified an award to International Energy Agency (**IEA**) based on the fact that it was an affiliate of an entity that was designated as a public international organization. However, IEA itself had not yet been designated as a public international organization. Therefore, it was not appropriate for the Bureau to award a grant to IEA without seeking or waiving competition.

The Bureau did not use competition extensively because, early during SEED Program implementation, it wanted to implement the Program quickly rather than taking the extra time to seek competition. For example, the Bureau quickly amended an existing grant with ACDI in order to address a perceived need for technical assistance in Hungary.

An additional reason for not seeking competition was that Congress earmarked assistance to two of the recipients in the audit sample, as follows:

- the SEED Act specifically cited IESC as an example of an organization to provide technical assistance to the people of Hungary and Poland. According to Bureau personnel, IESC enjoyed excellent relationships with both the Congress and State Department, and the Office of the Coordinator made it clear that IESC would be part of the SEED Program activities.

- The cooperative agreement with Georgetown University was based on language in the Fiscal Year 1990 Appropriations Act which specifically cited Georgetown's International Student Exchange Program.

As a result of not seeking competition more fully, the Bureau excluded other potential approaches of providing assistance to Central and Eastern Europe. Further, by not looking for lower-cost alternatives, the Bureau potentially increased costs for awards totalling about $17.5 million.

In conclusion, a lack of competition was understandable in the early stages of SEED Program implementation. However, now that the program is maturing, the Bureau for Europe and the Office of Procurement should move toward competition and stronger justification, where appropriate, for waiving competition.

Management Comments and Our Evaluation

The Bureau for Europe generally agreed and stated that it had already moved toward increased competition. The Bureau also said that the Regional Mission for Europe will prepare a mission order to clearly state the policy of using competition to the maximum extent possible and require a justified waiver in all cases where competition is not sought.

However, with respect to the award to Georgetown University, the Bureau stated that it used the best alternative for justifying that award. The Bureau stated that it reviewed all potentially applicable criteria in Handbook 13 but found none truly applicable. As the award to Georgetown was derived from a Congressional earmark, the Bureau said that under the circumstances it believed the notwithstanding authority was a more valid basis for waiving competition than using the provisions of Handbook 13, which the Bureau believed could prove difficult to defend.

Although the notwithstanding clause provided a stronger basis for waiving competition, we continue to believe that Handbook 3 provides an adequate basis for waiver and that the notwithstanding clause should be reserved for use only under extraordinary circumstances.

Based upon management's proposed action, Recommendation No. 1 is resolved upon report issuance. The recommendation may be closed upon completion of the above-cited action.

Need to Formally Address
Cost-Sharing Provisions

A.I.D. Handbook No. 1 requires that Agency activities either ensure that recipients share in project costs or that authorizing officials waive the requirement for cost sharing. The audit determined, however, that for five of nine agreements for which cost sharing was applicable, there was neither a cost-sharing arrangement nor a waiver of cost sharing. This occurred because Bureau officials did not consider cost sharing as a high priority and because the Office of Procurement did not help ensure that agreements include appropriate cost-sharing arrangements. Had the awards to the five assistance recipients included a 25 percent cost-sharing arrangement, the assistance recipients would have been responsible for providing about $5.7 million towards the projects.

> Recommendation No. 2: **We recommend that the Bureau for Europe, in consultation with the Office of Procurement, establish procedures to make sure that A.I.D. Handbook 1 provisions either requiring cost sharing for grants and cooperative agreements or waiving the requirements on a case-by-case basis are followed.**

A.I.D. Handbook 1, Policy Determination 16, states that "assistance activities should be designed and agreements negotiated to incorporate the largest reasonable and possible financial participation of the recipient in financing a project, except where this is determined not to be appropriate in the judgement of the A.I.D. official authorizing the assistance activity." The Policy Determination states further that this policy applies to **all** assistance provided by the Agency to nongovernmental organizations and that 25 percent financial participation is a useful reference point in designing and negotiating agreements.

The grants and cooperative agreements awarded under the Economic Restructuring Component were all made to nongovernmental organizations. Therefore, Policy Determination 16 is potentially applicable to all 12 grants and cooperative agreements in our audit sample. However, three grants and cooperative agreements in our sample were made to public international organizations. As A.I.D. Handbook 1 specifically exempts these organizations from having to provide a portion of project costs, only 9 of the 12 agreements in our audit sample were subject to cost sharing.

This audit determined, however, that cost sharing was not used or waived for five of the nine grants and cooperative agreements examined subject to cost sharing. Further, planning documentation for the five awards did not justify not using cost sharing. The five awards for which cost sharing was applicable--but was not used--follow:

- **Georgetown University** strongly resisted cost sharing and the Bureau reluctantly agreed to exclude a cost-sharing provision that would have required that Georgetown provide $269,000 towards the International Student Exchange Program. The Bureau intended that the $269,000 be used for enrolling an additional ten students in Georgetown's Management Training Program (the subject of the cooperative agreement). As of June 30, 1992, Georgetown had not reported any contributions toward the exchange program.

- The Bureau originally planned that the cooperative agreement with the International Executive Service Corps (IESC) would include cost-sharing provisions. However, according to Office of Procurement officials, IESC resisted cost sharing and was able to persuade the Bureau to agree to a non-mandatory provision that IESC was to provide contributions of some $28.7 million (including the value of volunteers' time) to the activities being carried out under its cooperative agreement, which at that time called for planned A.I.D. funding of about $20.6 million. IESC was to provide this amount on a "best effort" basis. Although IESC, through the efforts of volunteers and from other sources, was undoubtedly contributing extensively, as of March 31, 1992, it had reported contributions of only $566 towards the program.

- The Bureau also did not require cost sharing for a grant to the Volunteers in Oversees Cooperative Assistance (VOCA) totalling about $5.2 million or for a $686,680 amendment to an Agricultural Cooperative Development International (ACDI) grant.

- The Bureau did not use cost sharing for a $200,000 grant to the International Energy Agency (IEA), as the Bureau considered IEA to be a public international organization.

By contrast, cost sharing was used for four awards with planned funding totalling about $9.7 million. These four awards[2] included cost-sharing requirements for about $2.8 million, or about 28 percent of the planned funding.

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[2] The four awards were to Iowa State University, the National Cooperative Business Association, the United States Energy Association, and the State University of New York.

One of the factors contributing to A.I.D.'s cost-sharing policy not being implemented was the environment in which many of the awards were planned and implemented. According to Bureau officials, given the pressure to get the SEED Program implemented quickly, the Bureau did not consider cost sharing to be a high priority. Our audit found that the Bureau's normal review process, including project authorization and project implementation order review and approval, did not focus on the issue of cost sharing, mainly due to the premium the Bureau placed on getting the SEED Program implemented as quickly as possible.

Another reason that cost sharing was not formally required was the fact that the Office of Procurement permitted the awards to be made without mandatory cost-sharing provisions. The Office of Procurement considered cost sharing to be a prerogative of the Bureau for Europe. Further, the Office of Procurement stated that it did not know that cost sharing was required, as A.I.D. Handbook 13 did not specifically require cost sharing.

Since the Office of Procurement is involved in reviewing the Bureau's planning documentation prior to the actual award of the instrument, it is uniquely poised to review cost-sharing provisions or waivers thereof. Accordingly, we believe that the Bureau for Europe should consult with the Office of Procurement when introducing procedures to either require cost sharing or waive the requirement.

The effect of not having a cost-sharing provision in the planning documentation for the recipients in our audit sample was to exempt approximately $22.8 million from the requirement for cost sharing. Based upon suggested cost-sharing of 25 percent of total funding, the exclusion of mandatory cost-sharing provisions for the Georgetown, IESC, VOCA, ACDI, and IEA agreements effectively eliminated the requirement that these five activities track and report on contributions totalling some $5.7 million.

Management Comments and Our Evaluation

The Bureau for Europe stated that it will prepare a mission order requiring, for each future grant, that a determination be made whether or not to include cost sharing. The Bureau stated further that the Regional Mission for Europe Program Development Office will be given the responsibility for ensuring compliance with this requirement.

The Office of Procurement stated that it would cooperate with the Bureau for Europe in implementing Recommendation No. 2.

The above action resolves Recommendation No. 2. To close the recommendation, the Bureau should require that it coordinates the determination on the use of cost sharing with the Office of Procurement, when appropriate.

Did the Bureau for Europe and the Office of Financial Management follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in obligating, expending, and accounting for grants and cooperative agreements under the Economic Restructuring Component?

The Bureau for Europe and the Office of Financial Management followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in obligating, expending, and accounting for grants and cooperative agreements under the Economic Restructuring Component, except that the Office of Financial Management did not establish procedures to ensure that project officers in the Bureau for Europe administratively approve vouchers.

The audit determined that, with respect to the 12 agreements in the audit sample, the Bureau for Europe and the Office of Financial Management followed A.I.D. Handbook 19 provisions in the following:

- The Bureau properly prevalidated funds by recording budget allowances and fund reservations before funds were obligated.
- Amounts obligated by the Office of Financial Management did not exceed budget allowances or fund reservations.
- The Office of Financial Management accurately entered fund reservation, obligation, and expenditure data into the accounting system.
- The Office of Financial Management used valid and binding documents to support the transactions entered into the accounting system.

Our audit, however, identified an area needing improvement. The Office of Financial Management needs to establish procedures to ensure that project officers in the Bureau for Europe administratively approve financial reports detailing utilization of advances and return signed copies to the Office of Financial Management for filing. This problem area is discussed in more detail below.

Need to Improve Controls Over
<u>Administrative Approval Of Vouchers</u>

A.I.D. Handbooks 3 and 19 require that project officers administratively approve use of Agency funds. The audit determined, however, that Office of Financial Management and Bureau for Europe files did not show that the project officers had administratively approved most reports pertaining to advance utilization for applicable agreements in the audit sample. This occurred because, at the time of the audit, the Office of Financial Management did not have a system to ensure that vouchers were administratively approved and returned for filing. As a result, disbursements totalling approximately $17.5 million were made without ensuring that the A.I.D. official most familiar with the agreement reviewed fund utilization.

> **<u>Recommendation No. 3:</u> We recommend that the Office of Financial Management establish procedures to ensure that project officers administratively approve vouchers submitted under the letter-of-credit system.**

Administrative approval of fund utilization by project officers is an integral part of A.I.D.'s fund control process. A.I.D. Handbook 19, Chapter 3 states that project officers represent A.I.D.'s interest during all phases of project operations and are concerned with ensuring the prudent and effective utilization of U.S. resources. Handbook 19 states further that, for grants and cooperative agreements, administrative approval requires that project officers state that they have reviewed fund utilization and supporting documentation and, based on that review and their personal knowledge of the project, see no reason to withhold payment. According to the Handbook, the involvement of the project officer in the payment process strengthens A.I.D.'s management system.

Nine of twelve recipients in our audit sample received their funds through the Treasury letter-of-credit system. Under this system, the Office of Financial Management provides advances to recipients to finance project activities. The recipients then periodically report to the Office of Financial Management on the use of those funds. The Office of Financial Management sends the financial reports on advance use, under cover of a voucher, to project officers throughout the Agency for their administrative approval. Thus, under the letter-of-credit system, project officers provide their administrative approval **after** recipients receive their funds. Nevertheless, the project officers' administrative approval is an important internal control technique in the disbursement process, as only project officers can reasonably have detailed knowledge of recipients' operations under the grants and cooperative agreements.

The audit determined, however, that the Office of Financial Management's files did not contain evidence that project officers had administratively approved most of the vouchers pertaining to our audit sample. Specifically, the Office of Financial Management did not have on file 41 of the 46 vouchers that had been submitted by the recipients in the audit sample. The 41 reports amounted to approximately $17.5 million, or 88 percent of the $19.8 million in outlays reported by the recipients.

The Bureau's records indicated that project officers may have approved more vouchers than the Office of Financial Management had on file. The system used by the Bureau for Europe's Controller to monitor the administrative approval process showed that 19 of the 46 vouchers had been logged-in by the Controller, indicating that the project officers may have received at least 19 of the 46 vouchers. Therefore, it was unclear whether the Office of Financial Management, the Bureau for Europe Controller, or the project officers themselves had not processed the vouchers.

It appeared that both the Office of Financial Management and the Bureau for Europe needed procedures to track the vouchers. In response to this need, the Office of Financial Management, in July 1992, initiated action to implement an improved system for tracking vouchers under the letter-of-credit system. Similarly, the Bureau for Europe's Controller also implemented a procedure, now described in Mission Order 303, whereby they track and file vouchers submitted for administrative approval.

However, as the Bureau's system can control only what it receives from the Office of Financial Management, we believe that the latter's system should ensure that the vouchers are administratively approved and returned for filing.

Management Comments and Our Evaluation

The Office of Financial Management agreed with Recommendation No. 3 and provided a copy of procedures for the voucher tracking system that they introduced in July 1992.

Based upon management's response and our review of the attached procedures, Recommendation No. 3 is closed upon report issuance.

Did the Bureau for Europe follow A.I.D. policies and procedures, as modified for Central and Eastern Europe, in monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component?

Although some improvements were noted, the Bureau for Europe did not follow A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component.

The audit determined that the Bureau for Europe had made some progress toward improving its monitoring system. In accordance with Office of Management and Budget Bulletin A-110 and A.I.D. Handbook 13, the grants and cooperative agreements in the audit sample generally required periodic reports that compared progress against established goals. The audit also found that recipients were generally submitting the reports required by their grant or cooperative agreement. In addition, the Bureau had either completed or had in progress several mission orders on such topics as (1) the role of project officers and the A.I.D. Representatives and (2) controlling unsolicited proposals.

The Bureau for Europe has also introduced an evaluation plan. According to Bureau personnel, evaluations under the plan started on January 25, 1993. The plan includes two types of evaluation: sector evaluation and project evaluation. Bureau personnel believe that evaluation under the plan will be adequate to determine the recipients' progress toward achievement of grant purposes and to measure the grantees' impact on the broader development of the sectors in which they are working.

Despite these positive findings on the Bureau's monitoring and evaluation systems, the audit determined that:

- The Bureau was not yet effectively monitoring the progress of SEED Program activities (see below).

- The Bureau's evaluation plan may not adequately determine whether foreign assistance targets were being accomplished. Although the plan represents a significant effort, the plan does not include methodology for defining goals, determining factors to be measured to meet the goals, or setting targets against which progress can be measured (these factors are to be developed by the evaluators). Further, the Bureau's evaluation system may devote too few resources to evaluation. Nevertheless, we are not making a recommendation concerning the evaluation program. The Bureau recently instituted an evaluation system and should now have an opportunity to demonstrate that its system can effectively evaluate the program's impact.

The problem with the monitoring program is discussed in more detail below.

Need to Improve Performance Monitoring

A.I.D. policies and procedures require project officers to monitor recipients' effectiveness through such techniques as reviewing workplans and reports, visiting implementing activities, and assessing and reporting on progress to responsible officials. This audit determined, however, that the Bureau did not satisfactorily accomplish these techniques in monitoring grants and cooperative agreements. Organizational immaturity, project proliferation, and the project officers' distance from program implementation all impacted adversely on the Bureau's monitoring program. Ineffective monitoring could result in some implementation activities not accomplishing planned results or increase the potential for abuse, which may have occurred in Hungary under the cooperative agreement with the International Executive Service Corps.

Recommendation No. 4: We recommend that the Bureau for Europe:

4.1 when amending existing or developing future grants and cooperative agreements, require recipients to provide country-specific implementation plans;

4.2 establish procedures in a mission order for A.I.D. Representatives to be involved in regular and systematic in-country oversight and monitoring, including reporting their findings on field monitoring to the appropriate project officer; and

4.3 establish procedures in a mission order to require that project officers and Office of A.I.D. Representatives work together to accomplish the monitoring tasks required by A.I.D. Handbook 3.

Recommendation No. 5: We recommend that the Office of Procurement review Cooperative Agreement No. EUR-0023-A-00-1002-00 with the International Executive Service Corps to ensure that the recipient is no longer being reimbursed for finders' fees related to this cooperative agreement.

A.I.D. Handbook 3, Supplement A, establishes procedures for project officers to monitor the effectiveness of recipients of grants and cooperative agreements in order to help ensure successful program implementation. The procedures require that project officers:

- Review workplans and periodic progress reports to make sure that they adequately organize planned activities and measure progress as compared with established goals.

- Visit recipient offices and implementing activities in order to observe progress.

- Compare and analyze progress against plan and report results to responsible officials.

The audit determined, however, that these monitoring techniques were, in several respects, not successfully accomplished. Problems were noted in the areas of (1) implementation workplans, (2) progress reporting, (3) site visits, and (4) reporting on cost sharing.

A more detailed discussion of these points follows:

Implementation workplans were unsatisfactory for four of nine agreements requiring the workplans, with the result that project officers and A.I.D. Representatives (AIDREP) did not always have a clear concept of what the agreement was to accomplish. In this regard:

- The National Cooperative Business Association (NCBA) prepared a project implementation plan; however, the plan did not explain where or how many activities would take place or provide a proposed schedule for when activities would occur.

- According to terms of its cooperative agreement, the International Executive Service Corps (IESC) was to submit a country-specific implementation plan. For each country, the plan was to list activities to be undertaken, provide timeframes for the activities, and estimate outputs for each activity. However, IESC never prepared the implementation plan.

- **The Agricultural Cooperative Development International (ACDI) implemented** its amendment to an existing grant with little, if any, implementation planning.

- **Georgetown University** was required, by terms of its cooperative agreement, to submit an implementation plan for approval of the project officer. Georgetown submitted a plan, but four issues raised by the project officer (cost sharing, approval of sub-grant activities, selection of participating students, and selection criteria for participating colleges) were not resolved.

Six of nine recipients that were required to submit periodic progress reports did not comply with reporting requirements as established by their grant or cooperative agreement.

- The cooperative agreement with **IESC** required that IESC submit a summary sheet describing activities for each completed project. Although IESC was submitting some summaries, its progress reports through March 31, 1992 included only 94 of 239 summary sheets that should have been submitted through that date. When brought to IESC's attention, IESC submitted the past due sheets in its next quarterly report.

- The Organization of Economic Cooperation and Development **(OECD)**, although required to submit semiannual and annual performance reports, submitted only annual reports.

- The Volunteers in Overseas Cooperative Assistance **(VOCA)** submitted its required semiannual progress reports on a timely basis but excluded required information on areas of expertise of its volunteers, scopes of services rendered, and to whom the services were provided.

- **NCBA's** and the State University of New York's **(SUNY)** reports were not very substantive in that they had little in common with the project activities identified in their project implementation plans.

- Iowa State University's **(ISU)** reports did not clearly compare progress against benchmarks established in its project implementation plan.

Both Washington-based project officers and AIDREP personnel were unable to make site visits to many of the implementing activities abroad. Based on our visits to implementing activities in five countries (the Czech Republic, Hungary, Romania, Poland, and the Slovak Republic), we found that few implementing activities' overseas offices or implementation sites had been visited by a Washington-based project officer. The AIDREPs--who were on site and could have acted for the project officers in making site visits and assessing progress--were also generally not visiting the sites.

In fact, the AIDREPs in Prague, Budapest, Bucharest, and Bratislava did not have copies of the implementation plans or progress reports for many of the grants and cooperative agreements in the audit sample. Therefore, they really didn't know what the recipient was to accomplish or have a basis for verifying the accuracy of what the recipient was reporting to the Bureau for Europe.

Finally, the audit showed that one of four recipients (ISU) that was required to contribute $425,588 toward a total estimated grant amount of $1,921,447 was not reporting the amount of its contributions, as was required by its grant. A second recipient--the United States Energy Association--had reported cost sharing of only $4,260, compared with required cost sharing of $948,024. The Bureau stated that it will notify the recipients to comply with their reporting requirements.

Various factors contributed to the situation whereby project officers were unable to monitor grants and cooperative agreements as detailed by A.I.D. Handbook 3. Among these were (1) the Bureau for Europe was relatively new and was still developing its monitoring procedures, (2) a proliferation of programs such that a project officer could not spend much time on any single action, and (3) project officers were located great distances from where the recipients were implementing their programs.

The Bureau was still in the process of staffing its offices and devising monitoring procedures for a new type of regional program. Only about three years had passed since the SEED Act was signed on November 28, 1989. During that time, A.I.D. established an organizational structure in Washington (the Bureau for Europe and the Regional Mission for Europe) and in ten countries in Central and Eastern Europe (Offices of the A.I.D. Representatives). The Agency also staffed these new offices and established operating procedures under direction of the SEED Program Coordinator. And, the program was of a new type that was directed and managed in Washington while being implemented regionally, often under control of other Federal agencies. Given these circumstances, the Bureau had to develop procedures as the program was implemented, especially concerning utilizing AIDREPs effectively in monitoring SEED Program activities.

The Fiscal Year 1993 Appropriations Act addressed the role of the AIDREP in the monitoring effort. The Act stated that AIDREPs had primary responsibility, to the maximum practicable extent, for day-to-day implementation of the assistance program in their respective countries in Central and Eastern Europe. The Act directed further that A.I.D. should issue delegations of authority or other internal guidance in order to implement the Act.

In response, the Bureau on December 1, 1992 issued Mission Order No. 103, which states that AIDREPs would be responsible for in-country monitoring, which was defined as making inspections of specific project activities, events, or sites to check whether goods and services financed by A.I.D. are in fact being delivered and are having the intended effect. However, Mission Order No. 103 also specifies that AIDREPs are now also expected to establish clear plans and procedures for regular and systematic in-country oversight and monitoring. They are also expected to report their findings on field monitoring to the appropriate project officer, who is still considered to be responsible for overall management of the project. The guidance also specifies that project officers should develop a project monitoring plan to establish the frequency, intent, and reporting format that the AIDREP would use in monitoring the project.

Monitoring was also ineffective because of project proliferation. Due to the large number of individual actions, project officers had little time to dedicate to monitoring implementation of a given grant or cooperative agreement in an individual overseas location. Virtually all projects included a mixture of contracts, grants or cooperative agreements, and agreements with other Federal agencies. In most cases, the contracts and agreements were being implemented at a number of individual sites in more than one overseas country. For example:

- IESC was implementing its cooperative agreement in 10 countries. IESC had at least one office in each of these countries and each office was involved with implementing individual IESC projects. Although IESC was still getting geared up as of March 31, 1992, it reported that 239 of these projects had already been completed. In addition, IESC was also implementing a defense conversion initiative in the Slovak Republic and Poland.

- Under one project, the Bureau had 13 grantees, each of which was implementing its grant in at least one European country.

Accordingly, project officers were faced with more potential sites to visit than could reasonably be managed. This was especially true since the grants and cooperative agreements were all being implemented in Europe--far from the project officers in Washington, D.C. In order to observe activities for any given grant or cooperative agreement, project officers had to plan, schedule, and accomplish a lengthy trip to one or several countries. Therefore, they were not able to visit or otherwise closely monitor most of the implementing activities abroad.

An ineffective monitoring program could result in some implementation activities not accomplishing planned results. The scope of this audit did not include making detailed visits to the many implementing activities abroad. However, we did briefly visit some activities in five countries, including the Czech Republic, Hungary, Poland, the Slovak Republic, and Romania.

These observational, short, one-time visits were generally inadequate to determine whether the recipient was implementing the program as agreed. However, based on these visits, discussions with various A.I.D. personnel, and review of various files, we did note a problem concerning 1 of the 12 grants and cooperative agreements in the audit sample. This concerns A.I.D.'s Cooperative Agreement with IESC, as implemented in Hungary. It involved a situation under which IESC used A.I.D. funds to make bonus payments of $1,000 per project to an Hungarian firm--called "Know-How"--for work which IESC was already responsible and was being reimbursed for.

The bonus payment was based on a January 1991 agreement between IESC and Know-How under which IESC agreed to pay Know-How $1,000 for each completed project of at least 14 days duration. This bonus payment was effectively a "finders' fee." In addition, IESC agreed to pay all of Know-How's operating expenses.

Although the $1,000 bonus payments were being made, this audit's scope was not sufficient to determine exactly how much was paid. However, the audit showed that IESC was still paying the bonus payments in late 1992 and that IESC-Hungary had completed 90 projects through June 1992. Further, IESC had advanced $366,210 to Know-How through September 1992 for IESC-Hungary activities.

Further, (1) IESC's funds were commingled with Know-How's and some of Know-How's expense reports were rejected as they didn't meet IESC's reporting standards, and (2) Know-How was providing a variety of services, including data processing, travel, personnel, and the like to IESC-Hungary on a reimbursement basis.

In summary, we believe the involvement of Know-How in IESC's operations and the payment of a finders fee to Know-How for activities not contemplated by the cooperative agreement were inappropriate. Based upon subsequent discussions concerning this matter, IESC officials stated they terminated their arrangement with Know-How effective December 31, 1992 and that they no longer make bonus payments under terms of their cooperative agreement with the Bureau for Europe.

Management Comments and Our Evaluation

The Bureau for Europe stated that its personnel have increasingly traveled extensively to Europe in monitoring the SEED Program. The Bureau said that during Fiscal Year 1992, project officers and other Bureau personnel made 220 trips to Central and Eastern Europe in monitoring SEED Program activities, for a total duration of 3,642 days. The Bureau stated that it is also preparing a monitoring plan to target specific project activities during field visits.

Following are the specific actions that the Bureau has taken to address the report's recommendations:

- Recommendation 4.1 The Bureau said that the Deputy Assistant Administrator of the Bureau for Europe will send a memo to all Bureau staff implementing a policy requiring that recipients provide country-specific implementation plans. The Bureau stated further that Regional Mission for Europe's Program Officer will be responsible for making sure that PIOT/s include the requirement that the recipients include the country-specific implementation plans.

- Recommendation 4.2 As stated above, Mission Order No. 103, assigns AIDREPs with responsibility for in-country monitoring, which was defined as making inspections of specific project activities, events, or sites to check whether goods and services financed by A.I.D. are in fact being delivered and are having the intended effect. However, Mission Order No. 103 also specifies that AIDREPs are now also expected to establish clear plans and procedures for regular and systematic in-country oversight and monitoring. They are also expected to report their findings on field monitoring to the appropriate project officer, who is still considered to be responsible for overall management of the project.

- Recommendation 4.3 Mission Order No. 103 also requires that project officers develop a project monitoring plan to establish the frequency, intent, and reporting format that the AIDREP would use in monitoring the project. Thus Mission Order No. 103 requires that the project officer and the AIDREPs work together toward accomplishing the monitoring effort.

In responding to Recommendation No. 5, the Office of Procurement stated that it would, upon issuance of this final audit report, inform IESC in writing that (1) it must terminate its relationship with Know-How, and (2) no costs incurred after December 31, 1992 related to its association with Know-How should be billed.

Based on the above responses and the issuance of Mission Order 103, Recommendation Nos. 4.1 and 5 are resolved and Recommendation Nos. 4.2 and 4.3 are closed.

REPORT ON INTERNAL CONTROLS

This section provides a summary of our assessment of internal controls for the audit objectives.

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.

Our assessment of internal controls, which included obtaining a letter from the Directors, Bureau for Europe, Office of Procurement, and Office of Financial Management and providing written representations considered essential to our assessment, was limited to those controls applicable to the audit's objective and not to assess the auditees' overall internal control system.

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

General Background on Internal Controls

Under the Federal Managers' Financial Integrity Act and OMB's implementing policies, A.I.D.'s management is responsible for establishing and maintaining adequate internal controls. The General Accounting Office has issued "Standards for

Internal Controls in the Federal Government" to be used by agencies in establishing and maintaining internal controls.

The objectives of internal control and procedures 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 a system will work in the future is risky because (1) changes in conditions may require additional procedures or (2) the effectiveness of the design and operation of policies and procedures may deteriorate.

Conclusions for Audit Objective One

The first audit objective was to determine if the Bureau for Europe followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in planning grants and cooperative agreements under the Economic Restructuring Component. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbooks 3 and 13. For the purposes of this report, we have classified the relevant policies and procedures into the following categories: the project approval and authorization process; the process for ensuring that grants and cooperative agreements were supported by project decision papers and the Action Plan; the process for ensuring that grants and cooperative agreements were addressed by a project memorandum and were authorized by an appropriate Bureau for Europe official; the process for ensuring that project implementation orders described the nature of the proposed grant or cooperative agreement and were (1) consistent with the project memorandum and (2) approved by appropriate officials; and the process for including adequate benchmarks in grants and cooperative agreements that could be used as a basis for monitoring progress of the grant or cooperative agreement.

Our tests showed that the Bureau for Europe's controls were consistently applied.

Conclusions for Audit Objective Two

The second audit objective was to determine if the Bureau for Europe and the Office of Procurement followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in awarding grants and cooperative agreements under the Economic Restructuring Component. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in OMB Circulars A-110 and A-133 and A.I.D. Handbooks 1 and 13. For the purposes of this report, we classified the relevant policies and procedures into the following categories: determining whether the Bureau for Europe and the Office of Procurement used the appropriate award mechanism; determining whether the Office of Procurement appropriately determined that costs were reasonable and included appropriate audit requirements in grants and cooperative agreements; determining whether the Office of Procurement's reviews of contractor's qualifications followed A.I.D. procedures; and determining whether the Bureau for Europe and the Office of Procurement followed A.I.D. procedures in obtaining competition and ensuring that recipients shared costs to the maximum extent possible.

Our tests showed that the Bureau for Europe's and the Office of Procurement's controls were consistently applied except that the Bureau for Europe needed to enhance the competitive environment and ensure that recipients shared costs to the maximum possible extent.

Conclusions for Audit Objective Three

The third audit objective was to determine if the Bureau for Europe and the Office of Financial Management followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in obligating, expending and accounting for grants and cooperative agreements under the Economic Restructuring Component. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 19. For the purposes of this report, we classified the relevant policies and procedures into the following categories: determining whether the Bureau properly prevalidated funds by recording budget allowances and fund reservations before funds were obligated; determining whether the Office of Financial Management ensured that amounts obligated did not exceed budget allowances or fund reservations; determining whether the Office of Financial Management accurately entered fund reservation, obligation, and expenditure data into the accounting system; determining whether the Office of Financial Management used valid and binding documents to support the transactions entered into the accounting system; and determining whether the Office of Financial Management established procedures to ensure that project officers in the Bureau for Europe administratively approved vouchers and returned signed copies for filing.

Our tests showed that the Bureau for Europe's and the Office of Financial Management's controls were consistently applied except that the Office of Financial

Management needed to establish procedures to ensure that project officers in the Bureau for Europe administratively approved vouchers.

Conclusions for Audit Objective Four

The fourth audit objective was to determine if the Bureau for Europe followed A.I.D.'s policies and procedures, as modified for Central and Eastern Europe, in monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component. In planning and performing our audit, we considered the applicable internal control policies and procedures cited in A.I.D. Handbook 3 and OMB Circular A-110. For the purposes of this report, we classified the relevant policies and procedures into the following categories: determining whether the Bureau had adequate procedures for (1) reviewing workplans and periodic progress reports to ensure they were received timely and adequately planned and reported on progress as compared to established goals, (2) making visits to recipient offices and implementing activities to observe progress, (3) comparing and analyzing progress against plan and reporting on progress to responsible officials, and (4) evaluating grants and cooperative agreements.

Our tests showed that the Bureau for Europe had introduced an evaluation system. However, the Bureau's controls did not ensure that it had an adequate monitoring system.

Reporting Under Federal Managers' Financial Integrity Act

The Bureau for Europe reported significant internal control weaknesses in its planning, evaluating, and monitoring efforts resulting from staff shortages, the need to focus available staff resources on program start-up, and the absence of mission orders. The Bureau's reporting closely correlates with the internal control weaknesses identified by this audit; therefore, no addition reporting by the Bureau under the Federal Managers' Financial Integrity Act is required.

The Office of Financial Management reported a material weakness in its payment operation, including the administrative approval of vouchers. As the office has reported the weakness and taken action to correct it, no further reporting is needed.

REPORT ON COMPLIANCE

This section summarizes our conclusion on the auditees' compliance with applicable laws and regulations.

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 and illegal acts that could significantly affect the audit objectives); and

- report all significant instances of noncompliance and abuse and all indications of instances of illegal acts that could result in criminal prosecution that were found during or in connection with the audit.

We tested the Bureau for Europe, Office of Procurement, and Office of Financial Management's compliance, as appropriate, with (1) OMB Circulars A-110, A-122, and A-133; (2) grants and cooperative agreements; and (3) A.I.D. Handbooks 1, 3, 13, and 19 as they could affect our audit objectives. However, our objective was not to provide an opinion on the Bureau for Europe, Office of Procurement, and Office of Financial Management's overall compliance with such provisions.

As part of our assessment, we obtained a letter from the Director of the Bureau for Europe, the Office of Financial Management, and the Office of Procurement providing written representations considered essential to our compliance assessment.

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 an organization's 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 lie within the letter of laws and regulations but violate either their spirit or the more general standards of impartial and ethical behavior.

Compliance with OMB Circulars, A.I.D. Handbooks, and certain provisions of grants and cooperative agreements, such as substantial involvement requirements that require Bureau for Europe, Office of Procurement, or Office of Financial Management actions, is the overall responsibility of the Bureau for Europe, the Office of Financial Management and the Office of Procurement.

Conclusions on Compliance

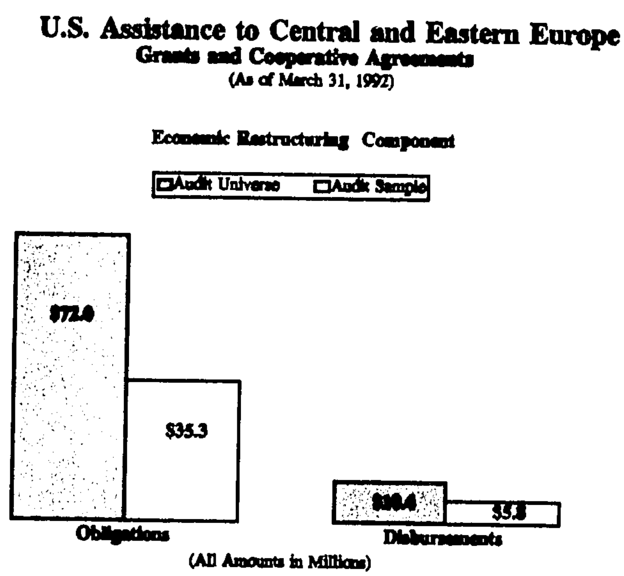
Our tests showed that the Bureau for Europe, the Office of Financial Management, and the Office of Procurement, as appropriate, complied with (1) OMB Circulars A-110, A-122, and A-133; (2) grants and cooperative agreements; and (3) A.I.D. Handbooks 1, 3, and 19 except for the following:

> Audit Objective No. 4 - The Bureau for Europe did not adequately monitor the recipients' performance, as required by OMB Circular A-110.

SCOPE AND METHODOLOGY

Scope

We audited grants and cooperative agreements under the Economic Restructuring Component in accordance with generally accepted government auditing standards. We conducted the audit from May 5, 1992 through December 11, 1992 and covered the systems and procedures relating to a sample of 12 of a total of 45 A.I.D. grants and cooperative agreements, related to the Economic Restructuring Component, that were administered by the Bureau for Europe and were active as of March 31, 1992. The sample of 12 agreements had cumulative obligations and disbursements, as of March 31, 1992, of about $35.3 million and $5.8 million, respectively. By comparison, all 45 agreements had cumulative obligations and disbursements, as of March 31, 1992, totalling about $72.0 million and $10.4 million, respectively.



Source: Bureau for Europe listing of grants and cooperative agreements active as of March 31, 1992. Data pertaining to the audit sample were audited, the remaining data were not audited.

In addition to the methodology described in the following section for each audit objective, we obtained a letter from the Director, Bureau for Europe and the Directors of the Office of Procurement and Financial Management that provided written representations that we considered essential for answering the audit objectives. We conducted our field work in the offices of the Bureau for Europe, the Regional Mission for Europe, the Office of Procurement, and the Office of Financial Management, all located in Washington, D.C. Overseas, we performed field work in the Offices of the A.I.D. Representatives in Prague, Czech Republic; Budapest, Hungary; Warsaw, Poland; Bucharest, Romania; and Bratislava, Slovakia, as well at recipients' offices in the Czech Republic, Hungary, Poland, Romania, and Slovakia. We also visited U.S. headquarters' offices of selected recipients: Georgetown University, the International Executive Service Corps, the National Cooperative Business Association, and the Volunteers in Overseas Cooperation.

We examined the evidence as described below in the Methodology Section of this report, using the techniques as discussed in the Methodology Section.

We coordinated our work with officials of the General Accounting Office (GAO), who were conducting work related to management of grants and cooperative agreements. However, we did not rely on the work of GAO or any other activity.

Methodology

The methodology for each audit objective follows.

Audit Objective One

The first audit objective was to determine if the Bureau for Europe followed A.I.D. policies and procedures, as modified for Central and Eastern Europe, in planning for grants and cooperative agreements under the Economic Restructuring Component. To accomplish this objective, we selected, using a combination of random and judgmental sampling techniques, 12 of the 45 agreements that were awarded through March 31, 1992. Six of the agreements were selected randomly from 38 agreements of less than $3 million each, while five agreements were selected judgmentally from the seven agreements that exceeded $3 million each. One other grant was selected judgmentally from the group that included grants and cooperative agreements under $1,000,000. The basis for judgmentally selecting the six agreements was to ensure

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that all Bureau for Europe projects and project officers were included in the overall audit sample.

For each agreement sampled, we reviewed procedures relating to the following management processes:

- The process of planning for grants and cooperative agreements. We assessed whether project decision papers and project memoranda specifically addressed and justified the sampled grants and cooperative agreements. We also determined whether the grants and cooperative agreements were consistent with the project decision papers and project memoranda and incorporated appropriate planning for project activities and for assessing progress against plans.

- The process for authorizing grants and cooperative agreements. We determined whether an appropriate Bureau for Europe official authorized the 12 agreements in the audit sample by signing a memorandum approving the project under which the sampled agreement was funded.

- The process for approving grants and cooperative agreements. The audit determined whether the project implementation orders used by the Bureau described the nature of the proposed grant or cooperative agreement and had been approved by appropriate officials after review by knowledgeable officials.

In addition to the above-indicated procedures, we reviewed the agreement files and held discussions with the grant officer and project officer, as appropriate.

Audit Objective Two

The second audit objective was to determine if the Bureau for Europe and the Office of Procurement followed A.I.D. policies and procedures, as modified for Central and Eastern Europe, in awarding grants and cooperative agreements under the Economic Restructuring Component. To accomplish this objective, we utilized the same audit sample as was used for the first audit objective and reviewed procedures relating to the following management processes:

- The process for selecting grants and cooperative agreements. The audit assessed whether the Bureau for Europe waived competition in accordance with A.I.D. Handbook 13 provisions.

- The process for negotiating and awarding grants and cooperative agreements. The audit assessed whether the Bureau for Europe and the Office of Procurement used the appropriate award mechanism (grant or cooperative agreement) for grants and cooperative agreements under the Economic Restructuring Component. We also determined whether the Office of Procurement, when required, (1) determined that costs were reasonable, and (2) included appropriate audit requirements in grants and cooperative agreements. Finally, we determined that, when required, the Office of Procurement's reviews of recipients' qualifications generally followed A.I.D. procedures and whether the grants and cooperative agreements contained appropriate cost-sharing arrangements.

In addition to the above-indicated procedures, we reviewed the project and agreement files and held discussions with the grant officers, project officers, and recipients, as appropriate.

Audit Objective Three

The third audit objective was to determine whether the Bureau for Europe and the Office of Financial Management followed A.I.D. policies and procedures, as modified for Central and Eastern Europe, in obligating, expending, and accounting for grants and cooperative agreements under the Economic Restructuring Component. To accomplish this objective, we utilized the same audit sample as was used for the first two audit objectives and reviewed procedures relating to the following management processes:

- The process for obligating grants and cooperative agreements. In examining the obligating process, we determined whether the Bureau properly prevalidated funds by recording budget allowances and fund reservations before funds were obligated. We also ensured that amounts obligated by the Office of Financial Management (1) were accurate, (2) did not exceed budget allowances or fund reservations, and (3) were supported by an appropriate obligating document.

- The process for expending grants and cooperative agreements. We determined whether the Office of Financial Management managed cash appropriately by ensuring that cash advances to recipients were reasonable and that the recipients, where appropriate, were paying interest on their advances. We also examined the Bureau for Europe and the Office of

Financial Managements' procedures for administratively approving the 12 recipients' accounting for the use of advances.

- The process for accounting for grants and cooperative agreements. For the accounting process, we examined whether (1) the Office of Financial Management accurately entered reservation, obligation, and expenditure data into the accounting system, and whether (2) the Office of Financial Management used valid and binding documents to support the transactions entered into the accounting system.

In addition to the above-indicated procedures, we reviewed the project, accounting, and letter-of-credit files and held discussions with the project officer, controller, and financial management and recipient personnel, as appropriate.

Audit Objective Four

The fourth audit objective was to determine if the Bureau for Europe followed A.I.D. policies and procedures, as modified for Central and Eastern Europe, in monitoring and evaluating grants and cooperative agreements under the Economic Restructuring Component. To accomplish this objective, we utilized the same audit sample as used for the first three audit objectives and reviewed procedures relating to the following management process:

- The process for monitoring grants and cooperative agreements. For the monitoring process, we reviewed workplans and periodic progress reports to make sure they were received timely and adequately established goals and reported on progress as compared to those goals. We determined whether project officers and/or staff members from the Offices of the AIDREPs (1) made site visits to recipient offices and implementing activities in order to observe progress, or (2) compared and analyzed progress against plan and reported on progress to responsible officials. We also determined whether project officers and AIDREPs were working together monitoring activities.

- The process for evaluating grants and cooperative agreements. For the evaluation process, we compared the Bureau for Europe's evaluation plan with the Agency's requirements for evaluation as established by A.I.D. Handbook 3. We also determined whether individual grants and cooperative agreements required evaluation and, if so, whether the recipient completed them.

In assessing the monitoring and evaluation processes, in addition to the above-indicated procedures, we reviewed the project and AIDREP files and held discussions with the project officer, AIDREP, and recipient personnel, as appropriate.

USAID

U.S. Agency for International Development

March 10, 1993

MEMORANDUM

TO: RIG/A/EUR/W, Toby L. Jarman

FROM: A-DAA/EUR, Frank Almaguer

SUBJECT: Draft Audit Report, Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

We received the subject draft audit report and concur with the recommendations. We plan to take the actions listed below to implement the recommendations which were not closed upon report issuance.

Recommendation No. 1: We recommend that the Director, Bureau for Europe, in coordination with the Office of Procurement, formalize procedures in a mission order that (1) emphasizes the importance of seeking competition unless a waiver is fully justified and (2) requires that formal management review processes, such as project authorization, examine the planning and need for competition.

As stated in our response to the Record of Audit Findings, RME will prepare a mission order to clearly state the policy of using competition to the maximum extent practicable and require a justification where competition is not sought.

Recommendation No. 2: We recommend that the Bureau for Europe, in consultation with the Office of Procurement, introduce procedures to make sure that A.I.D. Handbook 1 provisions to either require cost sharing for grants and cooperative agreements or to waive the requirements on a case-by-case basis are followed.

RME will prepare a mission order to require that for each future requested grant action that a determination be made whether or not to include cost sharing. RME/PD will be given the responsibility in the mission order for ensuring compliance with this requirement.

320 Twenty-First Street, N.W., Washington, D.C. 20523

<u>Recommendation No. 4.1:</u> **We recommend that the Bureau for Europe, when amending existing or developing future grants and cooperative agreements, require recipients to provide country-specific implementation plans.**

The Deputy Assistant Administrator of the Bureau for Europe will send a memo to all EUR and RME staff implementing this policy. RME/PD will be responsible for ensuring at the time PIO/Ts are issued for new grants or amendments that this requirement is complied with.

We also have two comments on the draft report. First, we request that a correction be made on the first line on page 40 by adding "not" to the sentence beginning with "Given these circumstances, the Bureau was (not) in a position ...". Secondly, in reference to the discussion on the non-competitive award to Georgetown University, we believe that we used the best alternative for justifying that award. Bureau and Mission staff reviewed all potentially applicable criteria in Handbook 13 but found none truly applicable. This was a Congressional earmark. Under these circumstances, we felt that use of notwithstanding authority was a more valid waiver basis than a marginal justification that could prove difficult to defend under close scrutiny.

We will keep you informed as progress is made in implementing the above-discussed open recommendations.

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

MAR 24 1993

MEMORANDUM

TO: RIG/A/EUR/W, Toby L. Jarman

FROM: FA/OP, Fred Will

SUBJECT: Draft Audit Report, Audit of Grants and Cooperative Agreements Under the Economic Restructuring Component

As requested in your cover memorandum of February 17, 1993, to the subject Draft Audit Report, the Office of Procurement hereby provides our planned action to implement the one recommendation, Recommendation No. 5, directed to this office. When the audit is issued in final, we will send IESC a formal letter asking them to confirm in writing that the relationship with Know-How has been terminated, as IESC indicated to the auditors they had done as of Dec. 31, 1992, and that no costs related to this relationship have been billed to AID since 12/31/92. We will also request the project office and FM to review vouchers and financial statements from IESC since that date for any indications that this expense has been billed or paid after 12/31/92.

In addition, we intend to cooperate fully with the Bureau for Europe on implementing their recommendations.

We appreciate your cooperation and consideration of our comments to the earlier draft of the audit report, and look forward to receiving the final report. If there are any additional questions, please contact me or Diane Miller (FA/OP/A/EE).

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

MAR 24 1993

MEMORANDUM

TO: RIG/A/EUR/W, Jack Ottke

FROM: FA/FM/CONT, R. T. Rollis

SUBJECT: Response to Draft Audit - Eastern European Program - Report No. 8-180-93-XX

Per our discussion of March 17, 1993 regarding our January 12, 1993 response to your RAF (copy attached) which detailed the procedures currently in place ensuring proper administrative approvals, we are again requesting closure of any recommendations associated with the administrative approval process upon report issuance. As agreed, our January 12th response represents our formal reply to the draft audit report and serves as our request for closure of the recommendation upon final report issuance.

Should you have any questions concerning this matter, or require additional information, please contact Mr. Thomas G. Putscher of my staff at 663-2164.

Attachment:a/s

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

USAID
U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

January 12, 1993

TO: RIG/A/EUR/W, Toby L. Jarman

FROM: FA/FM/CMP, David D. Ostermeyer

SUBJECT: Report of Audit Findings (RAF) Related to the Audit of the Eastern European Program

As a result of our December 1992 exit conference on the recent audit of the Eastern European Program, FA/FM/CMP has finalized a description of the process that currently is required to ensure administrative approval. A copy of this procedure is attached and will be available in the future as operating procedures in FA/FM/CMP/LC.

Since this process was operational in July 1992 (although not formalized) before completion of your audit, we request that any recommendations issued be closed upon issuance of the draft and final audit reports.

I would like to reinforce one further point. FA/FM/CMP fully agrees that obtaining administrative approval is in the best interest of the Agency. However, it should be recognized that administrative approvals on letter of credit expenditure reports do not drive the disbursing mechanism. The advance, via the letter of credit, actually releases the funds and is not subject to the administrative approval process.

If you have questions or would like to discuss the letter of credit process further, please contact me at 663-2322 or Gene Westlake at 663-2230.

Thank you.

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

Audit Sample of Grants and Cooperative Agreements Under the Economic Restructuring Component

GRANTEE/RECIPIENT NAME	GRANT/ COOPERATIVE AGREEMENT NUMBER	AGREEMENT/AMENDMENT DATE	GRANT AMOUNT	SUBTOTAL AMOUNT	AMOUNT DISBURSED
International Energy Agency (I.E.A.)	EUR-0030-G-00-1082-00	September 18, 1991	$200,000	$200,000	$0
United States Energy Association (U.S.E.A.)	EUR-0030-A-00-1085-00 Amendment No. 1	September 30, 1991 March 26, 1992	2,675,000 1,000,000	3,675,000	50,306
National Cooperative Business Association (N.C.B.A.)	EUR-0024-G-00-1068-00 Amendment No. 1	September 9, 1991 February 24, 1992	500,000 750,000	1,250,000	35,314
International Fertilizer Development Center (I.F.D.C.)	180-0024-3-2622235	December 10, 1991	200,000	200,000	0
International Executive Service Corps (I.E.S.C.)	EUR-0023-A-00-1002-00 Modification No. 2 Modification No. 3	February 28, 1991 September 29, 1991 March 27, 1992	5,365,600 949,000 5,355,000	11,669,600	2,619,691
Agricultural Cooperative Development International (A.C.D.I.)	EUR-0024-G-00-1066-00 Amendment No. 2	December 31, 1991	686,680	686,680	0
International Development Law Institute (I.D.L.I.)	180-0026-G-00-2-256-00	March 31, 1992	580,000	580,000	0
Organization for Economic Cooperation and Development (O.E.C.D.)	SPO-0026-G-00-1001-00 Amendment No. 1	December 31, 1990 December 30, 1991	1,500,000 2,700,000	4,200,000	0
Volunteers in Overseas Cooperative Assistance (V.O.C.A.)	EUR-0024-G-00-1036-00 Amendment No. 1 Amendment No. 2	May 21, 1991 September 30, 1991 February 21, 1992	2,600,000 650,000 2,000,000	5,250,000	1,359,248
Georgetown University	ANE-0002-A-00-0036-00 Amendment No. 2 Amendment No. 3	August 9, 1990 March 13, 1991 September 21, 1991	1,962,000 280,312 2,719,688	4,962,000	1,464,994
State University of New York (S.U.N.Y.)	EUR-0029-G-00-1061-00	July 23, 1991	1,117,417	1,117,417	134,728
Iowa State University	EUR-0029-G-00-1060-00	July 22, 1991	1,495,859	1,495,859	179,803

TOTAL OBLIGATIONS OF SAMPLE SELECTED AS OF 3/31/92 $35,286,556

TOTAL DISBURSEMENTS OF THE AWARDS IN THE AUDIT SAMPLE AS OF 3/31/92 $5,844,084

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