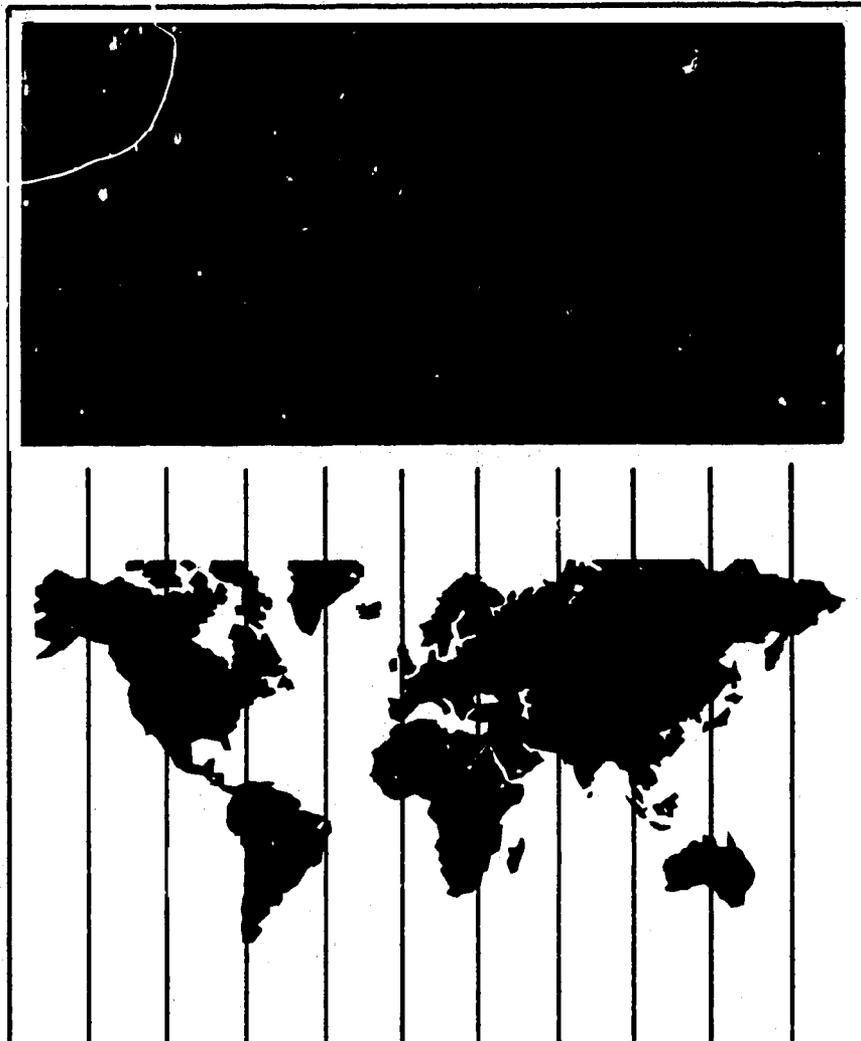


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UNITED STATES
AGENCY FOR INTERNATIONAL DEVELOPMENT

THE
INSPECTOR
GENERAL



Regional Inspector General for Audit
WASHINGTON

MEMORANDUM REPORT

SAVINGS IN BANK CHARGES POSSIBLE
IF AID ENFORCES ITS PAYMENT PROCEDURES

AUDIT REPORT NO. 0-000-83-66
May 27, 1983

The matter of AID financing procurement of goods and services through Bank Letters of Commitment (Bank L/COMs) versus Direct Letters of Commitment (Direct L/COMs) has been the subject of several IG audit reports during recent years. These reports have consistently held that Bank L/COM financing has been over-used by AID and that it involves more risk than other methods. This report reaffirms our previous position. Moreover, the Agency could achieve significant annual savings in bank charges and interest if it limited--to the maximum extent possible--the Bank L/COM method of paying suppliers/contractors.

memorandum

DATE: May 27, 1983

REPLY TO
ATTN OF:

RIG/A/W, Ernest H. Gustman 

SUBJECT:

Memorandum Audit Report No. 0-000-83-66 - Savings In Bank Charges Possible If AID Enforces Its Payment Procedures

TO:

M/FM, Curtis W. Christensen

We believe the Agency could achieve annual savings in bank charges by aggressively enforcing its payment procedures that limit the use of Bank Letters of Commitment (Bank L/COMs). While the Agencies guidelines and procedures have promoted limiting the use of Bank L/COMs in the past--in actual practice their use has been widespread. Recent Agency actions should help--but based on past experience--aggressive implementation and monitoring of these procedures will be required to achieve results. It is practically impossible for AID to validate the charges and interest charged by the bank to process Bank L/COMs. Further, this method carries a high risk because the Agency cannot scrutinize vouchers and supporting documentation prior to making payment to suppliers or contractors. If the Agency limited the use of Bank L/COMs--to the maximum extent possible--we believe significant annual savings in bank charges and interest could result.

BACKGROUND

AID has available several payment procedures for acquiring goods and services from suppliers in the United States. The subject of this report are the Bank and Direct Letters of Commitment payment procedures.

Bank Letter of Commitment

The Bank L/COM method utilizes established commercial banking channels to process payments to suppliers and contractors. This instrument can be used for all dollar procurement of equipment, materials and services under project assistance and is the usual method used for commodity import programs.

The Bank L/COM is an agreement between AID and a bank in the United States (acting on behalf of the AID borrower/grantee) that authorizes the bank to make payments to suppliers/contractors for eligible commodities and services. For commodities, the payment process begins when the supplier or contractor presents an invoice and other documents (bill of lading, AID forms 11 and 282, etc.) to the bank for payment. The bank makes sure that the prescribed documents are presented,

but does not review or authenticate them before making payment. If the prescribed documents are included, the bank pays the supplier or contractor the amount set forth on the invoice.

The bank then submits these documents and a payment voucher to an AID certifying officer--located in New York City--who reviews 1/ them for payment eligibility and completeness. If the documentation is in order, the Certifying Officer makes payment to the bank through the U.S. Treasury. In FY 1982, the AID certifying officer processed over \$1.6 billion in Bank L/Com vouchers. None of these payments were subject to audit by AID prior to payment.

2. Direct Letter of Commitment (Direct L/COM)

AID issues Direct L/COMs to suppliers or contractors and makes payments directly to them on receipt of invoices and supporting documentation. The Direct L/COM method permits AID to review the documentation before making payment. This method is generally preferable to Bank L/COMs for service type contracts, high value commodity shipments, and other transactions when it is advisable for AID to review the documentation before making payments. AID assumes a limited additional administrative burden by performing the banking function, but this eliminates corresponding banking charges otherwise paid out of AID program funds.

PURPOSE AND SCOPE OF REVIEW

Our review objectives were to determine (1) whether AID's commodity assistance programs now being financed under Bank L/COMs could be more economically financed under Direct L/COMs, and (2) whether AID exercises sufficient control over Bank L/Com payments to properly discharge its stewardship responsibilities over public funds.

To meet these objectives, we (1) examined AID payment transactions for commodity assistance, (2) reviewed AID procedures for paying letter of commitment vouchers, (3) analyzed AID produced statistical data on commodity assistance disbursements, (4) interviewed AID officials in Washington and New York, and (5) reviewed prior audit work on letter of commitment financing.

MANAGEMENT COMMENTS

A draft of this report was reviewed by appropriate AID officials who provided us with written comments. Those comments, where pertinent, were considered in preparing our final report.

1/ See page 8 for comments on the quality of these reviews.

OVERUSE OF THE BANK L/COM--A LONG-STANDING PROBLEM

We have concluded in several previous audit reports that the Bank L/COM is overused and is the highest risk procedure when compared to other methods of financing. Nevertheless, the Agency has done little in actual practice to limit the use of Bank L/COMs. If the use of Bank L/COMs was limited--to the maximum extent possible--we believe the Agency could save significant amounts annually. For example, in FYs 1980 and 1981, AID paid \$1.1 and \$1.2 million, respectively, in bank commissions and interest charges. Below are summary comments on the substance of our prior audit reports.

Audit Report 83-34, dated December 30, 1982, "Irregularities In The Financial Management Of The Ashuganj Fertilizer Plant Project In Bangladesh"

AID financed \$53 million to help set up a fertilizer plant in Bangladesh. We found that an exporter in the United States received about \$3.5 million in AID funds for ineligible items. These improper payments were all made using the Bank L/COM method of financing. Therefore, the payments were made without prior review by the Agency. The ineligible payments were made as follows.

--\$934,082 for ineligible freight charges.

--\$2,202,332 for commodities shipped in ineligible carriers.

--\$294,774 for unnecessary freight and handling charges.

--\$58,442 on miscellaneous overbillings.

Our audit report on this activity was ready for publication and issuance in November 1980. However, we were precluded from issuing the report pending the resolution of a criminal investigation of the export company. As a result of the investigation, in June 1982, two officials of the exporter were indicted by a U.S. Grand Jury on charges of fraudulently obtaining \$225,000 from the AID-financed loan. On December 8, 1982, the former vice president of the export company was convicted of one count of conspiracy to defraud the U.S. Government and four counts of wire fraud. The former secretary-treasurer, an unindicted co-conspirator, earlier pled guilty to one count of conspiracy.

Audit Report 82-38, dated January 27, 1982, "Voucher Approval: How Well Does It Work?"

This report concluded that unless some controls can be built into the system, the use of the Bank L/COM method of financing should be discouraged. This opinion was based primarily upon the fact that generally no AID official reviews the voucher and supporting documentation prior to payment.

Under the Bank L/COM method commercial banks pay suppliers directly upon presentation of the documents prescribed. AID reimburses the banks for these payments. Typically, to receive payment a supplier is required to present to the bank an invoice, an AID form 282 on which the supplier certifies that it has complied with various Government regulations, and some evidence of delivery such as a bill of lading or a dock receipt. The bank has little, if any, responsibility for assuring the authenticity of the documents presented by the supplier. The bank does not match the documents to corresponding purchase orders or contracts. The supplier's invoice and supporting documentation are not audited by the bank prior to making payment. The bank reviews the documents solely to determine whether they are required by the applicable Bank L/COM. If the "right" documents are submitted, the bank pays the total amount set forth on the supplier's invoice.

For AID to do business without problems using the Bank L/COM method of financing, two important factors must be present. First, the contractor must know and observe AID regulations. The contractor must do this because payments made under this procedure do not receive administrative review by an AID official prior to payments. Second, the contractor must be honest. Since there is no administrative review, payments are based solely upon presentation of the supplier's documents to the bank.

No one in AID attests to the actual receipt or delivery of the goods or services. Hence, an unscrupulous contractor could get paid without actually performing the service or delivery of the goods. Because of extremely limited professional staff, post audits of Bank L/COM transactions cannot be depended upon to discover all these errors. At best, only a limited percentage of Bank L/COM transactions can be audited.

The Agency's response to our report was to establish a task force to review AID's financing procedures. In August 1982, the task force tentatively recommended the use of Direct L/COMs rather than Bank L/COMs to finance commodity procurements except in cases where the Mission anticipated a proliferation of invoices. Further the task force recommended that the Mission submit a justification to AID/W whenever there is a general departure from this general policy. (Auditor's Note: We were advised that the task force's recommendations were approved by the Administrator on April 19, 1983.)

Audit Report 6-263-81-1, dated November 30, 1980, "The Financial Procedures And Controls Of The Commodity Import Program Of Egypt"

An Agency policy, approved in 1978, encouraged the use of Direct L/COMs to finance purchase of bulk commodities. The basic procedural guidance for this policy was set forth in the October, 1979, "Cash Management Procedures" of the Agency. Those procedures provide, in part:

"Careful consideration should be given to the selection of the method of financing covering any given procurement action. The direct letter of commitment method is particularly appropriate and generally preferable to bank letters of commitment for borrower/grantee service type of contracts, high bulk commodity shipments and for any type of transactions when it is necessary or advisable for AID to review documentation before making payments. AID can frequently assume a limited additional administrative burden through performing the banking function and in return, substantially reduce banking charges otherwise absorbed as project costs. Conversely, bank letter of commitment should be used if project implementation will produce a profusion of invoices for small amounts. In the latter instance it may be assumed that the cost to AID of assuming the added administrative burden would exceed the related banking charges."

In this report, we noted that in actual operations, USAID/Egypt practices did not comply with these "Cash Management Procedures". As a result, the controls inherent to the Direct L/COM method of financing were not implemented, and the Agency's risk factor in disbursing millions of dollars of payments under the Egyptian Commodity Import Program (CIP) was increased. Also, considerable sums of CIP assistance monies were spent on bank charges and interest that would not have been incurred if USAID/Egypt had used Direct L/COM procedures. We calculated that bank charges of about \$566,000 annually could have been saved if Bank L/COMs were discontinued for bulk purchases from single suppliers or one-time capital equipment procurements.

Our audit report concluded that financing CIP transactions through the Direct L/COM procedure, has significant benefits to the Agency, primarily in control over payments to assure contract performance. Since more control would be exercised by the Agency, this would reduce risks of unauthorized, improper, or duplicate payments. For instance, when a transaction is financed under a Bank L/COM, the documents are presented by the supplier to the bank. Before making payment to the supplier, the bank only verifies that the correct documents are submitted. They do not audit or verify the accuracy of the documents. If the same transaction was financed by a Direct L/COM, the Agency could perform an audit prior to making payment.

The audit report recommended that USAID/Egypt carry out the Agency's "Cash Management Procedures". The Mission met the recommendation by issuing a Mission Order which states that the Bank L/COM will serve as the standard financing instrument for all transactions that do not involve large bulk commodity purchases or procurement of high value capital equipment from a single supplier in the United States. In actual practice the intent of this order was not fully implemented. Our latest

review showed that USAID/Egypt continued to use Bank L/COMs to finance large dollar value transactions.

AID CONTINUES TO OVERUSE BANK L/COMS

Based on the results of our previous and most recent reviews, it appears that AID continues to overuse Bank L/COMs to finance large value commodity purchases. This practice results in significant bank charges per transaction. In our latest review, we analyzed all FY 1981 transactions for Egypt that involved four bulk commodities. We looked at that year's transactions because it was the last complete FY at the time of our review. The total value of commodities purchased exceeded \$150 million under 71 individual payment vouchers. Over 80 percent (59) of the vouchers exceeded \$500,000 in value. The average value of the 59 vouchers was about \$2.5 million; while the average bank commission for each voucher was about \$2,800.

<u>Commodity</u>	<u>No. of Payment Vouchers</u>	<u>Average Payment Voucher Amount</u>	<u>Bank Commission</u>	<u>Total Bank Commission</u>
Yellow corn	19	<u>\$3,558,000</u>	<u>\$ 3,782</u>	\$ 71,867
Bituminous coal	11	<u>\$2,577,000</u>	<u>\$ 2,985</u>	32,837
Tallow	21	<u>\$1,567,000</u>	<u>\$ 1,951</u>	40,980
Whole chicken	<u>8</u>	<u>\$2,184,000</u>	<u>\$ 2,356</u>	<u>18,850</u>
	<u>59</u>	<u>\$2,479,000</u>	<u>\$ 2,789</u>	<u>\$ 164,534</u>

Our review showed that banks in the United States are charging excessive amounts for processing large dollar value supplier invoices. This occurs because banks charge a set commission rate (usually one-eighth of one percent) on the value of the supplier invoice. Below are examples in which AID paid a total of \$24,258 in commissions to banks for processing 7 supplier invoices.

--A bank was paid a commission of \$4,937 for processing two suppliers' invoices totaling \$3,949,234, which represented purchases of tinsplate and coal. The documents received from each supplier and processed by the bank consisted of the commercial invoice, bill of lading, and AID forms 11 and 282.

--A bank was paid a commission of \$4,636 to process a supplier's invoice for coal valued at \$3,708,649. The documents processed were the commercial invoice, bill of lading, test report, and AID forms 11 and 282.

- A bank was paid a commission of \$4,578 for processing a supplier's invoice for yellow corn valued at \$3,662,620. The documents processed included the commercial invoice, bill of lading, grain inspection certificate, and AID forms 11 and 282.
- A bank was paid a commission of \$4,426 for processing two suppliers' invoices totaling \$3,540,895 for tinplate and coal. The documents processed for each supplier included the commercial invoice, bill of lading, and AID forms 11 and 282.
- A bank received \$5,681 in commissions to process a supplier invoice totaling \$4,544,662 for yellow corn. However, the bank apparently made a mathematical error on its payment voucher and billed AID \$4,549,662, or \$5,000 more than should have been billed. AID's Certifying Officer in New York City did not catch the error and the bank received the full amount of the payment voucher. We have requested AID's Office of Financial Management to issue a bill of collection to the bank for the \$5,000 overpayment plus interest. The documents processed by the bank on this transaction consisted of a commercial invoice, bill of lading, grain inspection certificates, and AID forms 11 and 282.

Recommendation No. 1

The Office of Financial Management should issue a bill of collection to the bank for the \$5,000 overpayment plus interest.

Management Comments

In commenting on our draft report, Agency officials advised us that recent actions taken by AID should help limit the use of Bank L/COMs to finance large value commodity purchases. These actions include the Administrator's approval of the task force recommendations discussed on page 4. We were advised that implementation of these recommendations will result in the Agency preparing various policy statements for inclusion in Handbook 1, as well as reviewing other Handbooks with a view to updating the many regulations involved.

On April 7, 1983, the Controller's Office circulated for comments, a revised statement of policy titled "Cash Management Policy Covering Borrower/Grantee Contracts, Commodity Import Programs, and Other Project Arrangements." This statement, in its final form, will be entered in Handbook 1, Supplement B, Chapter 15, Section B, and is very specific as to the conditions necessary to use a Bank L/COM as the method of financing.

Three of the recommendations approved by the Administrator directly impact on the issue of how project components should be financed. In summary these recommendations provide for (1) a comprehensive general assessment of methods of implementation and financing, on a regular basis parallel to the CDSS process, and inclusion of more specific assessments in project papers, (2) concurrence by the Controller of such assessments, and (3) justification by Missions of proposals to use Bank L/COMs rather than Direct L/COMs, except for CIP and project commodity financing for which a proliferation of invoices is expected.

We were also advised that Direct L/COMs are now used to finance coal in Egypt, and that large machinery contracts there are also now using that financing method. Agency officials further stated that although there are some cases outside Egypt where Bank L/COMs are being used for large value commodity transactions, that they do not believe the practice is widespread.

Auditor's Comments and Conclusions

We are supportive of the Agency's past and planned actions to improve its cash management practices. Revision of current policies to facilitate implementation of the recommendations recently approved by the Administrator, should result in strengthened cash management procedures.

We believe if the Agency aggressively enforces the procedures envisioned above, it should be able to limit--to the maximum extent possible--the use of Bank L/COMs and achieve savings in bank charges. Accordingly, we are not going to make any recommendations regarding the use of Bank L/COMs at this time. However, we plan to monitor the Agency's efforts to limit the use of that method of financing during future reviews.

MOST BANK L/COM TRANSACTIONS ARE NOT AUDITED

AID has no effective system for auditing Bank L/COM vouchers to assure that payments are proper. The prepayment review by the AID/FM certifying officer in New York is made under great time pressure. This review is limited, at best, to a quick check of required documents and to the Bank L/COM unliquidated balance for funds availability. At the present time, only 30 percent of the Bank L/COM transactions are scheduled for audit.

AID Handbook 15 (Chapter 9) provides that after payment, the Bank L/COM vouchers including the supplier's documentation pass through the Office of Financial Management (M/FM) and then to the Office of Commodity Management (M/SER/COM) for post audit. AID Regulation 1 (Section 201.60) states that post audit of Bank L/COM transactions will be made by AID to determine whether price provisions of the regulation have been met.

In the recent past, no procedure existed within AID for complete review of Bank L/COM vouchers after payment. AID relied on banks to check for required documents submitted from the supplier. However, any review by banks is tenuous because of limitations on their responsibilities under Regulation 1. In essence, the Regulation (Section 201.73) states that banks shall not be responsible for the truth or accuracy of any information or statements on documents provided by suppliers, and the bank shall not be obligated to look beyond any documents it submits to AID. The regulation further provides that the bank shall be entitled to receive reimbursement for all payments made by it, against documents it accepts in good faith as being genuine and valid, notwithstanding that such payments may be for a purchase in excess of the price calculated in accordance with provisions of Subpart G. That subpart contains the maximum price rules on commodities.

AID has acted to meet the requirements of Regulation 1 and Handbook 15 for post audit of Bank L/COM vouchers by entering into a contract with the Small Business Administration for the services of a firm named Grace Vaughn and Associates. This firm was engaged, at a cost of \$372,000, to review and analyze 2,000 of an estimated 6,500 Bank L/COM transactions during a one-year contract period ending November 15, 1983. M/SER/COM anticipates that the contractor will help achieve efficiency in the audit process by increasing coverage and possibly permitting further direct hire staff reductions. The contract is expected to be cost effective and recover more than its cost.

As of March 1, 1983, the contractor had completed a preliminary review of 205 Bank L/COM payment vouchers processed during fiscal years 1980-82. Based on a limited review, questionable payment items totaling \$2.1 million were identified. Final resolution of these items will require analysis of additional information from the banks, suppliers, and shippers.

By limiting--to the maximum extent possible--the use of Bank L/COMs, AID should be able to post-audit a higher percentage of these documents than has been done in the past. In view of the significant potential for pay-back resulting from such audits, we believe AID should endeavor to increase the post-audit coverage of Bank L/COMs by its contractor and direct hire staffs. Such action would be consistent with another recommendation recently approved by the Administrator. That recommendation is as follows:

"The Agency's commodity price analysis function should be strengthened to permit more adequate pre-payment or post-audit of commodity costs" (emphasis added).

PREPAYMENT AUDIT OF DIRECT L/COM TRANSACTIONS NO LONGER REQUIRED

The legal adviser of M/SER/COM has suggested that the policy of systematic pre-audits of Direct L/COM transactions be discontinued. This is contrary to AID Handbook 15 (Chapter 9) which provides for a full AID review of suppliers' invoices and supporting documents prior to payment.

A review system for commodity transactions was established in 1973 by a Memorandum of Understanding between M/FM and M/SER/COM. Under this memorandum M/SER/COM was designated "to perform the AID form 11 review for eligibility, the voucher examination for documentary completeness, and the review for price acceptability, all to assure compliance with the provisions of the Foreign Assistance Act, AID Regulation 1, and the applicable implementing documents". The review was to be adequate enough to support and protect the M/FM certifying officer who authorizes payment.

The AID certifying officer is now authorized to make payment on Direct L/COM vouchers without the benefit of pre-audit. The M/SER/COM legal adviser believes that because of inadequate personnel resources the Agency cannot make a thorough review of Direct L/COM vouchers and then be expected to make timely payment to suppliers, as required by the Prompt Payment Act of 1982. Further, the legal adviser noted that the standard Direct L/COM provisions do not allow for deductions based on alleged over-pricing without the issuance of a Bill for Collection. In his view, because all Bills for Collection are subject to a legal review, the pre-audit requirement is not necessary prior to making payment on Direct L/COM transactions. The M/SER/COM legal adviser concluded that AID's internal handbook, which allows deductions in payments for overpricing, is not a sufficient basis to justify a deduction not allowed by the Direct L/COM provisions.

In our opinion, the handbook provides for a full prepayment review by M/SER/COM analysts, with recommendations for deductions as appropriate, and a further review by the certifying officer. The standard provisions of the Direct L/COM can be revised to require prepayment audits of supplier vouchers. Aside from sound internal control requirements, the need for a full review system can be demonstrated by actual overbilling uncovered by SER/COM during prepayment audits. In 1981, M/SER/COM detected overbillings amounting to \$1.7 million during its prepayment audits of Direct L/COM vouchers. In 1982, M/SER/COM reviewed 810 Direct L/COM vouchers and questioned \$1.8 million in costs billed.

Management Comments

In our draft report we had recommended that "The M/SER should enforce the procedures of Handbook 15 that provide for a full prepayment audit of all Direct L/COM transactions." We had

envisioned that M/SER/COM would be able to utilize the services of Grace Vaughn and Associates to assist its in-house staff in meeting this requirement. In commenting on our draft report, M/SER/COM officials stated that the Agency does not have staff to process the paperwork involved with individual Direct L/COMs. The officials also stated:

"The idea that, under any system, this Agency could perform a full audit prior to each payment and do so within any acceptable time-frame--under either the Prompt Payment Act or good commercial practice--is not within the realm of practical reality."

- The M/SER/COM officials expressed the belief AID would pay for delays in its disbursements--as interest paid to banks--or as higher prices paid to commodity suppliers.

Auditor's Comments and Conclusions

It now appears that M/SER/COM's use of Grace Vaughn and Associates to assist in the prepayment audit of Direct L/COMs is no longer a viable alternative. Accordingly, we are withholding, at this time, our recommendation related to a full prepayment audit of all Direct L/COM transactions. However, the Agency should not lose sight of the fact that Handbook 15 requires a full prepayment audit of these transactions. Further, we believe the results of M/SER/COM's past prepayment audits, using a limited staff--\$1.7 million in overbillings detected in 1981, and \$1.8 million in questioned costs billed in 1982--points out the need for and potential payback that can result from such action.

We are concerned that the Agency may overlook the payback benefits that can result from audits of Direct L/COMs in its concern for prompt payments. We would encourage that these transactions receive adequate audit coverage whether or not such audits are done before or after payments are made. With this regard, we believe M/SER/COM should give serious consideration to increasing its in-house staff or entering into a contractual arrangement to provide adequate audit coverage of Direct L/COM transactions. Such action would appear necessary in order to implement the recommendation, recently approved by the Administrator, that is discussed on page 9 of this report.

LIST OF REPORT RECIPIENTS

Assistant to the Administrator For Management (AA/M)	1
Associate Assistant to the Administrator for Management Services (M/AAA/SER)	1
Office of Commodity Management (M/SER/COM)	1
Controller, Office of Financial Management (M/FM)	2
Audit Liaison Office, M/AAA/SER/SA	1
Office of General Counsel (GC)	1
Office of Public Affairs (OPA)	1
Office of Development Information and Utilization (S&T/DIU)	4
Office of Legislative Affairs (LEG)	1
Office of Inspector General (IG)	1
RIG/A/EA	1
RIG/A/EAFR	1
RIG/A/Egypt	1
RIG/A/NE	1
RIG/A/WA	1
AAO/New Delhi	1
RIG/A/LA/W	1
IG/PPP	1
AIG/II	1
IG/EMS/C&R	16