



September 2, 2003

**MEMORANDUM**

**FOR:** USAID/Philippines Director, Michael J. Yates

**FROM:** RIG/Manila, Bruce N. Boyer /s/

**SUBJECT:** Follow-Up of USAID/Philippines' Implementation of Recommendation No. 1, Audit Report No. 5-492-99-006-P, "Audit of USAID/Philippines' Response to Customs Duties on Donated Contraceptives," Dated September 27, 1999 (Report No. 5-492-03-002-S)

This is our final report on our follow-up of the implementation of Recommendation No. 1 in the Office of Inspector General's September 1999 report. We reviewed your comments to the draft report and included them in their entirety as Appendix II.

Since this report does not contain any recommendations, no further action is required of USAID/Philippines.

I appreciate the cooperation and courtesy extended to my staff during the recommendation follow-up.

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## Background

For many years, USAID has donated contraceptives to the Government of the Republic of the Philippines' Department of Health (DOH). For most of those years, the custom duties applicable to those contraceptives had essentially been handled as bookkeeping entries, referred to as "automatic appropriations" between Philippine government agencies. In essence, "automatic appropriations" is a mechanism whereby funds are allocated by the Philippines' Department of Budget and Management to a national government agency to pay customs duties and taxes owed to the Philippines' Bureau of Customs. (See flowchart at Appendix III.) However, in December 1997, the President of the Philippines issued Administrative Order No. 372 (Order 372) which, as implemented by the Department of Budget and Management in January 1998, required that customs duties and taxes on imported items—including donated commodities—be financed by national government agencies out of their existing budgets.

Subsequently, in February 1998, the DOH, which was covered by Order 372, requested that USAID suspend its shipment of donated contraceptives because the DOH did not have funds available to pay the required duties. Three months later, in May 1998, the DOH requested that, as a stopgap measure, USAID consign future contraceptive shipments to the United Nations Population Fund thereby taking advantage of the United Nations' ability to import goods on a duty-free basis. USAID/Philippines agreed to this arrangement—which worked until April 1999. However, in April 1999, the Philippines' Bureau of Customs challenged this arrangement and held up several shipments of USAID-donated contraceptives. The Philippines' Department of Finance and the DOH worked out yet another stopgap measure that achieved the release of the contraceptive shipments.

On September 27, 1999, the USAID Office of Inspector General (OIG) issued Audit Report No. 5-492-99-006-P. That report outlined OIG concerns with the way the Mission handled the situation concerning donated contraceptives:

1. The silence of USAID's Bilateral Agreement regarding customs duties.<sup>1</sup>
2. The acceptance of short term solutions for long term problems.
3. The focus on donated contraceptives rather on donated commodities.
4. The risks associated with using a United Nations organization as a consignee.

Because of these concerns, the OIG concluded that the overall issue of levying duties on USAID-donated commodities should have been, and still needed to be, addressed directly with the Philippine government. Therefore, the OIG recommended that USAID/Philippines develop, with the Philippines' Department

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<sup>1</sup> This refers to the 1951 *Agreement on Economic and Technical Cooperation* between the U.S. government and the Government of the Republic of the Philippines. Hereafter, this agreement is referred to as the Bilateral Agreement.

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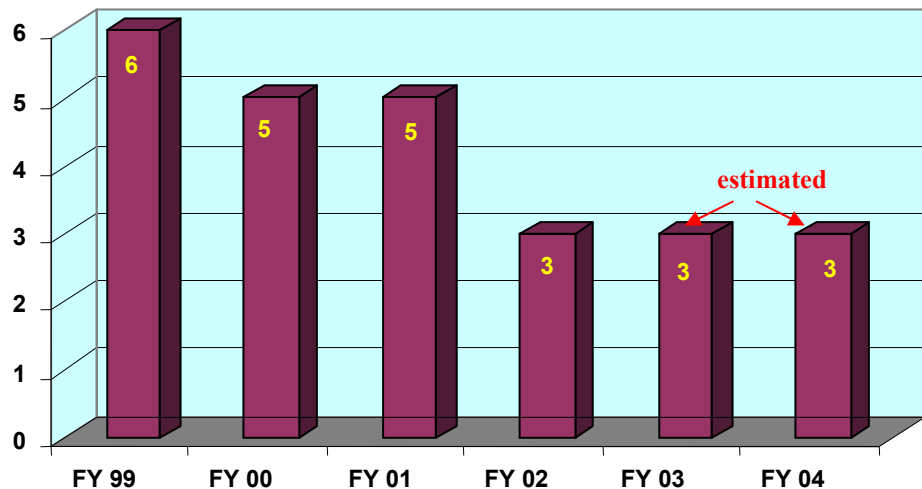
of Foreign Affairs and/or the National Economic Development Authority, an action plan—with targets and milestones—to eliminate the requirement that customs duties be paid on USAID-donated commodities.

On October 26, 1999, USAID/Philippines submitted an action plan to close the recommendation in the OIG audit report. Based on the Mission’s submission, USAID’s Office of Management Planning and Innovation closed the recommendation on December 10, 1999.

In accordance with Office of Management and Budget Circular No. A-50 and OIG audit policy, this recommendation follow-up was conducted to determine whether USAID/Philippines took effective corrective actions to justify the closure of Recommendation No. 1 of OIG Audit Report No. 5-492-99-006-P. Appendix I contains a complete discussion of the scope and methodology for this follow-up.

Since Recommendation No. 1 was made in 1999, USAID donations of contraceptives to the Philippines have declined—on a cost basis—from \$6 million to \$3 million annually. In total, USAID has donated contraceptives costing \$19 million from fiscal year 1999 through fiscal year 2002. The cost of donated contraceptives shown for fiscal years 2003 and 2004 are projected at \$3 million per year. In September 2002, USAID announced it would stop donating contraceptives to the Philippines after fiscal year 2004.

**Cost of Contraceptives Donated to the Philippines  
(In Millions of Dollars)**



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## Discussion

As Recommendation No. 1 of OIG Audit Report No. 5-492-99-006-P requested, USAID/Philippines developed an action plan with targets and milestones to eliminate the requirement that customs duties be paid on USAID-donated commodities. Based on that action plan, a management decision was reached

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with the OIG, and USAID closed the recommendation. However, the Mission's subsequent implementation of the action plan did not justify the closure of the recommendation because the Mission did not complete or adequately document the corrective actions outlined in its action plan. Additionally, the Mission's proposed solution of using the automatic appropriations mechanism to eliminate customs duties on USAID-donated commodities was not an ideal solution.

To respond to the recommendation, the Mission developed a 12-step action plan (Appendix IV) aimed at eliminating customs duties on USAID-donated commodities. The Mission implemented six steps in the action plan:

- Establishing a working group to implement the action plan. (Step No. 1)
- Initiating a meeting with the Philippine National Economic Development Authority to discuss the issues and identify options. (Step No. 2)
- Developing a list of current and future Mission activities involving USAID-donated commodities. (Step No. 3)
- Identifying the Philippine government agencies involved with the USAID-donated commodities. (Step No. 4)
- Identifying three options for eliminating customs duties on USAID-donated commodities: (1) amending its Strategic Objective Grant Agreements to provide appropriate exemptions, (2) using the automatic appropriations mechanism for all Philippine government agencies implementing USAID activities, or (3) maintaining the status quo of using the automatic appropriations mechanism for the Philippine Department of Health (DOH) and dealing with customs duties and tax issues for other Philippine government agencies as they arise. (Step No. 6)
- Reviewing the Government of Republic of Philippines' bilateral agreements with other donors (e.g. Japan, Australia, Canada, etc.), comparing those agreements with USAID's bilateral agreement and meeting with these other donors, if necessary. (Step No. 7)

However, the other six steps in the action plan were either not implemented or lacked supporting documentation to show they were implemented. Further, the problems identified in the OIG's September 1999 audit report could resurface because, in the end, the Mission reverted to the status quo of using the automatic appropriations mechanism for contraceptives donated to the Philippine DOH. These issues are discussed in the following sections.

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### **Action Plan Not Fully Implemented or Adequately Supported**

The Mission did not implement two steps of its 12-step action plan including the important final step. Further, the Mission did not have documentation to support that four other steps had been completed.

Office of Management and Budget Circular No. A-50 states that one of its principal objectives is to “To emphasize the importance of monitoring the implementation of resolved recommendations in order to assure that promised corrective action is actually taken.”<sup>2</sup> The Circular requires that Federal agencies assign a high priority to resolution of audit recommendations and to corrective action. Further, it requires agency follow-up systems that include maintaining accurate records of the status of audit reports or recommendations through the entire process of resolution and corrective action.

Step No. 9 and the important final Step No. 12 were not implemented. To eliminate customs duties on USAID-donated commodities, the action plan indicated that the Mission chose the second option of negotiating with the Philippine government to use the automatic appropriations mechanism for all Philippine government agencies implementing USAID programs and not just the DOH. The final step called for the Mission to meet with the appropriate government agencies to establish a date for implementing the automatic appropriations mechanism. However, this step was not carried out.

Additionally, there was either no documentation or insufficient documentation to support that Step Nos. 5, 8, 10, and 11 were actually completed. For example, Step No.10 called for the Mission to meet with the Philippine National Economic Development Authority or with the Department of Foreign Affairs to discuss options for eliminating customs duties as they may relate to the bilateral agreement between the US Government and the Government of Republic of Philippines. The Mission could not provide minutes of the meeting or other documentation to support when the meeting took place, who attended the meeting, or what was the outcome of the meeting. As another example, Step No. 8 required that the Mission meet with the Philippine Department of Budget and Management and Bureau of Treasury to discuss the automatic appropriations approach for handling taxes involving Philippine government agencies implementing USAID programs. Here again, there were no records to support that any meetings took place.

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<sup>2</sup> The Circular, for most audits, defines resolution as the point at which the audit organization and agency management or contracting officials agree on action to be taken on reported findings and recommendations.

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Because the final step in the action plan (to establish a date to implement the automatic appropriations mechanism for all Philippine government agencies) was not completed, the Mission's proposed solution to the recommendation in the OIG's 1999 audit report was never implemented. Rather, the handling of customs duties reverted to the way things had been before Philippine Presidential Administrative Order No. 372 was enacted in December 1997.

Before that order was enacted, the Philippine Department of Health (DOH) was the only Philippine government agency carrying out USAID programs that was using the automatic appropriations mechanism to pay customs duties and taxes on USAID-donated commodities. When the Philippine government reinstated the use of automatic appropriations, the DOH began using it again. Since the automatic appropriations mechanism was not extended to other Philippine government agencies as intended by the action plan, the DOH became, once again, the only Philippine government agency using automatic appropriations to pay customs duties and taxes on USAID-donated commodities. As noted in the Scope and Methodology section of this report, we did not review the result of not using the automatic appropriations mechanism for other Philippine government agencies implementing USAID activities.

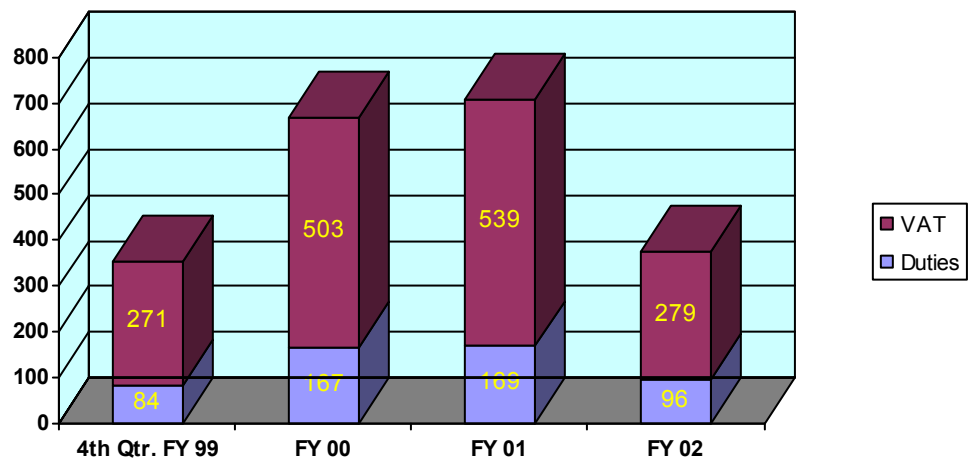
#### **Automatic Appropriations Not an Ideal Solution**

From FY 1999 through FY 2002, the automatic appropriations mechanism has worked effectively for USAID's contraceptive program administered through the Philippine DOH. However, the automatic appropriations mechanism is still susceptible to the problems caused by Presidential Administrative Order No. 372.

One problem was that Administrative Order No. 372 required Philippine national government agencies to pay customs duties and taxes on imported items—including donated commodities—out of their existing budgets. In its 1999 report, the OIG expressed concern that, while USAID policy did not proscribe the payment of duties by host country counterparts, such payments made from the budgets of host country counterparts would divert funds that could otherwise be used to further USAID and host government development objectives.

However, since the 1999 reinstatement of automatic appropriations mechanism, the DOH has not paid customs duties or taxes on USAID-donated contraceptives from its own budget. Rather, as the chart below shows, an estimated \$2 million in duties and taxes has been paid through automatic appropriation from the fourth quarter of fiscal year 1999 through fiscal year 2002.

**Customs Duties and Value Added Taxes (VAT) on Donated Contraceptives  
(In Thousands of dollars)**



Administrative Order No. 372 created a second problem that affected the DOH's use of the automatic appropriations mechanism in fiscal year 1999: The detention of USAID-donated contraceptives in Philippine customs. The contraceptives were detained because the DOH was unable to pay the required customs duties and taxes from its own budget. Here again, however, the reinstatement of the automatic appropriations has eliminated this problem. Specifically, shipping and receiving records—from August 1999 to June 2002—showed that only 1 of 46 shipments of USAID-donated contraceptives experienced a delay in Philippine customs. That lone delay was caused by personnel changes at the DOH.



Photograph of OIG auditors, and Mission and DOH officials inspecting contraceptives stored in a DOH warehouse (Manila, Philippines, January 2003).

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Since the Philippine government reinstated the automatic appropriations mechanism, neither USAID nor the DOH has paid customs duties on USAID-donated contraceptives. Therefore, delays in the release of contraceptives have not been a problem. However, the Philippine government could once again rescind the use of the automatic appropriations process. Thus, the DOH could once again be required to pay customs duties and taxes on USAID-donated contraceptives out of its own budget, and could once again experience detentions of those contraceptives in customs. Should this occur, USAID's contraceptive program in the Philippines could once again be adversely affected.

### **Recent Legislation and Current Agreements**

Recent U.S. Congressional legislation addresses the imposition of customs duties and value added taxes on commodities financed with U.S. assistance. Section 579 of Public Law 108-7 states that no funds appropriated under the public law may be made available to a foreign country under a new bilateral agreement unless such agreement includes a provision stating that assistance provided by the U.S. shall be exempt from taxation, or reimbursed by the foreign government. Section 579 also requires the Secretary of State to expeditiously seek to negotiate amendments to existing bilateral agreements, as necessary, to conform to this requirement. Further, Section 579 directs the Secretary of State to issue rules, regulations, or policy guidance, as appropriate, to implement the prohibition against the taxation of assistance contained in this section.

The Mission has several Strategic Objective Grant Agreements (SOAGs) with the Philippine government. The SOAG for the Integrated Family Planning Maternal Health Program, for example, includes a tax exemption provision that covers USAID-donated contraceptives. The Mission's other SOAGs contain similar exemption provisions for USAID-donated commodities. Although the SOAGs have tax exemption language, the exemption language is not as comprehensive as that normally required by Automated Directives System Chapter 350. These SOAGs have various completion dates. For example, the Integrated Family Planning Maternal Health Program SOAG has a completion date of December 31, 2003.

In 2002 the Mission began replacing its SOAGs with Memorandums of Understanding that do not provide any exemptions from customs duties or taxes for USAID-donated commodities. According to the USAID Regional Legal Advisor, the Mission is negotiating with the Philippine government to amend the Memorandums of Understanding to provide tax exemptions similar to the ones in the SOAGs. The Regional Legal Advisor also stated that the Mission would extend the completion dates of SOAGs, as necessary, to ensure the Mission is



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covered by the tax exemptions in those agreements while the MOUs are amended to include tax exemptions.

As noted in the OIG's 1999 report, the Bilateral Agreement between these two countries—signed in 1951—does not explicitly state that USAID-donated commodities will be free from taxes and customs duties. While not unique in this regard, U.S. bilateral agreements with other countries do contain such exemptions. And other countries such as Germany and Canada do have duty and tax exemption provisions in their bilateral agreements with the Philippine government. Consequently, the OIG is still concerned about the silence of the Bilateral Agreement regarding customs duties.

However, as noted above, the Secretary of State has been directed to issue appropriate rules, regulations or policy regarding customs duties and value added taxes levied on commodities financed with U.S. assistance.

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## **Conclusion**

As Recommendation No. 1 of OIG Audit Report No. 5-492-99-006-P requested, USAID/Philippines developed an action plan with targets and milestones to eliminate the requirement that customs duties be paid on USAID-donated commodities. However, closure of the recommendation was not subsequently justified because the Mission did not implement or adequately document the corrective actions outlined in its action plan.

Since the reinstatement of the automatic appropriations mechanism, the DOH has not had to pay duties and taxes on USAID-donated contraceptives from its own budget and those contraceptives have not experienced customs delays. However, the DOH is still at risk of having to pay customs duties and taxes out of its own budget, and still at risk of customs delays if it cannot afford to pay those duties and taxes. Should this occur, USAID's contraceptive program in the Philippines could once again be adversely affected.

We are not reopening the original recommendation or making any new recommendations at this time for three reasons. First, we did not identify any adverse effect from the current arrangements for contraceptives, and USAID/Philippines plans to stop donating contraceptives to the Philippines after fiscal year 2004. Second, as in the original audit, we did not review the situation regarding USAID-donated commodities other than contraceptives. Third, the U.S. Congress has directed the U.S. Secretary of State to issue appropriate rules, regulations or guidance regarding the imposition of customs duties and value added taxes on commodities financed with U.S. assistance. Nevertheless, we are making the following suggestions:

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- We suggest that USAID/Philippines maintain complete records of the status of recommendations through the entire process of resolution and corrective action.
  - Pending direction from the Secretary of State on the implementation of Section 579 of Public Law 108-7, we suggest that USAID/Philippines continue negotiating for its Memorandums of Understanding appropriate exemptions for USAID-donated commodities from customs duties.

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## **Management Comments and Our Evaluation**

In response to our draft report, USAID/Philippines provided written comments that are included in their entirety as Appendix II. Most of the Mission's comments pertain to one of the suggestions made to the Mission in the draft report. Below, we address the more pertinent Mission comments.

The OIG suggested that the Mission maintain complete records of the status of recommendations through the entire process of resolution and corrective action. This suggestion was made because this review found that the Mission had not fully implemented or adequately documented the steps in the action plan it submitted in response to Recommendation No. 1 of OIG Audit Report No. 5-492-99-006-P. However, the Mission believed that it did maintain appropriate records through the entire recommendation follow-up process because it prepared and presented for management decision and final action an action plan as required by the recommendation. The Mission added that based on that action plan, RIG/Manila had agreed to a management decision and M/MPI had issued final action on the recommendation. We disagree.

While Recommendation No. 1 called for an action plan, the recommendation and the audit report make clear that the sought after corrective action was the elimination of custom duties on USAID-donated commodities. The action plan itself would not eliminate those duties. Rather, only by implementing the steps in the action plan would the desired objective of eliminating customs duties be accomplished. RIG/Manila agreed to a management decision because, after reviewing the action plan, we reasonably believed that the customs duties would be eliminated if the action plan was carried out. Similarly, we believe that M/MPI had the same expectation when it issued final action.

As noted in this report, one of the principal objectives of Office of Management and Budget (OMB) Circular No. A-50 is to emphasize the importance of monitoring the implementation of recommendations to assure that promised corrective action is actually taken. The Circular further requires agency follow-up systems that include accurate records of the status of audit reports or recommendations through the entire process of resolution and corrective actions. The action plan contained the Mission's promised actions to achieve the elimination of customs duties on USAID-donated commodities. Consequently, to

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comply with the OMB Circular, the Mission should have maintained complete records of the status of the recommendation through the implementation of the action plan and the elimination of the customs duties.

As noted above, the review found that two steps in the action plan were not implemented. Additionally, there was no documentation or insufficient documentation to support that four other steps were actually completed. The Mission acknowledged that the two steps were not implemented, but added that they were not implemented because the steps were no longer necessary based on the course of action it chose to eliminate customs duties on USAID-donated commodities. Consequently, the Mission felt it was compliant in implementing the action plan to respond to Recommendation No. 1. However, if the steps were no longer necessary, the “Status/Action Taken” column of the action plan should have been updated or other documentation maintained to explain why it was no longer necessary to implement the steps. Since this was not done, there was no such recorded explanation. Further, we do not agree that one of the steps—Step No. 12— was no longer necessary. Rather, we believe that Step No. 12 was applicable to whatever course of action the Mission chose and, thus, should have been implemented. The Mission’s comments did not address the lack documentation or insufficient documentation for the other four steps.

We appreciate the Mission’s comments, but we did not make any changes to the report based on those comments. Additionally, we believe that our differences discussed above could have been readily resolved had complete records been maintained of the implementation of the action plan.

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**Scope and  
Methodology**

**Scope**

The Regional Inspector General/Manila conducted this recommendation follow-up to determine whether USAID/Philippines took effective corrective actions to justify the closure of Recommendation No. 1 of Audit Report No. 5-492-99-006-P, “Audit of USAID/Philippines’ Response to Customs Duties on Donated Contraceptives,” issued by RIG/Manila on September 27, 1999. This recommendation follow-up was not an audit. Fieldwork was conducted at USAID/Philippines and the Philippines’ Department of Health (DOH) from January 14, 2003 to April 24, 2003.

This recommendation follow-up was limited to imported contraceptive commodities because the OIG’s 1999 audit report focused on contraceptive commodities.

**Methodology**

We interviewed officials from USAID/Philippines including the Regional Legal Advisor and officials of the Philippines’ DOH. We reviewed Audit Report No. 5-492-99-006-P and its related working papers. At USAID/Philippines, we reviewed the Mission’s 12-step action plan dated February 23, 2000, and supporting documentation. We reviewed records pertaining to the value of contraceptives donated to the Philippines and the amount of customs duties and taxes paid on those contraceptives via the automatic appropriations process. We also reviewed (1) the Bilateral Agreement between the U.S. government and the Philippine government, (2) Strategic Objective Agreements and Memorandums of Understanding between the Mission and the Philippine government, and (3) bilateral agreements between the Philippine government and other countries. At the DOH, we reviewed contraceptive shipment records, inspected stored contraceptives, and obtained documentation on the automatic appropriations process.

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**Management  
Comments**

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August 14, 2003

**MEMORANDUM:**

To : Bruce N. Boyer  
RIG/Manila

/s/  
FROM: Michael J. Yates  
Mission Director  
USAID/Philippines

SUBJECT: Draft Report  
Follow-up of USAID/Philippines' Implementation of Recommendation No. 1,  
Audit Report No.5-492-99-006-P, "Audit of USAID/Philippines' Response  
to Customs Duties on Donated Contraceptives,"  
dated September 27, 1999

REFERENCE: RIG/Manila Memo dated July 02, 2003, received July 03, 2003

The Mission appreciates RIG/Manila's efforts in: (a) conducting a follow-up of Recommendation No. 1 of Audit Report No. 5-492-99-006-P to determine whether USAID/Philippines took corrective actions to justify closure of this recommendation; and (b) advising us that the report did not have any recommendations that would require any action by the Mission, although it did include 2 suggestions for the Mission's consideration.

As requested in the referenced memorandum, listed below are our comments in response to the following points raised in your draft report:

1. Page 10, first paragraph, which reads: "*We suggest that USAID/Philippines maintain complete records of the status of recommendations through the entire process of resolution and corrective action.*"

Recommendation No. 1 of Audit Report No. 5-492-99-006-P which became the basis for RIG's follow up-work states: "*We recommend that USAID/Philippines develop, with the*

*Philippines' Department of Foreign Affairs and/or the National Economic Development Authority an action plan—with targets and milestones—to eliminate the requirement that customs duties be paid on USAID-donated commodities.”*

In response to your suggestion, we have re-examined Mission audit records with an emphasis on analyzing the records within the context of this recommendation. Based on this latest examination, we believe that the Mission has maintained appropriate records throughout the entire audit recommendation follow-up process, which per ADS 595.3.1, consists of 3 stages, namely: no management decision, management decision, and final action. As you know, the terms “resolution” and “closure,” were replaced by the terms “management decision” and “final action.” The ADS presents the following definitions for these terms:

Corrective Action: Measures taken to implement audit findings and recommendations.

Management Decision: The evaluation of a recommendation by management and a decision upon an appropriate course of action.

Final Action: Based on a management decision, the completion of all actions that are necessary to resolve and implement findings and recommendations of an audit report.

The following actions, which were taken by the Mission in response to the audit recommendation, led to our conclusion that the Mission maintains adequate records and responded appropriately to the recommendation:

- a) The Corrective Action required in the recommendation was to develop an Action Plan.
- b) The Management Decision required was for the Mission to agree to the development of an Action Plan. The Mission did agree to this and such was relayed to RIG in its Comments to the Draft Audit Report that contained the above recommendation. This was accepted by RIG and reflected in the Final Audit Report (issued September 27, 1999), which stated: “Based on the above, USAID/Philippines has made a management decision on the one audit recommendation in this report.”
- c) The Final Action required was for the Mission to show that it developed an Action Plan on the basis of its Management Decision. The Action Plan, which was developed in October 1999, constituted the Mission’s final action on the recommendation. As such, this Action Plan became the Mission’s documentation and basis for justifying its request for M/MPI’s closure of Recommendation No. 1.

Therefore, from management decision to final action, the Mission complied with Recommendation No. 1 by developing an Action Plan. The appropriate documentation which was maintained was the Action Plan itself. The original Action Plan, dated and submitted to M/MPI in Oct. 1999 is on file in the Mission. This Action Plan also became M/MPI’s basis for closing Recommendation No. 1. In October 1999, when the Action Plan



was developed and submitted to MMPI, the steps detailed in that Action Plan had yet to be implemented. At that point in time therefore, it would not have been possible for the Mission to make available all records that would have supported these planned steps, which had targeted dates for implementation of beyond October 1999.

While it was impossible for the Mission to document implementation steps at the time M/MPI closed the audit recommendation, the Mission did follow through with implementation of the Action Plan it had submitted to M/MPI. Therefore, the Mission was compliant, in both developing and implementing an action plan to respond to the audit recommendation. In implementing the action plan, the Mission selected and used what it believed was the most feasible option for dealing with the problem of customs duties on USAID-donated commodities, the GOP's automatic appropriation mechanism for covering the cost of such duties. Please note that the original Action Plan consisting of 12 steps, which had been developed by the Mission and submitted to M/MPI in October 1999, had continued to evolve over time and was reduced to 10 steps. An explanation of this change is offered in Item 2 below.

2. Page 5, paragraph 3

We acknowledge the fact that some of the steps in this 12-step plan were not undertaken. These steps were no longer thought to be necessary since the most feasible option had already been selected.

The report stated: "*Step No. 9 and the important final Step No. 12 were not implemented.*" As shown in the Action Plan of February 23, 2000, Step 9 involved a plan to "*Meet with the US Embassy and seek their assistance if one of the options being considered is for the US to seek parity treatment from the GOP,*" while Step 12 involved a plan to "*Meet with the concerned GOP agencies and establish implementation date.*" Since the automatic appropriation mechanism - which the Mission had selected to be the most feasible of all the options identified - did not require the US to seek parity treatment from the GOP, there was no longer a need to undertake Step 9. In the same token, Step 12, which was planned to be undertaken after Step 9 had been implemented, also became an unnecessary step.

3. Page 2, second paragraph, second to the last sentence.

The Mission would like to clarify the statement under this section.

The reason for the hold-up of some shipments at port was because there was a change in consignee to the DOH, instead of the UNFPA, therefore the clearance process had to follow the longer DOH documentation and processing procedure.

4. Page 6, paragraph 2, second to the last sentence.

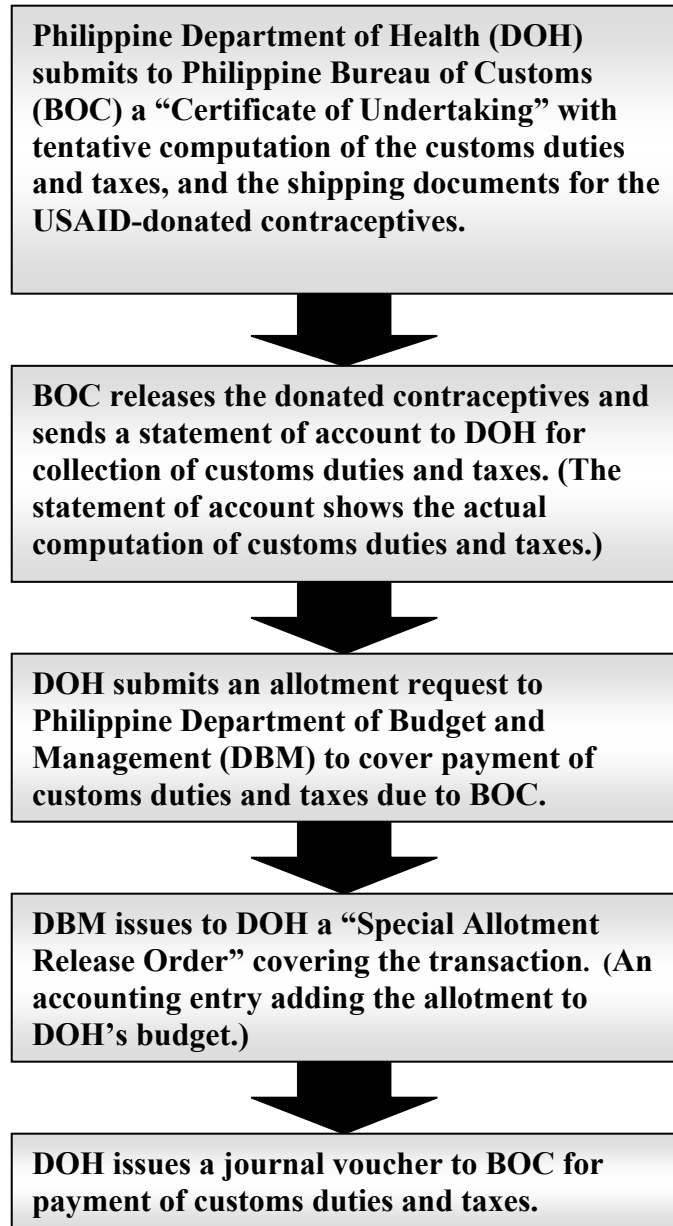
The Mission would like to reiterate our comments below, relayed to RIG in an earlier meeting to discuss the draft report.

The GRP automatic appropriation mechanism is extended to all national government agencies. Section 13 of the GOP's General Appropriations Act (GAA) states:

*“Sec. 13. National Internal Revenue Taxes and Import Duties. National internal revenue taxes and import duties, including value-added taxes on importation payable by national government agencies to the National Government arising from foreign donations, grants and loans are deemed automatically appropriated...”*

At the time the audit was performed, Strategic Objective (SO) 3 was the only Mission SO which was providing donated commodities with a GOP counterpart agency, as the consignee. Therefore, there was no opportunity for application of the automatic appropriation mechanism to other SO Team implementing entities.

5. In relation to item 4 above, we believe that it could be verified with the Department of Budget and Management (DBM) that other GOP government agencies could utilize the automatic appropriation mechanism. If the DBM verifies the availability of the automatic appropriation mechanism for other GOP Agencies, then the audit report would be accurate in its statement that only the Department of Health was using the mechanism; however, it would be inaccurate to state that the automatic appropriation mechanism had not been extended to other GOP Government Agencies.

**Flowchart of the Automatic Appropriations Mechanism<sup>3</sup>**

<sup>3</sup> Section 13 of the General Appropriations Act of the Philippine government stipulates that national internal revenue taxes and import duties, including value-added taxes on importation payable by national government agencies to the National Government arising from foreign donations, grants and loans are deemed automatically appropriated. This flowchart based on information obtained from the Philippines’ Department of Health.

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**USAID/Philippines**  
**Mission's Action Plan for USAID-Donated Commodities**  
**As of February 23, 2000**

| Activities/Milestones   | Original Target Completion Date | Revised Target Completion Date | Actual Completion Date | Responsible Office/Person | Status/Action Taken (To be Taken)   |
|---|---------------------------------|--------------------------------|------------------------|---------------------------|---|
| 1. Establish a Commodities Working Group  | 10/30/99                        |                                | 10/4/99                | Mission Mgt.              | Action Completed  |
| 2. Initial Meeting with NEDA to discuss the issues and identify options.  | 10/15/99                        |                                | 10/5/99                | Mission Mgt.              | Action Completed  |
| 3. Obtain a list of current and future activities involving commodities.  | 11/08/99                        |                                | 11/22/99               | Commodities Working Group | Action Completed  |
| 4. Identify the GOP-recipient agencies for these commodities  | 11/08/99                        |                                | 11/22/99               | -do-                      | Done for SOs1-5   |
| 5. Meet with these agencies and determine problems currently encountered in the receipt and release of these commodities from the BOC.                          | 11/22/99                        |                                | 11/22/99               | -do-                      | Each FA to relay to their respective SO teams the need to meet with the GOP recipient agencies and discuss any problems encountered in the receipt and release of commodities from the BOC.   |
| 6. Identify various options to eliminate requirement for customs duties payment on USAID-donated commodities.   | 11/22/99                        |                                | 11/22/99               | -do-                      | Three options were identified, namely: a) Amend the Bilateral/SOAGs; b) Negotiate with the GOP the automatic appropriation mechanism to all GOP IAs; and c) Maintain status quo.  |
| 7. Review the GOP's bilateral agreements with other donors (e.g. Japan, Australia, Canada etc.) and compare with USAID's; meet with these donors, if necessary. | 12/15/99                        |                                | 2/15/00                | -do-                      | Multilateral agencies (WB, ADB, UN system) are tax exempt as these are covered by multilateral agreements. Copies of the GOP's bilateral agreements with Australia, Germany, Belgium, Japan, and Canada being reviewed in the Mission. For Australia, ratification of its agreement took 4 years; Japan adopts the automatic appropriation mechanism. |
| 8. Meet with DBM and the BTR to discuss the automatic appropriation approach for handling taxes involving USAID-funded GOP agencies.                            | 12/15/99                        |                                | 1/28/00                | -do-                      | Preliminary meeting with a brief discussion on taxes, held at DOF on 1/28/00. Participants included DOF, DBM, BTR, DA, DENR and USAID. Further discussions on this to be made during the next meeting with DOF & other GOP agencies – to be scheduled in March.   |
| 9. Meet with the US Embassy and seek their assistance if one of the options being considered is for the US to seek parity treatment from the GOP.               | 01/30/00                        |                                |                        | -do-                      | Acting Dep. Dir. MYates to meet with Terry Breese of the U.S. Embassy and discuss the options identified by the Mission.  |
| 10. Meet with NEDA or with the DFA to discuss options as they may relate to the bilateral agreement between the USG and the GOP.                                | 01/30/00                        |                                | 2/16/00                | -do-                      | USAID meeting with NEDA held 02/16/00 – NEDA agreed in principle to the automatic appropriation mechanism as the most appropriate long-term solution. This is currently   |

## Appendix IV

| Activities/Milestones  | Original Target Completion Date | Revised Target Completion Date | Actual Completion Date | Responsible Office/Person | Status/Action Taken (To be Taken)   |
|--|---------------------------------|--------------------------------|------------------------|---------------------------|---|
|  |                                 |                                |                        |                           | being done by the Japanese.   |
| 11. Determine and recommend to Mission management the best and most feasible option. | 02/15/00                        |                                |                        | -do-                      | Automatic appropriation mechanism determined to be the best and most feasible option. |
| 12. Meet with the concerned GOP agencies and establish implementation date.          | 03/15/00                        |                                |                        | -do-                      | To be undertaken after ADD's meeting with TBreese                                     |

### List of acronyms used in the Action Plan:

|        |   |  |
|--------|---|--|
| ADB    | - | Asian Development Bank                               |
| ADD    | - | Acting Deputy Director                               |
| BOC    | - | Bureau of Customs                                    |
| BTR    | - | Bureau of Treasury                                   |
| CWG    | - | Commodities Working Group                            |
| DA     | - | Department of Agriculture                            |
| DBM    | - | Department of Budget and Management                  |
| DENR   | - | Department of Environment and Natural Resources      |
| DFA    | - | Department of Foreign Affairs                        |
| DOF    | - | Department of Finance                                |
| FA     | - | Financial Analyst                                    |
| GOP    | - | Government of the Philippines                        |
| GOPIAs | - | Government of the Philippines' Implementing Agencies |
| NEDA   | - | National Economic Development Authority              |
| SO     | - | Strategic Objective                                  |
| SOAGs  | - | Strategic Objective Grant Agreements                 |
| UN     | - | United Nations                                       |
| USG    | - | United States Government                             |
| WB     | - | World Bank   |

### Notes on Responsible Office/Person:

- 1) Mission Management was responsible for steps 1 and 2.
- 2) The Commodities Working Group was responsible for steps 3 through 12.