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OFFICE OF THE ASSISTANT DIRECTOR/CONTROLLER
UNITED STATES OPERATIONS MISSION TO KOREA
AGENCY FOR INTERNATIONAL DEVELOPMENT

REPORT OF AUDIT

EXPENDITURES AND ACCOMPLISHMENTS

ROK ECONOMIC DEVELOPMENT BUDGET SUPPORT

(PROJECT NO. 489-15-750-588)

For the Period from January 1, 1965 to September 30, 1966

REPORT NO. 67-22

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BACKGROUND INFORMATION

The Economic Development Special Account (EDSA) was established in 1963 to assist the Republic of Korea Government (ROKG) in carrying out its long-range development program. The EDSA is funded by contributions from the U.S. -- ROKG jointly controlled Counterpart Special Account and from ROKG general funds allocated from national revenues. Counterpart funds for EDSA are periodically released by the USOM to the ROKG Ministry of Finance (MOF) in accordance with annually negotiated project agreements to support ROKG economic development budget expenses and projects, including capital investment in ROKG-controlled banks, industries, and corporations.

The following summarizes (in billions of won) funds provided from ROKG general funds and counterpart for the fiscal years indicated:

<u>Fiscal Year</u>	<u>ROKG</u>		<u>Counterpart</u>		<u>Total Amount</u>
	<u>Amount</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>	
1963	₩ 7.8	56	₩ 6.1	44	₩13.9
1964	4.0	35	7.5	65	11.5
1965	8.8	51	8.6	49	17.4
1966	<u>18.9</u>	75	<u>6.4</u>	25	<u>25.3</u>
Total	<u>₩39.5</u>	<u>58</u>	<u>₩28.6</u>	<u>42</u>	<u>₩68.1</u>

EDSA procedures require that EDSA expenditure reports be submitted to the USOM by ROK governmental agencies through MOF in accordance with MOF-issued instructions. During the past four years, the USOM Controller's Office has conducted a series of audits focusing primarily on the reports submitted by the MOF covering expenditures made from the EDSA. Our examinations disclosed that many governmental agencies are having difficulty in following instructions and accomplishing the reporting objectives, even though assistance is being given by MOF-designated financial advisors in each province. During 1966, the USOM engaged Dr. Ralph J. Winston, a Certified Public Accountant and Professor, St. Louis University, as an accounting consultant to conduct a three-months' study of ROKG accounting for EDSA funds and to propose improvements in accounting controls, practices, forms, and reporting.

Dr. R. J. Winston arrived on June 17, 1966, and reviewed the procedures used by the ROKG in recording EDSA fund transactions at ministry, provincial government, and gun levels. Based upon information gathered in the field study and from an analysis thereof, a comprehensive report, "Accounting Procedures for the EDSA", was prepared describing the existing system and a proposed system, together with a suggested manual of instructions for the EDSA.

The completed report in both the English and Korean languages was distributed to MOF and other government entities. MOF-USOM sponsored orientation seminars were held for accounting personnel from the various ministries, provinces, and individual agencies. This proposed system provides for a current status report on each project (fund sources, expenditures, budget and cash balances). We believe that the proposed system if adopted and properly implemented, will eliminate many of the deficiencies noted in our previous and current examinations.

SCOPE OF AUDIT

This examination was performed to determine the reliability, accuracy, and timeliness of the monthly reports submitted by the MOF covering expenditures made from the EDSA for the ROK Government's FY 1965 (January 1 - December 31, 1965) and for the first nine months of FY 1966 (January 1 - September 30, 1966). Another primary purpose of our review was to determine if those expenditures made by the various levels of the Korean government were necessary, proper and in conformance with the intent of the EDSA subsidy. Our review further included a confirmation of the 1965 obligations approved for carryover into 1966 and carryover expenditures of the 1964 budget were examined on a selective test basis. This audit was made intermittently between March and June 1966, with follow-up in November 1966, subsequent to Dr. R. J. Winston's departure.

SUMMARY OF MAJOR FINDINGS

Our examination of the expenditure reporting revealed no serious discrepancies, however, we noted that deficiencies still remained in certain areas with respect to expenditure reporting, record keeping, the timeliness of monthly reports at the lower government reporting levels, and the propriety of certain expenditures. Adoption and proper implementation of the accounting and reporting system devised by Dr. Winston should substantially eliminate these problems.

Our review disclosed that a total of ₩535 million of the ₩1,256 million capital subscription of EDSA funds to the Korean Reconstruction Bank was not used by the Bank in accordance with the intent of the EDSA grant for industrial loans or as an investment in stocks. This amount was loaned to two firms (Dong Nip Industrial Company and Puksam Chemical Company), which had been confiscated by the ROKG for non-payment of fines for unreasonable profits under the ROKG illicit fortune laws. EDSA funds were loaned to the two companies for the express purpose of liquidating debts owed to the ROKG, and were not intended for use in the operations of the two companies. In view of the above, we are submitting to the ROKG a Bill for Collection for ₩262,150,000 representing the counterpart portion (49 percent) of the ₩535 million misapplied.

Our examination also indicated that some local government agencies still failed to maintain separate accounts for the EDSA funds as required by the ROK subsidy control law. This matter is again being called to the attention of appropriate ROKG officials for corrective action.

Details of the above and our recommendations for corrective action appear in the body of this report.

A copy of the draft audit report, was submitted to AD/P and PEFD, which have concurred in the findings and recommendations.

ACTION ON PRIOR AUDIT REPORT RECOMMENDATIONS

Our prior audit report (No. 66--6, dated October 29, 1965) covered a review of EDSA expenditures and accomplishments for the ROK FY 1964 and contained nine recommendations addressed to the Economic Planning Board (EPB) for ROKG action. Recommendation Nos. 1, 2a, 3, 4, 8, and 9 were cleared on the basis that satisfactory action had been taken. As of the close of the current examination, EPB's reports on the action taken to implement the remaining recommendations (Nos. 2b, 5, 6, and 7) had not been fully responsive; however, in view of the time which has elapsed since our last report was issued and the fact that EPB has been made aware of the deficiencies, and has, in part, taken action thereon, we are closing the remaining four recommendations in our prior audit report.

DETAILED FINDINGS AND RECOMMENDATIONS

Funding

Counterpart contributions to EDSA for 1965 totaled W8,634 million, and ROKG contributions totaled W8,793 million. CY 1965 EDSA funding (in millions of won) contributions by Project Sector was as follows:

<u>Project Sector</u>	<u>Expenditures Budget</u>	<u>Carryover From CY 1964</u>	<u>Total</u>
Agriculture & Forestry	W 5,757	W 20	W 5,777
Fisheries	1,089	75	1,164
Mining	334	1	335
Manufacturing	3,339	52	3,391
Electric Power	481	74	555
Railway Construction	447	-	447
Highway & Bridge	789	2	791
Port & Harbor	1,115	68	1,183
Marine Transportation and Aviation	179	-	179
Scientific & Technical Development	448	5	453
Other Services	<u>3,029</u>	<u>155</u>	<u>3,184</u>
Total	<u>W17,007</u>	<u>W452</u>	W17,459
Less: Misc. Revenues			<u>(32)</u>
Total CY 1965			<u>W17,427</u>

The CY 1966 EDSA funds (in millions of won) released and reported expenditures by ROKG Ministry/Board as of September 30, 1966, were as follows:

<u>Ministry/Board</u>	<u>CY 1966 Expenditures Budget</u>	<u>As of Sept. 30, 1966 Funds Released</u>	<u>Reported Expenditures</u>
Economic Planning Board	116	116	109
Finance	5,309	4,053	4,053
Education	3,663	2,327	1,931
Agriculture and Forestry	4,562	3,508	2,939
Commerce and Industry	1,327	710	690
National Construction	7,372	5,003	4,684
Health & Social Affairs	1,207	609	414
Transportation	272	186	156
Atomic Energy	79	79	78
Rural Development	757	565	471
Fisheries Affairs	<u>673</u>	<u>457</u>	<u>351</u>
Totals CY 1966	<u>W25,337</u>	<u>W17,613</u>	<u>W15,876</u>

Expenditure Reports Verification

MOF prepares monthly consolidated EDSA expenditure reports based on individual reports of expenditures submitted by the various ministries. The reports at the ministerial level are prepared from reports submitted by individual agencies and provincial governments, which in turn are based upon the expenditure reports submitted by gun offices. For our examination of expenditure reports, we selected two representative monthly (November and December 1965) consolidated reports for the period from January 1965 through February 1966. Our audit included a review, on a selective test basis, of the reports maintained at five ROKG ministries, four provincial headquarters offices, and two special cities offices. In general, the reporting continued to show improvement over prior periods; however, we found a repetition of the same types of errors noted in our prior examinations. Overall, the expenditure reports at the ministry level indicated a definite improvement since our prior examination. We found (18) instances, however, at provincial and gun level, in which expenditures were reported for which there were no supporting documents. We also found that lower reporting-level agencies failed to submit expenditure reports to higher levels on a timely and factual basis.

Our audit also disclosed (seven) instances in which EDSA fund expenditures for projects under the Ministry of Agriculture and Forestry (MAF) were duplicated in reporting by the provincial government offices.

In our opinion, the above deficiencies could be corrected by applying Dr. Winston's recommended "Accounting Procedures for the EDSA", issued by the Office of the Assistant Director/Controller, USOM/Korea, in September 1966, however, as of February 7, 1967, those changes, which are required in the ROKG laws before Dr. Winston's proposals can be put into effect, have not yet been promulgated. We are therefore, including herein the following recommendation.

RECOMMENDATION NO. 1

EPB should exert the utmost effort to implement the accounting procedures manual for the EDSA as soon as possible.

Expenditure Verification

Our review included verification of EDSA reported expenditures, on a selective test basis, of subsidiary organizations of the Ministry of Finance, the Ministry of Education, the Ministry of National Construction, the Ministry of Agriculture and Forestry, and the Ministry of Health and Social Affairs. This review was spread over a wide geographic area, and included examinations at five Provincial Headquarters (Kyonggi-do, Kyongsang-Pukto, Kyongsang-Namdo, Cholla-Pukto and Cholla-Namdo), two Special Cities (Seoul and Pusan), two regional construction bureaus (Young-Nam and Ulsan), and the Korean Reconstruction Bank. Physical inspections at 101 sites of 15 projects were made to verify that EDSA funds spent had resulted in those economic improvements anticipated. In total we examined paid vouchers and loan disbursements amounting to ₩1,677 million

(approximately 9.6%) of the ₩17,427 million reported expenditures for ROK FY 1965; and ₩104 million (approximately .7%) of the ₩15,877 million expended as of September 30, 1966, for FY 1966 funds.

Our comments cover two general areas, namely (1) the additional capital investment of the ROKG in KRB, and (2) budget subsidies to various levels of the ROKG for other types of economic development projects, as follows:

(1) ROKG Investment in Capital Stock of KRB

EDSA funds in the amount of ₩300 million were originally authorized to be granted to the Korean Reconstruction Bank (KRB), as part of the Capital Subscription to be paid by the ROKG into the KRB, to provide KRB with additional funds for industrial loans and investments in stocks. Effective with the third supplemental budgetary change to EDSA, this amount was increased to ₩1,256 million, all of which was disbursed to KRB. Our review of KRB records pertaining to this Capital Subscription disclosed that ₩300 million was loaned to the Dong Nip Industrial Company (Dong Nip), ₩256 million loaned to the Puksam Chemical Company (Puksam), and ₩700 million was commingled with other KRB funds to make a total of ₩8,800 million, which was loaned to approximately 200 companies as general industrial loans.

During 1960, the Dong Nip complex was confiscated by the ROKG in lieu of payment of illicit fortune fines owed by the owner of Dong Nip to the ROKG because of "unreasonable" profits earned by Dong Nip. The balance of these fines owed to the ROKG totaled ₩300,462,193 as of March 27, 1965. KRB informed us that, acting upon a proposal made by the Ministry of Finance and approved at ROKG Cabinet level, ₩300 million of EDSA funds were used on March 27, 1965 to make a loan of ₩300,462,193 to Dong Nip, which on the same date used the entire amount of the loan to pay the balance due to the ROKG. This loan to Dong Nip was added to the balance Dong Nip already owed to KRB from previous loans on which principal and interest due totaled ₩666,830,857 as of March 27, 1965. We were informed that interest on the previous loans had not been collected from Dong Nip for several years. As a condition of this latest loan, Dong Nip agreed that additional funds to complete its plant and to install equipment would not be borrowed from any Korean bank, and further that products which would ultimately be produced would be exported. We were informed during June 1966 by company officials that Dong Nip was negotiating for an \$11 million loan from the Pillsbury Company of the U. S. for funds to complete the plant and put the existing equipment into operating condition.

From the documents we saw at KRB, we determined that the loan made to Puksam was similar to the one made to Dong Nip. Of the total ₩256 million KRB loan to Puksam, ₩235 million was used to pay the ROKG for the balance due on illicit fortune fines, ₩10 million for repairing existing equipment, and ₩11 million for working capital to obtain raw materials.

Since the entire amount of the loan to Dong Nip and the major portion of the loan to Puksam merely changed hands from the ROKG to KRB to the ROKG, it is apparent that the funds were not used in accordance with the intent of the EDSA

grant for industrial loans or as an investment in stocks. We are therefore submitting concurrently with the issuance of this report a Bill of Collection for the portion of the EDSA funds improperly used which were generated from counterpart (49 percent of ₩535 million or ₩262,150,000).

(2) Other Economic Development Projects

We concluded that, in general, EDSA funds had been properly utilized on the various other economic development projects, but we noted several deviations as detailed below.

1. The provincial government of Kyongsang-Pukto reported EDSA expenditures for administrative expenses and travel expenses totaling ₩300,888 (\$1,115 equivalent) for various sub-projects under the (MAF) Creation of Land Foundation project. Our examination disclosed that these payments should have been funded solely from the ROK general budget and not from EDSA funds.

2. The provincial government of Kyongsang-Pukto also reported for an erosion control project expenditures for travel expenses, totaling ₩98,869 (\$365), paid to persons who had no direct connection with the project. Although we were unable to examine the pertinent supporting documents due to a movement of offices, the expenditure ledger indicated that payments were made to office secretaries and other administrative-type individuals.

3. According to final expenditure reports submitted by the Jinan Irrigation Association, Cholla-Pukdo, all of the ₩6,871,000 received under the FY 1965 EDSA subsidy for its irrigation project had been expended. Our examination disclosed, however, that the amount of ₩52,685 (\$195) had not been expended as of the authorized disbursement cut-off date of February 28, 1966. This balance (₩52,685) was expended for the project on May 6, 1966, without proper approval by the responsible ministry for obligated carryover.

Since the amounts involved in the above are relatively minor, no recommendation for corrective action is made herein; however, we call these discrepancies to the attention of EPB so that action may be taken to prevent recurrences of a similar nature.

Planning and Construction

We inspected 22 projects supported by EDSA funds to ascertain project progress and accomplishments. Our examination disclosed that, for the most part, project implementation was satisfactory with the exceptions described below.

Our examination at the Kwangju Technical High School (Cholla-Namdo), a vocational education project, disclosed evidence of lack of supervision of construction work on the experimental workshop concrete floor, which was cracked and of poor quality. Two of three rooms constructed with EDSA FY 1965 funds for a school mining experimental workshop were not utilized for the originally intended purpose but had been used as recreation and drafting rooms.

We also noted that the Mokpo City Education Office, Cholla-Namdo, had not maintained a project progress diary or other records to indicate the extent of supervision of construction work in progress, and had not undertaken inspections to ascertain if the material was used in accordance with the construction design and specifications. The preparation of a project progress diary is required by the National Construction Operation Manual.

At the Chonju Primary School, Cholla-Pukdo, we found that the actual construction work was started prior to the award of the public bid for the work. The construction diary maintained by the school indicated that construction started on October 1, 1965, when 300 bags of cement and six truck loads of sand were brought to the project site; two general laborers and two of the contractor's representatives were also employed. The public bid was, however, not awarded until October 4, 1965.

In view of the foregoing, we are recommending that EPB take appropriate action to prevent similar deficiencies in the future.

RECOMMENDATION NO. 2

EPB should instruct the Ministry of Education to take appropriate action to assure that construction projects are properly planned, supervised and implemented.

Obligated Carryover

The obligated carryover from FY 1964 into FY 1965 totaled ₩206,925,200 for ten projects under four ministries, of which ₩205,225,200 was released by the Bank of Korea (BOK). Expenditures reported for FY 1965 amounted to ₩201,771,802, and the unused cash balance of ₩2,453,398 was properly refunded to the BOK. The obligated carryover from FY 1965 to FY 1966 amounted to ₩451,827,664 for eighteen projects. Our review at the respective ministries concerned indicated that these carryovers had been properly approved by EPB.

Establishment of Separate EDSA Accounts

The ROK Subsidy Control Law (No. 1431) requires the ROKG and its agencies to install, as of January 1, 1964, and to maintain thereafter, separate accounts for EDSA funds released to local autonomous bodies. Our examination disclosed that the following local government organizations had failed to comply with this legal requirement:

<u>Organizations</u>	<u>Projects</u>
Jinhae City Office	Creation of Land Foundation
Ulsan Land Improvement Cooperative	Creation of Land Foundation

Organizations

Projects

Kyongnam Branch Office of the Daehan Forestry Cooperative Federation	Forestry Development
Daenan Forestry Cooperative Federation	Forestry Development
Wolsung Gun Office	Forestry Development Highway Project Sericultural Project Creation of Land Foundation
Chilkok Land Improvement Cooperative	Creation of Land Foundation
Kwangsan Gun Office	Creation of Land Foundation Sericultural Project Forestry Development
Naju Gun Office	Agricultural Material Creation of Land Foundation Sericultural Project
Wonju Gun Office	Forestry Development
Yengchun Gun Education Office	Compulsory Education
Board of Education, Seoul City	Vocational Education
Wanju Gun Office	Compulsory Education
Taegu, Tong-Ku Public Health Office	Family Planning Project
Taegu, Su-Ku Public Health Office	Family Planning Project
Jinju City Office	Urban Public Works
Muan Gun Office	Agricultural Material Creation of Land Foundation Forestry Development
Federation of Land Improvement Cooperative	Creation of Land Foundation
Kiho Land Improvement Cooperative	Creation of Land Foundation
Hankang Land Improvement Cooperative	Creation of Land Foundation
Koyang Land Improvement Cooperative	Creation of Land Foundation
Inchon City Education Office	Compulsory Education

RECOMMENDATION NO. 3

EPB should instruct the above organizations to comply with the ROK law relating to the maintenance of separate accounts for EDSA funds received.

Publicity

Our prior audit report No. 66-6 dated April 14, 1965 indicated that the U.S./ROK sign was not displayed at the various projects and we recommended that EPB take appropriate corrective action. EPB's letter reply dated May 18, 1966 stated that Ministers and Provincial Governors had been notified to display permanent and prominent signs. We found during the course of our current review that no action has as yet been taken at the project sites.

RECOMMENDATION NO. 4

EPB should take the necessary follow-up action to insure that the U.S./ROK sign is displayed in a location readily visible to the public at all EDSA project sites.

Distribution of Report

	<u>No. of Copies</u>
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EPB	<i>NONE</i> <i>5</i>
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