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UNITED STATES GOVERNMENT **FD-AAB-488-A1**

Memorandum

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TO : Mr. John R. Breen, Director
Central America (ARA-LA/CEN)

DATE: JAN 31 1972

FROM : R.L. Shearer, AAG/LA (N) *R. Shearer*

SUBJECT: Transmittal of Report of Audit No. 1-596-72-57, Management and Utilization of AID Loans by The Central American Bank for Economic Integration through the Regional Office for Central America and Panama (ROCAP)

In accordance with M.O. 798.2, we are transmitting one (1) copy of the subject Audit Report. We have made separate distribution to ROCAP/Guatemala.

The Audit Report contains nineteen (19) recommendations for ROCAP/Guatemala and requires no action by AID/W.

Enclosure: a/s

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AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

OFFICE OF THE AUDITOR GENERAL
AREA AUDITOR GENERAL - LATIN AMERICA (NORTH)

REPORT OF AUDIT
MANAGEMENT AND UTILIZATION OF AID LOANS
BY
THE CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION
THROUGH
AID REGIONAL OFFICE FOR CENTRAL AMERICA AND PANAMA
(ROCAP)

Audit Report No. i-596-72-57
January 13, 1972

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PART I

SCOPE OF AUDIT

The Area Auditor General-Latin America (North), under the authority of M.O. 203.5, performed an audit of the management and utilization of \$152 million of AID loans (Exhibit B) made available to the Central American Bank for Economic Integration (CABEI). The audit also included monitoring activities of the AID Regional Office for Central America and Panama (ROCAP), as they related to CABEI's management and utilization of loan funds. Our review covered the period from the establishment of CABEI on May 8, 1961 through October 31, 1971, with emphasis on current transactions. The audit was performed during the period August 16, 1971 to November 24, 1971. The Audit Exit Conference was deferred by the expiration of the AID Continuing Resolution during 1971. An Exit Conference was held with the Director, ROCAP and his staff on January 13, 1972. They concurred with the contents of the report and, as appropriate, their comments have been incorporated into the report.

The primary objectives of the audit were to evaluate the organization and management of CABEI's operations; the effectiveness and efficiency with which CABEI and its sub-borrowers have utilized loan funds to achieve the purposes for which the loans were made; and the actions taken by ROCAP to monitor CABEI's management and utilization of loan funds.

Audit work was performed at ROCAP in Guatemala City, Guatemala, CABEI Headquarters in Tegucigalpa, Honduras and at CABEI's four field offices of which one each is located in Guatemala City, San Jose (Costa Rica), San Salvador (El Salvador), and Managua (Nicaragua). The audit also included a review of 77 sub-loans made by CABEI, of which 39 visits were made to sub-borrowers and project sites located in each of the five Central American Common Market (CACM) countries. The audit included a review of the organization and policies established by CABEI and ROCAP; AID capital assistance papers, loan agreements and implementation letters; and records, reports and correspondence at CABEI, ROCAP and CABEI's sub-borrowers. Our audit was made in accordance with generally accepted auditing standards. Detailed examination of individual

transactions was limited to the extent necessary to determine the effectiveness of operations and internal controls.

The audit did not attempt to verify the accuracy of annual financial statements, as Price Waterhouse and Company performs annual financial audits at CABEI. Price Waterhouse has given an unqualified opinion on CABEI's financial statements since 1967. Therefore, we limited our verification of financial records to specific purposes for analysis only.

The audit was to include an evaluation of the coordination of planning for economic assistance to each of the CACM countries, within AID on a bilateral and regional basis, and between AID and multilateral agencies. However, this area was subsequently included as part of a comprehensive study to be performed by the Office of Program and Policy Coordination, AID/W. As a result we have deferred our audit coverage in this area.

PART II

BACKGROUND INFORMATION

The concept of a Central American Common Market (CACM) was first proposed in 1948 by a group of Latin American economists. The 1950's marked a series of steps taken by the five Central American countries; Guatemala, Honduras, Nicaragua, El Salvador and Costa Rica to fulfill these objectives. It was not until December 13, 1960, that the General Treaty of Central American Economic Integration (General Treaty) was signed by four of the five countries. The fifth country (Costa Rica) signed the General Treaty in July 1962. Concurrently with the signing of the General Treaty, the Central American countries approved a project to create the Central American Bank for Economic Integration (CABEI). CABEI was established on May 8, 1961.

CABEI is a Regional Development Bank, for the CACM countries, which operates in accordance with a Constitutive Agreement and Bylaws. Its principal office is in Tegucigalpa, Honduras and it has branch offices in each of the other CACM countries. CABEI's organization consists of a Board of Governors, a Board of Directors, a President, five staff offices, and seven operating departments (see Exhibit A). Initiating its operations with a staff of 20 employees, CABEI's staff had grown to 205 employees, as of June 30, 1971.

CABEI's objectives are two-fold: (i) to promote balanced economic development within each CACM country and (ii) to promote Central American economic integration. These objectives are being fulfilled through financing regional projects geared to the economic infrastructure, balance of payments, and urban development requirements of each country. CABEI processes loans through three funds, which are discussed in detail in subsequent sections of this report: (i) the Ordinary Fund which is used to finance industrial projects and projects related to exports and balance of payments, (ii) the Integration Fund which is used to finance economic infrastructure projects, and (iii) the Housing Fund which is used to create and sustain a regional secondary mortgage market for medium priced houses.

The AID, through its Regional Office for Central America and Panama, (ROCAP), has actively supported both the CACM as a concept and CABEI as an institution. On June 22, 1961, AID made available to CABEI \$2.0 million in the form of a grant to assist CABEI to begin operations. The funds were to be used to finance organizational costs of CABEI, loans by CABEI and costs of feasibility surveys.

To further enhance the thrust on regionalization and the CACM concept, AID established ROCAP in August 1962, under the Alliance for Progress, with offices in Guatemala City, Guatemala. Since 1962, AID has made direct loans to CABEI totalling \$142.5 million, a \$10 million loan under the Housing Investment Guaranty Program and has provided the Bank with the technical assistance required to establish a viable organization. Since 1963, the Inter-American Development Bank (IDB) has been the second largest source of financing to CABEI. IDB has made loans totalling \$61.3 million.

Beginning in 1966, CABEI's source of financing has expanded and it has loans or lines of credit from ten different countries. As of June 30, 1971, available resources to CABEI from subscribed capital stock from CACM countries, accumulated net earnings, and external resources (loans, lines of credit, etc.) totalled \$328.5 million. The status of these funds is shown on Exhibit B.

PART III

SUMMARY

CABEI has established itself, within a relatively short period of time, as a well-known and highly regarded regional development banking institution. As of June 30, 1971, it had assets of \$149.7 million and cumulative net earnings totalled \$9.0 million, of which \$2.8 million were earned in fiscal years 1970-71. External credit resources available to CABEI totalled about \$278.4 million at June 30, 1971, and CABEI's own resources totalled about \$50.1 million, for a potential capitalization of \$328.5 million.

① CABEI has made a substantial contribution to the economic development of the Central American Common Market (CACM) countries. It has financed 48 percent of the total investment of on-going regional infrastructure projects in such countries. In addition, CABEI has established in the CACM countries the concept of a secondary mortgage market for home loan financing, and through these efforts, established twenty-seven operative mortgage institutions. The most recent data indicates that CABEI's contribution to the industrial sector was about equal to all five public development banks in the CACM countries. Interregional trade increased tenfold during the ten years following CABEI's organization. While many factors influenced this expansion, such as relaxation of tariff barriers between the CACM countries, it seems obvious that the trade expansion was possible only through substantial inputs of capital for industrial expansion. ||

CABEI is in the process of making certain organizational and procedural changes to increase the efficiency of its operations. A study of the Financial Loan Administration Office is currently being conducted by Price Waterhouse and Company. The primary purpose is to increase the effectiveness of resource utilization through better coordination and communication. Realignment and reorganization of the staff functions will be initiated in the near future to accommodate the anticipated growth of CABEI.

② || Concurrently with our review of CABEI's operations, we observed the assistance role of ROCAP in relation to

CABEI's growth and accomplishments. Early recognition by ROCAP of certain operational and organization problems within CABEI, had resulted in effective corrective action which increased the efficiency of operations. One of the more important achievements was the recognition and correction of shortcomings in the CABEI accounting system.

In addition, ROCAP's liaison with CABEI has been effective, as evidenced by the successful initiation of a current loan package by CABEI which entails a \$30.0 million loan from AID to generate an additional \$70.0 million investment from the public and private sectors ~~(p.15)~~.

3 // We have concluded that CABEI is achieving the objectives for which it was organized and that it is a viable and effective force in the accomplishment of economic integration in Central America. In addition, ROCAP has and still continues to make a significant contribution, through CABEI, to the development and growth of the economies of the CACM countries. // However, as might be anticipated in a rapidly growing institution, opportunities exist to improve procedures and controls in certain management areas. In Section V. of this report, we have identified the cause, extent and effect of these problems and have presented suggestions for improvements which should assist management in assuring more effective and efficient utilization of resources. These conditions are summarized in the following paragraphs. //

ORGANIZATION AND ADMINISTRATION

CABEI was not preparing a short-term cash forecast to identify the amount of cash required to meet future disbursements. As a result, CABEI may have an excessive amount of cash on hand in relation to its short-term disbursement requirements for sub-loan commitments. It is also doubtful if funds on hand totalling \$16.5 million, have been invested to assure maximum return to CABEI. In addition, the absence of short-term cash forecasts may have resulted in CABEI requesting and AID disbursing loan funds in excess of current requirements (P.16).

THE HOUSING FUND

Available information indicates that the Housing Investment Guaranty Program (HIG) will not, for the

immediate future, meet CABEI's needs for the secondary mortgage market in Central America. The absence of flexibility in drawing down HIG loan funds, a shortage of eligible mortgages, and interest rates do not seem adaptable to present mortgage financing activities in Central America. As a result, CABEI has been unable to disburse loan funds on a timely basis and has been required to change its criteria for the types of mortgages that are eligible under the HIG program. ROCAP should explore the possibility of obtaining an AID direct loan, with concessionary terms, to continue CABEI's participation in the secondary mortgage market (P.27).

CABEI needs to develop an aggressive promotional program to stimulate interest in the mortgage and housing construction sectors to facilitate the implementation of the Housing Fund. At the time of our audit, limited promotional efforts were being exerted by the Home Loan Department. The need for additional emphasis on promotion activities is emphasized by the slow implementation of the program (P.31).

The cash balance of the Housing Fund indicated that funds remained idle for long periods of time before they were used to purchase eligible mortgages, or placed in short-term investments. During our test period, March 1, 1971 to May 31, 1971, we noted that an average of \$3.4 million was in the form of cash, earning no interest. Some of these funds were received under the HIG Loan to meet the mandatory draw-down dates of the loan. Funds were not used as rapidly as desired because eligible mortgages were not available for purchase, and, due to lack of coordination within CABEI, funds had not been placed in income-producing investments. In this regard, CABEI has engaged Price Waterhouse and Company to perform a comprehensive review of the financial activities of the various operating departments (P.34).

Although the mortgage institutions were current in their payments to CABEI, the delinquency rate of mortgages purchased by CABEI is high in several instances; up to 30 percent for one group of mortgages, and for other groups, the rate ranged from 9 to 20 percent. In addition, there are indications that mortgages retained by the mortgage institutions have high delinquency rates. Continued high rates of delinquency could, in time, impair the creditability of the mortgage institutions and jeopardize the collateral held by CABEI. We believe CABEI needs to:

(i) intensify its efforts with mortgage institutions in reducing delinquencies; (ii) notify mortgage institutions with high delinquency rates that continuation of this condition could result in disqualification for future financing; and, (iii) request a report of each mortgage institution's overall delinquency rate as a means of detecting potential problems (P.36).

CABEI is not adequately monitoring the housing construction program. As a result, it was not fully assured that the construction of housing for which eligible mortgages had been or will be purchased meet established mortgage requirements. As of September 15, 1971, CABEI had available approximately \$8.0 million of HIG loan funds and \$2.4 million of roll-over funds to purchase eligible mortgages. The efficient utilization of these funds requires that CABEI establish effective monitoring procedures for the housing construction program (P.38).

THE ORDINARY FUND

Disbursement of funds has been slower than anticipated due to delays by sub-borrowers in drawing down loan funds. This has delayed the timely completion of economic development projects financed by the Fund and has deferred the benefits to be realized from these projects. CABEI needs to improve its follow-up procedures and establish monthly progress reporting to assure timely draw-down of funds by sub-borrowers (P.44).

Delinquency rates of sub-loans have reached a level that warrant special attention by CABEI. As of June 30, 1971, 36 percent by number, and 7.5 percent by amount of all sub-borrowers whose loans were subject to amortization were delinquent in payments totaling \$3.0 million. We noted several reasons for this condition: sub-borrowers deviating from approved financial plans, lack of positive follow-up action by CABEI, absence of penalty clauses in loan contracts, and a reluctance on the part of CABEI to exercise its rights upon default by the sub-borrower (P.46).

The overall time-frame of nearly one year to process sub-loans is excessive and needs to be reduced to assure that projects are initiated on a timely basis. Although some processing procedures used by CABEI can be improved, the extended delays are primarily caused by the sub-borrowers.

Much of the excess time seems to be incurred in determining eligibility and fulfilling the pre-contract requirements. We believe simplified qualification procedures and improvements in pre-contract requirements would help to reduce the existing time to process sub-loans, and would facilitate the timely initiation of projects (P.49).

CABEI did not have statistical information to provide an accurate picture of the economic impact of the projects financed by the Fund. If CABEI is to effectively measure the accomplishments of the Fund, it needs to establish procedures to provide for the accumulation of statistical data to permit such evaluation (P.52).

CABEI is currently using multiple interest rates and amortization periods for its sub-loans to sub-borrowers. A given sub-loan may include up to five different interest rates and several amortization periods and, as a result, the accounting for sub-loans could become difficult to control. To assure that the interest rates and amortization periods provide for the optimum growth of CABEI and the CACM countries, and to facilitate the accounting thereof, we believe that CABEI should obtain the services of an appropriate expert to review the interest rate structure and amortization of sub-loans (P.54).

THE INTEGRATION FUND

The goals of the Integration Fund may not be achieved unless timely action is taken by the CACM countries to develop firm plans for implementation of future infrastructure projects to be financed through CABEI. The CACM countries have agreed to implement the regional infrastructure program in two phases. However, as of November 15, 1971, the CACM countries had not agreed on which projects would be included in the second phase. A loss of momentum has occurred in the integration movement due to economic and political differences among the CACM countries. As a result, there has been a diminished interest in planning and carrying out the second phase of the infrastructure projects. If this condition continues, CABEI will be prevented from planning, developing and arranging for funding to finance future infrastructure projects. CABEI is aware of the urgency for developing future planning

and it is taking an active role in trying to generate action on the part of CACM countries. In this regard, CACM country officials, CABEI and representatives from international lending institutions are meeting in March 1972 to begin work on a plan for phase two (P. 64).

We observed that Costa Rica and Honduras did not have adequate highway maintenance programs due to inadequate budgetary support, inadequate supply systems and insufficient quantities of maintenance equipment. Unless this condition is corrected, it will ultimately have adverse effects on highways financed through CABEI (P.66). Also, we noted that only one CACM country, Nicaragua, had a vehicle weight control system (P. 68). In addition, regional minimum design standards for highway construction projects had not been adopted by the CACM countries. As a result, highways in different countries will have different load-bearing capacities, and some highways will deteriorate at a much faster pace, especially those where lower design standards have been followed (P. 69). These factors, if not corrected, will shorten the life-expectancy and increase the maintenance cost of highway systems.

The processing time required to review and approve sub-loan applications and related sub-loan contracts for highway construction projects needs to be reduced. We observed instances where the elapsed time from the date of a sub-loan application to signing of the sub-loan contract ranged from 7 to 56 months. In addition, construction progress of some projects has been slow. In many instances no funds had been disbursed or construction started, although the sub-loan contracts had been signed for at least a year. These conditions exist primarily because of administrative and technical problems within the governments of the CACM countries. However, CABEI was aware of these problems and was taking action where possible (P. 70).

The bonding market is not adequately developed in Central America. Consequently, some Central American construction firms are unable to obtain performance and payment bonds on an equitable basis with U.S. firms, due to high cost and unrealistic collateral requirements. Because of difficulties in obtaining required bonding coverage, Central American construction firms have not

been active in bidding on CABEI financed infrastructure projects. The implication is strong that the reduced interest of Central American contractors may result in higher cost of construction through lack of competition. We believe that CABEI needs to consider the establishment of a guaranty fund to underwrite the bonding coverage of Central American firms, on a basis equitable with U.S. firms, to encourage the development of the Central America construction industry and to promote more competition in contract procurement (P. 73).

Professional services and construction contracts awarded by sub-borrowers do not include clauses for a standard set of cost principles, recovery of excessive cost due to defective cost or pricing data, and for an audit of modifications to a fixed price contract over a stated amount. In the absence of such contract provisions, the possibility of recovering excessive costs is reduced (P.75). In addition, there is a need for sub-borrowers to improve the cost and price analysis performed on contractor proposals for construction and professional service contracts. Available information indicates that these analyses were not performed because the sub-borrowers did not have the expertise to perform this type of evaluation. Without such an evaluation, there is no assurance that a fair and reasonable cost is being obtained for contracted services (P.76).

PART IV

FOLLOW-UP ON PRIOR REPORTS OF AUDIT

The Office of the Area Controller, Guatemala City, had issued the following audit reports on AID loans to CABEI:

67-19-R10	dated 6/30/67	Loan 596-L-001
67-18-R9	dated 5/ 3/67	Loan 596-L-002
67-10-R3	dated 4/12/57	Loan 596-L-003
67-11-R4	dated 4/10/67	Loan 596-L-004
67-44-R10	dated 6/12/69	Loan 596-L-006
69-50-R12	dated 6/30/69	Loan 596-L-007
67-17-R8	dated 6/23/67	Unnumbered Grant
68-30-R5	dated 3/29/68	Procedural Survey and Systems

Recommendations contained in above audit reports had all been cleared by ROCAP at the time of our audit in August 1971.

PART V

STATEMENTS OF CONDITION AND RECOMMENDATIONS

A. ORGANIZATION AND ADMINISTRATION OF CABEI

1. Background

Our audit included a review of the functions performed by the various offices within CABEI. Exhibit A of this report sets forth CABEI's organizational chart. In the interest of brevity, we are including in this section only a brief description of the primary executive offices of CABEI.

The primary governing body of CABEI is the Board of Governors in whom all powers of the bank are vested. The Board of Governors consists of ten members, five of which are the Ministers of Economy of the five member countries, and five are presidents or general managers of the Central Banks of each country.

The Board of Directors is the highest executive and administrative authority of the bank. It is responsible for conducting the operations of the bank and for this purpose, may exercise all the powers delegated by the Board of Governors. The Board of Directors consists of five members, one from each member country, and are elected for a term of five years. The Directors work on a full-time basis.

The Presidencia consists of the President who is the legal representative of the bank and the Executive Vice-President who performs as the General Manager. Attached to the Presidencia is the office of Public Relations, the Secretary, the Office of Business Administration, and the Legal Office.

The Office of Financial Management (OFM) is the financial and fiscal branch of CABEI. Under the OFM are the Treasury Department, Financial Loan Administration Department, Program and Planning Department and the Accounting Department. The OFM supervises all activities related to the administration of resources, treasury operations and maintenance of accounting records.

2. Achievements

a. CABEI

CABEI has established a sound organizational structure, including Branch Offices in the Central American Common Market (CACM) countries. The division of workload and internal controls are adequate. The qualifications and experience of key personnel appear to be excellent and the efforts of the President and Executive Vice-President have substantially facilitated the acceleration of the Bank's operations in recent years.

(14) In most areas, CABEI's promotion and planning have provided a reasonable balance of economic assistance to each of the CACM countries, and it has identified priority areas to receive financial assistance. The significance of this achievement can be illustrated by the planning and implementation of a \$100 million combination funding program to promote tourism, intermediate credit institutions and export of non-traditional products within the CACM countries. To assist in the carrying out of this program, CABEI has also added an Agriculture Department to provide technical assistance and lending services to the public sector through development banks and direct loans to governments.

CABEI has established a good accounting system and is exercising adequate controls over the disbursement of funds. Price Waterhouse and Company has issued an unqualified opinion on CABEI's balance sheets and statements of income and expenses since 1967.

(5) It is the policy of CABEI to distribute the employment of senior and junior executives on a regional basis. CABEI has established an excellent Personnel Management Program which provides its employees with on-the-job and formal training, adequate job descriptions, a merit promotional system, and fringe benefits including medical and life insurance, retirement and disability benefits. The staffing pattern of CABEI is controlled by position authorization. As of June 30, 1971, 229 positions were authorized of which 205 were filled. The employee turn-

4 over rate during the past five years was approximately eight percent; a remarkably low rate for the type and size of CABEI's operations. \

b. ROCAP

The association between ROCAP and CABEI covers a period of approximately 10 years. During this period ROCAP has provided CABEI with assistance in designing and implementing all phases of its operation. At the time of our audit, ROCAP considered CABEI to be a viable organization, capable of managing its own affairs, and was limiting its direct involvement to problem areas and new services offered by the Bank.

Early recognition by ROCAP of certain internal and organizational problems within CABEI has resulted in effective corrective action and increased efficiency of the bank. One of the more important achievements was the recognition of deficiencies in the CABEI accounting system. Through ROCAP efforts, Price Waterhouse and Company was contracted by CABEI to set up an adequate system of accounting. Following the installation of that system in 1966, Price Waterhouse and Company was able to give an unqualified opinion on the CABEI financial statements.

6 \ One of the basic needs in the economic development of the CACM countries, was a comprehensive study and identification, by priority, of the regional transportation facilities required in Central America. With the assistance of ROCAP, a study was undertaken, resulting in the "Central American Transportation Study (CATS-1965)" which is still a primary source of information for infrastructure planning in Central America. \

7 " Trip reports by ROCAP personnel indicated liaison with CABEI staff has been good and monitoring of on-going projects adequately covered by both on-site visits as well as CABEI prepared progress reports. \ However, we did observe certain areas in which additional ROCAP assistance was required. These problem areas are set forth in the following sections of this report.

3. Cash Forecast

a. Statement of Condition

CABEI may have an excessive amount of funds on hand in relation to short term requirements for operations and lending activities. Since there has not been a short-term cash forecast prepared since 1969, there is a reasonable doubt whether funds are being effectively invested to insure maximum return to CABEI as well as optimum utilization for the intended purposes. Because of the absence of a short-term cash forecast to identify and budget the medium and short-term cash requirements, CABEI is not receiving the maximum income from short-term investment of funds and AID may have disbursed loan funds to CABEI in excess of actual requirements.

As of June 30, 1971, CABEI had recovered from sub-borrowers \$29.1 million in principal repayments. CABEI had utilized some of these funds for principal amortizations, interest payments and for additional sub-loans. However, as of June 30, 1971, CABEI had \$9.9 million of roll-over funds on hand in cash and short-term investments. In addition to the roll-over funds on hand, CABEI also had funds totalling \$6.7 million which were received under direct loans, CACM contributions, operating profits, etc. (Other Funds). The status of these funds as of June 30, 1971, is set forth in the following schedule:

	(\$000)			
	<u>Roll-Over</u>	<u>Other Funds</u>	<u>Total</u>	<u>Percent</u>
Cash in Banks	\$1,579	\$ 7	\$ 1,586	9.6
Investments	<u>8,335</u>	<u>6,623</u>	<u>14,958</u>	<u>90.4</u>
TOTAL	<u>\$9,914</u>	<u>\$6,630</u>	<u>\$16,544</u>	<u>100</u>

At the time of our audit, CABEI was not preparing a short-term cash forecast. As a result, CABEI did not have sufficient data to identify the amount and the appropriate time periods for investments to insure the desired degree of liquidity and, at the same time obtain maximum

return from investment. Our analysis of CABEI's investment portfolio is set forth in the following schedule. It should be noted that \$10.1 million (68%) of investments do not exceed 120 days; 57 percent of CABEI's investment portfolio is yielding a maximum of six percent interest rate; 33 percent is yielding a maximum of eight percent interest; and only a minimal (10%) is yielding an interest rate of nine percent or higher.

Summary of Investments - All Funds
As of June 30, 1971
Interest Ranges and Amounts (\$000)

<u>Investment Term</u>	<u>4 3/4-6%</u>	<u>6 1/8-8%</u>	<u>9 - 12%</u>	<u>Total</u>	<u>Percent</u>
Less than 30 days	\$ 301	\$ 615		\$ 916	6
31 - 60 days	1,207	1,434		2,641	18
61 - 120 days	5,636	780	\$ 106	6,522	44
121 - 180 days	329	735		1,064	7
181 + Over	<u>1,044</u>	<u>1,490</u>	<u>1,281</u>	<u>3,815</u>	<u>25</u>
TOTAL	<u>\$ 8,517</u>	<u>\$ 5,054</u>	<u>\$1,387</u>	<u>\$14,958</u>	
Percent	<u>57</u>	<u>33</u>	<u>10</u>	<u>100</u>	<u>100</u>

In addition to the above conditions, CABEI requested that AID authorize a \$1.5 million revolving fund under Loan No. 596-L-010. The purpose of the revolving fund is to provide available funds, under Loan No. 010, for disbursements to sub-borrowers, rather than initially use CABEI funds and subsequently be reimbursed by AID under this Loan. The revolving fund was established on September 10, 1971.

Of the total available cash and/or investments (\$16.6 million) as of June 30, 1971, \$4.9 million had been invested in time deposits for periods exceeding 120 days. In addition, as previously discussed, CABEI had not developed a short-term cash forecast setting forth the funds that will be disbursed in the immediate future. Considering these conditions, there does not appear to be adequate justification or need for the advance of AID funds. However, the withdrawal of such funds at this time could delay the implementation of Loan No. 010 as this action

would require additional negotiations with CABEI. Accordingly, we have framed our recommendation to permit the utilization of AID funds for the present, with a suggestion that action be taken by ROCAP to substitute CABEI funds for AID funds in the Revolving Fund, at the earliest possible date.

b. Recommendation No. 1

ROCAP should:

(a) Request CABEI to establish procedures for preparing short-term cash forecasts and provide assistance as required.

(b) Request CABEI to utilize the data in short-term cash forecasts to evaluate its present investment portfolio, and to determine the amount of cash that should be maintained in banks.

(c) Negotiate with CABEI, at the earliest possible date, to substitute CABEI funds for AID funds to finance the operations of the Revolving Fund under Loan No. 010.

4. Internal Audit

a. Statement of Condition

CABEI should orient its internal audit function to performing management type audits and should provide additional auditor personnel to effectively implement this program. At the time of our review, CABEI's Audit Office was limiting its audit coverage primarily to the fiscal and accounting verification of assets and liabilities. As a result, CABEI was not receiving internal audit coverage of the type required by a large Development Bank.

While we are not minimizing the importance of financial type audits, we believe that management oriented audits will contribute significantly to the efficiency of CABEI management. This type of audit approach would have identified many of the problem areas set forth in this audit report.

Available information at the time of our review, indicated that the Audit Office did not have a sufficient auditor staff to perform its financially oriented audits. Obviously, the addition of a management oriented audit approach will require additional auditor personnel.

b. Recommendation No. 2

ROCAP should encourage CABEI to institute a management oriented audit concept in its Audit Office and provide the additional auditor personnel required to implement this audit program.

5. Agriculture Department

a. Statement of Condition

The Agriculture Department is the most recent addition to the operating departments of CABEI, having been organized in May 1971. The Department is set up to provide technical assistance and lending services to the public sector through development banks and direct loans to government agencies. The general objective of the Agriculture Department is to contribute to the creation of more adequate conditions for development of the agricultural sector in CACM countries. These actions contemplate the formation of infrastructure for the production and marketing of products, increase the agricultural capacity, establish government support services and promote organizations of medium and small producers.

AID, under Loan No. 596-L-010, (See Part V, paragraph C, Ordinary Fund), will provide approximately \$20 million for export promotion with emphasis on agro-industry. One loan of \$1.4 million has been made to INFONAC of Nicaragua for the production of tobacco, however, this was financed out of CABEI resources. Financing activities will cover the acquisition of fixed assets, the cost of pre-investment studies, working capital, the cost of establishing support services such as investigation, promotion, project start-up cost and technical assistance. Re-lending activities through the development banks will be to the private sector, chiefly to provide services such as cold storage warehousing, refrigerated transportation services, portside warehousing, etc. The Agriculture Department is not involved in agro-industry financing, as this area will continue to be handled under the Industrial Department.

The program outlined for the Agriculture Department of CABEI is sufficiently broad in scope to possibly duplicate or overlap areas presently covered by member-country USAIDs and International Lending Institutions. The general objectives such as upgrading agricultural capacity, establishment of government support services, and the promotion of organizations of medium and small producers are substantially the same as the USAIDs. The

successful implementation of the program will require adequate coordination with USAIDs and other financial institutions providing economic assistance to the CACM countries.

Our concern at this time is cautionary, as the program at CABEI is too recent of establishment to make a judgement of the direction it will take. As a result, we are not including a recommendation in this area.

B. HOUSING FUND

1. Background

In response to proposals by representatives of mortgage associations in Central America, CABEI in 1963 undertook a study to determine the feasibility of creating a secondary housing mortgage market for the Central America Common Market (CACM) countries. As a result of this study, CABEI and ROCAP concluded that there was a need for a secondary home mortgage financing program, as a part of regional integration. Available information indicated that the growth of the mortgage market had been limited due to the unavailability of capital for primary mortgage financing. The primary mortgage market was restricted to banks with small mortgage departments, limited participation by insurance companies, savings and loan associations which required 40-50% savings before eligibility, and national housing institutes financing primarily low-income housing.

AID, in November 1963, made a \$10 million loan (No. 596-L-003) to CABEI for initiation of a secondary mortgage market in the CACM. This loan was for 40 years with a grace period of ten years, at an interest rate of $3/4$ of 1 percent. In April 1964, CABEI established a Home Loan Department to implement this program.

Disbursement of loan funds by CABEI was slow due to the absence of eligible mortgages and eligible financing institutions. As a result of these conditions: (i) CABEI was authorized to engage in direct lending for housing construction rather than the purchase of existing mortgages and (ii) through CABEI/ROCAP efforts, ineligible institutions were able to meet the qualifications of the Loan Agreement by establishing mortgage loan departments and adopting procedures that made their operations compatible with the purpose of the loan. The loan was substantially disbursed during 1967 and 1968, with the final disbursement occurring February 11, 1969.

To continue the program, AID proposed and CABEI accepted, a Housing Investment Guaranty (HIG) Loan (No. 596-HG-001) of \$10 million. The loan, which was signed on March 25, 1970, is repayable in 88 installments, commencing March 31,

1973, with an interest rate of 8-1/8 percent. Additional costs consist of \$100,000 service fee paid to the U.S. Investors (Federal Home Loan Bank of Boston and Federal Home Loan Bank of New York). CABEI also pays to AID a guaranty fee of 1/2 of 1 percent of the outstanding balance. CABEI had received \$2,050,000 under this loan as of June 30, 1971.

As set forth in the following paragraphs, the MIG Loan differs substantially from the direct dollar loan made by AID to the Housing Fund.

a. Funds under the MIG are not provided by AID. AID negotiated with two financial investors in the U.S. to provide a \$10 million loan to CABEI's Housing Fund.

b. As an incentive to the U.S. investors to make these funds available, AID has provided a guaranty for repayment.

c. Prior to finalizing this loan, agreements were negotiated between AID, CABEI and the U.S. financial investors on the dates that CABEI would request draw-down of loan funds. The U.S. financial investors required the identification of these draw-down dates, in order that they could project their future funding requirements. Under the terms of the loan agreement the U.S. financial investors can unilaterally cancel the balance of the loan agreement, if CABEI does not comply with the agreed draw-down dates.

d. Prior to CABEI requesting a draw-down of loan funds, it must satisfy AID that it has completed negotiations with CACM mortgage institutions for the purchase of primary mortgages.

e. The terminal dates and dollar values of draw-downs under this loan are as follows:

September 15, 1970	\$ 300,000
March 31, 1971	700,000
March 31, 1972	4,000,000
March 31, 1973	<u>5,000,000</u>
	<u>\$10,000,000</u>

As of June 30, 1971, approximately \$21.9 million had been available to CABEI to finance its secondary mortgage program. The source and status of the funds are set forth in the following schedule:

(\$000)

<u>Source</u>	<u>Value of Mortgages on Hand</u>	<u>Funds Available</u>	<u>Total</u>
AID Loan			
No. 596-L-003	\$6,979	\$ 3,018 (a)	\$ 9,997
AID Loan			
No. 596-HG-001	1,305	8,695 (b)	10,000
Retained Earnings	<u>396</u>	<u>1,501</u>	<u>1,897</u>
	<u>\$8,680</u>	<u>\$13,214</u>	<u>\$21,894</u>

- (a) Includes repayment of \$2.4 million of sub-loans by borrowers.
- (b) Includes \$745,000 cash in bank, with \$7,950,000 available for future draw-downs from U.S. financing institutions.

2. Achievements

At the time of our audit, most of the achievements in the CABEI Home Loan Department had come about through the lending and mortgage purchase activities generated under AID Loan 596-L-003. For example, 27 financial institutions have been organized or reorganized as mortgage institutions to qualify for financing under Loan 596-L-003. In the majority of instances, previous mortgage activities were minimal or nonexistent, and the operations could scarcely be defined as those of a mortgage institution. Of these 27 institutions, 16 have been subsequently declared eligible under the Housing Guaranty Program.

8 (" For the first time in Central America, a secondary mortgage market exists to provide a continuing flow of capital for expansion of mortgage lending activities. Although progress to date has been less than desired, the slowly growing market for medium-priced housing gives promise of acceleration as the input of capital continues to increase." [As with similar long-term capital projects, the relending of funds has been slow in the early years. However, the program is stimulating the building industry to undertake larger projects in anticipation of an expanding mortgage market. A good example of this is in Honduras, where a \$2.6 million housing project is underway, utilizing private funding to generate mortgages to be purchased by CABEI.]

In seven years of operations, the Housing Fund has, principally through utilization of AID Loan 596-L-003, realized net earnings of \$1.9 million. Even recognizing the concessionary interest rate on funds loaned to CABEI, this gain is still impressive.

As of June 30, 1971, over 4,100 homes had been constructed, were under construction, or planned for construction, for a total value of \$35.8 million. It appears that the construction of medium-priced housing is in an expansionary phase that should begin to significantly influence the mortgage market in the immediate future. This should facilitate the disbursement of housing funds by CABEI.

We reviewed ten sub-loan files to evaluate their general content and compliance with good credit practices. The files were well organized, and in our judgement reflected careful analysis. We also reviewed the procedures used to execute a mortgage sales-purchase agreement and analyzed the elapsed time required. Although the elapsed time appears high, much of the excessive time was due to slow action by the mortgage institutions. At the time of our audit, CABEI was revising its procedures in order to expedite the processing of applications and commitment of funds.

9. Based on the data we have reviewed, ^Wwe conclude that a secondary mortgage market is a vital ingredient to increase housing construction in the CACM countries. It is also our conclusion that CABEI is a logical institution to implement this program. While the program is presently encountering certain problems, our on-site reviews at mortgage institutions utilizing CABEI financing, revealed a high degree of optimism for the secondary mortgage financing program. "

3. Utilization of Housing Investment Guaranty Loan Funds

a. Statement of Condition

Available information indicates that the Housing Investment Guaranty Program (HIG) will not, for the immediate future, meet the needs of the secondary mortgage market for the CACM countries. The primary causes of this condition are the absence of flexibility available to CABEI in requesting the receipt of loan funds, a shortage of eligible primary mortgages, and the interest rates required under HIG loans. As a result, CABEI has not disbursed HIG loan funds on a timely basis and has been required to change its criteria for the types of mortgages that are eligible for financing under this program.

As discussed in the background section, the HIG Loan requires CABEI to request draw-downs of loan funds on dates set forth in the HIG Loan Agreement, regardless of the availability of eligible mortgages. Eligible mortgages have been defined as those that meet prescribed dollar values and amortization periods, construction design and specifications standards, etc. At the time CABEI agreed to the dates for draw-down of loan funds, there was a limited number of eligible mortgages available for purchase. However, certain mortgage institutions forecast that they would have a sufficient number of eligible mortgages available for purchase by CABEI as of the dates of CABEI's first two draw-downs. The first two draw-downs under the HIG Loan (September 15, 1970 and March 31, 1971) provided CABEI with \$2,050,000. However, the mortgage institutions were unable to meet their prior commitments to provide the eligible primary mortgages for purchase by CABEI. Because of this condition, ROCAP waived its mortgage eligibility requirement to enable CABEI to use loan funds to purchase ineligible mortgages. A requirement was placed on the mortgage institutions to exchange ineligible mortgages with eligible mortgages within a 24 month period. While this action permitted CABEI to meet its target dates for the first two draw-downs, it only deferred the impact of the problem, as the mort-

gage institutions must now acquire a sufficient number of eligible mortgages to exchange for existing ineligible mortgages, plus the additional eligible mortgages to be financed in the future by CABEI under the HIG Loan.

Our discussions with CABEI officials disclosed that slow disbursements of funds will probably continue, because a sufficient number of eligible mortgages will not be available for purchase by the next draw-down date of March 31, 1972. As of September 15, 1971, there were \$300,000 of eligible mortgages endorsed to CABEI and approximately \$1.0 million were in the process of being endorsed. The March 31, 1972, draw-down is for \$4.0 million. However, CABEI estimates it will be about \$1.5 million short of eligible mortgages as of that date. Our discussions with officials at two mortgage institutions that had received previous loan funds disclosed that they were also concerned that eligible mortgages would not be generated fast enough to meet the draw-down deadline. Failure to accumulate sufficient eligible mortgages will presumably necessitate authorization by AID to again disburse funds to purchase ineligible mortgages (unless the investors extend the draw-down date). The purchase of ineligible mortgages will again compound the existing problem of mortgage institutions, as they must acquire a sufficient number of eligible mortgages for exchange of ineligible mortgages financed by CABEI under the first three draw-downs of loan funds.

The following paragraphs summarize some of the reasons why CABEI's program of utilizing HIG loan funds, for secondary mortgage financing, has not progressed as originally planned.

a. The construction of medium-priced housing has not reached the stage of expansion to respond effectively to the large input of the HIG Loan on a fixed time schedule for draw-downs.

b. The mortgage institutions' interest rate to the home owner, of 12 1/2 to 13 percent, has placed the institutions on the same level as the commercial

banks and, consequently, defeats one of the purposes in the creation of CABEI's Housing Fund, i.e. providing a lower interest rate. There is a reluctance on the part of mortgage institutions to make widespread utilization of the HIG loan funds due to the high interest cost.

c. The interest cost of the HIG Loan to CABEI is $8 \frac{5}{8}$ percent, (including the AID fee of $\frac{1}{2}$ percent) with an interest spread to CABEI of $\frac{5}{8}$ of 1 percent. This does not appear sufficient to cover the costs of operations, administration and credit risk to CABEI. Additionally, the loan requires payment of a credit fee, in the amount of \$100,000, to the U.S. Investors, or about two years income from full utilization of loan proceeds. There is also a possibility of losses through idle funds, as demonstrated in the first two draw-downs under the loan, in which interest expense on idle funds exceeded interest earned on these funds by \$40,000 because CABEI was unable to disburse funds on a timely basis. We were informed that this latter condition has been offset by a change in procedures for endorsement of mortgages and disbursement of funds. In the event that the mortgages are not endorsed at the time of the draw-down, a $9 \frac{1}{4}$ percent promissory note is signed by the mortgage institution, as collateral, in order that the disbursement of loan funds may be made immediately by CABEI. However, the problem will continue to exist with funds recovered from repayments if the funds are not immediately committed to new investments.

d. The interest rate ceiling of nine percent in El Salvador has prevented participation in any secondary mortgage financing through CABEI, because of CABEI's interest rate of $9 \frac{1}{4}$ percent.

We acknowledge that the use of the HIG Loan is more advantageous to the U.S. Government than the direct concessionary loan. We believe, however, that CABEI may be unable to effectively utilize the HIG Loan, in its present form, to accomplish its objectives of creating a secondary mortgage market. We have concluded, therefore, that a concessionary loan approach is still a primary need if CABEI is to continue its

efforts to develop a secondary mortgage market in the CACM countries. We base this conclusion on the need for a more lenient time schedule for disbursements of loan funds and the need for more concessionary interest rates to stimulate the mortgage program. As the mortgage market becomes self-generating, a gradual phase-in of the HIG program would be more practical.

b. Recommendation No. 3

ROCAP should:

(a) Continue to explore the possibility of obtaining direct loans, with concessionary interest rates, to provide capital to expand CABEI's secondary mortgage program for the CACM.

(b) Discuss with CABEI the advisability of deferring the use of additional HIG Loans, if direct loans with concessionary interest rates can be obtained.

(c) Discuss with CABEI the means by which the interest rates under HIG Loans can be reduced, if direct loans with concessionary interest rates cannot be obtained.

4. Promotion of a Regional Secondary Mortgage Market

a. Statement of Condition

CABEI has not developed an adequate promotional program to identify and stimulate the interest of mortgage institutions to participate in the Housing Fund. Part of the reluctance by CABEI to initiate this type of program has resulted from the increased interest rates necessitated by the HIG Loan, procedures utilized to commit funds to mortgage institutions, and funds tied to country utilization. As a result, CABEI has experienced difficulty in disbursing housing funds. For example, CABEI had \$2.4 million of roll-over funds available from loan No. 596-L-003 for an extended period of time. Approximately \$1.4 million of these funds were in short-term investments and \$1.0 million has been idle in banks earning no income.

To facilitate the implementation of the Housing Fund will require an aggressive promotional program to stimulate interest in the mortgage and construction sectors. At the time of our audit, the Promotional Department of CABEI was successfully promoting projects that were financed by the Ordinary Fund, however, it was not participating in the promotion of the Housing Fund. The limited promotional effort being exerted in this area was being performed by personnel of the Home Loan Department. The need for additional emphasis on promotion activities is emphasized by slow implementation of the program.

In 1970, CABEI increased the interest rate on roll-over funds (AID Loan 596-L-003) to 9 1/4 percent in order to maintain uniformity with Housing Guaranty loan funds. This practice, however, has impeded the use of roll-over funds because eligible mortgage institutions have been reluctant to borrow at the increased interest cost. Additionally, El Salvador and Guatemala presently have interest rate ceilings of 9 and 11 percent, respectively. Because of CABEI's interest rate of 9 1/4 percent, mortgage institutions

in El Salvador cannot utilize the roll-over funds and those in Guatemala are reluctant to borrow at the increased interest cost.

Of \$1,586,200 reported as commitments by CABEI as of June 30, 1971, only four agreements, totalling \$585,100 had been executed. In two instances, however, there had been no disbursement of funds since the agreements were signed in October 1969 and April 1970. The balance of commitments, totalling approximately \$1.0 million, actually represented an administrative assignment of funds to four mortgage institutions for over a year without signed agreements. Additionally, the mortgage institutions for which these funds were committed had made little, if any, utilization of housing funds previously made available by CABEI. We believe CABEI should initiate follow-up action to assure that commitment of funds be supported by signed agreements and to encourage mortgage institutions to promptly utilize such funds.

Through individual agreements between CABEI and the CACM countries, roll-over funds are to be available only for investment in the country that generates the repayment under the mortgages. While there is no fixed policy as to timing or amount to be utilized, the mobility of funds is restricted. Roll-over funds in excess of \$800,000 are available in El Salvador and Guatemala, but the mortgage institutions in these countries have no current plans to utilize CABEI's funds due to the interest cost. Consequently, there is no assurance that these funds will be utilized to purchase eligible mortgages.

The following schedule sets forth the status of roll-over funds that are tied to each CACM country, including the balance available at CABEI, as of June 30, 1971.

<u>Country</u>	<u>In Cash</u>	<u>Term Investments</u>	<u>Total</u>
Guatemala	\$ 497,592	\$ 200,609	\$ 698,201
El Salvador	88,746	109,830	198,576
Honduras	261,153	200,000	461,153
Nicaragua	34,932	-0-	34,932
Costa Rica	55,394	656,530	711,924
CABEI	<u>79,426</u>	<u>224,000</u>	<u>303,426</u>
 TOTAL	 <u>\$1,017,243</u>	 <u>\$1,390,969</u>	 <u>\$2,408,212</u>

b. Recommendation No. 4

ROCAP should request CABEI to:

(a) Implement an aggressive promotional program for the Housing Fund.

(b) Require signed commitment agreements with mortgage institutions prior to the commitment of funds.

(c) Identify, on a continuing basis, instances in which funds are not being utilized in a timely manner and initiate action to terminate these commitment agreements and make the funds available for use by other mortgage institutions.

(d) Investigate the possibility of transferring available funds in El Salvador and Guatemala to other CACM countries that can utilize the funds.

5 Investment of Funds

a. Statement of Condition

The Housing Fund cash balance indicated that funds remained idle for long periods of time before they were used to purchase eligible mortgages or placed in short-term investments. Funds were not used as rapidly as desired because eligible mortgages were not available to CABEI for purchase. A contributing cause for idle funds was the lack of adequate coordination within CABEI as to the timing and amount of funds that should have been placed in short-term investments. As a result, CABEI had incurred a loss of interest income on its funds.

During the period March 1, 1971 to May 31, 1971, the Housing Fund cash balance ranged from a low of \$2.2 million to a high of \$4.3 million, or an average of \$3.4 million. The reasons for the high cash balance was due to CABEI draw-downs of Housing Investment Guaranty (HIG) loan funds and receipt of roll-over funds from the AID direct loan, without disbursing them as planned to purchase eligible mortgages. For example, CABEI had drawn-down approximately \$2.0 million of HIG loan funds to purchase eligible mortgages, but mortgages were not available to CABEI for purchases at the time funds were received. CABEI did not place these funds in short-term investments during the period they were not needed to purchase mortgages; consequently, CABEI incurred an interest expense of approximately \$40,000 without offsetting the expense with interest income that could have been earned had the funds been used to purchase eligible mortgages or placed in short-term investments on a timely basis.

CABEI was aware of the above condition and, in June 1971, it had engaged Price Waterhouse and Company to make a comprehensive study of the overall financial administration of CABEI, including the need for improvements in coordination of the fund activities of the various operating departments. The study has an expected completion date of November 1971, with recommendations for

revised procedures available for implementation by February 1972.

b. Recommendation No. 5

ROCAP should continue to maintain close liaison with CABEI to assist CABEI in revising financial administration procedures.

6. Delinquency Rate of CABEI's Mortgage Portfolio

a. Statement of Condition

In several instances the delinquency rate of mortgages purchased by CABEI is high. Our review of six mortgage institutions revealed that one group of mortgages purchased by CABEI and serviced by the mortgage institutions was 30 percent delinquent, two groups were 20 percent, and three groups ranged from 2 percent to 9 percent. These mortgages had maintained this status during the period July 1970 through June 1971. Also, CABEI was not fully aware of the mortgage institutions' overall home loan mortgage delinquency rates. Therefore, it was not fully aware of problems, if any, regarding the institutions overall mortgage activities. Continued high rates of delinquency could, in time, impair the creditability of the mortgage institutions and jeopardize the collateral held by CABEI.

We were informed by CABEI that some of the delinquent mortgages were purchased from government housing institutions that had ineffective collection procedures. The problem is complicated by the fact that some of the institutions do not have available eligible mortgages for substitution of delinquent mortgages, as required under the contract. The purchase contract for primary mortgages calls for repayment or substitution of an acceptable mortgage for those delinquent in excess of 90 days.

We reviewed the CABEI collection policy and procedures and found them adequate. The procedures, however, are not vigorously enforced, due in part to CABEI's understandable reluctance to appear demanding or arbitrary in its assistance role. Since none of the mortgage institutions were delinquent in their payments to CABEI, its role continues to be passive and its efforts are restricted to reminding the institutions of their contractual obligation to maintain a current portfolio of mortgages. Our analysis indicates that some follow-up actions are taken by the mortgage institutions, but enforcement is difficult, therefore, the actions are not always effective.

We also noted the absence of information regarding the mortgage institutions' overall delinquency rate of

mortgages, since delinquency information submitted to CABEI covers only the mortgages purchased by CABEI. The substitution to CABEI of current mortgages for delinquent mortgages could tend to obscure a high rate of delinquency in the mortgage institutions' overall loan mortgage activities. The security of CABEI's investment is dependent on the continued solvency of the mortgage institutions, as well as the primary mortgages purchased by CABEI.

b. Recommendation No. 6

ROCAF should request CABEI to:

(a) Intensify its efforts with the mortgage institutions in reducing the delinquency rate of home loan mortgages

(b) Notify mortgage institutions with high delinquency rate that continuation of this condition could result in disqualification for future financing.

(c) Request a report from all mortgage institutions disclosing their delinquency rate of all home loan mortgage activities for CABEI's use as a means of detecting potential problems.

7. Housing Construction Monitoring Procedures

a. Statement of Condition

CABEI is not adequately monitoring the housing program to insure that the type of construction, specifications, etc. of homes to be financed meet the requirements for eligibility under the Housing Fund. Consequently, CABEI was not fully assured that the construction of housing for which eligible mortgages had been or will be purchased, meet its required construction norms and minimum specifications.

At the time of our review, construction of houses was in process for which eligible mortgages are to be purchased by CABEI utilizing Housing Guaranty Loan funds. We noted, however, that CABEI had not performed inspections of such construction. With regard to utilization of roll-over funds, CABEI inspections were performed on a time-permitting basis, instead of a planned program approach. We acknowledge that the construction of housing under the Housing Guaranty Program in Costa Rica, Nicaragua and Honduras is closely inspected by the respective Insurance Mortgage Institutions and/or mortgage institutions, and that CABEI places reliance on these inspections. We believe, however, that it must be recognized that these institutions' primary responsibility, with regard to construction requirements, is to their own organization and not to CABEI.

As of September 15, 1971, CABEI had available approximately \$8 million of Housing Guaranty loan funds and \$2.4 million of roll-over funds to purchase eligible mortgages. In our opinion, the efficient utilization of these funds requires that CABEI establish effective monitoring procedures to assure that housing construction plans, specifications and standards meet CABEI requirements.

b. Recommendation No. 7

ROCAP should encourage CABEI to establish adequate monitoring procedures to assure that home construction complies with the construction standards required by CABEI's Eligible Mortgage Requirements.

C. ORDINARY FUND

1. Background

The primary purpose for establishing CABEI was to create a Regional Development Bank, within the Central American Common Market (CACM), to promote economic integration in the private sector through loans to regionally oriented industries. This purpose was to be achieved by creating the Ordinary Fund (hereinafter referred to as the Fund). In summary, the Fund will be used to purchase machinery and equipment to expand the industrial sector, and to finance construction contract costs, working capital requirements and the cost of feasibility studies for specific projects. Ultimately, the Fund will provide financial assistance to the CACM countries in the following areas:

- a. New private industries;
- b. Sub-loans to governments for feasibility studies of roads and other projects;
- c. Equity participation in private industrial projects;
- d. Hotels, to increase tourism;
- e. Social projects;
- f. Sub-loans to intermediate credit institutions for further relending;
- g. Industries to increase non-traditional exports, and,
- h. Short-term working capital on the basis of the exporters' commercial paper.

CABEI's Economic Research and Promotion Department identifies areas of need within the CACM countries, locates interested parties to participate in these areas, and attempts to create interest for specific investments within the business communities. Subsequently, interested investors submit their loan applications to CABEI for review and approval.

As of June 30, 1971, the Fund had acquired \$150.7 million of resources, of which \$122.6 million had been committed and \$81.8 million had been disbursed. AID has provided \$47.5 million under four loans and the CACM countries had subscribed stock totalling \$12.4 million. As set forth in Exhibit C, the balance of the Fund's resources have been acquired by loans and lines of credit from international lending institutions and other countries. The following schedule sets forth the status of AID loans as of June 30, 1971:

	<u>Loan Number 596-L</u>			
	<u>001</u>	<u>002</u>	<u>004</u>	<u>010</u>
Amount (Millions)	\$5.0	\$2.5	\$10.0	\$30.0
Date	8/16/62	1/29/69	5/11/64	9/30/70
Grace Period (Years)	1	10	10	10
Grace Period Interest Rate	4%	3/4%	3/4%	2%
Term of Loan (Years)	15	40	40	40
Interest Rate	4%	3/4%	2%	3%
Disbursed (Millions)	\$5.0	\$2.5	\$10.0	-

During the past 10 years CABEI has committed \$122.6 million through 319 sub-loans, of which approximately 76 percent of funds have been committed during the last four years. Details by CACM country are set forth in the following schedule:

	<u>SUB-LOANS</u>		<u>PERCENTAGES</u>	
	<u>No. Loans</u>	<u>Amount</u> (\$000)	<u>No. Loans</u>	<u>Amount</u>
Costa Rica	47	\$ 17,624	14.7	14.4
El Salvador	56	24,528	17.6	20.0
Guatemala	53	17,598	16.6	14.4
Honduras	95	34,263	29.8	27.9
Nicaragua	<u>68</u>	<u>28,593</u>	<u>21.3</u>	<u>23.3</u>
Total	<u>319</u>	<u>\$122,606</u>	<u>100.0</u>	<u>100.0</u>

Honduras has been the major recipient of funds (27.9%) primarily because CABEI granted it certain preferential treatment. The following schedule sets forth in abbreviated form the sub-loans by sector. Although there has been a wide diversification in activities, it should be noted that about 67 percent of the loan activities have been concentrated in about nine areas.

<u>Sector</u>	<u>SUB-LOANS</u>		<u>PERCENTAGES</u>	
	<u>No. Loans</u>	<u>Amount</u> (\$000)	<u>No. Loans</u>	<u>Amount</u>
Textiles	35	\$ 24,333	10.9	19.8
Food Processing	27	10,566	8.4	8.5
Hotels	27	7,355	8.5	6.0
Transportation	27	8,308	8.5	6.7
Chemical Products	22	7,347	6.9	6.0
Agriculture Ind.	21	4,997	6.7	4.1
Construction				
Materials	20	10,504	6.3	8.5
Feasibility				
Studies	15	4,734	4.7	3.9
Development Bank				
Relending	14	7,376	4.3	6.0
Other	<u>111</u>	<u>37,086</u>	<u>34.8</u>	<u>30.5</u>
Total	<u>319</u>	<u>\$122,606</u>	<u>100.0</u>	<u>100.0</u>

2. Achievements

10 Based on the statistics set forth in the Background Section and other data reviewed during our audit, "we concluded that substantial achievements have been made in the utilization of the Ordinary Fund. As previously noted, over 75% of the Fund's sub-loan commitments have occurred in the most recent four years of its ten year existence, of which approximately \$18.0 million was disbursed in FY 1971, indicating that CABEI has now developed the capability to expand its banking operations at a much faster pace than in earlier years." While certain improvements in procedures and the organizational structure are recommended in this report, "CABEI has established an effective mechanism to utilize the resources in this Fund."

11 "Data provided by ROCAP reflected that the intra-regional trade between CACM countries, during the previous 10 years, have increased from an annual rate of \$32 million to approximately \$300 million in 1970. As the Fund is heavily oriented to the industrial sector, it obviously has made a substantial input to this accomplishment. "One of the more important contributions to regional integration is the telecommunications system financed through the Ordinary Fund. Central America will have, for the first time, an interconnecting telephone system providing dependable twenty-four hour service between countries and their capital cities.

12 "CABEI's promotion program has been successful in identifying investors to utilize resources available from this Fund, as indicated by the 319 sub-loans committed to date. In addition, a list is maintained of prospective investors and borrowers for future loans. Such loans have been identified to the priority needs of the CACM countries. CABEI is also performing a thorough technical review of loan applications, including plans and specifications. In numerous instances CABEI assists the sub-borrower in developing plans and specifications. "(

3. Utilization of Resources

a. Statement of Condition

Disbursement of funds under CABEI sub-loans has been slower than anticipated. The primary cause of this condition has been delays by sub-borrowers in drawing down their loan funds. This has prevented the timely completion of economic development projects financed by the Fund and had deferred the economic benefits to be realized from these projects. The following schedule sets forth the resources made available to the Fund and the amount of disbursement made under sub-loans.

(\$000)

<u>Fiscal Year</u>	<u>Funds Made Available</u>	<u>Funds Committed</u>	<u>Funds Disbursed</u>
1961	\$ -	\$ -	\$ -
1962	8,000	2,186	275
1963	12,904	5,598	2,471
1964	12,500	7,442	3,528
1965	9,200	9,942	7,038
1966	6,000	7,589	7,361
1967	8,518	10,494	10,321
1968	24,940	9,469	11,386
1969	5,500	23,682	11,562
1970	13,400	13,806	10,339
1971	<u>49,800</u>	<u>32,398</u>	<u>17,571</u>
Total	<u>\$150,762</u>	<u>\$122,606</u>	<u>\$81,852</u>

While the primary cause of this condition has been that sub-borrowers have not utilized loan funds in a timely manner, CABEI had not established adequate follow-up procedures to expedite the utilization of funds. Existing procedures do not provide for: (i) the designation of an individual to follow-up on specific loans and to prepare periodic progress reports on achievements made and problem areas encountered; (ii) full utilization of country delegates to study, analyze and act on slow moving loans; (iii) utilization of CABEI technical personnel to

assist the sub-borrower in resolving specific problem areas; and, (iv) a review of conditions precedent to loan disbursements in which the borrower is encountering difficulty implementing the terms of the loan with a view to modifying such conditions where justified.

b. Recommendation No. 8

ROCAP should encourage CABEI to review and initiate improvements in its follow-up procedures on slow moving loans, and to incorporate a progress reporting system on slow moving loans to keep CABEI management advised of progress achieved, problem areas encountered, and corrective actions required.

4. Delinquent Sub-Loans

a. Statement of Condition

The delinquency rates of sub-loans has reached a level to warrant special attention by CABEI. This has resulted from some borrowers deviating from their financial plan and from the lack of positive follow-up action by CABEI on chronic delinquencies. In addition, CABEI was not utilizing penalty clauses in its loan contracts for delinquent payments. If the delinquency rate continues to increase, it could ultimately have serious adverse effects on the operations of the Fund.

As of June 30, 1971, the outstanding balance of 145 sub-loans, whose grace period had expired, was \$41.3 million. Of the total of 145 sub-borrowers, 52 (36%) were delinquent in payments totalling \$3 million, or 7.5 percent of the \$41.3 million subject to amortization. The following schedule sets forth the status of this delinquency.

<u>Number of Days</u>	<u>Amount (\$000)</u>	<u>No. Loans Delinquent Percentage</u>
Less than 30 days	\$ 672	1.6%
31-90 days	644	1.6%
91-180 days	138	.3%
More than 180 days	1,641	4.0%
Total	<u>\$3,095</u>	<u>7.5%</u>

Although the sub-loan contracts give broad remedies to CABEI in the event of default by the sub-borrower, CABEI has been reluctant to exercise these remedies. CABEI appears to have developed a pattern of resolving chronic delinquency problems by adjusting the amortization schedules of the sub-loans. We observed 16 instances, totalling \$6.7 million, where CABEI had used this practice to resolve chronic delinquency conditions.

A CABEI Committee on delinquency payments was discontinued during 1971. Available information indicates

that this Committee, which reviewed delinquent loans and recommended corrective actions, had previously provided substantial assistance in this area. In addition, CABEI does not presently include a penalty clause in its loan contracts for delinquent payments. Without the use of the penalty clause or the application of other remedies available to CABEI, there is little inducement for timely payment by sub-borrowers.

During our field trips to sub-borrower sites, we observed two instances in which the borrower deviated from the approved financial plan. As a result of these actions, the sub-borrowers were encountering serious financial problems.

(1) CABEI Loan No. 283 EXIMCO

EXIMCO's problem is very complex. Briefly, the partners of the company paid in the subscribed capital but withdrew it after CABEI began disbursing the sub-loan. Their working capital was almost depleted at the time of our audit.

(2) CABEI Loan No. 266 COTICA

At the time of our field visit, COTICA seemed to be headed for bankruptcy. CABEI and the Company agreed on a specific investment plan. Subsequently and without CABEI's knowledge the sub-borrower changed the investment plan by purchasing a farm (US\$500,000); since it expected to use it as a source of raw material. The company had also mortgaged its equipment valued at \$125,000.

b. Recommendation No. 9

ROCAP should encourage CABEI to:

- (a) Place additional emphasis on delinquent loans.
- (b) Consider more interventions in the operations of delinquent borrowers with chronic financial problems.
- (c) Reactivate the Committee on Delinquent Loan Payments.

(d) Formulate and adopt, as appropriate, a clause in the loan contract which penalizes the sub-borrower for delinquent payment of interest and/or principal.

5. Processing Sub-Loans

a. Statement of Condition

While the processing time utilized by CABEI to review and approve loan applications (115 days) appears reasonable, the over-all time frame of nearly one year to sign a sub-loan appears to be excessive. Although some procedures utilized by CABEI can be improved, the extended delays are primarily caused by the sub-borrowers. As a consequence of extended delays, economic benefits to the CACM and the prospective borrower are deferred, and the additional administrative cost to CABEI may be substantial.

There are eight basic steps between the time of initial contact by sub-borrower to signature date of the respective sub-loan. The following schedule identifies each step and, based on the review of selected sub-loans, includes the average number of days required to complete each step.

<u>Procedural Steps</u>	<u>Total Average Time (days)</u>	<u>Per</u>	
		<u>CABEI</u>	<u>Sub-Borrower</u>
1. Pronouncement by CABEI on Project Eligibility	14.9	14.9	-
2. Notification to Sub-borrower on Project Eligibility	10.9	10.9	-
3. Notification by Sub-borrower of Interest in Obtaining Sub-loan	33.2	-	33.2
4. Submission of Credit Application	52.6	-	52.6
5. Submission of Feasibility Study and Evaluation and Analysis of Loan Application	69.8	69.8	-
6. Resolution from Board of Directors	11.0	11.0	-
7. Notification to Sub-borrower of Resolution	8.3	8.3	-

<u>Procedural Steps</u>	<u>Total Average Time (days)</u>	<u>Per</u>	
		<u>CABEI</u>	<u>Sub-borrower</u>
8. Fulfillment of Pre-contract Requirements	<u>144.7</u>		<u>144.7</u>
Total Average Days	<u>345.4</u>	<u>114.9</u>	<u>230.5</u>

We identified three areas which appear to require excessive processing time. Refinement of these areas could result in a substantial time-savings to both CABEI and the prospective borrower, and facilitate the initiation of the project.

- (1) Pronouncement by CABEI on project eligibility.
- (2) Notification by sub-borrower of interest in obtaining sub-loan.
- (3) Fulfillment of pre-contract requirements.

The criteria for borrower eligibility are well established. Since the actions taken are largely procedural, we feel the eligibility determination could be greatly simplified by giving authority to the CABEI country delegates to rule on eligibility of applicants.

CABEI's files did not indicate the reasons for the length of time required for borrowers to notify CABEI of their interest in obtaining a loan. This appears to be academic in view of the fact the prospective borrower had already indicated his interest by submitting an eligibility application. If the country delegates were authorized to rule on eligibility, this step could be simultaneously accomplished at the time he makes this contact.

During our field visits to sub-borrowers, we found that some borrowers felt the loan contract with CABEI contained unnecessary conditions and requirements. This could be an element in the excessive amount of time required to fulfill pre-contract requirements and sign the

loan agreement. We feel that an intensive review should be conducted and the loan contract revised, if required, to eliminate unnecessary or unduly restrictive terms and conditions.

b. Recommendation No. 10

ROCAP should request CABEI to:

(a) Study the feasibility of delegating authority to the Bank's Country Delegates to rule on project eligibility and contact the applicant to confirm his interest in obtaining a sub-loan, and thereby reducing or eliminating the need for loan proposals to be forwarded to the main office for eligibility declaration.

(b) Request CABEI to verify that complaints by sub-borrowers are adequately supported, and if required, assist CABEI in simplifying and eliminating unnecessary or unduly restrictive prequalification terms and conditions. (Implementation of this recommendation may require waivers to AID Manual Orders.)

6. Economic Impact of Projects

a. Statement of Condition

CABEI did not have statistical information that would provide an accurate picture of the economic impact of the projects financed by the Ordinary Fund within the CACM. Approximately 250 (of 319) sub-loans granted by CABEI had been made to the industrial sector, primarily to increase export and import substitutions. If CABEI and ROCAP are to measure the accomplishments of the Ordinary Fund, this will require the accumulation of statistical data to permit such evaluations.

While it was not within our audit scope to compile statistical information on the Fund, we did obtain the following information during our visits to sub-borrowers. This schedule supports our conclusion that the projects visited are making a favorable impact on the economies of the CACM countries.

<u>Country</u>	<u>No. of Projects Visited</u>	<u>Increase After Loan</u>	
		<u>Exports (\$000)</u>	<u>Employment</u>
Guatemala	4	\$1,944	129
El Salvador	7	5,096	1,335
Honduras	3	300	513
Costa Rica	6	203	266
Nicaragua	5	1,000	180
Total	<u>25</u>	<u>\$8,543</u>	<u>2,423</u>

b. Recommendation No. 11

ROCAP should request CABEI to develop procedures which will provide statistical information to evaluate the economic impact of the Ordinary Fund on the economies of the CACM countries. CABEI may wish to utilize a questionnaire, to be completed by the sub-borrowers, which provides

b. Recommendation No. 11 (Cont'd)

statistical data on the various economic factors prior to initiation and after the project is completed.

7. Interest Rates and Amortization Periods

a. Statement of Condition

There appears to be a need for CABEI to engage the services of an expert to review the interest rates and amortization periods used for sub-loans from the Ordinary Fund. At the present time, CABEI is using multiple interest rates and amortization periods for their sub-loans. The resources loaned to the Ordinary Fund also include multiple interest rates and varying amortization periods. It is important that the interest rates and amortization periods utilized by CABEI provide for the optimum growth of the CACM countries and, at the same time, insure the continued growth of CABEI.

During 1968, 1969 and 1971, CABEI's Board of Directors adopted resolutions which established the following interest rates and amortization periods for sub-loans from the Ordinary Fund.

<u>Sub-Loan Purpose</u>	<u>Interest Rates</u>	
	* <u>Tied Funds</u>	<u>Untied Funds</u>
A. Loans for General/Specific Studies:		
1. Public Sector	5 1/2	5 1/2 (a)
2. Private Sector	7	8
B. Other Loans Except Hotels		
1. Public Sector		
a. Roads	5 1/4 (a)	5 1/4 (b)
b. Electrification, Ports, etc.	5 3/4 (a)	5 3/4 (b)
c. Other Projects	6	6
2. Private Sector		
a. Fixed Investments	7	8
b. Working Capital	10	10

* These resources are provided by countries other than the U.S.

<u>Sub-Loan Purpose</u>	<u>Interest Rates</u>	
	<u>Tied Funds</u>	<u>Untied Funds</u>
C. Loans for Hotels		
1. Fixed investments	8	9
2. Working Capital	10	10
D. Feasibility Studies	6	6

(a) CABEI charges the interest rate stated above, provided the spread between this rate and the cost to CABEI is more than $\frac{1}{2}\%$. If the spread to CABEI is less than $\frac{1}{2}\%$, then CABEI charges interest cost plus $\frac{1}{2}\%$.

(b) CABEI charges the interest rate stated above, provided the spread between this rate and the cost to CABEI is more than 1%. If the spread to CABEI is less than 1%, then CABEI charges interest cost plus 1%.

The following is the maximum amortization period for sub-loans.

	<u>Period (Years)</u>	
	<u>Grace</u>	<u>Amortization</u>
A. Studies of Public Sector	2	10
B. Studies of Private Sector	1	7
C. Hotels:		
1. Building	3	10
2. Machinery and Equipment	2	7
3. Working Capital	1	3
4. Pre-Investment	1	3
D. Other Public Sector Projects	2	15
E. Other Private Sector Projects		
1. Fixed Investment	2	10
2. Working Capital	2	3

The complexity of the interest rate structure and amortization periods utilized by CABEI is compounded by several interest rates and amortization periods for different funds being provided under the same sub-loan. For

example, CABEI normally finances studies for specific projects. These costs, which may have been financed from tied or untied sources, are normally made part of the project sub-loan. In addition, these projects normally include financing of both fixed investments and working capital, which may also be financed from tied or untied sources. Consequently, a given sub-loan may include up to five different interest rates and several amortization periods. As a result of the complicated interest structure and amortization periods for sub-loans, approximately 1,800 loan cards are required to control 319 sub-loans. The accounting problem could become difficult to manage, if CABEI continues to expand its industrial loan activities in the same proportion as the past four years.

The previously mentioned problem is further aggravated by the numerous loans and lines of credit being received by CABEI at different, and sometimes multiple, interest rates and varying amortization periods. CABEI's resources for the Ordinary Fund are being provided through 29 loans or lines of credit (loans) from 12 different sources. The interest rate and maximum amortization periods of these loans are summarized in the following schedule.

<u>Interest Rates</u> <u>(Percentage)</u>	<u>Total</u> <u>Loans</u>	<u>Amortization Periods</u>			
		<u>1-8</u> <u>Years</u>	<u>9-19</u> <u>Years</u>	<u>20-29</u> <u>Years</u>	<u>30-40</u> <u>Years</u>
Less than 3	3	-	-	-	3
4 - 6	9	3	3	3	-
6.5 - 7.5	6	3	3	-	-
Multiple	7	3	3	-	1
1 - 1.5 over prime	<u>4</u>	<u>4</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total Loans	<u>29</u>	<u>13</u>	<u>9</u>	<u>3</u>	<u>4</u>

The above table focuses attention on some of the obstacles faced by CABEI in determining the optimum interest rates to be charged and the maximum amortization period to be granted sub-borrowers. While we were unable to verify the reasonableness of the interest rates and amortization periods used by CABEI, the statistical data presented in the above schedules indicates the complexities involved in these computations.

CABEI is aware of the complexity of procedures created by the present policies and its Financial Manager is currently performing a study in this area. However, available information indicates that the scope of the study may not encompass all of the relevant factors related to these areas.

b. Recommendation No. 12

ROCAP should request CABEI to obtain the technical services of an appropriate expert to review the various aspects of CABEI's interest rate structure and amortization period(s) to insure that such interest rate(s) and amortization period(s) provide for the optimum rate of growth for the CACM countries and the continued growth of CABEI.

D. INTEGRATION FUND

1. Background

One of the major efforts in the development of the Central America Common Market (CACM) is directed to infrastructure projects for the public sector within each CACM country. For this purpose, the Central America Fund for Economic Integration (hereinafter referred to as the Fund) was established on March 19, 1963, in accordance with the Charter of Punta del Este. CABEI was selected as the financial institution to administer the Fund for the CACM countries. The following schedule sets forth the sources of financing for this Fund as of June 30, 1971, including the self-help contributions by the CACM countries.

<u>Source of Funds</u>	<u>(\$000)</u>		
	<u>Amount of Available Resources</u>	<u>Amount Committed</u>	<u>Amount Disbursed</u>
AID	\$ 85,000	\$ 79,000	\$ 38,800
IDB	35,000	19,100	6,400
CACM Countries*	<u>30,600</u>	<u>24,000</u>	<u>12,800</u>
TOTAL	<u>\$150,600</u>	<u>\$122,100</u>	<u>\$ 58,000</u>

* Includes \$11.5 million of promissory notes.

As Administrator, CABEI is responsible for: (i) the development of infrastructure projects agreed to by CACM countries; (ii) evaluation of feasibility studies of projects submitted to CABEI to determine their technical and economic feasibility; (iii) supervision of project execution including compliance with conditions of sub-loan agreements; (iv) obtaining and distributing data on regional infrastructure projects within the Central American area; and (v) maintaining information regarding consulting and technical assistance services. CABEI administers the resources of the Fund which are accounted for separately from other resources of CABEI. CABEI's expenses in performing its function as Administrator are reimbursed from the Fund.

The Fund will ultimately provide assistance in the following areas:

- a. Transports;
- b. Telecommunications;
- c. Generation and distribution of electric energy and inter-connection of transmission lines;
- d. Infrastructure works and services for industrial development;
- e. Facilities for technological education centers;
- f. Investigation and evaluation of natural resources, including cadastral studies;
- g. Storage of grains and other food products;
- h. Irrigation, drainage and conservation of soils, including reforestation;
- i. Prevention and elimination of plagues affecting agricultural and forestry production;
- j. Development of the agricultural sector, including colonization and settling;
- k. Development of tourism; and
- l. Other fields of development agreed upon by the governments of the member countries of the Bank, and which are directed towards the fulfillment of the objectives of the Fund.

The planning for infrastructure projects has been projected in two phases. The priority projects were identified by the Central American Transportation Study (CATS), from which a long range plan for the first phase was developed and subscribed to by the CACM countries. The first phase included 65 projects at a total cost of approximately \$289.0 million, of which CABEI is involved in 32 projects totalling \$122 million. The second phase is estimated to include about 71 projects at a total cost of approximately \$576 million.

As of June 30, 1971, AID had made three loans, totaling \$85 million, to the Fund. The majority of these funds are being utilized to finance highway construction projects. The following schedule sets forth the details of each loan agreement.

	<u>Loan Number 596-L-</u>		
	<u>006</u>	<u>007</u>	<u>008</u>
Amount (millions)	\$35	\$20	\$30
Date	7/29/65	1/23/68	4/25/69
Grace Period (years)	10	10	10
Grace Period Interest Rate	1%	1%	2%
Term of Loan (years)	40	40	40
Interest Rate	2.5%	2.5%	2.5%
Committed (million)	\$35	\$20	\$24
Disbursed (million)	\$28.5	\$5.6	\$.7

Note: CABEI was in process of billing AID for \$4 million of loan funds previously disbursed by CABEI.

The following procedures are used by CABEI to review, approve and monitor sub-loans for infrastructure projects.

a. The CACM country submits a loan application and related feasibility study to CABEI. The infrastructure project to be constructed must be in accordance with priorities established in the CATS.

b. CABEI reviews and approves the loan application and drafts the loan agreement.

c. ROCAP reviews and approves the project if it is to be financed by an AID loan.

d. The loan agreement must be ratified by the National Congress of the CACM country receiving the loan.

e. CABEI approves the selection of consulting firm(s) engaged to prepare the construction plans and specifications and to supervise the construction work.

f. CABEI approves the construction plans and specifications prepared by the consultant and the contract procurement procedures to be utilized by the CACM country.

g. CABEI approves and the CACM country awards the construction contract.

h. The CACM country, through its consultant, and CABEI monitor the implementation of the contract.

i. ROCAP concurs in the approval of the Consultant Engineers selected by each of the countries concerned upon the recommendation of CABEI. ROCAP concurs in the approval of the Contractors for construction and all contractual arrangements covering consultant work as well as construction. ROCAP also assists in monitoring all construction contracts.

2. Achievements

The purpose of CABEI is to promote balanced economic integration of the CACM countries. To accomplish this purpose, CABEI stimulates the development of infrastructure projects in the public sector. CABEI has established an efficient Infrastructure Department to plan and monitor the Infrastructure Program.

As of June 30, 1971, CABEI had made available to the CACM countries \$122 million for the financing of 32 infrastructure projects, of which \$58 million had been disbursed. Prior to 1966, the amount which had been loaned totalled only \$3 million. This indicates a clear index of the increased growth in recent years for infrastructure loans. As of June 30, 1971, CABEI's financing of regional infrastructure projects represented 48 percent of the total investment of on-going infrastructure projects in the CACM countries.

13 // The infrastructure projects financed through CABEI have made a substantial contribution to the development of the CACM countries. The CACM countries will ultimately have an interconnecting network of primary highways. At the time of our audit, 200 kilometers of highways had been completed and 800 kilometers were under construction. In addition, other projects are currently in process in such areas as electric energy, seaports, airports, canals, grain silos, railroads and aerial navigation. "

14 "The Infrastructure Department of CABEI is heavily oriented towards the development function. Five supervisory engineers are assigned to the department to assist in the planning, design and supervision of infrastructure projects. Three technical advisors, who report directly to the President of CABEI, are primarily charged with the planning of future infrastructure programs for CACM countries. The Infrastructure Department maintains a continuous surveillance of on-going projects through engineers from the headquarters office in Tegucigalpa and from the Branch Office in El Salvador. On site supervisory and monitoring inspections of infrastructure projects

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average about ten visits per year. The technical assistance made available by ROCAP and CABEI has, we believe, made a significant contribution to the development of the infrastructure projects in Central America.

3. Planning for Future Infrastructure Projects

a. Statement of Condition

The goals of the Fund may not be achieved, unless timely action is taken by the CACM countries to develop firm plans for future infrastructure projects to be financed through CABEI. As of November 1971, there were only two projects, valued at \$6 million, available for new financing beyond 1972. It appears that a loss of momentum has occurred in the integration movement due to economic and political differences among the countries of the CACM, resulting in a diminished interest in planning and carrying out the second phase of the infrastructure projects. If this condition continues, CABEI will be prevented from planning, developing and arranging for funding to finance future infrastructure projects.

Original plans provided for the infrastructure projects to be implemented in two phases. The CACM countries developed plans and identified projects to be financed by CABEI through the Integration Fund for the first phase. As of June 30, 1971, CABEI had arranged for financing all of their projects under the first phase. While CABEI has the capability to presently initiate action for planning and financing future infrastructure projects, CABEI cannot initiate such action until the CACM countries agree on which projects will be initiated in the second phase. Continuation of this condition could require CABEI to reduce or phase-out its Infrastructure Department and impede or ultimately prevent CABEI and the Integration Fund from participating in future infrastructure projects.

CABEI is aware of the urgency of the present condition and is taking an active role in trying to generate action on the part of the member countries. A Task Force consisting of representatives from IDB, IBRD, UN, SIECA and CABEI plan to meet in March 1972 to begin work on a feasibility plan similar to the one formulated for the first phase. CABEI will act as the Executive Council for the Task Force.

b. Recommendation No. 13

ROCAP through SIECA should continue to assist CABEI in making the CACM countries aware of the urgency for developing plans for future infrastructure projects and of the adverse effects on the regional integration that can result from their failure to initiate prompt action.

4. Highway Maintenance Program

Costa Rica and Honduras do not have an adequate highway maintenance program. We were informed by host country personnel that this condition resulted from inadequate budgetary support, inadequate supply systems and an insufficient quantity of maintenance equipment. Unless this condition is corrected, it will ultimately have adverse effects on highways financed through CABEI.

Since highways financed through CABEI are all of relatively recent construction, maintenance problems are not yet apparent. We, therefore, based our judgement of maintenance standards on roads of older vintage which have had time to develop signs of good or poor maintenance practices. We made on-site observations of the following highways:

- a. San Jose - Alajuela in Costa Rica
- b. San Jose - Heredia in Costa Rica
- c. San Jose - Cartago in Costa Rica
- d. Tegucigalpa - San Pedro Sula in Honduras
- e. Tegucigalpa - Choluteca in Honduras
- f. San Pedro Sula - Puerto Cortes in Honduras

We observed major defects in these roads which indicate that adequate maintenance had not been performed.

It is recognized that CABEI requires a maintenance plan for each highway project prior to initial disbursement under its loans. However, the conditions set forth above raise serious doubt if Costa Rica and Honduras will have the capability to comply with these maintenance requirements. This condition would substantially reduce the life expectancy of roads financed through CABEI and the benefits to be achieved through these infrastructure projects.

b. Recommendation No. 14

ROCAP should encourage CABEI to request Costa Rica and Honduras to provide adequate assurance that all CABEI financed highways will be provided an effective maintenance program. The failure to provide effective maintenance should be considered in approving future loans for highway construction.

(We were informed by ROCAP during the Exit Conference that existing loans to Costa Rica and Honduras should significantly improve their highway maintenance programs.)

5. Vehicle Weight Control

a. Statement of Condition

With the exception of Nicaragua, there was no vehicle weight control in the highway programs of the CACM countries. This condition has resulted, at least in part, by the regional highway program not adopting the concept of weight control and highway weight stations. In discussing this problem with CABEI engineers, we were told that overweight trucks are a significant factor in the rapid deterioration of highways in Central America, particularly in the areas where lower design standards have been followed in constructing highways.

b. Recommendation No. 15

ROCAP should assist CABEI in establishing uniform standards of vehicle weight control, utilizing highway weight-stations for enforcement. This requirement should be incorporated into CABEI's future loan agreements with sub-borrowers.

(During the Exit Conference we were informed by ROCAP that it had and would continue to provide assistance to the CACM countries on implementation of vehicle weight control procedures. Subsequent to our audit Costa Rica installed a number of weight stations.)

6. Uniform Design Standards for Highway Construction

a. Statement of Condition

Minimum design standards have not been established for the regional highway program financed through the Integration Fund. This has resulted from CACM countries not agreeing on minimum standards and uniform design for regional highway construction.

The Central American Transportation Study (CATS) report recommended, in part:

- a. "that uniform design and construction standards for the entire region be adopted and that the minimum requirements be no less than those given in Table IV-E 2" (Table IV-E 2 provides the design and specification minimum for various types of terrain and anticipated traffic).
- b. "(1) These standards must be high enough to serve the existing need and such reasonable future need as can be readily projected; (2) They should give a facility with a built-in ability to serve the needs, without excessive maintenance and user costs; (3) Finally, and of primary importance, the standards should be such that future improvements can be made with minimum loss of the initial investment."

Due to efforts by ROCAP, highways financed by AID funds have been required to meet minimum standards published by the U.S. Bureau of Public Roads. However, there is no assurance that roads financed from other funding sources meet the same standards. In view of the large investment in the CACM highway program, it would appear that adoption of minimum design standards would be a requirement to assure that optimum benefits will be derived from funds invested.

b. Recommendation No. 16

ROCAP should continue to assist CABEL in obtaining the CACM countries' agreement on minimum uniform design standards for the regional highway construction program.

7. Delays in Implementation of Sub-Loans

a. Statement of Condition

The processing time required to review and approve sub-loan application and related sub-loan contracts for highway projects needs to be reduced. In some instances, the elapsed time from the date of a sub-loan application to signing of the sub-loan contract ranged from 7 to 56 months. In addition, construction progress of certain projects has been slow. The delays in processing sub-loans and in initiating constructive work, are primarily caused by administration and technical problems of the sub-borrowers. As a result, construction projects have not been implemented and funds have not been disbursed on a timely basis.

As of June 30, 1971, there were 29 signed sub-loans utilizing AID funds for highway construction projects. On a selective basis, we reviewed seven project files to determine the time-frames in which sub-loan applications and related sub-loan contracts were processed. In five instances, the processing time ranged from 7 to 12 months and, in two other instances, it ranged from 2½ to 4½ years. Examples follow:

<u>Sub-Borrower</u>	<u>Sub-Loan No.</u>	<u>Date Loan Application</u>	<u>Date Loan Signed</u>	<u>Elapsed Months</u>
Costa Rica	17	Sept. 1969	Apr. 1970	7
El Salvador	3	May 1970	Feb. 1971	9
Costa Rica	22	Sept. 1967	May 1970	32
Honduras	26	June 1969	June 1970	12
El Salvador	21	Dec. 1965	July 1970	56

Some of the principal reasons for delay in processing sub-loans are described below:

(1) The requirement of some CACM countries that their National Congresses approve and ratify all sub-loans.

(2) Political differences among Congressmen in approving the need for sub-loans.

(3) Major modifications to sub-loan contracts need to be made before the National Congress of the respective country will approve the sub-loans.

(4) Reassessment of, and major changes to, completed feasibility studies and preliminary plans are required before the National Congress of the respective country will approve the sub-loans.

We also reviewed 11 project files to determine the construction progress of the projects and if funds for the projects were being disbursed on a timely basis. Our review indicated that all 11 projects, totalling approximately \$26.7 million, had not progressed as rapidly as desired. In eight instances, no funds had been disbursed although the sub-loans had been signed for at least 12 months. Examples follow:

(1) TEGUCIGALPA-DANLI HIGHWAY

A loan for \$6.6 million was signed by the Government of Honduras (GOH) in June 1970. No disbursement had been made on this loan and construction had not been initiated as of June 1971. CABEI did not accept the plans and specifications because a soil test had not been performed of the terrain where the highway was to be located. CABEI has repeatedly requested the GOH to submit a soil test but no action has been taken. As a result, CABEI has referred this matter to the President of Honduras for his decision.

(2) EL COCO AIRPORT

This loan for \$2.1 million was signed by the Government of Costa Rica (GOCR) in February 1969. Construction work on this project, the El Coco Airport, was started in December 1970 and as of June 30, 1971, \$189,000 had been expended. Subsequently, the contractor was awarded another contract by the GOCR for the construction of a highway. The contractor did not have sufficient equipment available to perform both projects simultaneously. The GOCR considers the highway project as a higher priority than the El Coco Airport. Consequently, the contractor is using all of his resources for the highway construction and work at the El Coco Airport has been deferred.

(3) ATLANTIC CHANNEL

This loan for \$1.5 million was signed by the Government of Costa Rica (GOCR) in May 1970, but construction work had not been started as of October 1971. Delay in beginning construction was due to delays in obtaining bids because the Port Authority was not familiar with the procurement procedures required by the CABEI loan. Subsequently, the Port Authority received only one bid, which being 60% over the government estimate, was considered excessive. A decision has not been made on whether to negotiate with the contractor or to perform the work by force account.

(4) SANTA ANA - ANGUIATU HIGHWAY

This loan was signed by the Government of El Salvador (GOES) in July 1970 for \$4 million. The construction has not been initiated because the GOES has encountered difficulties in obtaining consultant services to prepare plans and specifications. The GOES selected a consultant firm but CABEI did not approve the contract because the cost was considered excessive. The GOES is currently preparing the highway plans and specifications, and the consultant will be used only for supervision. It is expected that the consultant and construction contracts will be signed by November 1971.

CABEI is fully aware of the conditions described above, and of the need to implement construction projects on a timely basis. Although CABEI was taking appropriate action, where feasible, it is restricted, however, in the actions it can take to improve some of the conditions because: (i) it is dealing with sovereign political entities; (ii) of its advisory rather than political role; and (iii) no reasonable alternatives exist, such as cancellation or rejection of the sub-loan application since this practice would tend to further strain the cohesion of the CACM. In view of these factors, we are not making a recommendation in this area.

(During the Exit Conference we were informed by ROCAP that, subsequent to our audit, contracts were awarded for the Atlantic Channel and Santa Ana Highway projects and that action had been initiated on the El Coco Airport to insure completion by the contract completion date.)

8. Bonding Requirements

a. Statement of Condition

The inability of the Central American (CA) construction industry to obtain performance and payment bonds has severely restricted the CA construction contractors from participating in the infrastructure projects. The bonding market is not adequately developed in Central America; consequently, the insurance premiums are very high (5-6 times the U.S. rate) and collateral requirements often exceed the assets of the prospective construction firms. As a result, CA construction firms are unable to bid on an equal basis with U.S. firms, and the implication is very strong that this may result in higher cost of construction through lack of competition.

CABEI's policy is to encourage the development of the CA construction industry. This is considered important to develop Central American technological capacity, ease the Central American balance of payments, and help assure adequate competition in contract procurement. CA construction firms have not been active in bidding on CABEI financed infrastructure projects because of difficulties in obtaining required bonding coverage.

Although information is limited as to the actual number of firms that have dropped out of competition because of their inability to obtain the required bonds, our review indicates the number may be substantial. For example, fourteen firms pre-qualified for the construction of the Cuchilla Highway in El Salvador. However, only two bids were received, both from U.S. firms. Both bids were substantially higher than the government estimate. The architect-engineer firm recommended that:

"Considering the experiences of the two bidders, and the lack of interest shown by construction companies due to the high bonding requirements, to re-bid this project would be a waste of time."

b. Recommendation No. 17

ROCAP should:

(a) Discuss with CABEI the feasibility of establishing a guaranty fund by CABEI, as a means of underwriting the bonding coverage for Central American firms on an equitable basis with U.S. firms.

(b) Assist in obtaining the services of a qualified insurance expert to assist CABEI, in the event that it is determined feasible for CABEI to underwrite bonding coverage for CABEI financed contracts.

(It is our understanding that IDB's bonding requirements are substantially lower than AID. AID may wish to explore this area as a partial solution to the above condition.)

9. Contract Provisions

a. Statement of Condition

There is a need to improve the provisions included in professional service contracts that are utilized under CABEI financed projects. We observed that these contracts did not include: (i) a standard set of cost principles for inclusion in cost reimbursable contracts; and, (ii) a clause for recovery of excessive cost due to defective cost or pricing data. In addition, the contracts presently in use specify only a fixed overhead rate and do not provide for the use of provisional overhead rates. The absence of the above contract provisions reduces the possibility of recovering excessive costs under such contracts.

b. Recommendation No. 18

ROCAP should request CABEI to require the sub-borrowers to incorporate into their contracts a standard set of cost principles, a recovery clause for defective pricing data, and the use of provisional overhead rates where appropriate.

10. Cost and Price Analysis

a. Statement of Condition

There is a need for sub-borrowers and CABEI to improve the cost and price analysis performed on contractor proposals for construction and professional service contracts. This need is more acute on professional service contracts, as they are not awarded on the basis of competitive bidding. Available information indicates that these analyses were not performed because the CACM countries do not have the expertise to perform this type of evaluation. Without adequate cost and price analysis, the CACM countries do not have assurance that they are obtaining a fair and reasonable cost for their contracted services.

Contracts for architectural, engineering and other professional services are awarded by negotiation, and may be lump sum, cost-plus-fixed-fee or a combination of both. The degree of precision with which the required services can be defined usually determines the type of contract to be negotiated. Regardless of the type of contract ultimately negotiated, a cost analysis of the contractor's proposal for professional services is necessary prior to awarding the contract.

Our review of eight active contracts for professional services indicated that sufficient data was lacking to support the indirect expenses, the overhead rate could not be properly evaluated and data was not available to evaluate the contractor's cost system. As all contracts reviewed included a fixed overhead rate, it is imperative that a cost analysis be performed prior to negotiations. Due to the absence of cost analysis and the lack of auditable data, there is little basis for determining whether the contract costs are reasonable.

In the contracts we reviewed, an analysis of the contractors job-site overhead rate had not been performed. In addition, detailed cost proposals of job-site indirect expense were not submitted by the contractors. Therefore, it was not possible to determine the relationship of local indirect expense to overhead. As a result, there was no assurance that contractors' central or branch office

overhead was not duplicated in the job-site indirect expenses. For example, one contracting firm was paid \$40,900 for job-site indirect costs such as general, management and administrative costs. An additional \$98,600 was also paid, which could have been additional expenses incurred by the contractor but might have constituted duplicate payment of general, management and administrative costs.

d. Recommendation No. 19

ROCAP should:

(a) Encourage CABEI to provide a training program for appropriate personnel within CABEI and the CACM countries on the techniques of performing cost and price analysis of contractor bid proposals.

(b) Assist CABEI and the CACM countries in preparing a manual setting forth the techniques and procedures to be utilized in performing cost and price analysis of contractor bid proposals.

AUDIT OF CABEI
 CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION
 ORGANIZATIONAL CHART
 As of June 30, 1971

EXHIBIT A

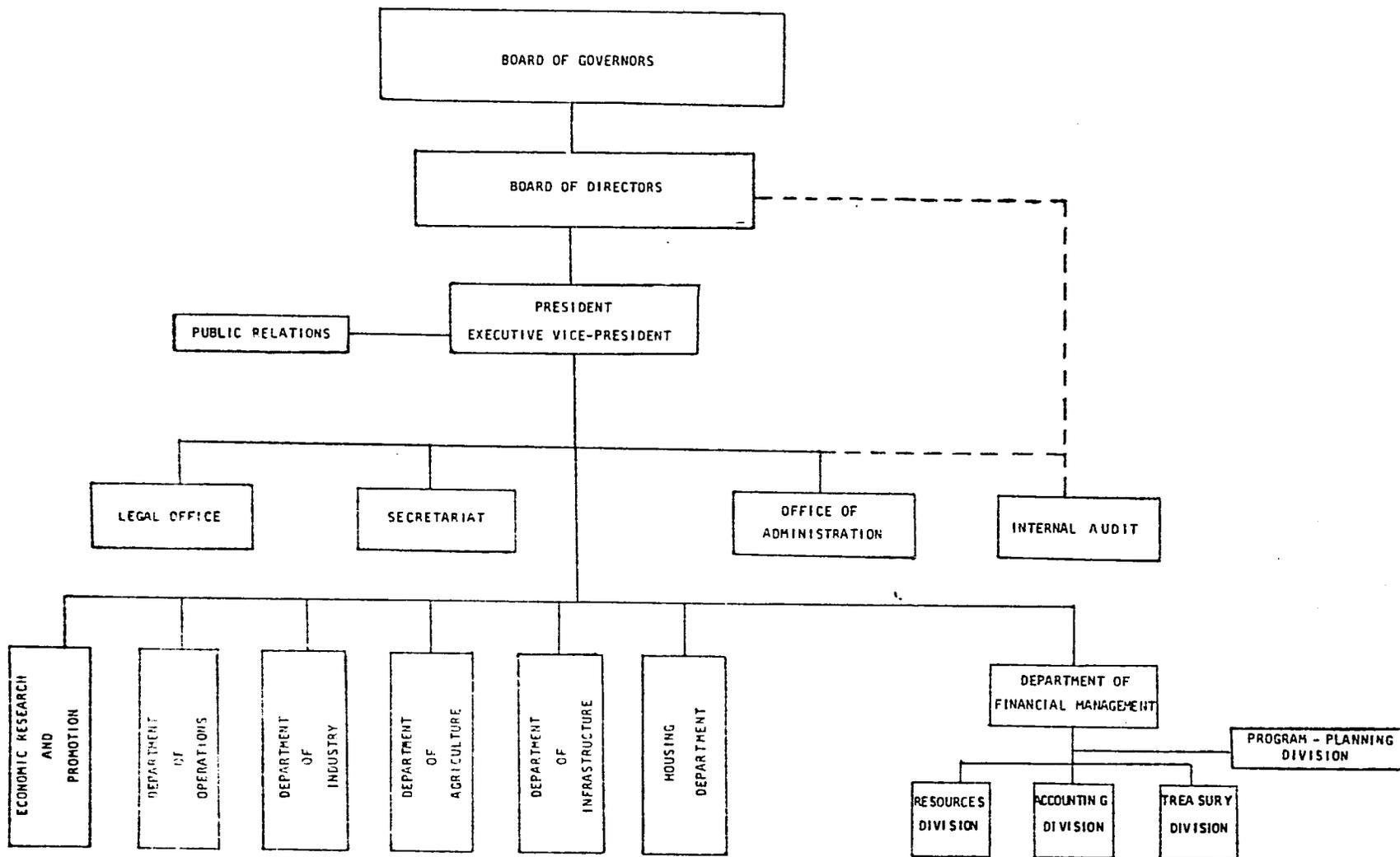


EXHIBIT B

AUDIT OF CABEI
LOANS MADE TO CABEI BY AID
As of June 30, 1971

<u>Loan Title</u>	<u>Number</u>	<u>Date Signed</u>	<u>Term Years</u>	<u>Grace Period Years</u>	<u>Interest Rate</u>		<u>Amount in US Dollars</u>		
					<u>During Grace Period</u>	<u>After Grace Period</u>	<u>Loan Ceiling</u>	<u>Disbursements</u>	<u>Balance</u>
Agricultural & Industrial Development	AID-598-001	8-16-62	15	None	4%	4%	\$ 5,000,000	\$ 5,000,000	\$ -
Feasibility Studies	AID-598-002	11-29-63	40	10	3/4 of 1%(a)	3/4 of 1%	2,500,000	2,500,000	-
Home Loan Program	AID-596-003	11-29-63	40	10	3/4 of 1%(a)	3/4 of 1%	9,997,000	9,999,948	(2,948) (b)
Industrial Projects	AID-596-004	5-11-64	40	10	3/4 of 1%	2%	10,000,000	9,998,599	1,401
Infrastructure	AID-596-006	7-29-65	40	10	1%	2 1/2%	35,000,000	28,536,846	6,463,154
-	AID-596-007	1-23-68	40	10	1%	2 1/2%	20,000,000	5,565,736	14,434,264
-	AID-596-008	4-25-69	40	10	2%	2 1/2%	30,000,000	653,912	29,346,088
Industries for Export & Tourism	AID-596-010	9- 9-70	40	10	2%	3%	30,000,000	-	30,000,000
Housing Investment Guaranty	AID-596-HG-001	3-25-70	25	3	8-5/8%	8-5/8%	10,000,000(c)	1,305,000	8,695,000
Total							<u>\$152,497,000</u>	<u>\$63,560,041</u>	<u>\$88,936,959</u>

Note (a) The loan refers to this as a Credit Fee rather than Interest.

(b) This amount was refunded to AID.

(c) This is not a direct AID loan but provided under the AID Housing Investment Guaranty Program.

AUDIT OF CABEI
MODIFIED STATEMENT OF SOURCE OF FUNDS
As of June 30, 1971

Country Source of Funds	Original Amount	Available Resources		Balance Outstanding	(US \$000) Unutilized Balance
		Utilized By CABEI	Repaid to Source		
1.0 Ordinary Fund					
1.1 USA	\$ 47,500	\$ 17,499	\$ 1,551	\$ 15,948	\$ 30,001
1.1.1 AID	3,500	1,159	-	1,159	2,341
1.1.2 EXIM Bank	15,000	5,574	2,284	3,290	9,426
1.1.3 Private Banks	27,204	21,427	2,276	19,151	5,777
1.2 I.D.B.					
1.3 CACN - CABEI					
1.3.1 Subscribed Capital	12,400	11,400	-	11,400	1,000
1.3.2 Accumulated Net					
Earnings					
1.4 Mexico	5,288	5,288	-	5,288	-
1.5 Italy	6,000	3,302	909	2,393	2,698
1.6 Holland	211	211	-	211	-
1.7 Switzerland	1,400	762	-	762	638
1.8 Belgium	6,340	1,758	231	1,527	4,582
1.9 Japan	5,000	455	50	405	4,545
1.10 England	11,400	5,134	-	5,134	6,266
1.11 Germany	7,200	339	17	322	6,861
1.12 Spain	3,300	70	-	70	3,230
	<u>4,307</u>	<u>1,020</u>		<u>1,020</u>	<u>3,287</u>
Sub-Totals	\$156,050	\$ 75,398	\$ 7,318	\$ 68,080	\$ 80,652

AUDIT OF CABEI
MODIFIED STATEMENT OF SOURCE OF FUNDS
As of June 30, 1971

Country Source of Funds	Available Resources (US \$000)					
	Original Amount	Utilized By CABEI	Repaid to Source	Balance Outstanding	Unutilized Balance	
2.0	<u>INTERBANCY FUND</u>					
2.1	USA/AID	\$ 85,000	\$ 34,757	\$ -	\$ 34,757	\$ 50,243
2.2	SID.F.	35,000	6,659	-	6,659	28,341
2.3	CACH - CABEI					
2.3.1	Subscribed Capital	27,600	16,100 (a)	-	16,100	11,500
2.3.2	Accumulated Net Earnings	<u>2,969</u>	<u>484</u>	<u>-</u>	<u>484</u>	<u>2,485</u>
	Sub-Totals	<u>\$150,569</u>	<u>\$ 58,000</u>	<u>\$ -</u>	<u>\$ 58,000</u>	<u>\$ 92,569</u>
3.0	<u>Housing</u>					
3.1	USA					
3.1.1	AID	\$ 9,997	\$ 9,997	\$ -	\$ 9,997	\$ -
3.1.2	Housing Invest- ment Guaranty	10,000	2,050	-	2,050	7,950
3.2	CACH - CABEI					
3.2.1	Accumulated Net Earnings	<u>1,897</u>	<u>1,897</u>	<u>-</u>	<u>1,897</u>	<u>-</u>
	Sub-Totals	<u>\$ 21,894</u>	<u>\$ 13,944</u>	<u>\$ -</u>	<u>\$ 13,944</u>	<u>\$ 7,950</u>
	Grand Totals	<u>\$328,513</u>	<u>\$147,342</u>	<u>\$ 7,318</u>	<u>\$140,024</u>	<u>\$181,171</u>

Note (a) CABEI had disbursed \$4.4 million, but had not billed AID for this amount.

AUDIT OF CABEI
STATEMENT OF FINANCIAL CONDITION (a)
As of June 30, 1971

	In U.S. Dollars (\$000)			
	Ordinary Fund	Integration Fund	Housing Fund	All Funds
<u>Assets</u>				
Cash in Banks	\$ 1,060	\$ (1,271)	\$ 1,797	\$ 1,586
Temporary Investments	8,371	2,989	3,436	14,796
Loans Receivable	55,228	58,070	8,587	121,885
Compensatory Loans			6,321	6,321
Inter-Fund Loans	436			(b)
Accumulated Interest & Commissions Receivable on Loans & Investments	1,737	1,109	157	3,003
Real Estate, Office Equipment & Accesories	630			630
Investments on Projects having great regional significance	163			163
Other Assets	<u>1,106</u>	<u>40</u>	<u>175</u>	<u>1,321</u>
Total Assets	\$ <u>68,731</u>	\$ <u>60,937</u>	\$ <u>20,473</u>	\$ <u>149,705</u>

AUDIT OF CABEI
STATEMENT OF FINANCIAL CONDITION (a)
As of June 30, 1971

	In U.S. Dollars (\$000)			
	Ordinary Fund	Integration Fund	Housing Fund	All Funds
<u>Liabilities, Reserve & Capital</u>				
<u>Liabilities</u>				
Short-Term Bank Loans Accumulated Interest & Commission Payable on Loans	\$ 547	\$ 120	\$ 87	\$ 754
Accumulated Expenses & Accounts Payable	109		17	126
Inter-Fund Loans		332	104	(b)
Long-Term Accounts Payable	51,392	41,416	12,047	104,855
Compensatory Loans			6,321	6,321
<u>Reserves</u>				
Reserves for Fringe Benefits	(4)			(4)
<u>Capital</u>				
Authorized Capital (\$60,000)				
Subscribed Capital	12,400	27,600		40,000
Unpaid Capital	(1,000)	(11,500)		(12,500)
Outstanding Share	11,400	16,100		27,500
<u>Surplus & Reserves</u>				
Donated Surplus	2,165			2,165
Accumulated Net Earnings	2,066	1,533	1,544	5,143
Net Earnings for Year	1,056	1,436	353	2,845
Total Liabilities, Reserve & Capital	\$ <u>68,731</u>	\$ <u>60,937</u>	\$ <u>20,473</u>	\$ <u>149,705</u>

Note (a) Source of this information was the certified financial statements issued by Price Waterhouse & Co.

Note (b) Inter-Fund loans were not added on the consolidated totals.

LISTING OF RECOMMENDATIONS

Recommendation No. 1

ROCAP should:

- (a) Request CABEI to establish procedures for preparing short-term cash forecasts and provide assistance as required.
- (b) Request CABEI to utilize the data in short-term cash forecasts to evaluate its present investment portfolio, and to determine the amount of cash that should be maintained in banks.
- (c) Determine the need to continue the \$1.5 million revolving fund established under Loan No. 010.

Recommendation No. 2

ROCAP should encourage CABEI to institute a management oriented audit concept in its Audit Office and provide the additional auditor personnel required to implement this audit program.

Recommendation No. 3

ROCAP should:

- (a) Continue to explore the possibility of obtaining direct loans, with concessionary interest rates, to provide capital to expand CABEI's secondary mortgage program for the CACM.
- (b) Discuss with CABEI the advisability of deferring the use of additional HIG Loans, if direct loans with concessionary interest rates can be obtained.
- (c) Discuss with CABEI the means by which the interest rates under HIG Loans can be reduced, if direct loans with concessionary interest rates cannot be obtained.

Recommendation No. 4

ROCAP should request CABEI to:

- (a) Implement an aggressive promotional program for the Housing Fund.
- (b) Require signed commitment agreements with mortgage institutions prior to the commitment of funds.
- (c) Identify, on a continuing basis, instances in which funds are not being utilized in a timely manner and initiate action to terminate these commitment agreements and make the funds available for use by other mortgage institutions.
- (d) Investigate the possibility of transferring available funds in El Salvador and Guatemala to other CACM countries that can utilize the funds.

Recommendation No. 5

ROCAP should continue to maintain close liaison with CABEI to assist CABEI in revising financial administration procedures.

Recommendation No. 6

ROCAP should request CABEI to:

- (a) Intensify its efforts with the mortgage institutions in reducing the delinquency rate of home loan mortgages.
- (b) Notify mortgage institutions with high delinquency rates that continuation of this condition could result in disqualification for future financing.
- (c) Request a report from all mortgage institutions disclosing their delinquency rate of all home loan mortgage activities, for CABEI's use as a means of detecting potential problems.

Recommendation No. 7

ROCAP should encourage CABEI to establish adequate monitoring procedures to assure that home construction complies with the construction standards required by CABEI's Eligible Mortgage Requirements.

Recommendation No. 8

ROCAP should encourage CABEI to review and initiate improvements in its follow-up procedures on slow moving loans, and to incorporate a progress reporting system on slow moving loans to keep CABEI management advised of progress achieved, problem areas encountered, and corrective actions required.

Recommendation No. 9

ROCAP should encourage CABEI to:

- (a) Place additional emphasis on delinquent loans.
- (b) Consider more interventions in the operations of delinquent borrowers with chronic financial problems.
- (c) Reactivate the Committee on Delinquent Loan Payments.
- (d) Formulate and adopt, as appropriate, a clause in the loan contract which penalizes the sub-borrower for delinquent payment of interest and/or principal.

Recommendation No. 10

ROCAP should request CABEI to:

- (a) Study the feasibility of delegating authority to the Bank's Country Delegates to rule on project eligibility and contact the applicant to confirm his interest in obtaining a sub-loan, and thereby reducing or eliminating the need for loan proposals to be forwarded to the main office for eligibility declaration.
- (b) Request CABEI to verify that complaints by sub-borrowers are adequately supported, and if required, assist CABEI in simplifying and eliminating unnecessary or unduly

restrictive prequalification terms and conditions.
(Implementation of this recommendation may require waivers to AID Manual Orders.)

Recommendation No. 11

ROCAP should request CABEI to develop procedures which will provide statistical information to evaluate the economic impact of the Ordinary Fund on the economies of the CACM countries. CABEI may wish to utilize a questionnaire, to be completed by the sub-borrowers, which provides statistical data on the various economic factors prior to initiation and after the project is completed.

Recommendation No. 12

ROCAP should request CABEI to obtain the technical services of an appropriate expert to review the various aspects of CABEI's interest rate structure and amortization period(s) to insure that such interest rate(s) and amortization period(s) provide for the optimum rate of growth for the CACM countries and the continued growth of CABEI.

Recommendation No. 13

ROCAP through SIECA should continue to assist CABEI in making the CACM countries aware of the urgency for developing plans for future infrastructure projects and of the adverse effects on the regional integration that can result from their failure to initiate prompt action.

Recommendation No. 14

ROCAP should encourage CABEI to request Costa Rica and Honduras to provide adequate assurance that all CABEI financed highways will be provided an effective maintenance program. The failure to provide effective maintenance should be considered in approving future loans for highway construction.

(We were informed by ROCAP during the Exit Conference that existing loans to Costa Rica and Honduras should significantly improve their highway maintenance programs.)

Recommendation No. 15

ROCAP should assist CABEI in establishing uniform standards of vehicle weight control, utilizing highway weight-stations for enforcement. This requirement should be incorporated into CABEI's future loan agreements with sub-borrowers.

(During the Exit Conference we were informed by ROCAP that it had and would continue to provide assistance to the CACM countries on implementation of vehicle weight control procedures. Subsequent to our audit, Costa Rica installed a number of weight stations.)

Recommendation No. 16

ROCAP should continue to assist CABEI in obtaining the CACM countries' agreement on minimum uniform design standards for the regional highway construction program.

Recommendation No. 17

ROCAP should:

(a) Discuss with CABEI the feasibility of establishing a guaranty fund by CABEI, as a means of underwriting the bonding coverage for Central American firms on an equitable basis with U.S. firms.

(b) Assist in obtaining the services of a qualified insurance expert to assist CABEI, in the event that it is determined feasible for CABEI to underwrite bonding coverage for CABEI financed contracts.

(It is our understanding that IDB's bonding requirements are substantially lower than AID. AID may wish to explore this area as a partial solution to the above condition.)

Recommendation No. 18

ROCAP should request CABEI to require the sub-borrowers to incorporate into their contracts a standard set of cost principles, a recovery clause for defective pricing data, and the use of provisional overhead rates where appropriate.

Recommendation No. 19

ROCAP should:

(a) Encourage CABEI to provide a training program for appropriate personnel within CABEI and the CACM countries on the techniques of performing cost and price analysis of contractor bid proposals.

(b) Assist CABEI and the CACM countries in preparing a manual setting forth the techniques and procedures to be utilized in performing cost and price analysis of contractor bid proposals.

EXHIBIT F

DISTRIBUTION OF AUDIT REPORT

<u>Distribution</u>	<u>No. of Copies</u>
ROCAP Director, ROCAP/Guatemala	6
PMCA LA/Region, AID/W	2
ARA-LA/CEN, AID/W	1
AA/A, Office of Housing, AID/W	1
LA/DR, Office of Development Resources, Bureau for Latin America, AID/W	1
IIS, Panama City, R.P.	1
IGA, AID/W	1
AG/AUD, AID/W	6
Resident Auditor, ROCAP/Guatemala	1