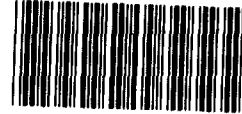


GAO

Testimony



140977

For Release  
on Delivery  
Expected at  
10:00 a.m. EST  
Thursday  
March 29, 1990

Accountability and Control Over  
Foreign Assistance

Statement of  
Frank C. Conahan, Assistant Comptroller General  
National Security & International Affairs  
Division

Before the Committee on Appropriations  
Subcommittee on Foreign Operations, Export  
Financing, and Related Programs

House of Representatives



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to provide GAO's perspective on the potential for misuse of foreign economic and military aid funds. I will discuss the Agency for International Development's (AID's) accountability and control over cash transfers, its control over local currencies generated from U.S. assistance, and its management of overseas contracting and procurement systems. I will also talk about AID's malaria vaccine program, which provides a good case study of the abuses that can occur when controls are weak. Our discussions of military aid will focus on grant aid accountability, control over technology transfers, accounting systems for military aid, and the difficulties encountered in auditing covert aid. I will also discuss special program accountability issues identified in our reviews of fuel transfers to El Salvador, military aid to the Philippines, and humanitarian assistance to the Nicaraguan Democratic Resistance, or Contras.

#### SUMMARY OF FINDINGS

In looking at AID over the years, our reviews have identified a number of management and internal control problems. In some cases, such as with Economic Support Fund (ESF) cash transfer policy, improvements have been made in accountability based on legislative requirements for the maintenance of separate accounts for U.S. dollars. However, questions of accountability and control remain

because AID's current policy for ESF cash transfers does not contain agencywide standards for verification and audit of dollar accounts.

Our reviews of Commodity Import Program (CIP) and Public Law 480 food assistance programs showed that AID could not determine whether local currency generated from the assistance was deposited, or used as required. Serious accountability issues continue to confront AID in its monitoring of local currency use. These include the lack of audit coverage for local currency accounts, poor host country reporting on account activity, and lack of assessments of host country capability to manage the accounts. Also, there is debate between AID management and the AID Inspector General over the extent to which AID, or the host-government, should maintain accountability and control over local currencies.

Our reviews of AID's overseas contracting system have also identified significant management and control weaknesses. These include (1) the lack of accountability for certain property in the hands of contractors, (2) inadequate contract close-out procedures and final audit coverage, and (3) poor procurement planning by AID's overseas missions.

A good case study of what can happen when financial accountability and internal control systems are weak is AID's malaria vaccine research project. Our review of this project found that inadequate

project monitoring, lack of financial audit, and other management weaknesses directly contributed to the misuse and waste of economic assistance funds. The responsible AID project officer ultimately pled guilty to the acceptance of an illegal gratuity, and a principal university researcher was indicted for the theft of AID grant funds.

Certain problems, which increase the risk of misuse in many economic assistance programs, appear to be systemic in AID. We have found these to include limitations on AID's ability to monitor decentralized field operations, the lack of standard accountability requirements for the overseas missions, weaknesses in agency accounting and information systems, and limitations in audit coverage. AID recognizes that such problems can threaten the integrity of the program. As part of the Federal Manager's Financial Integrity Act process, AID has identified the following as material agency internal control weaknesses.

- A primary accounting system that has not been fully integrated with subsidiary and program systems.
- Inadequate audit coverage of overseas mission programs.
- Insufficient number of direct-hire staff.
- Inadequate assessments of host-country capability to manage AID-financed host country contracts.
- Inadequate procedures for tracking host country-owned local currency.

Our reviews of U.S. military aid have also identified a number of accountability and management problems, including

- limitations on U.S. monitoring of military grant aid,
- the unauthorized use of technology,
- inadequate accounting systems for management of military aid,  
and
- difficulties in auditing covert aid operations.

The case that probably best demonstrates management oversight, accountability, and control problems in military aid is the transfer of military fuels in El Salvador. We found that (1) grant aid-funded fuel supplied to the Salvadoran Air Force had been improperly transferred to air crews involved in a resupply operation supporting the Contras and (2) there were no U.S. controls over Salvadoran Air Force use of the proceeds generated from selling fuel back to the U.S. government and its contractors.

Our 1986 review of military aid to the Philippines concluded that U.S. aid was not always used or managed effectively to counter the communist insurgency in that country. We found several problems, including questionable military purchases by the Philippine military and lack of U.S. access to Philippine bases to monitor equipment use. A subsequent review indicated that some improvements had taken place.

We have also looked at the Department of State's management of humanitarian assistance for the Contras. We found that State's control procedures were insufficient to ensure that the funds were used as intended by law. Specifically, problems included State's inability to monitor and verify the validity of purchases made in the Central American region, and a limited ability to verify and monitor final delivery and use of items purchased under the program. Since 1988, AID assumed management of the Contra assistance program at the direction of the Congress.

I will now discuss these issues in more detail.

#### ECONOMIC ASSISTANCE

Our past and ongoing reviews of AID operations and programs have identified numerous control and management weaknesses. These weaknesses not only increase the vulnerability of AID to fraud, waste, and abuse, but also reduce the overall efficiency and effectiveness of assistance efforts. We found instances where AID could not determine if funds and commodities were used as intended. In other instances, we found that local currencies and commodities were misused.

#### Cash Transfers

Over the years, the United States has provided several billion dollars in ESF cash transfers as part of its assistance package.

Our reviews of ESF programs in the 1980s indicated that accountability for cash transfers was weak:

- U.S. dollars were often commingled with other host country revenues, making accounting for these funds difficult and, in some instances, impossible.
- Many missions relied on host countries to tell them how the money was used, instead of verifying actual use.
- Host-country reporting on fund use was frequently late, inaccurate, or nonexistent.

For example, our 1986 report on U.S. assistance to the Philippines concluded that the disposition or actual use of over \$200 million in cash transfers (provided as of February 1986) could not be determined. Special accounts were not required by AID, and ESF funds were commingled with other receipts in the Philippine Treasury. In a 1987 report on assistance to Liberia, we identified a variety of control weaknesses affecting the ESF program in the early and mid 1980s, including (1) the Liberian Government's failure to report its use of initial ESF grants, or to report within established time frames and (2) AID's failure to audit the ESF program, even though accountability problems were apparent.

Legislation in effect since February 1987 requires special accounts to help track the use of ESF cash transfers. Nonetheless, we found in a review subsequent to passage of the legislation that AID still could not always trace ESF funds to their end use. Although some

aid recipients we looked at (Egypt, Jamaica, and Senegal) initially deposited ESF grants into separate accounts as required, they later transferred the funds to commingled accounts before disbursing them. In some cases, however, commingling was difficult to avoid because dollars supported foreign exchange auctions or were provided to members of regional monetary unions. We also found that (1) AID's missions did not plan to systematically verify recipient reports on the use of cash transfers or audit the special accounts and (2) AID did not require separate accounts for certain types of ESF sector grants and project assistance because it did not define such assistance as cash transfers.

The most recent information available to us on the status of ESF dollar accounts is a June 1989 AID survey of its overseas missions. The AID survey developed information on both dollar and local currency accounts, including the number of such accounts, the amounts, and specific problems encountered by the missions in monitoring them. In response, the missions reported that dollar accounts had been established in commercial or federal reserve banks and that dollars were not being commingled. However, questions of accountability remain due to the lack of agencywide standards for verification and audit of dollar accounts. AID's policy on ESF cash transfers, which was established in October 1987, states that (1) assistance agreements should provide for appropriate audit, (2) recipients should periodically report on the disposition of funds, and (3) recipients should make available to



AID the records supporting their reports for 3 years after the final disbursement. AID's special account survey did not report on the extent dollar accounts have been audited.

Subsequent to AID's survey of its overseas missions, the fiscal year 1990 appropriations act for foreign operations required that separate accounts also be established by recipients of cash transfers provided as nonproject sector assistance. AID officials told us that they are now considering agencywide guidance to implement this account requirement, along with standards for verification and audit of all dollar accounts.

#### Local Currency Issues

As of June 1989, AID reported about 250 host country-owned local currency accounts with deposits exceeding \$1 billion. Local currency is often generated from commodity and food sales and, in some cases, recipients of cash transfers are required to deposit local currency into special accounts. Our reviews of CIP and Public Law 480 food assistance programs during the 1980s concluded that inadequate accounting, monitoring, and reporting systems have prevented AID from (1) verifying that required local currency deposits were actually made and (2) determining whether withdrawals and disbursements were made for agreed purposes. Misuse of both commodities and local currency has occurred.

For example, we reported in 1987 that both Public Law 480 title I rice and local currency generated from the rice sales were misused by the Liberian Government and its agents. A several million dollar shortfall in accounts resulted. In addition, we found that the government-owned bank that managed the local currency accounts made unauthorized withdrawals of approximately \$1.7 million from the fiscal year 1986 account. Our 1987 report on assistance to Indonesia also identified weaknesses in AID's accounting for the title I program. Although the problems were not nearly as serious as those in Liberia, AID did not require local currency funds to be deposited in a special account to avoid commingling, nor did it enforce Indonesian compliance with financial reporting requirements.

In 1988, we reported that the mission accounting and monitoring systems in Egypt and Pakistan--two of the largest commodity import programs--did not provide complete or accurate information on commodity imports. CIP transactions for one fiscal year were underreported by \$95 million in Egypt and about \$84 million in Pakistan. Without complete information on commodity transactions, AID could not identify all commodities for end use checks, or verify that required local currency deposits were made. AID monitoring of the local currency in those countries was not sufficient to provide reasonable assurance that funds were used for their intended purposes.

As previously mentioned, the June 1989 AID survey of the overseas missions provided more current information on local currency accounts. The survey indicated that significant accountability issues remain because (1) most local currency accounts had not been audited, (2) host country reporting on currency accounts was generally untimely or inaccurate, and (3) most of the missions had not assessed whether the host governments had adequate financial management systems to manage the accounts. AID missions cited the lack of staff as an obstacle in monitoring the accounts.

One issue currently being debated within AID concerns the degree of accountability and control that AID missions should exercise over local currency generated through our assistance programs. AID's management recognizes that it must have "reasonable assurance" that local currencies are used for appropriate development efforts, but it holds the host countries primarily accountable for providing adequate financial management controls because they own the funds. On the other hand, the AID Inspector General's position is that the agency must maintain control because local currency is generated from U.S. assistance. This issue has been debated for some time without being resolved, but AID officials said that they are considering several options for providing reasonable assurance that local currencies are being appropriately used. These options include (1) requiring formal and standard financial assessments of host country agencies responsible for local currency accounts and the organizations receiving the funds, (2) strengthening reporting

and verification procedures for local currencies held in special accounts, and (3) requiring audits of host country agencies managing the accounts and the organizations receiving the funds.

#### Contracting and Procurement Issues

A significant portion of the AID program is administered through two types of contracts: direct and host country. Direct contracts are negotiated and awarded by AID, while host country contracts are negotiated and awarded by host country officials. The value of active contracts financed by AID exceeded \$2 billion at the end of fiscal year 1989.

Our recently completed and ongoing reviews of AID's direct contracting system identified several internal control and management deficiencies. We found that AID does not exercise adequate accountability for project-funded nonexpendable property in the possession of contractors (for example, computer hardware and software, motor vehicles and office equipment). Also, AID was somewhat lax in ensuring that completed contracts received a final audit and were expeditiously closed out. Weak contracting and procurement management at the overseas missions, in our opinion, also contribute to internal control problems and reduced program efficiency. Potential problems identified during our ongoing review include (1) inadequate procurement planning by the missions, (2) a lack of procurement training for mission staff, particularly project officers, and (3) concerns about the independence of

overseas contracting officers. Also, reliable information on AID-financed host country contracts is not available at either AID/Washington or at many of the AID missions.

#### The Malaria Vaccine Research Project

AID's malaria vaccine research project illustrates that U.S. programs can be subject to fraud and abuse when management, financial accountability, and internal controls are weak. AID has obligated over \$90 million since 1966 for malaria vaccine research and field trial activities. Our 1989 review of this project disclosed that the project generally lacked program and financial accountability. As a result, project funds were misused or wasted. A fundamental control weakness was the lack of supervision of the malaria vaccine research project officer. The project officer and the technical office responsible for the project had misrepresented the results of pre-award evaluations of at least three research proposals and based on these misrepresentations, the proposals were selected and fully funded despite negative pre-award evaluations. We also found that competition had been waived for 10 of 11 subprojects and the basis for waiving competition was questionable in all 10 instances. Waivers had been based, in part, on inaccurate documentation sent from the technical office responsible for the malaria vaccine research project to AID procurement officials.

In addition, AID did not ensure financial audit coverage of project expenditures. Audits performed prior to 1988 focused on indirect costs and overhead rates, and did not cover direct project expenses. Consequently, these audits identified few questionable costs and uncovered no major financial management weaknesses, misuse of funds, or indications of fraud. Ours was a management review, not a fraud investigation, but it is important to note that the AID project officer ultimately pled guilty to criminal charges, including acceptance of an illegal gratuity. Also,

- the principal researcher from the University of Hawaii was indicted for theft of AID funds;
- University of Illinois auditors were investigating claims that the university's principal researcher had diverted AID funds to personal use; and
- a contractor for the malaria vaccine research program has alleged that the principal researcher for a subproject at the National Institute of Health in Bogota, Colombia, defrauded the U.S. government by submitting false claims to the prime contractor.

#### MILITARY AID

Our reviews of U.S. military aid have identified several problems. Among these are a lack of accountability and control over aid transfers, ineffective management and use of U.S. aid by the recipient countries, and recipient transfers of items in violation of agreements governing the provision of U.S. aid and technology.

### Assistance without Accountability

From the 1950s through the early 1970s, the military aid program provided U.S. equipment and services on a grant basis for use by foreign recipients. Grant aid legislation provided that items supplied under the program were subject to U.S. monitoring and control. In the 1970s, the program evolved from a grant of U.S. property to primarily a sales program. The new sales legislation was silent on authorizing U.S. monitoring. In the early 1980s, grant aid was revived as a major component of U.S. security assistance. At the Administration's request, the Congress approved administering grant aid under the sales program legislation. As a result, there is no statutory provision specifically providing for U.S. monitoring of items provided as grant aid after delivery.

This lack of U.S. legislative authority to monitor grant aid can act as a constraint on U.S. accountability over foreign aid. For example, our 1989 report on the Philippines program noted that most U.S. military aid provided to the Philippines under current foreign aid legislation becomes the property of the Philippines. The Philippine military is not required to and does not report on the distribution of this aid. Additionally, U.S. government attempts to monitor usage are dependent upon the discretion of the Philippine military to allow U.S. officials access to Philippine bases and forces. Although the access situation has improved, U.S. access to these bases and forces is still limited.

The accountability and control problem associated with monitoring foreign aid use at the discretion of the recipient is compounded by the fact that what monitoring is done is not a primary function of U.S. officials in the foreign country. While the Department of Defense (DOD) still requires monitoring, this is a secondary function for these officials. We plan to conduct a worldwide review of accountability of U.S. military aid. Among the issues to be addressed are those of constraints on U.S. accountability of equipment funded on a grant basis, the impact of national sovereignty on controls, and the trade-offs between personnel levels and accountability. The Philippines will be one of the countries included in this review.

#### Technology Transfers

Technology transfers is another area of increasing concern because of the potential for misuse of the technology (including that funded by U.S. foreign aid), as well as the long-term negative impact on the U.S. industrial base of unauthorized production and sales of equipment of U.S. origin. For example, our 1988 report on Korea's coproduction of the M-16 rifle disclosed that (1) Korean M-16 rifles and parts production funded with U.S. military aid exceeded levels authorized in the production agreements and (2) Korea had entered into unauthorized sales agreements with third parties, including at least one confirmed sale. These problems



resulted, in part, from limited U.S. government monitoring and oversight of the program.

Our follow-up report in 1989 found similar problems. Specifically, the executive branch did not directly manage or monitor worldwide coproduction programs to ensure compliance with agreement restrictions on production quantities and third country sales. We found that unauthorized third country sales of coproduced equipment occurred in 5 of 18 major programs and in numerous minor programs. In those instances where the State Department took action regarding these violations, the typical response was a diplomatic protest.

We recommended that the Departments of State and Defense improve management controls over these transfers by adopting internal control procedures and increasing monitoring of compliance with the agreements that govern the transfers. To date, some of our recommendations have been implemented and others are in the process of being implemented.

#### Accounting System Problems

In addition to our reviews of the management of the provision of U.S. military aid, we have also reviewed the accounting system that supports these transfers. For over 10 years, GAO and DOD auditors have reported major accounting and internal control weaknesses that impair DOD's ability to properly manage the foreign military sales trust fund and to provide accurate statements to its

customers. Additionally, these problems recently resulted in the Office of Management and Budget placing foreign military sales on its list of "high risk" areas in the federal government.

We are involved in a multi-stage review of DOD efforts to address these long-standing accounting problems. Our January 1990 report concluded that DOD has implemented enhancements to the central accounting system that are intended to ensure that records are accurate and that discrepancies between disbursements and billing records are promptly identified and corrected. We also concurred with the decision to postpone implementation of a new trust fund account until it can perform its designated function. Subsequent reports will cover the development of a new accounting and billing system for foreign military sales.

#### Covert Programs Hamper Auditing Controls

We are all aware of the Iran-Contra scandal. Our 1987 report on DOD's arms transfers to the Central Intelligence Agency (CIA) disclosed that DOD bypassed its normal review and approval channels in managing the arms transfers, and it underpriced the arms by \$2.1 million. We recommended, in part, that DOD adjust its billing and obtain reimbursement. The CIA provided DOD with an additional payment of about \$300,000 as partial reimbursement for the undercharge. CIA officials stated that this was the remainder of the funds that it had received from the third party for the sale of the missiles. Thus, the U.S. government received \$1.8 million less

as a result of this sale than the actual value of the missiles. In addition to the CIA role in the sale of the missiles between two agencies, GAO wanted to review the CIA's role in the overall missile transfer. However, the CIA would not allow GAO to review its role in any aspect of the Iran-Contra transfers.

We have encountered similar problems and concerns regarding the provision of aid to the Afghan rebels. In 1987 and 1989, we were requested to review the provision of military aid to the Afghan rebels, including reports of diversions and misuse of the aid. In both cases, we were not able to perform our work because the CIA would not allow us to audit a covert program. However, we were allowed to review the AID-administered Afghan assistance program. Our work confirmed our concerns about control and accountability problems associated with Afghan-related programs. Other cases that demonstrate the problems in accountability and control of military and humanitarian aid follow.

#### Salvadoran Fuel Transfers

In a 1989 report, we reported on allegations that U.S. military grant aid-funded fuel supplied to the Salvadoran Air Force had been improperly transferred to air crews involved in a resupply operation supporting the Contras. The State Department had been asked previously to investigate this matter and concluded that no significant diversion had occurred. I would point out that we subsequently discovered that the State investigation was

fundamentally flawed. State did not question those persons with direct knowledge of the resupply operation about refueling activities.

Regarding the diversion question, we found that over \$100,000 in fuel transfers to the Contras and other third parties occurred in 1986 and 1988. These transfers violated agreements between the United States and El Salvador, stipulating that title or possession of U.S.-supplied defense items or services cannot be transferred without prior U.S. government consent. Following a lengthy review of our work, the executive branch acknowledged that the diversions took place and formally notified the Congress.

We also found that the Salvadoran Air Force sold almost \$1.5 million of fuel, provided on a grant basis under the U.S. military aid program, back to the U.S. government and its contractors. Sales of U.S. government-funded fuel trace back to 1985. Under the sales arrangement, the Salvadoran Air Force received local currency checks from the U.S. embassy in San Salvador for fuel transferred to U.S. military aircraft and dollar payments from contractor personnel for fuel transferred to aircraft performing work under U.S. government contracts. The use of the sales proceeds was at the discretion of the Salvadoran Air Force, with no U.S. government control or accountability over their expenditure.

Concerned about the propriety of direct payments and the lack of U.S. government control over these funds, DOD officials indicated procedures were established in April 1987 to credit U.S. fuel payments to a DOD account against future government-to-government transfers of military aid. In December 1988, we discovered that the credit system did not include the dollar payments from the contractor flights because U.S. officials had not been aware of these sales.

In June 1989 testimony on the fuel sales and the credit system, a DOD official stated, in part, that DOD had "taken appropriate steps to ensure . . . that payments received for authorized transfers are properly controlled and reutilized." Our subsequent check disclosed that this was not the case. We found that the fuel proceeds were placed in a Salvadoran account used for commercial purchases that is not reviewed or approved by the U.S. government, as the Congress and GAO had been led to believe. From April 1987 to September 1989, the Salvadoran military used the proceeds in the account to make over \$1 million in commercial purchases. Among the items funded from this account were a \$350,000 purchase of buildings in El Salvador, despite U.S. government concerns that the property was overvalued, and a car for the Salvadoran military attache in Washington. In addition, funds were planned for but not expended on two trips by the then Salvadoran Air Force commander. We are continuing to review the operation of this account.

I will make one final point about the fuels case. El Salvador is one of the four countries that have received fuel in recent years under the U.S. military aid program. The others are Honduras, Israel, and the Philippines. We have informally suggested to DOD officials that they review the provision of fuels to these countries to ensure that similar control and accountability problems have not occurred. While there was some agreement that this would be a prudent management practice, there has been little done to implement our suggestion. Management attentiveness of this nature could be a major factor in stopping the occurrence and continuation of problems with accountability and control.

#### Philippines Aid

In a 1986 report, we stated that U.S. military aid to the Philippines was not always managed or used effectively to counter the communist insurgency. Specifically, we found controversial Philippine military purchases, including one that was being investigated for fraud by the Justice Department, poor procurement planning, problems in the selection, retention, and utilization of U.S.-trained Philippine military personnel, and limited U.S. access to Philippine military installations in order to monitor how equipment was used. We noted that the United States had taken steps to reverse a general attitude that U.S. military aid was Philippine government money to be spent as it wanted, regardless of whether it addressed the primary threat.

In a 1989 follow-up report, we found that various improvements had taken place to ensure that U.S. aid was better directed toward countering the internal insurgency. Specifically, the Philippine military had improved its planning, procurement, and training. However, while U.S. officials had greater access to various Philippine bases, they were generally unable to visit the bases and operations of front line units actively engaged in the counterinsurgency program. As such, questions remain as to whether adequate control and accountability is being exercised regarding the eventual distribution of U.S. military aid.

#### Contra Aid

In 1985, the Congress authorized \$27 million in humanitarian assistance for the Contras. A key provision of the law required the President to establish appropriate procedures to ensure that program funds were not used for other than humanitarian purposes.

We reported in 1986 that the State Department's control procedures were insufficient to ensure that the funds were used as intended by law. The State Department could not establish management controls outside the United States because certain Central American governments were unwilling to allow it to establish offices in their countries. While the State Department exercised a considerable level of control over items purchased in the United States, it could not verify the validity of purchases made in the region (64 percent of the program). State was also limited in

verifying the final delivery and use of the items purchased under the program. State subsequently discovered that some payments were based on false receipts, or were for munitions, which were prohibited under the program.

About \$6 million in payments for items purchased in the region were made to U.S. bank accounts of agents acting on behalf of the suppliers. State officials took the position that such payments completed the transaction between State and the suppliers, and that it had no authority to trace funds further. We disagreed with this position, since a key requirement of the authorizing legislation was the maintenance of appropriate controls to prevent misuse of the funds. Our examination of the bank account records raised several questions about the disposition of funds in the accounts. For example, we were able to trace only a small amount of the funds to specific regional suppliers, and large payments were made to the armed forces of one country.

Since 1988, when AID assumed management of the Contra assistance program at the direction of the Congress, we have observed a considerable improvement in the management of the program's operation. However, our report on the second phase of assistance pointed out that AID's medical contractor did not have a reliable system for estimating requirements for medical supplies and medicines. During the third phase, the contractor hired a subcontractor, at AID's request, to assist in developing usage



rates and to handle medical procurement. We are presently reviewing these activities.

Based on a 2-year investigation by the AID Inspector General, the Justice Department has recently charged the deputy director of the AID task force in Honduras with accepting bribes from the subcontractor. The Inspector General's staff is continuing its investigation, and we are working closely with them.

Mr. Chairman, this concludes my remarks. I am available to answer any questions that you or the Subcommittee may have.