

Audit of USAID/Philippines' Role In Obtaining  
Audits of Its Contracts, Grants and  
Cooperative Agreements

Audit Report No. 5-492-98-001-F  
November 28, 1997

Regional Inspector General  
Bangkok

November 28, 1997

**MEMORANDUM**

**TO:** USAID/Philippines Director, Kenneth G. Schofield

**FROM:** RIG/Bangkok, Bruce M. Watts

**SUBJECT:** Audit of USAID/Philippines' Role In Obtaining Audits of Its Contracts, Grants and Cooperative Agreements, Report No. 5-492-98-001-F

This memorandum is our report on the subject audit. We have considered your comments on the draft report and have included them as Appendix III to the report.

The report contains four recommendations. Based on your comments, Recommendation No. 1 remains open pending a management decision. Management actions described in the comments are responsive to Recommendation Nos. 2 and 3 which are closed upon issuance of this report. A management decision responsive to Recommendation No. 4 has been made. A request to close Recommendation No. 4 can be submitted to the Office of Management Planning and Innovation, Bureau for Management (M/MPI) after final action to implement the Recommendation has been completed.

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

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**Background**

In March 1992, USAID established an audit management program to improve audit coverage of its assistance activities in developing countries. Recognizing that financial audits could improve accountability for funds provided to grantees and contractors, the audit management program made USAID missions responsible for:

- establishing a management control review committee to address all management control issues including audit;
- issuing mission-specific guidance on audit responsibilities and procedures;
- including specific audit management responsibilities in employees' performance evaluation reports;
- designating an audit management officer to manage the audit program at the mission level;
- preparing a database of all contracts and assistance agreements which may need to be audited; and
- developing an audit plan to help ensure complete audit coverage of contracts and assistance agreements.

In May 1996, USAID consolidated its policies and procedures for financial audits, previously found in several different directives, in Chapter 591 of the Automated Directives System (ADS). The audit requirements and USAID management's role in making sure that the audits are actually performed are summarized below.

**U.S. non-profit organizations** receiving \$25,000 or more in USAID funds in any one year (under grants, cooperative agreements, or contracts) shall have periodic audits performed in accordance with Office of Management and Budget Circular A-133. These audits will normally be performed annually, but must be performed no less frequently than every two years. The Office of Procurement in USAID/Washington is responsible for making sure that USAID funds provided to these organizations are audited.

**U.S. for-profit firms** receiving USAID funds under direct contracts, grants, or cooperative agreements (or cost-reimbursable host country contracts or subcontracts over \$250,000) will have annual audits performed. The Office of Procurement in USAID/Washington is responsible for making sure that USAID funds provided to these organizations are audited.

**Foreign private for-profit and non-profit organizations** receiving \$100,000 or more in USAID funds during a year will have an annual audit performed. (We have interpreted "a year" as meaning "the recipient's fiscal year.") USAID overseas missions are responsible for making sure that these audits are done.

**Foreign government agencies** receiving \$25,000 or more in USAID funds during a calendar year will have an annual audit performed. USAID overseas missions are responsible for making sure that these audits are done.

**International organizations** receiving USAID funds may have audit requirements dependent on grant provisions.

During the period from January 1, 1993 through September 30, 1995, USAID/Philippines disbursed \$684,433,553.<sup>1</sup>

U.S. entities (USAID/Washington has audit responsibility)	\$445,508,898
Non-U.S. entities (USAID/Philippines has audit responsibility)	
Not Requiring Audit	170,363,778
Requiring Audit	54,283,843
International entities (Audit responsibility dependent on grant provisions)	<u>14,277,034</u>
Total	<u>\$684,433,553</u>

<sup>1</sup> This figure excludes disbursements not typically audited under USAID's Audit Management and Resolution Program such as leases, travel authorizations, participant training, personal service contracts, etc. The figure also excludes disbursements that USAID/Philippines made on behalf of other USAID missions and offices and charged to the other missions and offices. The disbursed amounts presented in this report are those reported by USAID/Philippines. We did not audit the accuracy of these disbursements.

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## **Audit Objective**

As part of a worldwide audit, the Office of the Regional Inspector General/Bangkok audited USAID/Philippines' audit management program to answer the following audit objective:

Has USAID/Philippines carried out its role in obtaining audits of its contracts, grants, and cooperative agreements?

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

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## **Audit Findings**

### **Has USAID/Philippines carried out its role in obtaining audits of its contracts, grants, and cooperative agreements?**

Although USAID/Philippines has generally carried out its role in obtaining audits of its contracts, grants, and cooperative agreements, improvements can be made.

USAID/Philippines has taken several steps to implement an effective audit management program. For example, the Mission has:

- established a management control review committee to address management control issues including audit;
- issued written guidance to its staff on audit policies and procedures;
- designated an audit management officer in the controller's office to manage the audit program;
- prepared an accurate audit inventory (database) listing grants and contracts that may be subject to audit requirements;
- prepared annual audit plans;
- generally included appropriate audit provisions in contracts and grants and budgeted funds for required audits;
- monitored audits to ensure they complied with generally accepted government auditing standards; and
- followed-up on recipient contracted audit recommendations.

USAID/Philippines was responsible for obtaining audits for \$54.3 million of the Mission's \$224.6 million in disbursements to non-U.S. entities.<sup>1</sup> As of October 31, 1996, a total of 58 audits should have been performed. As shown in the following table, all but ten of these audits were carried out:

	<i>Required</i>	<i>Actually Performed</i>	<i>Required But Not Performed</i>
Number of audits:	58	48	10
Disbursements covered:	\$54,283,844	\$51,825,762	\$2,458,082

In addition, the audit found that annual audit management plans for some contractors and grantees have not been prepared, the Mission's Audit Management and Resolution Program does not cover host government organizations and performance evaluation forms for key Mission personnel do not include audit follow-up responsibilities.

The following sections discuss ways that USAID/Philippines can strengthen its audit management program.

### **Required Audits Should Be Performed**

Both USAID's Automated Directive System and the standard audit clauses incorporated into grants and cooperative agreements require that audits be conducted once disbursements to recipients exceed certain thresholds. Additionally, although USAID's standard audit clause for contracts does not require annual audits, Federal Acquisition Regulations Subpart 4.805-5(a)(12) states that the contracting office must ensure that an audit is done before closing out a contract. Despite these criteria, eight required annual audits of grantees and/or cooperating agencies were not performed and submitted to the Mission by the recipients. Furthermore, the Mission has not obtained required audits of closed contracts with two non-U.S. contractors.

USAID/Philippines cited several reasons why the above mentioned audits were not done. For example, in one case the Mission pointed out that it had obtained a financial review of a recipient. However, in our opinion this review did not satisfy the requirement for a recipient audit and, in any event, only covered the first nine months of the grantee's fiscal year. In another case, through an oversight, the first six months of a grantee's fiscal year 1993 expenses were not audited. In a third example, the Mission did not believe that disbursements to the recipient had exceeded the applicable threshold when, in fact, that threshold had been exceeded. As a result of these and similar occurrences, several grantees were not in compliance with the terms of their grants and the Mission was not in full compliance with USAID's Audit Management and Resolution Program and Automated Directive System. Furthermore, the Mission did not have the same level of assurance concerning the propriety of the expenditures billed by these recipients that would have been provided by the required audits.

Most of the disbursements which were not covered by required audits were made during the start-up years of the Mission's Audit Management and Resolution Program. Since audit coverage improved as the program matured, we do not believe changes to the Mission's current procedures are necessary. However, we do believe that the Mission should ensure that the required audits are performed.

<sup>1</sup>Some of the disbursements did not require audit, such as those for fixed price contracts and those which did not exceed the dollar threshold triggering recipient contracted audits (see page 2).

**Recommendation No. 1: We recommend that USAID/Philippines ensure that the ten required audits identified in Appendix II are performed.**

**Audit Plans Should Be Developed  
For Recently Acquired Organizations**

According to Section E591.5.17 of the ADS, USAID missions are to develop annual audit management plans to ensure complete audit coverage of all non-U.S. organizations awarded direct contracts and grants and host country-owned local currency accounts. We determined that USAID/Philippines had developed a fiscal year 1997 audit management plan covering the contracts and grants it had awarded. However, we also determined that, at the time of our audit, the Mission had yet to develop plans for ensuring audit coverage for contractors, grantees and local currency accounts which USAID/Philippines inherited from other USAID Missions.<sup>1</sup>

The Mission indicated that these plans were not developed because the majority of the contractors and grantees were only recent additions to its portfolio and that it intended to prepare these plans in the near future. We believe the plans should be prepared, not only to comply with the ADS, but also to provide a systematic method of planning and monitoring audits of the contractors and grantees.

**Recommendation No. 2: We recommend that USAID/Philippines prepare audit management plans covering recently acquired direct contracts and grants and host country-owned local currency accounts.**

**Mission Guidance Should  
Cover Government Organizations**

Foreign host government entities receiving \$25,000 or more in a year under direct USAID grants are required to have annual audits (ADS Section 591.5.4). However, USAID/Philippines' Audit Management and Resolution Program guidance does not reflect this requirement. We believe that this omission was an oversight one that leaves the Mission without the necessary level of assurance concerning the propriety of costs incurred by government organizations. Accordingly, we believe the Mission should add the audit requirement for foreign host governments to its Audit Management and Resolution Program guidance.

**Recommendation No. 3: We recommend that USAID/Philippines revise its Audit Management and Resolution Program guidance to include audit requirements for foreign host governments.**

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<sup>1</sup>USAID/Philippines assumed responsibility for the USAID/Fiji portfolio in September 1994 and the USAID/Thailand and USAID Regional Support Mission for East Asia portfolios in September 1996.

## **Performance Evaluations Should Reflect Audit Follow-up Responsibilities**

Section 591.5.24 of ADS Chapter 591 stipulates that Annual Evaluation Forms (AEFs) shall reflect audit follow-up responsibilities and that employees shall be evaluated on their effectiveness in carrying out those responsibilities. Furthermore, Section 591.4.24 of the same ADS chapter notes that the contract/grant officer is generally responsible for responding to recommendations from financial audits and for ensuring that corrective action is completed. While the evaluation forms for select Mission staff contained audit-related work objectives, the AEFs for USAID/Philippines' contracting officers and the controller, who is the Audit Management Officer, did not specifically address audit follow-up responsibilities.

This situation was noted by the Mission in its fiscal year 1996 internal control assessment, which was completed in September 1996. The assessment also noted that the requirement concerning evaluations and audit follow-up responsibilities was newly implemented in April 1996 and that future AEFs would reflect those responsibilities. However, as stated above, at the time of our audit these responsibilities had not been incorporated into the contracting officers' and controller's AEFs. As a result, their evaluations may not clearly evidence their effectiveness in resolving and implementing audit recommendations, as required by the ADS.

**Recommendation No. 4: We recommend that USAID/Philippines modify the Annual Evaluation Forms of its contracting officers and controller to include a work objective and performance measure(s) reflecting audit follow-up responsibilities.**

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## **Management Comments and Our Evaluation**

USAID/Philippines' management commented that the report will assist the Mission in strengthening systems and procedures relative to its Audit Management and Resolution Program (AMRP). Management noted that most of the disbursements that we originally identified as not having been audited were made during the start-up years of the Mission's AMRP. Management attributes the less than full audit coverage to the Mission's limited resources which required it to focus audit coverage on contracts and grants with the greatest fiscal year obligation levels.

In response to Recommendation No. 1, the Mission has taken action to ensure that audits or other acceptable verification methods are carried out for five of the ten grantees and contractors identified in Appendix II. Recommendation No. 1 remains open, however, pending a management decision to obtain the required audits or other acceptable verification methods for the following five organizations:

Bacnotan Consolidated Industries, Inc. for 1993;

CocaCola Bottlers Philippines for 1993;

Actuator for Socio-Economic Progress, Inc. for 1994;

Lusok Projects, Inc. for 1994; and

Asia Business Consultants, Inc

Management indicates that the Mission's audit plan for fiscal year 1998 includes the recently acquired direct contracts, grants and host country-owned local currency accounts under the Regional Support Mission/East Asia portfolio. In addition, in preparing the fiscal year 1998 audit plan the Mission revised its procedures to include audit requirements for foreign host governments. These actions are responsive to Recommendation Nos. 2 and 3 which are closed upon issuance of this report.

With reference to Recommendation No. 4, management has decided to revise the Mission's internal procedures for accomplishing Annual Evaluation Forms to ensure that work elements and performance appraisals for the contracting officers, controller and other appropriate individuals reflect their effectiveness in resolving and implementing audit recommendations. This management decision is responsive to Recommendation No. 4. After final action to revise the Mission's internal procedures has been completed, a request for closure can be submitted to the Office of Management Planning and Innovation, Bureau for Management (M/MPI).

## SCOPE AND METHODOLOGY

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### Scope

We conducted our audit in accordance with generally accepted government auditing standards. Fieldwork for the audit took place from January 22, 1997 through April 11, 1997. The audit scope covered whether USAID/Philippines (1) provided adequate direction for its financial audit program, (2) included appropriate audit clauses and budgets in grants and cooperative agreements with overseas entities, (3) established an accurate audit universe, and (4) requested audits when required. The audit examined USAID/Philippines' role in obtaining audit coverage of \$54.3 million in disbursements from January 1, 1993 through September 30, 1995. The audit considered financial audits completed as of October 31, 1996.

The audit included an assessment of USAID/Philippines' internal controls over the financial audit process and the foreign recipient-contracted audit program. We limited our conclusions to the items actually tested: that is, we did not attempt to project the results of our tests on the accuracy of the sampled data to data we did not test.

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### Methodology

We performed the following procedures in answering the audit objective of whether USAID/Philippines obtained the needed audit coverage of its overseas grantees and contractors:

- *an examination of whether appropriate audit clauses and funding for audits were included in grants, cooperative agreements, and contracts with overseas entities, including reviewing a judgmental sample of 39 grants, cooperative agreements, and contracts based on dollar amounts.*
- *a determination of whether USAID/Philippines issued guidance and established direction for financial audits, including reviewing (1) USAID/Philippines Audit Management and Resolution Program guidance, (2) minutes of meetings of the Mission's Management Control Review Committee, and (3) other documentation.*

- *a determination of whether the Mission established an audit inventory (database) and prepared audit plans, including (1) reviewing and testing the methodology for preparation of the audit inventory, (2) reviewing the justification for excluding certain contracts and grants, (3) verifying the accuracy of selected data entered into the audit inventory by comparing the data with source documents, and (4) examining several USAID/Philippines audit plans.*
- *an examination of whether USAID/Philippines requested audits when required by USAID directives, including (1) comparing the audit inventory with audit reports on file at USAID/Philippines to see if required audits were completed in a timely manner and (2) reviewing audit reports to see if they complied with generally accepted government auditing standards.*

Our threshold level for reporting material exceptions was a five percent error rate.

**APPENDIX II**

**SCHEDULE OF REQUIRED AUDITS NOT PERFORMED**

<u><b>Grantees and Cooperating Agencies</b></u>	<u>Fiscal Year(s)</u>	<u>Disbursements</u>	<u>Type of Audit</u>	
Actuators for Socioeconomic Progress	1994	\$ 100,875	Recipient Contracted	
Bacnotan Consolidated Industries	1993	141,838	Recipient Contracted	
CocaCola Bottlers Philippines	1993	100,085	Recipient Contracted	
Lusok Projects Inc.	1994	148,224	Recipient Contracted	
Settlement and Livelihood Foundation	1994	129,893	Recipient Contracted	
National Electrification Administration (Paid to the Treasurer of the Philippines)	1993	113,201	Recipient Contracted	
National Electrification Administration (Paid to the Treasurer of the Philippines)	1994	45,189	Recipient Contracted	
National Electrification Administration (Paid to the Treasurer of the Philippines)	1995	188,321	Recipient Contracted	
 <b><u>Non-U.S. Contractors</u></b> <sup>1</sup>				
Urban Integrated Consultants Audit	1993 - 1995	870,046	Contract	Closeout
Asia Business Consultants Audit	1993 - 1995	620,410	Contract	Closeout
Total		<u>\$2,458,082</u>		

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<sup>1</sup>While annual audits were not required as a provision of these contracts, Subpart 4.805-5(a)(12) of the Federal Acquisition Regulations states that the contracting office must ensure that an audit is done before closing out a contract.



## APPENDIX III

NEW DELHI, INDIA

### MEMORANDUM

TO: RIG/Bangkok, Bruce M. Watts

FROM: USAID/Director, Linda E. Morse

SUBJECT: Audit of USAID/India' s Role in Obtaining Audits of its Contracts, Grants, and Cooperative Agreements

Thank you for giving us the opportunity to review and comment on the draft report on the subject. We find the report factually correct and are pleased to note that USAID/India has generally complied with the audit provisions and taken several steps to implement an effective audit management program.

We accept the audit recommendation made in the report. We are continuing to follow up with concerned implementing agencies and the Comptroller and Auditor General of India to get the pending audits of IFPS and PVOH II project completed as soon as possible. We are hopeful of getting these audit reports in the near future and will transmit them to you when they are received.

An audit Representation Letter signed by me is attached.

Attachment: Representation Letter