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USAID/COSTA RICA'S MONITORING OF AND CONTROLS OVER DOLLAR AND LOCAL CURRENCY RESOURCES UNDER ECONOMIC RECOVERY AND PL 480 TITLE I PROGRAMS

MEMORANDUM SURVEY REPORT NO. 1-515-85-8

June 21, 1985

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SUMMARY

USAID/Costa Rica (USAID) and the Government of Costa Rica (GOCR) embarked upon these programs in order to provide balance of payments support, promote financial stabilization, and achieve economic recovery. The USAID disbursed $326 million under these programs between July 1982 and January 28, 1985 and authorized $89.9 million in PL 480 Title I commodities. The purpose of our survey was to determine the effectiveness of the USAID's monitoring of and controls over U.S. Government-provided resources and local currency generated by the transfer of those resources.

BACKGROUND

Economic Recovery Program

On July 14, 1982, AID began a financial assistance program with the Government of Costa Rica for balance-of-payments support and to promote financial stabilization and economic recovery. As of January 31, 1985, AID had transferred almost $326 million under an Economic Stabilization and Recovery (ESR) program to the GOCR in loans and grants as follows:

FY 1982	$ 20,000,000	
FY 1983	155,735,000	
CY 1984	130,000,000	
CY 1985 (to date)	20,000,000	
Total		$325,735,000

Further details on these Economic Support Fund transfers are contained in Exhibit A to this report.

One condition to the use of the dollar funds was that the GOCR make available an equivalent amount of foreign exchange to import raw materials, intermediate goods, and spare parts from the United States within 12 months from the dates of the respective agreements. Another condition was that an equivalent amount in local currency (counterpart funds) be deposited into a special account and used for purposes agreed to by the two governments. As of January 31, 1985, the GOCR had deposited the equivalent of $117 million in Costa Rican colones in a special interest-bearing account with the Banco Central de Costa Rica (BCCR) of which about $24 million had been disbursed. Certain portions of those funds have been programmed to support development activities, such as GOCR counterpart contributions to AID and other donor projects, lines of credit for the private sector, and Private Voluntary Organization (PVO) projects. Deposits in the special account had earned the equivalent of approximately $8.9 million in interest at the time of our review.

Not all the assistance received from AID ($326 million) were to be deposited in the special account with the BCCR. Loans and grants totaling $188 million were used by the BCCR for lines of credit to the private sector, while $21 million in grants was deposited directly into bank accounts of Private Voluntary Organizations.

The program agreements also provided that the GOCR would comply with an International Monetary Fund (IMF) Standby Agreement and take other steps to promote economic recovery as conditions precedent to disbursements. The USAID and the Ministry of Planning are responsible for programming and monitoring the use of local currency. The BCCR is responsible for:

-- checking the prices of imports and exports to prevent their manipulation, a potential cause of capital flight;

-- attributing imports to dollars provided under the program; and

-- maintaining the special account for local currency generated under the program.

PL 480 Title I Program

The GOCR and the U.S. Embassy executed sales agreements to import commodities valued at $89.9 million (wheat, yellow corn, soybean oil, and rice) between March 25, 1982 and November 19, 1984; however, no commodities included in the most recent Sales Agreement had been received at the time of our review.

The National Production Council (Consejo Nacional de Produccion) was responsible for receiving and selling the commodities imported under the program, as well as collecting the sales proceeds from the millers and other grain buyers and depositing them in a special account. An Implementing Unit in the Ministry of Planning (MIDEPLAN) and USAID are jointly responsible for programming the uses of and accounting for the local currency disbursed for development projects financed with Title I sales proceeds.

The status of the PL 480 Title I Program in Costa Rica 1/ since its inception through January 31, 1985 was:

Total Authorized	$ 89,900,000 2/	
Total Shipped	$ 66,756,279	
Total Sales Proceeds	$ 57,982,163	(local currency equivalents)
Total Deposited	$ 55,974,320	" " "
Total Programmed	$ 52,875,910	" " "
Total Disbursed	$ 26,426,206	" " "

1/ See Exhibit B for a detailed presentation of the status of this program.
2/ Includes $23,143,721 in commodities not received at the time of our audit.

In addition, approximately $2 million had been disbursed into a U.S. Government account at a local bank for currency use payments (CUP). The CUP was established to help defray U.S. Government expenses in Costa Rica. The CUP represented 5% of the commodities financed in 1982 and 2.5% for 1983-85.

PURPOSE AND SCOPE

A survey of the Economic Stabilization and Recovery Program (ESR) and the PL 480 Title I Program was made from January 28 through February 14, 1985. Our principal objective was to determine the effectiveness of program controls and USAID/Costa Rica's monitoring over the dollar resources provided by AID as well as the local currency generated in connection with the transfer of these resources. We did not make an in-depth audit of these programs. With the exception of the items mentioned herein, nothing came to our attention that would indicate that internal controls generally were not acceptable.

We interviewed USAID, BCCR, Ministry of Finance, Ministry of Planning, and National Production Council (Consejo Nacional de Produccion) personnel and reviewed pertinent records of these institutions. Our review covered the attribution process for ESF dollar transfers ($326 million), the generation and deposit of PL 480 Title I local currency sales proceeds ($58 million), and local currency disbursements from pertinent special accounts as of January 31, 1985: $24 million equivalent generated by transfers of Economic Support Funds and $26 million equivalent from the sale of PL 480 Title I commodities. We held an exit conference in San Jose at the conclusion of our review and USAID/Costa Rica was provided an opportunity to review this report in draft form and provide us with their comments. The report has been modified or the Mission's comments have been inserted, as we deemed appropriate, in preparing the final report.

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

Economic Stabilization and Recovery Program

Attribution of Dollar Transfers to Imports

We reviewed attribution of dollar transfers to import transactions at the BCCR and determined that BCCR had not compared or verified the reasonableness of the amounts billed by exporters in the USA to determine whether overbillings or shortlandings of imports took place. Nor had USAID/Costa Rica verified the accuracy of reports on imports submitted by the BCCR. The program agreements required the BCCR to attribute eligible import transactions to cash transfers within three to six months of the termination of disbursement of the cash transfer. In addition, the importing country was to furnish at least quarterly reports of commodities purchased and imported or utilized under the agreements. Loan Agreement 515-K-043, dated May 7, 1984, required the BCCR to prepare by June 30, 1984 a plan of action that would include, _inter alia_, steps to develop and progressively strengthen a Price Checking Unit to deter potential capital flight.

A major contributor to capital flight may lie with the deliberate price manipulation of imported/exported commodities for the purpose of diverting foreign exchange into individual private accounts outside the country. To ensure capital flight is minimized, both import and export transactions should be reviewed and verified to determine that import/export prices are not purposely overvalued/undervalued and that the quantity and quality of imported/exported goods coincide with declarations made to local authorities in charge of foreign exchange controls. Although capital flight is not considered by most observers to be a major problem at this time in Costa Rica, verification of import/export transactions is useful in helping to identify and deter capital flight. This verification can be accomplished by the use of random testing of import/export transactions. Also advisable is the monitoring of customs reports on inspections of selected imports/exports to verify that the price, quality and quantity of imported/exported agree with those authorized for the transactions.

At the time of our review, we verified that no Price Checking Unit had yet been established to verify that: purchases of imports are not submitted more than once, do not differ from declared quantity and quality of items being imported/exported, and do not include improperly inflated prices. Responsible Mission officials informed us that a Price Checking Unit was in the process of being established at the BCCR. Six employees had reportedly been appointed and the Unit was to have been operational by the end of March 1985. USAID/Costa Rica had reserved over $90,000 in local currency to support this activity.

USAID/Costa Rica understood the potential for capital flight and contracted with the accounting firm of Price Waterhouse/Costa Rica over one year ago to verify whether any overbilling had occurred in a selected number of transactions between U.S. exporters and local private sector importers. Price Waterhouse concluded that they could not obtain sufficient competent evidence to determine whether the selected import transactions included overbillings.

We believe that USAID/CR's monitoring of reports provided by the BCCR should be more proactive. Currently, the reports are simply filed away because the value of imports listed therein far exceeds AID's ESR Program assistance to Costa Rica. There have been no attempts to selectively verify the reasonableness of amounts billed for either import or export transactions. BCCR personnel are of the opinion that capital flight in Costa Rica is minimal and did not appear to be overly concerned about it.

USAID/CR's Comments

The BCCR reports frequently on the status of imports from the U.S. They report by NAUCA Code, as do all CACM countries. These reports are very specific and serve to inform all international donors and the UN. The Mission does not cross check the report. AID funds are not tied to any specific import transactions.

Conclusions and Recommendation

Given the inconclusive nature of the Price Waterhouse study and the absence of other efforts to determine the integrity of Costa Rican import/export transactions, it was not possible for us to reach any conclusions with respect to the existence of capital flight through export or import price manipulation. In view of the actions taken by the BCCR and USAID/CR in establishing a Price Checking Unit, we are not making a recommendation at this time. Nevertheless, we are requesting that USAID/Costa Rica obtain from the Price Checking Unit documentary evidence attesting to the fact that it has actually begun verifying import/export transactions and forward a copy of same to us for our files.

Project Proliferation - A Problem Currently Being Addressed

USAID/Costa Rica approved about 60 local-currency-funded projects of varying albeit relatively small size for implementation during the 1982-84 period. These activities were financed by local currencies generated in connection with ESF dollar transfers made to the GOCR during the same period. Notwithstanding the worthwhile nature of these various activities, each required a certain amount of documentation whose negotiation and preparation consumed substantial professional and clerical effort at a time when the USAID was understaffed.

Recent Congressional hearings on the Agency's operations have emphasized legislative intent in the sense that project numbers be reduced in order to enhance management's span of control. USAID/CR plans to implement one large ($120 million) project under the current fiscal year's Economic Stabilizational Recovery Program. Given the Mission's responsiveness to Congressional intent, no recommendation is deemed necessary at this time.

PL 480 Title I Program

The National Production Council (Consejo Nacional de Produccion) (CNP) Was Overdue in Depositing PL 480 Title I Sales Proceeds Into the Special Account

At the time of our visit, CNP had not deposited over 95 million colones ($2,007,843) from 1984 sales proceeds into the Special Account at the BCCR in the name of MIDEPLAN. According to criteria established in a Memorandum of Understanding signed November 22, 1983, the CNP was to deposit the colon equivalent of the FOB value of the commodities imported and sold by participating millers within 75 days of their arrival in Costa Rica. During 1984, the GOCR imported over $22 million in commodities from the United States, as authorized by AID. Proceeds from the sale of these commodities amounted to $20,780,013 which should have been deposited in the special account. At the time of our review, more than 75 days had elapsed since the arrival of the last shipment of wheat and yellow corn. As shown in Exhibit B, only $18,772,170 had been deposited, leaving a balance of $2,007,843 (95,372,547 colones) undeposited. Notice of this deposit shortfall was provided to the CNP and MIDEPLAN requesting the deposit of this outstanding balance. Subsequent to our visit we were provided documentation showing deposits made by CNP covering the amount owed the special account.

Conclusions and Recommendation

Under the terms of the PL 480 Title I Sales Agreements, local currency generated from the sales of the imported commodities was to be deposited in a special account at the BCCR. The local currency generations are to be used to finance specific self-help measures and development activities.

Recommendation No. 1

We recommend that USAID/Costa Rica, in collaboration with the Ministry of Planning and the BCCR:

a) include in future PL 480 Title I Sales Agreements a provision making participating millers, and not the CNP, responsible for depositing the sales proceeds from commodities imported under the PL 480 Program directly into the Special Account at the BCCR; and

b) institute a system of imposing penalties for making late deposits of Title I sales proceeds.

USAID/CR's Comments

Mission agrees with recommendation. MIDEPLAN and Mission have already approached the CNP and millers on this issue, and action is being taken to include this provision in future agreements.

Inactivity in Projects Financed with PL 480 Title I Sales Proceeds

Proceeds from the sale of commodities financed under the PL 480 Title I Sales Agreements are to be used for financing the self-help measures described in the Agreements, and for development projects in the agricultural development sector in a manner designed to increase the access of the poor to an adequate, nutritious and stable food supply.

We reviewed the financial status reports of PL 480 Title I Program generations for the years 1982 through 1984 and determined that there had been no disbursements of funds under 18 of the 20 projects we reviewed. Furthermore, only three percent of the local currency generations programmed for the remaining projects had been disbursed since 1982. Total undisbursed funds programmed for these 20 projects were 893 million colones, or about $18.8 million. Total undisbursed sales proceeds reached 1,498,907,975 colones ($31,555,957) at the time of our review. In our view, some of the delays were attributable to weak feasibility studies underlying the projects approved for financing, or because the GOCR was unable or faced difficulty in carrying out the self-help measures called for in the sales agreements. The projects included various food-related activities: construction of storage facilities, fumigation chambers, and developing producer and consumer food pricing policies.

Some of these projects experienced difficulties, such as the one sponsored by the Comision Nacional de Alimentos (CONALI) for the purpose of employing more hand labor, especially among rural dwellers. For reasons which we were unable to determine, implementation of the project was eventually assumed by the Catholic church; however, the church used the hand labor to repair its own buildings and to perform other church-related work. Hence, much of the work performed was not appropriate under the approved food-for-work project. CONALI also failed to submit a final report to MIDEPLAN causing a small portion of the funds remaining (2.3 million of the 167.8 million colon total) to be reprogrammed.

Conditions such as these have delayed the effective use of programmed local currency generations. In addition, MIDEPLAN, for reasons we were unable to sufficiently clarify, was reluctant to deobligate funds programmed for stalled projects in order to ward off the large demand for these funds for purposes not considered appropriate for development, as established in the sales agreements. During our review, a joint AID/MIDEPLAN effort to reprogram undisbursed funds had been initiated.

USAID/CR's Comments

There were 17 transfers and projects without disbursements (one project is programmed under two sales agreements).... The audit survey attributes the lack of disbursements to weak feasibility studies. However, a closer look... shows that sixteen (16) of these activities were either programmed under the FY 1984 sales agreement or during 1984. In other words, fully 80% of these activities correspond to the last calendar year. Also,... significant progress has been made towards implementing most of these projects; measuring progress against just disbursements is a superficial measure.

The reprogramming of undisbursed funds was actually initiated prior to the audit, and is part of normal, periodic reviews of the Title I LC portfolio. Funds are not reprogrammed for the sake of reprogramming; but are programmed or reprogrammed to most effectively use limited resources. This action is a joint AID/MIDEPLAN effort.

IG Response

The information presented in the foregoing finding section is based mainly on our own observations and audit conclusions. However, those observations and conclusions were confirmed in large part during our interviews with cognizant GOCR officials with whom we discussed the progress and problems of the projects that make up the PL 480 Title I portfolio. Although, as is apparent from the Mission's response, we have not been able to entirely reconcile our views on this matter with theirs, we feel the exchange has been salutary and, consequently, no recommendation is required at this time.

Program Oversight

MIDEPLAN's Implementing Unit lacks the personnel to thoroughly supervise these projects; thus, independent auditors are authorized to review expenditures. However, no audits had been made of the PL 480 Program. The USAID Controller's Office has neither the personnel nor the time to conduct in-depth reviews of this program. Therefore, the controller has requested a non-federal audit of this program under the auspices of the Office of the Inspector General. That review began shortly after our fieldwork under this engagement ended.

Deposits of Sales Proceeds under PL 480 Title I Program Were Not Generating Interest Income

We verified that local currency sales proceeds of 2.7 billion colones under PL 480 Title I Program were being deposited in a non-interest-bearing Special Account with the BCCR.

PL 480 Title I agreements in Costa Rica are silent on the issue of interest earnings on sales proceeds. However, the cost of money on deposit in the Costa Rica banking system is currently between 18 and 22 percent per annum. As noted previously herein, Economic Support Fund generations of local currency amounting to about 5 billion colones ($117 million) were deposited in interest-bearing accounts and had earned about 643 million colones ($8.9 million) in interest as of January 1985. When we inquired why USAID/Costa Rica had not followed guidance contained in AID Policy Determination No. 5 which encourages the deposit of sales proceeds in commercial bank accounts, we were advised essentially as follows by the USAID Director:

> During negotiations in 1981 which resulted in the execution of ESF and PL 480 Title I assistance agreements with the GOCR, the issue of placing Title I sales proceeds at interest was raised with, but objected to by, the GOCR. Their rationale was that, in contrast to ESF transfers, which they regarded as donations, sales proceeds were really the results of commodity loans which are to be repaid in dollars. While it is true that Title I loan terms include a high grant element, it was seen as more important at the time (and continues to remain so) to obtain certain policy reforms from the GOCR such as the elimination of price controls for farm products, improvement in food marketing and distribution, etc. than to press for placing the sales proceeds at interest. Since those negotiations were not documented at the time, it is considered appropriate to include a summary record of them in the results of this survey because conditions could change, at which point the matter of placing sales proceeds in interest-bearing commercial accounts could also be re-examined in the light of new circumstances.

In the light of these statements made to us by the USAID Director, we find no need to make a recommendation on this matter at this time.

EXHIBIT A

ECONOMIC STABILIZATION AND RECOVERY PROGRAM
ECONOMIC SUPPORT FUND TRANSFERS 1982-1985

Project	Transferred Funds Grant	Transferred Funds Loan	$ Equivalent Special Account Deposits	Local Currency Generations	Local Currency Disbursements
ESR I					
515-K-037	$ 5,000,000 1/			¢ 223,500,000	
		$ 15,000,000 2/		570,000,000	
ESR II					
515-K-040	11,250,000 1/			500,925,000	
	5,000,000 3/			215,500,000	
	21,485,000		$ 21,485,000	926,353,500	¢ 879,830,939
		118,000,000 2/		4,931,868,000	
ESR III					
515-K-043	95,000,000		95,000,000	4,306,250,000	217,788,482
		35,000,000 2/		1,524,050,000	
ESR IV					
515-0094	20,000,000 2/			950,000,000	
TOTALS	$157,735,000	$168,000,000	$116,485,000	¢14,148,446,500	¢1,097,619,421 4/

1/ Transferred to Coalicion Costarricense de Iniciativas de Desarrollo (CINDE)

2/ Used to expand credit available through the national banking system

3/ Transferred to Instituto Nacional de Viviendas Urbanas (INVU national housing institute)

4/ Exchange Rate = 44.95 ($24,418,675)

EXHIBIT B

COSTA RICA
PL - 480 TITLE - I
STATUS OF ACCOUNTS
AS OF JANUARY 31, - 1985
SALES - AGREEMENT

Date of Sales Agreement	25 March 1982	30 October 1982	22 November 1983	19 November 1984	TOTAL	$ EQUIVALENT 1/
Amount Authorized	$ 18,000.000.00	$ 28,000.000.00	$ 22,500.000.00	$ 21,400.000.00	$ 89,900.000.00	--
Amount Imported	$ 17,196.939.82	$ 27,144.731.81	$ 22,414.607.72	N/A 2/	$ 66,756.279.35	--
TOTAL PROCEEDS in Costa Rican Colones	C 659,760.040.28	C 1,107,342.122.46	C 987,050.592.32	-o-	C 2,754,152.758.06	57,982,163
Deposited Proceeds	C 659,760.040.28	C 1,107,342.122.46	C 891,678.044.88	-o-	C 2,658,780.207.62	55,974,320
Non Deposited Proceeds	-o-	-o-	C 95,372.550.44	-o-	C 95,372.550.44	2,007,843
Currency Use Payment (CUP)	C 37,102.398.00	C 30,198.514.70	C 24,676.264.90 3/	-o-	C 91,977.177.60	1,936,362
Unprogrammed Funds	C 3,193.942.00	C 2,128.607.76	C 145,247.330.42	-o-	C 150,569.880.18	3,169,892
Obligated for Sub-Projects	C 619,463.700.00	C 1,075,015.000.00	C 817,127.000.00	-o-	C 2,511,605.700.00	52,875,909
Disbursed	C 484,284.293.70 4/	C 452,460.123.70 4/	C 318,500.365.00	-o-	C 1,255,244.782.40	26,426,206
Undisbursed Balance 5/	C 175,475.746.30	C 654,881.998.76	C 668,550.230.32	-o-	C 1,498,907.975.38	31,555,957
Number of Sub-Projects	13	23	26	18	80	

1/ Rate of Exchange=47.50 (for purposes of this table only)
2/ First shipment of commodities arrived in Costa Rica approximately February 22, 1985; therefore no proceeds were available at time of audit.
3/ Not yet deposited.
4/ Includes CUP (5% 1982 and 2.5 1983-85).
5/ Includes unprogrammed funds.

APPENDIX A

LIST OF REPORT RECIPIENTS

	Copies
USAID/COSTA RICA	5
AA/LAC	1
LAC/CAP	1
EXRL	1
LEG	1
OPA	2
GC	1
AA/M	1
M/FM/ASD	2
PPC/CDIE	3