

**Audit of Accountability for Costs Incurred in Peru by
U.S.-Based Contractors and Grantees**

Audit Report No. 1-527-03-002-F

December 20, 2002

San Salvador, El Salvador



December 20, 2002

MEMORANDUM

FOR: USAID/Peru Director, Patricia Buckles

FROM: Acting RIG/San Salvador, Steven H. Bernstein

SUBJECT: Audit of Accountability for Costs Incurred in Peru by U.S.-Based Contractors and Grantees (Report No. 1-527-03-002-F)

This memorandum is our report on the subject audit.

This report does not contain any recommendations for your action. Your comments to our draft report have been included, in their entirety, as Appendix II.

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

Table of Contents

Summary of Results	3
Background	4
Audit Objectives	5
Audit Findings	5
What testing of costs incurred in Peru has been performed for USAID/Peru’s U.S.-based contractors and grantees?	5
What additional measures has USAID/Peru taken to help ensure that the costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable?	7
Management Comments and Our Evaluation	9
Appendix I – Scope and Methodology	10
Appendix II – Management Comments	12

Summary of Results

USAID's U.S.-based contractors are subject to incurred-cost audits that are generally conducted by the Defense Contract Audit Agency (DCAA) pursuant to a memorandum of understanding between the USAID Office of Inspector General and DCAA. U.S.-based grantees are subject to audits performed by audit firms pursuant to Office of Management and Budget (OMB) Circular A-133. Federal agencies must rely on these audits if they meet the agencies' needs, and any additional audit work should not duplicate audit work already performed. (See page 4.)

In response to a request by USAID/Peru, the Regional Inspector General/San Salvador performed this audit to determine (1) what testing of costs incurred in Peru has been performed for USAID/Peru's U.S.-based contractors and grantees and (2) what additional measures USAID/Peru has taken to help ensure that the costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable. (See page 5.)

For the 11 U.S.-based contractors and grantees in our sample, DCAA and the audit firms tested \$1,666,309 (6.5 percent) of the \$25,636,946 disbursed to the contractors and grantees by USAID/Peru during the most recent fiscal years examined by the auditors. It should be noted that auditors in the United States, if they are not familiar with local conditions, business practices, and price levels in Peru, may not be able to determine the reasonableness of costs incurred in Peru. Audit testing in Peru was performed for only one of the entities in our sample of 11 U.S.-based contractors and grantees. (See page 5.)

USAID/Peru monitors costs incurred in Peru by U.S.-based contractors and grantees through voucher reviews, which include administrative approvals by contract technical officers who have first-hand knowledge of services provided, as well as occasional reviews conducted by USAID/Peru financial analysts. In addition, USAID/Peru staff review progress reports and conduct site visits and meetings with contractors and grantees to maintain cognizance of the activities carried out by U.S.-based contractors and grantees in Peru. USAID/Peru relies on OMB Circular A-133 and DCAA audits and has not arranged for any additional audit testing of costs incurred in Peru by its U.S.-based contractors and grantees. (See page 7.)

If considered necessary, USAID/Peru could increase audit coverage of its programs in two ways. First, it could request A-133 audit firms or DCAA to perform additional audit procedures. Second, USAID/Peru could arrange for additional audits of U.S.-based contractors and grantees, building on but not duplicating audit work previously performed. (See page 7.)

USAID/Peru agreed with the report and our findings. (See page 9.)

Background

Based on program funding levels, USAID/Peru is the second-largest mission in the Latin American and Caribbean region, with a fiscal year 2003 budget request level of \$147 million. Many of USAID/Peru's programs are carried out by contractors and grantees with headquarters in the United States.

U.S.-based contractors are subject to incurred-cost audits that are generally conducted by DCAA pursuant to a memorandum of understanding between USAID's Office of Inspector General and DCAA. U.S.-based grantees are subject to audits performed by audit firms pursuant to OMB Circular A-133. Federal agencies must rely on these audits if they meet the agencies' needs, and any additional audit work should not duplicate audit work already performed.

In accordance with Section 42.003 of the Federal Acquisition Regulations, the federal agency with the largest amount of negotiated contracts with a for-profit organization is the cognizant federal agency. Pursuant to the terms of the memorandum of understanding referred to above, DCAA performs incurred-cost audits for substantially all of the contractors for which USAID is the cognizant federal agency.

Pursuant to the Single Audit Act Amendments of 1996 (Public Law 104-156), grantees expending more than \$300,000 in one year are subject to a single financial audit covering all federal awards. Regulations implementing the Single Audit Act were issued in OMB Circular A-133. The extent of the audit procedures to be applied is determined by whether a grantee qualifies as low-risk¹ and whether a program is determined to be a major program.²

For a low-risk grantee, the audit firms need only audit as major programs those federal programs with federal awards expended that, in the aggregate, encompass at least 25 percent of total federal awards expended. For other grantees, audit coverage is required to be at least 50 percent.³

¹ A grantee qualifies as low-risk if, for the preceding two years, there were unqualified opinions on audits of the financial statements and the schedule of expenditures; there were no material weaknesses identified in the internal controls; there were no material instances of noncompliance with provisions of laws, regulations or grant agreements; and none of the programs in which \$300,000 (or a higher threshold as set forth in OMB Circular A-133) in federal awards was expended had questioned costs that exceeded five percent of the total federal awards expended for the program during the year (OMB Circular A-133, Section 530).

² A major program is a program in which \$300,000 (or a higher threshold as set forth in OMB Circular A-133) in federal awards are expended in one year, unless the auditor has made a determination that the program is low-risk. Generally, a low-risk program is one that was audited as a major program in one of the last two years, and in the most recent audit period there were no significant findings. Additionally, a program in which federal awards are less than \$300,000 (or other threshold pursuant to OMB Circular A-133) is audited as a major program if it is determined to be a high-risk program (OMB Circular A-133, Section 520).

³ OMB Circular A-133, Section 520(f).

Audit firms performing A-133 audits are required to conduct their audits in accordance with generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. Under GAGAS, the audit firms perform financial statement audits to determine if financial statements are fairly presented in accordance with generally accepted accounting standards. To obtain sufficient evidence to support their opinion on an entity's financial statements, the audit firms normally assess the effectiveness of the entity's system of internal control and then perform substantive tests of individual transactions. The audit firms are also responsible for verifying compliance with applicable laws, regulations, and contract or agreement terms if noncompliance could have a direct and material effect on the financial statements. For major programs, in addition to following GAGAS requirements, OMB Circular A-133 requires audit firms to perform more in-depth testing of internal controls relevant to the compliance requirements for each major program. It also requires that auditors determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each of its major programs.⁴

Audit Objectives

In response to a request by USAID/Peru, the Regional Inspector General/San Salvador performed the audit to answer the following questions:

- What testing of costs incurred in Peru has been performed for USAID/Peru's U.S.-based contractors and grantees?
- What additional measures has USAID/Peru taken to help ensure that the costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable?

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

Audit Findings

What testing of costs incurred in Peru has been performed for USAID/Peru's U.S.-based contractors and grantees?

For the 11 U.S.-based contractors and grantees in our sample, DCAA and the audit firms tested \$1,666,309 (6.5 percent) of the \$25,636,946 disbursed to the contractors

⁴ OMB Circular A-133, Sections 500(c)(2)(i) and 500(d)(1).

and grantees by USAID/Peru during the most recent fiscal years examined by the auditors.⁵

For-Profit Firms – Our sample included five U.S.-based contractors: Louis Berger International, Abt Associates, Chemonics International, the University Research Corporation, and the International Science & Technology Institute.

DCAA tested \$561,063 in costs incurred in Peru by Louis Berger International and \$12,150 in costs incurred in Peru by Abt Associates. This testing consisted of reviewing documentation available at the contractors' headquarters in the United States.

DCAA did not test any costs associated with USAID/Peru contracts for Chemonics International, the International Science & Technology Institute, or the University Research Corporation.

Non-Profit Entities – Our sample included six U.S.-based grantees: Pathfinder International, Winrock International Institute for Agricultural Development, CARE, Catholic Relief Services (CRS), Private Agencies Collaborating Together (PACT) and the National Democratic Institute.

The audit firm for Pathfinder International tested \$1,081,312 in costs incurred in Peru. The audit firm used its Peru office to test the costs and to determine if they were reasonable, allocable, and allowable. The audit tests performed included determining if expenditures were properly authorized, tracing transactions to original documentation, determining if transactions were properly recorded, reviewing transactions for reasonableness, determining if transactions were allowable, and determining if the transactions complied with Pathfinder International's policies as well as applicable laws and regulations.

The audit firm for Winrock tested \$11,784 in costs incurred in Peru. The audit tests consisted of reviewing supporting documentation on file at Winrock's headquarters in the United States.

The audit firms for CARE, CRS, PACT, and the National Democratic Institute did not test any costs incurred in Peru during the most recent audit periods.

Auditors in the United States may not be familiar with local conditions, business practices, and price levels in Peru; consequently, making a determination of the reasonableness of costs incurred in Peru may be difficult. Similarly, auditors in the United States would not normally be familiar with Peruvian laws and regulations; therefore, determining if contractors and grantees have complied with

⁵ Our sample included the five contractors and six grantees with the largest disbursements during the fiscal years covered by their most recent available audits. See Appendix I for additional details on the audit sample.

them would also be difficult. No audit testing was performed in Peru for any of the contractors or grantees in our sample except for Pathfinder International.

What additional measures has USAID/Peru taken to help ensure that the costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable?

USAID/Peru monitors costs incurred in Peru by U.S.-based contractors and grantees through voucher reviews, which include administrative approvals by contract technical officers who have first-hand knowledge of services provided, as well as occasional reviews conducted by USAID/Peru financial analysts. In addition, USAID/Peru staff review progress reports and conduct site visits and meetings with contractors and grantees to maintain cognizance of the activities carried out by U.S.-based contractors and grantees in Peru. USAID/Peru relies on OMB Circular A-133 and DCAA audits and has not arranged for any additional audit testing of costs incurred in Peru by its U.S.-based contractors and grantees.

If the audits performed by DCAA and the audit firms conducting OMB Circular A-133 audits do not fully meet USAID/Peru's needs, USAID/Peru can increase audit coverage of its programs with U.S.-based contractors and grantees in two ways. First, it can request A-133 audit firms or DCAA to perform additional audit procedures. Second, USAID/Peru can arrange for additional audits of U.S.-based contractors and grantees, building on but not duplicating audit work previously performed. These two alternatives are discussed below. Following the discussion of these two alternatives, we discuss a finding, previously reported by the Office of Inspector General's Financial Audit Division (IG/A/FA), that USAID as an agency might be able to obtain more effective audit coverage of its programs by listing its programs with U.S.-based contractors and grantees in the *Catalog of Federal Domestic Assistance*.

Request That Additional Audit Procedures Be Performed – For U.S.-based grantees, who are subject to A-133 audits, USAID/Peru can request that the A-133 auditors treat USAID/Peru's programs as major programs. As discussed in the background section above, the significance of this is that, for major programs, audit firms are required to perform more in-depth testing of internal controls relevant to the compliance requirements for each major program. They are also required to determine whether the auditee has complied with laws, regulations, and the provisions of contracts or grant agreements that may have a direct and material effect on each major program.

In order to request that a program be audited as a major program, USAID must submit a request to the grantee and its audit firm, if known, at least 180 days prior to the end of the fiscal year to be audited. The grantee is required to inform USAID whether the program would otherwise be audited as a major program and, if not, the estimated additional cost. USAID is then required to confirm that it wants the program audited as a major program. If the program is audited as a

major program based upon USAID's request, USAID must agree to pay the additional costs.

Any such request by a mission would be submitted through the Office of Procurement's Contract Audit Management Branch (M/OP/PS/CAM). M/OP/PS/CAM would then submit the request to the grantee and its audit firm, while keeping IG/A/FA informed.

USAID/Peru can also request that DCAA perform more in-depth audit work on a specific program. The mission would submit such a request to M/OP/PS/CAM, which would include the additional work in the statement of work. M/OP/PS/CAM would provide the statement of work to IG/A/FA, who would then issue an engagement letter to DCAA asking them to perform the requested audit work.

Arrange for Additional Audits – USAID/Peru can also obtain increased audit coverage of its programs with U.S.-based contractors and grantees by arranging for additional audits to be performed in Peru. It should be emphasized that any such additional audits should build on, not duplicate, any other audit work performed.⁶

If USAID/Peru needs additional audits to be performed by an audit firm or by DCAA in Peru, the audit would be handled as an agency-contracted audit in accordance with Section 590.3.4.1 of the Automated Directives System and would be coordinated through the Regional Inspector General/San Salvador (RIG/San Salvador). USAID/Peru would be responsible for paying for the audit, contracting for the audit, and following up on any recommendations contained in the audit report. RIG/San Salvador would be responsible for approving the audit statement of work and signing the engagement letter with DCAA, attending the entrance and exit conferences if possible, and approving the draft and final audit reports.

Catalog of Federal Domestic Assistance – USAID might also be able to increase audit coverage of its programs by listing programs with U.S.-based contractors and grantees in the *Catalog of Federal Domestic Assistance (Catalog)* published by the General Services Administration. USAID grants and cooperative agreements with U.S.-based nonprofit organizations, universities, and state and local governments are treated as federal domestic assistance for purposes of inclusion in the *Catalog*. Not including USAID's programs in the *Catalog* results in A-133 audit firms not having sufficient guidance on USAID's federal assistance programs. As noted in Audit Report No. 0-000-02-001-F, *Report on USAID's Compliance with Provisions of the Federal Program Information Act of 1977* dated February 13, 2002:

⁶ See Section 215(a) of OMB Circular A-133 and Section 42.002 of the Federal Acquisition Regulations.

Auditors conducting [OMB Circular A-133] audits lack guidance in identifying USAID's Federal assistance programs because these programs do not contain unique program identification numbers for inclusion in the GSA *Catalog of Federal Domestic Assistance*.

This situation can cause auditors to make substantially different judgments in determining which USAID awards are subject to compliance testing for the purpose of performing an acceptable A-133 audit.

As an example, an auditor of a USAID award recipient may determine that all USAID awards should be considered as one population for the purpose of compliance testing, regardless of the various program objectives of these individual awards. However, an auditor of another USAID award recipient may determine that each of its USAID awards should each be considered separately for the purpose of selecting those awards that will be subject to A-133 compliance testing. [The significance of this is that there is a greater likelihood that USAID programs qualifying as major programs will be selected for testing of costs if the programs are listed separately.]

Because only a sample of awards are selected for compliance testing for an A-133 audit of a nonprofit organization, the lack of guidance on the selection of these items can cause inconsistent audit approaches, as explained in the previous examples. OMB Circular A-133 audits of USAID assistance are therefore potentially inconsistent and less effective than possible.

USAID's Office of Procurement concurred in the report's recommendation that USAID include its grant programs in the *Catalog*, but it has not yet implemented the recommendation.

**Management
Comments and
Our Evaluation**

USAID/Peru, in its comments to our draft report, agreed with the report and findings.

**Scope and
Methodology****Scope**

We conducted this audit in accordance with generally accepted government auditing standards. We conducted the audit at RIG/San Salvador and at USAID/Peru from August 25, 2002 through October 18, 2002. Our work covered the most recent audit period for which a financial audit was completed for each of 11 contractors and grantees in the sample we drew (see the methodology section below for details on our sample). The most recent audit periods for these contractors and grantees ranged from the year ending June 30, 1997 through the year ending December 31, 2001.

The audit focused on determining (1) what testing of costs incurred in Peru has been performed for USAID/Peru's U.S.-based contractors and grantees and (2) what additional measures USAID/Peru has taken to help ensure that the costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable.

We assessed USAID/Peru's management controls related to monitoring the costs of U.S.-based contractors and grantees. Specifically, we assessed USAID/Peru's controls for ensuring that costs incurred in Peru by U.S.-based contractors and grantees are allowable, allocable, and reasonable. These controls include voucher reviews, financial reviews, audits, quarterly progress reporting, site visits, and regular communications with contractors and grantees concerning their activities in Peru.

Methodology

In answering the first audit objective, which was to determine what testing of costs incurred in Peru has been performed for USAID/Peru's U.S.-based contractors and grantees, we reviewed a sample of 5 U.S.-based contractors and 6 U.S.-based grantees from the population of 12 U.S.-based contractors and 17 U.S.-based grantees in USAID/Peru's fiscal year 2001 audit inventory. Statistical sampling was not feasible because of the small size of the population. We therefore judgmentally selected the 7 U.S.-based contractors and 7 U.S.-based grantees with the largest disbursements shown in USAID/Peru's fiscal year 2001 audit inventory. Two grantees were, however, excluded because their programs had ended more than five years ago. The audit sample was then adjusted by deleting one contractor and one grantee because USAID/Peru did not make any disbursements to them in the period covered in their most recent audits. Another contractor was deleted from the sample because its programs had not been audited yet. The population and sample are summarized in the following table.

	Total USAID/Peru Audit Inventory		Audit Sample	
	<u>Number</u>	<u>Disbursements</u>	<u>Number</u>	<u>Disbursements</u>
Contractors	12	\$26,716,356	5	\$21,883,527
Grantees	17	\$73,185,133	6	\$68,983,201
Total	29	\$99,901,489	11	\$90,866,728

For the U.S.-based contractors in our sample, we contacted IG/A/FA to obtain copies of the most recent audit reports issued by DCAA. After reviewing the audit reports, we contacted the individual DCAA offices that performed the audits and obtained from them information regarding the testing of costs incurred in Peru.

For the U.S.-based grantees in our sample, we searched the Single Audit Act database to identify the audit firms who conducted the most recent audits. We contacted the audit firms for the selected grantees and obtained from them information regarding the testing of costs incurred in Peru in the most recent audit years. We also visited the offices of Pathfinder International’s audit firm in Lima, Peru to review audit working papers. We also obtained from IG/A/FA copies of all quality control reviews performed in fiscal years 2001 and 2002 of USAID/Peru’s U.S.-based grantees as well as summary data regarding the testing of costs.

In answering the second audit objective, which was to determine what additional measures USAID/Peru has taken to help monitor costs incurred in Peru by U.S.-based contractors and grantees, we interviewed USAID/Peru staff and reviewed documentation such as USAID/Peru’s internal management control assessment, its audit universe, and the quarterly workplan for USAID/Peru’s financial analysts.

**Management
Comments**

Date: December 6, 2002

To: Timothy Cox, RIG/A/SS

From: Patricia K. Buckles, Mission Director

Subject: Audit of Accountability for Costs Incurred in Peru by U.S.-Based
Contractors and Grantees

USAID/Peru would like to thank you for the professional work performed by you and your staff on the subject audit. Your findings included in this audit report will help our Mission to improve audit coverage for costs incurred in Peru by U.S.-Based Contractors and Grantees.

Below you will find our comments on your audit report dated November 14, 2002

Management Comments:

USAID/Peru fully concurs with the report. Our long standing concern that audit coverage has been very limited on these types of costs was validated by your findings, considering that independent audit firms and/or DCAA have audited only 6.5% of the total amount disbursed during the most recent fiscal years. Monitoring of costs incurred by U.S.-Based Contractors and Grantees in USAID/Peru has been strengthened through voucher reviews as well as occasional financial reviews conducted by USAID/Peru financial analysts but only on a limited basis. Although we have previously relied on OMB-A-133 and DCAA audits, we recognize a need to increase our coverage in the future. The findings of this audit will serve to guide our decisions in this regard.

As a result of your efforts, we understand clearly the ways this audit coverage can be expanded and we will do so depending on the circumstances and current needs. Technical Offices as well as the Controller's Office will be consulted on the needs for this additional audit coverage and its justification.