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**USE OF AND ACCOUNTABILITY FOR LOCAL
CURRENCY REVOLVING FUNDS GENERATED
BY USAID/HONDURAS' ECONOMIC
RECOVERY PROGRAM
MEMORANDUM AUDIT REPORT NO. 1-522-85-5
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MEMORANDUM AUDIT REPORT

USE OF AND ACCOUNTABILITY FOR LOCAL CURRENCY REVOLVING FUNDS GENERATED BY USAID/HONDURAS' ECONOMIC RECOVERY PROGRAM

SUMMARY

The Government of Honduras has disbursed \$2.4 million in local currency into five revolving funds to help implement five AID-financed projects. The \$2.4 million derived from a Special Account that the Government of Honduras established under the terms of a \$131 million AID economic recovery program for Honduras. USAID/Honduras requested that we review these revolving funds.

Our survey focused on whether the revolving funds were properly established and are being effectively used to finance local currency expenditures in a timely manner. We found that the revolving funds were not functioning properly because of inadequate management, monitoring and reporting. As a result, at least one of the three funds we reviewed was nearly depleted rendering it useless as a viable source of future project funding. This report recommends actions to develop explicit procedures and assign responsibilities for managing and monitoring the funds.

BACKGROUND

Scope

On September 24, 1982, AID started a financial assistance program to the Government of Honduras (GOH) for balance of payments support to promote financial stabilization and economic recovery. As of September 30, 1984, AID had obligated \$131 million under this program of which \$121 million had been transferred to the GOH.

As part of this economic recovery program, the GOH was required to deposit the equivalent amount in local currency (counterpart funds) into a Special Account, to be used for purposes agreed to by both governments. As of September 30, 1984, the GOH had programmed the equivalent of \$121 million of local currency in the Special Account of which \$48.7 million had been disbursed to 80 development activities. 1/

1/ Based on USAID/Honduras' September 30, 1984 Local Currency Status report.

Among these activities, the GOH has deposited a total of \$2.4 million into revolving funds for the purpose of facilitating implementation of five AID financed projects. The USAID Controller's office in Honduras requested that we review these funds because of their uniqueness and because of USAID/Honduras' lack of knowledge as to how these funds were being utilized. These revolving fund accounts and their status are as follows:

STATUS OF REVOLVING FUND ACCOUNTS
AS OF SEPTEMBER 30, 1984

<u>Revolving Fund</u>	<u>Date Authorized</u>	<u>Amount Programmed</u>	<u>Amount Deposited</u>	<u>Account Balance</u>
Rural Primary Education	6/10/83	\$1,500,000	\$1,500,000	\$9,822
Health Sector I	11/28/83	250,000	250,000	0
Rural Housing Improvement	11/28/83	300,000	150,000	5,500
Rural Trails & Access Roads	11/28/83	250,000	250,000	80,949
Small Farmers' Coffee Improvement	11/28/83	250,000	250,000	568
Export Promotion & Service ^{a/}	9/19/84	<u>50,000</u>	<u>0</u>	<u>0</u>
Totals		<u>\$2,600,000</u>	<u>\$2,400,000</u>	<u>\$96,839</u>

^{a/} This account is presented for information purposes only. It was not included in our survey because implementation letters had not been finalized and local currency had not been deposited into the account.

The mechanism used to establish and authorize the uses of the revolving funds is an Implementation letter co-signed by USAID/Honduras and the GOH. With the exception of the Health Sector fund, which is managed by the Ministry of Health, the implementing agreements give the Ministry of Finance and Public Credit management responsibility for the accounts.

The revolving funds were established to enable the respective project implementing organizations -- Ministry of Education, Ministry of Health, National Institute of Housing, Secretary of Communication and Public Transportation (SECOPT), and the Honduran Coffee Institute (IHCAFE) -- to promptly finance various local currency expenditures. For example, the Ministry of Education is to use the funds to purchase materials, labor and other costs incurred in school construction and the Secretary of Communication and Public Transportation is to use the funds to make advances to contractors for operating expenses. The revolving funds are to be replenished from AID reimbursements under the appropriate AID loan or grants, and are to be liquidated after the project activity is completed in accordance with implementation agreements.

The objectives of our survey were to determine: (i) whether the revolving funds were established and operating in accordance with program implementation letters; (ii) whether disbursements from and replenishments into the funds are being made on a timely basis; and (iii) whether the funds are adequately monitored.

Our survey was performed in November 1984. We interviewed USAID, Ministry of Finance and Public Credit, Ministry of Education, SECOPT, and Honduran Central Bank personnel. We also visited two contractors involved with the Rural Trails and Access Roads Program and inspected one Rural Access Road project. We reviewed pertinent records at these locations and reviewed all applicable implementation letters.

Our survey concentrated on three of the six revolving funds -- Rural Primary Education, Rural Trails and Access Roads and the Small Farmers Coffee Improvement Project. These three funds represent \$1.0 million out of the total \$2.4 million revolving fund deposit balance. The Special Account funds and the six Revolving Fund Accounts are in Honduran Lempiras. However, we have converted all monetary values to U.S. dollars at the official exchange rate of Lps. 2 - US\$1.00.

USAID/Honduras was provided a draft of this report for review and comments prior to publication, and their comments were considered in preparing this final report.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

The revolving funds have facilitated AID project implementation by providing GOH implementing units with a source of funds to pay local currency expenditures. Among other things, the availability of these funds has lessened the need for USAID advances of project funds and has helped implementing units and contractors with mobilization and large material expenditures.

However, the funds are not without problems. For example:

- one of the funds was nearly depleted rendering it useless as a viable source of future project fundings;
- disbursements from the funds were not always made promptly; and
- monitoring and reporting of fund activities were generally nonexistent.

These problems have occurred because the funds are not governed by clear operating procedures and because monitoring and reporting responsibilities have not been assigned. This report recommends actions to improve the overall management and accountability of the funds.

Inadequate Operating Procedures

In order for the revolving funds to achieve their intended purposes, the Ministry of Finance and Public Credit, the five agencies that use the funds, and USAID/Honduras need to develop specific mutually agreeable operating instructions so that all agencies will know exactly what is expected of them.

To date such instructions have not been prepared. The only guidance available concerning the operation of the revolving funds are project Implementation Letters, and they do not provide adequate detailed instructions on how the funds are to be managed. As a result, one of the funds had not been replenished because its intended replenishments were incorrectly deposited into another account. Another fund had not been replenished as soon as expected by the Ministry of Finance and Public Credit and, when it was, it too was initially deposited into a wrong account.

According to Program Implementation Letters under the Rural Primary Education Project, the revolving fund was to be replenished from USAID reimbursements for completed schools. USAID has made three reimbursements totaling about \$405,000 to the Ministry of Finance and Public Credit for completed schools and

some or all of these funds should have been used to replenish the revolving fund. However, instead of replenishing the revolving fund account, these reimbursements were deposited into the main project account.

According to the Director of the Ministry of Finance and Public Credit, the lack of specificity in the program implementing letters has caused the problem. The Director stated that clear procedures were never established and there have been no meetings with USAID staff on the procedures to be followed in replenishing the fund.

The condition of the revolving fund was discovered before serious problems occurred. The situation, however, could have delayed the implementation of a new private sector initiative. Under this initiative, future rural primary schools will be built by private contractors, instead of the Ministry of Education's construction implementing unit. The revolving fund will be used to provide operating advances to 12 contractors which were to start work in December 1984. An October 1984 draft Implementing Letter discussing the new initiative estimates that about \$412,000 will be needed for the advances. This amount exceeds the current revolving fund balance by \$402,678.

Our findings were discussed with USAID/Honduras officials. As a result, a meeting between the Ministry of Finance and Public Credit and USAID staff has occurred. At this meeting, procedures were agreed to as regards replenishing the revolving fund to meet the immediate need of the private sector initiative. If the problems with the revolving fund had not been identified early, classroom construction under the private initiative would have been delayed while the problem was being resolved.

Rural Trails and Access Roads revolving fund monies have been used during the past six months to provide contractors with advance, of ten percent of their contract amount, for the initiation of road projects. The outstanding advances are to be liquidated by deducting ten percent from each payment voucher submitted by the contractor for USAID reimbursement. The USAID Controller's office is responsible for computing and making the advance deductions from the contractor's voucher and forwarding these funds to the Ministry of Finance for replenishment of the revolving fund.

However, the Rural Trails and Access Roads project revolving fund Implementation Letters do not specify when USAID/Honduras is to reimburse the revolving fund. In fact, the fund managers at the Ministry of Finance and Public Credit stated they thought that USAID/Honduras was to reimburse the fund fully after each contractor advance was made rather than after the contractors had submitted their vouchers for payments. As a result, they

initially requested full fund reimbursement after the first contractor advances were made. USAID did not approve the request and did not reimburse the fund until it had accumulated deductions from contractor vouchers for two months. This misunderstanding could have been averted if implementing procedures specified when reimbursements would be made. Without a clear understanding of when funds will be reimbursed, estimating the amount of funds available for future advances would be difficult.

In addition to the misunderstanding as to when reimbursements would be made, we were told by Ministry of Finance personnel that the initial USAID reimbursement was originally desposited into the wrong account. According to the Director of Public Credit, the reimbursement check was deposited incorrectly because it was not clear where it should be deposited. The Director said procedures should be developed which require that USAID reimbursement checks identify the account into which the funds should be deposited.

Fund Disbursements Not Always Made Promptly

The revolving funds were established, among other reasons, so that local currency expenditures could be made promptly. However, disbursements are not always being made promptly.

For example, delays have occurred in processing Rural Trails and Access Roads Revolving Fund advance payments. The time to process the advances averaged about 47 days and ranged from 14 to 75 days. Similar delays have occurred with some disbursements made from the Rural Primary Education revolving fund. A review of 19 payments showed that the disbursement process ranged from about one to seven months with 12 of the 19 payments being processed in less than 2 months.

We detected no serious adverse impact on program operations because of the delays. However, the two Rural Trails and Access Roads contractors that we contacted commented that shortening the time to receive their advances would enable them to mobilize their equipment and workers faster. In our opinion, establishing reasonable processing time frames and objectives and including them in operating procedures may help ensure that revolving fund disbursements are made promptly.

Monitoring and Reporting Responsibilities Have Not Been Assigned

The USAID/Honduras Controller's Office and respective project managers were unaware of the problems with the revolving funds because the funds are not systematically monitored or reported on.

Monitoring and reporting responsibilities have never been clearly defined. Although the Ministry of Finance and Public Credit is in the best position to monitor and report on the funds, it has not done so because it assumed that USAID/Honduras was doing this. This assumption was based on the fact that an accountant staff member from the USAID Controller's Office visits the Ministry monthly to obtain and verify various financial records. The Ministry assumed that the Controller's staff was monitoring the revolving fund activities through these visits. However, the accountant told us that he only reviewed the funds at the beginning to verify that the GOH actually disbursed funds into the account to make them operational. Thereafter he no longer reviewed the funds during his monthly visits.

The USAID/Controller's Office indicated that it would start to monitor the revolving fund's activities and report on their balances monthly.

Our review of the Small Farmers Coffee Improvement fund also indicated management problems. For example, The Small Farmers' Coffee Improvement revolving fund implementation letters give the Ministry of Finance responsibility for managing the fund. However, the Ministry of Finance appears not to have assumed those responsibilities. It is unclear who has management responsibilities for this fund and under what authorization. In addition, it appears that the revolving fund activities have been commingled with the project's main bank account. These matters need to be addressed and corrected.

Finally, the USAID project officer for the Rural Primary Education Program stated that USAID and the GOH have not formally agreed on how the Rural Primary Education revolving funds will be liquidated after the project activity is completed. He stated that the GOH has indicated it would like to build more schools with the remaining funds while he would prefer to see the monies used to provide maintenance and equipment for the schools built under the project. The time limitation for a formal agreement specified in the implementation letter has elapsed. Nevertheless, the manner in which these funds should be liquidated should be formally agreed to by both governments as soon as possible to preclude future misunderstanding on the use of these funds.

Conclusions and Recommendation

Revolving funds established to support AID projects in Honduras have facilitated payment of local currency expenditures, although some payments have not always been made promptly. Periodic replenishment of the funds are essential to their continued use. However, reimbursement problems have occurred jeopardizing the operability of the funds. To ensure that the

funds operate properly and are available when needed, specific operating procedures need to be developed and adhered to. Furthermore, the funds need to be monitored and periodically reported on to ensure that problems are discovered and corrected in a timely manner.

Recommendation No. 1

USAID/Honduras in collaboration with the Ministry of Finance and Public Credit and appropriate implementing agencies:

(a) Develop procedures specifying how the funds are to be used, managed, replenished and liquidated, and

(b) Designate who is to be responsible for monitoring and reporting on revolving fund activities.

USAID/Honduras cabled comments on an earlier draft in which we recommended that USAID/Honduras schedule periodic meetings with the Ministry of Finance and Public Credit to discuss the status of the funds. USAID/Honduras stated that "Office of Controller's personnel will be checking monthly the status of each revolving fund." We, therefore, deleted that recommendation from the final report.

APPENDIX A

LIST OF REPORT RECIPIENTS

	<u>Copies</u>
USAID/Honduras	5
AA/LAC	2
LAC/CAP	2
LAC/DR	1
LAC/DP	1
LAC/CONT	1
GC/LAC	1
FVA/PPE	1
FVA/FFP	1
LEG	1
AA/M	1
M/FM/ASD	1
AA/XA	1
DAA/XA/PA	1
PPC/CDIE	1
PPC/CDIE/DI	1