PD-ABH-621

Regional Inspector General for Audit
Singapore

AUDIT OF
USAID/INDONESIA'S CONTRACT WITH
DEVELOPING ECONOMIES GROUP
INDONESIA

Audit Report No. 5-497-94-003-N
January 7, 1994

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INSPECTOR GENERAL

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

January 7, 1994

TO: Charles F. Weden, Mission Director
USAID/Indonesia

FROM: Richard C. Thabet, RIG/A/Singapore

SUBJECT: Audit of USAID/Indonesia's Contract with
Developing Economies Group - Indonesia
Report No. 5-497-94-003-N

Enclosed are five copies of the subject audit report (prepared by the accounting firm, Hans Tuanakotta & Mustofa) for your action. This financial audit of USAID/Indonesia's contract with Developing Economies Group (DEG) under the Development Studies Project covered the period from June 15, 1987, through June 30, 1992. DEG reported that it spent $1.3 million in Indonesia during this period. The background on the contract and the project is presented on pages 1 and 2 of the report.

The audit objectives were to:

- Determine whether DEG's Statement of Expenditures presents fairly the expenditures under the contract;
- Report on DEG's system of internal controls; and
- Report on DEG's compliance with applicable laws, regulations, and terms of the agreement.

The audit report concluded that DEG's:

- Statement of Expenditures presents fairly the expenditures incurred under the contract;

- Internal controls had six reportable conditions, which were not considered to be material weaknesses. The reportable conditions arose mainly in the areas of employment contracts; and

- Operations complied in all material respects with applicable laws, regulations, and terms of the contract.

This audit report contains eight findings and recommendations which includes questioned costs of $56,243. In their response, DEG officials generally agreed with these findings and recommendations except for findings 1 and 3. Their comments are summarized after each finding in the report and presented in their entirety as Appendix 3.

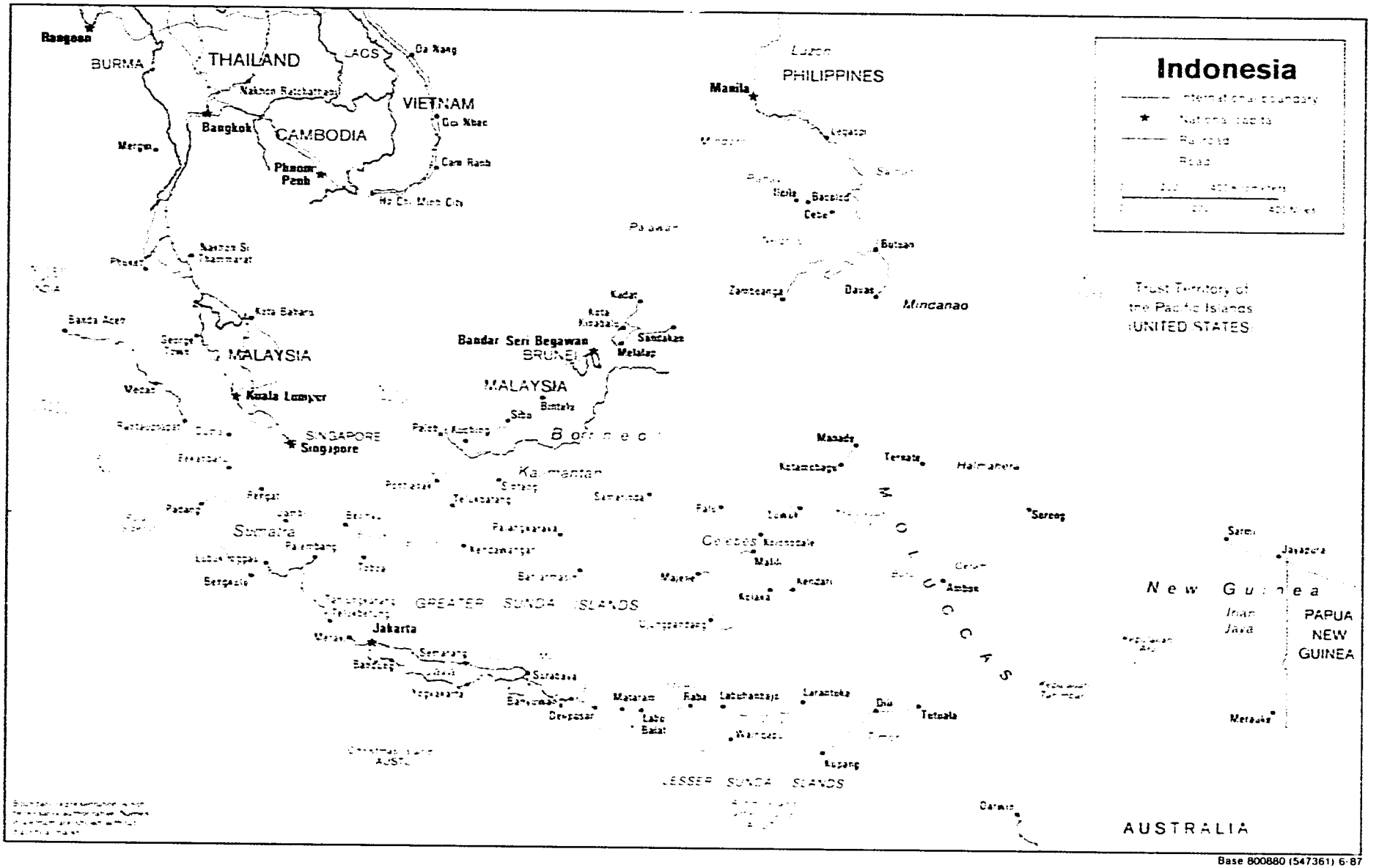
USAID/Indonesia needs to ensure that necessary action is taken to correct the problems noted in this audit. In addition, the following recommendations will be included in the Inspector General's recommendation follow-up system:

> **<u>Recommendation No. 1</u>: We recommend that USAID/Indonesia resolve the $56,243 in questioned costs ($7,097 ineligible, $49,146 unsupported) with DEG and recover any amounts due.**
>
> **<u>Recommendation No. 2</u>: We recommend that USAID/Indonesia verify that DEG establishes and implements adequate internal controls over the maintenance of their employment contracts to: (a) ensure that contracts are drawn up and maintained for all employees and (b) all changes to these contracts are appropriately approved by the Mission.**

We appreciate the courtesies and cooperation USAID/Indonesia and DEG extended to the auditors and our staff during the course of this audit.

Please advise me within 30 days of any actions planned or taken to close the above recommendations.

Attachment: a/s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Hans Tuanakotta & Mustofa

FINANCIAL AUDIT OF DEVELOPING ECONOMIES GROUP'S CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA FOR THE DEVELOPMENT STUDIES PROJECT FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

FINANCIAL AUDIT OF DEVELOPING ECONOMIES GROUP'S CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA FOR THE DEVELOPMENT STUDIES PROJECT FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

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Mustofa

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No. 190293 IR AID DEG SR1

Mr. Richard C. Thabet
Regional Inspector General
for Audit/Singapore
United States Agency for International
Development
111 North Bridge Road
No. 17-03 Peninsula Plaza
Singapore 0617

Dear Mr. Thabet,

This report presents the results of our audit of Developing Economies Group (DEG) and its contract with the United States Agency for International Development in Indonesia (USAID/I) on the Development Studies Project (DSP) under Contract No. 497-0340-C-00-7104-00 (the Contract). Our audit covers all costs incurred under the Contract, excluding the U.S.- based home office support costs, since the beginning of the Contract on June 15, 1987, to June 30, 1992.

BACKGROUND

Since the establishment of the New Order Government in 1965, Indonesia has enjoyed a sustained period of political stability, economic growth and general prosperity. This was coupled by impressive achievements in the development of the nation's infrastructure, agriculture, health and education systems. Oil and liquid natural gas (LNG) were primary sources of savings and investments during this period.

In the early 1980's, however, the world economy depressed oil revenues significantly. Government budgets were cut severely in 1986 for the first time since the New Order Government was established. The government responded through austere budgets, a sizable devaluation in 1983 which stabilized the value of the currency, substantial deregulation of banking and finance, and simplification of investment procedures. New value added, income and property tax laws were passed to generate greater internal resources, and procedures were established to improve tax discipline. Increased attention was also given to improving the performance of non-oil exports through the establishment of new marketing organizations and export product standards.

With the strong possibility that the downturn in international oil and LNG prices may last for many years, the Government of Indonesia (GOI) is urgently faced with the need to formulate new policy responses.

USAID/I's Involvement in the Project

In 1987, USAID/I awarded a contract under the DSP in Indonesia to DEG, a joint venture agreement between Development Alternatives, Inc. (DAI), a U.S. - based for profit organization, and the Boston Institute for Developing Economies, Ltd. (BIDE).

Project's Goal and Purpose

The purpose of the DSP is to help strengthen the analysis of selected issues and problems related to Indonesian development policies and programs, and thereby improve policy and program formulation. The objective of the Contract is to assist the GOI with the examination of key issues affecting its plans for national development in employment, trade and industry, and other related policy areas. This will be done initially through the provision of long-term technical assistants working with the National Development Planning Agency (BAPPENAS) and the Central Bureau of Statistics (BPS). With support under the Contract, these agencies will produce specified policy analyses and develop staff capacities and relevant data bases to undertake such analyses beyond the life of the project. DEG was contracted to provide such services.

AUDIT OBJECTIVES AND SCOPE

We conducted a financial audit of DEG's fund accountability statement pertaining to its Contract (No. 497-0340-C-00-7104-00) with USAID/I for the period June 15, 1987, to June 30, 1992. The fund accountability statement comprises of the Statement of Expenditures and the accompanying notes to the statement. The Statement of Expenditures relates only to amounts spent in Indonesia and excludes support costs incurred by DEG's U.S. - based home office.

For information purposes only, we included as part of Note 3 to the Statement of Expenditures an unaudited statement of receipts and expenditures for the whole contract.

The results of our audit, which excludes the U.S. - based home office support costs, are reflected in the following accompanying independent auditors' reports :

1. Statement of Expenditures

2. Internal Control Structure

3. Compliance with the Terms of the Contract, Applicable Laws and Regulations

The objectives of our audit were to:

a. Determine whether the Statement of Expenditures presents fairly the expenditures covering the period June 15, 1987, to June 30, 1992 in accordance with the terms of the Contract with USAID/I and to identify costs which were not fully supported with adequate records or which were not allocable, reasonable or allowable under the terms of the Contract.

b. Report on DEG's internal control structure as it relates to its Indonesian operations.

c. Report on DEG's compliance with the applicable laws, regulations and terms of the Contract.

The audit was conducted in accordance with generally accepted U.S. Government Auditing Standards and, accordingly, included such tests to determine whether funds were properly accounted for, and used as directed by the Contract, other applicable program documents and the laws of Indonesia.

The scope of our work primarily included the following general procedures:

a. Holding meetings with USAID/I, DEG and RIG/A/S officials.

b. Reviewing the Contract between USAID/I and DEG, including all amendments, Office of Management and Budget (OMB) Circulars A-110 and A-122, AID Handbook 14, USAID/I contract files, and annual, quarterly and monthly reports submitted to USAID/I and to GOI.

c. Reviewing DEG's internal control structure, accounting records, and control procedures.

d. Assessing DEG's compliance with the terms of the Contract, applicable laws and regulations.

e. In performing some of the above procedures, compliance and substantive testing procedures were devised and performed. These included confirming balances with the USAID/I offices, DAI's head office and BIDE office.

f. Designing appropriate audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the results of our audit. We were also aware of the possibility of illegal acts that could have an indirect and material effect on the results of our audit.

RESULTS OF THE AUDIT

Opinion on Statement of Expenditures

Out of the US$ 1,295,385 included in the Statement of Expenditures, we questioned US$ 56,243 in costs due mainly to DEG's noncompliance with the Contract terms, applicable laws and regulations. The questioned costs are reported in summary in Appendix 1 and in detail as Findings 1 to 8 on pages 13 to 20, and in Appendix 2 of this report.

In our opinion, the Statement of Expenditures presents fairly, in all material respects, the expenditures of DEG, excluding U.S. - based home office support costs, for the period June 15, 1987, to June 30, 1992, in conformity with generally accepted accounting principles and the terms of the Contract with USAID/I.

Internal Control Structure

Our study and evaluation of the internal control structure were considered in determining the nature, timing and extent of the audit tests applied by us in the examination of the related Statement of Expenditures.

For all the significant internal control structure categories examined, we obtained an understanding of the design of relevant policies and procedures and whether they had been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions, and these matters are reported as Findings 1 to 6 on pages 13 to 18 of this report. None of these reportable conditions was considered to be a material weakness. In addition, we noted other matters involving the internal control and its operation that we have reported to the management of DEG in a separate letter dated February 19, 1993.

Since our study and evaluation of the system of internal control was made for limited purposes, it would not necessarily disclose all weaknesses in the system and, therefore, we do not express an opinion on the system of DEG's internal control taken as a whole.

Compliance with Terms of the Contract, Applicable Laws and Regulations

As part of our audit, we performed tests of DEG's compliance with certain provisions of the Contract, applicable laws and regulations, and binding policies and procedures. We performed those tests of compliance as part of obtaining reasonable assurance about whether the Statement of Expenditures is free of material misstatement; our objective was not to provide an opinion on compliance with such provisions.

Our tests of compliance disclosed several instances of immaterial noncompliance. These instances have resulted in questioned costs of US$ 56,243, the findings for which are listed in summary in Appendix 1 and are set out in detail as Findings 1 to 8 on pages 13 to 20, and in Appendix 2 of this report.

The results of our tests indicate that with respect to the items tested, DEG complied, in all material respects, with the terms of the Contract, applicable laws and regulations. With respect to items not tested by us, nothing came to our attention that caused us to believe that DEG had not complied, in all material respects, with those provisions.

SUMMARY OF MANAGEMENT COMMENTS

The management of DEG generally agreed with our findings and recommendations, but rebuttal on some of our observations have also been provided. The full text of their comments is attached as Appendix 3 to this report.

FOLLOW-UP ON PRIOR AUDITS

Prior findings and recommendations were noted by the Office of Finance, Finance Analysis Division, of the USAID/I through its FIN/FA Report 90-10 dated April 6, 1990. The audit disclosed that DEG administered project funds outside the Contract. In response to this, all administrative responsibility outside the Contract was turned over to Bappenas in April 1990. No similar findings were noted by us during our audit.

OTHER MATTERS

We noted other matters relating to findings that do not have an effect on the Statement of Expenditures. These are presented on pages 21 to 22 of this report.

ACKNOWLEDGEMENT

We would like to take this opportunity to express our gratitude for the assistance extended to us by RIG/A/S, USAID/I and DEG during the course of the audit.

HANS TUANAKOTTA & MUSTOFA

Drs. Irwanta Wanatirta
Registered Accountant No. D-4118

February 19, 1993

INDEPENDENT AUDITORS' REPORT
ON THE
STATEMENT OF EXPENDITURES

5a

Hans Tuanakotta & Mustofa

HTM

JAKARTA, SURABAYA, DENPASAR & BANDUNG

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No. 190293 IR AID DEG SR2

Mr. Richard C. Thabet
Regional Inspector General
for Audit/Singapore
United States Agency for International
Development
111 North Bridge Road
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Singapore 0617

Dear Mr. Thabet,

FINANCIAL AUDIT OF
DEVELOPING ECONOMIES GROUP'S
CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

INDEPENDENT AUDITORS' REPORT
ON THE STATEMENT OF EXPENDITURES

We have audited the accompanying Statement of Expenditures of DEG's Indonesian expenditures pertaining to its Contract (No. 497-0340-C-00-7104-00) with the USAID/I for the DSP for the period June 15, 1987, to June 30, 1992. The Statement of Expenditures and the notes thereon, as set out on pages 8 to 9, is the responsibility of DEG's management. Our responsibility is to express an opinion on the Statement.

We conducted our audit in accordance with generally accepted U.S. Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Expenditures is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the Statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the Statement. We believe our audit provides a reasonable basis for our opinion.

As stated in Notes 2 and 3 on page 8, the Statement of Expenditures presents only the expenditures of DEG as they pertain to those expenditures incurred in Indonesia under its Contract with USAID/I for the period detailed above, and is not intended to present fairly the total expenditures of DEG for the whole contract, or for DEG, the organization, as a whole.

Deloitte Touche
Tohmatsu
International

During the course of our audit, we identified immaterial instances of noncompliance with the terms of the Contract, applicable laws and regulations that resulted in questioned costs of US$ 56,243 out of the US$ 1,295,385 in local expenditures covered. These questioned costs relate mainly to excessive salaries and unallowable direct costs incurred. The related findings are summarized in Appendix 1 and are set out in detail as Findings 1 to 8 on pages 13 to 20, and in Appendix 2 herein.

In our opinion, the Statement of Expenditures of DEG presents fairly, in all material respects, the expenditures of DEG for the period June 15, 1987, to June 30, 1992, in conformity with generally accepted accounting principles and the terms of the Contract with USAID/I.

This report is intended for the information of the audit committee, management and others within the organization. This restriction is not intended to limit the distribution of this report which is a matter of public record.

HANS TUANAKOTTA & MUSTOFA

Drs. Irwanta Wanatirta
Registered Accountant No. D-4118

February 19, 1993

DEG
Developing Economies Group
Jalan Teuku Cik Ditiro 29A Jakarta 10310 INDONESIA

DSP
DEVELOPMENT STUDIES PROJECT II
BAPPENAS / BPS
CONSULTANT TEAM

DEVELOPING ECONOMIES GROUP
USAID/I CONTRACT NO.497-0340-C-00-7104-00
STATEMENT OF EXPENDITURES
FOR THE PERIOD FROM JUNE 15, 1987 TO JUNE 30, 1992
(Amounts in United States Dollars)

EXPENDITURES		
Salaries of Indonesian staff		
Research Assistants	93,523	
Office Manager	32,690	126,213
Travel, transportation and per diem		113,125
Allowances		129,497
Project support		
Jakarta office support	566,656	
Communinication	89,658	
Office Equipment,Repair & Maintenance	85,822	
Vehicle repairs and maintenance	56,762	
Production	38,098	
Miscellaneous office expenses	67,947	904,943
Other direct costs		21,607
Total		1,295,385

The accompanying notes form an integral part of
the Statement of Expenditure

Approved:

Kenneth M. Chomitz
Acting Chief of Party

Prepared:

Sabdono Yudhi Wibowo
Office Manager

Phone : (0-1) 3105975, 3101816, 372893 Tlx : 7407368 DSPI UC (USA) Fax : (021) 3101816

DEVELOPING ECONOMIES GROUP
NOTES TO THE STATEMENT OF EXPENDITURES
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

1. SIGNIFICANT ACCOUNTING POLICIES

The Statement of Expenditures is prepared in accordance with the historical cost concept. The records are maintained in United States dollars. Transactions during the period involving the Rupiah currency are recorded at the approximate rates of exchange prevailing at the time the transactions are made.

Project furniture and equipment purchases are included as part of expenditures.

2. COMPONENT UNIT OF THE ORGANIZATION

The Statement of Expenditures presents all costs incurred under the Contract for the period, excluding U.S. - based home office support costs, and is not intended to present fairly all the transactions of DEG under the Contract or DEG as a whole.

3. UNAUDITED STATEMENT OF EXPENDITURES FOR THE CONTRACT IN TOTAL

The costs incurred under the Contract for the DSP were partly spent in the United States and partly spent in Indonesia. Those spent in the United States were not the subject of this audit as the related supporting documents are maintained in DAI and BIDE's offices in the United States.

Reimbursements of all expenditures, including those expended in the United States, are processed locally by DEG in Indonesia. USAID/I reimburses DEG for the approved costs and fees under the Contract to DEG's bank account in Washington. The Chief of Party in Jakarta periodically draws a US cheque against this dollar account in the US and exchanges it with a local money changer for Rupiahs, depending on the need for Rupiahs for the payment of expenditures in the Jakarta office.

The following unaudited schedule pertains to the Contract budget and the Statement of Expenditures for the Contract as a whole for the period June 15, 1987, to June 30, 1992:

	Budget Amount	Total Cumulative Expenditures (Unaudited)
	US$	US$
EXPENDITURES		
Salaries and wages	3,585,236	2,687,583
Overhead	2,773,870	2,043,161
Allowances	1,884,057	1,415,680
Project support	1,289,935	1,061,483
Fixed fee	832,272	644,681
Travel, transportation and per diem	725,591	519,146
Fringe benefits	602,343	433,614
Other direct costs	465,086	352,079
Subcontract	281,210	77,154
Total	12,439,600	9,234,581

INDEPENDENT AUDITORS' REPORT
ON THE
INTERNAL CONTROL STRUCTURE

90

Hans Tuanakotta & Mustofa

HTM

JAKARTA, SURABAYA, DENPASAR & BANDUNG

Registered Public Accountants

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No. 190293 IR AID DEG SR3

Mr. Richard C. Thabet
Regional Inspector General
for Audit/Singapore
United States Agency for International
Development
111 North Bridge Road
No. 17-03 Peninsula Plaza
Singapore 0617

Dear Mr. Thabet,

FINANCIAL AUDIT OF
DEVELOPING ECONOMIES GROUP'S
CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

INDEPENDENT AUDITORS' REPORT ON THE INTERNAL CONTROL STRUCTURE

We have audited the Statement of Expenditures of DEG pertaining to its Contract with USAID/I on the DSP for the period June 15, 1987, to June 30, 1992, and have issued our report thereon dated February 19, 1993.

We conducted our audit in accordance with generally accepted U.S. Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Expenditures is free of material misstatement.

In planning and performing our audit, we considered DEG's internal control structure in order to determine our auditing procedures for the purpose of expressing an opinion on the Statement of Expenditures and not to provide assurance on DEG's internal control structure.

The management of DEG is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related cost of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of the Statement of Expenditures in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

Accounting system and record keeping
Payroll
Cash disbursements
Cash receipts
Cost allocation and allowability
Reimbursement request
Financial reporting
Monitoring

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the Statement of Expenditures.

The reportable conditions that we have noted relate mainly to record keeping and monitoring. These conditions are reported in full under Findings 1 to 6 on pages 13 to 18 and in Appendix 2. Appendix 1 summarizes the effect of these findings on the Statement of Expenditures.

A material weakness is a condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the Statement of Expenditures being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we have reported to the management of DEG in a separate letter dated February 19, 1993.

This report is intended for the information of the audit committee, management and others within the organization. This restriction is not intended to limit the distribution of this report which is a matter of public record.

HANS TUANAKOTTA & MUSTOFA

Drs. Irwanta Wanatirta
Registered Accountant No. D-4118

February 19, 1993

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INDEPENDENT AUDITORS' REPORT

ON

COMPLIANCE WITH THE TERMS OF THE CONTRACT, APPLICABLE LAWS AND REGULATIONS

Hans
Tuanakotta &
Mustofa

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JAKARTA, SURABAYA, DENPASAR & BANDUNG

Registered Public Accountants

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United States Agency for International
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111 North Bridge Road
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Dear Mr. Thabet,

FINANCIAL AUDIT OF
DEVELOPING ECONOMIES GROUP'S
CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

INDEPENDENT AUDITORS' REPORT
ON COMPLIANCE WITH THE TERMS OF THE CONTRACT,
APPLICABLE LAWS AND REGULATIONS

We have audited the Statement of Expenditures of DEG pertaining to its Contract with USAID/I for the DSP for the period June 15, 1987 to June 30, 1992. The Statement and the notes thereon are set out on pages 7 to 8. We have issued our report thereon dated February 19, 1993.

We conducted our audit in accordance with generally accepted U.S. Government Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Expenditures is free of material misstatement.

Compliance with laws, regulations, contracts, and binding policies and procedures applicable to DEG is the responsibility of DEG's management. As part of our audit, we performed tests of DEG's compliance with certain provisions of laws, regulations, contract, and binding policies and procedures. However, it should be noted that we performed those tests of compliance as part of obtaining reasonable assurance about whether the Statement of Expenditures is free of material misstatement; our objective was not to provide an opinion on compliance with such provisions.

The results of our tests of compliance disclosed several immaterial instances of noncompliance. These instances have resulted in questioned costs of US$ 56,243, the findings for which are listed in summary in Appendix 1 and are set out in detail as Findings 1 to 8 on pages 13 to 20, and in Appendix 2 of this report.

The results of our tests indicate that with respect to the items tested, DEG complied, in all material respects, with the terms of the Contract, applicable laws and regulations. With respect to items not tested by us, nothing came to our attention that caused us to believe that DEG had not complied, in all material respects, with those provisions.

This report is intended for the information of the audit committee, management and others within the organization. This restriction is not intended to limit the distribution of this report which is a matter of public record.

HANS TUANAKOTTA & MUSTOFA

Drs. Irwanta Wanatirta
Registered Accountant No. D-4118

February 19, 1993

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Hans Tuanakotta & Mustofa

DEVELOPING ECONOMIES GROUP'S
CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

SUMMARY OF COMPLIANCE ISSUES

1. Missing Employment Contracts
2. Noncompliance with Terms of the Employment Contract on Annual Leave Compensation, and Inconsistency Between Provisions of the Contract and DAI Manual
3. Semiannual Increases in the Salary
4. Noncompliance with Terms of the Employment Contract on the Amount of Salary to be Paid
5. Renewal of Unexpired Employment Contracts
6. Travel Claim in Excess of Amount Allowable
7. Fluctuating Exchange Rates
8. Payment of Value Added Tax (VAT)

COMPLIANCE ISSUES

AUDIT FINDINGS AND RECOMMENDATIONS

1. MISSING EMPLOYMENT CONTRACTS

Condition
Mr. Sabdono has been employed by DEG since July 1987 up to the present and he had employment contracts during his stay with DEG, except for the period July 1988 to November 1990. His total salary for this period amounts to Rp 55,133,284 or US$ 30,990. The details of this questioned cost are set out in Appendix 2 of this report.

Criteria
FAR 52.215.2 (a) provides that, "if this is a cost-reimbursement ...contract,...the Contractor shall maintain...books, records, documents, and other evidence and accounting procedures and practices...sufficient to reflect properly all costs claimed to have been incurred in performing this contract." For salaries, we believe that the basic documents to support the cost incurred are the employment contracts.

Effect
Salaries amounting to US$ 30,990 were paid without supports from employment contracts. Finding 3 further discloses that there were semiannual increases in the salary. Therefore, the reasonableness of the salary and the salary increases are questioned.

Cause
DEG's employment process involves the preparation of a contract (except for certain part-time or temporary people) at the beginning of the employment period. The contract is important for new employees to familiarize them with working conditions, salary, etc. Because of ongoing negotiations, unclear conditions, etc., DEG does not always issue new contracts when existing ones expire. Under these circumstances the general provisions of the existing contract are assumed to continue to hold.

Recommendation
We recommend that DEG resolve with USAID/I the amounts questioned and refund all amounts deemed unallowable. We further recommend that DEG maintain employment contracts during the employment period of individual employees to support salaries paid.

Management Response
DEG management does not believe that the basic documents to support personnel costs are employment contracts. They are not mentioned in the FAR and DEG management believes that they can be substituted or supplemented by other evidence, timesheets, daily logs, etc. However, DEG management accepts that employment contracts are desirable for both the employee and the company and will strive to maintain up-to-date contracts.

Mr. Sabdono was included as a key personnel in the contract amendment executed in December 1990. Therefore, the management believes that his salary approval in this amended contract may be construed as approval for his previous salary.

Moreover, the management has sufficient evidence that Mr. Sabdono was employed full time on the DSP project over the period in question including daily logs, records of absences (leave and sick), and affidavits from the DSP Chief's of Party for the entire period.

2. NONCOMPLIANCE WITH TERMS OF THE EMPLOYMENT CONTRACT ON ANNUAL LEAVE COMPENSATION, AND INCONSISTENCY BETWEEN PROVISIONS OF THE CONTRACT AND DAI MANUAL

Condition

On April 30, 1991, Mr. Sabdono received Rp 4,091,420 as compensation for 27 days of annual leave he was entitled to for the period June 1987 to November 1990. The amount was computed by multiplying US$ 1,750 (monthly salary) with 27/22 (days) and 1905 (the exchange rate). US$ 1,750 was his salary for the period December 1990 to November 1991 while his leave was earned prior to this period. The payment voucher was signed by Mr. Sabdono twice, i.e., under Received by (for receiving the money) and under Accounting (for approving the voucher). There was no written approval from DAI for the conversion of the annual leave.

In addition, he had no employment contract for the period July 1988 to November 1990 (see Finding No. 1). The available employment contracts between DEG and its employees also provide for cash payments in lieu of vacation time and do not make annual leave mandatory.

Criteria

Per DAI Long-Term Project Manual dated May 1989 article 2.2e(2), "Annual leave is not intended to be accumulated and applied to the end of a tour to shorten it; neither is it intended to be accumulated and exchanged for cash."

The employment contract of Mr. Sabdono (part III) states that, "The employee is entitled to an annual leave of 20 days for each twelve months of service. Annual leave may not be accrued beyond a single contract year, so that this employee may not accrue more than twenty days work of annual leave in a contract year. Annual leave may be converted to cash or other forms of compensation, agreed upon by DAI."

Effect

There is inconsistency between the provisions in the employment contract and the provisions of the DAI Manual.

Since there was no written approval from DAI for the conversion of the annual leave, the whole amount of Rp 4,091,420 or about US$ 2,119 is questioned.

There is also a weakness in the internal control structure. Since every employee is not required to take a vacation and have his normal duties performed by someone else, the likelihood of a defalcation is increased.

Cause

According to DEG, the DAI long-term manual is a guide for the Chief of Party. It does not set the terms of individual contracts. It is not generally applicable to local hire staff. Finally, it is not a binding document, only a suggested set of procedures. The individual contract provisions take precedence over the DAI long-term manual. As such Mr. Sabdono is entitled, upon the agreement of DAI, to convert his annual leave to cash.

The days accumulated by Mr. Sabdono were over the period June 1987 to November 1990 but were still outstanding in April 1991. DAI indicated that it is their policy to pay out accrued annual leave at the pay rate at the time of claim.

DAI Washington indicated that payment at that time constituted constructive review and no written approval is required.

Recommendation

We recommend that DEG resolve the amounts questioned with USAID/I and refund all amounts deemed unallowable to USAID/I. Further, the provisions in the employment contracts should be in agreement with the provisions in the DAI Long-Term Project Manual.

Internal control is strengthened when all employees take annual leave and their work is performed by others. We suggest that DEG consider requiring all employees to take annual leave and exceptions to this policy should be severely restricted.

Management Response
The management does not accept HTM's contentions about the necessity of annual leave, or the relevance of the DAI Long-Term Project manual.

While annual leave is desirable, DEG (or the DSP project) is quite small and key staff (such as Mr. Sabdono, among others) do not always have the flexibility to take their annual leave in the year that it is accrued. It would be disastrous to a project such as DSP to insist on a mandatory leave rule such as proposed by the auditor. Parenthetically the Minister of Bappenas (DEG's GOI counterparts) does not allow any annual leave in the current year, and as such taking leave for high level DSP staff is quite difficult. The DSP project team is not large enough to effect a mandatory leave policy. The thrust of HTM's contention is too academic for what amounts to a small business like DEG.

However, the management accepts HTM's interpretation of Mr. Sabdono's Contract and will reimburse USAID/I for the full amount.

3. SEMIANNUAL INCREASES IN THE SALARY

Condition
For the period January 1988 to June 30, 1988 and July 1988 to November 1990 for which he has no employment contracts, Mr. Sabdono received semiannual increases in his salary, some of which were more than 10%. No USAID/I approval was obtained for the increases.

Criteria
Per Section B.8.1.(d) of the Contract, "Merit or promotion increases may not exceed those provided by the Contractor's established policy and practice...Merit or promotion increases exceeding these limitations...may be granted only with the advance written approval of the Contracting Officer."

Further, the DAI Long-Term Project Manual, May 1989 Section 2.2b states that, "At the end of each 12 months of satisfactory service, the employee is normally eligible for a salary increase up to a maximum indicated in the contract..." Mr. Sabdono's employment contracts for July 1, 1987 to June 30, 1988 and December 1990 up to June 1992 provide only a 10% annual increase.

Effect
Since no USAID/I approval was obtained for the increases in the above-mentioned periods, salary amounting to Rp 19,083,640 or about US$ 10,870, is questioned on the basis of reasonableness. The amount is detailed in Appendix 2 of this report. The US$ 10,870 questioned is part of the US$ 30,990 questioned in Finding 1 on page 14.

Cause
According to DEG, prior to Mr. Sabdono's explicit contract with DAI (beginning with the project extension) he was considered an employee of the DSP project (local staff). The management believes that Section B.8.1 (d) of the Contract is not applicable here. This section is generally applicable to the project's key personnel and not to local staff. DEG management feels that the Section B.8.1(f) was applicable to Mr. Sabdono at this time. Mr. Sabdono's salary was specifically provided for in the budget when he was offered employment as a key personnel instead of a local hire in December 1990. Since then, his raises have been in line with his contract and B.8.1(d), and any larger raise would require Contract Management approval.

Again, the management contends that the DAI long term manual is for guidance, and even this guidance is aimed at provisions for key personnel. As a project hire, most of the provisions of the

DAI long-term manual (post differential, medical evacuation, home leave, R&R, etc.) do not apply.

The Contract explicitly allows for increases in line with established policy and practice. Over the period of 1989 and 1990, the market demand for people with Mr. Sabdono's background and ability rose very rapidly, primarily due to demand from the banking community. The raises indicated were required to keep pace with the labor market. DEG believes the salary increases reflect Mr. Sabdono's market worth and are at or below the rate of individuals with similar qualifications and seniority at the Embassy or USAID/I.

Recommendation
We recommend that DEG resolve with USAID/I the amounts questioned and refund to USAID/I all amounts deemed unallowable. We further recommend that contracts entered into by DEG and all policies and procedures manuals be reviewed by a responsible officer who will ensure that contract provisions, policies and procedures are consistent with procedures in the company's manual.

Management Response
The management believed that they have adhered to clause B.8.1.(f) of the Contract which states:

f) Third Country and Cooperating Country Nationals

Salaries and wages paid to such persons may not, without specific written approval of the Contracting Officer, exceed either the Contractor's established practice; or the level of salaries paid to equivalent personnel by the Embassy in the Cooperating Country, as determined by AID, paid to personnel of equivalent technical competence."

Thus, the management, following DAI, has an established practice of matching local pay scales and checking them against salary levels for comparable personnel at the Embassy.

Mr. Sabdono is a Cooperating Country National and as such the provisions of the above paragraph clearly apply to him.

The DAI long-term manual is equally inapplicable since it is for guidance (not mandatory) on policies for U.S. based consultants.

The management has reviewed the local compensation plan for all U.S. Government agencies in Indonesia and can prove that Mr. Sabdono was at or below comparable personnel in the plan. They will be happy to share their analysis with USAID/I or whoever else may be designated.

They also noted that the local compensation plan for all U.S. agencies had a semi-annual increase in 1988 and additional increases over this period in excess of 20% each. It should be noted that these increases are in addition to step increases on employees anniversaries between 5% and 10%.

DEG management (and USAID/I) have copies of Mr. Sabdono's salary explicitly listed in the December 1990 extension amendment and approval by USAID/I Contract Management.

4. NONCOMPLIANCE WITH TERMS OF THE EMPLOYMENT CONTRACT ON THE AMOUNT OF SALARY TO BE PAID

Condition
The salaries paid to several Research Assistants (RAs) and Secretaries for several periods were in excess of or less than the amounts stated in their employment contracts. DEG was reimbursed by USAID/I for the amount actually paid to the RAs and Secretaries. Please refer to Appendix 2 for the details of this questioned cost.

Criteria
FAR 52.215.2 (a) provides that the contractor shall maintain records, documents sufficient enough to reflect properly all costs claimed to have been incurred. DEG should pay the salary as stated in the employment contracts because these contracts are supposed to support the cost incurred.

Effect
The salaries paid in excess of or less than the amounts stated in the contracts are questioned. The net questioned amount is about US$ 4,597.

Cause
According to DEG, the employment contract sets the initial conditions for new workers and indicates the conditions of employment. The salaries for some of the workers are often adjusted by DEG to stay abreast with changing employment market conditions, which is in line with DAI's policy. No amendments or new contracts are drawn up during the process. In practice, raises are typically granted at the anniversary of the employee, however, on occasion, to maintain competitiveness when the government has raised prices for basic services, general "across-the-board" salary increases have been granted in line with practices elsewhere.

Recommendation
We recommend that DEG review and resolve with USAID/I the amounts questioned and refund to USAID/I all amounts deemed unallowable. We further recommend that DEG pay the employees' salaries as stated in the employment contracts, and attach amendments in the contracts when salary revisions are made.

Management Response
The salaries and contracts do not agree because of across-the-board increases granted at several points over the years and contracts were not updated to reflect these increases.

The management notes that this seems to be the practice at USAID/I as well. When across-the-board increases were given, individual contracts were not redrawn either.

However, when such raises occur in the future, DEG management will draw up a blanket amendment and attach it to the contracts in question.

Payments less than the contract were for part time work when the contract stipulates a full time wage.

5. RENEWAL OF UNEXPIRED EMPLOYMENT CONTRACTS

Condition
The employment contracts for the secretaries, Clara, Titi, and Halimah, for the period July 1988 to June 1989 provide for a monthly salary of Rp 675,000. New employment contracts for the period March 1989 to March 1990 were made with immediate effect, increasing the monthly salary to Rp 756,250, despite the 3 months remaining from the July 1988 to June 1989 contracts.

Criteria
Per Section B.8.1.(f) of the Contract, "Salaries and wages paid to (third country and cooperating nationals) may not, without specific written approval of the Contracting Officer, exceed either the Contractor's established practice; or the level of salaries paid to equivalent personnel by the Embassy in the Cooperating Country; or the prevailing rates in the Cooperating Country, as determined by USAID/I, paid to personnel of equivalent technical competence."

Further, the DAI Long-Term Project Manual, May 1989 Section 2.2b states that, "At the end of each 12 months of satisfactory service, the employee is normally eligible for a salary increase up to a maximum indicated in the contract..."

Effect
The increase in the salary of the secretaries of Rp 975,000 or about US$ 555 is a questioned cost.

Cause
A new secretary was hired for the period March 1989 to March 1990 for a monthly salary of Rp 756,250. With the employment of the new secretary, salaries of the existing secretaries were increased in order to keep the salary scales in line with market conditions; this would then deter the present secretaries from quitting.

Recommendation
We recommend that DEG resolve with USAID/I the amounts questioned and refund to USAID/I all amounts deemed unallowable. We further recommend that DEG comply with the Contract provision requiring advance written approval of the Contracting Officer for promotion increases that exceed DEG's policy.

Management Response
The secretaries were all at or below Compensation Plan Scales for FSN 7 (secretaries some college required, English III) at the point the raises were made.

DEG management will amend rather than draw up new contracts in the future.

6. TRAVEL CLAIM IN EXCESS OF AMOUNT ALLOWABLE

Condition
On August 5, 1991, a long-term employee, Yahya Jammal, bought an "excursion fare ticket to the West Coast of the US" for US $1,328 when the lowest available airfare at that time was, according to him, US$ 1,119. He, however, bought a ticket for US$ 1,328 and promised to pay the difference of US$ 209. DEG claimed from USAID/I and got reimbursed for the full amount of US$ 1,328. Yahya Jammal was not required to pay the US$ 209.

Criteria
AID Handbook 14 clause 752.7002 provides, "The Contractor shall be reimbursed for the cost of travel performed by regular employees and dependents for purposes of rest and recuperation provided that reimbursement does not exceed that authorized for AID direct hire employees, and provided further that no reimbursement will be made unless approval is given by the Contractor's Chief of Party."

Effect
The amount of US$ 209 is a questioned cost.

Cause
USAID/I was inadvertently charged for the full amount.

Recommendation
We recommend that DEG resolve with USAID/I the amounts questioned and refund to USAID/I all amounts deemed unallowable.

Management Response
The management will reimburse the $ 209 overcharge if it was truly above the USAID/I guidelines as indicated by Dr. Jammal.

7. FLUCTUATING EXCHANGE RATES

Condition
A comparison of the rate used by DEG (rate per ledger) for translating rupiah to US Dollar and the rate per Bank Indonesia (BI) for selected months in each year reveal that DEG uses a lower rate

than the rate per BI. Please refer to Appendix 2 for the details.

Criteria
According to AIDAR 752.7010 (Conversion of US Dollars to Local Currency), "Upon arrival in the Cooperating Country, and from time to time as appropriate, the Contractor's Chief of Party shall consult with the Mission Director who shall provide, in writing, the procedure the Contractor and its employees shall follow in the conversion of United States dollars to local currency."

Effect
Since the rate used by DEG is almost always lower than the rate per BI, DEG could be charging more. The effect for the six (6) months tested amounts to an overclaim of US$ 2,466, the details for which are in Appendix 2 of this report. The potential effect for the whole audit period amounts to about US$ 13,559.

Cause
The DSP project was established on a cost reimbursement basis. From the beginning of the project converting dollar to rupiah has involved DEG converting dollars drawn on a DAI or BIDE (the joint venture partner) account in a US bank to pay for expenses in rupiah in Jakarta. Each month several transactions are made (to pay salaries or other local costs). The following month the average of these transactions (DEG's actual cost of funds in this case) is used to apply for reimbursement from USAID/I.

Far 52.215.2(a) provides that the contractor shall maintain records, documents sufficient enough to reflect properly all costs claimed to have been incurred. In this case DEG management believes that the appropriate record would be the receipt on the transaction of dollars into rupiah. The logical way to handle this in the voucher is to take the average of these transactions over the preceding month and apply this amount to the total rupiah expended. This procedure is in line with cost reimbursement principle and has been followed since the inception of the project with no objection from USAID/I Finance.

Recommendation
We recommend that DEG review and resolve with USAID/I the amounts questioned and refund to USAID/I all amounts deemed unallowable.

Transactions that need to be translated to U.S. dollars should be recorded at the rates of exchange prevailing at the time the transactions are made, which are the rates provided by the Mission Director or the rates per BI.

Management Response
The management has initiated discussions with USAID/I Contract Management and will determine whether the current system is acceptable or if changes are required in converting Rupiah to Dollars for the voucher. Any changes, if required, will be included in the extension of the DEG contract being negotiated currently.

8. PAYMENT OF VALUE ADDED TAX (VAT)

Condition
VAT was paid by DEG and reimbursed by USAID/I on the following items:

Telephone	2,819,131	1,505
Telemail	2,757,307	1,472
Storage	1,265,878	676
Airfare	1,032,737	551
Office supplies	18,250	10
Total based on samples only	7,893,303	4,214

Criteria
According to Federal Acquisition Regulation 52.229-8 (a), "Any tax or duty from which the United States Government is exempt by agreement with the Government of Indonesia,..., shall not constitute an allowable cost..."

Paragraph H.2.10 (a) of the Contract further states that, "The Contractor and those of its employees who are not citizens or permanent residents of Indonesia shall be free of all taxes, fees, levies, or impositions imposed under the laws of Indonesia with respect to all work and services performed under this contract..."

Effect
Payment of VAT resulted in an overclaim by DEG from USAID/I of at least Rp 7,893,303 or about US$ 4,214.

Cause
DEG did not realize that VAT should not be claimed to USAID/I.

Recommendation
Since USAID/I is eligible to claim from the Government of Indonesia (GOI) all the VAT paid to its suppliers or contractors, DEG should submit a list of VAT payments to USAID/I for reimbursement from the GOI.

DEG should start implementing within their finance and accounting department a system for reimbursement of VAT, after clarification from the USAID/I.

Management Response
DEG management has begun to collect information on VAT paid. This information will be transmitted to the Mission as requested.

OTHER MATTERS

DEVELOPING ECONOMIES GROUP'S
CONTRACT (NO. 497-0340-C-00-7104-00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

OTHER MATTERS

In the conduct of our audit, we noted the following matters which relate to findings that do not have an effect on the fund accountability statement.

1. UNRECONCILED AMOUNTS

Condition
The confirmations we have received from USAID/I, BIDE and DAI for the amounts disbursed by them under the DSP during the audit period showed the following amounts.

Per BIDE	US$ 5,002,046
Per DAI	4,247,671
Total	US$ 9,249,717
Per DEG (See page 8)	9,234,581
Difference	US$ 15,136

The DEG total reported on page 8 agrees with the USAID/I total. The difference noted above arose between the records of DAI/BIDE and DEG.

Criteria
Sound internal controls require timely and regular reconciliations of significant amounts in the accounts.

Effect
The failure to prepare the reconciliation on a routine basis results in differences between the records going undetected, and makes the reconciliation preparation difficult and time consuming. Timely and regular reconciliations will ensure greater accuracy of the accounting records and allow timely investigations into differences and disputes.

Cause
Occasionally, costs are suspended pending additional documentation or other reasons. DEG suspects that these suspended costs created the discrepancy. Thus one or both of the joint venture partners are indicating disbursements higher than those indicated by DEG who communicates more frequently with USAID/I.

Recommendation
We recommend that DEG implement a system for periodic reconciliation of amounts.

Management Response

DEG compiled their records monthly from the beginning of the project and sent them to DAI and BIDE for reconciliation. DAI and BIDE have each tasked one their financial staff to complete the reconciliation and DEG will communicate the results directly to USAID/I.

2. INCONSISTENCY IN CONTRACT PROVISIONS AS TO PROCUREMENT OF EQUIPMENT

Condition
DEG procured several equipment amounting to US$ 74,507 out of the funds available from the Contract budget. DEG has the authority to procure commodities as it has a line item for equipment in the Contract budget. Paragraph C.3.5 of the Contract, however, contradicts this authority.

Criteria
Paragraph C.3.5 of the Contract provides, "Although the bulk of commodity procurement under this project will be undertaken directly by the GOI, the contractor, under the direction and guidance of the Amendment Steering Committee, will procure books, materials, and other small value commodities as may be required for timely project implementation. Funds for this purpose will be from project funds and outside the technical assistance contract. These shall be procured in accordance with USAID/I regulations and procedures."

Effect
There is a question on whether DEG is authorized or not to procure equipment using Contract funds.

Cause
DEG management appreciates that the wording of paragraph C.3.5 is confusing. However, they do not agree that DEG is not allowed to purchase equipment or even that there is an inconsistency.

The management indicated that paragraph C.3.5 refers to DEG's obligations for purchases using PIL money (GOI money), e.g., the reference to funds outside the technical assistance contract. A previous audit FIN/FA Report 90-10 indicated that, in spite of this Contract wording, it was not permissible for DEG to administer funds outside the technical assistance contract. Beginning April 1990 all administrative responsibility for these funds was turned over to Bappenas. (See page 4 of this report.)

Recommendation
We recommend that DEG and USAID/I review and interpret Paragraph C.3.5, and amend it if necessary.

Management Response
DEG management and USAID/I contract management have begun discussions on amending the Contract and deleting this paragraph.

Appendix 1

DEVELOPING ECONOMIES GROUP
CONTRACT (NO. 497–0340–C–00–7104–00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

SUMMARY OF QUESTIONED COSTS

NONCOMPLIANCE ISSUES AFFECTING THE STATEMENT OF EXPENDITURES

Finding No.	Nature	Amount in US$	Basis	Ref.
1.	Salaries	30,990	Unsupported	2.1
2.	Annual leave	2,119	Unallowable	–
3.	Salaries	–	Reasonableness	2.2
4.	Salaries	4,597	Unsupported	2.3
5.	Salaries	555	Unallowable	–
6.	Travel	209	Unallowable	–
7.	All costs–exchange rate	13,559	Reasonableness	2.4
8.	Value added tax	4,214	Unallowable	–
	Total Noncompliance Issues Affecting the Statement of Expenditures	56,243		

* Unsupported cost refers mainly to cost incurred that was inadequately supported by documentation.

Appendix 2

DEVELOPING ECONOMIES GROUP
CONTRACT (NO. 497–0340–C–00–7104–00) WITH THE UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT IN INDONESIA
FOR THE DEVELOPMENT STUDIES PROJECT
FOR THE PERIOD JUNE 15, 1987, TO JUNE 30, 1992

DETAILS OF QUESTIONED COSTS

For Noncompliance Issues

2.1. Finding No. 1

Period	Salary for the Period in Rp	In US$
July 88 – Dec 88	6,768,000	
Jan 89 – June 89	11,144,640	
July 89 – May 90	23,051,808	
June 90 – Oct 90	11,613,800	
Nov 90	2,555,036	
Total unsupported salaries	55,133,284	30,990

2.2. Finding No. 3

Period	Rp Salary	Rp Increase	%	Rp Questioned
Dec 87	958,000			
Jan – June 88	980,000	22,000	2	–
July – Dec 88	1,078,000	98,000	10	588,000
Jan – June 89	1,466,400	388,400	36	2,918,400
July 89 – May 90	1,759,680	293,280	20	8,576,480
June – Oct 90	2,111,600	351,920	20	5,658,000
Nov 90	2,322,760	211,160	10	1,342,760
Total unallowable increase				Rp 19,083,640
				Or US$ 10,870

2.3. Finding No. 4

The questioned amounts (in Rupiah) are as follows :

For the Research Assistants :

Name	Period	Contract Amount Per Month	Amount Paid and Billed Per Month	Total Amount Questioned
Supriadi S.	May – June 90	1,016,500	500,000	(1,033,000)
Nur Khalik	Aug – Oct 91	1,100,000	1,265,000	495,000
	Nov 91	1,391,500	1,265,000	(126,500)
	Feb – Mar 92	1,391,500	1,265,000	(253,000)
Vivi Alatas	Aug 91 – June 92	1,100,000	1,265,000	1,815,000
Net for Research Assistants				897,500

For the Secretaries :

Name	Period	Contract Amount Per Month	Amount Paid and Billed Per Month	Total Amount Questioned
Titi	March 88 – June 88	550,000	675,000	625,000
	March 89	675,000	687,500	12,500
	Nov 90 – March 91	831,875	915,200	416,625
	Aug 91 – March 92	1,006,500	1,157,475	1,207,800
	April 92	1,273,225	1,157,475	(115,750)
Halimah	March 88 – July 88	550,000	675,000	750,000
	March 89	675,000	687,500	12,500
	Nov 90 – March 91	831,875	915,200	416,625
	Aug 91 – March 92	1,006,583	1,157,475	1,207,136
	April 92	1,273,225	1,157,475	(115,750)
Clara	March 88 – June 88	550,000	675,000	625,000
	March 89	756,250	687,500	(68,750)
	Nov 90 – March 91	831,875	915,200	416,625
	Aug 91 – March 92	1,006,500	1,157,475	1,207,800
	April 92	1,273,225	1,157,475	(115,750)
Siti	Nov 90 – Feb 91	798,600	878,460	319,440
	May 91	966,306	1,006,720	40,414
	Aug 91 – Feb 92	966,306	1,111,252	1,014,622
Net for Secretaries				7,856,087

Total salaries paid in excess Rp 8,753,587

Or US$ 4,597

2.4. Finding No. 7

Month	Year	Rp/US$ Rate per Ledger	Rp/US$ Rate per BI	Rp Difference	US$ Expense for the Month	US$ Effect
September	1987	1630	1641	11	10,477	70
November	1988	1680	1714	34	11,303	224
September	1989	1750	1780	30	10,138	171
April	1990	1743	1822	79	16,842	730
October	1991	1940	1968	28	64,659	920
April	1992	1990	2016	26	27,188	351
Over claim due to higher foreign exchange rate						2,466
Potential effect for the whole audit period						13,559

DEG
Developing Economies Group
Jalan Teuku Cik Ditiro 29A Jakarta 10310 INDONESIA

DSP
DEVELOPMENT STUDIES PROJECT II
BAPPENAS / BPS
CONSULTANT TEAM

No. 084/DEG-DSP/WW/IX/93

1 September 1993

Mr. Irwanta Wanatirta
Hans Tuanakotta & Mustofa
Wisma Antara 12th Floor
Jl. Medan Merdeka Selatan No. 17
Jakarta 10110

Dear Irwanta,

We have reviewed the final draft of the financial audit and our management response is included. We are assuming the 15 days to respond you cite in your letter are 15 work days, if you meant 15 calendar days we are sorry for any inconvenience this may have caused. Also attached is a letter that you indicated we should forward with our response.

We appreciate your statement that there are no material weaknesses and essentially, are almost in agreement with the remaining issues raised, however, a few differences remain.

Internal Control Finding, 1

We would like to you to point out that the DEG total reported agrees with the USAID total and the difference, which we are trying to resolve, is between the joint venture partners DAI/BIDE and DEG and not between USAID and DEG. The finding as written could be interpreted as an implying a difference between DEG and USAID which is not correct.

Compliance Issues Finding 3, 4, and 5

These are the most important area of difference. Your findings are based on your reading of the contract that we have to obtain explicit approvals from AID for adjustments. However, the paragraph from the contract that you quote in your findings, clearly does not apply to Cooperating Country Nationals and the next paragraph in the contract explicitly does. The guidance of the paragraph on Cooperating Country Nationals indicates <u>only</u> that our salaries should be at or below comparable salaries at the embassy. This issue is important and should be finalized before you conclude your review.

We have now reviewed our salaries with respect to these guidelines and can demonstrate that they are at or below the embassy schedule. In addition, we note that there were general across the board increases (sometimes twice yearly (1988), and these raises were almost always in excess of 10% and finally that

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these raises are on top of annual contractual (step) raises of close to 10%). Further it was indicated to us that individual contracts are not revised when such across the board increases are done.

We feel that you have not reviewed this issue in line with the guidance from our contract. If you would like you can convey to USAID that these salary levels should be checked, but we do not believe that there is anything from your audit to assume we are not in compliance and as such no findings should be issued.

Compliance Issue Finding 6

The company that issued the insurance voucher has been located and the proof you requested is included. They had changed address.

Compliance Issue Finding 7

The title of this finding is inaccurate, since Dr. Jammal did obtain approval.

Compliance Issue Finding 10

We do not believe this should be a finding. It is true that the wording is confusing but there is no indication of inconsistency. Again we suggest noting this for AID but do not think a finding should be issued.

Finally, on behalf of Mr. Sabdono and myself, I want you to know that we appreciate how difficult these audits must have been and that we have a high regard for the dedication and effort you, Regie, Anita, and others have exhibited. I must admit that on the whole the process has been quite productive. Thanks again for your efforts.

Sincerely,

William Wallace
Chief of Party, DSP II

Internal Control Issue

1. Unreconciled Amounts

The auditors found that the amounts indicated to have been disbursed by the joint venture partners DAI and BIDE do not add up to the amount that USAID/I indicates that it disbursed with a difference being that USAID/I indicates disbursing $15,136 less than DAI and BIDE indicate that they had disbursed.

DEG Management Response

DEG management would like to point out several things.

A. The auditor was tasked in its terms of reference to audit DEG local costs, and the reconciliation of the above amount should be considered outside the scope of this audit. The auditor's scope of reference and objective was a financial audit of DEG not DAI or BIDE.

B. This finding has no material impact on financial issues between DEG and USAID/I and, in fact, the exit conference suggestion was that this finding be relegated to a footnote. In view of this DEG management is surprised to see this issue still listed as a finding.

C. The statement of the condition by the auditor is misleading. DAI and BIDE are joint venture partners in DEG and it is DEG that compiles the vouchers for submission to USAID/I. The amounts indicated disbursed by DEG do reconcile with USAID/I. The auditor did not find an unreconcilable balance between DEG and USAID/I records.

D. On occasion costs are suspended pending increased documentation or for other reasons. What we suspect is that it is in the treatment of these suspended costs that has created the discrepancy. Thus one or both of the joint venture partners is indicating disbursements higher than those indicated DEG who communicates more directly with USAID/I. We have compiled DEG records of these disbursements (including both DAI's and BIDE's and matching USAID/I's) monthly from the beginning of the project and sent them to DAI and BIDE for reconciliation. DAI and BIDE have each tasked one of their financial staff to complete the reconciliation and we will communicate the result directly to USAID/I.

We appreciate the auditors bringing up this issue, but we do not believe it is relevant to the auditor's scope and objectives. Therefore, we request that this finding be dropped from the final report.

Compliance Issues

1. Missing Employment Contracts

The auditors note that while the Office manager (Mr. Sabdono) worked on the DSP Project from 1987 to the present he had no contract during the period July 1988 to November 1990. The auditor quotes the FAR to the effect that the Contractor should maintain records to support costs. The auditor then states that the basic document to support salaries is the employment contract.

DEG Management Response

A. The auditor's summary of the previous DEG management response (listed as Cause) does not accurately reflect what was conveyed earlier. First, part time staff have typically received contracts. Second, ongoing or difficult contract negotiations do often affect the timing of subsequent contracts. However the auditors statement "... continual negotiations to remain competitive with the commercial market ..." confuses the contract issue with the salary issue and was not in previous DEG response as such.

B. DEG management does not believe the auditor has made their case that the basic documents to support costs are employment contracts. They are not mentioned in the FAR and DEG management believes that they can be substituted for or supplemented by other evidence, timesheets, daily logs, etc.

However, DEG management accepts that employment contracts are desirable for both the employee and the company and strives to maintain up to date contracts. Mr. Sabdono is included as a key person in the contract amendment executed in December 90. Therefore DEG management believes that his salary approval in that contract can be construed as approval of his previous salary.

C. DEG management has sufficient evidence that Mr. Sabdono was employed full time on the DSP project over the period in question including daily logs, records of absences (leave and sick), and affidavits from the DSP Chief 's of Party for the entire period.

D. For the salary issue please see the responses to Findings 3, 4, and 5.

2. Noncompliance with Terms of the Employment Contract on Annual Leave Compensation, and Inconsistency between provisions of the contract and DAI Manual

The Auditor indicates that Mr. Sabdono received the cash equivalent of his accumulated leave (27 days) accumulated between 1987 and November 1990. This leave was paid out in April 1991 at his salary rate at that time. Mr. Sabdono's contract indicates that he is entitled to cash in his leave, but can not accrue more than twenty days of annual leave in a contract year.

Further, the auditor points out that DEG contracts (with employees) provide for cash payments in lieu of vacation time and do not make annual leave mandatory.

DEG Management Response

A. DEG management does not accept the Auditors contentions about the necessity of annual leave, or the relevance of the DAI Long-Term Project manual, and notes that the auditor has not responded to the previous DEG management explanations, on these issues.

While annual leave is desirable, DEG (or the DSP project) is quite small and key staff (such as Mr. Sabdono among others) do not always have the flexibility to take their annual leave in the year that it is accrued. It would be disastrous to a project such as DSP to insist on a mandatory leave rule such as proposed by the auditor. Parenthetically the Minister of Bappenas (our direct GOI counterparts) is not allowing any annual leave this year, and as such taking leave for high level DSP staff is quite difficult. The DSP project is not large enough to allow the redundancy required by a mandatory leave policy. The thrust of the auditors contention is too academic for what amounts to a small business like DEG.

B. DEG management does accept the auditors interpretation of Mr. Sabdono's Contract and will reimburse USAID for the full amount.

3. Semiannual Increases in the Salary

The Auditor finds that in the period when Mr. Sabdono did not have an explicit employment contract he was receiving semi-annual pay increases some of which were for more than 10%.

Further the auditor quotes Section B.8.1.(d) of the Contract between DEG and AID indicates as follows

"Merit or promotion increases may not exceed those provided by the Contractor's established policy and practice.. Merit or promotion increases exceeding these

limitations... may be granted only with the advance written approval of the Contracting Officer."

Finally, the auditor notes that the DAI long term manual Section 2.2b states that, "At the end of each 12 months of satisfactory service, the employee is normally eligible for a salary increase up to a maximum indicated in the contract .." Mr. Sabdono's explicit contracts before and after the period in question have a provision restricting him to a 10% increase.

The auditor indicates that the effect is that no approval was obtained from USAID and questions the total amount of the raises.

DEG Management Response

A. DEG management would like to make some changes to the auditors summary of earlier DEG responses (listed under Cause).

First, the paragraph of the contract DEG management feels is relevant B.8.1.(f) while referred to as above is not included in the auditors statement.

Second, DEG management does not believe that the use of B.8.1.(d) or (f) as binding is a question for belief or feeling on the part of DEG management as was indicated earlier. DEG management points out that the full text of the earlier response to the Auditor (April 20, 1993) (listed under finding 1) was as follows.

"... DEG management adheres to the clause in its contract, clause B.8.1(f) which states as follows:

f) Third Country and Cooperating Country Nationals

Salaries and wages paid to such persons may not, without specific written approval of the Contracting Officer, exceed either the Contractor's established practice; or the level of salaries paid to equivalent personnel by the Embassy in the Cooperating Country; or the prevailing rates in the Cooperating Country, as determined by AID, paid to personnel of equivalent technical competence."

Thus DEG management following DAI has an established practice of matching local pay scales and checking them against salary levels for comparable personnel at the Embassy."

Mr. Sabdono is a Cooperating Country National and as such the provisions of the above paragraph clearly apply to him.

B. The DAI long term manual is equally inapplicable since it is for guidance (not mandatory) on policies for US based consultants.

C. DEG management has reviewed the local compensation plan for all U.S. Government agencies in Indonesia and can prove that Mr. Sabdono was at or below comparable personnel in the plan. We will be happy to share our analysis with USAID/I or whoever else may be designated.

D. DEG management notes that the local compensation plan for all U.S. agencies also has a semi-annual increase in 1988 and additional increases over this period in excess of 20% each. It should be noted that these increases are in addition to step increases on employees anniversaries between 5% and 10%.

E. DEG management (and USAID) have copies of Mr. Sabdono's salary explicitly listed in the December 90 extension amendment and approved by AID Contract Management.

F. DEG management requests that this finding be dropped since approval was not required, the auditor has not demonstrated that Mr. Sabdono's salary was outside the contract guidelines and DEG can prove that it was within the contract guidelines and approved by AID contract management.

4. Noncompliance with Terms of the Employment Contract on the Amount of Salary to be Paid

The auditor finds that salaries paid to Research Assistants and Secretaries do not match the amounts listed in their contracts. The auditor further states "We recommend that DEG pay the employees' salaries as stated in the employment contracts."

DEG Management Response

A. The salaries and contracts do not agree because of across the board increases granted at several points over the years in question and contracts were not updated to reflect these increases.

B. DEG management notes that this seems to be the practice at USAID as well. When across the board increases were given individual contracts were not redrawn either. See Local Compensation Plan for all U.S. Government Agencies in Indonesia (Various Issues)

C. However, when such raises occur in the future DEG management will draw up a blanket amendment and attach it to the contracts in question.

D. Payments less than the contract were for part time work when the contract stipulates a full time wage.

E. DEG management requests this finding be dropped since DEG managemcnt is followed accepted USAID practice with regard contracts and salaries when across the board increases were granted.

5. Renewal of Unexpired Employment Contracts

The auditor finds that new contracts with raises were drawn up for several secretaries before existing contracts expired. The auditor again cites paragraph B.8.1.(d) on the necessity for an approval from the contracting officer in such a case and further states "We further recommend that DEG comply with the Contract provision requiring advance written approval of the Contracting Officer for promotion increases that exceed DEG policy."

DEG Management Response

A. DEG management again points out that paragraph B.8.1.(d) is not the relevant guidance here and paragraph B.8.1.(f) above is, since the secretaries were all cooperating country nationals.

B. The secretaries were all at or below Compensation Plan Scales for FSN 7 (secretaries some college required, English III) at the point the raises were made.

C. DEG management will amend rather than draw up new contracts in the future.

D. DEG management requests this finding be dropped since the criteria is incorrect and DEG has followed AID guidance as indicated in its contract.

6. Inadequately Supported Car Insurance Cost

The Auditor finds that a voucher for car insurance and the policy were not in De file. The cost of this insurance was US$ 1,359.

DEG Management Response

A. DEG Management was able to find a copy of the voucher and policy from the insurance company and it is attached.

B. DEG management requests this finding be dropped.

7. Rest and Recuperation Travel not Approved

Dr. Yahya Jammal took an R&R to the US in August 1991. The cost of his ticket was $209 above what he stated was the Mission's R&R guideline at the time.

DEG Management Response

A. DEG management feels that the condition in this finding is incorrect. As the auditor notes, under the criteria section, the only approval required is from the contractors Chief of Party and this approval exists.

B. DEG management accepts that inadvertently USAID/I was charged for the full amount (rather than the amount reduced by $209) and will reimburse the $209 overcharge if it was truly above the USAID guidelines as indicated by Dr. Jammal.

8. Fluctuating Exchange Rates

The auditor recommends that DEG use a foreign exchange rate indicated by the Mission director or the BI rate.

DEG Management Response

DEG management has initiated discussions with USAID Contract management and will agree with them whether the current system is acceptable or if changes are required in converting Rupiah to Dollars for the voucher. Any changes, if required, will be included in the extension of the DEG contract being negotiated currently.

9. Payment of Value Added Tax

The auditor notes that US$ 4,214 of VAT tax was claimed on their audit sample. The DSP project and DEG should not have to pay taxes under the agreement between the US and the Indonesian government.

DEG Management Response

DEG management since having this matter drawn to their attention has begun to collect information on VAT paid. This information will be transmitted to the Mission as requested.

10. Inconsistency in Contract Provisions as to Procurement of Equipment

The auditor indicates that paragraph C.3.5 seems to preclude DEG from buying equipment while there is an explicit line item in the DEG contract that allows purchasing of equipment.

DEG Management Response

A. DEG management appreciates that the wording of paragraph C.3.5 is confusing. However, it does not accept the auditors contention that DEG is not allowed to purchase equipment or even that there is an inconsistency.

DEG management previously indicated to the auditor that paragraph C.3.5 refers to DEG obligations for purchases using PIL money (GOI money), e.g., the reference to funds outside the technical assistance contract. A previous audit FIN/FA Report 90-10 indicated that, in spite of this contract wording, it was not permissible for DEG to administer funds outside the technical assistance contract. Beginning April 1990 all administrative responsibility for these funds was turned over to Bappenas. See page 4 of the Auditor's report.

B. Since this clause is no longer applicable DEG management and AID contract management have begun discussions on amending the contract and dropping this paragraph.

C. DEG management requests that this finding be dropped.

APPENDIX 4

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