USAID

OFFICE OF THE REGIONAL INSPECTOR GENERAL
37 PETCHBURI SOI 15
BANGKOK10400
THAILAND

U.S. AGENCY FOR
INTERNATIONAL
DEVELOPMENT

December 3 1, 1998

MEMORANDUM FOR DIRECTOR, USAID/Nepal, Frederick E. Machmer

FROM: Acting RIG/A/Bangkok, Nathan S. Lokos

SUBJECT: Audit of USAID/Nepal's Review and Certification of Unliquidated Obligations for Project and Non-project Assistance, Audit Report No. 5-367-98-003-F

This memorandum is our final report on the subject audit. In preparing the final report we considered your comments on the draft and included them as Appendix II. The audit identifies $397,184 in obligations that were excessive as of September 30, 1996 and $64,148 in excessive obligations as of the time of our field work in August 1997.

The report contains two audit recommendations. Based on your comments to the draft report, an acceptable management decision has been reached on Recommendation No. 1. After management action in response to Recommendation No. 1 is completed, a request for closure can be submitted to the Office of Management Planning and Innovation, Bureau for Management (M/MPI). Since actions described in the management comments are responsive to Recommendation No. 2, we consider final action to have been taken on this recommendation.

I appreciate the cooperation and courtesy extended to my staff during the audit.

Background

This audit is part of the Office of the Inspector General's (OIG) worldwide review of the Agency's obligations for project and non-project assistance. The OIG's Division of Performance Audits (IG/A/PA) is leading this worldwide effort, with the assistance of auditors from all OIG offices of Regional Inspectors General.

The worldwide audit is limited to obligations for project and non-project assistance which had unliquidated balances on September 30, 1996. It does not cover obligations funded with U.S.-owned local currency, obligations for disaster relief, or obligations maintained by USAID for the Trade and Development Agency.

U.S. MAILING ADDRESS
C/O U.S. EMBASSY
BOX 47
APO AP 96546-7200

TELEPHONE
66-Z-253-3739
FAX
66-2-255-4857

IG/A/PA randomly selected USAID sites for detailed audit work and also determined the number of unliquidated obligations to be randomly selected and reviewed at each site. A total of 19 sites (USAID/Washington and 18 missions) were selected for review. USAID/Nepal was among those missions randomly selected for review.

Mission records indicate that, as of September 30, 1996, USAID/Nepal had 36 unliquidated obligations for project and non-project assistance with balances totaling $40,662,852.[1]

Audit Objective

The worldwide audit was designed to answer the following objective:

> Did USAID/Nepal review and certify its unliquidated obligations for project and non-project assistance in accordance with U.S. laws and regulations and agency policies and procedures?

To test the effectiveness of USAID's internal control systems related to this objective, we reviewed randomly selected obligations to determine whether the obligations, and their associated commitments, were valid when recorded and whether their unliquidated balances complied with Agency funding guidance. For the purposes of this audit we considered obligations and commitments to be excessive which did not appear to be required to meet immediate funding needs at September 30, 1996 and/or at the time of our audit fieldwork.

Appendix I contains a discussion of the scope and methodology for audit work conducted at USAID/Nepal.

Audit Findings

> **Did USAID/Nepal review and certify its unliquidated obligations for project and non-project assistance in accordance with U.S. laws and regulations and agency policies and procedures?**

For the items tested, USAID/Nepal generally reviewed and certified its unliquidated obligations for project and non-project assistance in accordance with U.S. laws and regulations. However, for the items tested, the Mission did not review and certify its unliquidated obligations for project and non-project assistance in accordance with USAID policies and procedures. The Mission conducted ongoing Section 13 11 and pipeline reviews to assess the validity and continued need for unliquidated obligations and

---

[1]This report reflects unliquidated obligation balances as reported by USAID/Nepal. We did not determine the accuracy of those balances.

commitments, but for the obligations in our sample the reviews were not fully documented in accordance with USAID requirements. The audit identified no invalid obligations or commitments[2] among the items tested at USAID/Nepal. However, two of the 17 sample items were found to have excessive balances as of September 30, 1996. One of the two items continued to carry an excessive balance at the time of our audit, which should be deobligated. A third sample item was also found to have an excessive balance at the time of the audit, needing deobligation.

Some Obligations Had
Excessive Balances

Of the 17 unliquidated obligations totaling $8,243,831 reviewed during this audit, two obligations had balances on September 30, 1996 which exceeded anticipated needs, as defined in Agency guidance, by a total of $397,184. One of these obligations continued to carry an excessive balance of $4,564 at the time of our audit. In addition, at the time of our audit a third obligation had an excessive balance of $59,584. Causes for these situations are discussed in the section titled "Observations On Internal Controls" below. The Mission should take action to deobligate the balances, totaling $64,148, which were excessive at the time of our audit.

> **Recommendation No. 1: We recommend that USAID/Nepal deobligate the $64,148 in excess balances as of August 1997 as described in Appendix III of this report.**

Each year, USAID's Bureau for Policy and Program Coordination issues guidance for the preparation of mission and office budgets. Guidance applicable to the period under audit stated that budgets should be prepared as follows:

> New Projects or Activities - Obligations should provide funding for at least the first 18 months, but not more than 24 months.
>
> Continuing Activities - Obligations should be sufficient to fund anticipated expenses for no more than 12 months beyond the end of the fiscal year in which the obligation takes place.

We reviewed obligation balances as of September 30, 1996, and applied the Agency's guidance as follows:

2 GAO's ***Principles of Federal Appropriations Law*** defines an obligation as "some action that creates a liability or definite commitment on the part of the government to make a disbursement at some later time." USAID Financial Management Bulletin, Part II, No. 14A, defines a commitment as "funds set aside [for an obligation] to pay for the goods or services being procured."

New Activities - In general, obligation or commitment balances were considered reasonable if they did not exceed anticipated expenses for a period of 24 months following the date of obligation or commitment, or through September 30, 1998, whichever was later.

Continuing Activities - In general, obligation or commitment balances were considered reasonable if they did not exceed anticipated expenses for the 12-month period ending September 30, 1997, the expiration date of the obligating or commitment document, or the project assistance completion date, whichever was earlier. We also took into account balances of earlier or planned obligations which affected the continuing need for part or all of the unliquidated balance being audited. Any questioned amount was discussed with appropriate mission staff.

Finally, when assessing new and continuing activities, we considered USAID's Financial Management Bulletin - Part II - No.14A which contains Agency policy on the review of unliquidated obligations at field missions.

For two of the 17 obligations tested, the Mission- i n conducting its Section 13 11 review-did not identify and properly document funds which were excessive as of September 30, 1996. One of these obligations continued to have an excessive balance at the time of our audit. A third obligation was also found to have an excessive amount of unliquidated funds at the time of the audit. The funds were not identified and documented, in part, because the Mission needed to improve aspects of its Section 13 11 review process. Specifically, better documentation of the scope and conclusions of their review is needed. (A discussion of this issue follows on page 5 in our Observations on Internal Controls.) The details of excessive obligations noted during the audit are discussed below.

The audit identified $4,564 in excessive funding for a grant (Grant No. 936-5600) to conduct agricultural research at a Nepal university. Although the activity ended on November 30, 1995, this balance remained unliquidated at the time of our audit. According to a Mission official, the university researcher who received the funding had not compiled a final billing. After contacting the researcher, the official determined that the $4,564 was excessive and action was taken to deobligate the funds.

Another of the sampled obligations, a grant to the Government of Nepal (Grant No. 367-0160) with a scheduled completion date of July 3 1, 1997, had an unliquidated balance of approximately $400,000 for one activity as of September 30, 1996. The Mission subsequently determined that this amount exceeded anticipated needs. Prompt and appropriate action was then taken and the Mission deobligated $392,620 in January 1997, an amount which we therefore concluded was excessive as of September 30, 1996.

A third obligation, for a grant to a private voluntary organization (Grant No. 367-0159-G-00-4200) with a scheduled completion date of July 15, 1997, had $59,584 in unliquidated funding that exceeded total grant expenditures. This amount was determined to be excessive at the time of our audit in August 1997, and we are therefore recommending that it be deobligated.

A summary schedule of the three items discussed above is attached as Appendix III of this report.

Observations on Internal Controls

While conducting our fieldwork at USAID/Nepal, we observed that certain Agency procedures related to the review and certification of obligations for project and non-project assistance were not being followed.

> **Recommendation No. 2: We recommend that USAID/Nepal strengthen its internal procedures to ensure that documentation of its Section 1311 reviews is developed and retained in accordance with USAID procedures.**

USAID Financial Management Bulletin - Part II - No. 14A provides detailed guidance on how missions are to conduct their Section 13 11 reviews. USAID/Nepal also developed local procedures providing limited guidance to mission staff on the requirements for review of unliquidated obligations and commitments. However, the Mission did not follow agency guidance, and their own procedures were only of a general nature and did not define individual roles and responsibilities. In our opinion, improved Mission procedures and documentation of the Section 13 11 review process would have assisted in identifying and addressing the excessive obligations and commitments as of September 1996 noted during the audit. Discussed below are the details of this management control issue.

Agency guidance states that the Mission accounting reports used in Section 13 11 reviews must be annotated to show (1) the date of the review and the names of the reviewers, (2) the decision made with regard to the individual obligation/commitment accounts, including the summarized rationale for the decision, and (3) related actions that should be taken to appropriately adjust the affected accounts. Mission controllers must assure a high standard of documentation and level of analysis that would lead any auditor to conclude that (1) a careful review of each unliquidated obligation and commitment document was conducted, (2) the review was properly documented, and (3) the findings and conclusions are supported by the analyses and documentation.

The audit showed that the Mission did not develop and retain working papers documenting its Section 13 11 review for the fiscal year ending September 30, 1996. For example, there was no documentation showing the reviewer's name and date for the review of individual obligations and commitments, nor was there any specific notation regarding decisions made after assessing the individual obligation or commitment accounts.

Mission officials acknowledged that the scope and conclusions of their Section 13 11 review were not well documented and attributed this to a reduction in staffing and the transition from a project-based management structure to the strategic objective approach. We are therefore recommending that procedures be adopted within the Mission to improve compliance with the Agency's documentation standards for its review of unliquidated obligations.

Management Comments and Our Evaluation

USAID/Nepal management generally concurred with the audit findings and recommendations. However, they pointed to several statements in the draft report with which they disagree. Management disagrees with the statement that the Mission did not identify two obligations, one for $4,564 and the other for $392,620, as excessive as of September 30, 1996 in its Section 13 11 review. Although acknowledging that the two obligations should be deobligated, management contends that both of these amounts were identified in the Section 13 11 review process. Management states that the Section 13 11 review process includes a combination of periodic and on-going reviews, and that both obligations were identified through the on-going reviews. According to management, discussions were held between the Controller's Officer and the Strategic Objective Team Leader and plans were made to deal with the excess obligations. Management acknowledges, however, that documentation of the review process is incomplete and can be improved.

Management disagrees with an assertion in the transmittal memo to the draft report that amounts determined to be excessive as of September 30, 1996 could have been deobligated as of that date. Management states that funds found to be excessive cannot necessarily be deobligated immediately. While the **$4,564** obligation should have been deobligated as of September 30, 1996, the same can not be said for the $392,620 obligation. According to management this amount was sub-obligated in a technical assistance contract, and was not available for deobligation. Once the amount was identified as excess by the Mission, negotiations with the contractor, and a contract amendment were necessary to remove the funds from the contract. The Government of Nepal also had to be advised of the intent to deobligate. According to management, all steps in the process were performed as quickly as possible, and the deobligation was completed in January.

In response to Recommendation No. 1, management says that the $4,564 obligation was deobligated in September 1997. Management agrees that the other obligation addressed in Recommendation No. 1 carries excess funds of approximately $59,584. Management has decided to deobligate the excess amount. However, a final voucher has not been received. Without the final voucher it is not possible to determine the exact amount to deobligate. Management's decision is responsive to Recommendation No. 1 which we consider to have received an appropriate management decision. Deobligation of the excess funds would complete final action on this recommendation.

Management disagrees that improved documentation of the Mission's Section 13 11 review process would have assisted in identifying and addressing the excessive obligations and commitments noted in the report. However, the Mission has adopted additional documentation procedures which meet the requirements specified in this report. The new procedures were followed in the Section 13 11 review conducted in September 1997. Mission actions are responsive to Recommendation No. 2 and we consider the new documentation procedures to be final action on this recommendation.

SCOPE AND METHODOLOGY

This audit is part of the Office of the Inspector General's (OIG) worldwide review of the Agency's obligations for project and non-project assistance. The worldwide review is limited to obligations for project and non-project assistance which had unliquidated balances on September 30, 1996. It does not cover obligations funded with U.S.-owned local currency, established for disaster relief, or maintained by USAID for the Trade and Development Agency.

The Regional Inspector General/Bangkok audited USAID/Nepal's review and certification of unliquidated obligations for project and non-project assistance, as of September 30, 1996. The audit was conducted at USAID/Nepal, from July 25 through August 21, 1997, and was performed in accordance with generally accepted government auditing standards. At our request, USAID/Nepal compiled a list of its obligations for project and non-project assistance which had unliquidated balances on September 30, 1996. From this list, totaling $40,606,67 1, we randomly selected 15 obligations totaling $8,187,650 for detaiied audit testing. We also tested two obligations totaling $56,18 1 which were inadvertently omitted from USAID/Nepal's list. The OIG did not establish materiality thresholds at the mission level because it was believed that insufficient items were being tested to provide reasonable assurance at each mission selected for review.

Our fieldwork at USAID/Nepal included tests to determine whether the sampled obligations, and their related commitments, were valid. These included limited tests of compliance with USAID procedures related to Section **13** 11 and pipeline reviews. A section 13 11 review assesses the validity of obligations whereas a pipeline review assesses the unliquidated balances of those obligations.

We also reviewed the unliquidated balance of each selected obligation to determine whether, on September 30, 1996, the balance was needed, in full or in part, to cover expenses anticipated during reasonable future periods. In making these decisions, we considered Agency guidance for forward funding, activity-specific budgets and spending plans, actual disbursements, progress reports, accruals and USAID's Financial

Management Bulletin - Part II - No.14A which contains Agency policy on the review of unliquidated obligations at field missions. When amounts were questioned, we interviewed relevant activity managers and contracting or grant officers. The results of field work at USAID/Nepal will be consolidated with the results of field work conducted at USAID/Washington and other missions and used to make Agency-wide projections.

In addition to capturing information and making calculations as of September 30, 1996, for Agency-wide projections, we determined whether the unliquidated balances for obligations and commitments reviewed were excessive at the time of our field work. If so, we recommended that the excess funds be deobligated or decimated, as appropriate.

UNITED STATES OF AMERICA
AGENCY FOR INTERNATIONAL DEVELOPMENT
MISSION TO NEPAL

KATHMANDU, NEPAL

October 27, 1997

MEMORANDUM

TO: **Bruce** M. Watts, RIG/A/Bangkok

FROM: Frederick E. Machmer Jr., Director USAID/Nepal

SUBJECT: Audit of USAID/Nepal's Review and Certification of Unliquidated Obligations for Project and Non-Project Assistance, Audit Report No. 5-367-98-00X-F

The Mission generally concurs with the audit recommendations. **However** before responding to **the** specific recommendations and discussing the actions the Mission has taken in response, I would like to note some statements in the draft audit report with which I disagree.

The draft reports states that the Mission did not identify the amounts noted as excessive as of September 30, 1996 in its Section 1311 review. The audit identifies two obligations in the amounts of $4,564 and $392,620. Both of these amounts were identified as excessive by the Mission in our Section 131 1 review. The Mission believes the Section 1311 review is a process not a set of documentations. The Mission uses a combination of periodic and on going reviews in this process. For the $4,564, our accrual work sheets, which represent one of our key periodic reviews, clearly noted "deobligate." The **second amount was also identified** in the review process. Well before the end of the fiscal year as part of our on going review of pipeline, it was noted that nearly half the funds obligated for a specific type of activity remained undisbursed, even though the PACD was less than one year away. The Controller questioned the contractor's ability to expend the funds before the PACD. There were discussions and an e-mail exchange between the Controller's Office and the Strategic Objective Team Leader on the subject. Copies of part of this e-mail exchange show that the Mission was aware of the apparent excess and making plans for dealing with the situation as early as June **1996.** The contract file shows that funds were removed from the contract in October 1997. This could not have happened **if the Mission had not identified** the **excess** much earlier. As noted in the audit, the Mission's specific documentation of its Section 131 1 review is incomplete. However, documentation does exist indicating that the Mission did identify excess funds in its review process. The Mission would be happy to provide copies of these documents if you wish.

Although this assertion is not included in the audit, your cover memo states that the amounts determined to be excessive as of September 30, 1996 could have been deobligated as of that date. The Mission disagrees with this statement. Funds that are found to be excess cannot necessarily be deobligated immediately. While the $4,564 obligation could, and in fact should, have been deobligated as of September 30, 1996, the same cannot be said for the much larger $392,620 obligation. This amount was sub-obligated in a technical assistance contract, and was not available for deobligation. Once the amount was identified as excess by the Mission, negotiations with the contractor, and a contract amendment were required to remove the funds from the contract. The Government of Nepal (GON) also had to be advised of our intention to deobligate the funds from an on-going project. Predictably, the GON put forward several suggestions for rapid expenditure of the funds. The Mission had to review these proposals, and determined that they did not fit within the scope of the original project. Only then was the Mission able to deobligate the funds. All steps in the process were performed as quickly as possible, and the deobligation was completed in January. Effort to remove funds from active contracts and project agreements inevitably meet with strong resistance from AID's counterparts in such agreements. I believe deobligating a large chunk of funds from an active project within a 7 month time frame is very speedy work.

Finally, the audit states that improved documentation of the Section 1311 process would have assisted in identifying and addressing the excessive obligations and commitments noted during the audit. As stated previously, the amounts noted in the audit were identified by the Mission in our Section 131 1 review process. The Mission, therefore, believes that any deficiencies in documentation did not impact negatively on our identification of excess funds. The auditors agree that prompt and appropriate action was taken with regards to the large majority (nearly 99%) of the excess funds identified. Indeed, in reviewing over $8,000,000 in unliquidated obligations, the audit identifies less than $5,000 where Mission actions needed improvement. Although the Mission strives to have a perfect record, we believe the audit shows our Section 1311 process to be very successful. The Mission agrees to improve documentation procedures as required by USAID policy and directives, however, the Mission does not believe the change in documentation procedures will have any significant impact on its ability to identify or address excess obligations.

With regard to the specific audit recommendations.

> <u>Recommendation No. 1</u>: *We recommend that USAID/Nepal deobligate the $64,148 in excess balances as of August 199 7, as described in Appendix III of this report.*

The Mission deobligated Obligation No. 936-5600.06 in the amount of $4,564, in September 1997. The Mission agrees that Obligation No. 367-0159-G-00-4200 carries excess funds of approximately $59,584. However as noted previously, approximate amounts that appear to be excess cannot always be deobligated immediately. Until the Mission receives a final voucher, it is impossible to say exactly what total expenditures will be. We have an estimate of costs for the final 3 months from the grantee's local office. However it is very possible that there will be home office costs, or other costs that have not been previously billed, in the final voucher. To deobligate funds from a grant based on a local office estimate could potentially result in funds being unavailable to cover legitimate costs under the grant. The Mission will press to get a final voucher as soon as possible, and will deobligate whatever funds remain in the grant after payment. Although an exact deobligation amount can not be agreed upon at this point, we request that this recommendation be resolved upon issuance of the audit report. We will request closure once the final voucher for obligation 367-0159-G-00-4200 has been received and excess funds have been deobligated.

> *Recommendation No. 2. We recommend that MAID/Nepal strengthen its internal procedures to ensure that documentation of its Section 131 1 reviews is developed and retained in accordance with USAID procedures.*

Mission concurs with this recommendation. The Mission has adopted additional procedures relating to documentation of the Section 131 1 review process, which meet the requirements as laid out in the second paragraph of discussion on this recommendation. These procedures were followed in our Section 131 1 review for September 30, 1997. Samples of this documentation can be provided at your request, and full documentation can be viewed by auditors at the Mission. Based on these actions we request that this recommendation be closed upon issuance of the audit report.

Amounts Identified as Excessive Obligations
As of September 30, 1996

Obligation No.	Amount of Excessive Obligation	Reason for IG Conclusion
936-5600.06	**$ 4,564**	Obligation Exceeded Actual Expenses
367-0160	$ **392,620** (This excess balance was deobligated in January 1997)	Obligation Exceeded Anticipated Expenses
TOTAL	$ 397,184	

Amounts Recommended for Deobligation
As of August 4, 1997

Obligation No.	Project Assistance Completion Date (PACD)	Amount Recommended for Deobligation	Reason for IG Conclusion
936-5600.06	11/30/95	$ 4,564	Obligation Exceeded Expenses Through PACE
367-O 159-G-00-4200	7/15/97	$ **59,584** (This amount was determined to be excessive upon final estimation of the grantee's overhead costs)	Obligation Exceeded Expenses Through PACE
TOTAL		$ 64,148	