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Report to the Chairman, Subcommittee on Asian and Pacific Affairs, Committee on Foreign Affairs, House of Representatives

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FOREIGN AID

Accountability and Control Over U.S. Assistance to Indonesia

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National Security and
International Affairs Division

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The Honorable Stephen J. Solarz
Chairman, Subcommittee on Asian and
Pacific Affairs
Committee on Foreign Affairs
House of Representatives

Dear Mr. Chairman:

On June 9, 1986, you requested that we review the accountability and controls over the U.S. assistance programs to Indonesia to ensure that assistance is not diverted for unintended purposes. This report expands upon the information we provided to your representatives in a December 18, 1986, briefing. The results of our work are summarized below and discussed in more detail in the appendixes.

Between fiscal years 1982-86, Public Law 480 food assistance to Indonesia totaled $199.1 million—$168.4 million under the title I sales program and $30.7 million under the title II donated commodities program. During the same period, development assistance totaled $333.0 million, and military assistance totaled $172.4 million—$161.6 million in Foreign Military Sales credits, $10.6 million under the International Military Education and Training program, and $218,000 in Military Assistance Program grants. No Economic Support Fund assistance is provided to Indonesia, and little disaster assistance funds have been provided in the past few years.

Public Law 480 Assistance

We did not identify instances of misuse or diversion of title I commodities or sales proceeds and found only a minor diversion of several metric tons of wheat, valued at about $800, in the title II program. However, we found a number of problems in the Indonesian government's compliance with agreements and Agency for International Development (AID) mission oversight of the title I program. Because of these compliance and oversight weaknesses, neither we nor AID can determine whether some local currency funds have been misused or diverted.

Title I

The AID mission had not provided adequate oversight over the title I program. We found that audited reports of commodity sales receipts and expenditures were not submitted by the Indonesian government; self-help measure progress reports were generally late, incomplete, and/or inaccurate; and required project expenditures of the local currency equivalent of $26 million were not made. We also found that most self-help projects were not monitored by the mission; Public Law 480 programs were not included in the mission's Federal Manager's Financial Integrity Act vulnerability assessments; and local currency funding levels for projects, generated from the sale of title I food, were incorrectly calculated, resulting in a shortfall of about $700,000 in local currency equivalent for the period 1982-85.

The accounting requirements for Public Law 480 title I local currency use in Indonesia do not permit the "tracking" of specific title I funds. Although AID has increasingly required recipient governments to establish special accounts to facilitate programming and monitoring of funds, such a requirement has not been included for the Indonesian program. The local currency generated from title I commodity sales is commingled with the Indonesian government's budget funds in its general fund rather than deposited into a special account. Funds are to be transferred to the various ministries that implement self-help projects. The government is required to submit interim and annual self-help measure progress reports and annual audited financial reports to the AID mission. For the period 1982-85, the government did not submit audited financial reports, and its progress reports were incomplete, did not cover all projects, and often were not submitted on time.

Based on reports that Indonesia did submit, we found that the government spent an average of only about 75 percent of the agreed-upon amounts for self-help projects during 1982-85, leaving the local currency equivalent of $26 million unaccounted for. AID officials were unaware of the funding shortfall but speculated that the spending shortfall may be attributed to multi-year funding of projects that have not yet been completed. However, the Indonesian budget process does not permit multi-year funding or unspent title I local currency to roll over from year to year. We examined each of the self-help projects in agreements for 1982-85 to determine whether specific dates were noted by which funds should have been spent; 13 of 18 projects had specific dates, including 7 projects for which funds were not completely spent during the specified period. Mission officials could not explain the discrepancy, account for the underspending, or account for the unexpended funds. We believe that the mission should reconcile the discrepancy of the $26 million with the Indonesian government and ensure that agreed-upon amounts are spent as intended.

In negotiating the title I agreements, the mission did not require self-help measures to be described in specific and measurable terms as set forth in section 109(d) of Public Law 480 title I. Although AID maintains that self-help measures have been adequately described since 1983, we examined all measures in the 1983-86 agreements and found that self-help measures were adequate for less than one-third of project descriptions; the remaining descriptions lacked such benchmarks as the number of people to be trained by a certain date and statistics on project construction and/or procurement stages that would permit measurement and evaluation of project progress.

We also found that the AID mission was not monitoring the implementation of many self-help projects. At the time of our visit, the mission had not developed monitoring procedures, had not assigned staff to monitor each project, and had conducted no site visits during fiscal year 1986. Instead, mission officials said that they relied on regular contact with Indonesian government implementing-agencies and the government's progress reports to monitor some projects. However, we found that self-help progress reports were not submitted on time and were generally poorly written, thus providing limited information to the mission. In its comments on a draft of this report, AID stated that the mission assigns a staff member to monitor each of the local currency projects, and in most cases, the staff members maintain regular contact with the implementing institutions to ensure that government budget funds reach the projects. AID said that these direct contacts, coupled with the mission's review of annual government reports, permit the mission to maintain oversight of the program.

During our work in Indonesia, we found no documentation listing staff assigned to monitor self-help projects; consequently, we asked mission officials which staff members were responsible for monitoring self-help projects. We interviewed the designated staff and found that most were either unaware of their project monitoring responsibilities or had conducted very limited contact with responsible Indonesian government implementing-agencies.

An examination of mission files showed that some project officers do maintain close contact with their Indonesian counterparts, but we were unable to find evidence of regular contact for the majority of projects. We believe this occurred because most monitors were not assigned until

November 1986, during our audit. Also, since many Indonesian government reports were either not submitted or, when submitted, were incomplete and inaccurate, we question their value to the mission in serving as a monitoring mechanism.

In carrying out the Federal Manager's Financial Integrity Act of 1982 (31 U.S.C. 3512(b)), AID requires its missions to conduct biennial vulnerability assessments to identify areas subject to waste, loss, unauthorized use or misappropriation. The mission did not include title I in such assessments because mission officials mistakenly considered it outside the requirement. In commenting on our draft report, AID stated that it has instructed the mission to include Public Law 480 programs in its future assessments.

We found that the mission incorrectly calculated the funding levels required of the Indonesian government for self-help projects. For example, from fiscal year 1982 to fiscal year 1985, the mission agreed to funding levels of the local currency equivalent of $106.6 million, about $700,000 lower than the required amount of $107.3 million. AID agreed with our calculation of the required level of title I funding and, in commenting on our draft report, said that it has instructed the mission to conform its accounting practices to our calculations.

Title II

The title II program in Indonesia is operated by two U.S. private voluntary organizations—the Catholic Relief Services and the Cooperative League of the USA. We found that the AID mission performs limited oversight of the organizations' activities, including their internal controls over title II commodities and funds.

The mission is responsible for providing guidance to the private voluntary organizations and for monitoring their administration and implementation of the program. Our limited review of Catholic Relief and the Cooperative League's controls identified no major weaknesses; however, we noted that the mission had not assessed their internal controls. Furthermore, the mission provided little direct monitoring of title II activities. For example, based on available documentation, mission officials had made only two field visits to project sites in 1986, although there were 335 sites in Indonesia. The mission's title II specialist said that although private voluntary organizations' staffs make site visits for which they file reports, the mission does not receive copies of the reports. Instead, the mission relies for its monitoring on annual program summaries and evaluations provided by the organizations. We do not believe this constitutes adequate monitoring. AID stated in its comments on our draft report that title II monitoring will be improved.

We identified a minor diversion of several metric tons of wheat valued at $800. The private voluntary organization involved in the program was investigating the diversion, and we so informed the AID mission's title II specialist. We found no other instances of diversions or misuse of title II commodities or funds. As with title I, the mission had not included title II in its biennial vulnerability assessment but will do so in the future.

Development Assistance

We found no evidence of major misuse or diversions of development assistance funds and, at the time of our review, the AID Inspector General was conducting no investigations concerning misuse or diversions of funds. In 1985, the Inspector General did investigate the improper sale of AID-financed vehicles, valued at $100,000 to Indonesian government employees. As a result of the audit, the mission took corrective actions, including monitoring the use of project vehicles. The mission does not inventory or monitor other AID-financed goods. As of September 1986, $31.7 million in commodities and equipment (excluding those for malaria control, immunizations, and family planning) had been allocated to active projects and $12.9 million had been spent. We believe the mission should ensure that inventory and monitoring controls to parallel those for AID-financed vehicles are properly implemented by establishing criteria and issuing specific guidance for control and accountability of major project goods, such as road equipment.

Military Assistance

U.S. officials said that they had received no allegations nor were they aware of misuse or diversion of U.S. military assistance provided under a variety of programs, including Foreign Military Sales, International Military Education and Training, and Military Assistance Program. We found no evidence of misuse or diversion under any of these programs.

Since fiscal year 1982, about 83 percent of Indonesia's Foreign Military Sales credits have been used to purchase military items directly from the U.S. government; this minimizes opportunities for misuse or diversions of funds. The Defense Security Assistance Agency recently instituted new controls and procedures for commercially applied credits, which have accounted for the remaining 17 percent of the credits.

There is no transfer of funds under the International Military Education and Training program where the United States provides training, supplies, and required transportation to students selected from the Indonesian armed forces. According to Department of Defense officials, Indonesia appears to be making good use of these personnel.

Defense officials in the U.S. embassy track the use of Military Assistance Program equipment through reports submitted by the Indonesian government and field trips. Indonesia had not complied with a Defense requirement for annual updates of its Military Assistance Program inventory since 1983. During our fieldwork in October 1986, Defense officials requested that Indonesia update the inventory, as required.

Conclusions and Recommendations

The AID mission needs to improve its oversight of the Public Law 480 program. Specifically, improvements are needed in obtaining better government of Indonesia compliance in providing title I financial and progress reports on self-help measures and in reconciling funding shortfalls from previous title I agreements. The mission needs to improve its monitoring of self-help projects to ensure that funds are spent and projects are implemented as agreed. It also needs to negotiate more specific self-help measures in future projects.

The mission should also evaluate the adequacy of internal controls of private voluntary organizations implementing Public Law 480 title II programs. For its development assistance program, the mission should ensure that inventory and monitoring controls are properly implemented by establishing criteria and issuing specific guidance for control and accountability of major project goods, such as road equipment.

We recommend that the Administrator of AID direct the mission director to

- negotiate specific and measurable Public Law 480 title I self-help requirements with the Indonesian government, to include quantifiable baseline information, specific time frames, and detailed budget information;
- implement the terms of U.S.-Indonesian agreements by requiring the Indonesian government to submit the required audited reports on sales proceeds and receipts and to improve the content and timely submissions of its progress reports;

- reconcile discrepancies in title I self-help project expenditures for 1982-85 with the Indonesian government and ensure that agreed-upon local currency amounts are spent as intended;
- consider requiring the Indonesian government to establish a separate Public Law 480 local currency account for future agreements;
- evaluate the adequacy of private voluntary organizations' control under title II programs; and
- develop procedures with specific criteria for monitoring major AID-financed development assistance items such as road equipment.

Agency Comments and GAO's Evaluation

The Department of Defense concurred with the report as it applied to the Department.

The Department of State commented that it shares AID's view "that the difficulty of monitoring self-help measures is intrinsic to certain features of the [Public Law 480] title I program common worldwide and not unique to Indonesia."

AID agreed that some improvements were needed in its monitoring of the Public Law 480 program. AID stated in its comments that the mission is improving its monitoring of the use of local currency, reducing the number of self-help measures and linking them to development assistance projects to facilitate improved field monitoring, introducing more specificity in self-help measure benchmarks, and improving the self-help measure reporting format.

In addition, AID said that the mission is taking steps to obtain required reports from the Indonesian government, and that one private voluntary organization will be audited and the other will have its management and internal controls assessed.

AID disagreed that its oversight of the Public Law 480 program was inadequate and said that there was no evidence of significant misuse or diversion of assistance. AID said that the government of Indonesia's "substantive performance has been impressive on a wide range of development issues..." and that "this performance inclines us against any attempt to micro-manage the implementation of development activities financed by currencies that are legally the property of the [Indonesian government]."

While it is not our intent to advocate micromanagement, neither AID oversight nor Indonesian government performance has been adequate to ensure that terms of Public Law 480 agreements have been met. In addition, the agreements signed by the Indonesian government grant the United States oversight of local currency expenditures. We believe AID should provide sufficient oversight to ensure that funds Indonesia agrees to provide, under terms of its agreements with the United States, are accounted for, spent for agreed upon purposes, and that self-help measures are adequately identified and monitored. We believe AID oversight is particularly important given the unaccounted for $26 million in local currency for the 1982-85 period.

AID concurred with our recommendation in our draft report on the need for monitoring development assistance project commodities but noted that types of resources involved and geographic distribution make oversight of specific items difficult. We have revised our final recommendation to focus on major items such as road equipment.

In our draft report we recommended that AID issue regulations and additional guidance for the administration of the Public Law 480 program, that the mission include these programs in its vulnerability assessments, and that the funding levels for self-help projects be based on the greater of commodity sales proceeds or the U.S. government-financed amounts.

In its comments on the draft, AID stated that it was revising its handbook and policy determination and the mission was improving its project officers' procedures. AID also said that it had instructed the mission to include Public Law 480 programs in the vulnerability assessments and to base self-help funding levels on our calculations.

In view of AID's actions and/or commitment to actions which we believe will improve mission oversight of U.S. assistance, we are not making recommendations in these areas at this time.

We are sending copies of this report to AID, the Departments of State and Defense, and appropriate congressional committees and making copies available to others upon request.

Sincerely yours,

Frank C. Conahan

Frank C. Conahan
Assistant Comptroller General

Contents

Abbreviations

AID	Agency for International Development
CLUSA	Cooperative League of the USA
CRS	Catholic Relief Services
DA	Development Assistance
DSAA	Defense Security Assistance Agency
FMS	Foreign Military Sales
GAO	General Accounting Office
IG	Inspector General
IMET	International Military Education and Training program
MAP	Military Assistance Program
OMADP	Office of the Military Attache for Defense Programs
PVO	Private voluntary organization

Public Law 480 Assistance to Indonesia

During fiscal years 1982-86, the U.S. government provided approximately $199.1 million in food aid to Indonesia through Public Law 480 titles I and II programs. Title I, the larger of the two programs, provides for U.S. government financing of sales of U.S. agricultural commodities at concessional credit terms. The U.S. and the Indonesian governments negotiate annual agreements for these commodities, and the proceeds from their sales are to be used for economic development and self-help projects to benefit the poor. The projects are undertaken by various Indonesian government agencies. During fiscal years 1982-86, approximately $168.4 million was programmed for the title I program in Indonesia and 18 self-help projects were negotiated in such areas as agricultural development, road construction, and irrigation.

Under the title II program, U.S. agricultural commodities are donated to alleviate malnutrition and to promote economic development. More than half of the title II food distribution program in Indonesia was implemented by two U.S. private voluntary organizations (PVOS)—the Catholic Relief Services (CRS) and the Cooperative League of the USA (CLUSA), now called the National Cooperative Business Association.

CRS, operating under various Indonesian government and voluntary agencies and their distributors, provided food commodities to eligible recipients. CLUSA, under contract with the Indonesian government, provided technical assistance to various Indonesian cooperatives. With U.S. approval, CLUSA sold[1] the title II commodities to the Indonesian government and used the cash proceeds to fund CLUSA activities. Total title II commodities going to Indonesia during fiscal years 1982-86 were worth about $30.7 million.[2]

Controls Over the Title I Program

U.S.-Indonesian agreements on title I require that the Indonesian government submit 6-month interim and annual (1) audited receipt and expenditure reports and (2) self-help measure progress reports. In addition, section 109 (d) of title I of Public Law 480 requires that self-help measures in the agreements be described, to the maximum extent feasible, in specific and measurable terms. Although AID requires that many recipient governments establish special accounts for title I-generated

[1] AID's term for selling title II commodities for cash is "monetization" of commodities.

[2] CRS and CLUSA commodities were valued at about $17.7 million and $2.5 million, respectively. The remaining $10.5 million in commodities was donated to the U.N. World Food Program and another U.S. PVO whose program is phasing out.

local currency, such a requirement has not been established for Indonesia. Thus, the local currency is commingled with the Indonesian government's own budget funds and its use cannot be "tracked".

The mission did not ensure that audited reports of commodity sales receipts and expenditures were submitted by the Indonesian government as required by the title I agreements. Since the Indonesian government was not required to establish a special account for local currency by which expenditures could be tracked, the audited reports would serve as one means of ensuring that funds were spent as intended. The Indonesian government submitted annual reports on receipts, but these reports were not audited and did not include expenditures. In its comments on a draft of this report, AID stated that "the mission is taking measures to obtain audited reports on sales receipts and to obtain reports certified by the appropriate [Indonesian government] audit authority on expenditures."

Indonesian government progress reports were not always timely and did not always include sufficient information to evaluate project progress, and the mission did not always follow up on information in the reports. For example, our review of the government's unaudited progress reports disclosed that for fiscal years 1982-85 it reported spending the local currency equivalent of $80.2 million (an average of only 75 percent) of the agreed-upon $106.6 million; for 1984, reported government spending was as low as 58 percent—$18.7 million of the required $32.0 million. Mission officials had not determined what use had been made of the remaining $26.4 million. AID officials were unaware of the funding shortfall but speculated that it might be attributed to multi-year funding of projects that have not yet been completed. However, the Indonesian budget process does not permit multi-year funding or unspent title I local currency to roll over from year to year. We examined each of the self-help projects in agreements for 1982-85 to determine whether specific dates were noted by which funds should have been spent; 13 of 18 projects had specific dates, including 7 projects for which funds were not completely spent during the specified period.

In implementing title I, AID requires mission officials to determine what self-help projects are accomplishing. However, the mission had not developed monitoring procedures to do so. In addition, about two-thirds of the self-help measure project descriptions we reviewed were vaguely written with no specific time frames or quantifiable baseline data and little cost information. We believe that if detailed budget estimates were provided in project papers, mission officials would have a basis for assessing the reasonableness of projected costs and for monitoring expenditures. The mission director and the chief of the program office agreed that detailed budget information would be useful and indicated they would negotiate with the Indonesian government to include it in future self-help project descriptions.

Also, the mission did not require staff to visit sites to ensure that projects were undertaken and implemented in accordance with the agreement, and no site visits were made during fiscal year 1986. The mission used the Indonesian government's progress reports to monitor some projects. Project files indicated that the mission had been monitoring 7 of 18 self-help projects to some extent using these reports. However, we found no documentation showing that 11 other projects, valued at $84.7 million, were monitored. Consequently, we asked mission officials which staff members were responsible for monitoring self-help projects. We interviewed the designated staff and found that most were either unaware of their project monitoring responsibilities or had very limited contact with responsible Indonesian government implementing agencies. In fact, the mission had not assigned specific personnel to monitor most projects until November 1986 during the course of our audit.

One project officer who had been assigned to monitor the purchase of road equipment for a 1986 project said that he had not reviewed project costs, had no idea what the equipment would cost, played no role in reviewing or overseeing any other part of the project, and viewed his appointment as "an exception to normal AID practice...." For another project, the costs for land purchased to establish sites in 30 different municipalities were all reported as the same by the Indonesian government. The mission director said that as long as costs appear reasonable, the mission does not question government figures.

The mission did not comply with provisions in the title I agreements in calculating the funding levels for self-help projects. The annual agreements require that project funding levels be determined by comparing the sales proceeds with the amount financed by the United States, less any "currency use payments,"[3] and the greater of the two is to be used as the funding level for the self-help projects. Instead of using this method, the mission set funding levels as a percentage of the value of the commodities programmed for the country. The mission director and

[3]Defined as local currency made available by the host-country government to the U.S. government and treated by the U.S. government as advance payments of interest and principal.

program officer believed this method provided the largest possible funding levels for self-help projects. We found, however, that the technique results in the mission agreeing to project funding that is lower than required. For example, in 3 of the 4 years that we reviewed (fiscal years 1982-85), the mission agreed to funding levels of the local currency equivalent of $106.6 million, about $700,000 lower than the required amount of $107.3 million.

Controls Over Title II Commodities

AID has charged PVOs with responsibility for implementing title II programs and for ensuring that program commodities are properly controlled. The mission is responsible for providing guidance to the PVOs and monitoring their administration and implementation of the program. The mission reviewed and approved CRS and CLUSA program plans and provided limited oversight of their program implementation by reviewing various reports and evaluations. Also, the mission had not assessed the internal controls of the PVOs.

The CRS had written operating procedures that prescribed controls to be followed by the Indonesian PVOs and their distributors and required CRS and its local PVOs to make site visits. CLUSA's controls required a special account for commodity sales proceeds and various program reports and evaluations.

Although the scope of our review did not entail a detailed audit of CLUSA and CRS title II programs, we did perform a limited assessment of their program controls. We reviewed CRS' written controls over food commodities. They appeared adequate to ensure program integrity, if implemented properly. We tested these controls at six distribution centers and one central warehouse and found that the consignees were following them. We also concluded that CLUSA's controls appeared to be adequate and seemed to be followed. CLUSA had established the special account for commodity sales proceeds and was submitting the required financial reports to the mission.

We identified a minor diversion of several metric tons of wheat valued at about $800. In this case, a CRS official discovered the wheat for sale in a public market. A CRS representative in Jakarta told us that it appeared that the wheat was diverted from an Indonesian PVO's warehouse. He believed that the PVO may have submitted fraudulent reports because all the inventory records were in order. AID title II program officials in Washington and Indonesia told us that they were not aware of any other recent diversion or misuse of title II commodities in Indonesia. AID said the mission would bring the wheat diversion to the attention of the government.

We found that mission officials were not making site visits to ensure that controls were in place. AID maintains that the mission regularly reviews and assesses PVOs' management and internal controls. Although documentation at the mission indicated that mission staff had made two site visits in fiscal year 1986, AID stated in its comments on the draft report that mission staff performed 10 field visits of title II sites, out of a total of 335 sites. We continue to believe that this is not adequate monitoring, and the mission director and controller acknowledged that they have not assessed the CRS operations manual or CLUSA's internal controls. Therefore, the mission had not assured itself that sufficient controls existed to preclude misuse or diversion of title II commodities. One PVO official said that the mission had provided very little guidance on internal control and "knows very little about his operation." According to another PVO official, an AID mission representative visits the Jakarta headquarters of his PVO every 2 to 3 months. The mission title II specialist said that, although PVO employees make site visits and file reports, the mission does not receive the reports nor do mission staff review them at the PVO offices; the mission does receive annual summaries of PVO activities, but the summaries do not identify specific problems at particular sites. For example, the specialist was unaware of the diversion of title II wheat until we told him. AID also said that the mission would improve its title II monitoring.

Programs Not Assessed for Vulnerability

In May 1985, AID directed its overseas missions to undertake vulnerability assessments, to include all programs, in accordance with the Federal Manager's Financial Integrity Act. The mission did not include Public Law 480 programs in its assessments but it has taken steps to include the programs in subsequent assessments.

Conclusions

Because the mission had incorrectly implemented U.S.-Indonesian agreement requirements, had performed limited project monitoring, and had not negotiated specific and measurable self-help measures with the Indonesian government, it was not in a position to ensure that title I local currency was used as intended. Accountability and control could have been enhanced by ensuring that the Indonesian government submitted all required reports in a timely manner; introducing procedures for monitoring projects, including preparation of documentation of site visits; improving self-help project descriptions; and correctly calculating self-help project funding levels.

While the title II controls employed by the PVOs appeared to be sufficient to preclude misuse or diversion of title II commodities, the mission did not have adequate procedures for monitoring PVO activities and assessing their internal controls. Such procedures could have provided the mission greater assurance that proper controls were in place and were being implemented.

Development Assistance to Indonesia

We reviewed AID's accountability and control of development assistance (DA) in Indonesia, including financial controls, project monitoring, and project documentation requirements. AID officials had received no allegations of and were not aware of any misuse or diversion of funds. We found no evidence of major misuse or diversions of development assistance. However, the AID IG had investigated some instances in 1985, resulting in corrective mission actions. At the time of our review, the IG was not involved in any ongoing investigations concerning the misuse or diversion of DA funds.

The Indonesia mission's procedures and internal controls for managing DA projects are contained in AID handbooks and guidebooks and in mission orders. However, the guidance is neither specific nor mandatory and gives wide discretion to mission personnel. We believe the mission could provide greater assurance that the controls are consistently implemented by developing more detailed operating procedures for reviewing and approving project documents, monitoring AID-financed commodities and equipment, and making site visits. Also, the biennial vulnerability assessment required by AID in implementing the Federal Manager's Financial Integrity Act, if conducted in compliance with AID requirements, could help the mission identify projects vulnerable to misuse or diversions.

During fiscal years 1982-86, the U.S. government provided approximately $333 million in DA to Indonesia. These funds were used to support bilateral development projects focused primarily on agriculture and rural development, population and health, and education. As of September 30, 1986, there were 30 active DA projects in Indonesia—11 agriculture and rural development projects, 8 population and health projects, 5 education and human resources projects, and 6 other projects.

Controls Over DA Funds

AID is responsible for ensuring that DA program resources are being used for intended purposes. Various Indonesian government agencies implement DA projects, but the mission reviews and approves the projects and fund disbursements using AID policies and procedures. The mission oversees DA activities from project identification and approval to implementation and final closeout. Responsibility is governed by specific accounting and project management controls contained in AID handbooks and mission orders.

Project controls generally consist of review and documentation requirements that must be met before a project is approved and funds obligated and expended. All projects must have detailed, approved project papers that discuss all aspects of the project, including disbursement mechanisms.

AID's project disbursement mechanisms include reimbursements and advances to the Indonesian implementing agencies and direct payments to contractors. Depending on the type of project, these mechanisms are agreed to in loan or grant documents, which specify how procurement will be accomplished.

Procurements are generally made through direct or host-country contracts and are subject to review and approval by various mission officials and, in some cases, by AID Headquarters. Once a contract has been approved, obligations are made through project implementation orders or letters after a determination is made that funds are available. Payments for goods and services are then made upon review and approval of required documentation.

An additional control employed by the mission is a post-payment voucher verification review. Among items reviewed are the internal controls of a project and supporting documentation for previously paid vouchers.

Mission project officers visit project sites and monitor project activities. During visits they concentrate on project progress rather than controls over commodities and equipment. Although the mission has not required documentation of site visits, some project officers have prepared trip reports.

We reviewed the mission's approval and payment procedures and verified their use through spot checks of project papers, project implementation letters and orders, vouchers presented for payment, and voucher verification review reports. We visited two projects and reviewed numerous project files and found that the project officers and other mission officials were generally monitoring implementation of the projects.

Some Improvements Needed

The mission did not provide specific guidance for monitoring AID-financed commodities and equipment and for documenting site visits through trip reports. The mission also should comply more fully with AID requirements for vulnerability assessments.

A 1985 AID IG audit disclosed that AID-financed vehicles purchased for projects were subject to misuse and that at least 12 vehicles, purchased for about $100,000, had been sold at concessional prices to Indonesian government employees. The projects were therefore deprived of the vehicles as well as the proceeds from their sale, since the money was deposited in the Indonesian government's general fund. As a consequence of the audit, the mission issued an order requiring yearly physical inventories of AID-financed vehicles.[1] However, the mission did not monitor other AID-financed goods. The mission could ensure greater control over major project equipment, such as heavy equipment, by issuing an order similar to that issued on vehicles. As of September 30, 1986, $31.7 million in commodities and equipment (excluding those for malaria control, immunizations, and family planning) had been allocated to active mission projects and $12.9 million of it had been expended.

While documentation of site visits was not a requirement, some project officers prepared trip reports. However, this practice is neither uniform nor extensive. For example, during fiscal year 1986, only 9 of 33 projects active during the year had documented site visit reports. The emphasis of the visits was on monitoring project implementation progress.

Vulnerability assessments are one way to help identify internal control weaknesses. The mission is required to perform biennial vulnerability assessments covering all phases of its operation to help identify areas vulnerable to waste, loss, unauthorized use, or misappropriation. A voluntary organization co-financing project received a "medium" vulnerability rating in the 1985 assessment, and the project's internal controls were evaluated as adequate. However, a subsequent IG audit of the project found a lack of internal controls and an inadequate financial management system. Such a large disparity in assessments of the project's internal controls suggests that the vulnerability assessment was not conducted in sufficient depth to identify potential internal control problems. AID required that all activities receiving a "medium" or higher assessment be scheduled for internal control review. These reviews were scheduled by the mission but never conducted. By complying more fully with AID requirements, the mission could improve the usefulness of the vulnerability assessments.

[1] Audits and investigations conducted by the IG between April 1982 and July 1986 disclosed one other case of misuse of DA funds in Indonesia; a 1985 investigation disclosed that a U.S. consultant submitted false vouchers and was overpaid $26,000.

The mission controller told us he plans to contract with an independent certified public accounting firm for in-depth internal control reviews of the Office of Finance and the Office of the Director. Based on the results of these reviews, the controller said he will decide whether additional reviews would be beneficial.

Conclusions

The mission should provide greater assurance that financial and management controls are implemented by providing specific guidance and operating procedures to appropriate officials. Accountability and control could be enhanced by instituting procedures for monitoring AID-financed equipment and requiring the documentation of such monitoring through site-visit reports. Without sufficient documentation of activities, it is difficult for mission officials or others to ensure that all development assistance funds are used as intended.

Military Assistance to Indonesia

U.S. officials said that they had received no allegations, and had no knowledge, of misuse or diversion of U.S. military assistance funds from their intended purposes. We found no evidence that misuse or diversion had occurred. U.S. military assistance to Indonesia for fiscal years 1982-86 totaled $172.2 million—$161.6 million in loans under the Foreign Military Sales (FMS) credit program, $10.4 million in grants from the International Military Education and Training program (IMET), and $218,000 in grants under the Military Assistance Program (MAP).

FMS Credit Program

The FMS credit program, which is administered by the Defense Security Assistance Agency (DSAA), permits allies and friendly foreign governments to purchase U.S.-origin equipment, spare parts, and training with U.S. financial assistance. Credit recipients make purchases either from the U.S. government or directly from commercial firms. Purchases from the U.S. government are referred to as government-to-government sales, since the appropriate military service, such as the Air Force in the case of Indonesia's purchase of F-16 aircraft, acts as the foreign government's procurement agent. Government-to-government sales are not as susceptible to the diversions or misuse of funds that may occur under direct commercial contracts. In direct commercial sales, DSAA which must approve FMS-financed commercial sales, only approves the use of credits to pay the contractor and is not involved in contract negotiations. Thus, commercial contracts have more opportunity for the misuse or diversion of funds, such as "padding" of contracts to pay unauthorized fees or commissions.

Although DSAA requires that commercial contractors certify that illegal payments have not been made, the potential for such payments always exists. Approximately 83 percent of Indonesia's FMS assistance since fiscal year 1982 has consisted of government-to-government sales, with 17 percent commercial.

Policies and procedures for government-to-government sales are set forth in the Security Assistance Management Manual, while purchases made by the Department of Defense on behalf of a foreign country are governed by the Federal Acquisition Regulation. Regulations governing commercial contracts were not established until July 1984 when DSAA announced a new set of review procedures. Before then, DSAA viewed its role in commercial sales as that of a banker. Since loans used to finance commercial sales had to be repaid, DSAA was reluctant to question contracts negotiated by credit recipients, and its review was generally limited to determining whether or not the sales made sense from a program point of view.

A growing concern about irregularities in commercial contracts led DSAA to formally establish review procedures. The necessity for such procedures was underscored by problems that surfaced during 1984 involving commercial contracts negotiated earlier by some foreign governments.

Under DSAA regulations, the purchasing country submits its proposed contract to the DSAA Controller for review of fund availability. The proposal also undergoes technical review in DSAA and is matched against the country's defense needs. If approval is granted, payments are made by DSAA directly to the commercial supplier. In the event exceptions to the regulations are required, or there are differences of opinion within DSAA as to whether the full contract should be approved or disapproved, a decision by the Director of DSAA is required.

The DSAA commercial sales review process is based upon the assumption that the buyer and seller have successfully negotiated a contract, the buyer is satisfied with the terms, and the seller intends to fulfill the terms. A key element of DSAA's review is establishing the reliability of the contractor. Thus, firms that have not had prior contracts with Defense may be subject to a pre-award survey as a condition for obtaining FMS financing. The review also examines the fairness of contract pricing and payment and delivery provisions for compliance with the regulations. On a random basis, prices are compared to those in government-to-government or other commercial contracts. Down payments must be related to work progress, and transportation must be on U.S. flag vessels. Finally, contractors are required to certify that no illegal payments have been made and that commissions included in the contract price do not exceed $50,000.

Indonesian FMS-financed commercial purchases between January 1982 and March 1986 included $8.9 million in 1982 for revolvers and spare parts, radio equipment, and aircraft spare parts (including parts for T-34Cs, A-4s and C-130s); $8.4 million in 1983 for sonar equipment; $1.3 million in 1985 for F-5 aircraft spare parts; and $1.4 million in 1986 for aircraft spare parts (including parts for C-130s and A-4s).

Since January 1984, DSAA has denied funding for travel, lodging, and per diem of Indonesian personnel in connection with a sonar system contract

(April 1985) and the funding of eight aircraft spare-parts items that DSAA considered too expensive (May 1985). DSAA also rejected a contract in January 1986, which included agents' fees and/or commissions of $234,700—far in excess of the allowable $50,000. The contract was revised and resubmitted with only $50,000 in fees.

DSAA and the Indonesian government have tentatively agreed that future FMS credits will be used only for government-to-government transactions for the purchase of F-16 aircraft from the United States and that future commercial purchases will be from Indonesia's own funds.

IMET Program

The IMET program provides instruction and training in military doctrine and skills to military personnel in allied and friendly countries. In addition to expanding U.S. influence, it exposes future leaders in these governments to the United States and to American values. Program levels are set through coordination between the State and Defense Departments. No funds are transferred to foreign governments; the U.S. government provides transportation, training, and a supplemental daily allowance. The foreign government provides all other financing of its personnel during training.

IMET candidates are selected jointly by the Indonesian Defense Department and the U.S. Office of the Military Attache for Defense Programs (OMADP) from the U.S. embassy. Candidates must have some proficiency in the English language (less so if they are to receive language training), pass a U.S. embassy security investigation and a medical examination, and be working and qualified in the area/specialty in which training is to be provided. The IMET program includes English-language training, tours of the United States for high-level Indonesian officers, and mobile-training units that are sent to Indonesia. The OMADP monitors the Indonesian Defense Department's use of personnel who have participated in IMET, principally through reports submitted by that Department. OMADP also debriefs returning students and sends yearly letters to Indonesia's Defense Department about the location and use of students. During meetings and conferences, OMADP personnel question Indonesian defense officials about the assignments of U.S.-trained personnel. Information obtained is reported to the OMADP training branch and used to spot-check these statements. Over 900 Indonesians participated in IMET between fiscal years 1982-86, and U.S. officials said the Indonesians appear to be doing a good job in using their U.S.-trained personnel.

Military Assistance Program

MAP was established under the Mutual Defense Assistance Act of 1949 and originally provided for the loan or grant of military equipment, materials, and services to allied and friendly governments. In fiscal year 1982, MAP was converted to a program called "MAP Merger" through which funds were made available to purchase U.S. equipment in addition to FMS credits and the recipient-government's own cash.

Although aircraft were provided to Indonesia under MAP 15 to 20 years ago, recent equipment has consisted of mortars, machine guns, radios, and fire and trash trucks.

The OMADP tracks use of the equipment through field trips by its personnel and reports from the Indonesian Defense Department. According to officials, Indonesia has never refused them access to military installations to check MAP equipment but it has not been responsive to requests for equipment accountability. Although Defense's security assistance manual requires that an inventory of MAP equipment be maintained and that the recipient government update the inventory annually, the Indonesian Defense Department has not submitted reports since late 1983. During our fieldwork in Indonesia, the OMADP sent a letter to the Indonesians on October 21, 1986, requesting compliance with U.S.-Indonesian agreements.

We visited the Indonesian Defense Department's 7th Cavalry and an engineer division and saw well-maintained MAP-provided vehicles (e.g., personnel carriers and water tankers) as well as unusable equipment marked for disposal. Disposal of excess and/or obsolete equipment is governed by the U.S. Defense Department's security assistance manual and defense demilitarization manual. OMADP personnel said that by the time Indonesia determines that equipment is excess, it generally has no further useful life and must be sold as scrap.

In 1979, the Indonesian government signed a memorandum of understanding with the United States giving it the first right of purchase of such equipment. Upon receipt of Indonesian notice of excess equipment, U.S. personnel inspect and photograph the equipment. A price and contract terms are set by Defense's Disposal Contract Office at Subic Bay, the Philippines. Items classified as munitions (e.g., aircraft and weapons) must be dismantled and destroyed to prevent reuse. Once the equipment is dismantled or destroyed and photographs taken again, the Indonesian government can purchase the parts for scrap.

Objectives, Scope, and Methodology

As requested by the Chairman of the Subcommittee on Asian and Pacific Affairs, we addressed the following questions: (1) Is there any evidence that any U.S. military or economic assistance has been diverted for unintended purposes? (2) How is each type of assistance accounted for and controlled? (3) Do any weaknesses exist that could lead to misuse or diversions of U.S. funds? (4) Are any additional controls needed to ensure that U.S. assistance is reaching intended beneficiaries?

Our review covered fiscal years 1982-86 and focused on the Defense Department's Foreign Military Sales program, International Military Education and Training program, and Military Assistance Program; and AID's development assistance program and its administration of Public Law 480 titles I and II programs. We were unable to include the value of all commodities financed under the title I program for fiscal year 1986 as all shipments had not taken place at the time of our review. We also excluded the title II program of one PVO that was being phased out. Further, we did not review AID's disaster assistance for Indonesia as there has been little activity in this area in the past few years.

We conducted our review from July through November 1986 and performed fieldwork in Indonesia during September through November 1986. In Washington, D.C., we met with officials of the Departments of State, Defense, and Agriculture, and with AID and reviewed applicable files and audit reports. In Hawaii, we met with Defense officials of the Commander in Chief, Pacific. In Indonesia, we met with officials of State, Defense, Agriculture, Commerce, and AID and we reviewed relevant mission files. We also met with officials of the Indonesian Department of Defense and Security and the Ministry of Manpower and with American and Indonesian PVO representatives. We made site visits to two Indonesian military units and a language lab, two AID development assistance projects located in Sumatra, and Public Law 480 title I projects and various title II distribution points in Java.

Our review was made in accordance with generally accepted government auditing standards.

Comments From the Department of Defense

DEFENSE SECURITY ASSISTANCE AGENCY

WASHINGTON, DC 20301-2800

8 MAY 1987

In reply refer to:
I-013029/86CT

Mr. Frank C. Conahan
Assistant Comptroller General
National Security and
International Affairs Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Conahan:

This is the Department of Defense (DOD) response to the General Accounting Office (GAO) draft report entitled, "FOREIGN AID: Accountability and Control Over U.S. Assistance to Indonesia," dated April 23, 1987 (GAO code 472114/OSD Case 7283).

The Department concurs with the report material that applies to the DOD, and the Department has no further comments.

Sincerely,

Glenn A. Rudd

GLENN A. RUDD
DEPUTY DIRECTOR

Comments From the Department of State

United States Department of State

Comptroller

Washington, D.C. 20520

June 11, 1987

Dear Mr. Conahan:

I am replying to your letter of April 23, 1987 to the Secretary which forwarded copies of the draft report entitled "Foreign Aid: Accountability and Control Over U. S. Aid to Indonesia" for review and comment.

Enclosed are comments prepared in the Bureau of East Asian and Pacific Affairs.

We appreciate having had the opportunity to review and comment on the draft report.

Sincerely,

Roger B. Feldman

Roger B. Feldman

Enclosure:
As stated.

Mr. Frank C. Conahan,
Assistant Comptroller General
National Security and
International Affairs Division
U.S. General Accounting Office
Washington, D. C. 20548

DRAFT REPORT COMMENTS: FOREIGN AID: ACCOUNTABILITY AND CONTROL OVER U.S. AID TO INDONESIA

The Bureau of East Asian and Pacific Affairs of the Department of State appreciates the opportunity to review and comment on the draft of the GAO report entitled Foreign Aid: Accountability and Control Over U.S. Aid to Indonesia (GAO code 472114). I am pleased the report suggests that our economic and security assistance programs have generally been well managed over the period under review.

The GAO draft report identifies several problem areas related to management and oversight of P.L. 480 programs. We share the AID view that the difficulty of monitoring self-help measures is intrinsic to certain features of the title I program common worldwide and not unique to Indonesia. With regard to the Indonesia program, it is our understanding that during the period reviewed by the GAO, the AID mission in Jakarta implemented a number of improvements. Moreover, as noted in the final three sentences of the first paragraph on page 3, the GAO has raised questions which the AID mission in Jakarta is addressing to strengthen its oversight of the P.L. 480 program. The GAO report might usefully acknowledge these points.

Now on p. 2.

In addition, I believe the report should note disincentives which undermine our ability to convince P.L. 480 recipients, like Indonesia, of the importance of extensive, enduring monitoring systems and which also limit possibilities for long-term self-help measures' planning. These include uncertainty over annual P.L. 480 title I funding levels and the often limited time for negotiation of self-help measures because of program approvals late in our fiscal year.

I would appreciate the GAO's taking these comments into account.

Gaston Sigur
Assistant Secretary
Bureau of East Asian and Pacific Affairs

Comments From the Agency for International Development

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

ASSISTANT
ADMINISTRATOR

JUN 12 1987

Mr. Frank Conahan
Assistant Comptroller General
National Security and International Affairs Division
General Accounting Office

Dear Mr. Conahan:

Attached are the Agency for International Development's comments and recommendations on the GAO Draft Report, "Accountability and Control Over U.S. Assistance to Indonesia."

We appreciate the GAO team's assessment on oversight of U.S. assistance provided to Indonesia between the years 1982 and 1986. We are pleased that the GAO team found no evidence of major misuse or diversions of U.S. economic assistance, and at the time of the GAO review, the A.I.D. Inspector General was conducting no investigations concerning misuse or diversions of funds.

See p. 9.

The report notes a few shortcomings regarding the monitoring of A.I.D. PL-480 food assistance and Development Assistance. These insights have been helpful to us, especially since we are in the process of reviewing Agency guidance on the programming of PL-480 generated local currencies. As noted to you in my letter of 19 May, the Agency is completing a worldwide cable, "Supplemental Guidance on Programming Local Currency". This issuance will supplement information contained in Policy Determination Number 5, dated February, 1983, which is our basic directive on the subject. The supplemental guidance has been prepared in recognition of the growing importance of local currency generations under Economic Support Fund, Development Assistance and PL-480 programs. We will provide your staff with copies of this guidance as soon as it is issued.

With respect to the other findings, recommendations, and wording of the report, we have prepared detailed comments and suggested revisions regarding some issues raised, particularly focused on PL-480 food assistance. Incorporation of these comments in the final report would, we believe, result in a more balanced discussion of the complex issues associated with PL-480.

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See p. 8.

The A.I.D. mission in Jakarta has also taken a number of actions to clarify procedures or correct deficiencies since the team's field visits which we would like to have reflected in the final report. We would also appreciate the inclusion of our comments as an attachment thereto.

As already discussed with John DeForge, your representative on this report, A.I.D. personnel will be meeting with your representatives to review A.I.D. comments and clarify any of the points made in our response.

Please advise if any other assistance is needed.

Sincerely,

Julia Chang Bloch

Julia Chang Bloch
Assistant Administrator
Bureau for Asia and Near East

Attachment: a/s

AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMENTS ON DRAFT GAO REPORT ON INDONESIA

"Foreign Aid: Accountability and Control over U.S. Asistance to Indonesia"

I. PL 480 Assistance

A.I.D. Washington ("AID/W") and USAID/Jakarta ("the Mission") have carefully considered the statements and analyses presented in the draft report ("the Report"). The Report includes some insightful observations and very useful recommendations. It also includes information or assertions which we believe are incorrect. We have addressed these latter matters in the following paragraphs. Our comments are organized on thematic lines, with page references noted as appropriate.

See p. 8.

A.I.D. recognizes that some of the conclusions of the report require immediate redress. In this vein the Mission in Indonesia is adding staff time to monitor self-help measures (SHMs) and the use of local currency, reducing the number of SHMs and linking them to DA projects to facilitate field monitoring, introducing where appropriate greater specificity in SHM benchmarks, and improving the SHM reporting format. In addition, the Mission has obtained GOI agreement to expand the PL 480 planning team to include the Ministry of Finance and the Planning Agency. These measures will facilitate the Mission's monitoring of the allocation/expenditure process.

A. Agency Policy Guidance and "Control"

See pp. 2, 8, 9.

The first theme to be considered is not explicitly stated, but nevertheless sets the tone which pervades the Draft Report: It is that A.I.D., both Washington and Mission, should exercise a considerably greater degree of control than it presently does over that portion of the Government of Indonesia (GOI) development program financed with funds owned by the GOI but derived from Title I sales.

A.I.D.'s view is that the degree of Mission oversight of activities financed with local currencies owned by cooperating governments should be commensurate with the programming burden that the Agency imposes on itself in the corresponding local currency use agreements. While a federal agency has extensive responsibility for the use of appropriated funds, A.I.D.'s monitoring of country-owned local currency generated by Title I sales is properly limited, we believe, to ensure that statuatory requirements regarding such funds are satisfied

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(e.g., Section 106(b) of PL 480) and that the country adequately performs its agreements with A.I.D. In its regulations and instructions, the Agency has established guidelines within which Missions have the authority to determine the level of oversight of local currency-financed activities.

Policy Determination Number 5 (PD-5) of February 1983, "Programming PL 480 Local Currency Generations" -- as updated but not substantially changed by subsequent guidance messages -- places emphasis on the exercise of sound judgement by the USAID in deciding how intensively individual PL 480 local currency programs need to be managed to best advance overall USG interests. This is the policy guidance provided by Washington and acted on by the Mission during the period covered by the Report. PD-5 points out:

> "Title I legislation does not require formal A.I.D. involvement in programming the expenditure of these proceeds, nor does it require recipient countries to deposit sales proceeds into special accounts. Nevertheless, it contemplates some degree of A.I.D. involvement, since A.I.D. must monitor the use of sales proceeds and assure that they are allocated to support economic development objectives. A.I.D. involvement can range from one extreme where the recipient government assumes primary responsibility for allocating its own budgetary resources to the other extreme where A.I.D. plays a more active role in such allocation decisions, including, inter alia, detailed programming prior to signing the agreement, the establishment of a special account, Mission concurrence on disbursements from the account, or periodic reporting and monitoring on the status of financial accounts and individual projects." PD-5, Part I, Pages 1-2.

* * * * * * * * * * *

> "Enhancing the developmental impact of PL 480 resources is a major objective of A.I.D. There is a broad consensus within A.I.D. that we should have a major interest in the policies pursued by A.I.D recipient countries which govern the allocation of domestic resources. Accordingly, Agency policy explicitly encourages A.I.D. participation in the programming of country-owned local currency generated by the sale of PL 480 Title I commodities when such involvement promises to help in achieving developmental objectives". PD-5, Part II; page 2.

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"A.I.D. participation in programming local currency is not an end in itself, but rather a tool for moving toward the more important goal of an overall host country budget that represents a sound, development-oriented allocation of budgetary resources. A.I.D participation in local currency programming is appropriate in those circumstances where it will help achieve the overall goal." PD-5, Part II, page 4.

These aspects of PD-5 followed a review of A.I.D. experience with implementing PL 480 programs which revealed that too much USG involvement in programming local currencies was often counterproductive. PD-5 notes that:

"In countries where our participation in the programming of local currency has proved to be ineffective, the major reasons were:

A.I.D.'s involvement in programming country-owned local currency was regarded by the recipient country as a highly visible, unjustified, and intolerable interference in its domestic affairs.

The establishment of a separate account for the local currency, subject to special rules, frustrated the Finance Ministry in carrying out its normal budgetary procedures.

The government feared that A.I.D.'s participation in the programming of local currency would stimulate other donors to follow this precedent, resulting in conflicting advice and confusion within the government concerning how its development priorities should be ordered.

The government feared that A.I.D.'s motivation may be to promote the commercial interests of the U .S. rather than the welfare of its country. PD-5, Part III, p. 6.

See pp. 8, 9.

Despite occasional procedural shortfalls noted elsewhere herein, the GOI's substantive performance has been impressive on a wide range of development issues of interest to A.I.D. and other donor agencies. This performance inclines us against any attempt to micro-manage the implementation of development activities financed by currencies that are legally the property of the GOI.

B. Oversight and Accountability:

The GAO team's most serious criticism in our view is that "neither we nor A.I.D. can determine whether misuse or

Now on pp. 2, 3, 13, 14, 16.

See pp. 8, 9.

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diversions have occurred due to the mission's lack of oversight of the program." (Report, p.2.) This charge is repeated in various forms on pages 3, 12-13, 15, and 19, using such phrases as "did not correctly implement" (p.3.) and "had not developed monitoring procedures" (p.15.).

Although improvements in the Mission's oversight were needed (and have been made), we believe the team's generalization is unfounded and is not supported in the Report. There is, in fact, substantial evidence of Mission and Washington oversight of the program, and no evidence to date of significant misuse or diversion of resources. This favorable condition led the Mission to rely in large part on GOI oversight, which, as noted, is consistent with the range of judgements allowed the Mission by PD-5.

There is and has been considerable oversight by both USDA Foreign Agriculture Service (FAS) personnel and the Mission and evidence that commodities and funds were used in accordance with both the applicable USG regulations and the Title I agreements. Initial program oversight includes receipt and review by FAS of the following commodity related reports: Up-to-date shipping and arrival reports for commodities, by vessel and date; annual compliance reports, covering the disposition of commodities (into storage or markets); an official (but unaudited) report of the value of proceeds generated and their remission to the Ministry of Finance. All of these reports are up to date. (Many were supplied to the GAO during their Washington briefings.) Furthermore, FAS, depending on commodity arrivals, visits unloading facilities and warehouses and checks commodity receipts. Information from various official and unoffical sources (Indonesian customs, the Central Bureau of Statistics, and trade contacts) is used to cross check the validity of the abovementioned reports.

The import and handling of commodities under the system with FAS/AID monitoring seems to have performed quite well, although the GAO team did note some minor descrepancies in warehouse reports on Title II commodities. The Mission will bring these problems to the attention of appropriate GOI authorities.

Once Title I commodities are sold and the funds remitted to the Ministry of Finance, they become part of GOI revenues and therefore lose their PL 480 identity. The next step in the oversight process, therefore, is to ensure that agreed-upon amounts ofGOI budgetary funds are provided for the mutually agreed upon purposes, but recognizing that the Mission now is following GOI budget funds and not USG-owned currencies.

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A.I.D.'s oversight in Indonesia actually begins earlier when the Mission is advised of Title I levels. USAID staff participate with the GOI "Team PL 480" to ensure that funds are not allocated for unacceptable purposes and are in line with agency policy. Self-help measures which are synonymous with local currency allocations in the Indonesion Title I agreements, also receive Washington inter-agency scrutiny and approval. If negotiating time permits, the Mission works directly with line ministry staff on planning SHM and local currency projects. For example, in 1985 and 1986, out of 17 SHMs, USAID staff worked with line ministries in helping plan 14. The Mission also assigns a staff member to monitor each of the local currency projects, although at the time of the audit the USAID had apparrently not formally recorded these assignments. In most cases, USAID staff maintain regular contact with the implementing institutions to ensure that GOI budget funds reach SHM projects; in 1985 and 1986 the Mission reports that its staff carried out this key function for 15 of 17 projects supported with PL 480 proceeds. These direct contacts coupled with the Missions review of annual GOI reports permit the USAID to identify projects that were not being implemented in accordance with agreements or that were being delayed or having funding difficulty.

See pp. 3, 4, 14.

We believe that this oversight meets current A.I.D. policy guidelines on programming PL 480 local currency generations. PD-5 states that "Missions should entrust the recipient country with as much of the work of utilizing and accounting for the country-owned local currency as possible," (PD-5, p. 4) and that cases should be avoided where "joint programming of the local currency required additional A.I.D. and host country manpower and management resources which did not produce results commensurate with the added administrative costs." (PD-5, p.6) Furthermore, the Standard Negotiating Instructions, Section 109 (F) state that monitoring is to occur "through the established yearly reporting process for self-help measures and through discussions or consultations on progress which take place during the year between recipient government and mission personnel." PD-5 does not contain specific requirements for site visits, although such visits are carried out from time to time by mission staff.

See pp. 4, 14.

Based upon up-to-date arrival and disposition reports submitted by the GOI to FAS, compliance reports, and reports of sales proceeds and remission to the Ministry of Finance, as well as from A.I.D. monitoring as described above, the Mission, like the GAO team, found no evidence of misuse or diversion of commodities or sales proceeds. Given the evidence of A.I.D. and USDA oversight at various levels, and the lack of evidence of misuse or diversion of resources, we believe that the criticism of the Mission's performance in this regard is inappropriate and should be deleted.

C. Adequacy of Agency Regulations on the Administration of Title I:

See p. 9.

The draft report criticizes the Agency stating that it "... has not issued regulations on the administration of Title I." (Draft Report, p. 2.) This proposition is later modified to state: "The governing handbook, cables and policy directives do not provide full coverage..." (Draft Report, p. 18.)

In our judgement, an adequate balance between Washington guidance and field decision-making authority has been struck and is being maintained; this guidance is provided principally in A.I.D.'s Policy Determination No. 5 and A.I.D. Handbook No. 9. Further, A.I.D. and the other Development Coordinating Committee (DCC) members provide detailed "Negotiating Instructions," guidance that is tailored to the specific country situation, for each Title I program. Copies of these documents have been made available for GAO inspection. As you know, the Agency periodically reviews its policy and procedural guidance in an effort to improve it. Such an effort is now underway on PD-5 and Handbook 9. We would welcome the GAO's suggestions.

D. Specificity of Self-help Measures:

Now on p. 3.
Now on p. 14.

Refering to Section 109 of PL-480 legislation, the Report notes that, "In negotiating the Title I agreements, the Mission did not require self-help measures to be described in specific and measurable terms..." (Draft Report, p. 3.) This theme is repeated on pages 4 and 13-14 of the Draft Report. The Report recommended "...that the Administrator direct the Mission to negotiate specific and measurable Public Law 480 Title I self-help requirements..." (Draft Report, pp. 7-8.)

We agree that the Self-Help Measures in the earlier Title I Agreements reviewed by the GAO were less detailed than desirable, although they were consistent with policy guidance existing at that time. It was because of this type of deficiency that A.I.D. changed its instructions to the field in PD-5, issued in February, 1983, and in subsequent "Negotiating Instructions" sent from Washington to the Mission. This guidance required greater specificity in Self-Help Measures.

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See pp. 3, 8, 14.

We have provided key sections of A.I.D.'s guidance to the field in Annex A to this document. We believe that these examples illustrated sufficient guidance from A.I.D./W. and full compliance by the Mission. Annex B provides examples of self-help measures taken from the FY 1985 and FY 1986 Agreements. These examples illustrate full compliance with Washington guidance. We thus believe that the GAO's observation was true only some years ago and that the draft recommendation should be deleted from the Report.

E. Monitoring and Control of PL 480 Title II Activities

See pp. 5, 16.

The GAO found no problems with programs or controls, but concluded that the Mission does not have adequate procedures for monitoring PVO activities and assessing their internal controls. We believe that this conclusion is exaggerated and, if it cannot be eliminated entirely, it should be rewritten to focus on improving monitoring of PVO activities.

A.I.D.'s major PVO policy paper indicates that "A.I.D. views PVOs as development partners, both as intermediaries for A.I.D. programs and as independent development agencies in their own right." As partners, the detailed oversight which a Project Officer normally provides to a DA project is often left to the PVO itself, especially when it has a proven track record of good management and control. In the case of the largest Title II recipients, the Cooperative League of the U.S.A. and the Catholic Relief Service (they consume about 97 percent of total Title II), the track record is demonstrated by the results of recent worldwide audits of these organizations which the Mission reviewed. Furthermore, the Cooperative League was audited locally in FY 1983, and Catholic Relief Service's will be audited in FY 1988. Both organizations are large U.S. organizations with years of overseas experience, and understanding of A.I.D. financial and commodity control requirements.

Contrary to statements in the draft report, the Mission reviews Catholic Relief Service's (by itself CRS consumes 90 percent of Title II) operational procedures and internal controls while examining three major documents: the Annual Program Plan, Quarterly Recipient and Commodity Status Reports, and Quarterly Commodity Orders, or Call Forwards. In reviews of each of these documents, the Mission regularly assesses Catholic Relief Service's management of the distribution and handling of commodities and finance, commodity uses, and the level of commodity loss/damage. When preparing the Annual Program Plan, Catholic Relief Service conducts an internal assessment of its management and internal controls, a document which is also

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reviewed by USAID. Given the Mission's efforts described above, the comment attributed to the Mission Director appears to be a case of miscommunications and we suggest it be deleted from the report.

In addition to the procedures and controls described above, both the Cooperative League of the U.S.A. and Catholic Relief Service are registered with AID/W as private non-profit organizations. Among other requirements for registration, they must submit to A.I.D./W. Annual Audited Financial Statements.

See pp. 5, 16.

The GAO allegation that Mission staff visited only two of 335 Title II distribution sites is misleading. In FY 1986, ten field inspections to Title II distribution sites were made and several sites were visited during each inspection. The GAO report cites only the two trips which were made by an FSN Program Analyst for which reports were on file. In each of these two visits the analyst visited five or more sites. The other trips were in conjunction with other monitoring purposes, but included visits to Title II distribution sites and examination of records in the presence of Catholic Relief Service staff. But of more importance the Mission reviews annually internal field reports prepared by Catholic Relief Service/Indonesia staff. During FY 1985, Catholic Relief Service staff visited 278 distribution sites spending 524 workdays. In FY 1986, CRS visited 286 centers spending 428 workdays examining records and internal controls.

In view of the above, we believe that the Mission's understanding of the commodity and financial controls of these organizations, and the level and frequency of review are quite adequate. Nevertheless, the Mission plans to follow up on the GAO's observations and suggestions to improve Title II monitoring. Steps to be taken include:

- -- Recruitment of another FSN Field Site Inspector.
- -- Audit of Catholic Relief Service and Church World Service (a very small Title II recipient) in FY 1988.
- -- Further assessment of the Cooperative League of the U.S.A.'s management and internal controls in conjunction with a program evaluation scheduled for late 1987.

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F. Disbursements for SHMs:

The GAO Team noted that "... Indonesia reported spending an average of only 75 percent of the agreed upon amounts... for self-help projects during fiscal years 1982-85." (Report, p.3.) The implication is that the remainder may have been diverted or that the government fell short in its obligation to effect SHMs. The concept of project stretch-out was apparently not considered in preparation of the Report, for it was not mentioned in either a positive or a negative vein.

Now on pp. 2, 3.

Projects for which GOI funding has not reached 100 percent of the planned levels simply may not yet be completed. If you would provide a list showing each project that you felt to be under the planned funding level, we would be pleased to check with the Mission to find out whether disbursements of PL 480-generated local currencies are still occurring for those projects. Confirmation that this is the case, we believe, would permit you to eliminate this recommendation.

G. Manner of Calculatating SHM Funding Levels (Report pages 8 and 13.)

Now on pp. 4, 8.

We agree with the Report that the appropriate level of project funding is that set forth in Part I. Article II. F. of the sales agreement: the local currency equivalent of the CCC dollar expediture on the commodities less Currency Use Payment (CUP). Actual CCC expenditures will sometimes vary slightly from the amount authorized, but the practical level of generations in Indonesia will be about 81% of the authorized amount. The GOI pays 10% of the authorized amount as an initial payment; it then pays 10% of the remaining 90% as the Currency Use Payment or 9% of the total authorized amount. This leaves a net of 81%. A.I.D./Washington has reviewed the document, agrees that the 81% figure is correct and has advised the Mission to conform its accounting practices to this rule. The Mission plans to use this calculation method in its FY 1987 programming.

H. Adequacy of Indonesian Reporting on Commodity Receipts and Expenditures (Report p. 14.)

Now on pp. 2, 13.

We believe that the Mission has generally received the data required on the receipt and expenditure of proceeds. However, some of these reports containing these data are not "certified by the appropriate audit authority" as is required in the sales agreements. The Mission is taking measures to obtain audited reports on sales receipts and to obtain reports certified by the appropriate GOI audit authority on expenditures.

Now on p. 8.

I. SHM Progress Reporting (Report p. 15.)

As the Mission has reported, there are problems with the SHM reports. The GOI reports are generally weak and arrive late. That is why the Mission relies to a considerable degree on staff consultations to determine the status of SHMs. The Mission is giving increased attention to the reporting system. Reports received to date cover all but two of the activities undertaken during the period covered by the audit.

Now on p. 9.

J. Title II Monetization Guidelines (Report pp. 4-5, and 7.)

Page 4 of the GAO report asserts that " A.I.D. has not provided the Mission with adequate guidance on the procedure to be observed in selling Title II commodities." The report also recommends that A.I.D. issue regulations and additional guidelines on selling commodities and administering sales proceeds.

We do not agree that the current guidance is inadequate and thus do not see the need for augmenting that guidance. In the Indonesian case, the Transfer Authorization (TA) signed by AID/FVA/FFP and CLUSA provides the basis for establishing value of the commodity. TA No. 497-XXX-000-5613, 7H, reads as follows: "BULOG will open a letter of credit in favor of CLUSA. The amount of the letter of credit will reflect the value of the commodity, as purchased by the CCC, plus the value of the ocean transportation as determined by the Ocean Transportation Division [of USDA] as per Appendix C." Appendices C and D of the same TA are texts of signed agreements between CLUSA and BULOG covering the manner of sale of the wheat, how a letter of credit will be established in the name of CLUSA, and how funds will be expended.

These agreements conform to Food for Peace guidelines contained in Handbook 9, Chapter 11 "Local Currency Projects." A.I.D. has provided copies of the Transfer Authorization and guidelines to the GAO Team.

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See p. 9.
Now on p. 16.

K. Vulnerability Assessments to include PL 480 (Report pp. 5 and 18.)

A.I.D. agrees with the GAO Team's suggestion that PL 480 should be included in future mission Vulnerability Assessments. Moving in that direction, the Mission in Indonesia already has established an Indefinite Quantity Contract which enables the Mission, for its own management purposes, to obtain independent vulnerability assessments of different units within the Mission.

Now on pp. 13, 14.

L. Adequacy of SHM and Local Currency Project Budget Estimates, Timetables and Baseline Data (Report p. 14.)

As discussed under theme 1. above, this is the type of program-specific matter that we feel should be left to the Mission to decide on a case-by-case basis. We note the statement in the Draft Report that the Mission Director and program officer agreed to negotiate with the GOI on possible inclusion of such material in some future self-help descriptions.

II. Development Assistance

The GAO Team found no significant difficulties with the largest part of the USG's assistance program, the Development Assistance (DA) program. The GAO does, however, cite four areas for improvement:

> The GAO suggests that the Mission provide greater assurance that controls are consistently implemented by developing more detailed operations procedures and providing them to appropriate officials.

See p. 9.

A.I.D. believes this suggestion should be modified for the following reasons: 1) detailed A.I.D. guidance is already provided to staff in Handbook 3, Project Assistance and the comprehensive Project Officer's Guidebook; 2) detailed guidance is also provided to the GOI in Project Implementation Letter (PIL) 1, and in detailed instructions for procurement and disbursement with A.I.D. funds, available both in English and Indonesian and attached to PIL 1; 3) Pre-Implementation workshops are held for large projects and GOI staff are briefed at these sessions on management and control of assistance.

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The GAO notes that, except for vehicles, the Mission does not adequately inventory or monitor A.I.D.-financed commodities and therefore recommends that the A.I.D. field Mission issue specific guidance for monitoring project commodities.

A.I.D. concurs with this recommendation, but cautions that it would not be practicable to operate a system with the same degree of specificity that is used for vehicles. There are too many different types of resources, and widespread geographic distribution makes oversight of specific items difficult. The Mission therefore has to rely on project reviews, in part on GOI or contractors' reporting, and, as recommended by the GAO, improved field monitoring.

The Indonesia Development Assistance program includes far more A.I.D.-financed institution building and technical assistance inputs than purchases of commodities. Project officers therefore monitor A.I.D. commodities in the course of general project implementation monitoring and through contractor reports. The GAO did find that "...project officers and other Mission officials were generally monitoring the implementation of projects."

The GAO also notes that in many cases field trip reports are not filed by Mission staff members and they recommend developing procedures to document site visits.

A.I.D. guidance on monitoring and trip reporting is available in Handbook 3 and the Project Officers' operating Guidebook; USAID/Jakarta will update its project officer's procedures accordingly.

The GAO refers to A.I.D. Inspector General (IG) investigations, conducted during 1985 without any further remarks. This could be misinterepreted to mean that A.I.D. was experiencing financial or control problems in its portfolio. This reference should be redrafted to note that the A.I.D. Mission requested IG investigative support for specific purposes, in accordance with Agency procedures; but in no case did the IG uncover serious problems.

III. Summary of A.I.D. Comments on the GAO's Draft Recommendations

The following Agency comments are provided in response to the GAO Team's recommendations:

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1. We recommend that the Administrator of A.I.D.:

See p. 9.

a. **Ensure that all financial and management controls are properly implemented by issuing regulations and providing guidance to the Indonesia Mission for administering the Title I program to include monitoring and administering sales of Title II commodities.**

A.I.D. Response:

In our judgment, A.I.D. regulations and directives already provide a balance between Washington guidance and flexibility to support field decision-making authority. This guidance is provided principally in A.I.D.'s Policy Determination No. 5 and A.I.D. Handbook Number 9. Further, A.I.D. and the other Development Coordinating Committee (DCC) members provide detailed "Negotiating Instructions," guidance that is tailored to the specific country situation, for each Title I program.

The Agency nevertheless periodically reviews its policy and procedural guidance in an effort to improve it. Such an effort is now underway on PD-5 and Handbook 9. We are reviewing the GAO's suggestions and will provide appropriate clarification therein. The Indonesia Mission is already strengthening its programming of self-help measures and adding staff resources to improve the monitoring of its PL 480 activities.

Now on p. 8.
See p. 9.

b. **Direct the Indonesia Mission Director to (1) develop procedures with specific criteria for monitoring AID-financed development assistance goods and documenting site visits, and (2) ensure that the next vulnerability assessment includes Public Law 480 programs and conforms to AID requirements.**

A.I.D. Response

(1) We believe adequate guidance exists in Handbook 3, Project Assistance, and the Project Officer's Guidebook to cover monitoring responsibilities regarding A.I.D-financed commodities. These references also outline implementation monitoring and site visit responsibilities. Given the variety of project commodities and their geographic dispersion, it is not practical to have inventory and control lists such as those used for motor vehicles. The approach must be somewhat flexible. The Mission nevertheless checks on commodities as part of site visits; but must rely, in part, on contractor and GOI reporting and

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occasional audit assistance. We believe this system provides adequate coverage.

Now on p. 7.

(2) The Mission has established an Indefinite Quantity Contract for internal vulnerability assessments and will include PL 480 activities in its future reviews.

2. We recommend that the Administrator direct the Mission to negotiate specific and measurable Public Law 480, Title I self-help requirements with the Indonesian Government, and correctly implement the terms of U.S.-Indonesian agreements by:

See p. 9.

a. basing funding levels for self-help projects on the greater of commodity sales proceeds or the U.S. government-financed amounts;

A.I.D. Response:

We concur with the recommendation; A.I.D./W has reviewed the documentation and agrees with the GAO calculations. The Mission has already been advised of the appropriate calculation and plans to use it in its FY 1987 programming.

Now on p. 7.

b. describing self-help projects clearly with quantifiable baseline information, specific time frames, and detailed budget information;

A.I.D. Response:

We do not believe the GAO Team was correct in its conclusion that definition of self-help measures is a problem needing current attention. Earlier Agreements did not have much specificity, but were basically consistent with guidance in existence at that time, and more recent Agreements reflect improvements brought about by Policy Determination Number 5, i.e., providing increased and acceptable specificity. The Mission will continue to negotiate such details in future self-help descriptions. We therefore believe this recommended action should be deleted from the Report.

ANNEX A

EXCERPTS FROM NEGOTIATING INSTRUCTIONS
PROVIDED TO USAID/INDONESIA

Section 109 - Self-Help measures.

[a] Section 109 [a] of PL 480 requires that, before entering into agreements for the sale of commodities, consideration be given to the extent to which the recipient country is undertaking self-help measures to increase per capita production and improve the means for storage and distribution of agricultural commodities. In addition, it is required that particular account be taken to determine the extent to which the measures are being carried out in ways designed to contribute directly to development progress in poor rural areas and to enable the poor to participate actively in increasing agricultural production through small farm agriculture. Section 109 includes literacy and health programs for the rural poor as possible subjects for self-help measures.

[b] The self-help measures which the recipient country agrees to undertake shall be described [a] to the maximum extent feasible, in specific and measurable terms, and [b] in a manner which ensures that the needy people in the recipient country will be the major beneficiaries of the self-help measures pursuant to each agreement. To the maximum extent feasible, self-help measures agreed to are to be additional to the measures that the recipient country otherwise would have undertaken irrespective of this agreement. All appropriate steps are to be taken to determine whether the self-help provisions of each agreement and amendment entered into are being carried out. Under current interpretation, it must be possible, after a given period, such as a year, to determine the extent to which the self-help measures have or have not been carried out.

[c] In negotiations with recipient government on self-help measures for the agreement, the mission must seek specific commitments or targets as a means to measure the extent to which economic development and self-help measures have been carried out. Specific and measurable targets by which to measure progress can include physical progress, financial measures, policy changes, price announcements, or deadlines for completing research studies, funding or completing projects, signing contracts, or implementing policy changes. It is expected that targets for the self-help measures will be set so

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rural people in rural infrastructure development, and (2) to enhance increased food and agricultural production.

Benchmarks: Project activities to be carried out under the Directorate of Development of Intensive Labor and Self-Employment, Directorate General of Manpower and Placement of the Ministry of Manpower, include the construction/rehabilitation of (1) approximately 833 km feeder roads, (2) 26 units water reservoirs, and (3) 15 units flood control dikes in provinces of North Sumatra, South Sumatra, South Kalimantan, Bali, West Nusa Tenggara and East Nusa Tenggara.

Completion of all activities is scheduled for Indonesian FY 1986/1987. Approximately US$5.0 million will be allocated from sales proceeds under this Agreement to cover costs of this project.

Each of these Title I Agreements contained some 15 pages of such specific and measurable material covering its self-help and local currency use provisions.

The above citations from the FY 1985 and 1986 Title I Agreements demonstrate that USAID/Indonesia has indeed followed its negotiating instructions.

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that achieving them will not be automatic, but will require special effort. The specific targets you devise to measure progress need not be included in the agreement itself, but can be put in attached memorandum of understanding signed at the same time as the agreement itself. [Note that such attached memorandum of understanding may be eventually transmitted to the U.S. Congress and published in the treaties and other international agreements series by the Department of State]. The memorandum should also contain goals for expenditures of sales proceeds for projects related to self-help measures and other development purposes.

[d] Concerning section 109 [d] [1] [b] of PL 480, mission should indicate how needy people will be major beneficiaries of the self-help measures. This is particularly important for self-help measures where the connection between the measures to be taken and benefits to the needy may not be immediately apparent. Preferably this should be done in an attached memorandum of understanding.

[e] Concerning additionality, this provision is interpreted to require that, to the maximum feasible extent, self-help measures identified in the agreement represent an expanded effort undertaken by the purchasing country that would not, as best may be determined, have been implemented in the absence of the agreement or amendment. Intention is that self-help measures are not ones that would have taken place regardless of PL 480 aid; but they may include measures previously considered and favored by recipient government but which require the impetus of a PL 480 agreement to be implemented.

[f] Determination as to whether economic developments and self-help measures are being fully carried out is to be made through the established yearly reporting process for self-help measures and through discussion or consultations on progress which take place during the year between recipient government and mission personnel. Mission should maintain routine consultations with recipient government regarding their progress and establish a timeframe for such consultations in the memorandum of understanding on self-help measures [or in the minutes of negotiations if there is no memorandum of understanding]. Such consultations should be arranged to enable mission to cable Washington by August 31 of each year a summary of self-help progress to date.

Annex B

SELF-HELP MEASURES EXCERPTED FROM INDONESIA'S PL 480 AGREEMENTS

Applied Agriculture Research Project.

Objectives: To improve the welfare of the rural population through the assistance to agricultural research by building facilities, procuring equipment, improving the capabilities of the staff through short term training, and provision of technical assistance to one Central Research Institute, three Research Institutes, ten Research Substations and three Experimental Farms.

Benchmarks: At 19 different locations the Applied Agriculture Research Project is constructing 400 buildings and developing the farms where the field research will take place. This will result in the provision of improved technologies to farmers in many different agroclimatic zones.

During 1985/86 the following project activities have been planned by the Project Unit:

(i) continuation of short term training and technical assistance programs to increase the capacity of the AARD staff to carry out agricultural research;

(ii) completion of the construction program at the 19 locations;

(iii) continuation of the procurement program to provide field and laboratory equipment to the institutes, sub-stations and farms for improving the capacity to do research;

(iv) continuation and substantial expansion of the farm development program at each of the 19 locations. Approximately US$5.0 million will be earmarked from sales proceeds under the Agreement to cover the cost of the construction and farm development at the 19 locations.

Similarly from the FY 1986 Agreement:

PADAT KARYA GAYA BARU PROJECT

Objectives: (1) To provide job opportunities and increase farm family income and welfare through increasing participation of

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