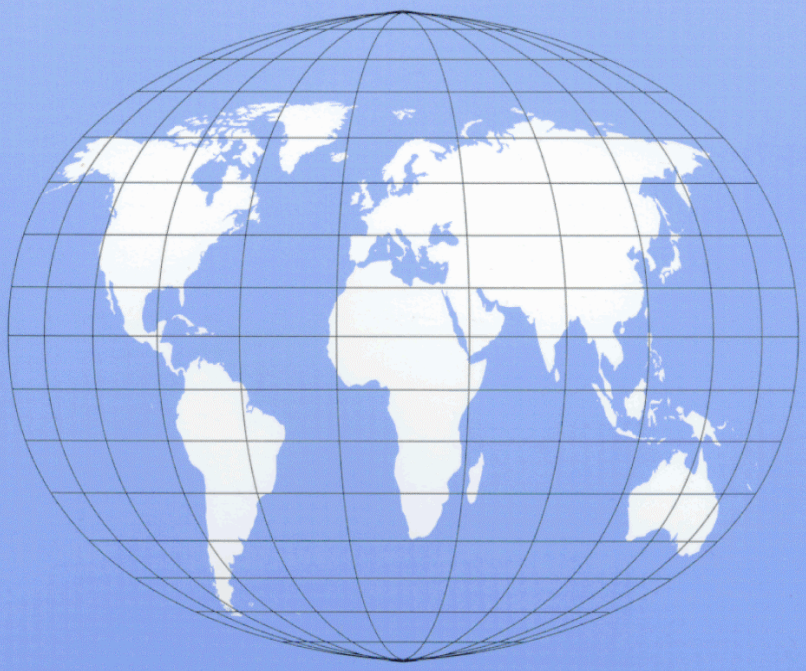
Report of Audit

Audit of Selected Processes at the Inter-American Foundation

Report No. 9-IAF-01-001-P
February 26, 2001



Washington, D.C.

OFFICE OF INSPECTOR GENERAL
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

February 26, 2001

MEMORANDUM FOR IAF Interim President, David W. Valenzuela

FROM: IG/A/PA, Dianne L. Rawl

SUBJECT: Audit of Selected Processes at the Inter-American Foundation (Audit Report No. 9-IAF-01-001-P)

This memorandum is our report on the subject audit. In finalizing this report, we considered your comments on our draft report. We have included those comments, in their entirety, as Appendix II.

We conducted this audit in response to a request by the Chairman of the Senate Foreign Relations Committee. This report includes two procedural recommendations. Based on your written comments on the draft report, we concur with management's decisions with respect to both recommendations. Please provide written notice within 30 days relating to actions taken or planned to complete the corrective actions for each of the recommendations in this report.

I want to express my sincere appreciation for the cooperation and courtesies extended to my staff during this review.

Background

The Inter-American Foundation (the "Foundation") is a U. S. Government corporation created in 1969[1] as an experimental U. S. foreign assistance program. The Foundation awards grants to local "grassroots" organizations throughout Latin America and the Caribbean to promote equitable, participatory, and sustainable self-help development. The management of the Foundation is vested in a nine-person Board of Directors appointed by the President of the United States. Six Board members are drawn from the private sector and three from among officers or employees of agencies of the United States government concerned with inter-American affairs. The Board appoints the Foundation's president who acts as the chief executive officer.

[1] See the Foreign Assistance Act of 1969 (22 USC 290f).

Foundation headquarters are located in Arlington, Virginia, and staffed with about 46 employees. The Foundation has no overseas staff. It obtains in-country services by contracting with local professionals to provide technical assistance to Foundation grantees and evaluations of grant results.

The Foundation's budget consists of congressional appropriations and funds derived through the Social Progress Trust Fund. The Foundation's budget for fiscal year 2000 included $10 million in appropriations ($5 million in new appropriations and $5 million in unused appropriations from the prior years) and $12 million in trust funds. Since 1972, the Foundation has made 4,257 grants totaling $502 million. Currently, the Foundation has about 230 active grants in 16 countries.

In November 1999, Public Law 106-113 amended the responsibilities of the USAID Office of the Inspector General (OIG), under Section 8A(a) of the Inspector General Act of 1978, to include audit responsibility for the Foundation. Pursuant to this new authority, the Chairman of the Senate Foreign Relations Committee requested that we answer the questions shown below.

Audit Objective

We designed the audit to answer the following questions:

> **Did the Inter-American Foundation select the appropriate mechanisms for obtaining in-country services and representation?**
>
> **Did the Inter-American Foundation comply with federal laws and regulations pertaining to the rate of obligation of appropriated funds in the last month of the fiscal year?**
>
> **Did the Inter-American Foundation properly categorize program and operating costs?**

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

Audit Findings

Did the Inter-American Foundation select the appropriate mechanisms for obtaining in-country services and representation?

The Foundation has decided to use competitively awarded contracts as the mechanism for obtaining in-country services and representation. In our opinion, such contracts are appropriate mechanisms for obtaining in-country services and representation. Earlier in 2000, however, the Foundation considered using cooperative agreements to obtain some of the services it had previously obtained only through contracts and notified Congress of

those plans. While awaiting Congressional approval, all of the Foundation's existing contracts for in-country services expired. While discussions between the Foundation and Congress concerning the proposed use of cooperative agreements continued, the Foundation awarded short-term non-competitive purchase orders to ensure that technical assistance services would continue to be available in some countries where it has programs. Once the Foundation decided not to use cooperative agreements to obtain any overseas services, it began to award new contracts but had not completed this process by the end of our audit.

The Foundation Needs to Complete the
Process of Awarding Competitive Contracts

Federal laws and regulations require agencies to use procurement contracts when the principal purpose of the obligation of funds is to acquire property or services for the direct benefit or use of the U.S. Government. The Federal Acquisition Regulation (FAR) and the Competition in Contracting Act (CICA) require that Federal agencies obtain services, except in certain situations, through competitive contracts with full and open competition. As stated above, the Foundation allowed all of its in-country technical assistance contracts to expire as of June 30, 2000, planning to replace them with cooperative agreements. When Congress resisted this plan, the Foundation executed short-term, sole-source contracts, on an interim basis, in 5 of the 16 countries in which it has activities. Sole-source waivers were obtained. Subsequently, Foundation management decided to abandon its plan to use cooperative agreements and agreed to "follow the contractual route." Meanwhile, the Foundation currently has no provision for obtaining technical assistance services for grantees in most of the countries in which it has activities. Without competitive long-term contracts in place, many of the Foundation's grant recipients may not receive needed technical assistance and training on a timely basis. Also, the Foundation's use of interim sole-source contracts could potentially result in higher costs, reduced quality of service, and unfair selection of contractors.

> **Recommendation No. 1: We recommend that the Inter-American Foundation promptly complete the process of awarding competitive contracts to obtain in-country technical assistance for grantees in all countries in which the Foundation has activities.**

Determining the appropriate funding mechanism to provide assistance or obtain services has not been a simple matter for Federal agencies. Long-standing confusion between grant relationships and procurement relationships resulted in the Federal Grant and Cooperative Agreement Act of 1977.[2] This legislation established standards for agencies to use in order to choose the most appropriate funding vehicle–a procurement contract, a grant, or a cooperative agreement. According to the Act, agencies were to use a procurement contract when "the principal purpose of the instrument is to acquire…property or services for the direct benefit or use of the United States

[2] 31 USC §§ 6301-6308.

Government."[3] On the other hand, a cooperative agreement was to be used when "the principal purpose of the relationship is to transfer a thing of value to the…recipient to carry out a public purpose of support or stimulation authorized by a law of the United States instead of acquiring…property or services for the direct benefit or use of the United States Government."[4]

Prior to July 2000, the Foundation employed In-Country Service (ICS) contractors in each country in which it had active grants[5]. The ICS contractors were responsible for providing pre-award assistance to potential grantees and continuing technical assistance to approved grantees. In addition, ICS contractors monitored and evaluated grantee projects for the Foundation. We believe that the principal purpose of the Foundation's relationship with its ICS contractors was to acquire the services of those contractors, as overseas intermediaries, to perform functions that might otherwise be performed by Foundation staff. Consequently, based on the criteria reviewed above, we believe that a procurement contract was, and remains, the appropriate mechanism for obtaining those services.

However, the Foundation recently determined that it was inappropriate for ICS contractors to provide technical assistance to help grantees design and implement projects and also evaluate their resulting performance. Therefore, the Foundation decided to separate these functions by 1) using cooperative agreements with one organization, or individual, to provide technical assistance, and 2) contracts with another to provide evaluation services in each of the countries in which the Foundation funded grants. Consequently, the Foundation allowed all of its ICS contracts to expire as of June 30, 2000, with the expectation of quickly awarding new contracts for evaluation services and cooperative agreements for technical assistance services.

By November 2000, the Foundation had competitively awarded new contracts to provide evaluation services in 15 of the 16 countries in which it had active grants and was in the process of selecting a contractor in the last remaining country. However, when the Foundation proposed and sought Congressional approval to use cooperative agreements to obtain technical assistance services, the Senate Foreign Relations Committee withheld its approval pending a discussion of the appropriateness of using cooperative agreements for such a purpose.[6] After several months, the Foundation decided to abandon its proposal and continue using contracts, even though Foundation management continued to

[3] 31 USC § 6303.
[4] 31 USC § 6305.
[5] The contractor in Argentina also monitored projects in Chili and Paraguay; the contractor in Bolivia monitored projects in Ecuador, the contractor in Panama monitored projects in Nicaragua, and Foundation Headquarters monitored projects in Cost Rica.
[6] The Foundation's General Counsel laid out management's reasoning for selecting cooperative agreements in a memo to the Senate Foreign Relation's Counsel dated September 22, 2000. While we disagree with this reasoning based on the criteria presented in this report, the argument becomes moot since the Foundation has decided not to use cooperative agreements (see following footnote).

believe that cooperative agreements would have been appropriate mechanisms for providing technical assistance to grantees.[7]

When it became aware that Congressional approval for its proposal would not be immediately forthcoming, the Foundation awarded some short-term, sole-source purchase orders in order to provide grantees with technical assistance on an interim basis. Appropriate sole-source waivers were obtained when necessary. However, as of December 2000, the Foundation had only awarded purchase orders in 5 of the 16 countries in which it had active grants. Consequently, at the conclusion of our audit, the Foundation did not have a mechanism for providing in-country technical assistance services to grantees in most of the countries in which it had activities. Without such a mechanism, many of the Foundation's grant recipients may not receive needed technical assistance and training on a timely basis.

The Federal Acquisition Regulation (FAR) and the Competition in Contracting Act (CICA) require that federal agencies obtain services, except in certain situations, through competitive contracts with full and open competition. The Foundation's continued use of short-term, non-competitive purchase orders could potentially result in higher costs and services of less than the best available quality. Consequently, we recommended that the Foundation proceed as quickly as possible to complete the process of awarding competitive contracts to provide technical assistance services to grantees in all countries in which the Foundation has activities. In response to this recommendation, Foundation management stated that it had already begun the process of awarding such contracts prior to our audit. Based on its response to Recommendation No. 1, we concur with management's decision.

Did the Inter-American Foundation comply with federal laws and regulations pertaining to the rate of obligation of funds during the last month of the fiscal year?

The Foundation complied with a provision in foreign operations appropriations legislation for fiscal year 1999 that required that not more than 15 percent of the appropriations provided for that year be obligated during the last month of availability. Nevertheless, the Foundation's General Counsel does not believe that this provision applies to the Foundation. To help ensure future compliance with this provision, if necessary, we believe that the Foundation should obtain a definitive legal determination as to its applicability to the Foundation.

[7] In a November 8, 2000 letter to the Chairman of the Senate Foreign Relations Committee, the Foundation's Interim President indicated that the Foundation had decided to withdraw its proposed cooperative agreements for providing training and technical assistance to Foundation grantees in favor of contracts. The letter stated, "While we continue to believe that a cooperative agreement is an appropriate instrument for providing this assistance to our grantees, we will follow the contractual route."

The Applicability of a Funding Provision
<u>to the Foundation Needs to be Determined</u>

Section 501 of the Foreign Operations Appropriation Act of 1999 requires that not more than 15 percent of any appropriation be obligated during the last month of availability. According to the Act, the funds appropriated for the Foundation for fiscal year 1999 were "two-year" funds which were to remain available for obligation until September 30, 2000. However, because there is uncertainty as to whether or not this provision applies to the Foundation, and the applicability of this provision may impact the Foundation in the future, we are recommending that the Foundation seek a legal opinion from USAID's Office of General Counsel concerning the applicability of this provision to the Foundation.

> **<u>Recommendation No. 2:</u> We recommend that the Inter-American Foundation seek a formal legal opinion from the U.S. Agency for International Development's Office of General Counsel as to whether or not the provision in Section 501 of Title V of the annual Foreign Operations, Export Financing, and Related Programs Appropriations Acts applies to the Foundation.**

According to the Foreign Operations Appropriation Act of 1999, USAID was to make available to the Foundation an amount not to exceed $20 million from its Development Assistance appropriation. The funds appropriated to USAID, and subsequently transferred to the Foundation, were "two-year" funds that were available for obligation through September 30, 2000. Section 501 of Title V of the same Act includes a provision that states, "…not more than 15 percent of any appropriation item made available by this Act shall be obligated during the last month of availability[8]."

We reviewed the Foundation's rate of obligation of fiscal year 1999 appropriations to determine the percentage obligated during September 2000, the final month of availability. As the Foundation's original appropriation of $20 million had been reduced by $34,000 due to a Government-wide rescission, we reviewed the obligations associated with the remaining balance of $19,966,000. We found that as of September 30, 2000, the Foundation had obligated the entire balance of its fiscal year 1999 appropriations. Of that amount, $896,500, or 4.5 percent, was obligated during September 2000, well below the 15 percent limitation in Section 501.

Although the Foundation's rate of obligation for fiscal year 1999 appropriations complied with the 15 percent limitation provision, the Foundation's General Counsel expressed the opinion that this requirement did not apply to the Foundation because it was overcome by

[8] This same general provision has also been included in Section 501 of Title V of the appropriation acts for foreign operations in fiscal years 2000 and 2001.

Section 537 of the same Act[9]. Nevertheless, the Foundation's practice has been to obligate funds early in the period of availability. Section 537 states:

> Unless expressly provided to the contrary, provisions of this or any other Act, including provisions contained in prior Acts authorizing or making appropriations for foreign operations, export financing, and related programs, shall not be construed to prohibit activities authorized by or conducted under the Peace Corps Act, the Inter-American Foundation Act or the African Development Foundation Act.

We believe that the 15 percent requirement in Section 501 does apply to the Foundation. In our opinion, the above paragraph reflects Congress' intent to allow the Foundation to operate in countries where other U.S. agencies are prohibited from operating and was not intended to exempt the Foundation from all restrictions and provisions in this or any other act. However, for future reference, we recommended that the Foundation seek a definitive legal opinion on this issue from USAID's Office of General Counsel. In response to this recommendation, Foundation management indicated that it would request a legal opinion for USAID's Office of General Counsel. Based upon management's response to Recommendation No. 2 we concur with management's decision, and look forward to the result of USAID's General Counsel's legal opinion.

Did the Inter-American Foundation properly categorize program and operating costs?

For the items tested, the Foundation categorized program and operating costs in accordance with a format prescribed by the Office of Management and Budget (OMB). Although the Foundation did improperly allocate one charge, the amount was not material in comparison to the Foundation's annual budget.

OMB Bulletin 97-01, Form and Content of Agency Financial Statements, defines *program costs* as the direct costs and all other costs that can be directly traced, assigned on a cause-and-effect basis, or reasonably allocated to program outputs. Legislation providing the Foundation's funding has not required that the Foundation account for program costs and operating costs separately. However, OMB has, through a series of correspondence with the Foundation, prescribed a specific budget format that the Foundation has agreed to use.

In accordance with this correspondence, the Foundation budgets and accounts for obligations and expenditures of appropriations by classifying them as either program costs or operating costs. Additionally, per this guidance, the Foundation classifies program costs under three distinct categories: Development Assistance (development

[9] While this provision is found in Section 537 of the Foreign Operations Appropriations Act for fiscal year 1999, the same provision was renumbered as Section 535 in the foreign operations appropriation acts for fiscal years 2000 and 2001.

grants), Development Research and Dissemination (research grants), and In-Country Support (technical assistance and other activities). All other costs are classified under Program Management and Operation (operating costs).

We reviewed a judgmental sample of fiscal year 2000 transactions to determine whether the Foundation was properly categorizing costs. All sampled costs were properly categorized except for one procurement request for $35,000. The Foundation charged this request, to design and print the Foundation's 1999 Year in Review, as a program cost rather than an operating cost. OMB had instructed the Foundation to classify all costs related to general Foundation publications under its "Program Management and Operation" category. OMB specifically identified the Foundation's Annual Review as such a general publication. Due to this misclassification, the Foundation's program costs may have been slightly overstated and operating costs may have been slightly understated for fiscal year 2000. As nothing came to our attention to indicate that this was a systemic problem, we have not made a formal recommendation that the Foundation take corrective action in this regard.

Management Comments and Our Evaluation

In response to Recommendation No. 1, in which we recommended that the Foundation promptly complete the process of awarding competitive contracts to obtain in-country technical assistance for its grantees, Foundation management stated that it would proceed with awarding competitive contracts. However, management added that this action would not require any change in the Foundation's conduct or policies because it had already begun the process prior to our audit. Based on management's comments, we concur with management's decision.

Although management indicated that the Foundation would award competitive contracts to obtain in-country technical assistance for its grantees, management noted that the draft report seemed to establish a standard of review for the Foundation's selection of a funding mechanism that was inconsistent with the practices of other federal agencies. With regard to the standard of review used during the audit, we note that we relied on criteria—the Federal Grant and Cooperative Agreement Act of 1977—applicable to all federal agencies.

Management also provided additional information support its original view that cooperative agreements were appropriate mechanisms for obtaining in-country services. However, because management has decided to use contracts, instead of cooperative agreements, we no longer consider this issue t be relevant and have consequently deleted our discussion of it from the report.

Concerning Recommendation No. 2, which dealt with a provision to not obligate more than 15 percent of appropriated funds in the final month of availability, Foundation management agreed to implement the recommendation by seeking a legal opinion from the USAID Office of General Counsel regarding whether Section 501 of the annual foreign operations appropriation act applies to the Foundation. According to management, the Foundation obligates 85 percent of its appropriated funds before the last month of availability as a matter of policy and good management. Nevertheless, management maintained that the Foundation was exempt from Section 501 and that the draft report relied on Congressional intent that the Foundation was unable to trace. Based on management's comments, we also concur with management's decision. Barring USAID General Counsel's legal opinion to the contrary, we continue to believe that Section 501 applies to the Foundation.

Management's comments are included, in their entirety, as Appendix II.

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Scope and Methodology

Scope

The Office of Inspector General (OIG) conducted an audit of selected processes at the Inter-American Foundation. The audit was requested on behalf of the U.S. Senate Committee on Foreign Relations. Fieldwork was conducted at Foundation headquarters in Arlington, Virginia, from November to December 2000. All work was conducted in accordance with generally accepted government auditing standards.

The scope of the first audit objective included all Foundation in-country service contracts that expired during fiscal year 2000, as well as all new ICS contracts awarded as of the time of our audit. We included 100 percent of such contracts in our review. As all contracts for in-country services were reviewed as a group, we determined that materiality thresholds were not appropriate for this objective.

The scope of the second objective included all obligations made during fiscal years 1999 and 2000 and funded with fiscal year 1999 appropriations of $19,966,000. Our tests incorporated 100 percent of those obligations. As we dealt with cumulative balances over a two-year period, we determined that materiality thresholds were not appropriate for this objective either.

The scope of the third objective consisted of obligations made during fiscal years 1999 and 2000 and funded with fiscal year 1999 appropriations of $19,966,000, as well as the Foundation's fiscal year 2001 budget request. As part of our risk assessment, we conducted limited testing to determine how the Foundation was categorizing program and operating costs. We rated the risk of misclassifying costs as low, therefore, we decided that neither materiality thresholds nor expanded testing would be necessary.

Methodology

To accomplish these audit objectives we interviewed officials from the Foundation, USAID, OMB, and OIG. We also examined pertinent documents and performed the following tasks:

- reviewed GAO's *Federal Appropriations Law-Volume II*, applicable sections of the Federal Acquisitions Regulation, the Competition in Contracting Act, the Inter-American Foundation Act, the Federal Grant and Cooperative Agreement Act, and the Foreign Assistance Act;

- reviewed files for In-Country Service contracts that expired in fiscal year 2000 and all fiscal year 2001 contracts for Country Liaison Offices in effect at the time of our audit;

- reviewed monthly obligations for the Foundation's fiscal year 1999 appropriations and supporting accounting entries;

- assessed management controls with respect to each of the audit objectives;

- reviewed the Foundation's fiscal year 2001 budget request and applicable OMB guidance; and

- tested a sample of cash disbursements (35 transactions across 9 object class codes) as well as three additional transactions which we believed to be problematic.

MANAGEMENT COMMENTS

Inter-American Foundation

An Independent Agency of the U.S. Government

MEMORANDUM

February 12, 2001

TO: Diane Rawls
USAID/IG/A/PA

FROM: David Valenzuela
President

SUBJECT: Audit of Selected Processes at the Inter-American Foundation

We are in receipt of your draft memorandum (the "Draft Report") dated January 30, 2001. The Chair of the Board of Directors has asked that I respond on behalf of the Foundation.

The Draft Report makes two recommendations. Neither recommendation requires any change in the Foundation's conduct or policies. The first suggests only that the Foundation continue to award certain contracts, which the Foundation intended to do in any case. The second calls for an outside legal opinion as to the applicability of Section 501 of the Fiscal Year 2000 foreign operations appropriation act. The Foundation will be glad to seek that opinion, although the Foundation complies with Section 501 as a matter of policy. The opinion will thus have no impact on Foundation guidelines or practices.

Recommendation Number One:

"We recommend that the Inter-American Foundation promptly complete the process of awarding competitive contracts to obtain in-country technical assistance for grantees in all countries in which the Foundation has activities."

Response Number One:

The Foundation will proceed with the award of competitive contracts—a process it commenced before this audit was initiated.

The Foundation neither had nor has any plans to change course with regard to the subject contracts. The Foundation would note, however, that the Draft Report's pronouncements regarding the use of intermediaries are inconsistent with the practices of other federal

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agencies we contacted. Indeed, the Draft Report seems to establish a standard of review for the Foundation's choices of instrument that is not used to evaluate other agencies' choices of instrument.

Moreover, the GAO itself has ruled consistent with the Foundation's view. One significant example was omitted from the Draft Report, to wit:

> On the other hand, if the program purpose contemplates support to certain types of intermediaries to provide consultation or other specified services to third parties, GAO has approved the agency's choice of a grant rather than a contract as the preferred funding vehicle. Thus, in 58 Comp. Gen. 785 (1979), GAO found that the Department of Commerce's Office of Minority Business Enterprises (now the Minority Business Development Agency) could properly award a noncompetitive grant to an intermediary organization to provide management and technical assistance to minority business firms. (*Principles of Federal Appropriations Law-Vol. II, p. 10-14* (GAO/OGC-92-13))

Recommendation Number Two:

"We recommend that the Inter-American Foundation seek a formal legal opinion from the U.S. Agency for International Development's Office of General Counsel as to whether or not the provision in Section 501 of the annual Foreign Operations, Export Financing, and Related Programs Appropriations Acts applies to the Foundation."

Response Number Two:

The Foundation will seek the opinion the Draft Report recommends.

As a matter of policy and good management, the Foundation obligates 85 percent of its appropriation before the last month of availability. The Foundation maintains that it is exempt from Section 501, but to put the matter at rest we will be glad to seek the opinion the Draft Report recommends. We wish to point out, however, that in asserting that Section 501 applies, the Draft Report relies on Congressional intent which we have been unable to trace. We have thoroughly researched all relevant proceedings of Congress and have discovered that the record is entirely silent on the expression of intent as to the issue.