

January 1996

FOREIGN ASSISTANCE

Controls Over U.S. Funds Provided for the Benefit of the Palestinian Authority



**National Security and
International Affairs Division**

B-265866

January 8, 1996

The Honorable Jesse A. Helms
Chairman, Committee on Foreign
Relations
United States Senate

The Honorable Benjamin A. Gilman
Chairman, Committee on International
Relations
House of Representatives

Your June 6, 1995, letter requested that we analyze a series of letters that allegedly were prepared by the Palestinian Authority's Finance Minister and the Director General of the Palestine Economic Council for Development and Reconstruction (PECDAR). These letters indicate that \$138 million from an unidentified source(s) was "diverted" in late 1994 to finance a number of covert transactions, such as purchasing land and building apartments in Jerusalem, funding a Palestinian journal, and providing financial support to groups inside Israel sympathetic to the Palestinian cause.

To address your general concern that U.S. assistance funds may have been involved in one or more of these transactions, we ascertained (1) what financial controls were set up by the World Bank and the U.S. Agency for International Development (USAID) to monitor the use of U.S. funds provided to Palestinian Authority, PECDAR, or Palestine Liberation Organization (PLO) officials for budget support purposes and (2) what controls USAID established over project funds provided to other U.S. government agencies, private contractors, nongovernmental organizations (NGO), private voluntary organizations (PVO), and the United Nations for the benefit of the Palestinian Authority.

We did not examine whether the letters are authentic since you asked the Central Intelligence Agency to make that determination. We did not have the authority to review whether the funds spent by other donor nations for Palestinian Authority police salaries and project assistance were at risk. Other nation funding accounted for approximately three-quarters of the estimated \$389 million in total donor disbursements in 1994. Our report focuses on the estimated \$51 million the United States disbursed in 1994:

\$10 million to the World Bank's Holst Fund,¹ \$5 million to help pay for Palestinian Authority police salaries, and \$36 million for specific development projects.

Results in Brief

Accountability concerns over the use of U.S. funds for budget support purposes should be mitigated by the extensive financial controls implemented by the World Bank and USAID. Most notably, donor funds provided to the World Bank's Holst Fund in 1994 were audited and accounted for by a team of Touche Ross, Saba & Co., auditors located in Israel and the self-rule territories. According to Bank officials, Touche Ross agents reviewed 10 percent of all salary payments, 25 percent of all other payments, and all contracts valued in excess of \$25,000 in 1994. In the case of the \$5 million the United States spent on Palestinian Authority police salaries in 1994, USAID hired an Egyptian audit firm to accompany the PLO's paymaster to verify individual payment records and to provide an overall accounting of disbursed funds.

USAID project assistance funds were distributed to a wide variety of recipients, including other U.S. government agencies, private contractors, NGOs, PVOS, and the United Nations. No project funds were directly disbursed to Palestinian Authority, PECDAR, or PLO officials. USAID's contracts, grants, cooperative agreements, and memorandums of understanding with funds recipients incorporated standard U.S. assistance provisions, such as (1) grant and project officer oversight, (2) incremental funding, (3) monthly or quarterly financial status reports, (4) progress reports, and (5) auditing provisions. USAID's audit provisions call for annual audits of each contractor's overhead rate, contract-specific audits on an as-needed basis, and close-out audits of all contracts valued in excess of \$500,000 (all USAID contracts exceeded this threshold). Nonprofit organizations receiving funds through grants and cooperative agreements are subject to the Office of Management and Budget's A-133 audit process.

Budget Support Versus Project Assistance

The financial assistance pledged by the United States and other nations after the PLO and Israel signed the Declaration of Principles may be divided into two broad categories: (1) infrastructure and technical assistance projects and (2) budget support to help finance the Palestinian Authority's

¹The World Bank established the Holst Fund as a central repository for donations to help the Palestinian Authority pay start-up expenses and short-term operating costs. The World Bank is responsible for overseeing the use of these funds on behalf of the contributing donors. In 1994, the Holst Fund disbursed approximately \$51 million to the Palestinian Authority and PECDAR. This total includes a \$10-million contribution from the United States.

operating expenses. Individual donor projects cover a wide range of infrastructure and technical assistance needs. These needs include housing construction; wastewater plants; health services; jobs programs; and technical assistance in such areas as establishment of a legal system; studies to modernize and strengthen the financial sector; and training for Palestinian staff in the electric, water, highway, and sanitation sectors.

The budget support category was established to help the Palestinian Authority meet its operating expenses while it established its own revenue collection system and revenue clearance arrangements with Israel. It includes three components: (1) the World Bank's Holst Fund; (2) police salaries funneled through the U.N. Relief and Works Agency; and (3) transitional costs funded by individual donor nations to help support a number of activities.²

Table 1 shows total donor disbursements in 1994 by assistance category and major distribution channels. As indicated, the budget support category accounted for 38 percent of total donor disbursements.

²These transitional costs include (1) central administration costs not covered by the Holst Fund; (2) resettlement of prisoners released by Israel; (3) job creation efforts in Gaza—principally organized through the U.N. Development Program; and (4) temporary NGO support services in the health, education, and agriculture sectors and in youth and women's programs.

Table 1: Donor Disbursements by Assistance Category and Major Distribution Channels for 1994

Dollars in millions		
Assistance category	Disbursements	Major distribution channels
Infrastructure and technical assistance projects total	\$240.8 (62 percent)	Bilateral aid projects, U.N. Relief and Works Agency, U.N. Development Program, and the World Bank
Budget support		
Holst Fund	50.9	World Bank
Police recurrent costs	40.9	U.N. Relief and Works Agency ^a
Transitional projects		
Central administration	16.8	European Union, U.N. Development Program
Ex-detainees	8.4	European Union
Gaza employment creation	8.6	U.N. Development Program
NGO financing	22.4	European Union
Total	\$148.0 (38 percent)	
Total	\$388.8	

^aInitially, the United States and several other donors provided funds directly to the PLO or Palestinian Authority to cover police salaries and equipment needs. Later, the U.N. Relief and Works Agency was selected to centrally manage and oversee donor donations to the police force.

Table 2 shows total U.S. fiscal year 1994 disbursements by assistance category and major distribution channels.

Table 2: U.S. Disbursements by Assistance Category and Major Distribution Channels for Fiscal Year 1994

Dollars in millions		
Assistance category	Disbursements	Major distribution channels
Infrastructure and technical assistance projects total	\$27.8^a (65 percent)	USAID grantees (i.e., PVOs, NGOs, other federal agencies, World Bank, U.N. Relief and Works Agency) and for-profit contractors
Budget support		
Holst Fund	10.0	USAID grant to the World Bank
Police recurrent costs	5.0	USAID grant to the PLO ^b
Transitional projects		
NGO financing	0.2	USAID grant to the Palestinian Housing Council
Total	\$15.2 (35 percent)	
Total	\$43.0	

Note: We used fiscal year data since USAID officials could not provide us with detailed expenditure data for calendar year 1994. The calendar year data used earlier in this report was based on a global estimate by USAID officials that the United States spent a total of \$51 million in calendar year 1994 on budget support and project assistance.

^aFigure includes an estimated \$3.3 million in political risk insurance issued by the Overseas Private Investment Corporation. It also includes \$3.2 million in other agency funding attributed to U.S. assistance efforts.

^bGrant awarded prior to the U.N. Relief and Works Agency's involvement in disbursing and monitoring police salaries. Grant was made to the PLO for the benefit of the Palestinian Authority.

Controls Over Budget Support Funds

As indicated in table 2, U.S. assistance funds were distributed through bilateral aid recipients, the United Nations, World Bank, and other U.S. agencies. Most U.S. assistance funds could not be directly accessed by Palestinian Authority or PECDAR officials. Two major exceptions were in the budget support category. First, the United States provided a \$10-million grant to the World Bank's Holst Fund to help cover the Palestinian Authority's start-up and short-term operating expenses. Second, the United States provided a \$5-million grant to the PLO on behalf of the Palestinian Authority to cover police salaries. In each case, Palestinian Authority, PECDAR, or PLO officials did have direct access to these funds through special accounts set up by the World Bank and USAID. However, in each instance, extensive controls were established to oversee disbursed funds.

World Bank Controls

The World Bank implemented several controls over the use of Holst Fund donations. First, the Bank established a grant agreement with PEC DAR stipulating certain categories of eligible expenditures and expectations regarding funds accountability and oversight procedures. Second, Holst Fund accounts accessible to Palestinian Authority and PEC DAR officials were capped to make the level of monthly expenditures consistent with the Palestinian Authority's budget needs. Third, the firm of Touche, Ross, Saba & Co., was hired to act as the Bank's auditor in the field. According to a senior World Bank official, the firm reviewed 10 percent of salary payments and 25 percent of all other payments to ensure that expenses were properly documented and that funds were only used for approved purposes. In addition, Touche Ross individually examined all contracts valued in excess of \$25,000. The same official noted that the auditors also performed spot checks of individuals receiving salary checks and goods or services received.³ Fourth, the Bank only released additional funds to the Holst Fund accounts after the auditors approved the replenishment requests filed by the Palestinian Authority and PEC DAR. According to a senior World Bank official, this process had accounted for all Holst Fund disbursements through June 1995.⁴

USAID Controls

The U.S. contribution of \$5 million toward police salaries was made directly to the PLO on behalf of the Palestinian Authority because the disbursement system managed by the U.N. Relief and Works Agency was not in place when these funds were made available. The United States did, however, contract with the Egyptian audit firm of Farid S. Mansour & Co., to monitor the disbursement of these funds. The auditor reported that the \$5 million was appropriately disbursed and used only for the intended purposes. The United States does not plan to provide any further funding for police salaries.

³Both USAID and the World Bank indicated that they intend to review Touche Ross' compliance with its contract terms. The USAID Inspector General plans to review the auditor's oversight activities in connection with a broad review of World Bank financial controls related to the disbursement of U.S. assistance. USAID is currently seeking approval for this audit. Per its grant agreement with USAID, the World Bank must arrange for an external audit of the records and accounts maintained by Touche Ross with respect to approved expenditures. A Bank official stated that this audit is tentatively planned for early 1996.

⁴The Holst Fund did encounter certain problems in early 1995 that appear to have been satisfactorily resolved. These problems related to the use of bank overdrafts by the Palestinian Authority to help cover operating expenses that exceeded the monthly funding levels provided by the Holst Fund. This led to a commingling of donor and Palestinian Authority funds. To resolve this situation, the Bank closed the Palestinian Authority's accounts in June 1995 after receiving certified replenishment requests that met or exceeded the total amount advanced into each account. New accounts were subsequently opened that explicitly forbid the use of overdrafts and the commingling of funds.

Controls Over Project Funds

As noted in table 2, USAID funds for infrastructure and technical assistance projects were disbursed through four main vehicles: (1) direct contracts with for-profit organizations, (2) grants and cooperative agreements with PVOS and NGOs, (3) grant agreements with the World Bank and United Nations, and (4) USAID project funds provided to other U.S. government agencies. In all these instances, Palestinian Authority, PECDAR, and PLO officials did not have direct access to U.S. assistance funds.

As a standard practice, USAID dispenses funds through contracts, grants, cooperative agreements, or memorandums of understanding. These documents stipulate the funded amount; the purpose and scope of the funded activity; procedures for requesting and receiving incremental funding; and provisions relating to project oversight, funds accountability, and audit requirements.⁵ These standard oversight mechanisms also apply to grants to international organizations such as the World Bank and the United Nations, although the active involvement of USAID project and grant officers is reduced since each of these organizations has its own field staff and project monitoring structure. In the case of agreements between USAID and another U.S. agency, the receiving agency is responsible for the use, management, and audit of transferred funds.

As a general rule, USAID grantees and contractors are paid after the cognizant project officer has reviewed the recipient's monthly or quarterly expenditure claim.⁶ Although these expenditure vouchers show only line-item totals, project officers must certify that the claimed amounts look reasonable based on project reports and their on-site visits.

USAID contractors are audited by the U.S. government agency that has the most business with that contractor. The three types of audits commonly performed on all USAID-funded contracts are annual audits of the contractor's overhead rate, contract-specific audits on an as-needed-basis, and close-out audits for contracts valued in excess of \$500,000.

⁵Project oversight is mainly provided by a cognizant USAID project officer who is responsible for all programmatic aspects of the project and a USAID grant officer who is responsible for monitoring pre-award activities and post-award financial data. Project officer duties include reviewing periodic financial and progress reports from the aid recipient as well as conducting site visits to confirm that funded activities are performing as expected. USAID has offices in Tel Aviv and Jerusalem to monitor project activities in the area. USAID grant officers are stationed in Amman, Jordan.

⁶The U.S. contribution to the World Bank's Holst Fund was an exception to this rule since the funded amount was disbursed in two lump sums of \$5 million. This was done because the Holst Fund was established to serve as a repository for donor contributions that could not be earmarked for specific project activities.

Nonprofit organizations receiving U.S. funding are also periodically audited under the Office of Management and Budget's A-133 audit process. International organizations use their own audit procedures and provide copies of final audit reports to cognizant USAID officials. A-133 audits include a review of the recipient's internal controls and a sample of contracts and line-item expenses. A-133 and direct contract audits are performed either by Inspector General staff from the cognizant audit agency or by approved U.S. or foreign audit firms with a review by Inspector General staff. In addition to the A-133 and contract audit, the Inspector General periodically performs program audits that supplement the standard audits performed for individual recipients of U.S. assistance.⁷

Agency Comments

USAID officials provided us with oral comments on a draft of this report. These officials agreed with the report's presentation, but they did note a limited number of technical points, which they believed needed to be corrected or clarified. We incorporated these technical changes where appropriate.

Scope and Methodology

To obtain information for this report, we met with officials at the State Department and USAID to discuss their analyses of the same letters you sent us. We also met with USAID officials to discuss the types of controls in place to ensure that U.S. assistance funds were used only for their intended purposes. We obtained copies of a number of contracts, grants, cooperative agreements, and memorandums of understanding to see whether standard financial controls were incorporated into these documents.

We did not review USAID project records and field activities to determine whether described controls were effectively implemented. However, we did ask USAID officials to provide data on the implementation of oversight controls for 10 projects funded by USAID in the West Bank and Gaza in 1994. Citing end-of-fiscal year work demands and the absence of key staff, USAID indicated that it could not provide us with the requested data in a timely manner. In commenting on a draft of this report, USAID officials indicated that had they been given additional time, they could have

⁷For example, the USAID Inspector General recently issued a report on whether (1) USAID's offices in the West Bank and Gaza are capable of monitoring USAID's programs in the area and (2) PVOs receiving U.S. assistance have the capability to implement USAID programs. On the whole, the Inspector General's report concluded that adequate capabilities exist in each case. USAID staff also indicated that the Regional Inspector General in Cairo plans to examine the controls the Palestinian Authority has put in place and its ability to ensure accountability of funds it receives and manages.

responded to our data request. Based on discussions with the Senate Committee on Foreign Relations staff, we intend to follow up with USAID officials to obtain this data. We will report the results of this effort in a separate report.

We met with World Bank officials to review the financial controls used to ensure that donor funds provided to the Palestinian Authority and PECDAR were appropriately used. Planned audits by the World Bank and USAID's Inspector General should document whether the Bank's auditors properly implemented applicable control procedures.

We did not review the financial controls used by the U.N. Relief and Works Agency to monitor the disbursement of donor support for police salaries. We also did not review the controls developed by other nations to account for the use of their project funds.

We conducted our review from July through August 1995 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Administrator, U.S. Agency for International Development; the Director, Office of Management and Budget; and other interested congressional committees and members. Copies will also be made available to others upon request.

This report was prepared under the direction of Benjamin F. Nelson, Director, International Relations and Trade Issues. Other major contributors to this report were Diana Glod, Assistant Director and Michael ten Kate, Evaluator-in-Charge. Please contact Ms. Glod at (202) 647-1588 if you or your staff have any questions about this report.



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