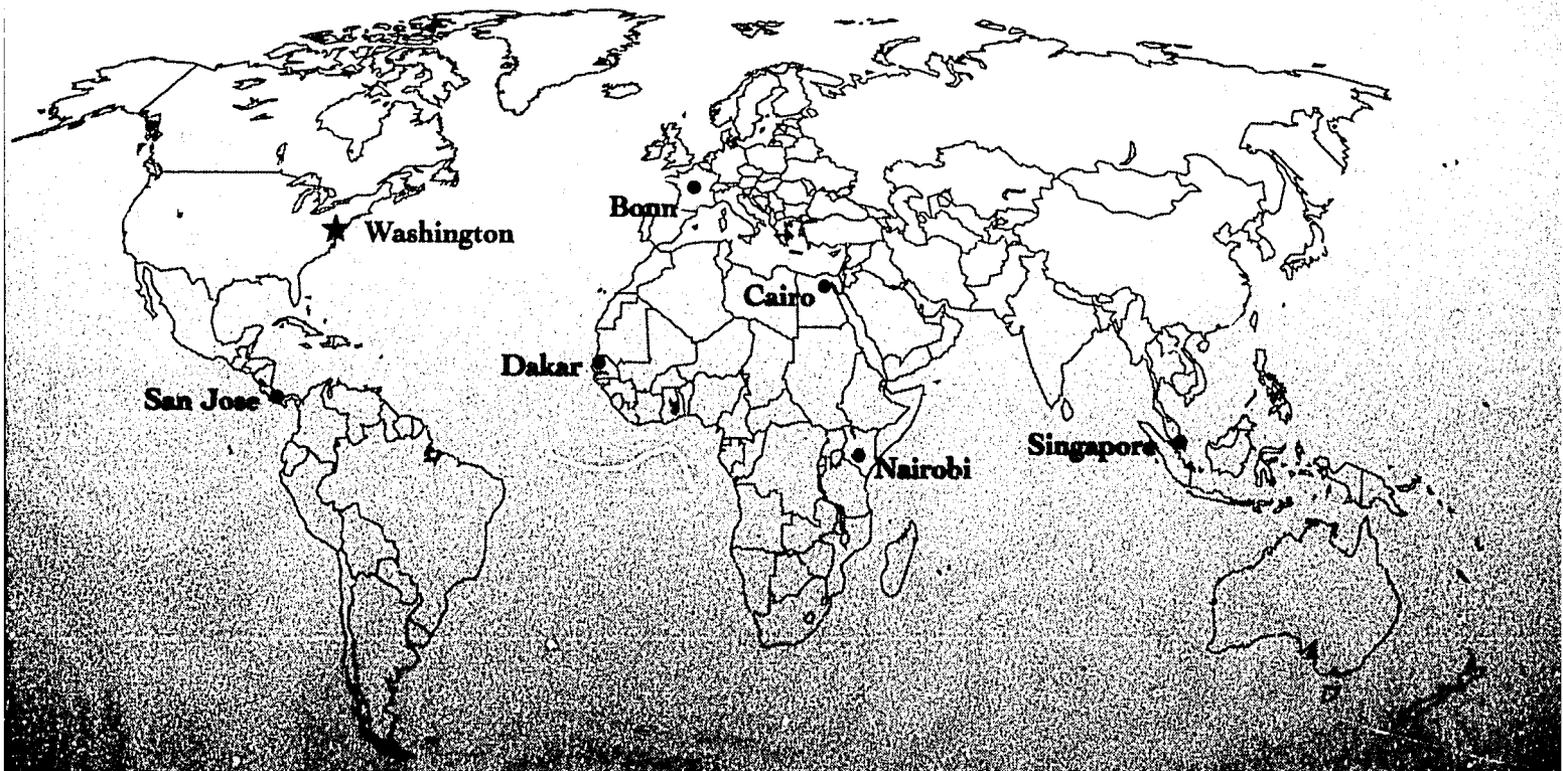

**AUDIT OF USAID/PHILIPPINES'
MANAGEMENT OF PROJECT-FUNDED
COMMODITIES**

**Audit Report No. 5-492-95-008
March 31, 1995**





U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

March 31, 1995

MEMORANDUM

TO: Kenneth Schofield, Mission Director
USAID/Philippines

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

SUBJECT: Audit Report on USAID/Philippines' Management of Project-Funded
Commodities (Audit Report No. 5-492-95-008)

Enclosed are three copies of the subject audit report. We concluded that commodities generally arrived on time, commodity procurement complied with source and eligibility requirements, and commodities were used as intended. We did, note however, that the Mission needs to better ensure that (1) commodities for one project are installed, (2) certain commodity procurement complies with origin requirements and (3) the commodity tracking system is updated.

Your comments to the draft were very responsive and greatly facilitated the completion of the report. The comments have been incorporated in the body of the report, are summarized after each finding and included in their entirety as Appendix II. All recommendations except Recommendation No. 1, are resolved, pending the completion of planned actions.

Please provide us information within 30 days indicating any actions planned or taken to implement the open recommendations. I very much appreciate the collaborative and supportive working relationships that you and your staff maintained with this office during the audit.

Attachments: a/s

EXECUTIVE SUMMARY

The Office of the Regional Inspector General for Audit, Singapore audited USAID/Philippine's management of project-funded commodities to determine whether: the commodities arrived on time; were procured in accordance with source, origin and eligibility requirements; and were used as intended (page 1).

USAID-financed commodities generally arrived on time and complied with source, origin and eligibility requirements except for a small number of procurements. USAID/Philippines also ensured that the commodities were used as intended.

USAID/Philippines, however, needs to better ensure that commodities for one project are installed in a timely manner (page 4), commodity procurement complies with origin requirements (page 11), and a commodity tracking system is updated (page 16).

This report recommends that USAID/Philippines:

- obtain legal counsel's opinion on the advisability of recovering from the host government, the additional costs USAID incurred due to delays in the completion of site development work, and carry out the legal opinion rendered (page 4);
- resolve \$110,000 in questioned costs, representing commodities with ineligible origins purchased under three projects (page 11); and
- ensure that a commodity tracking system is updated (see page 17).

In responding to a draft of this report, USAID/Philippines officials generally agreed with the report's findings and recommendations. We carefully considered their comments in preparing this final report. The complete text of the Mission's comments to our draft report is provided in Appendix II.

Office of the Inspector General

Office of the Inspector General
March 31, 1995

PHILIPPINES

Area: 116,000 sq miles

Population: 58 million

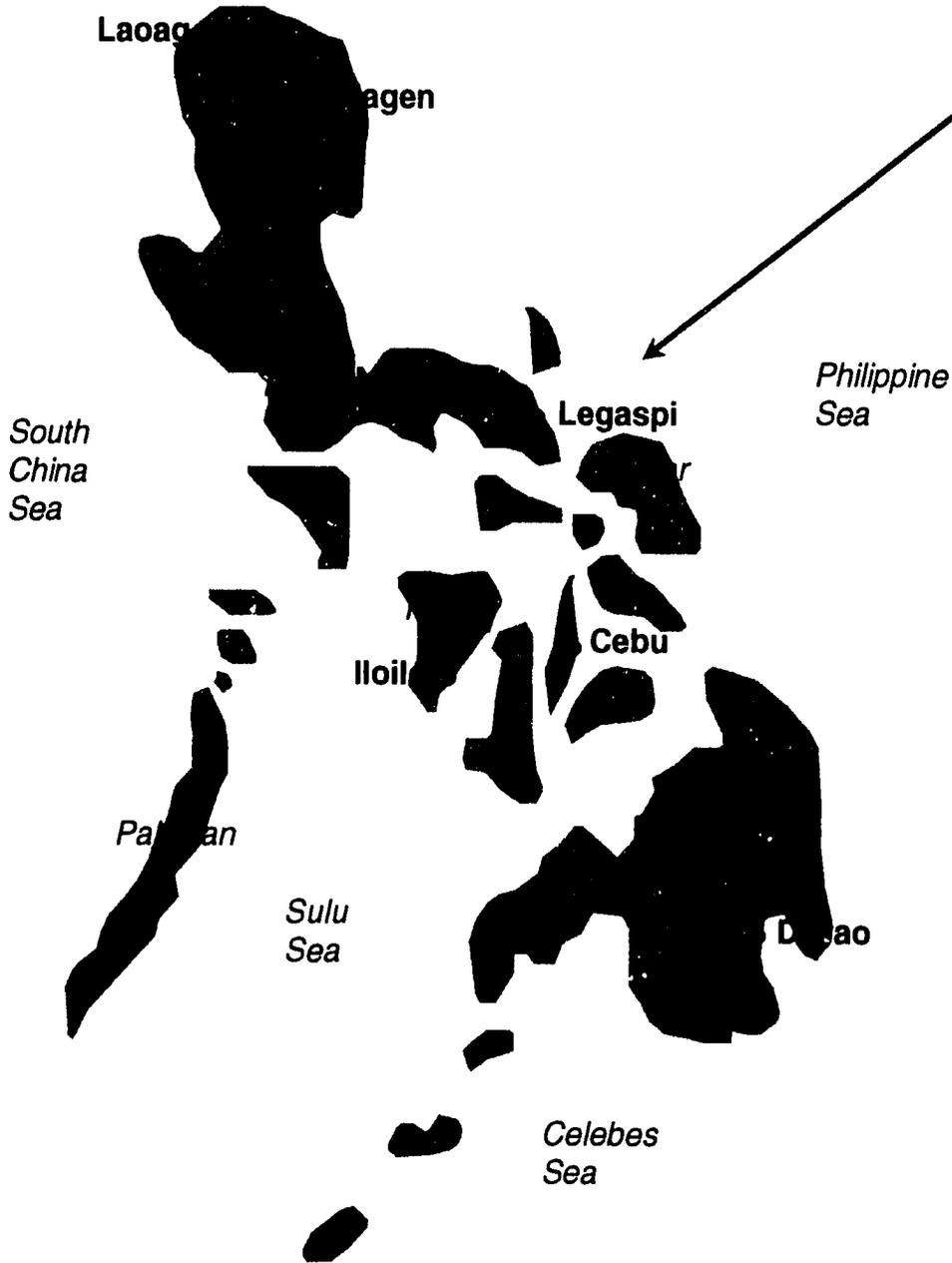
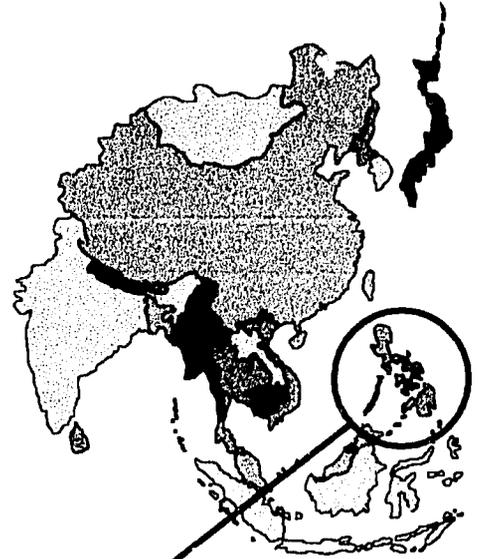


Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY	i
INTRODUCTION	1
Audit Objectives	1
Background	1
REPORT OF AUDIT FINDINGS	3
USAID-financed commodities arrived on time to meet procurement plans and implementation schedules. But,	3
The installation of some commodities was delayed.	4
Commodity procurement complied with U.S. Government and USAID source and eligibility requirements. However,	10
Commodity procurement under three projects did not always comply with origin requirements.	11
USAID/Philippines followed USAID policies and procedures to ensure that commodities were used as intended. But,	14
The Commodity Tracking System should be updated.	16
	<u>Appendix</u>
SCOPE AND METHODOLOGY	I
MANAGEMENT COMMENTS	II
USAID/PHILIPPINES' ACTIVE PROJECTS AS OF MARCH 31, 1994	III
LISTING OF ITEMS OF UNAUTHORIZED ORIGIN	IV

INTRODUCTION

Audit Objectives

The Office of the Regional Inspector General for Audit, Singapore audited USAID/Philippines' management of project-funded commodities to answer the following objectives¹:

- **Did USAID/Philippines-financed commodities arrive on time to meet project procurement plans and implementation schedules?**
- **Were USAID/Philippines-financed commodities procured in accordance with U.S. Government and USAID source, origin and eligibility requirements, unless waived for good reason?**
- **Did USAID/Philippines follow USAID policies and procedures to ensure that USAID-financed commodities were used as intended?**

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

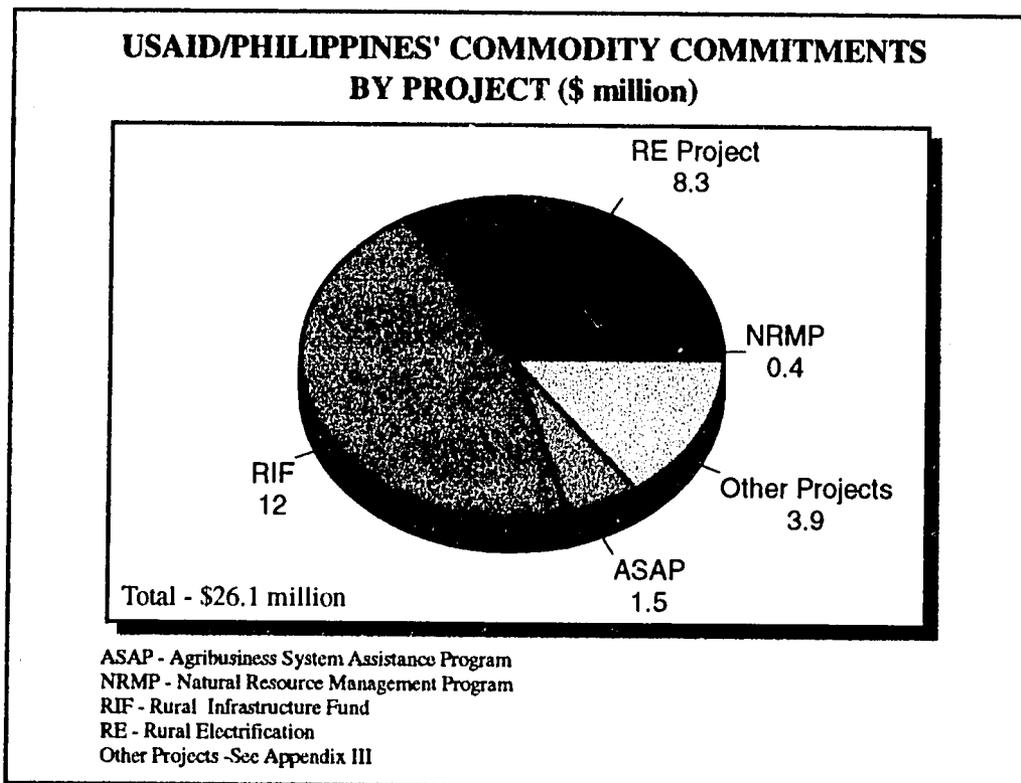
Background

USAID/Philippines finances the purchase of commodities to help achieve the objectives of projects and is responsible for ensuring that USAID-financed commodities are used to further such objectives. The Mission is also responsible for ensuring that procurement is made in accordance with the "Buy American" Act.

USAID Handbook 1, Supplement B defines commodities as any material, article, supply, goods or equipment. As of March 31, 1994, the Mission had

¹ This audit is part of an agency-wide audit directed by the Office of the Regional Inspector General for Audit, Dakar which plans to prepare a summary report based on the results of this audit and the audits made by other Offices of the Regional Inspector General.

expended \$23.4 million² of the \$26.1 million committed for the purchase of commodities under 25 projects. The audit reviewed commodities under the Family Planning Assistance Program, the Rural Infrastructure Fund Project, the Rural Electrification Project, the Natural Resources Management Program, and the Agribusiness System Assistance Program. Commodities reviewed under these five projects accounted for \$19.6 million in commitments or 75 percent of the Mission's total commitments for commodities. The chart below and Appendix III provide a summary of USAID/Philippines' commodity commitments by project.



The audit focused on non-expendable commodities, except for contraceptives under the Family Planning Assistance project. Non-expendable property is defined as a property which is complete in itself, does not lose its identity or become a component of another article when put to use, is durable (with an expected service life of two years or more), and costs \$500 or more per unit.

² This figure is a rough estimate provided by USAID/Philippines.

REPORT OF AUDIT FINDINGS

Did USAID/Philippines-Financed Commodities Arrive on Time to Meet Project Procurement Plans and Implementation Schedules?

USAID-financed commodities arrived on time to meet project procurement plans and implementation schedules except that some commodities for one project were not installed when envisioned.

Although USAID procurement and implementation plans did not always contain schedules specifying dates when the commodities were needed, the projects' implementors as well as Mission management believed that the commodities arrived when needed. Our visits to project sites and review of Mission records disclosed no evidence of adverse effects on the projects' implementation because of any untimely arrival of commodities. For the five projects reviewed, the contractors and grantees prepared receiving reports to ensure that the commodities paid for were received.

For the Family Planning Assistance Project, USAID/Philippines monitored commodity procurement to ensure that the need for contraceptives was met through the maintenance of a security stock level of at least six months. At the end of June 1994, the stock levels at the main warehouse in Manila for three of the major contraceptives consisted of 10,579,200 oral pills, 8,960,800 condoms and 138,000 intra-uterine devices. According to a Logistics Program Officer for the project, these stock levels represent a security level of 9.6 months for the pills, 6.6 months for the condoms, and 6.9 months for the intra-uterine devices.

For the Rural Electrification Project, the project purpose was to establish the commercial viability of selected rural electric cooperatives by addressing institutional, policy and technical weaknesses of the rural electrification system. USAID/Philippines financed the \$8.2 million procurement of computer hardware and software for the National Electrical Administration and the Rural Electric Cooperatives. According to the Mission's records, the timely arrival of these commodities (within 240 days) was an essential factor to the successful completion of the project. According to one Mission

official, the computerization of the National Electrification Administration headquarters, 12 of its regional offices, and 119 Electric Cooperatives is one of the most ambitious computer installation projects ever financed by USAID in the Philippines.

For the Natural Resources Management Program and the Agribusiness System Assistance Program, commodities procured costing \$571,000 generally arrived as needed for project implementation. Although procurement plans did not specify the dates when commodities were to arrive, neither Mission officials nor contractors identified any adverse effects on project implementation from this omission.

For the Rural Infrastructure Project, USAID/Philippines executed a fixed-priced contract for procuring, installing, and commissioning \$10.6 million worth of air navigational equipment at 18 airports over an approximate period of two years, commencing in May 1992. Within nine months of that date, the contractor had procured and delivered approximately 53 per cent of all equipment. Although the equipment arrived on time, other problems (as discussed below) delayed the installation of \$3.3 million worth of commodities.

The Installation of Some Commodities Was Delayed

USAID guidelines stipulate that USAID-financed commodities should arrive and be used in a timely fashion. Although the commodities arrived on time for the five projects reviewed, \$3.3 million worth of commodities for one project were not installed when envisioned for seven of the 18 sites. This delay in installing the equipment occurred because the Government of Philippines did not complete the site development work as scheduled, and USAID/Philippines did not ensure that the host government fulfilled its responsibilities. As a result, these commodities were not used, and the Mission modified the contract for an additional cost of \$320,000 to install the equipment.

Recommendation No. 1: We recommend that USAID/Philippines:

- 1.1 Obtain legal counsel's opinion on the advisability of taking legal action to recover, from the host government, the additional costs USAID incurred due to delays in the completion of site development work, and**
- 1.2 Carry out the legal opinion rendered.**

USAID Handbook 15, Chapter 10, Section 10A says that effective utilization of USAID assistance requires that commodities financed by USAID reach the end user on a timely basis, in a usable condition and are used for the purpose intended within a prescribed time period, usually one year.

USAID/Philippines contracted with a U.S. firm to procure and install navigational aid commodities, in accordance with the contract schedule, at 18 airports. USAID tasked the Government of Philippines with responsibility of site development at seven airports before installation of commodities could proceed. The Mission initially planned the site development work as part of the "Statement of Work" for the USAID-direct contract but, for unknown reasons, the "Statement of Work" was not brought forward from the "Invitation For Bid" into the "Statement of Work" for the contract. Instead, in March 1992, USAID/Philippines assigned the Government of the Philippines responsibility for developing sites for installation of an Integrated Landing System in Zamboanga, Cagayan de Oro, Davao, Bacolod and Iloilo. The Government of Philippines also accepted responsibility for site development for the installation of the Very High Omni Range Directional Beacon/Distance Measuring Equipment in Iligan and Kalibo.

However, the host government delayed the site development work. A Government of Philippines official said that the delays were due to the high cost and large scope of civil works (the Government agreed to budget the necessary funds for the work). He also attributed the delays to an implementation schedule shorter than what had initially been planned. He said that the Mission intended to award the contract in October 1991 with a completion date three years later. However, it delayed awarding the contract until May 1992 due to a protest by the other bidding party. As a result, this Government official believed that the shortened time period for the contract adversely affected the accomplishment of the site development work.

As of July 1994, \$3.3 million worth of commodities had not been sent to six airports for installation because the host government did not complete the necessary site preparation work.

The contractor informed USAID/Philippines as early as July 1992 that the contract schedule for installing commodities was in jeopardy. The contractor's progress reports also highlighted site development as a problem area. For example, in the January 1993 progress report, the contractor said that the host government did not make any progress toward the site development.

Because of delays in site development work, USAID/Philippines revised the contract completion date in Amendment No. 3 (dated June 23, 1993) from June 15, 1994 to September 15, 1994. This amendment established new payment terms and a completion date after which remaining work would be subject to renegotiation. Section A, Paragraph 4 of this amendment provides that:

"If any airport sites are not ready for equipment installation by June 15, 1994, and equipment has been delivered prior to that date, this situation will be grounds for a contract modification and equitable adjustment in contract price."

USAID/Philippines did not take sufficient action to ensure that the Government of Philippines accomplished the site development work. Although the Mission has on many occasions stressed the importance of completing the site development work to the Government of the Philippines, it was not until February 1994 that the host country's financial liability was emphasized in writing. USAID/Philippines alerted the Government of the Philippines that if the required site development work was not accomplished by June 15, 1994, USAID would enforce agreement provisions to deal with the financial liability for uncompleted projects.

However, the Government of Philippines did not meet this deadline. USAID/Philippines then gave another deadline of November 1, 1994. As a result, on July 13, 1994, the Government of the Philippines Undersecretary for Transportation informed the USAID/Philippines Director of the completion dates for site development work:

- Zamboanga International Airport site development work will be completed by July 17, 1994.
- Davao International Airport site development work will be completed by August 10, 1994.
- Kalibo and Cagayan de Oro Airports site preparation work will be completed by July 20 and July 29, 1994, respectively.
- Iloilo Airport site development will be completed by September 9, 1994.
- Iligan Airport Very High Omni Range Directional Beacon/Distance Measuring Equipment will be installed at Lubang Airport. As no site development is required, installation can commence anytime.

Bacolod instrument landing system will be installed on or before the Project Assistance Completion Date (December 31, 1994).

On July 14, 1994, we visited the Davao International Airport; one of seven sites which required site development. According to the Government of Philippines, site development work was to have been accomplished by June 1993. It's latest targeted completed date was August 10, 1994. However, as of July 14, 1994, site development work was not progressing, as shown in the photograph below. In addition, no equipment, landfill materials or personnel were on site and, based on our observations, little site development had been accomplished.



Unfinished Site Development Work at Davao Airport in July 1994

According to the contractor, completion of the site development work will take approximately eight weeks, since 100,000 cubic feet of material is needed to level the sites. A USAID project official conceded that the site development work had not been completed at Davao by the targeted date of August 10, 1994. The host government has also failed to meet the latest

completion dates for the three other sites projected to be completed by August (USAID officials planned to make site visits in September to assess the status of site development work).

Because the host government did not accomplish the site preparation work within deadlines, the USAID contractor was unable to install commodities at those seven sites during the term of his contract. To retain the contractor's technical services, USAID/Philippines negotiated an extension of the contract from September 15, 1994 to December 31, 1994 at a cost of approximately \$320,000. The \$320,000 negotiated for the contract extension would not have been necessary had the host government completed the site development work by June 15, 1994, thereby allowing the USAID contractor sufficient time to install the commodities.

Furthermore, the Mission Director said that the site development was a sensitive issue because it had political implications. He added that complex problems at three of the seven airports have obstructed site development. For example, the Philippines government should relocate a squatter settlement near one airport.

The Project Officer was also not optimistic that the site development work at these three airports can be accomplished by the project's completion date of December 31, 1994. However, he believed that site development and subsequent installation of navigational equipment at the remaining four airports will be accomplished. (Commodities slated for the Iligan airport will instead be installed at Lubang airport which does not require site development.)

USAID/Philippines should have closely monitored the site development work and have taken more forceful actions to ensure that the projected schedules were maintained. In our view, the Mission should not use USAID funds to cover cost overruns incurred as a result of the host country's delays in performing work it had earlier agreed upon.

Management Comments and Our Evaluation

USAID/Philippines did not dispute that delays in the site development necessitate an extension of the contract at a cost of about \$320,000. The Mission characterized the contract extension as a "minimal extension" and emphasized that, due to the additional time, nav aids equipment was installed at five more airports. Thus, by the project completion date, USAID nav aids equipment was in 16 of the 18 airports targeted.

Nonetheless additional costs were incurred. However, the Mission said that

it had yet to make a judgement that the Government of the Philippines is responsible for all of the delays which led to the contract extension.

Based on the Mission's response, we have revised the recommendation. USAID/Philippines should obtain legal counsel's opinion on the advisability of taking legal action to recover, from the host government additional costs USAID incurred due to delays in the completion of site development work. This recommendation is unresolved pending agreement of action to be taken.

Were USAID/Philippines-financed Commodities Procured in accordance with U.S. Government and USAID Source, Origin and Eligibility Requirements, Unless Waived for Good Reason?

Commodity procurement under the five projects was made in accordance with U.S. Government and USAID source, origin and eligibility requirements except that some commodities under three projects were of unauthorized origin for which waivers were not obtained.

For example, all vehicles totaling \$166,500 procured for the five projects were manufactured in the United States, in accordance with Section 636(i) of the Foreign Assistance Act which limits the eligibility of motor vehicles to those manufactured in the United States. For the Family Planning Assistance Project, contraceptives costing \$189,000 tested at three provincial warehouses were made in and shipped from the United States.

Although several items procured for the one cooperative agreement reviewed under the Agribusiness System Assistance Program were not manufactured in the U.S. or the Philippines, the grantee did not violate terms of the agreement. These items included a telephone system, camera, film processor, computer printers, and facsimile machines. The total cost of these commodities was \$43,000 of \$218,000 in total commodities under this cooperative agreement. The grantee had properly documented the justification for procurement of commodities from origins other than U.S. USAID/Philippines approved the procurement because:

- American brands for the camera and the film processor were not available in the Philippines, and the service and maintenance of U.S. brands were not available locally. In addition, the price differential for procurement from U.S. sources exceeded by 50 percent or more the delivered price from the non-U.S. source.
- Procurement of a U.S. origin telephone system could not have been made quickly and would have delayed project implementation.

These non-U.S. procurement were in accordance with the provisions for procurement from non-U.S. origins under certain circumstances. These procurements met those circumstances.

As discussed below, however, commodity procurement under the Rural Infrastructure, the Rural Electrification and the Natural Resources Management projects did not always comply with origin requirements.

**Commodity Procurement Under
Three Projects Did Not Always
Comply With Origin Requirements**

U.S. law, USAID policies, the projects' agreements, and the USAID/Philippines' contracts require commodities to be procured with source and origin in the United States or the host country. However, about \$110,000 of the \$11,384,000 in commodities procured under the three projects were of unauthorized origin for which the Project Officers did not obtain waivers. This occurred because the Mission assigned procurement responsibility to contractors but did not sufficiently monitor the procurement to ensure that the contractors fully complied with the requirements to "Buy America". As a result, questionable non-U.S. procurement worth about \$110,000 was made without the Mission's approval.

Recommendation No. 2: We recommend that USAID/Philippines resolve \$110,000 in questioned costs, representing commodities of ineligible origins purchased under the three projects and paid for by USAID.

Section 604(a) of the Foreign Assistance Act, as amended in October 1992, is the basic regulation for source and origin policies. This section limits procurement of goods and services to the United States, the recipient country, and other developing countries. USAID source and origin policies, as stipulated in Handbook 1, are consistent with Section 604(a). These policies allow for waivers in such cases as emergency situations and unavailability of items from the United States.

A contract under the Rural Infrastructure Project demonstrates the lack of compliance with the above criteria that commodities be of American or Filipino origin. The contractor procured 11 non-U.S. oscilloscopes totaling approximately \$44,600 without obtaining a source/origin waiver. Our examination of an oscilloscope at one of the sites visited revealed that it was manufactured in the Netherlands. When questioned about this procurement, the contractor claimed he was unaware of this fact and

commented that he thought that the oscilloscopes had been manufactured in the United States. He added that the company intended to procure commodities of United States origin and that, because commodities were purchased from the United States, he assumed they were also made there.

Although USAID/Philippines officials visited all the sites with oscilloscopes, they did not examine these items to verify their origin and were also unaware of this discrepancy.

Under this same project, the host country's contractor procured approximately \$12,000 of \$287,000 worth of commodities without obtaining waivers. Neither the contractor nor USAID/Philippines officials could explain why waivers were not obtained for these procurements. Although a Mission official made frequent site visits, he did not ensure that all commodities procured were of U.S. origin, unless waived for good reason.

Under a second project—Natural Resources Management—one contractor procured \$42,000 of \$353,000 in commodities which were not manufactured in the United States. The contractor thought that the items bought from American companies were also manufactured there. However, this was not always the case. For example, one computer purchased in the U.S. was manufactured in Taiwan, and four other computers purchased in the Philippines were manufactured in Australia. The contractor did not obtain authorization from USAID/Philippines to purchase computers of these origins. Although the Mission's Project Officer made site visits, he was not aware that the contractor obtained computers of non-U.S. origin.

Under the Rural Electrification Project, six items costing \$11,052 were also of non-U.S. origin: four printers and a plotter made in Japan, and one digitizer made in Malaysia. As the contract had recently ended, the contractor was not available to explain why (contrary to the terms of the contract) these procurements were made without waivers. Nevertheless, USAID still should seek recourse against the contractor to recover the amounts paid for these ineligible procurements. A Mission official was co-located at the Government of Philippines Implementing Agency office to monitor project implementation. However, neither he nor the Project Officer was aware that procurement was made from non-U.S. origins.

Commodity procurement problems as discussed above occurred because the Mission assigned procurement responsibility to contractors but did not sufficiently monitor the procurement to ensure that the contractors fully complied with the requirements to "Buy America". The contracts for the above procurement properly restricted procurement to those of U.S. or host-country origin. USAID personnel, aware of these provisions, relied on

the contractors to comply, and did not verify compliance during site visits. Contractors purchased items, in many cases from U.S. sources or U.S. companies, thinking that such items were of U.S. origin. One Project Officer made the same assumptions and thus did not verify the origins.

In summary, questionable non-U.S. procurement, totaling about \$110,000 was made without giving the USAID/Philippines Director the opportunity to decide whether the procurement was justified (see Appendix IV). The Mission should resolve these questionable costs with the respective contractors.

Management Comments and Our Evaluation

The Mission concurred with the finding and recommendation. It also emphasized its controls on source and origin compliance, citing that 99 percent of the commodities procured met the source/origin requirements. In the response to the draft report, the Mission identified one item (a Sharp photocopier costing \$10,445) and suggested that it should be deleted from the finding as it could come under a blanket waiver for procurement of photocopiers. However, the Mission subsequently informed us that it could not find such a waiver and accordingly the finding was not revised. The Mission will prepare the source/origin waivers for those commodities we had identified whose origin was from an ineligible source.

The Mission said that it will take action to reiterate the requirement to ensure that source and origin rules are strictly followed and that all necessary waivers are secured in advance for future procurement. It will circulate a Notice to Project Officers reminding them of the importance to verify source and origin for all commodities procured with U.S. government funds.

We consider this Recommendation resolved, and we will close it upon receipt of the Mission notice cited above and source/origin waivers for the commodities procured from "ineligible" origins.

Did USAID/Philippines Follow USAID Policies and Procedures to Ensure that USAID-Financed Commodities Were Used as Intended?

USAID/Philippines followed USAID policies and procedures to ensure that USAID-financed commodities were used as intended; however, its commodity tracking system needs to be updated.

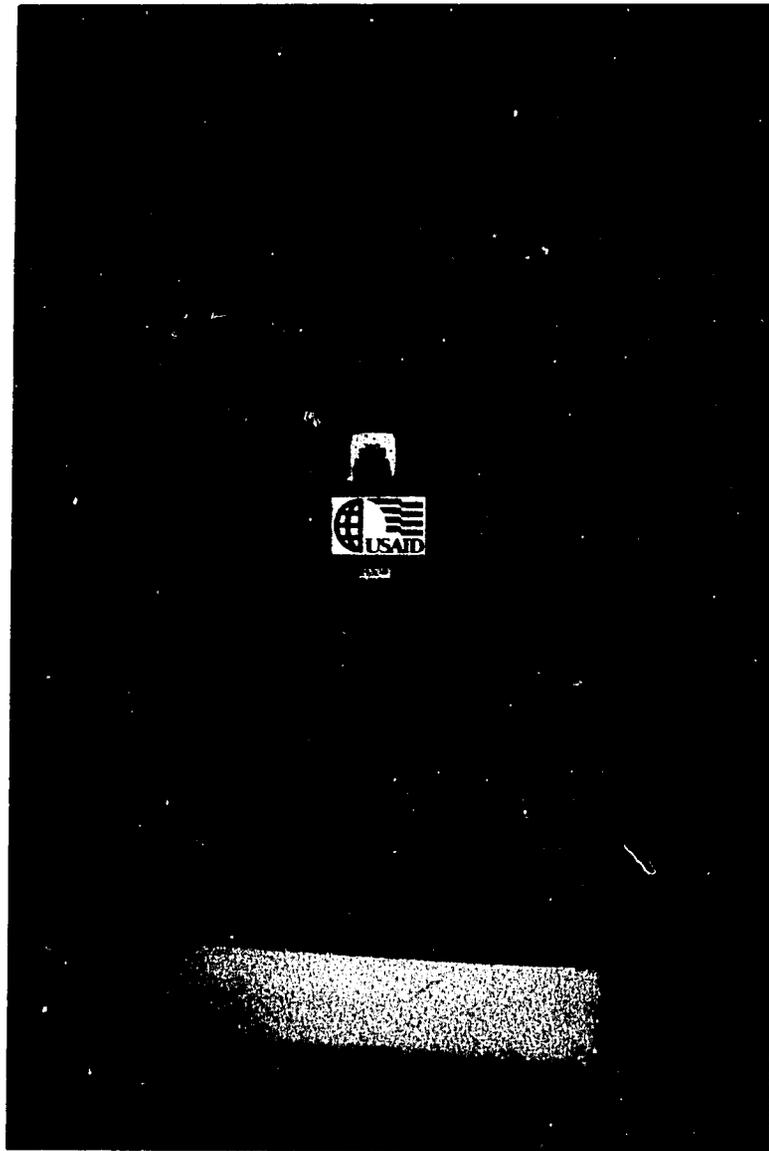
The policies and procedures followed by USAID/Philippines included (1) incorporating the appropriate clauses in contracts and agreements, (2) obtaining inventory reports from contractors, (3) making site visits, and (4) properly marking the commodities with USAID's logo.

USAID/Philippines included the appropriate clause in all five project grant agreements to require that commodities be used for project purposes. For example, the Mission included the following clause in all five agreements with the Government of Philippines: "*Section B.3 Utilization of Goods and Services Any resources financed under the Grant will, unless otherwise agreed in writing by A.I.D., be devoted to the Project until completion of the Project, and thereafter will be used so as to further the objectives sought in carrying out the Project.*" The Mission also included the mandatory standard provisions in the cooperative agreements with non-U.S., nongovernmental grantees: TITLE TO AND USE OF PROPERTY (GRANTEE TITLE). These provisions stipulate that the grantee agrees to use and maintain the property for the purposes of the grant.

For contractors, USAID/Philippines also included the appropriate contract clauses—USAID Acquisition Regulation No. 752.245.70 and 71—which require the contractor to establish a program to properly control non-expendable property and to submit an annual inventory report on non-expendable property. For the contracts reviewed, the contractors submitted these annual inventory reports to the Mission.

In addition, USAID/Philippines made site visits to ensure that the commodities were used as intended. For example, as a result of a site visit to one project, the USAID Project Officer took appropriate action when a computer intended for use as a workstation at an electrical cooperative was diverted to a supervisor's office.

For the five projects reviewed, commodities were properly marked with USAID logos, as the following picture shows:



Navalds equipment marked with USAID logo

For the Family Planning Assistance Project, the four warehouses visited had adequate storage facilities because USAID/Philippines' contractor had provided the provincial city health offices with guidelines on storage facilities. Examples of such guidelines are listed below:

"Store Contraceptive in a dry, well lit and well ventilated storeroom Out of Direct Sunlight.

Stack Contraceptive cartons at least 10 centimeters (4 inches) off the floor, 30 centimeters (1 foot) away from the walls and other stacks, and no more than 2.5 meters (8 feet) high.

Store Contraceptive cartons in a manner accessible for "First expiry First-Out (FEFO), counting and general management".

In September 1993, USAID/Washington's contractor made a quality assurance testing of USAID/Philippines-supplied condoms. Because of the low quality index for some samples tested, the Mission made an additional test of these contraceptives to ensure that they met these standards.

USAID/Philippines, however, needs to improve the accountability for commodities by updating the commodity tracking system. The Mission developed this commodity tracking system in response to audit findings that recipients did not update commodity inventory records to reflect the results of periodic inventories, and to reflect complete information such as acquisition cost, serial number and commodity condition. The need for an updated commodity tracking system is discussed more fully below.

The Commodity Tracking System Should be Updated

USAID policies and procedures require missions to ensure that USAID-financed commodities are received, accounted for, and used as intended. Since previous audits showed that recipients were not always able to provide proper accountability for commodities, USAID/Philippines developed a commodity tracking system at an approximate cost of \$110,000. However, the Mission needs to update the new system because it does not include all the USAID-financed commodities. The commodity tracking system has not been completely updated because the responsible Mission personnel did not believe that the office had enough staff. The failure to update the commodity tracking system has a dampening effect on the level of commodity accountability.

Recommendation No. 3: We recommend that USAID/Philippines ensure that the commodity tracking system is updated periodically with current data.

USAID Handbook 13 and USAID Acquisition Regulation 752.245-70 require accountability by grantees and contractors for nonexpendable property. Handbook 13, Appendix 4D, and USAID Acquisition Regulation 752.245.71 require the grantee and contractor to prepare and establish a program for the receipt, use, maintenance, protection, custody, and care of nonexpendable property, for which the grantee or contractor has custodial responsibility. Furthermore, USAID Acquisition Regulation 752.245-70 requires contractors to provide the missions with an annual report of non-expendable property.

USAID/Philippines funded a contractor-developed commodity tracking system in response to audit findings³ which identified a lack of proper accountability for USAID-financed commodities by some host country entities, contractors, grantees and recipients. The objective of this system was to support the Mission in ensuring effective assistance by monitoring and accounting for all commodities procured with USAID funds. To establish this system, the Mission issued two delivery orders. The first delivery order was issued in October 1992, and the contractor was asked to generate a comprehensive list of all USAID-financed commodities for all active projects/programs. As required by the Mission, the contractor was to:

- Gather and compile commodity reports from the various implementing agencies and grantees. If the reports were not available, the contractor was to assist the entity in accomplishing the report.
- Compile commodity reports which have to be submitted by entities to project offices.
- Verify completeness of reports.
- Prepare an inventory listing of commodities by project.

³ Audit Report No. 2-492-92-01, "Audit of USAID/Philippines' Rural Infrastructure Fund Project No. 492-0420"

The Mission issued a second delivery order in August 1993, requiring the contractor to:

- Assist recipients of USAID-financed commodities in establishing accounting and reporting procedures that conform with USAID requirements, and
- Update the comprehensive USAID-financed commodity inventory list maintained by the Mission.

The contractor developed the commodity tracking system for USAID/Philippines. The USAID contractor also visited the grantee and three contractors we reviewed and provided them a standardized format for use in commodity reporting. These four organizations submitted annual inventory reports on non-expendable property which met USAID requirements. In addition, the contractor held seminars to train participants on reporting for USAID-financed commodities. These inventory reports contain the necessary information for each item of commodity, such as acquisition cost and location. The contractor met with 90 organizations and obtained data on USAID-financed commodities which was incorporated in the commodity tracking system. In February 1994, the contractor delivered the commodity tracking system to USAID/Philippines. The contractor included all but nine organizations with USAID-financed commodities in the commodity tracking system.

According to a Mission official, the Mission did not intend to review all organizations with commodities because sufficient funding was not available. The Mission intended to add commodities not included at the earliest opportune time. However, since accepting this system, USAID/Philippines has not maintained the data base by updating all project-financed commodities as appropriate. According to the Mission's Controller's Office (the office charged with the responsibility of implementing the system), the office was not adequately staffed to implement and maintain the system. The Mission has sustained reductions in staff positions (as well as to USAID's assistance levels for the Philippines), and foresees managing the commodity tracking system with in-house resources. The updating of the system was slow because the Mission gave it a low priority.

USAID's decision to initiate a commodity tracking system by making a contractor survey of commodities and educating the recipients has resulted in better accountability for commodities. For example, the physical inventories of commodities that we made at field sites did not disclose any significant discrepancies.

Therefore, the Mission should update the commodity tracking system with current data in order for all USAID-financed project commodities to be included. Otherwise, the commodity tracking system objective — to improve accountability of commodities — will not be fully achieved, thereby increasing the potential for fraud, waste, and abuse. Mission personnel support the commodity tracking system's objectives and intend to increase their focus on updating of the system. To continue to reap the benefits of the commodity tracking system, updating should be given high priority.

Management Comments and Our Evaluation

The Mission agreed that the commodity tracking system should be updated periodically. The Mission said that it will have contractors and grantees submit updated non-expendable commodity inventory reports which will be used to update the commodity tracking system. This recommendation is resolved, and will be closed when documentation is provided supporting submission by contractors and grantees of updated non-expendable commodity inventory reports and updating of the commodity tracking system.

SCOPE AND METHODOLOGY

Scope

The Office of the Regional Inspector General for Audit, Singapore, audited USAID/Philippines' management of project-funded commodities in accordance with generally accepted government auditing standards. The fieldwork took place from May 23, 1994 through September 9, 1994, and included work at USAID/Philippines in Manila and at several contractors' and grantees' offices in Manila, Cebu and Davao.

The audit covered commodities under the Family Planning Assistance Program, the Rural Infrastructure Fund Project, the Rural Electrification Project, the Natural Resources Management Program, and the Agribusiness Assistance Program. Commodities under these five projects accounted for \$19.6 million in commitments or 75 percent of the Mission's total commitments for commodities. As of March 31, 1994, USAID/Philippines had expended \$23.4 million⁴ of the \$26.1 million committed for commodities.

In addition to the methodology described in the following section, we have received written representations from USAID/Philippines management confirming information that we consider essential for answering our audit objectives and for assessing internal controls and compliance.

⁴ This figure is a rough estimate provided by USAID/Philippines.

Methodology

The methodology for each audit objective is discussed below:

Audit Objective One

The first audit objective was to determine whether USAID/Philippines ensured that USAID-financed commodities arrived on time to meet project procurement plans and implementation schedules. To accomplish this objective, we reviewed applicable policies and procedures contained in USAID Handbooks 1, 3, and 13 which relate to the procurement process, the receiving and inspection process, and the process of placing commodities in service for the five projects.

We then reviewed project papers, project agreements, annual workplans, implementation schedules, contracts and receiving reports, and interviewed Mission officials and contractors to determine the dates the commodities were supposed to have arrived versus the date when the commodities actually arrived. Finally, we followed up with USAID/Philippines and contractor officials to determine the reasons for any significant delays and to ascertain the effect, if any, on the projects.

Audit Objective Two

The second audit objective was to determine whether USAID/Philippines-financed commodities were procured in accordance with U.S. Government and USAID source, origin and eligibility requirements, unless waived for good reasons. We reviewed applicable policies and procedures contained in Handbooks 1, 3 and 13 and the Foreign Assistance Act of 1961 relating to the source, origin and eligibility determination process, and the process of obtaining waivers.

We determined the source and origin of the commodities by physically inspecting the items, and by reviewing receiving reports and suppliers' invoices. For any non-U.S. procurement, we also reviewed any waiver authorization documentation. Finally, we interviewed Mission, grantee and contractor individuals to determine the reasons for any non-compliance with USAID source and origin regulations.

Audit Objective Three

The third audit objective was to determine whether USAID/Philippines followed procedures to ensure that USAID-financed commodities were used as intended. To accomplish this objective, we applied policies and procedures in the Federal Acquisition Regulations, USAID Handbooks 3, 13 and reviewed internal controls relating to the process of maintaining inventory records, the commodity storage process and the commodity monitoring process.

We tested \$1.3 million of \$26.1 million USAID-financed commodities. We visited commodity storage areas and physically inspected the items and interviewed Mission, contractor and grantee individuals to determine if the commodities were used as intended. We (1) reviewed site visit reports to see if Project Officers had identified idle commodities, (2) examined storage facilities to determine if commodities were adequately stored, and (3) compared items physically inspected to the inventory reports to assess whether the reports were complete and accurate.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID / Philippines
APO AP 96440



Fax No.: 632 - 521 - 4811
Tel. No.: 632 - 522 - 4411

JAN 30 1995

MEMORANDUM

TO: Mr. Richard C. Thabet
RIG/A/Singapore

FROM: Mr. Gordon H. West *G. West*
Acting Director, USAID/Philippines

SUBJECT: Audit of USAID/Philippines' Management of
Project-Funded Commodities

Following is the Mission's response to the findings and recommendations on the subject audit.

Mission Response to Findings and Recommendations:

First Objective: Did USAID/Philippines-financed commodities arrive on time to meet project procurement plans and implementation schedules?

Finding: Installation of some commodities was delayed. Commodities worth \$3.3 million for the RIF project were not installed when envisioned for 7 of the 18 sites. The delay in installing the equipment occurred because USAID/Philippines and the Government of the Philippines (GOP) changed the project's implementation plans. USAID did not ensure that the GOP met its new responsibilities for accomplishing all site development work. As a result, these commodities have not been used, and the Mission plans to spend an additional \$320,000 at least, to install the commodities.

Recommendation No. 1: That USAID/Philippines require the Government of the Philippines to pay the additional cost incurred as a result of its delay in completing all site development work for the Rural Infrastructure Project.

Mission Response: The Mission is pleased to report that as a result of the contract extension from September through December 1994, the Navaid's equipment has now been installed at 16 of the 18 airports. In retrospect, we believe the decision to approve this minimal extension proved sound considering the progress made since your audit. As for the recommendation, the Mission believes it is premature, inasmuch as the Mission has not yet made a judgment that the Government of the Philippines is responsible for all of the delays which led to the contract extension. That judgment will require careful analysis by our Regional Legal Advisor and Regional Contracting Officer, and a decision by Mission Management. So as not to bind the Mission to

a course of action which may not be warranted on the facts, we suggest you rewrite the recommendation as follows: "That USAID/Philippines consider requiring the Government of the Philippines to pay the additional cost incurred in order to provide USAID the flexibility to consider various options on dealing with the finding."

Second Objective: Were USAID/Philippines-financed commodities procured in accordance with U.S. Government and USAID source, origin and eligibility requirements, unless waived for good reason.

Finding: Commodity procurement under three projects (RIF, RE and NRMP) did not always comply with origin requirements. A total of \$110,000 of the \$11,384,000 in commodities procured under the three projects were of unauthorized origin for which the Project Officers did not obtain waivers. This occurred because the Mission assigned procurement responsibility to contractors but did not sufficiently monitor the procurement to ensure that the contractors fully complied with the requirements to "Buy America." As a result, questionable non-U.S. procurement worth about \$110,000 was made without the Mission's approval.

Recommendation No. 2: Recommend that USAID/Philippines resolve \$110,000 in questioned costs, representing commodities of ineligible origins purchased under the three projects and paid for by USAID.

Mission Response: We have reviewed the commodities listed as not meeting the source and origin requirement. Our review identified one item in the list, the Sharp Photocopier costing \$10,445, which should be deleted. This procurement is covered by a blanket waiver for procurement of photocopiers and should not have been included in the list. Ninety-nine percent of the commodities procured met the source and origin requirement as the goods were purchased in the U.S, so the Mission believes its controls on source and origin are working very well. Nevertheless, the Mission will prepare the source/origin waivers as necessary to allow these few commodities whose origin was incorrect to be considered as "eligible" commodities. A Mission notice has also been circulated to project offices reminding them of the importance to verify source and origin for all commodities procured with U.S. government funds.

The Mission will take action to reiterate the requirement to ensure that source and origin rules are strictly followed and that all necessary waivers are secured in advance.

Third Objective: Did USAID/Philippines follow USAID policies and procedures to ensure that USAID-financed commodities were used as intended?

Finding: The Mission's Commodity Tracking system has not been completely updated because the responsible Mission personnel did not believe that the office had enough staff. The failure to update the commodity tracking system has a dampening effect on the level of commodity accountability.

Recommendation No. 3: We recommend that USAID/Philippines ensure that the commodity tracking system is updated periodically with current data.

Mission Response: The Mission concurs that the commodity tracking system should be updated periodically. Accordingly, the Mission will send a follow-up letter to all grantees and contractors to submit an updated non-expendable commodity inventory report for commodities procured by USAID funds under their active grant or contract. The inventory report will be used to update the commodity tracking system.

cc: IG/A/FA, USAID/W
ANE/ORR, USAID/W

Attachment: Representation Letter

25

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

USAID / Philippines
APO AP 96440



Fax No.: 632 - 521 - 4811
Tel. No.: 632 - 522 - 4411

JAN 30 1995

Mr. Richard C. Thabet
Regional Inspector General for Audit/Singapore
U.S. Agency for International Development
FPO AP 96534

Subject: Audit of USAID/Philippines' Management of
Project-Funded Commodities

Dear Mr. Thabet:

You have asked that USAID/Philippines provide a Management Representation Letter in connection with your audit of the USAID/Philippines' Management of Project-Funded Commodities. Your staff informed us that the audit covered commodities under the Family Planning Assistance Project, the Rural Infrastructure Fund Project, the Rural Electrification Project, the Natural Resources Management Program, and the Agribusiness System Assistance Program and was intended to answer the following audit objectives:

- o Did USAID/Philippines-financed commodities arrive on time to meet project procurement plans and implementation schedules?
- o Were USAID/Philippines-financed commodities procured in accordance with U.S. Government and USAID source, origin and eligibility requirements, unless waived for good reason?
- o Did USAID/Philippines follow USAID policies and procedures to ensure that USAID-financed commodities were used as intended?

I have asked the offices concerned with the audit, particularly the Office of Financial Management, the Office of Regional Procurement, the Office of Natural Resources, Agriculture & Decentralization, and the Office of Investment and Enterprise Development to make available to your staff all records in our possession for the purpose of the audit. They have assured me that all records in our possession have been made available.

In making the representations contained herein, we relied extensively on USAID's Office of the Inspector General as a primary element of internal control to determine the compliance with applicable laws and regulations, and to ensure the accuracy of accounting and management information.

Based upon the representations made to me by my staff and their concurrence with the representations made herein, and in reliance on your office which has not informed me of any difficulty in obtaining records or information, or of any difficulty in obtaining the full cooperation of the offices and staff involved, I confirm, as a layman and not as a lawyer, the following representations with respect to the audit of the management of the Mission's project funded commodities:

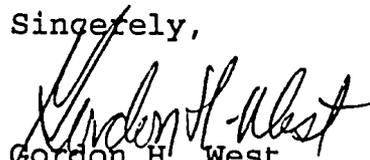
1. USAID/Philippines is responsible for: (a) the Mission's internal control system relating thereto; (b) the Mission's compliance with applicable U.S. laws, regulations, and the project agreements relating thereto; and (c) the fairness and accuracy of the Mission's accounting and management information relating thereto.
2. To the best of my knowledge and belief, USAID/Philippines has made available to RIG/A/S auditors all Mission record(s) relating to the audit objectives.
3. To the best of my knowledge and belief, Mission records relating to the audit objectives are accurate and complete and give a fair representation as to the management of the Mission's project-funded commodities.
4. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines is not aware of any instances which we consider material where financial or management information directly relating to this audit has not been properly and accurately recorded, other than the findings in the draft report.
5. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines has made available information regarding any known irregularities which we consider material related to the management of project-funded commodities involving Mission employees with internal control responsibilities for the matter under audit. For purposes of this representation, "irregularities" means the intentional noncompliance with applicable laws or regulations and/or intentional misstatements, omissions or failure to disclose.
6. To the best of my knowledge and belief, as a layman and not as a lawyer, USAID/Philippines is not aware of any instance (other than what has been included in the draft audit report or reported by the Mission during the course of the audit) in which, in the Mission's judgment, there has been a material noncompliance by the Mission with USAID policies

and procedures or violation of U.S. law or regulation, which would substantially impact upon the matter under audit.

7. Following our review of your draft audit report and further consultation with my staff, and to the best of my knowledge and belief, there are no other facts as of the date of this letter (other than those expressed in our Management Comments to the draft report) which would materially alter the conclusions reached in the draft report.

I request that this Representation Letter be included as part of the official Mission comments on the draft report and that it be published as an Annex to the final report.

Sincerely,


Gordon H. West
Acting Director

DB

USAID/PHILIPPINES' ACTIVE PROJECTS AS OF MARCH 31, 1994

PROJECT NO.	PROJECT NUMBER	PROJECT TITLE	PACD	COMMIT. UNDER COMMODITY LINE	EXPENDIT. FOR COMMODITIES
1	396	Family Planning Assistance	30-Sep-95	\$120,722	\$0
2	406	Child Survival Program	31-Mar-95	\$0	\$0
3	446	Health Finance Development	30-Sep-96	\$247,636	\$83,609
4	473	AIDS Surveillance & Education	30-Sep-97	\$900,000	\$0
5	395	Enterprise in Community Develop.	07-Sep-96	\$214,502	\$178,624
6	419	PVO CO-Financing III	31-Dec-96	\$535,082	\$325,163
7	470	PVO Co-Financing IV	30-Sep-98	\$135,779	\$65,271
8	432	Technical Resources	30-Sep-97	\$0	\$0
9	439	Development Training Project	31-Dec-95	\$0	\$0
10	429	Rural Electrification Project	31-Dec-95	\$8,345,237	\$8,345,237
11	420	Rural Infrastructure Fund	31-Dec-94	\$11,997,198	\$11,993,570
12	452	Philippine Assistance Program	30-Sep-98	\$143,018	\$65,975
13	456	Mindanao Development Fund	30-Sep-96	\$643,329	\$473,815
14	463	Local Govt. Infrastructure Fund	30-Sep-96	\$229,093	\$0
15	444	Natural Resources Management	30-Sep-95	\$430,485	\$460,901
16	465	Industrial Environment Management	30-Sep-96	\$133,691	\$18,172
17	388	Decentralized Shelter & Urban Develop.	30-Sep-94	\$0	\$0
18	436	Local Develop. Assistance Program	30-Sep-94	\$154,723	\$116,149
19	445	Agribusiness System Assistance	30-Sep-96	\$1,490,952	\$1,144,438
20	447	Capital Market Development	30-Sep-97	\$0	\$0
21	449	Private Invest. & Trade Opportunity	16-Sep-94	\$170,000	\$138,937
22	457	Private Enterp. Policy Support	31-Dec-95	\$198,318	\$5,339
23		Support for Development Prog. II		\$0	\$0
24	450	USAID Direct Contract	31-Jul-94	\$54,500	\$794
25	4196	PVO Co-financing II	24-Apr-94	\$3,077	\$3,077
			TOTALS	\$26,147,342	\$23,419,071

Note: Total commitments and expenditure for commodities as shown here are rough estimates based on data provided by USAID/Philippines as of March 31, 1994

APPENDIX IV

LISTING OF ITEMS OF UNAUTHORIZED ORIGIN

Item Number	Description	Qty	Cost	Notes*
1	PC/XT Turbo computer	2	1,538	Made in Taiwan
2	PC/AT compatible computer	2	4,538	Made in Taiwan
3	Fuji Xerox machine	1	5,454	Made in Japan
4	Oscilloscopes	11	44,600	Made in Netherlands
5	Matrix printer LQ 1170	2	2,230	Made in Japan
6	Line printer	1	4,200	Made in Japan
7	Laser printer	1	2,545	Made in Japan
8	Digitizer	1	1,000	Made in Malaysia
9	Plotter	1	1,077	Made in Japan
10	Panasonic KX.P Dot Matrix	1	265	Made in Japan
11	Epson LQ 1170	1	1,004	Made in Japan
12	VGA monitors	4	1,969	Made in Taiwan
13	Uniden transportable phone	2	1,686	Made in Hong Kong
14	Data Interface Jack	1	562	Made in Hong Kong
15	AST computer 386	1	2,330	Made in Taiwan
16	Sharp copier	1	10,445	Made in Japan
17	AST Bravo Notebook	2	4,754	Made in Taiwan
18	IBM Valve Pt.	3	12,202	Made in Australia
19	Relaskop	3	7,211	Made in Austria
	TOTAL		<u>\$109,610</u>	

*We determined origin through physical inspections